ARCH COAL INC
Form 10-Q
August 09, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 2012

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to .

Commission file number: 1-13105

Arch Coal, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**43-0921172** (I.R.S. Employer Identification Number)
One CityPlace Drive, Suite 300, St. Louis, Missouri (Address of principal executive offices)	**63141** (Zip code)

Registrant s telephone number, including area code: **(314) 994-2700**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

At July 31, 2012 there were 212,268,960 shares of the registrant s common stock outstanding.

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Part I

FINANCIAL INFORMATION

Item 1. Financial Statements.

Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(Unaudited)			
Revenues	$ 1,063,538	$ 985,528	$ 2,103,189	$ 1,858,466
Costs, expenses and other				
Cost of sales	881,259	715,590	1,732,130	1,369,274
Depreciation, depletion and amortization	132,868	97,236	272,834	180,773
Amortization of acquired sales contracts, net	(4,451)	1,262	(18,468)	7,206
Mine closure and asset impairment costs	525,762		525,762	
Goodwill impairment	115,791		115,791	
Selling, general and administrative expenses	35,178	29,040	66,039	59,474
Change in fair value of coal derivatives and coal trading activities, net	(32,054)	2,672	(35,667)	888
Acquisition and transition costs related to ICG		48,666		48,666
Other operating income, net	(1,831)	(4,292)	(20,329)	(5,407)
	1,652,522	890,174	2,638,092	1,660,874
Income (loss) from operations	(588,984)	95,354	(534,903)	197,592
Interest expense, net:				
Interest expense	(78,728)	(42,249)	(153,500)	(76,829)
Interest income	1,088	755	2,109	1,501
	(77,640)	(41,494)	(151,391)	(75,328)
Other nonoperating expense				
Bridge financing costs related to ICG		(49,490)		(49,490)
Net loss resulting from early retirement and refinancing of debt	(19,042)	(250)	(19,042)	(250)
	(19,042)	(49,740)	(19,042)	(49,740)
Income (loss) before income taxes	(685,666)	4,120	(705,336)	72,524
Provision for (benefit from) income taxes	(250,242)	(2,510)	(271,321)	10,020
Net income (loss)	(435,424)	6,630	(434,015)	62,504
Less: Net income attributable to noncontrolling interest	(65)	(318)	(268)	(591)
Net income (loss) attributable to Arch Coal, Inc.	$ (435,489)	$ 6,312	$ (434,283)	$ 61,913
Earnings per common share				
Basic earnings (loss) per common share	$ (2.05)	$ 0.04	$ (2.05)	$ 0.37

Diluted earnings (loss) per common share	$	(2.05)	$	0.04	$	(2.05)	$	0.37
Weighted average shares outstanding								
Basic		212,048		174,244		211,868		168,442
Diluted		212,048		175,272		211,868		169,554
Dividends declared per common share	$	0.03	$	0.11	$	0.14	$	0.21

The accompanying notes are an integral part of the condensed consolidated financial statements.

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Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income

(in thousands, except per share data)

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
	(unaudited)			
Net income (loss)	$ (435,424)	$ 6,630	$ (434,015)	$ 62,504
Other comprehensive income (loss), net of income taxes:				
Pension, postretirement and other post-employment benefits	(3,584)	293	(3,121)	866
Unrealized gains (losses) on available-for-sale securities	62	(1,434)	314	(687)
Unrealized gains and losses on derivatives, net of reclassifications into net income:				
Unrealized gains (losses) on derivatives	991	(3,127)	2,751	6,374
Reclassifications of (gains) losses into net income	(518)	(4,360)	4,307	(6,484)
Total other comprehensive income (loss)	(3,049)	(8,628)	4,251	69
Total comprehensive income (loss)	$ (438,473)	$ (1,998)	$ (429,764)	$ 62,573

The accompanying notes are an integral part of the condensed consolidated financial statements.

