

ARCH COAL INC
Form 10-K/A
January 09, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

**FORM 10-K/A
Amendment No. 1
ANNUAL REPORT
PURSUANT TO SECTIONS 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2004**

**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
Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, \$.01 par value	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange
5% Perpetual Cumulative Convertible Preferred Stock	None

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes No

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

At June 30, 2004, based on the closing price of the registrant's common stock on the New York Stock Exchange on that date, the aggregate market value of the voting stock held by non-affiliates of the registrant was approximately \$1,599,826,582. In determining this amount, the registrant has assumed that all of its executive officers and directors, and persons known to it to be the beneficial owners of more than five percent of its common stock, are affiliates. Such assumption shall not be deemed conclusive for any other purpose.

At December 31, 2005, there were 64,548,850 shares of the registrant's common stock outstanding.

Documents incorporated by reference:

1. Portions of the registrant's definitive proxy statement, filed with the Securities and Exchange Commission on March 11, 2005, are incorporated by reference into Part III of this Form 10-K
 2. Portions of the registrant's Annual Report to Stockholders for the year ended December 31, 2005 are incorporated by reference into Parts I, II and IV of this Form 10-K.
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<u>Section 1350 Certification of Robert J. Messey</u>	

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This Amendment No. 1 to our Annual Report on Form 10-K amends and restates Items 8 and 9A of Part II and Item 15 of Part IV of, and Exhibit 13 to, our Annual Report on Form 10-K for the year ended December 31, 2004 filed with the Securities and Exchange Commission on March 10, 2005, primarily to amend Notes 20 and 23 to our consolidated financial statements and to include a revised report of our independent registered public accounting firm. No information included in the original report on Form 10-K has been amended by this Form 10-K/A to reflect any information, events, developments or results subsequent to the filing of the original report on Form 10-K, except as contained in Note 24 to our consolidated financial statements.

PART II**Item 8. Financial Statements and Supplementary Data.**

Reference is made to Item 15 of Part IV of this Amendment No. 1 to our Annual Report on Form 10-K for the information required by Item 8.

Item 9A. Controls and Procedures.

We performed an evaluation under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2004. Based on that evaluation, our management, including our chief executive officer and chief financial officer, concluded that the disclosure controls and procedures were effective as of such date. There were no changes in internal control over financial reporting that occurred during our fiscal quarter ended December 31, 2004 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Reference is made to Item 15 of Part IV of this Amendment No. 1 to our Annual Report on Form 10-K for management's annual report on internal control over financial reporting and the report of independent registered public accounting firm.

PART IV**Item 15. Exhibits and Financial Statement Schedules**

Our consolidated financial statements and related notes and report of independent registered public accounting firm follow.

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All other schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions or are inapplicable and, therefore, have been omitted.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To Board of Directors and Shareholders
of Arch Coal, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Reporting, that Arch Coal, Inc. maintained effective internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Arch Coal Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Arch Coal, Inc. maintained effective internal control over financial reporting as of December 31, 2004, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Arch Coal, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2004, based on the COSO criteria.

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We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Arch Coal, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2004 of Arch Coal, Inc. and our report dated February 23, 2005 expressed an unqualified opinion thereon.

Ernst & Young LLP

St. Louis, Missouri
February 23, 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To Board of Directors and Shareholders
of Arch Coal, Inc.

We have audited the accompanying consolidated balance sheets of Arch Coal, Inc. and subsidiaries as of December 31, 2004 and 2003, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Arch Coal, Inc. and subsidiaries at December 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Arch Coal, Inc.'s internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 23, 2005, expressed an unqualified opinion thereon.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for asset retirement obligations effective January 1, 2003.

Ernst & Young LLP

St. Louis, Missouri
February 23, 2005

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MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Exchange Act Rules 13a-15(f). Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the criteria set forth in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on our evaluation, our management concluded that our internal control over financial reporting is effective as of December 31, 2004.

Our management's assessment of the effectiveness of our internal control over financial reporting as of December 31, 2004 has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report, which is included herein.

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REPORT OF MANAGEMENT

The management of Arch Coal, Inc. is responsible for the preparation of the consolidated financial statements and related financial information in this annual report. The financial statements are prepared in accordance with accounting principles generally accepted in the United States and necessarily include some amounts that are based on management's informed estimates and judgments, with appropriate consideration given to materiality.

The Company maintains a system of internal accounting controls designed to provide reasonable assurance that financial records are reliable for purposes of preparing financial statements and that assets are properly accounted for and safeguarded. The concept of reasonable assurance is based on the recognition that the cost of a system of internal accounting controls should not exceed the value of the benefits derived. The Company has a professional staff of internal auditors who monitor compliance with and assess the effectiveness of the system of internal accounting controls.

The Audit Committee of the Board of Directors, composed of directors who are free from relationships that may impair their independence from Arch Coal, Inc., meets regularly with management, the internal auditors, and the independent auditors to discuss matters relating to financial reporting, internal accounting control, and the nature, extent and results of the audit effort. The independent auditors and internal auditors have full and free access to the Audit Committee, with and without management present.

Robert J. Messey
Senior Vice President and Chief Financial Officer

Steven F. Leer
President and Chief Executive Officer

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NET INCOME (LOSS)	\$	113,706	\$	16,686	\$	(2,562)
Preferred stock dividends		(7,187)		(6,589)		
Net income (loss) available to common shareholders	\$	106,519	\$	10,097	\$	(2,562)
EARNINGS PER COMMON SHARE						
Basic earnings (loss) before cumulative effect of accounting change		1.91		0.26		(0.05)
Cumulative effect of accounting change				(0.07)		
Basic earnings (loss) per common share	\$	1.91	\$	0.19	\$	(0.05)
Diluted earnings (loss) before cumulative effect of accounting change		1.78		0.26		(0.05)
Cumulative effect of accounting change				(0.07)		
Diluted earnings (loss) per common share	\$	1.78	\$	0.19	\$	(0.05)

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

Table of Contents**CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2004	2003
	(In thousands of dollars except share data)	
ASSETS		
Current assets		
Cash and cash equivalents	\$ 323,167	\$ 254,541
Trade accounts receivable	180,902	118,376
Other receivables	34,407	29,897
Inventories	119,893	69,907
Prepaid royalties	12,995	4,586
Deferred income taxes	33,933	19,700
Other	25,560	16,638
Total current assets	730,857	513,645
Property, plant and equipment		
Coal lands and mineral rights	1,725,339	1,085,517
Plant and equipment	1,423,550	1,090,762
Deferred mine development	408,657	285,150
	3,557,546	2,461,429
Less accumulated depreciation, depletion and amortization	(1,524,346)	(1,146,294)
Property, plant and equipment, net	2,033,200	1,315,135
Other assets		
Prepaid royalties	87,285	70,880
Goodwill	37,381	
Deferred income taxes	241,226	246,024
Equity investments		172,045
Other	126,586	69,920
Total other assets	492,478	558,869
Total assets	\$ 3,256,535	\$ 2,387,649
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Accounts payable	\$ 148,014	\$ 89,975
Accrued expenses	217,216	180,314
Current portion of debt	9,824	6,349
Total current liabilities	375,054	276,638

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Long-term debt	1,001,323	700,022
Accrued postretirement benefits other than pension	380,424	352,097
Asset retirement obligations	179,965	143,545
Accrued workers compensation	82,446	77,672
Other noncurrent liabilities	157,497	149,640
Total liabilities	2,176,709	1,699,614
Stockholders equity		
Preferred stock, \$.01 par value, \$50 liquidation preference, authorized 10,000,000 shares, issued 2,875,000 shares	29	29
Common stock, \$.01 par value, authorized 100,000,000 shares, issued 62,500,458 and 53,561,979 shares	631	536
Paid-in capital	1,280,513	988,476
Retained deficit	(166,273)	(255,936)
Unearned compensation	(1,830)	
Less treasury stock, at cost, 357,200 shares	(5,047)	(5,047)
Accumulated other comprehensive loss	(28,197)	(40,023)
Total stockholders equity	1,079,826	688,035
Total liabilities and stockholders equity	\$ 3,256,535	\$ 2,387,649

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

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
Three Years Ended December 31, 2004

	Common Stock	Preferred Stock	Paid-In Capital	Retained Earnings (Deficit)	Unearned Compensation	Treasury Stock at Cost	Accumulated Other Comprehensive Loss	Total
(In thousands of dollars except share and per share data)								
BALANCE AT JANUARY 1, 2002	\$ 527	\$	\$ 835,427	\$ (239,336)	\$	\$ (5,047)	\$ (20,829)	\$ 570,742
Comprehensive income								
Net loss				(2,562)				(2,562)
Minimum pension liability adjustment							(16,416)	(16,416)
Unrealized losses on derivatives							(5,192)	(5,192)
Total comprehensive loss								(24,170)
Dividends paid (\$.23 per share)				(12,045)				(12,045)
Issuance of 81,454 shares of common stock under the stock incentive plan, including income tax benefits			336					336
BALANCE AT DECEMBER 31, 2002	527		835,763	(253,943)		(5,047)	(42,437)	534,863
Comprehensive income								
Net income				16,686				16,686
Minimum pension liability adjustment							3,403	3,403
Unrealized losses on derivatives							(5,940)	(5,940)
Net amount reclassified to income							4,951	4,951
Total comprehensive income								19,100
Dividends Common (\$.23 per share)				(12,090)				(12,090)

Preferred (\$2.29 per share)				(6,589)			(6,589)
Issuance of 2,875,000 shares of perpetual cumulative convertible preferred stock	29	138,995					139,024
Issuance of 770,609 shares of common stock under the stock incentive plan, including income tax benefits	9	13,718					13,727
BALANCE AT DECEMBER 31, 2003	536	29	988,476	(255,936)	(5,047)	(40,023)	688,035
Comprehensive income							
Net income				113,706			113,706
Minimum pension liability adjustment						1,221	1,221
Mark-to-market for available-for-sale securities						2,081	2,081
Net amount reclassified to income						8,524	8,524
Total comprehensive income							125,532
Dividends							
Common (\$2.975 per share)				(16,856)			(16,856)
Preferred (\$2.50 per share)				(7,187)			(7,187)
Issuance of 7,187,500 shares of common stock pursuant to public offering	72	230,455					230,527
Issuance of 500,000 shares of common stock as contribution to pension plan	5	15,435					15,440
Issuance of 149,190 shares of common stock	1	4,246		(4,247)			

under the stock incentive plan restricted stock units								
Expense recognized on restricted stock units								
Issuance of 1,658,179 shares of common stock under the stock incentive plan stock options, including income tax benefits	17	41,901						
BALANCE AT DECEMBER 31, 2004	\$ 631	\$ 29	\$ 1,280,513	\$ (166,273)	\$ (1,830)	\$ (5,047)	\$ (28,197)	\$ 1,079,826

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

Table of Contents**CONSOLIDATED STATEMENTS OF CASH FLOWS****Year Ended December 31,****2004 2003 2002****(In thousands of dollars)****OPERATING ACTIVITIES**

Net income (loss)	\$ 113,706	\$ 16,686	\$ (2,562)
Adjustments to reconcile to cash provided by operating activities:			
Depreciation, depletion and amortization	166,322	158,464	174,752
Prepaid royalties expensed	13,889	13,153	8,503
Accretion on asset retirement obligations	12,681	12,999	
Gain on sale of units of Natural Resource Partners, LP	(91,268)	(42,743)	
Net gain on disposition of property, plant and equipment	(6,668)	(3,782)	(751)
Income from equity investments	(10,828)	(34,390)	(10,092)
Net distributions from equity investments	17,678	49,686	17,121
Cumulative effect of accounting change		3,654	
Other non-operating (income) expense	7,966	(4,256)	
Changes in operating assets and liabilities (see Note 21)	(67,406)	(375)	(4,634)
Other	(9,344)	(6,735)	(5,920)
Cash provided by operating activities	146,728	162,361	176,417

INVESTING ACTIVITIES

Payments for acquisitions, net of cash acquired	(387,751)		
Capital expenditures	(292,605)	(132,427)	(137,089)
Proceeds from sale of units of Natural Resource Partners, LP	111,447	115,000	33,603
Proceeds from coal supply agreements		52,548	
Additions to prepaid royalties	(33,813)	(32,571)	(27,339)
Proceeds from disposition of property, plant and equipment	7,428	4,282	2,522
Cash (used in) provided by investing activities	(595,294)	6,832	(128,303)

FINANCING ACTIVITIES

Net borrowings (payments) on revolver and lines of credit	25,000	(65,971)	(26,513)
Net payments on long-term debt	(302)	(675,000)	
Proceeds from issuance of senior notes	261,875	700,000	
Debt financing costs	(12,806)	(18,508)	(8,228)
Proceeds from sale and leaseback of equipment			9,213
Reductions of obligations under capital lease			(8,210)
Dividends paid	(24,043)	(17,481)	(12,045)
Proceeds from issuance of preferred stock		139,024	
Proceeds from sale of common stock	267,468	13,727	336

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Cash provided by (used in) financing activities	517,192	75,791	(45,447)
Increase in cash and cash equivalents	68,626	244,984	2,667
Cash and cash equivalents, beginning of year	254,541	9,557	6,890
Cash and cash equivalents, end of year	\$ 323,167	\$ 254,541	\$ 9,557

SUPPLEMENTAL CASH FLOW INFORMATION:

Cash paid during the year for interest	\$ 53,558	\$ 30,014	\$ 51,695
Cash paid (received) during the year for income taxes	\$ 13,350	\$ (6,407)	\$ (3,115)

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In Thousands of Dollars Except Per Share Data)

1. Accounting Policies***Principles of Consolidation***

The consolidated financial statements include the accounts of Arch Coal, Inc. and its subsidiaries (the Company), which operate in the coal mining industry. The Company s primary business is the production of steam and metallurgical coal from surface and deep mines throughout the United States, for sale to utility, industrial and export markets. The Company s mines are primarily located in the Powder River Basin, Central Appalachia and Western Bituminous regions of the United States. All subsidiaries (except as noted below) are wholly owned. Intercompany transactions and accounts have been eliminated in consolidation.

