

ARCH COAL INC
Form 10-Q
August 08, 2014
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

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 No

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 No

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
Non-accelerated filer
(Do not check if a smaller reporting company)

Accelerated filer
Smaller reporting company

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

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At July 31, 2014 there were 212,279,999 shares of the registrant's common stock outstanding.

Table of Contents

TABLE OF CONTENTS

| | Page |
|--|-------------|
| <u>Part I FINANCIAL INFORMATION</u> | 3 |
| <u>Item 1. Financial Statements</u> | 3 |
| <u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 27 |
| <u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u> | 34 |
| <u>Item 4. Controls and Procedures</u> | 35 |
| <u>Part II OTHER INFORMATION</u> | 35 |
| <u>Item 1. Legal Proceedings</u> | 35 |
| <u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u> | 38 |
| <u>Item 4. Mine Safety Disclosures</u> | 38 |
| <u>Item 6. Exhibits</u> | 38 |

Table of Contents**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, | | Six Months Ended June 30, | |
|---|-----------------------------|-------------|---------------------------|--------------|
| | 2014 | 2013 | 2014 | 2013 |
| | (Unaudited) | | | |
| Revenues | \$ 713,776 | \$ 766,332 | \$ 1,449,747 | \$ 1,503,702 |
| Costs, expenses and other operating | | | | |
| Cost of sales (exclusive of items shown separately below) | 622,137 | 656,198 | 1,308,451 | 1,305,941 |
| Depreciation, depletion and amortization | 102,464 | 111,085 | 206,887 | 221,278 |
| Amortization of acquired sales contracts, net | (3,239) | (2,209) | (6,935) | (5,019) |
| Change in fair value of coal derivatives and coal trading activities, net | (2,992) | (9,008) | (2,078) | (7,700) |
| Asset impairment costs | 1,512 | 20,482 | 1,512 | 20,482 |
| Selling, general and administrative expenses | 29,931 | 34,302 | 59,067 | 67,511 |
| Other operating income, net | (232) | (8,239) | (8,230) | (11,081) |
| | 749,581 | 802,611 | 1,558,674 | 1,591,412 |
| Loss from operations | (35,805) | (36,279) | (108,927) | (87,710) |
| Interest expense, net | | | | |
| Interest expense | (97,960) | (94,756) | (194,431) | (189,830) |
| Interest and investment income | 2,036 | 1,216 | 3,879 | 4,052 |
| | (95,924) | (93,540) | (190,552) | (185,778) |
| Loss from continuing operations before income taxes | (131,729) | (129,819) | (299,479) | (273,488) |
| Benefit from income taxes | (34,869) | (49,468) | (78,480) | (108,821) |
| Loss from continuing operations | (96,860) | (80,351) | (220,999) | (164,667) |
| Income from discontinued operations, net of tax | | 8,145 | | 22,412 |
| Net loss | \$ (96,860) | \$ (72,206) | \$ (220,999) | \$ (142,255) |
| Losses per common share | | | | |
| Basic and diluted LPS - Loss from continuing operations | \$ (0.46) | \$ (0.38) | \$ (1.04) | \$ (0.78) |
| Basic and diluted LPS - Net loss | \$ (0.46) | \$ (0.34) | \$ (1.04) | \$ (0.67) |
| Basic and diluted weighted average shares outstanding | 212,225 | 212,082 | 212,198 | 212,072 |
| Dividends declared per common share | \$ | \$ 0.03 | \$ 0.01 | \$ 0.06 |

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

Table of Contents

Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Loss)