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Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Balance Sheets

(in thousands, except per share data)

	June 30, 2012 (Unaudited)	December 31, 2011
Assets		
Current assets		
Cash and cash equivalents	$ 512,527	$ 138,149
Restricted cash	5,740	10,322
Trade accounts receivable	327,402	380,595
Other receivables	70,103	88,584
Inventories	455,091	377,490
Prepaid royalties	11,214	21,944
Deferred income taxes	65,531	42,051
Coal derivative assets	53,351	13,335
Other	67,568	110,304
Total current assets	1,568,527	1,182,774
Property, plant and equipment, net	7,397,131	7,949,150
Other assets		
Prepaid royalties	89,441	86,626
Goodwill	480,312	596,103
Equity investments	235,299	225,605
Other	183,228	173,701
Total other assets	988,280	1,082,035
Total assets	$ 9,953,938	$ 10,213,959
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable	$ 316,669	$ 383,782
Coal derivative liabilities	7,090	7,828
Accrued expenses and other current liabilities	360,793	348,207
Current maturities of debt and short-term borrowings	111,260	280,851
Total current liabilities	795,812	1,020,668
Long-term debt	4,464,351	3,762,297
Asset retirement obligations	424,289	446,784
Accrued pension benefits	49,040	48,244
Accrued postretirement benefits other than pension	42,028	42,309
Accrued workers compensation	82,372	71,948
Deferred income taxes	730,495	976,753
Other noncurrent liabilities	223,131	255,382
Total liabilities	6,811,518	6,624,385
Redeemable noncontrolling interest	17,500	11,534
Stockholders Equity		
Common stock, $0.01 par value, authorized 260,000 shares, issued 213,768 and 213,183 shares at June 30, 2012 and December 31, 2011, respectively	2,138	2,136
Paid-in capital	3,022,014	3,015,349

Treasury stock, at cost		(53,848)		(53,848)
Retained earnings		158,374		622,353
Accumulated other comprehensive loss		(3,758)		(7,950)
Total stockholders equity		3,124,920		3,578,040
Total liabilities and stockholders equity	$	9,953,938	$	10,213,959

The accompanying notes are an integral part of the condensed consolidated financial statements.

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Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

	Six Months Ended June 30, 2012	2011
	(Unaudited)	
Operating activities		
Net income (loss)	$ (434,015)	$ 62,504
Adjustments to reconcile to cash provided by operating activities:		
Depreciation, depletion and amortization	272,834	180,773
Amortization of acquired sales contracts, net	(18,468)	7,206
Bridge financing costs related to ICG		49,490
Net loss resulting from early retirement of debt and refinancing activities	19,042	250
Noncash mine closure and asset impairment costs	501,942	7,316
Goodwill impairment	115,791	
Prepaid royalties expensed	16,551	19,491
Employee stock-based compensation expense	7,014	7,071
Amortization relating to financing activities	8,948	5,093
Changes in:		
Receivables	52,291	(25,329)
Inventories	(80,199)	(31,476)
Coal derivative assets and liabilities	(37,985)	4,902
Accounts payable, accrued expenses and other current liabilities	(64,965)	8,912
Income taxes, net	22,869	(15,186)
Deferred income taxes	(272,094)	18,177
Other	(14,248)	15,006
Cash provided by operating activities	95,308	314,200
Investing activities		
Acquisition of ICG, net of cash acquired		(2,910,380)
Change in restricted cash	4,582	(74,814)
Capital expenditures	(202,073)	(107,725)
Proceeds from dispositions of property, plant and equipment	22,551	1,411
Purchases of investments and advances to affiliates	(9,292)	(38,059)
Additions to prepaid royalties	(8,634)	(25,212)
Cash used in investing activities	(192,866)	(3,154,779)
Financing activities		
Proceeds from the issuance of senior notes		2,000,000
Proceeds from term note	1,386,000	
Proceeds from the issuance of common stock, net		1,249,407
Payments to retire debt	(452,654)	(307,984)
Change in restricted cash		(260,663)
Net increase (decrease) in borrowings under lines of credit and commercial paper program	(391,300)	303,096
Net payments on other debt	(11,164)	(8,845)
Debt financing costs	(34,381)	(112,334)
Dividends paid	(29,696)	(34,192)
Issuance of common stock under incentive plans	5,131	846

Cash provided by financing activities		471,936		2,829,331
Increase (decrease) in cash and cash equivalents		374,378		(11,248)
Cash and cash equivalents, beginning of period		138,149		93,593
Cash and cash equivalents, end of period	$	512,527	$	82,345

The accompanying notes are an integral part of the condensed consolidated financial statements.