The Company s Wyoming, Colorado and Utah coal operations are included in a joint venture named Arch Western Resources, LLC (Arch Western). Arch Western is 99% owned by the Company and 1% owned by BP Amoco. The Company also acts as the managing member of Arch Western.

As of and for the period ending July 31, 2004, the membership interests in the Utah coal operations, Canyon Fuel Company, LLC (Canyon Fuel), were owned 65% by Arch Western and 35% by a subsidiary of ITOCHU Corporation. Through July 31, 2004, the Company s 65% ownership of Canyon Fuel was accounted for on the equity method in the Consolidated Financial Statements as a result of certain super-majority voting rights in the joint venture agreement. Income from Canyon Fuel through July 31, 2004 is reflected in the Consolidated Statements of Operations as income from equity investments (see additional discussion in Note 5, Equity Investments). On July 31, 2004, the Company acquired the remaining 35% of Canyon Fuel. See Note 3, Business Combinations for further discussion.

The Company s 17.5% partnership interest in Dominion Terminal Associates is accounted for on the equity method in the consolidated balance sheets. Allocable costs of the partnership for coal loading and storage are included in other expenses in the consolidated statements of operations. (See additional discussion in Commitments and Contingencies in Note 20.)

Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Accounting Change

On January 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations* (FAS 143). FAS 143 requires legal obligations associated with the retirement of long-lived assets to be recognized at fair value at the time the obligations are incurred. Upon initial recognition of a liability, the cost should also be capitalized as part of the carrying amount of the related long-lived asset and allocated to expense over the useful life of the asset. Previously, the Company accrued for the expected costs of these obligations over the estimated useful mining life of the property. See additional discussion in Note 11, Asset Retirement Obligations.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In Thousands of Dollars Except Per Share Data)

Cash and Cash Equivalents

Cash and cash equivalents are stated at cost. Cash equivalents consist of highly liquid investments with an original maturity of three months or less when purchased.

Allowance for Uncollectible Receivables

The Company maintains allowances to reflect the expected uncollectability of its trade accounts receivable and other receivables based on past collection history, the economic environment and specified risks identified in the receivables portfolio. Allowances recorded at December 31, 2004 and 2003 were \$3.0 million and \$1.5 million, respectively.

Inventories

Inventories consist of the following:

	December 31,	
	2004	2003
Coal	\$ 76,009	\$ 38,249
Supplies, net of allowance	43,884	31,658
	\$ 119,893	\$ 69,907

Coal and supplies inventories are valued at the lower of average cost or market. Coal inventory costs include labor, supplies, equipment costs and operating overhead. The Company has recorded a valuation allowance for slow-moving and obsolete supplies inventories of \$23.0 million and \$18.8 million at December 31, 2004 and 2003, respectively.

Coal Acquisition Costs and Prepaid Royalties

The costs to obtain coal lease rights are capitalized and amortized primarily by the units-of-production method over the estimated recoverable reserves. Amortization occurs either as the Company mines on the property or as others mine on the property through subleasing transactions.

Rights to leased coal lands are often acquired through royalty payments. Where royalty payments represent prepayments recoupable against production, they are capitalized, and amounts expected to be recouped within one year are classified as a current asset. As mining occurs on these leases, the prepayment is charged to cost of coal sales.

Coal Supply Agreements

Acquisition costs allocated to coal supply agreements (sales contracts) are capitalized and amortized on the basis of coal to be shipped over the term of the contract. Value is allocated to coal supply agreements based on discounted cash flows attributable to the difference between the above or below-market contract price and the then-prevailing market price. The net book value of the Company's above-market coal supply agreements was \$11.1 million and \$6.4 million at December 31, 2004 and 2003, respectively. These amounts are recorded in other assets in the accompanying Consolidated Balance Sheets. The net book value of all below-market coal supply agreements was \$29.2 million at December 31, 2004. This amount is recorded in other noncurrent liabilities in the accompanying Consolidated Balance Sheets. Amortization expense on all above-market coal supply agreements was \$3.8 million, \$16.6 million and \$22.2 million in 2004, 2003 and 2002, respectively. Amortization income on all below-market coal supply agreements was \$4.1 million in 2004. Based on expected shipments related to these contracts, the Company expects to record annual amortization

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In Thousands of Dollars Except Per Share Data)

expense on the above-market coal supply agreements and annual amortization income on the below-market coal supply agreements in each of the next five years as reflected in the table below.

	Above-market contracts	Below-market contracts
2005	\$ 6,487	\$ 15,183
2006	769	12,326
2007	361	1,342
2008	361	389
2009	361	

During 2003, the Company agreed to terms with a large customer seeking to buy out of the remaining term of an above-market coal supply contract. The buy-out resulted in the receipt of \$52.5 million in cash during the quarter. The Company wrote off the remaining contract value of \$37.5 million and recorded a deferred gain of approximately \$15 million related to this transaction. The deferred gain will be recognized ratably through 2012.

Exploration Costs

Costs related to locating coal deposits and determining the economic mineability of such deposits are expensed as incurred.

Property, Plant and Equipment*Plant and Equipment*

Plant and equipment are recorded at cost. Interest costs applicable to major asset additions are capitalized during the construction period. Expenditures which extend the useful lives of existing plant and equipment or increase the productivity of the asset are capitalized. Plant and equipment are depreciated principally on the straight-line method over the estimated useful lives of the assets, which range from three to 30 years except for preparation plants and loadouts. Preparation plants and loadouts are depreciated using the units-of-production method over the estimated recoverable reserves, subject to a minimum level of depreciation.

Leased plant and equipment meeting certain criteria is capitalized and the present value of the related lease payments is recorded as a liability. Amortization of capitalized leased assets is computed on the straight-line method over the term of the lease.

Deferred Mine Development

Costs of developing new mines or significantly expanding the capacity of existing mines are capitalized and amortized using the units-of-production method over the estimated recoverable reserves that are associated with the property being benefited. Additionally, the asset retirement obligation asset has been recorded as a component of deferred mine development.

Coal Lands and Mineral Rights

A significant portion of the Company's coal reserves are controlled through leasing arrangements. Amounts paid to acquire such lease rights are capitalized and depleted over the life of those reserves that are proven and probable. Depletion of coal lease rights is computed using the units-of-production method and the rights are assumed to have no residual value. The leases are generally long-term in nature (original terms range from 10 to 50 years), and substantially all of the leases contain provisions that allow for automatic extension of the lease term as long as mining continues.

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The net book value of the Company's leased coal interests was \$1,169.7 million and \$693.3 million at December 31, 2004 and 2003, respectively. This increase is due to the addition of leased coal interests resulting from the North Rochelle and Canyon Fuel acquisitions and the Little Thunder leasing arrangement (See additional discussion in Commitments and Contingencies in Note 20).

Goodwill

Goodwill represents the excess of purchase price and related costs over the value assigned to the net tangible and identifiable intangible assets of businesses acquired. In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets* (FAS 142), goodwill is not amortized but is tested for impairment annually, or if certain circumstances indicate a possible impairment may exist. Impairment testing is performed at a reporting unit level. An impairment loss generally would be recognized when the carrying amount of the reporting unit exceeds the fair value of the reporting unit, with the fair value of the reporting unit determined using a discounted cash flow analysis.

Asset Impairment

If facts and circumstances suggest that a long-lived asset may be impaired, the carrying value is reviewed. If this review indicates that the value of the asset will not be recoverable, as determined based on projected undiscounted cash flows related to the asset over its remaining life, then the carrying value of the asset is reduced to its estimated fair value.

Revenue Recognition

Coal sales revenues include sales to customers of coal produced at Company operations and coal purchased from other companies. The Company recognizes revenue from coal sales at the time title passes to the customer. Transportation costs that are billed by the Company and reimbursed to the transportation provider (pass through costs) are included in coal sales and cost of coal sales.

Other Operating Income

Other operating income reflects income from sources other than coal sales, including administration and production fees from Canyon Fuel (these fees ceased as of the July 31, 2004 acquisition by the Company of the remaining 35% interest in Canyon Fuel), royalties earned from properties leased to third parties, and gains and losses from dispositions of long-term assets. These amounts are recognized as services are performed or otherwise earned.

Derivative Financial Instruments

Derivative financial instruments are accounted for in accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133). FAS 133 requires all derivative financial instruments to be reported on the balance sheet at fair value. Changes in fair value are recognized either in earnings or equity, depending on the nature of the underlying exposure being hedged and how effective the derivatives are at offsetting price movements in the underlying exposure.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objectives for undertaking various hedge transactions. The Company evaluates the effectiveness of its hedging relationships both at the hedge inception and on an ongoing basis. Any ineffectiveness is recorded in the Consolidated Statements of Operations. Ineffectiveness for the years ended December 31, 2004 and 2003 was \$0.2 million and \$0.4 million, respectively.

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The Company has historically utilized interest-rate swap agreements to modify the interest characteristics of outstanding Company debt. The swap agreements essentially convert variable-rate debt to fixed-rate debt. These agreements require the exchange of amounts based on variable interest rates for amounts based on fixed interest rates over the life of the agreement. The Company accrues amounts to be paid or received under interest-rate swap agreements over the lives of the agreements. Such amounts are recognized as adjustments to interest expense over the lives of agreements, thereby adjusting the effective interest rate on the Company's debt.

At December 31, 2004, the Company's net interest rate swap position is as follows:

Swaps with a notional value of \$25.0 million which are designated as hedges of future interest payments to be made under the Company's revolving credit facility. Under these swap agreements, the Company pays a fixed rate of 5.96% (before the credit spread over LIBOR) and receives a weighted-average variable rate based upon 30-day LIBOR. At December 31, 2004, the remaining term of the swap agreements was 30 months.

Swaps with a total notional value of \$500.0 million consisting of offsetting positions of \$250.0 million each. Because of the offsetting nature of these positions, the Company is not exposed to market interest rate risk related to these swaps. Under these swaps, the Company pays a weighted average fixed rate 5.72% on \$250.0 million of notional value and receives a weighted average fixed rate of 2.71% on \$250.0 million of notional value. The remaining terms of these swap agreements at December 31, 2004 ranged from 8 to 31 months.

Changes in the market value of the interest-rate swaps that no longer qualify as hedges are recorded as income or expense in the period of the change. During 2003, the Company recorded gains of \$13.4 million resulting from changes in the market value of interest-rate swaps. This amount is included as other non-operating income in the accompanying Consolidated Statements of Operations.

Income Taxes

Deferred income taxes are based on temporary differences between the financial statement and tax basis of assets and liabilities existing at each balance sheet date using enacted tax rates for years during which taxes are expected to be paid or recovered.