(in thousands)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|-----------------------------|-------------|---------------------------|--------------|
| | 2014 | 2013 | 2014 | 2013 |
| | (Unaudited) | | | |
| Net loss | \$ (96,860) | \$ (72,206) | \$ (220,999) | \$ (142,255) |
| Derivative instruments | | | | |
| Comprehensive income (loss) before tax | 1,007 | (391) | 778 | (1,570) |
| Income tax benefit (provision) | (362) | 143 | (280) | 568 |
| | 645 | (248) | 498 | (1,002) |
| Pension, postretirement and other post-employment benefits | | | | |
| Comprehensive income (loss) before tax | (2,269) | 1,750 | (4,116) | 3,704 |
| Income tax benefit (provision) | 817 | (630) | 1,482 | (1,333) |
| | (1,452) | 1,120 | (2,634) | 2,371 |
| Available-for-sale securities | | | | |
| Comprehensive income (loss) before tax | (1,203) | 4,959 | (3,236) | 6,512 |
| Income tax benefit (provision) | 433 | (1,788) | 1,165 | (2,347) |
| | (770) | 3,171 | (2,071) | 4,165 |
| Total other comprehensive income (loss) | (1,577) | 4,043 | (4,207) | 5,534 |
| Total comprehensive loss | \$ (98,437) | \$ (68,163) | \$ (225,206) | \$ (136,721) |

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

Table of Contents

Arch Coal, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
(in thousands, except per share data)

| | June 30, 2014 | December 31, 2013 |
|---|------------------|----------------------|
| | (Unaudited) | |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 740,154 | \$ 911,099 |
| Short term investments | 248,647 | 248,414 |
| Trade accounts receivable | 203,782 | 198,020 |
| Other receivables | 35,369 | 31,553 |
| Inventories | 228,726 | 264,161 |
| Prepaid royalties | 7,932 | 8,083 |
| Deferred income taxes | 48,786 | 49,144 |
| Coal derivative assets | 14,122 | 14,851 |
| Other current assets | 54,270 | 56,746 |
| Total current assets | 1,581,788 | 1,782,071 |
| Property, plant and equipment, net | 6,603,458 | 6,734,286 |
| Other assets | | |
| Prepaid royalties | 87,494 | 87,577 |
| Equity investments | 229,514 | 221,456 |
| Other noncurrent assets | 153,854 | 164,803 |
| Total other assets | 470,862 | 473,836 |
| Total assets | \$ 8,656,108 | \$ 8,990,193 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Accounts payable | \$ 160,209 | \$ 176,142 |
| Accrued expenses and other current liabilities | 294,317 | 278,587 |
| Current maturities of debt | 27,266 | 33,493 |
| Total current liabilities | 481,792 | 488,222 |
| Long-term debt | 5,116,353 | 5,118,002 |
| Asset retirement obligations | 395,813 | 402,713 |
| Accrued pension benefits | 13,925 | 7,111 |
| Accrued postretirement benefits other than pension | 38,034 | 39,255 |
| Accrued workers' compensation | 74,083 | 78,062 |
| Deferred income taxes | 332,207 | 413,546 |
| Other noncurrent liabilities | 172,512 | 190,033 |
| Total liabilities | 6,624,719 | 6,736,944 |
| Stockholders' equity | | |
| Common stock, \$0.01 par value, authorized 260,000 shares, issued 213,792 shares at both June 30, 2014 and December 31, 2013. | 2,141 | 2,141 |
| Paid-in capital | 3,044,082 | 3,038,613 |
| Treasury stock, at cost | (53,848) | (53,848) |
| Accumulated deficit | (994,471) | (771,349) |
| Accumulated other comprehensive income | 33,485 | 37,692 |
| Total stockholders' equity | 2,031,389 | 2,253,249 |
| Total liabilities and stockholders' equity | \$ 8,656,108 | \$ 8,990,193 |

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

Table of Contents

Arch Coal, Inc. and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(in thousands)