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Arch Coal, Inc. and Subsidiaries

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Arch Coal, Inc. and its subsidiaries and controlled entities (the Company). The Company s primary business is the production of steam and metallurgical coal from surface and underground mines located throughout the United States, for sale to utility, industrial and export markets. On June 15, 2011, the Company acquired International Coal Group, Inc. (ICG). The Company currently operates 18 mining complexes in West Virginia, Kentucky, Maryland, Virginia, Illinois, Wyoming, Colorado and Utah. All subsidiaries (except as noted below) are wholly-owned. Intercompany transactions and accounts have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial reporting and U.S. Securities and Exchange Commission regulations. In the opinion of management, all adjustments, consisting of normal, recurring accruals considered necessary for a fair presentation, have been included. Results of operations for the three and six month periods ended June 30, 2012 are not necessarily indicative of results to be expected for the year ending December 31, 2012. These financial statements should be read in conjunction with the audited financial statements and related notes as of and for the year ended December 31, 2011 included in the Company s Annual Report on Form 10-K/A filed with the U.S. Securities and Exchange Commission.

The Company owned a 99% membership interest and acted as the managing member in Arch Western Resources, LLC (Arch Western) a joint venture with Delta Housing, Inc., a subsidiary of BP p.l.c, Arch Western operates coal mines in Wyoming, Colorado and Utah. On April 9, 2012, Delta Housing, Inc. exercised their contractual right to require us to purchase their membership interests in Arch Western. The negotiated purchase amount of $17.5 million was paid on July 2, 2012.

2. Accounting Policies

There is no new accounting guidance that is expected to have a significant impact on the Company s financial statements.

3. Debt

	June 30, 2012	December 31, 2011

		(In thousands)		
Indebtedness to banks under credit facilities		90,000		481,300
Term loan ($1.4 billion face value) due 2018		1,386,292		
6.75% senior notes ($450.0 million face value) due 2013				450,971
8.75% senior notes ($600.0 million face value) due 2016		589,963		588,974
7.00% senior notes due in 2019 at par		1,000,000		1,000,000
7.25% senior notes due 2020 at par		500,000		500,000
7.25% senior notes due 2021 at par		1,000,000		1,000,000
Other		9,356		21,903
		4,575,611		4,043,148
Less current maturities of debt and short-term borrowings		111,260		280,851
Long-term debt	$	4,464,351	$	3,762,297

The current maturities of debt include contractual maturities, as well as amounts borrowed that are supported by credit facilities that have a term of less than one year and amounts borrowed under credit facilities with terms longer than one year that the Company does not intend to refinance on a long-term basis, based on cash projections and management s plans.

On May 16, 2012, the Company entered into an amendment to its senior secured revolving credit facility that amended certain financial maintenance covenants, suspending the Company s compliance with the debt-to-EBITDA ratio, easing other financial covenants through September 2014 and adding defined minimum EBITDA targets. The maximum borrowing capacity of the revolving credit facility was reduced from $2 billion to $600 million. In conjunction with the amendment, the Company borrowed $1.4 billion under a six-year secured term loan facility, issued at a 1% discount. The term loan contains no financial maintenance covenants, is prepayable and is secured by the same assets as borrowings under the revolving credit facility. Quarterly principal payments of $3.5 million are due beginning in September 2012, plus interest at a rate of the greater of Libor or 1.25%, plus 450 basis points. The

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proceeds of the term loan were used to retire all outstanding borrowings under the revolving credit facility and the outstanding $450.0 million principal amount of 6 ¾% Senior Notes due 2013 issued by Arch Western Finance, LLC (Arch Western Finance), the Company s indirect subsidiary.