Stock-Based Compensation

These financial statements include the disclosure requirements of Financial Accounting Standards Board Statement No. 123, *Accounting for Stock-Based Compensation* (FAS 123), as amended by Statement of Financial Accounting Standards No. 148, *Accounting for Stock-Based Compensation - Transition and Disclosure* (FAS 148). With respect to accounting for its stock options, as permitted under FAS 123, the Company has retained the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*, and related Interpretations. Had compensation expense for stock option grants been determined based on the fair value at the grant dates consistent with the method of FAS 123, the Company's net income (loss) and

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earnings (loss) per common share would have been changed to the pro forma amounts as indicated in the following table:

	Year Ended December 31		
	2004	2003	2002
As reported			
Net income (loss) available to common shareholders	\$ 106,519	\$ 10,097	\$ (2,562)
Basic earnings (loss) per share	1.91	0.19	(0.05)
Diluted earnings (loss) per share	1.78	0.19	(0.05)
Pro forma (unaudited)			
Net income (loss) available to common shareholders	\$ 101,054	\$ 858	\$ (11,168)
Basic earnings (loss) per share	1.81	0.02	(0.21)
Diluted earnings (loss) per share	1.70	0.02	(0.21)

On December 16, 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 123 (revised 2004), *Share-Based Payment* (FAS 123R), which requires all public companies to measure compensation cost in the income statement for all share-based payments (including employee stock options) at fair value for interim or annual periods beginning after June 15, 2005. The Company intends to adopt FAS 123R on July 1, 2005 using the modified-prospective method and anticipates a pre-tax charge to income of approximately \$3.5 million for the expensing of unvested stock options and price contingent stock awards for the period July 1, 2005 through December 31, 2005. FAS 123R also requires the benefits of tax deductions in excess of recognized compensation cost to be reported as a financing cash flow, rather than as an operating cash flow as required under current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption.

Recent Accounting Pronouncements

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4* (FAS 151). This Statement amends the guidance in ARB No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). Provisions of this statement are effective for fiscal years beginning after June 15, 2005. The Company does not expect the adoption of this statement to have a material impact on its financial statements.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 153, *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions* (FAS 153). This Statement's amendments are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, FAS 153 eliminates the narrow exception for nonmonetary exchanges of similar productive assets and replaces it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. Provisions of this statement are effective for fiscal periods beginning after June 15, 2005. The Company does not expect the adoption of this statement to have a material impact on its financial statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Reclassifications

Certain amounts in the prior years' financial statements have been reclassified to conform with the classifications in the current year's financial statements with no effect on previously reported net income or stockholders' equity.

2. Changes in Estimates and Other Non-Recurring Revenues and Expenses

During the year ending December 31, 2004, the Company assigned its rights and obligations on a parcel of land to a third party resulting in a gain of \$5.8 million. The gain is reflected in other operating income.

During 2004, the Company filed a royalty rate reduction request with the Bureau of Land Management (BLM) for its West Elk mine in Colorado. The BLM notified the Company that it would receive a royalty rate reduction for a specified number of tons representing a retroactive portion for the year totaling \$2.7 million. The retroactive portion was recognized as a component of cost of coal sales in the Consolidated Statement of Operations.

In connection with the settlement of tax audits for prior years, the Company recorded interest income of \$2.2 million in 2004 related to federal income tax refunds. This amount is reflected as interest income.

During the year ending December 31, 2004, the Company was notified by the IRS that it would receive additional black lung excise tax refunds and interest related to black lung claims that were originally denied by the IRS in 2002. The Company recognized a gain of \$2.8 million (\$2.1 million refund and \$0.7 million of interest) related to the claims. The \$2.1 million refund was recorded as a component of cost of coal sales, while the \$0.7 million of interest was recorded as interest income.

During the year ending December 31, 2004, Canyon Fuel, which was accounted for under the equity method through July 31, 2004, began the process of idling its Skyline Mine (the idling process was completed in May 2004), and incurred severance costs of \$3.2 million for the year ended December 31, 2004. The Company's share of these costs totals \$2.1 million and is reflected in income from equity investments.

During the year ending December 31, 2003, the Company instituted cost reduction efforts throughout its operations. These cost reduction efforts included the termination of approximately 100 employees at the Company's corporate headquarters and its Central Appalachia mining operations and the recognition of expenses related to severance of \$2.6 million. Of this amount, \$1.6 million was reported as a component of cost of coal sales, with the remainder reported in selling, general and administrative expenses. Substantially all of the amounts noted were paid during 2003.

During the year ended December 31, 2003, the Company was notified by the State of Wyoming of a favorable ruling relating to the Company's calculation of coal severance taxes. The ruling resulted in a refund of previously paid taxes and the reversal of previously accrued taxes payable. The impact on the 2003 financial results was a gain of \$2.5 million, which was reflected as a reduction of cost of coal sales.

During the year ended December 31, 2003, the Company repaid its variable-rate term loans with the proceeds from the sale of fixed-rate notes. At that time, the Company determined that certain interest rate swaps that had been designated as hedges of the variable-rate interest payments were no longer effective hedges. Historical mark-to-market losses related to these swaps totaling \$27.0 million had been previously deferred and are now being amortized as additional expense over the contractual terms of the swap agreements. The swap agreements' contractual termination dates

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range from September 2005 through October 2007. During 2004 and 2003, the Company recognized expenses of \$8.3 million and \$4.3 million, respectively, related to the amortization of these previously deferred mark-to-market adjustments. The Company recognized an additional \$0.7 million and \$4.7 million of expense in 2004 and 2003, respectively, that represented early debt extinguishment costs. These amounts are included in expenses resulting from early debt extinguishment and termination of hedge accounting for interest rate swaps in the accompanying Consolidated Statements of Operations.

During the year ended December 31, 2002, the Company settled certain coal contracts with a customer that was partially unwinding its coal supply position and desired to buy out of the remaining terms of those contracts. The settlements resulted in a pre-tax gain of \$5.6 million, which was recognized in other operating income in the Consolidated Statements of Operations.

The Company recognized a pre-tax gain of \$4.6 million during the year ended December 31, 2002 as a result of a workers' compensation premium adjustment refund from the State of West Virginia. During 1998, the Company entered into the West Virginia workers' compensation plan at one of its subsidiary operations. The subsidiary paid standard base rates until the West Virginia Division of Workers' Compensation could determine the actual rates based on claims experience. Upon review, the Division of Workers' Compensation refunded \$4.6 million in premiums, which was recognized as an adjustment to cost of coal sales in the Consolidated Statements of Operations.

During 2002, the Company filed a royalty rate reduction request with the BLM for its West Elk mine in Colorado. The BLM notified the Company that it would receive a royalty rate reduction for a specified number of tons representing a retroactive portion for the year totaling \$3.3 million. The retroactive portion was recognized as a component of cost of coal sales in the Consolidated Statement of Operations. Additionally in 2002, Canyon Fuel was notified by the BLM that it would receive a royalty rate reduction for certain tons mined at its Skyline mine. The rate reduction applies to certain tons mined representing a retroactive refund of \$1.1 million. The retroactive amount was reflected in income from equity investments in the Consolidated Statement of Operations.

3. Business Combinations

Canyon Fuel 35% Acquisition

On July 31, 2004, the Company purchased the 35% interest in Canyon Fuel that it did not own from ITOCHU Corporation. The purchase price, including related costs and fees, of \$112.2 million was funded with cash of \$90.2 million and a five-year, \$22.0 million non-interest bearing note. Net of cash acquired, the fair value of the transaction totaled \$97.4 million. As a result of the acquisition, the Company owns substantially all of the ownership interests of Canyon Fuel and will no longer account for its investment in Canyon Fuel on the equity method but will consolidate Canyon Fuel in its financial statements. As of December 31, 2003, Canyon Fuel controlled approximately 161.0 million tons of low-sulfur coal reserves in Utah and produced approximately 13.0 million tons of coal in 2003. The results of operations of the Canyon Fuel mines are included in the Company's Western Bituminous segment.

The preliminary purchase accounting allocation related to the acquisition has been recorded in the accompanying consolidated financial statements as of, and for the period subsequent to, July 31, 2004. The final valuation of the assets acquired and liabilities assumed is expected to be finalized once third-party appraisals are completed. The Company expects the completion of these appraisals during the first half of 2005.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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The following table summarizes the preliminary estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition (dollars in thousands):

Accounts receivable	\$ 7,432
Materials and supplies	3,751
Coal inventory	7,434
Other current assets	6,466
Property, plant, equipment and mine development	125,881
Accounts payable and accrued expenses	(10,379)
Coal supply agreements	(33,378)
Other noncurrent assets and liabilities, net	(9,823)
Total purchase price, net of cash received of \$11.0 million	\$ 97,384

Amounts preliminarily allocated to coal supply agreements noted in the table above represent the liability established for the net below-market coal supply agreements to be amortized over the remaining terms of the contracts. The liability is classified as an other noncurrent liability on the accompanying Consolidated Balance Sheet. The amortization period on these acquired coal supply agreements ranges from one to three years.

Triton Acquisition

On August 20, 2004, the Company acquired (1) Vulcan Coal Holdings, L.L.C., which owns all of the common equity of Triton Coal Company, LLC (Triton), and (2) all of the preferred units of Triton for a purchase price of \$382.1 million, including transaction costs and working capital adjustments. Prior to the acquisition, Triton was the nation's sixth largest coal producer in 2003 and operated two mines in the Powder River Basin, North Rochelle and Buckskin. Following the consummation of the transaction, the Company completed the agreement to sell Buckskin to Kiewit Mining Acquisition Company (Kiewit). The net sales price for this second transaction was \$73.1 million. The total purchase price, including related costs and fees, was funded with cash on hand, including the proceeds from the Buckskin sale, \$22.0 million in borrowings under the Company's existing revolving credit facility and a \$100.0 million term loan at its Arch Western Resources subsidiary. Upon acquisition, the Company integrated the North Rochelle mine with its existing Black Thunder mine in the Powder River Basin.

The preliminary purchase accounting allocations related to the acquisition have been recorded in the accompanying consolidated financial statements as of, and for the periods subsequent to, August 20, 2004. The final valuation of the assets acquired and liabilities assumed is expected to be finalized once third-party appraisals are completed. The Company expects the completion of these appraisals during the first half of 2005.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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The following table summarizes the preliminary estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition (dollars in thousands):

Accounts receivable	\$ 14,233
Materials and supplies	4,161
Coal inventory	4,874
Other current assets	2,200
Property, plant, equipment and mine development	325,194
Coal supply agreements	8,486
Goodwill	37,381
Accounts payable and accrued expenses	(72,408)
Other noncurrent assets and liabilities, net	(15,550)
Total purchase price, net of cash received of \$0.4 million	 \$ 308,571

Amounts preliminarily allocated to coal supply agreements noted in the table above represent the value attributed to the net above-market coal supply agreements to be amortized over the remaining terms of the contracts. The amortization period on these acquired coal supply agreements ranges from one to seven years.

The goodwill amount above arose due to the delay in time between the execution of the acquisition agreement and the date of closing because of the Federal Trade Commission's lawsuit to block the acquisition and is attributable to the loss of value from the tons mined during this period. Of the \$37.4 million allocated to goodwill above, \$27.5 million was deductible for income tax purposes.

Included in the amounts allocated to accounts payable and accrued expenses noted in the table above are \$5.5 million of liabilities incurred in connection with terminating Vulcan employees upon acquisition. Upon acquisition, the Company identified 24 employees of Vulcan who were terminated as part of the integration of the North Rochelle mine into the Company's Black Thunder mine. All amounts accrued for severance have been paid as of December 31, 2004.

Pro Forma Financial Information

The following unaudited pro forma financial information presents the combined results of operations of the Company, the remaining Canyon Fuel interest acquired from ITOCHU Corporation and the North Rochelle operations acquired from Triton, on a pro forma basis, as though the purchases had occurred as of the beginning of each period presented. The pro forma financial information does not necessarily reflect the results of operations that would have occurred had the

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Company and the operations acquired from Canyon Fuel and Triton constituted a single entity during those periods:

	Year Ended December 31,	
	2004	2003
	(In thousands, except per share data)	
Revenues:		
As reported	\$ 1,907,168	\$ 1,435,488
Pro forma	2,156,958	1,876,205
Income before accounting changes:		
As reported	113,706	20,340
Pro forma	103,933	13,747
Net income available to common shareholders:		
As reported	106,519	10,097
Pro forma	96,746	1,058
Basic earnings per share:		
As reported	1.91	0.19
Pro forma	1.73	0.02
Diluted earnings per share:		
As reported	1.78	0.19
Pro forma	1.63	0.02

4. Other Comprehensive Income

Other comprehensive income items under Statement of Financial Accounting Standards No. 130, *Reporting Comprehensive Income*, are transactions recorded in stockholders' equity during the year, excluding net income and transactions with stockholders. Following are the items included in other comprehensive income (loss), net of a 39% tax rate:

	Financial Derivatives	Minimum Pension Liability Adjustments	Available-for-sale Securities	Accumulated Other Comprehensive Loss
Balance January 1, 2002	\$ (17,978)	\$ (2,851)	\$	\$ (20,829)
2002 activity	(5,192)	(16,416)		(21,608)
Balance December 31, 2002	(23,170)	(19,267)		(42,437)
2003 activity	(989)	3,403		2,414
Balance December 31, 2003	(24,159)	(15,864)		(40,023)
2004 activity	8,524	1,221	2,081	11,826
Balance December 31, 2004	\$ (15,635)	\$ (14,643)	\$ 2,081	\$ (28,197)

The 2004 activity for financial derivatives is comprised substantially of reclassifications to net income.