| | Six Months Ended June 30, | |
|---|---------------------------|--------------|
| | 2014 | 2013 |
| | (Unaudited) | |
| Operating activities | | |
| Net loss | \$ (220,999) | \$ (142,255) |
| Adjustments to reconcile net loss to cash provided by (used in) operating activities: | | |
| Depreciation, depletion and amortization | 206,887 | 237,668 |
| Amortization of acquired sales contracts, net | (6,935) | (5,019) |
| Amortization relating to financing activities | 7,757 | 12,346 |
| Prepaid royalties expensed | 3,575 | 9,251 |
| Employee stock-based compensation expense | 5,469 | 5,804 |
| Asset impairment costs | 1,512 | 20,482 |
| Gains on disposals and divestitures, net | (18,506) | (2,819) |
| Deferred income taxes | (78,568) | (102,172) |
| Changes in: | | |
| Receivables | 267 | (3,909) |
| Inventories | 3,522 | 8,771 |
| Accounts payable, accrued expenses and other current liabilities | 10,495 | (4,062) |
| Income taxes, net | (571) | (29) |
| Other | 7,749 | 17,988 |
| Cash provided by (used in) operating activities | (78,346) | 52,045 |
| Investing activities | | |
| Capital expenditures | (95,746) | (169,064) |
| Payments of minimum royalties | (3,341) | (10,162) |
| Proceeds from sale-leaseback transactions | | 5,080 |
| Proceeds from disposals and divestitures | 43,245 | 34,919 |
| Purchases of short term investments | (168,951) | (61,870) |
| Proceeds from sales of short term investments | 166,018 | 47,097 |
| Investments in and advances to affiliates | (9,501) | (8,142) |
| Change in restricted cash | | 2,368 |
| Cash used in investing activities | (68,276) | (159,774) |
| Financing activities | | |
| Payments on term loan | (9,750) | (8,250) |
| Net payments on other debt | (9,390) | (11,703) |
| Debt financing costs | (1,957) | |
| Dividends paid | (2,123) | (12,735) |
| Change in restricted cash | (1,103) | |
| Cash used in financing activities | (24,323) | (32,688) |
| Decrease in cash and cash equivalents | (170,945) | (140,417) |
| Cash and cash equivalents, beginning of period | 911,099 | 784,622 |
| Cash and cash equivalents, end of period | \$ 740,154 | \$ 644,205 |

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

Table of Contents

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 (the Company). The Company's primary business is the production of thermal and metallurgical coal from surface and underground mines located throughout the United States, for sale to utility, industrial and steel producers both in the United States and around the world. The Company currently operates mining complexes in West Virginia, Illinois, Wyoming and Colorado. All subsidiaries are wholly-owned. Intercompany transactions and accounts have been eliminated in consolidation.

The Company completed the sale of Canyon Fuel Company, LLC (Canyon Fuel) on August 16, 2013. The results of Canyon Fuel have been segregated from continuing operations and are reflected, net of tax, as discontinued operations in the condensed consolidated statements of operations for the three and six months ended June 30, 2013.

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 months ended June 30, 2014 are not necessarily indicative of results to be expected for the year ending December 31, 2014. 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, 2013 included in the Company's Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission.

2. Accounting Policies

In May 2014, the FASB issued comprehensive authoritative guidance for the recognition and presentation of revenue from contracts with customers. The revenue recognition model is based on changes in contract assets (right to receive consideration) and liabilities (obligations to provide a good or perform a service). The guidance also requires comprehensive quantitative and qualitative disclosures intended to enable financial statement users to understand the nature, timing and uncertainty of revenue and the related cash flows. This guidance will be effective for the Company in the first fiscal quarter of 2017, with early adoption not permitted. The Company is currently assessing the impact the guidance will have upon adoption, but expects no significant changes to its existing revenue recognition policies.

3. Accumulated Other Comprehensive Income

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The following items are included in accumulated other comprehensive income (AOCI):

| | Derivative Instruments | Pension, Postretirement and Other Post- Employment Benefits | (In thousands) | Available-for- Sale Securities | Accumulated Other Comprehensive Loss |
|--------------------------------|---------------------------|--|----------------|-----------------------------------|---|
| Balance at December 31, 2013 | \$ 565 | \$ 31,112 | \$ | 6,015 | \$ 37,692 |
| Unrealized gains (losses) | 788 | | | (3,146) | (2,358) |
| Amounts reclassified from AOCI | (290) | (2,634) | | 1,075 | (1,849) |
| Balance at June 30, 2014 | \$ 1,063 | \$ 28,478 | \$ | 3,944 | \$ 33,485 |