On May 16, 2012, Arch Western Finance accepted for purchase an aggregate of approximately $304.0 million principal amount of its 6 ¾% Senior Notes due 2013 in an initial settlement pursuant to the terms of its tender offer and consent solicitation, which commenced on May 1, 2012, and called for redemption all of the remaining notes outstanding after the completion of the tender offer. The consideration for each $1,000 of principal purchased under the tender offer and consent solicitation was $1,002.50, for a total purchase consideration of $304.8 million. On May 30, 2012, the remaining notes with an outstanding principal amount of $146.0 million were redeemed at par value.

The Company incurred financing costs of $27.4 million in conjunction with the term loan, which have been deferred on the balance sheet. The Company wrote off $17.3 million of the $24.8 million of financing costs that had previously been deferred relating to the reduction in capacity of the senior secured revolving credit facility and $1.1 million related to the redemption of the 6 ¾% Senior Notes due 2013, offset by the $0.8 million of unamortized issue premium on the notes. The write-off of deferred financing fees, along with other transaction fees associated with these transactions is reflected in Loss on extinguishment and refinancing of debt in the condensed consolidated statements of operations.

At June 30, 2012, cash on hand was $512.5 million and availability was $345.0 million under our lines of credit.

4. Mine Closure and Asset Impairment Costs

An extreme downturn in demand for thermal coal resulted in the Company announcing on June 21, 2012 the closing of four mining complexes and the temporary idling of a fifth complex, all acquired with ICG, as well as cutbacks in production at other Appalachia mines. These actions resulted in a total workforce reduction of approximately 750 positions. The operations had ceased production prior to June 30, 2012, and will incur minimal ongoing annual maintenance costs customary with idling operations. The terms of customer contracts will be fulfilled by other operations.

The following costs are reflected in the line Mine closure and asset impairment costs on the condensed consolidated statements of operations for the three and six months ended June 30, 2012:

Parts and supplies inventory writedown	$	2,598
Impairment of property, plant and equipment		95,641
Impairment of coal properties and deferred development costs		403,279
Royalty obligations		11,546
Employee termination benefits		12,274
Pension, postretirement and occupational disease curtailment charge, net (see notes 11 and 12)		424
	$	525,762

The fair value of the closed or idled operations property, plant and equipment of approximately $51 million was based on the analysis of the marketability of thermal coal properties in the current market environment and our ability to redeploy equipment to other facilities.

The majority of the employee termination benefits will be paid in the third quarter of 2012. The royalty obligations represent minimum payments on various leases and will be paid over the remaining term of the leases, through 2016.

The announcement of the closures triggered an actuarial curtailment under the Company s sponsored pension, post-retirement medical and black lung benefit programs. Certain employees were informed that they would be terminated effective August 21, 2012, which will trigger the recognition of the remaining pension plan curtailment impact in the third quarter of 2012, a curtailment benefit of $2.2 million.

5. Goodwill

A significant drop in the Company s stock price during the second quarter of 2012, combined with continuing weak demand for thermal coal during the quarter and the Company s resulting production cuts, indicated that the fair value of the Company s goodwill could be less than its carrying value. Accordingly, the Company has performed the first step of the two-step goodwill impairment test as of June 30, 2012. The fair values of the reporting units are determined using a discounted cash flow (DCF) technique. A number of significant assumptions and estimates are involved in the application of the DCF analysis to forecast operating cash flows, including the discount rate and projections of sales volumes, selling prices and costs to produce.

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The value of the Company s Black Thunder reporting unit in the Powder River Basin, where $115.8 million of goodwill had been allocated, is sensitive to thermal market demand. The further weakening in thermal coal markets in the second quarter significantly impacted the projected demand for and pricing of coal produced at Black Thunder. In step one of the goodwill impairment testing, the fair value of the Black Thunder reporting unit did not exceed its carrying value, primarily due to the impact of lower demand on near term sales volumes and pricing. The second step of the test requires that we determine the fair value of Black Thunder s goodwill. This will involve determining the value of Black Thunder s assets and liabilities. Based on initial estimates of the fair values of the assets and liabilities and the deficit of the fair value when compared to the related book values, we recorded a preliminary write-off of the entire $115.8 million of goodwill allocated to the Black Thunder reporting unit during the second quarter of 2012.