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5. Equity Investments

As of December 31, 2004, the Company held no equity investments. The Company purchased the remaining 35% interest in Canyon Fuel on July 31, 2004. Prior to July 31, 2004, the Company accounted for its investment in Canyon Fuel on the equity method. Additionally, prior to March 10, 2004, the Company accounted for its investment in Natural Resource Partners, LP (NRP) on the equity method. Amounts recorded in the Condensed Consolidated Financial Statements are as follows:

	December 31,	
	2004	2003
Equity investments:		
Investment in Canyon Fuel	\$	\$ 146,180
Investment in NRP		25,865
Equity investments as reported in Consolidated Balance Sheets	\$	\$ 172,045

	Year Ended December 31,		
	2004	2003	2002
Income from equity investments:			
Income from investment in Canyon Fuel	\$ 8,410	\$ 19,707	\$ 7,774
Income from investment in NRP	2,418	14,683	2,318
Income from equity investments in the Consolidated Statements of Operations	\$ 10,828	\$ 34,390	\$ 10,092

Investment in Canyon Fuel

The following tables present unaudited, summarized financial information for Canyon Fuel, for periods in which it was accounted for on the equity method.

Condensed Income Statement Information

	Period Ended July 31, 2004	Year Ended December 31,	
		2003	2002
Revenues	\$ 142,893	\$ 242,060	\$ 250,325
Total costs and expenses	133,546	223,357	249,325
Net income before cumulative effect of accounting change	\$ 9,347	\$ 18,703	\$ 1,000

65% of Canyon Fuel net income	\$	6,075	\$	12,157	\$	650
Effect of purchase adjustments		2,335		7,550		7,124
Arch Coal's income from its equity investment in Canyon Fuel	\$	8,410	\$	19,707	\$	7,774

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Condensed Balance Sheet Information

December 31, 2003

	Canyon Fuel Basis	Arch Ownership of Canyon Fuel Basis	Arch Purchase Adjustments	Arch Basis
Current assets	\$ 51,660	\$ 33,579	\$ (2,492)	\$ 31,087
Noncurrent assets	324,777	211,105	(59,622)	151,483
Current liabilities	25,692	16,700		16,700
Noncurrent liabilities	30,292	19,690		19,690
Members equity	\$ 320,453	\$ 208,294	\$ (62,114)	\$ 146,180

Through July 31, 2004, the Company's income from its equity investment in Canyon Fuel represented 65% of Canyon Fuel's net income after adjusting for the effect of purchase adjustments related to its investment in Canyon Fuel. The Company's investment in Canyon Fuel reflects purchase adjustments primarily related to the reduction in amounts assigned to sales contracts, mineral reserves and other property, plant and equipment. The purchase adjustments are amortized consistent with the underlying assets of the joint venture.

Effective January 1, 2003, Canyon Fuel adopted FAS 143 and recorded a cumulative effect loss of \$2.4 million. The Company's 65% share of this amount was offset by purchase adjustments of \$0.5 million. These amounts are included in the cumulative effect of accounting change reported in the Company's Consolidated Statements of Operations.

Investment in Natural Resource Partners, L.P.

During 2002, the Company contributed 454 million tons of coal reserves with a net book value of \$84.9 million to Natural Resource Partners L.P. in exchange for 4.8 million of NRP's common limited partnership units, 4.8 million of NRP's subordinated limited partnership units, and 42.25% of NRP's general partner interest. Concurrent with the contribution, the Company entered into various leases with NRP for the right to mine approximately 57 million tons of the contributed reserves. No gain was recorded at the time of the contribution of the reserves and formation of NRP. On October 17, 2002, the Company sold 1.9 million of its common limited partner units in a public offering for proceeds of \$33.6 million.

On December 22, 2003, the Company sold its 4.8 million subordinated units and its general partner interest for a purchase price of \$115.0 million. This sale resulted in a gain of \$70.6 million, of which \$42.7 million was recognized in 2003 and the remainder was deferred. After this sale, the Company's remaining ownership in NRP consisted of 2.9 million common limited partnership units, representing approximately 12.5% of NRP's outstanding partnership interests.

During the year ended December 31, 2004, the Company sold its remaining limited partnership units of NRP in three separate transactions occurring in March, June and October. These sales resulted in proceeds of approximately \$111.4 million and gains of \$91.3 million.

As of December 31, 2004, the Company had deferred gains from its sales of NRP units totaling \$21.8 million, which are included as Other noncurrent liabilities in the accompanying Consolidated Balance Sheets. These deferred gains will be recognized over the remaining term of the Company's leases with NRP, as follows: \$7.6 million in 2005,

\$4.6 million in 2006, \$3.9 million in 2007, and a total of \$5.7 million from 2008 through 2012.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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6. Accrued Expenses

Accrued expenses included in current liabilities consist of the following:

	December 31,	
	2004	2003
Payroll and related benefits	\$ 32,358	\$ 36,846
Taxes other than income taxes	76,246	49,140
Postretirement benefits other than pension	29,685	26,324
Workers compensation	12,774	13,088
Interest	35,102	26,025
Asset retirement obligations	19,632	19,186
Other accrued expenses	11,419	9,705
	\$ 217,216	\$ 180,314

7. Income Taxes

Significant components of the provision (benefit) for income taxes are as follows:

	December 31,		
	2004	2003	2002
Current:			
Federal	\$ 7,583	\$ 4,668	\$ (21,646)
State			
Total current	7,583	4,668	(21,646)
Deferred:			
Federal	(5,412)	(24,438)	5,788
State	(2,301)	(3,440)	(3,142)
Total deferred	(7,713)	(27,878)	2,646
	\$ (130)	\$ (23,210)	\$ (19,000)

A reconciliation of the statutory federal income tax expense (benefit) on the Company's pretax income (loss) to the actual provision (benefit) for income taxes follows:

	December 31,		
	2004	2003	2002

Income tax expense (benefit) at statutory rate	\$ 39,760	\$ (1,005)	\$ (7,547)
Percentage depletion allowance	(22,807)	(16,211)	(21,366)
State taxes, net of effect of federal taxes	1,729	(2,123)	(4,585)
Change in valuation allowance, affecting provision	(265)	3,543	25,880
Reversal of reserve for capital loss		(5,850)	
Favorable tax settlement	(16,861)	(1,464)	(10,506)
Other, net	(1,686)	(100)	(876)
	\$ (130)	\$ (23,210)	\$ (19,000)

During 2004, the IRS completed an audit and review of tax returns and claims for tax years 1999 through 2002 resulting in a favorable tax settlement, which includes a \$9.7 million reduction in prior

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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years tax reserves. Also, compensatory stock options were exercised resulting in a tax benefit of \$5.0 million that was recorded to paid in capital.

During 2003, the Company reversed a \$5.8 million tax reserve, which was established in prior years, for capital loss deductions which the Company deemed had no value at that time. Capital losses are only deductible to the extent that a company has capital gains. Capital gains generated during 2003 and projected to be generated in future years will fully absorb the capital loss. Also during the year, the Company reversed a \$1.5 million tax reserve as a result of filing amended state income tax returns based on prior year IRS audit changes.

During 2002, the Company received notice from the IRS that it will receive tax refunds of \$3.6 million as a result of proposed adjustments to tax years 1997 and 1998. In addition, carryover adjustments have been allowed which will reduce the Company's 1999 and 2000 taxes paid by an additional \$5.3 million. These favorable adjustments are primarily the result of revisions in the tax treatment of acquisitions made during the audit years. Tax refunds for 1999 and 2000 will not be realized until audits of those years have been completed.

Management believes that the Company has adequately provided for any income taxes and interest which may ultimately be paid with respect to all open tax years.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Significant components of the Company's deferred tax assets and liabilities that result from carryforwards and temporary differences between the financial statement basis and tax basis of assets and liabilities are summarized as follows:

	December 31,	
	2004	2003
Deferred tax assets:		
Postretirement benefits other than pension	\$ 152,622	\$ 144,993
Alternative minimum tax credit carryforward	99,582	92,229
Net operating loss carryforwards	74,226	77,127
Reclamation and mine closure	42,776	41,953
Workers' compensation	32,453	33,239
Plant and equipment	19,143	20,372
Other comprehensive income	16,412	18,918
Tax intangibles	13,880	17,999
Advance royalties	13,303	13,023
Coal Supply Agreements	10,233	
Other	32,463	41,789
Gross deferred tax assets	507,093	501,642
Valuation allowance	(163,005)	(161,113)
Total deferred tax assets	344,088	340,529
Deferred tax liabilities:		
Investment in tax partnerships	38,251	33,230
Coal supply agreements		971
Other	30,678	40,604
Total deferred tax liabilities	68,929	74,805
Net deferred tax asset	275,159	265,724
Less current asset	33,933	19,700
Long-term deferred tax asset	\$ 241,226	\$ 246,024

The Company has federal net operating loss carryforwards for regular income tax purposes of \$145.2 million which will expire in the years 2007 to 2022. The Company has an alternative minimum tax credit carryforward of \$99.6 million, which may carry forward indefinitely to offset future regular tax in excess of alternative minimum tax.

The Company has recorded a valuation allowance for a portion of its deferred tax assets that management believes, more likely than not, will not be realized. These deferred tax assets include a portion of the alternative minimum tax credits and some of the deductible temporary differences that will likely not be realized at the maximum effective tax rate.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Such valuation allowance consisted of the following components at December 31 on the years indicated:

	2004	2003
Unrealized future deductible temporary differences	\$ 114,776	\$ 117,564
Unutilized alternative minimum tax credits	48,229	43,549
Valuation Allowance at December 31	\$ 163,005	\$ 161,113

8. Debt and Financing Arrangements

Debt consists of the following:

	December 31,	
	2004	2003
Indebtedness to banks under lines of credit	\$	\$
Indebtedness to banks under revolving credit agreement, expiring December 22, 2009 (weighted average rate at December 31, 2004 4.73%)	25,000	
6.75% senior notes (\$950.0 million face value) due July 1, 2013	961,613	700,000
Promissory note	17,523	
Other	7,011	6,371
	1,011,147	706,371
Less current portion	9,824	6,349
Long-term debt	\$ 1,001,323	\$ 700,022

On December 22, 2004, the Company entered into a \$700.0 million revolving credit facility that matures on December 22, 2009. The rate of interest on borrowings under the credit facility is a floating rate based on LIBOR. The Company's credit facility is secured by substantially all of its assets as well as its ownership interests in substantially all of its subsidiaries, except its ownership interests in Arch Western and its subsidiaries. The credit facility replaced the Company's existing \$350.0 million revolving credit facility. At December 31, 2004, the Company had \$69.0 million in letters of credit outstanding which, when combined with the \$25.0 million of outstanding borrowings under the revolver, resulted in \$606.0 million of unused borrowings under the revolver.

On October 22, 2004, the Company issued \$250.0 million of 6.75% Senior Notes due 2013 at a price of 104.75% of par. Interest on the notes is payable on January 1 and July 1 of each year, beginning on January 1, 2005. The senior notes were issued under an indenture dated June 25, 2003, under which the Company previously issued \$700.0 million of 6.75% Senior Notes due 2013. The senior notes are guaranteed by Arch Western and certain of Arch Western's subsidiaries and are secured by a security interest in loans made to Arch Coal by Arch Western. The terms of the senior notes contain restrictive covenants that limit Arch Western's ability to, among other things, incur additional debt, sell or transfer assets, and make certain investments.

On July 31, 2004, the Company issued a five year, \$22.0 million non-interest bearing note to help fund the Canyon Fuel acquisition. At its issuance, the note was discounted to its present value using a rate of 7.0%. The promissory

note is payable in quarterly installments of \$1.0 million through July 2008 and \$1.5 million from October 2008 through July 2009.

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The Company also periodically establishes uncommitted lines of credit with banks. These agreements generally provide for short-term borrowings at market rates. At December 31, 2004, there were \$20.0 million of such agreements in effect, of which none were outstanding.

Aggregate contractual maturities of debt are \$10.9 million in 2005, \$4.1 million in 2006, \$4.0 million in 2007, \$4.5 million in 2008, \$29.5 million in 2009 and \$950.0 million thereafter.

Terms of the Company's credit facilities and leases contain financial and other covenants that limit the ability of the Company to, among other things, effect acquisitions or dispositions and borrow additional funds and require the Company to, among other things, maintain various financial ratios and comply with various other financial covenants. In addition, the covenants require the pledging of assets to collateralize the Company's revolving credit facility. The assets pledged include equity interests in wholly-owned subsidiaries, certain real property interests, accounts receivable and inventory of the Company. Failure by the Company to comply with such covenants could result in an event of default, which, if not cured or waived, could have a material adverse effect on the Company. The Company was in compliance with all financial covenants at December 31, 2004.