The following amounts were reclassified out of AOCI:

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Table of Contents

| Details About AOCI | Amounts Reclassified from AOCI | | | | Line Item in the Condensed Consolidated Statement of Operations |
|--|-------------------------------------|------------|-----------------------------------|------------|---|
| | Three Months Ended June 30, 2014 | 2013 | Six Months Ended June 30, 2014 | 2013 | |
| | (In thousands) | | | | |
| Derivative instruments | \$ 151 | \$ 542 | \$ 454 | \$ 1,401 | Revenues |
| | (55) | (196) | (164) | (505) | Benefit from income taxes |
| | \$ 96 | \$ 346 | \$ 290 | \$ 896 | Net of tax |
| Pension, postretirement and other post-employment benefits | | | | | |
| Amortization of prior service credits (1) | | | | | |
| | \$ 2,591 | \$ 2,673 | \$ 5,217 | \$ 5,581 | |
| Amortization of actuarial gains (losses), net (1) | | | | | |
| | (321) | (4,423) | (1,100) | (9,285) | |
| | 2,270 | (1,750) | 4,116 | (3,704) | |
| | (817) | 630 | (1,482) | 1,333 | Benefit from income taxes |
| | \$ 1,453 | \$ (1,120) | \$ 2,634 | \$ (2,371) | Net of tax |
| Available-for-sale securities (2) | | | | | |
| | \$ (1,123) | \$ (250) | \$ (1,679) | \$ (309) | Interest and investment income |
| | 404 | 90 | 604 | 111 | Benefit from income taxes |
| | \$ (719) | \$ (160) | \$ (1,075) | \$ (198) | Net of tax |

1 Production-related benefits and workers compensation costs are included in inventoriable production costs.

2 The gains and losses on sales of available-for-sale-securities are determined on a specific identification basis.

Table of Contents**4. Divestitures**

During the first quarter of 2014, the Company entered into agreements to sell an operating thermal coal complex and an idled thermal coal mine in Kentucky and the Company's ADDCAR subsidiary, which manufactures a patented highwall mining system. The sales closed during the first quarter of 2014 for total consideration of \$45.3 million. The Company has received \$34.2 million in cash, and the remaining \$11.0 million is payable on December 31, 2014. The Company recognized a net pre-tax gain of \$12.8 million from these divestitures, reflected in other operating income, net in the condensed consolidated statement of operations.

The following table summarizes the assets and liabilities of the divested operations reflected in the December 31, 2013 consolidated balance sheet (in thousands):

| | | |
|---------------------------------------|----|---------|
| Inventories | \$ | 33,283 |
| Other current assets | | 1,032 |
| Net property, plant & equipment | | 104,587 |
| Other noncurrent assets | | 139 |
| Accounts payable and accrued expenses | | 13,005 |
| Other noncurrent liabilities | | 24,276 |

The following table summarizes the results of Canyon Fuel, reflected as discontinued operations in the condensed consolidated statement of operations through the date of disposition:

| | Three Months Ended June 30, 2013 | | Six Months Ended June 30, 2013 | |
|--|-------------------------------------|--------|-----------------------------------|---------|
| | (in thousands) | | | |
| Total revenues | \$ | 85,107 | \$ | 173,239 |
| Income from discontinued operations before income taxes | \$ | 9,748 | \$ | 28,737 |
| Less: income tax expense | | 1,603 | | 6,325 |
| Income from discontinued operations | \$ | 8,145 | \$ | 22,412 |
| Basic and diluted earnings per common share from discontinued operations | \$ | 0.04 | \$ | 0.11 |

5. Inventories

Inventories consist of the following:

| | June 30, 2014 | | December 31 2013 | |
|------|------------------|---------|---------------------|---------|
| | (In thousands) | | | |
| Coal | \$ | 101,195 | \$ | 117,531 |

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| | | |
|---------------------------|------------|------------|
| Repair parts and supplies | 127,531 | 137,497 |
| Work-in-process | 9,133 | |
| | \$ 228,726 | \$ 264,161 |

The repair parts and supplies are stated net of an allowance for slow-moving and obsolete inventories of \$8.7 million at June 30, 2014 and \$8.4 million at December 31, 2013.