The goodwill amounts allocated to certain reporting units in the Company s Appalachia segment are particularly sensitive to volatility in the demand for metallurgical coal. Should metallurgical coal markets weaken, affecting the volumes and pricing of metallurgical coal from the Company s operations, it could cause the fair value of the reporting units to be less than their carrying value, requiring us to perform step 2 of the test for impairment.

6. Equity Investments and Membership Interests in Joint Ventures

The Company accounts for its investments and membership interests in joint ventures under the equity method of accounting if the Company has the ability to exercise significant influence, but not control, over the entity. Below are the equity method investments reflected in the condensed consolidated balance sheets:

In thousands	**Knight Hawk Holdings, LLC**	**DKRW Advanced Fuels, LLC**	**Dominion Terminal Associates**	**Tenaska Trailblazer Partners, LLC**	**Millennium Bulk Terminals, LLC**	**Tongue River Railroad, LLC**	**Total**
Balance at December 31, 2011	$ 135,225	$ 19,715	$ 16,086	$ 15,266	$ 26,324	$ 12,989	$ 225,605
Investments in affiliates							
Advances to (distributions from) affiliates, net	(1,801)		2,150		4,842	675	5,866
Equity in comprehensive income (loss)	9,641	(1,551)	(2,374)		(1,888)		3,828
Balance at June 30, 2012	$ 143,065	$ 18,164	$ 15,862	$ 15,266	$ 29,278	$ 13,664	$ 235,299
Notes receivable from investees:							
Balance at December 31, 2011	$	$ 30,751	$	$ 5,059	$	$	$ 35,810
Balance at June 30, 2012	$	$ 34,817	$	$ 5,047	$	$	$ 39,864

The Company may be required to make future contingent payments of up to $73.0 million related to development financing for certain of its equity investees. The Company s obligation to make these payments, as well as the timing of any payments required, is contingent upon a number of factors, including project development progress, receipt of permits and construction financing.

7. Derivatives

Diesel fuel price risk management

The Company is exposed to price risk with respect to diesel fuel purchased for use in its operations. The Company anticipates purchasing approximately 73 to 78 million gallons of diesel fuel for use in its operations during 2012. To protect the Company s cash flows from increases in the price of diesel fuel for its operations, the Company uses forward physical diesel purchase contracts, as well as heating oil swaps and purchased call options. At June 30, 2012, the Company had protected the price of approximately 80% of its expected purchases for the remainder of fiscal year 2012 and 50% of its 2013 purchases. At June 30, 2012, the Company had purchased heating oil call options for approximately 71 million gallons for the purpose of managing the price risk associated with future diesel purchases.

During the first quarter of 2012, the Company determined the effectiveness of the heating oil options could not be established as of December 31, 2011 and on an ongoing basis. As a result, the amount remaining in accumulated other comprehensive income of $8.2 million, or $5.2 net of income taxes, was recorded in earnings, in the other income, net line on the condensed consolidated statement of income.

The Company also purchased heating oil call options to hedge the fuel surcharges on its barge and rail shipments that cover increases in diesel fuel prices. These positions reduce the Company s risk of cash flow fluctuations related to these surcharges but the

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positions are not accounted for as hedges. At June 30, 2012, the Company held purchased call options for approximately 18.0 million gallons for the purpose of managing the fluctuations in cash flows associated with fuel surcharges on future shipments.

Coal risk management positions

The Company may sell or purchase forward contracts, swaps and options in the over-the-counter coal market in order to manage its exposure to coal prices. The Company has exposure to the risk of fluctuating coal prices related to forecasted sales or purchases of coal or to the risk of changes in the fair value of a fixed price physical sales contract. Certain derivative contracts may be designated as hedges of these risks.