9. Fair Values of Financial Instruments

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amounts approximate fair value.

Debt: At December 31, 2004 and 2003, the fair value of the Company's senior notes and other long-term debt, including amounts classified as current, was \$1,000.6 million and \$728.5 million, respectively.

Interest rate swaps: The fair values of interest rate swaps are based on quoted prices, which reflect the present value of the difference between estimated future amounts to be paid and received. At December 31, 2004 and 2003 the fair value of these swaps are liabilities of \$12.4 million and \$22.5 million, respectively. This liability is included in other noncurrent liabilities in the Consolidated Balance Sheets.

10. Accrued Workers' Compensation

The Company is liable under the federal Mine Safety and Health Act of 1969, as subsequently amended, to provide for pneumoconiosis (black lung) benefits to eligible employees, former employees, and dependents. The Company is also liable under various states' statutes for black lung benefits. The Company currently provides for federal and state claims principally through a self-insurance program. Charges are being made to operations as determined by independent actuaries, at the present value of the actuarially computed present and future liabilities for such benefits over the employees' applicable years of service.

In addition, the Company is liable for workers' compensation benefits for traumatic injuries that are accrued as injuries are incurred. Traumatic claims are either covered through self-insured programs or through state sponsored workers' compensation programs.

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Workers' compensation expense consists of the following components:

	2004	2003	2002
Self-insured black lung benefits:			
Service cost	\$ 1,447	\$ 1,491	\$ 916
Interest cost	2,660	2,942	3,060
Net amortization	(1,080)	(247)	(639)
Total black lung disease	3,027	4,186	3,337
Traumatic injury claims and assessments	18,725	14,008	9,038
Total provision	\$ 21,752	\$ 18,194	\$ 12,375
Payments for workers' compensation benefits	\$ 21,068	\$ 17,072	\$ 9,856
Discount rate	6.00%	6.50%	7.00%
Cost escalation rate	4.00%	4.00%	4.00%

Net amortization represents the systematic recognition of actuarial gains or losses over a five year period.

As discussed in Note 2, the Company recognized a pre-tax gain of \$4.6 million in 2002 as a result of a workers' compensation premium adjustment refund from the State of West Virginia.

Summarized below is information about the amounts recognized in the consolidated balance sheets for workers' compensation benefits:

	December 31,	
	2004	2003
Black lung costs	\$ 51,793	\$ 47,038
Traumatic and other workers' compensation claims	43,427	43,722
Total obligations	95,220	90,760
Less amount included in accrued expenses	12,774	13,088
Noncurrent obligations	\$ 82,446	\$ 77,672

The reconciliation of changes in the benefit obligation of the black lung liability is as follows:

	December 31,	
	2004	2003
Beginning of year obligation	\$ 46,722	\$ 46,856
Service cost	1,447	1,491
Interest cost	2,660	2,942
Actuarial gain	(1,122)	(1,243)

Benefit and administrative payments	(2,066)	(3,324)
Net obligation at end of year	47,641	46,722
Unrecognized gain	4,152	316
Accrued cost	\$ 51,793	\$ 47,038

Receivables related to benefits contractually recoverable from others of \$0.4 million in both 2004 and 2003 are recorded in other long-term assets.

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11. Asset Retirement Obligations

The Company's asset retirement obligations arise from the federal Surface Mining Control and Reclamation Act of 1977 and similar state statutes, which require that mine property be restored in accordance with specified standards and an approved reclamation plan. The required reclamation activities to be performed are outlined in the Company's mining permits. These activities include reclaiming the pit and support acreage at surface mines, sealing portals at deep mines, and reclaiming refuse areas and slurry ponds.

The Company records its asset retirement obligations at the time that they are incurred or acquired. Obligations are incurred at the time that development of a mine commences for deep and surface mines and at the time that construction begins for support facilities, refuse areas and slurry ponds. The liability is determined using discounted cash flow techniques and is accreted to its then present value each period. Accretion on the asset retirement obligation begins at the time the liability is incurred. Amortization of the related asset is recorded on a units-of-production basis over the mine's estimated recoverable reserves.

The Company reviews its asset retirement obligation at least annually and makes necessary adjustments for permit changes as granted by state authorities and for revisions of estimates of costs and productivities. For ongoing operations, adjustments to the liability result in an adjustment to the corresponding asset. For idle operations, adjustments to the liability are recognized as income or expense in the period the adjustment is recorded.

As discussed in Note 1, effective January 1, 2003, the Company began accounting for its reclamation obligations in accordance with FAS 143. The cumulative effect of this change on periods prior to January 1, 2003 resulted in a charge to income of \$3.7 million (net of income taxes of \$2.3 million), or \$0.07 per share, which is included in the Company's results of operations for the year ended December 31, 2003. In addition, the net income of the Company, excluding the cumulative effect of accounting change, for the year ended December 31, 2004 is \$0.4 million (\$0.01 per share) more than it would have been if the Company had continued to account for these obligations under its old method. The net income of the Company, excluding the cumulative effect of accounting change, for the year ended December 31, 2003 is \$1.2 million (\$0.02 per share) less than it would have been if the Company had continued to account for these obligations under its old method. The unaudited pro forma amounts below reflect the retroactive application of FAS 143 as if the Company had adopted the standard on January 1, 2002 and the corresponding elimination of the cumulative effect of accounting change:

	Year Ended December 31,		
	2004	2003	2002
As Reported			
Net income (loss) available to common shareholders	\$ 106,519	\$ 10,097	\$ (2,562)
Basic income (loss) per share	1.91	0.19	(0.05)
Diluted income (loss) per share	1.78	0.19	(0.05)
Pro Forma			
Net income (loss) available to common shareholders	\$ 106,519	\$ 13,751	\$ (5,322)
Basic income (loss) per share	1.91	0.26	(0.10)
Diluted income (loss) per share	1.78	0.26	(0.10)

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The following table describes the changes to the Company's asset retirement obligation for the years ended December 31, 2004 and 2003:

	2004	2003
Balance at January 1 (including current portion)	\$ 162,731	\$ 125,440
Impact of adoption		41,198
Accretion expense	12,681	12,999
Additions resulting from property additions	37,784	4,640
Adjustments to the liability from annual recosting	(1,571)	(1,117)
Liabilities settled	(12,028)	(20,429)
Balance at December 31	199,597	162,731
Current portion included in accrued expenses	(19,632)	(19,186)
Long-term liability	\$ 179,965	\$ 143,545

12. Employee Benefit Plans***Defined Benefit Pension and Other Postretirement Benefit Plans***

The Company has non-contributory defined benefit pension plans covering certain of its salaried and non-union hourly employees. Benefits are generally based on the employee's age and compensation. The Company funds the plans in an amount not less than the minimum statutory funding requirements nor more than the maximum amount that can be deducted for federal income tax purposes.

The Company also currently provides certain postretirement medical/life insurance coverage for eligible employees. Generally, covered employees who terminate employment after meeting eligibility requirements are eligible for postretirement coverage for themselves and their dependents. The salaried employee postretirement medical/life plans are contributory, with retiree contributions adjusted periodically, and contain other cost-sharing features such as deductibles and coinsurance. The postretirement medical plan for retirees who were members of the United Mine Workers of America (UMWA) is not contributory. The Company's current funding policy is to fund the cost of all postretirement medical/life insurance benefits as they are paid.

The Company uses a December 31 measurement date for its pension and postretirement benefit plans.

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Obligations and Funded Status. Summaries of the changes in the benefit obligations, plan assets and funded status of the plans are as follows:

	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
CHANGE IN BENEFIT OBLIGATIONS				
Benefit obligations at January 1	\$ 182,946	\$ 166,807	\$ 531,933	\$ 452,476
Service cost	8,861	8,188	4,145	3,637
Interest cost	11,781	11,293	29,695	31,126
Plan amendments	139			
Acquisitions	23,380		10,748	
Benefits paid	(15,288)	(11,791)	(29,585)	(26,286)
Transfer from Canyon Fuel Pension Plan	57	4,038		
Other-primarily actuarial (gain) loss	6,187	4,411	(11,066)	70,980
Benefit obligations at December 31	\$ 218,063	\$ 182,946	\$ 535,870	\$ 531,933
CHANGE IN PLAN ASSETS				
Value of plan assets at January 1	\$ 151,126	\$ 115,595	\$	\$
Actual return on plan assets	17,974	24,380		
Acquisitions	15,599			
Employer contributions	21,641	18,904	29,585	26,286
Benefits paid	(15,288)	(11,791)	(29,585)	(26,286)
Transfer from Canyon Fuel Pension Plan	57	4,038		
Value of plan assets at December 31	\$ 191,109	\$ 151,126	\$	\$
NET AMOUNT RECOGNIZED				
Funded status of the plans	\$ (26,954)	\$ (31,820)	\$ (535,870)	\$ (531,933)
Unrecognized actuarial loss	34,683	34,239	129,753	159,642
Unrecognized prior service gain	(886)	(1,157)	(3,992)	(6,130)
Prepaid (accrued) benefit cost	\$ 6,843	\$ 1,262	\$ (410,109)	\$ (378,421)
BALANCE SHEET AMOUNTS				
Accrued benefit liabilities	\$ (17,628)	\$ (21,436)	\$ (410,109)	\$ (378,421)
Intangible asset (Other assets)	592	526		
Minimum pension liability adjustment (accumulated other comprehensive income)	23,879	22,172		
Net asset (liability) recognized	6,843	1,262	(410,109)	(378,421)
Less current portion	(6,843)	(1,262)	29,685	26,324

Long term liability	\$	\$	\$ (380,424)	\$ (352,097)
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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Other Postretirement Benefits

The actuarial gain in 2004 resulted from impact of the Medicare Prescription Drug Act implementation discussed below. The actuarial loss in 2003 resulted from changes in certain actuarial assumptions, including an increase in the expected health care cost trend rate and a reduction in the discount rate.

Pension Benefits

The accumulated benefit obligation for all pension plans was \$208.7 million and \$172.7 million at December 31, 2004 and 2003, respectively.

Transfers from the Canyon Fuel Company Pension Plan represent transfers of the benefit obligation (as actuarially determined) and related plan assets for employees who were transferred from Canyon Fuel to Arch Coal in 2004 and 2003.

Components of Net Periodic Benefit Cost. The following table details the components of pension and other postretirement benefit costs.

Year Ended December 31,	Pension Benefits			Other Postretirement Benefits		
	2004	2003	2002	2004	2003	2002
	(In thousands)					
Service cost	\$ 8,861	\$ 8,188	\$ 8,031	\$ 4,145	\$ 3,637	\$ 2,903
Interest cost	11,781	11,293	11,268	29,695	31,126	24,265
Expected return on plan assets*	(14,539)	(13,687)	(12,336)			
Other amortization and deferral	4,802	1,435	(284)	16,685	21,315	(3,171)
Net benefit cost	\$ 10,905	\$ 7,229	\$ 6,679	\$ 50,525	\$ 56,078	\$ 23,997

* The Company does not fund its other postretirement liabilities.

Assumptions. The following table provides the assumptions used to determine the actuarial present value of projected benefit obligations at December 31.

	Pension Benefits		Other Postretirement Benefits	
	2004	2003	2004	2003
Weighted Average Assumptions:				
Discount rate	6.00%	6.50%	6.00%	6.50%
Rate of compensation increase	3.50%	3.75%	N/A	N/A

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The following table provides the assumptions used to determine net periodic benefit cost for years ended December 31.

	Pension Benefits			Other Postretirement Benefits		
	2004	2003	2002	2004	2003	2002
Weighted Average Assumptions:						
Discount rate	6.50%	7.00%	7.50%	6.50%	7.00%	7.50%
Rate of compensation increase	3.75%	4.25%	4.50%	N/A	N/A	N/A
Expected return on plan assets	8.50%	9.00%	9.00%	N/A	N/A	N/A

The Company establishes the expected long-term rate of return at the beginning of each fiscal year based upon historical returns and projected returns on the underlying mix of invested assets. The Company utilizes Modern Portfolio Theory modeling techniques in the development of its return assumptions. This technique projects rates of returns that can be generated through various asset allocations that lie within the risk tolerance set forth by members of the Company's Pension Committee. The risk assessment provides a link between a Pension's risk capacity, management's willingness to accept investment risk and the asset allocation process, which ultimately leads to the return generated by the invested assets. For the determination of net periodic benefit cost in 2005, the Company will utilize an expected rate of return of 8.50%.

The following table provides information regarding the assumed health care cost trend rates at December 31.