6. Investments in Available-for-Sale Securities

The Company has invested in marketable debt securities, primarily highly liquid AA - rated corporate bonds and U.S. government and government agency securities. These investments are held in the custody of a major financial institution. These securities, along with the Company's investments in marketable equity securities, are classified as available-for-sale securities and, accordingly, the unrealized gains and losses are recorded through other comprehensive income.

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Table of Contents

The Company's investments in available-for-sale marketable securities are as follows:

| June 30, 2014 | | | | | | | |
|---------------------------|------------|------------------------------|-------------------------------|---------------|---------------------------------|-----------------|--------|
| | Cost Basis | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Balance Sheet Classification | | |
| | | | | | Short-Term Investments | Other Assets | |
| (In thousands) | | | | | | | |
| Available-for-sale: | | | | | | | |
| Corporate notes and bonds | \$ 251,038 | \$ | \$ (2,391) | \$ 248,647 | \$ 248,647 | \$ | |
| Equity securities | 5,420 | 11,245 | (2,701) | 13,964 | | | 13,964 |
| Total Investments | \$ 256,458 | \$ 11,245 | \$ (5,092) | \$ 262,611 | \$ 248,647 | \$ | 13,964 |

| December 31, 2013 | | | | | | | |
|---------------------------------------|------------|------------------------------|-------------------------------|---------------|---------------------------------|-----------------|--------|
| | Cost Basis | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value | Balance Sheet Classification | | |
| | | | | | Short-Term Investments | Other Assets | |
| (In thousands) | | | | | | | |
| Available-for-sale: | | | | | | | |
| U.S. government and agency securities | \$ 65,002 | \$ 11 | \$ (75) | \$ 64,938 | \$ 64,938 | \$ | |
| Corporate notes and bonds | 184,773 | 7 | (1,304) | 183,476 | 183,476 | | |
| Equity securities | 5,271 | 13,660 | (2,902) | 16,029 | | | 16,029 |
| Total Investments | \$ 255,046 | \$ 13,678 | \$ (4,281) | \$ 264,443 | \$ 248,414 | \$ | 16,029 |

The aggregate fair value of investments with unrealized losses that were owned for less than a year was \$242.5 million and \$164.3 million at June 30, 2014 and December 31, 2013, respectively. The aggregate fair value of investments with unrealized losses that were owned for over a year, and were also in a continuous unrealized loss position during that time, was \$6.5 million and \$48.7 million at June 30, 2014 and December 31, 2013, respectively.

The debt securities outstanding at June 30, 2014 have maturity dates ranging from the third quarter of 2014 through the fourth quarter of 2015. The Company classifies its investments as current based on the nature of the investments and their availability to provide cash for use in current operations.

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 57 to 67 million gallons of diesel fuel for use in its operations during 2014. 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 and purchased heating oil call options. At June 30, 2014, the Company had protected the price of approximately 88% of its expected purchases for the remainder of 2014 and 80% of its

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expected 2015 purchases through the third quarter. At June 30, 2014, the Company had purchased heating oil call options for approximately 70 million gallons for the purpose of managing the price risk associated with future diesel purchases.

The Company has also purchased heating oil call options to manage the price risk associated with fuel surcharges on its barge and rail shipments, which cover increases in diesel fuel prices for the respective carriers. At June 30, 2014, the Company held heating oil call options for 3.4 million gallons that will settle ratably through February 2015 for the purpose of managing the fluctuations in cash flows associated with fuel surcharges on future shipments.

These positions reduce the Company's risk of cash flow fluctuations related to these surcharges but the positions are not accounted for as hedges.

Table of Contents

Coal price 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, 2014, the Company held derivatives for risk management purposes that are expected to settle in the following years:

| (Tons in thousands) | 2014 | 2015 | Total |
|----------------------------|-------------|-------------|--------------|
| Coal sales | 2,504 | 2,380 | |