At June 30, 2012, the Company held derivatives for risk management purposes that are expected to settle in the following years :

(Tons in thousands)	2012	2013	2014	2015
Coal sales	3,821	3,517	3,240	720
Coal purchases	1,168	420	720	

Coal trading positions

The Company may sell or purchase forward contracts, swaps and options in the over-the-counter coal market for trading purposes. The Company is exposed to the risk of changes in coal prices on the value of its coal trading portfolio. The estimated future realization of the value of the trading portfolio is $0.6 million of gains in the remainder of 2012 and $2.1 million of losses in 2013.

Tabular derivatives disclosures

The Company s contracts with certain of its counterparties allow for the settlement of contracts in an asset position with contracts in a liability position in the event of default or termination. Such netting arrangements reduce the Company s credit exposure related to these counterparties. For classification purposes, the Company records the net fair value of all the positions with a given counterparty as a net asset or liability in the consolidated balance sheets. The amounts shown in the table below represent the fair value position of individual contracts, and not the net position presented in the accompanying condensed consolidated balance sheets. The fair value and location of derivatives reflected in the accompanying condensed consolidated balance sheets are as follows:

	June 30, 2012		December 31, 2011	
Fair Value of Derivatives (In thousands)	**Asset Derivative**	**Liability Derivative**	**Asset Derivative**	**Liability Derivative**
Derivatives Designated as Hedging Instruments				
Heating oil diesel purchases	$	$	$ 8,997	$

Coal	5,156	(1,284)		1,109		
Total	5,156	(1,284)		10,106		
Derivatives Not Designated as Hedging Instruments						
Heating oil diesel purchases	5,534					
Heating oil fuel surcharges	1,310			1,797		
Coal held for trading purposes	37,492	(38,921)		15,505	(19,927)	
Coal risk management	56,125	(12,307)		14,855	(6,035)	
Total	100,461	(51,228)		32,157	(25,962)	
Total derivatives	105,617	(52,512)		42,263	(25,962)	
Effect of counterparty netting	(45,422)	45,422		(18,134)	18,134	
Net derivatives as classified in the balance sheets	$ 60,195	$ (7,090)	$ 53,105	$ 24,129	$ (7,828)	$ 16,301

		June 30, 2012	December 31, 2011
Net derivatives as reflected on the balance sheets			
Heating oil	Other current assets	$ 6,844	$ 10,794
Coal	Coal derivative assets	53,351	13,335
	Coal derivative liabilities	(7,090)	(7,828)
		$ 53,105	$ 16,301

The Company had a current liability for the obligation to post cash collateral of $25.2 million at June 30, 2012 and a current asset for the right to reclaim cash collateral of $12.4 million at December 31, 2011. These amounts are not included with the derivatives presented in the table above and are included in accrued expenses and other current liabilities and other current assets , respectively, in the accompanying condensed consolidated balance sheets.

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The effects of derivatives on measures of financial performance are as follows for the three month periods ended June 30:

Derivatives used in Cash Flow Hedging Relationships (in thousands)

	Gain (Loss) Recognized in OCI (Effective Portion)		Gains (Losses) Reclassified from OCI into Income (Effective Portion)	
	2012	**2011**	**2012**	**2011**
Heating oil diesel purchases	$	$ (6,337)	$	$ 6,654(2)
Coal sales	2,231	1,344	809	237(1)
Coal purchases	(742)	97		(2)
Totals	$ 1,489	$ (4,896)	$ 809	$ 6,891

No ineffectiveness or amounts excluded from effectiveness testing relating to the Company s cash flow hedging relationships were recognized in the results of operations in the three month periods ended June 30, 2012 and 2011.