	2004	2003
Health care cost trend rate assumed for next year	8.00%	8.00%
Ultimate trend rate	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2011	2010

The health care cost trend rate assumption has a significant effect on the amounts reported. For example, increasing the assumed health care cost trend rate by one percentage point each year would increase the accumulated postretirement obligation as of December 31, 2004 by \$66.2 million, or 12.4%, and the net periodic postretirement benefit cost for 2004 by \$4.0 million, or 7.9%.

Plan Assets. The Company's pension plan weighted average asset allocations at December 31, 2004 and 2003, by asset category are as follows:

	Plan Assets at December 31,	
	2004	2003
Equity securities	67%	69%
Debt securities	28%	28%
Cash and equivalents	5%	3%
Total	100%	100%

The Company's Pension Committee (the Committee) is responsible for overseeing the investment of pension plan assets. The Committee is responsible for determining and monitoring appropriate asset allocations and for selecting or replacing investment managers, trustees and custodians. The pension plan's current investment targets are 65% equity, 30% fixed income securities and 5% cash. The Pension Committee reviews the actual asset allocation in light of these

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targets on a periodic basis and rebalances among investments as necessary. The Committee evaluates the performance of investment managers as compared to the performance of specified benchmarks and peers and monitors the investment managers to ensure adherence to their stated investment style and to the plan's investment guidelines.

Cash Flows. The Company currently does not anticipate making any contributions to its pension plan in 2005.

The following represents expected future benefit payments, which reflect expected future service, as appropriate:

	Pension Benefits	Other Postretirement Benefits
2005	\$ 18,429	\$ 29,274
2006	19,636	28,441
2007	19,793	30,794
2008	20,487	31,832
2009	20,883	33,018
Years 2010-2014	105,579	190,080
	\$ 204,807	\$ 343,439

Impact of Medicare Prescription Drug, Improvement and Modernization Act of 2003. On December 8, 2003, the President signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). The Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. The Company has included the effects of the Act in its financial statements for the year ending December 31, 2004 in accordance with FASB Staff Position No. FAS 106-2, *Accounting and Disclosure Requirements related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* (FSP 106-2). Incorporation of the provisions of the Act resulted in a reduction of the Company's postretirement benefit obligation of \$68.0 million. Postretirement medical expenses for fiscal year 2004 after incorporation of the provisions of the Act resulted in an amount of \$18.2 million less than that previously anticipated (substantially all of which is recorded as a component of cost of coal sales). The benefit for the year ending December 31, 2004 was partially offset by increased costs resulting from changes to other actuarial assumptions that were incorporated at the beginning of the year.

Multi-employer Pension and Benefit Plans

Under the labor contract with the United Mine Workers of America (UMWA), the Company made no payments in 2004, 2003 and 2002 into a multi-employer defined benefit pension plan trust established for the benefit of union employees. Payments are based on hours worked and are expensed as hours are incurred. Under the Multi-employer Pension Plan Amendments Act of 1980, a contributor to a multi-employer pension plan may be liable, under certain circumstances, for its proportionate share of the plan's unfunded vested benefits (withdrawal liability). The Company is not aware of any circumstances that would require it to reflect its share of unfunded vested pension benefits in its financial statements. At December 31, 2004, approximately 13% of the Company's

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workforce was represented by the UMWA under a collective bargaining agreement that is effective through December 31, 2006.

The Coal Industry Retiree Health Benefit Act of 1992 (Benefit Act) provides for the funding of medical and death benefits for certain retired members of the UMWA through premiums to be paid by assigned operators (former employers), transfers of monies in 1993 and 1994 from an overfunded pension trust established for the benefit of retired UMWA members, and transfers from the Abandoned Mine Lands Fund (funded by a federal tax on coal production) commencing in 1995. The Company treats its obligation under the Benefit Act as a participation in a multi-employer plan and records expense as premiums are paid. The Company recorded expense of \$6.0 million in 2004, \$5.1 million in 2003, and \$3.2 million in 2002 for premiums pursuant to the Benefit Act.

Other Plans

The Company sponsors savings plans which were established to assist eligible employees in providing for their future retirement needs. The Company's contributions to the plans were \$8.8 million in 2004, \$8.3 million in 2003, and \$8.4 million in 2002.

13. Capital Stock

On November 24, 2004, the Company filed a registration statement on Form S-3 with the Securities and Exchange Commission. The registration statement allows us to offer, from time to time, an aggregate of up to \$1.0 billion in debt securities, preferred stock, depositary shares, purchase contracts, purchase units, common stock and related rights and warrants.

On October 28, 2004, the Company completed a public offering of 7,187,500 common shares at \$33.85 per share. The proceeds from the offering, net of the underwriters' discount and related expenses, were \$230.5 million. Net proceeds from the offering were used primarily to repay borrowings under the Company's revolving credit facility incurred to finance the acquisition of Triton and the first annual payment under the Little Thunder lease, and the remaining net proceeds will be used for general corporate purposes, including the development of the Mountain Laurel mine complex in the Central Appalachia Basin.

On January 31, 2003, the Company completed a public offering of 2,875,000 shares of 5% Perpetual Cumulative Convertible Preferred Stock. The net proceeds realized by the Company from the offering of \$139.0 million were used to reduce indebtedness under the Company's revolving credit facility, and for working capital and general corporate purposes. Dividends on the preferred stock are cumulative and payable quarterly at the annual rate of 5% of the liquidation preference. Each share of the preferred stock is initially convertible, under certain conditions, into 2.3985 shares of the Company's common stock. The preferred stock is redeemable, at the Company's option, on or after January 31, 2008 if certain conditions are met. The holders of the preferred stock are not entitled to voting rights on matters submitted to the Company's common shareholders. However, if the Company fails to pay the equivalent of six quarterly dividends, the holders of the preferred stock will be entitled to elect two directors to the Company's board of directors.

On September 14, 2001, the Company's Board of Directors approved a stock repurchase plan, under which the Company may repurchase up to 6.0 million of its shares of common stock from time to time. Through December 31, 2004, the Company repurchased 357,200 shares of its common stock for \$5.0 million pursuant to the plan at an average price of \$14.13 per share. The repurchased shares are being held in the Company's treasury, which the Company accounts for using the average

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cost method. Future repurchases under the plan will be made at management's discretion and will depend on market conditions and other factors.

14. Stockholder Rights Plan

On March 3, 2000, the Board of Directors adopted a stockholder rights plan under which preferred share purchase rights were distributed as a dividend to the Company's stockholders of record on March 20, 2000. The rights are exercisable only if a person or group acquires 20% or more of the Company's Common Stock (an Acquiring Person) or announces a tender or exchange offer the consummation of which would result in ownership by a person or group of 20% or more of the Company's Common Stock. Each right entitles the holder to buy one one-hundredth of a share of a series of junior participating preferred stock at an exercise price of \$42, or in certain circumstances allows the holder (except for the Acquiring Person) to purchase the Company's Common Stock or voting stock of the Acquiring Person at a discount. At its option, the Board of Directors may allow some or all holders (except for the Acquiring Person) to exchange their rights for Company Common Stock. The rights will expire on March 20, 2010, subject to earlier redemption or exchange by the Company as described in the plan.

15. Stock Incentive Plan and Other Incentive Plans

Under the Company's 1997 Stock Incentive Plan (the Company Incentive Plan), 9,000,000 shares of the Company's common stock were reserved for awards to officers and other selected key management employees of the Company. The Company Incentive Plan provides the Board of Directors with the flexibility to grant stock options, stock appreciation rights, restricted stock awards, restricted stock units, performance stock or units, merit awards, phantom stock awards and rights to acquire stock through purchase under a stock purchase program (Awards). Awards the Board of Directors elects to pay out in cash do not count against the 9,000,000 shares authorized in the Company Incentive Plan.

As of December 31, 2004, stock options, performance units, restricted stock units and price contingent stock awards were the types of awards granted. Each is discussed more fully below.

Stock Options

Stock options are generally subject to vesting provisions of at least one year from the date of grant and are granted at a price equal to 100% of the fair market value of the stock on the date of

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grant. Information regarding stock options under the Company Incentive Plan is as follows for the years ended December 31, 2004, 2003 and 2002 (Options in thousands):

	2004		2003		2002	
	Common Shares	Weighted Average Price	Common Shares	Weighted Average Price	Common Shares	Weighted Average Price
Options outstanding at January 1	4,622	\$ 21.29	5,485	\$ 20.85	3,153	\$ 21.32
Granted	6	33.61	114	19.23	2,443	20.38
Exercised	(1,658)	22.15	(771)	17.54	(31)	10.69
Canceled	(5)	21.46	(206)	22.60	(80)	22.51
Options outstanding at December 31	2,965	20.85	4,622	21.29	5,485	20.85
Options exercisable at December 31	1,783	\$ 21.15	2,692	\$ 21.94	1,115	\$ 19.76
Options available for grant at December 31	2,677		2,981		2,886	

The Company applies APB 25 and related Interpretations in accounting for the Company Incentive Plan. Accordingly, no compensation expense has been recognized for the fixed stock option portion of the Company Incentive Plan. The after-tax fair value of options granted in 2004, 2003 and 2002 was determined to be \$0.1 million, \$0.7 million and \$14.9 million, respectively, which for purposes of the pro forma disclosure in Note 1 is recognized as compensation expense over the options vesting period. The fair value of the options was determined using the Black-Scholes option pricing model and the weighted average assumptions noted below. Substantially all stock options granted vest ratably over four years.

	2004	2003	2002
Weighted average fair value per share of options granted	\$ 15.38	\$ 8.33	\$ 8.41
Assumptions (weighted average)			
Risk-free interest rate	3.65%	2.84%	2.96%
Expected dividend yield	1.0%	1.5%	2.0%
Expected volatility	52.7%	53.5%	52.7%
Expected life (in years)	5.0	5.0	5.0

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In Thousands of Dollars Except Per Share Data)

The table below shows pertinent information on options outstanding at December 31, 2004 (Options in thousands):

Range of Exercise prices	Number Outstanding	Options Outstanding		Options Exercisable	
		Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$8.50-\$10.69	159	4.46	\$ 10.56	159	\$ 10.56
\$16.09-\$21.95	1,103	7.10	18.82	484	19.55
\$22.00-\$22.90	1,561	4.94	22.71	1,012	22.78
\$23.45-\$35.30	142	3.01	27.70	128	27.69
\$8.50-\$35.30	2,965	5.63	\$ 20.85	1,783	\$ 21.15

Performance Units

Performance stock or unit awards can be earned by the recipient if the Company meets certain pre-established performance measures. Until earned, the performance awards are nontransferable, and when earned, performance awards are payable in cash, stock, or restricted stock as determined by the Company's Board of Directors. In January 2004, the Company granted performance unit awards that are earned if the Company meets certain financial, safety and environmental targets during the three years ending December 31, 2006. Amounts accrued during 2004 for these awards totaled \$3.1 million. During the fourth quarter of 2003, the Company's Board of Directors approved awards under a four-year performance unit plan that began in 2000 totaling \$19.6 million (including \$1.9 million awarded to employees of Canyon Fuel), which was paid in cash in the first quarter of 2004.

Restricted Stock Unit Awards

On January 14, 2004 and January 30, 2004, the Company granted restricted stock unit awards of 38,807 and 110,383 shares, respectively. The fair value of the units on the date of grants was \$30.88 and \$27.62 per share, respectively. The restricted stock units require no payment from the employee. Compensation expense is based on the fair value on the grant date and is recorded ratably over the vesting period of three years. During the vesting period, the employee receives compensation equal to dividends declared on common shares. Amounts accrued during 2004 for these awards totaled \$2.4 million.

On December 18, 2002, the Company granted a restricted stock unit award of 50,000 shares. The fair value of the shares on the date of grant was \$21.11 per share. The units will vest in their entirety on January 31, 2008. The Company will recognize compensation expense in the amount of the total fair value of the grant ratably over the vesting period of the award.

Price Contingent Stock Awards

On January 14, 2004, the Company granted an award of 220,766 shares of performance-contingent phantom stock that vests only if the Company's stock price reaches an average pre-established price over a period of 20 consecutive trading days within five years following the date of grant. The award can be paid in either Company stock or in cash, at the discretion of the Company's Board of Directors. This grant has been accounted for in accordance with APB 25 in the accompany-

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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ing financial statements. Under APB 25, no compensation expense is recorded for this type of award until the performance contingency is met. If the performance contingency is met prior to the adoption of FAS 123R on July 1, 2005, the Company will recognize compensation expense equal to the number of shares multiplied by the stock price on the date the contingency is met.

16. Concentration of Credit Risk and Major Customers

The Company places its cash equivalents in investment-grade short-term investments and limits the amount of credit exposure to any one commercial issuer.

The Company markets its coal principally to electric utilities in the United States. Sales to customers in foreign countries were \$134.0 million for the year ended December 31, 2004. As of December 31, 2004 and 2003, accounts receivable from electric utilities located in the United States totaled \$127.7 million and \$92.2 million, respectively, or 71% and 78% of total trade receivables for 2004 and 2003, respectively. Generally, credit is extended based on an evaluation of the customer's financial condition, and collateral is not generally required. Credit losses are provided for in the financial statements and historically have been minimal.

The Company is committed under long-term contracts to supply coal that meets certain quality requirements at specified prices. These prices are generally adjusted based on indices. Quantities sold under some of these contracts may vary from year to year within certain limits at the option of the customer. The Company and its operating subsidiaries sold approximately 123.1 million tons of coal in 2004. Approximately 76% of this tonnage (representing 70% of the Company's revenue) was sold under long-term contracts (contracts having a term of greater than one year). Prices for coal sold under long-term contracts ranged from \$5.15 to \$86.64 per ton. Long-term contracts ranged in remaining life from one to 13 years. Some of these contracts include pricing which is above current market prices. Sales (including spot sales) to major customers were as follows (in thousands):

	2004	2003	2002
Progress Energy	228,203	165,514	77,076
AEP	173,528	222,580	233,530

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In Thousands of Dollars Except Per Share Data)

17. Earnings (Loss) Per Share

The following table sets forth the computation of basic and diluted earnings (loss) per common share:

	2004		
	Numerator (Income)	Denominator (Shares)	Per Share Amount
Basic EPS:			
Net income	\$ 113,706	55,901	\$ 2.04
Preferred stock dividends	(7,187)		(0.13)
Basic income available to common shareholders	\$ 106,519		\$ 1.91
Effect of dilutive securities:			
Effect of common stock equivalents arising from stock options and restricted stock grants		937	
Effect of common stock equivalents arising from convertible preferred stock	7,187	6,896	
Diluted EPS:			
Diluted income available to common shareholders	\$ 113,706	63,734	\$ 1.78

	2003		
Basic EPS:			
Net income before cumulative effect of accounting change	\$ 20,340	52,511	\$ 0.39
Cumulative effect of accounting change	(3,654)		(0.07)
Preferred stock dividends	(6,589)		(0.13)
Basic income available to common shareholders	\$ 10,097		\$ 0.19
Effect of dilutive securities:			
Effect of common stock equivalents arising from stock options		374	
Diluted EPS:			
Net income before cumulative effect of accounting change	\$ 20,340	52,885	\$ 0.38
Cumulative effect of accounting change	(3,654)		(0.07)
Preferred stock dividends	(6,589)		(0.12)
Diluted income available to common shareholders	\$ 10,097		\$ 0.19

2002**Basic and diluted EPS:**

Net loss	\$ (2,562)	52,374	\$ (0.05)
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At December 31, 2003 and 2002, 0.2 million, and 3.8 million shares, respectively, were not included in the diluted earnings per share calculation since the exercise price is greater than the average market price.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In Thousands of Dollars Except Per Share Data)

At December 31, 2004 and 2003, the Company had outstanding 2,875,000 shares of preferred stock that are convertible, at the option of the holder, into 6,896,000 shares of the Company's common stock. The effect of the preferred stock was anti-dilutive, and therefore, not included in the diluted earnings per share calculation for 2003.

For the year 2002, employee stock options did not have a dilutive impact because the Company incurred a loss in that period.

18. Sale and Leaseback

On June 27, 2002, the Company sold certain mining equipment for \$9.2 million and leased back the equipment under operating leases with terms ranging from three to seven years. The leases contain renewal options at lease termination and purchase options at amounts approximating fair value at lease termination. The gain on the sale and leaseback was deferred and is being amortized over the base term of the leases as a reduction of lease expense.

19. Related Party Transactions

The Company received administration and production fees from Canyon Fuel for managing the Canyon Fuel operations through July 31, 2004. The fee arrangement was calculated annually and approved by the Canyon Fuel Management Board. The production fee was calculated on a per-ton basis while the administration fee represented the costs incurred by the Company's employees related to Canyon Fuel administrative matters. The fees recognized as other operating income by the Company and as expense by Canyon Fuel were \$4.8 million, \$8.5 million and \$9.5 million for the years ended December 31, 2004, 2003 and 2002, respectively. Amounts receivable from Canyon Fuel were \$6.5 million as of December 31, 2003 and are classified as other receivables in the Consolidated Balance Sheets.

From October 2002 through October 2004, the Company held an ownership interest in NRP. The Company leases certain coal reserves from NRP and pays royalties to NRP for the right to mine those reserves. Terms of the leases require the Company to prepay royalties with those payments recoupable against production. Amounts recognized as cost of coal sales for royalties paid to NRP during the years ended December 31, 2004, 2003 and 2002 were \$15.4 million, \$12.6 million and \$2.1 million, respectively. Amounts paid to NRP and included in the accompanying balance sheet as prepaid royalties as of December 31, 2004 and 2003 were \$1.3 million and \$1.5 million, respectively.

20. Commitments and Contingencies

The Company leases equipment, land and various other properties under noncancelable long-term leases, expiring at various dates. Certain leases contain options that would allow the Company to extend the lease or purchase the leased asset at the end of the base lease term. Rental expense related to these operating leases amounted to \$22.7 million in 2004, \$17.4 million in 2003, and \$19.0 million in 2002. The Company has also entered into various non-cancelable royalty lease agreements and federal lease bonus payments under which future minimum payments are due. On September 22, 2004, the Company was the successful bidder in a federal auction of certain mining rights in the 5,084-acre Little Thunder tract in the Powder River Basin of Wyoming. The Company's lease bonus bid amounted to \$611.0 million for the tract that is to be paid in five equal installments of \$122.2 million. The first \$122.2 million installment was paid in September 2004 with the remaining four annual payments to be paid in fiscal years 2006 through 2009. These remaining lease bonus

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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payments are reflected below as a component of Royalties. The tract contains approximately 719.0 million mineable tons of high Btu, low-sulfur coal and is adjacent to the Company's Black Thunder mine.

Minimum payments due in future years under these agreements in effect at December 31, 2004 are as follows (in thousands):

	Operating Leases	Royalties
2005	\$ 25,282	\$ 32,227
2006	23,310	155,466
2007	21,457	153,854
2008	19,713	149,384
2009	16,073	148,603
Thereafter	29,066	72,715
	\$ 134,901	\$ 712,249

The Company is a party to numerous claims and lawsuits with respect to various matters. The Company provides for costs related to contingencies when a loss is probable and the amount is reasonably determinable. After conferring with counsel, it is the opinion of management that the ultimate resolution of pending claims will not have a material adverse effect on the consolidated financial condition, results of operations or liquidity of the Company.

The Company holds a 17.5% general partnership interest in Dominion Terminal Associates (DTA), which operates a ground storage-to-vessel coal transloading facility in Newport News, Virginia. DTA leases the facility from Peninsula Ports Authority of Virginia (PPAV) for amounts sufficient to meet debt-service requirements. Financing is provided through \$132.8 million of tax-exempt bonds issued by PPAV (of which the Company is responsible for 17.5%, or \$23.2 million) which mature July 1, 2016. Under the terms of a throughput and handling agreement with DTA, each partner is charged its share of cash operating and debt-service costs in exchange for the right to use its share of the facility's loading capacity and is required to make periodic cash advances to DTA to fund such costs. On a cumulative basis, costs exceeded cash advances by \$13.9 million at December 31, 2004 (such amount is included in other noncurrent liabilities). Future payments for fixed operating costs and debt service are estimated to approximate \$2.7 million annually through 2015 and \$26.0 million in 2016.

In connection with the Company's acquisition of the coal operations of Atlantic Richfield Company (ARCO) and the simultaneous combination of the acquired ARCO operations and the Company's Wyoming operations into the Arch Western joint venture, the Company agreed to indemnify another member of Arch Western against certain tax liabilities in the event that such liabilities arise prior to June 1, 2013 as a result of certain actions taken, including the sale or other disposition of certain properties of Arch Western, the repurchase of certain equity interests in Arch Western by Arch Western or the reduction under certain circumstances of indebtedness incurred by Arch Western in connection with the acquisition. If the Company were to become liable, the maximum amount of potential future tax payments was \$211.5 million at December 31, 2004, of which none is recorded as a liability on the Company's financial statements. Since the indemnification is dependent upon the initiation of activities within the Company's control and the Company does not intend to initiate such activities, it is remote that the Company will become liable for any obligation related to this indemnification. However, if such indemnification obligation were to arise, it could potentially have a material adverse effect on the business, results of operations and financial condition of the Company.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In Thousands of Dollars Except Per Share Data)

21. Cash Flow

The changes in operating assets and liabilities as shown in the consolidated statements of cash flows are comprised of the following:

	2004	2003	2002
Decrease (increase) in operating assets:			
Receivables	\$ (31,570)	\$ 18,805	\$ 14,028
Inventories	(12,422)	(2,857)	(6,666)
Increase (decrease) in operating liabilities:			
Accounts payable and accrued expenses	(6,780)	8,844	(4,711)
Income taxes	(4,215)	(13,822)	(15,826)
Accrued postretirement benefits other than pension	18,019	27,558	(1,559)
Asset retirement obligations	(7,555)	(20,606)	6,336
Accrued workers' compensation	(1,257)	(3,313)	2,217
Other noncurrent liabilities	(21,626)	(14,984)	1,547
Changes in operating assets and liabilities	\$ (67,406)	\$ (375)	\$ (4,634)

22. Segment Information

The Company produces steam and metallurgical coal from surface and deep mines for sale to utility, industrial and export markets. The Company operates only in the United States, with mines in the major low-sulfur coal basins. The Company has three reportable business segments, which are based on the coal basins in which the Company operates. Coal quality, coal seam height, transportation methods and regulatory issues are generally consistent within a basin. Accordingly, market and contract pricing have developed by coal basin. The Company manages its coal sales by coal basin, not by individual mine complex. Mine operations are evaluated based on their per-ton operating costs (defined as including all mining costs but excluding pass-through transportation expenses). The Company's reportable segments are Powder River Basin (PRB), Central Appalachia (CAPP) and Western Bituminous (WBIT). The Company's operations in the Powder River Basin are located in Wyoming and include one operating surface mine (into which the North Rochelle mine was integrated) and one idle surface mine. The Company's operations in Central Appalachia are located in southern West Virginia, eastern Kentucky, and Virginia and include 14 underground mines and eight surface mines. The Company's Western Bituminous operations are located in southern Wyoming, Colorado and Utah and include four underground mines (one of which was idled in May 2004) and two surface mines (which were both put into reclamation mode in 2004).

Operating segment results for the years ended December 31, 2004, 2003, and 2002 are presented below. Results for the operating segments include all direct costs of mining. Corporate,

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In Thousands of Dollars Except Per Share Data)

Other and Eliminations includes corporate overhead, land management, other support functions, and the elimination of intercompany transactions.