Derivatives Not Designated as Hedging Instruments (in thousands)

	Gain (Loss) Recognized	
	2012	**2011**
Coal unrealized	$ 27,446	$ (374)(3)
Coal realized	8,671	147(4)
Heating oil diesel purchases	(22,509)	(4)
Heating oil fuel surcharges	$ (2,599)	$ (4)

Location in Statement of Income:

(1) Revenues

(2) Cost of sales

(3) Change in fair value of coal derivatives and coal trading activities, net

(4) Other operating income, net

The effects of derivatives on measures of financial performance are as follows for the six month periods ended June 30:

Derivatives used in Cash Flow Hedging Relationships (in thousands)

	Gain (Loss) Recognized in OCI (Effective Portion)		Gains (Losses) Reclassified from OCI into Income (Effective Portion)	
	2012	2011	2012	2011
Heating oil diesel purchases	$	$ 7,921	$	$ 9,824(2)
Coal sales	4,724	2,750	1,010	324(1)
Coal purchases	(944)	(779)		(2)
Totals	$ 3,780	$ 9,892	$ 1,010	$ 10,148

No ineffectiveness or amounts excluded from effectiveness testing relating to the Company s cash flow hedging relationships were recognized in the results of operations in the three month periods ended June 30, 2012 and 2011.

Derivatives Not Designated as Hedging Instruments (in thousands)

	Gain (Loss) Recognized	
	2012	2011
Coal unrealized	$ 34,998	$ (1,419)(3)
Coal realized	11,829	147(4)
Heating oil diesel purchases	(22,086)	(4)
Heating oil fuel surcharges	$ (2,232)	$ (4)

Location in Statement of Income:

(1) Revenues

(2) Cost of sales

(3) Change in fair value of coal derivatives and coal trading activities, net

(4) Other operating income, net

The Company recognized net unrealized and realized gains of 4.6 million and $2.3 million during the three months ended June 30, 2012 and 2011, respectively, related to its trading portfolio. The Company recognized net unrealized and realized gains of $0.7 million $0.5 million during the six months ended June 30, 2012 and 2011, respectively, related to its trading portfolio, which are included in the caption Change in fair value of coal derivatives and coal trading activities, net in the accompanying condensed consolidated

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statements of operations, and are not included in the previous tables reflecting the effects of derivatives on measures of financial performance.

Based on fair values at June 30, 2012, gains on derivative contracts designated as hedge instruments in cash flow hedges of approximately $4.0 million are expected to be reclassified from other comprehensive income into earnings during the next twelve months.

8. Inventories

Inventories consist of the following:

		June 30, 2012		December 31, 2011
		(In thousands)		
Coal	$	267,600	$	206,517
Repair parts and supplies		178,626		163,527
Work-in-process		8,865		7,446
	$	455,091	$	377,490

The repair parts and supplies are stated net of an allowance for slow-moving and obsolete inventories of $11.3 million at June 30, 2012, and $13.1 million at December 31, 2011.

9. Fair Value Measurements

The hierarchy of fair value measurements prioritizes the inputs to valuation techniques used to measure fair value. The levels of the hierarchy, as defined below, give the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

• Level 1 is defined as observable inputs such as quoted prices in active markets for identical assets. Level 1 assets include available-for-sale equity securities and coal futures that are submitted for clearing on the New York Mercantile Exchange.

• Level 2 is defined as observable inputs other than Level 1 prices. These include quoted prices for similar assets or liabilities in an active market, quoted prices for identical assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. The Company s level 2 assets and liabilities include commodity contracts (coal and heating oil) with fair values derived from quoted prices in over-the-counter markets or from prices received from direct broker quotes.

- Level 3 is defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. These include the Company s commodity option contracts (coal and heating oil) valued using modeling techniques, such as Black-Scholes, that require the use of inputs, particularly volatility, that are rarely observable. Changes in the unobservable inputs would not have a significant impact on the reported Level 3 fair values at June 30, 2012.

The table below sets forth, by level, the Company s financial assets and liabilities that are recorded at fair value in the accompanying condensed consolidated balance sheet:

	Fair Value at June 30, 2012			
	Total	**Level 1**	**Level 2**	**Level 3**
	(In thousands)			
Assets:				
Investments in equity securities	$ 8,035	$ 8,035	$	$
Derivatives	60,195	51,701	1,650	6,844
Total assets	$ 68,230	$ 59,736	$ 1,650	$ 6,844
Liabilities:				
Derivatives	$ 7,090	$		