December 31, 2004	PRB	CAPP	WBIT	Corporate, Other and Eliminations	Consolidated
Coal sales	\$ 582,421	\$ 1,126,258	\$ 198,489	\$	\$ 1,907,168
Income from equity investments			8,410	2,418	10,828
Income from operations	72,441	39,196	18,145	48,264	178,046
Total assets	1,154,317	2,088,224	1,663,764	(1,649,770)	3,256,535
Depreciation, depletion and amortization	78,074	62,761	24,113	1,374	166,322
Capital expenditures	55,035	84,450	23,276	129,844	292,605
Operating cost per ton	6.19	34.84	15.71		

December 31, 2003	PRB	CAPP	WBIT	Corporate, Other and Eliminations	Consolidated
Coal sales	\$ 409,352	\$ 917,981	\$ 108,155	\$	\$ 1,435,488
Income from equity investments			19,707	14,683	34,390
Income (loss) from operations	57,118	(43,872)	22,951	4,174	40,371
Total assets	975,796	1,964,384	1,087,508	(1,640,039)	2,387,649
Equity investments			146,180	25,865	172,045
Depreciation, depletion and amortization	44,202	64,980	18,851	30,431	158,464
Capital expenditures	18,351	47,527	8,971	57,578	132,427
Operating cost per ton	5.45	30.87	15.41		

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In Thousands of Dollars Except Per Share Data)

December 31, 2002	PRB	CAPP	WBIT	Corporate, Other and Eliminations	Consolidated
Coal sales	\$ 390,097	\$ 966,514	\$ 113,440	\$ 3,507	\$ 1,473,558
Income from equity investments			7,774	2,318	10,092
Income from operations	31,942	5,547	21,842	(30,054)	29,277
Total assets	883,249	1,939,567	385,981	(1,025,989)	2,182,808
Equity investments			160,787	70,764	231,551
Depreciation, depletion and amortization	47,992	71,583	21,393	33,784	174,752
Capital expenditures	37,333	49,591	14,027	36,138	137,089
Operating cost per ton	5.31	28.26	14.53		

Reconciliation of segment income from operations to consolidated income (loss) before income taxes and cumulative effect of accounting change:

	2004	2003	2002
Total Segment Income from Operations	\$ 178,046	\$ 40,371	\$ 29,277
Interest expense	(62,634)	(50,133)	(51,922)
Interest income	6,130	2,636	1,083
Other non-operating (expense) income	(7,966)	4,256	
Income (loss) before income taxes and cumulative effect of accounting change	\$ 113,576	\$ (2,870)	\$ (21,562)

23. Quarterly Financial Information (Unaudited)

Quarterly financial data for 2004 and 2003 is summarized below:

	March 31	June 30	September 30	December 31
	(a)(b)(c)	(a)(b)(c)	(a)(b)(d)	(a)(b)(e)(f)(g)
2004:				
Coal sales	\$ 403,490	\$ 422,778	\$ 527,775	\$ 553,125
Gross profit	19,689	23,449	36,370	23,054
Income from operations	106,909	24,870	26,335	19,932
Net income available to common shareholders	68,186	9,311	8,979	20,043
Basic earnings per common share(l)	1.27	0.17	0.16	0.33
Diluted earnings per common share(l)	1.14	0.17	0.16	0.32

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In Thousands of Dollars Except Per Share Data)

	March 31	June 30	September 30	December 31
	(h)(i)	(b)(i)(j)	(b)(j)	(a)(b)(k)
2003:				
Coal sales	\$ 327,390	\$ 378,892	\$ 354,276	\$ 374,930
Gross profit	(12,042)	2,043	5,244	1,171
Income (loss) from operations	(6,265)	9,367	6,526	30,743
Net income (loss) available to common shareholders before cumulative effect of accounting change	(14,384)	(3,254)	9,252	22,137
Net income (loss) available to common shareholders	(18,038)	(3,254)	9,252	22,137
Basic earnings (loss) per common share(1)	(0.34)	(0.06)	0.18	0.42
Diluted earnings (loss) per common share(1)	(0.34)	(0.06)	0.18	0.40

- (a) During 2004 and 2003, the Company sold its investment in Natural Resource Partners in four separate transactions occurring in December 2003 and March, June and October 2004. The Company recognized a gain of \$42.7 million in the fourth quarter of 2003 and gains of \$89.6 million, \$0.3 million, \$0.3 million and \$1.1 million in the four quarters of 2004, respectively.
- (b) In connection with the Company's repayment of Arch Western's term loans in 2003, the Company recognized expenses of \$8.3 million and \$4.3 million in 2004 and 2003, respectively, related to the costs resulting from the termination of hedge accounting for interest rate swaps. For 2004, this amount was recognized ratably throughout the year. For 2003, amounts recognized were \$0.1 million in the second quarter and \$2.1 million in both the third and fourth quarters. During 2004 and 2003, the Company also recognized expenses of \$0.7 million and \$4.7 million, respectively, related to early debt extinguishment costs. Amounts for 2004 were recognized in the fourth quarter, while amounts for 2003 were recognized in the second quarter. Additionally, subsequent to the termination of hedge accounting for interest rate swaps, the Company recognized income of \$13.4 million in 2003 (\$1.0 million in the second quarter, \$10.6 million in the third quarter, and \$1.8 million in the fourth quarter) related to changes in the market value of the swaps.
- (c) During the year ending December 31, 2004, Canyon Fuel, which was accounted for under the equity method through July 31, 2004, began the process of idling its Skyline Mine (the idling process was completed in May 2004), and incurred severance costs of \$3.2 million for the year ended December 31, 2004. The Company's share of these costs totals \$2.1 million and is reflected in income from equity investments. The impact on the 2004 financial results was a charge of \$1.2 million during the first quarter and a charge of \$0.9 million in the second quarter.
- (d) During the third quarter of 2004, the Company was notified by the IRS that it would receive additional black lung excise tax refunds and interest related to black lung claims that were originally denied by the IRS in 2002. The Company recognized a gain of \$2.8 million (\$2.1 million refund and \$0.7 million of interest) related to the claims.

The \$2.1 million refund was recorded as a component of cost of coal sales, while the \$0.7 million of interest was recorded as interest income.

- (e) During the fourth quarter of 2004, the Company assigned its rights and obligations on a parcel of land to a third party resulting in a gain of \$5.8 million. The gain is reflected in other operating income.
- (f) During 2004, the Company filed a royalty rate reduction request with the BLM for its West Elk mine in Colorado. The BLM notified the Company that it would receive a royalty rate reduction for a specified number of tons representing a retroactive portion for the year totaling \$2.7 million. The retroactive portion was recognized as a component of cost of coal sales in the Consolidated Statement of Operations.
- (g) In connection with the settlement of tax audits for prior years, the Company recorded interest income of \$2.2 million during the fourth quarter of 2004 related to federal income tax refunds. This amount is reflected as interest income.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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- (h) On January 1, 2003, the Company adopted Statement of Financial Accounting Standards No. 143, Asset Retirement Obligations. Implementation of this pronouncement resulted in a cumulative effect of accounting change of \$3.7 million (net of tax).
- (i) During the year ending December 31, 2003, the Company instituted ongoing cost reduction efforts throughout its operations. These cost reduction efforts included the termination of approximately 100 employees at the Company's corporate headquarters and its Central Appalachia mining operations and the recognition of expenses related to severance of \$2.6 million. Of this amount, \$0.6 million was recorded during the first quarter of 2003, with the remainder recorded during the second quarter.
- (j) During the year ended December 31, 2003, the Company was notified by the State of Wyoming of a favorable ruling relating to the Company's calculation of coal severance taxes. The ruling resulted in a refund of previously paid taxes and the reversal of previously accrued taxes payable. The impact on the 2003 financial results was a gain of \$3.3 million during the second quarter and expense of \$0.8 million in the third quarter.
- (k) During the fourth quarter of 2003, the Company recognized expenses of \$15.0 million for amounts earned under a long-term incentive compensation plan.
- (l) The sum of the quarterly earnings (loss) per common share amounts may not equal earnings (loss) per common share for the full year because per share amounts are computed independently for each quarter and for the year based on the weighted average number of common shares outstanding during each period.

24. Events (unaudited) Subsequent to Date of Independent Auditors' Report

On December 31, 2005, the Company entered into a Purchase and Sale Agreement (the "Purchase Agreement") with Magnum Coal Company ("Magnum"). Pursuant to the Purchase Agreement, Arch sold stock in four of its active Central Appalachian mining operations, representing a total of 455 million tons of reserves, to Magnum. These mining properties together had sales of 14.0 million tons through December 31, 2004.

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ARCH COAL, INC. AND SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS
(in thousands)

	BALANCE AT BEGINNING OF YEAR	ADDITIONS CHARGED TO COSTS AND EXPENSES	CHARGED TO OTHER ACCOUNTS	DEDUCTIONS(1)	BALANCE AT END OF YEAR
Year Ended December 31, 2004					
Reserves deducted from Asset Accounts					
Other Assets Notes and Accounts Receivable	\$ 1,469	\$ 570	\$ 962(2)	\$	\$ 3,001
Current Assets					
Supplies Inventory	18,763	1,746	3,010(2)	543	22,976
Deferred Income Taxes	161,113		2,157(3)	265	163,005
Year Ended December 31, 2003					
Reserves deducted from Asset Accounts					
Other Assets Notes and Accounts Receivable	3,894	1,315		3,740(5)	1,469
Current Assets					
Supplies Inventory	17,515	1,583		335	18,763
Deferred Income Taxes	145,603	3,543	11,967(4)		161,113
Year Ended December 31, 2002					
Reserves deducted from Asset Accounts					
Other Assets Notes and Accounts Receivable	544	3,409		59	3,894
Current Assets					
Supplies Inventory	16,598	1,831		914	17,515
Deferred Income Taxes	119,723	25,880			145,603

(1) Reserves utilized, unless otherwise indicated.

(2) Balance at acquisition date of subsidiaries.

- (3) Amount represents the valuation allowance for tax benefits from the exercise of employee stock options. The benefit, net of valuation allowance, was recorded as paid-in capital.
- (4) Amount represents state net operating loss carryforwards identified in 2003 which were fully reserved.
- (5) Amount includes \$1.6 million that was recognized as income upon collection of the related receivable.

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Exhibits filed as part of this Annual Report on Form 10-K are as follows:

Exhibit	Description
3.1	Restated Certificate of Incorporation of Arch Coal, Inc. (incorporated by reference to Exhibit 3.1 of the registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2000).
3.2	Restated and Amended Bylaws of Arch Coal, Inc. (incorporated by reference to Exhibit of the registrant's Annual Report on Form 10-K for the year ended December 31, 2000).
4.1	Form of Rights Agreement, dated March 3, 2000 (incorporated by reference to Exhibit 1 to the registrant's Current Report on Form 8-A filed on March 9, 2000).
4.2	Description of Indenture pursuant to Shelf Registration Statement (incorporated herein by reference to the Registration Statement on Form S-3 (Registration No. 333-58738) filed by the registrant on April 11, 2001).
4.3	Certificate of Designations Establishing the Designations, Powers, Preferences, Rights, Qualifications, Limitations and Restrictions of the registrant's 5% Perpetual Cumulative Convertible Preferred Stock (incorporated herein by reference to Exhibit 3 to the Registration Statement on Form 8-A filed by the registrant on March 5, 2003).
4.4	Indenture, dated as of June 25, 2003, by and among Arch Western Finance, LLC, Arch Coal, Inc., Arch Western Resources, LLC, Arch of Wyoming, LLC, Mountain Coal Company, L.L.C., Thunder Basin Coal Company, L.L.C. and The Bank of New York, as trustee (incorporated herein by reference to Exhibit 4.1 to the Registration Statement on Form S-4 (Reg. No. 333-107569) filed by Arch Western Finance, LLC on August 1, 2003).
4.5	Credit Agreement, dated as of December 22, 2004, by and among Arch Coal, Inc., the Banks party thereto, PNC Bank, National Association, as administrative agent, Citicorp USA, Inc., JPMorgan Chase Bank, N.A., and Wachovia Bank, National Association, as co-syndication agents, and Fleet National Bank, as documentation agent (incorporated by reference to Exhibit 99.1 to the Current Report on Form 8-K filed by the registrant on December 28, 2004).
10.1	Amended and Restated Retention Agreement between Arch Coal, Inc. and Steven F. Leer, dated October 1, 2004 (incorporated by referenced to Exhibit 10.1 to the registrant's Annual Report on Form 10-K for the year ended December 31, 2004).
10.2	Form of Retention Agreement between Arch Coal, Inc. and each of its Executive Officers (other than its Chief Executive Officer) (incorporated by referenced to Exhibit 10.2 to the registrant's Annual Report on Form 10-K for the year ended December 31, 2004).
10.3	Deed of Lease and Agreement between Dingess-Rum Coal Company and Amherst Coal Company (predecessor to Ark Land Company), dated June 1, 1962, as supplemented January 1, 1968, June 1, 1973, July 1, 1974 and November 12, 1987; Lease Exchange Agreement dated July 2, 1979 amended as of January 1, 1984, January 7, 1993 and February 24, 1993; Partial Release dated as of May 6, 1988; Assignments dated March 15, 1990 and October 5, 1990 (incorporated herein by reference to Exhibit 10.8 of the Registration Statement on Form S-4 (Registration No. 333-28149) filed by the registrant on May 30, 1997).

- 10.4 Agreement of Lease by and between Shonk Land Company, Limited Partnership and Lawson Hamilton (predecessor to Ark Land Company), dated February 8, 1983, as amended October 7, 1987, March 9, 1989, April 1, 1992, October 31, 1992, December 5, 1992, February 16, 1993, August 4, 1994, October 1, 1995, July 31, 1996 and November 27, 1996 (incorporated herein by reference to Exhibit 10.9 of the Registration Statement on Form S-4 (Registration No. 333-28149) filed by the registrant on May 30, 1997).
- 10.5 Lease between Little Coal Land Company and Ashland Land & Development Co., a wholly-owned subsidiary of Ashland Coal, Inc. which was merged into Allegheny Land Company, a second tier subsidiary of the registrant (incorporated herein by reference to Exhibit 10.11 of a Post-Effective Amendment No.1 to a Registration Statement on Form S-1 (Registration No.33-22425), as amended, filed by Ashland Coal, Inc. on August 11, 1988).

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Exhibit	Description
10.6	Agreement of Lease dated January 1, 1988, between Courtney Company and Allegheny Land Company (legal successor by merger with Allegheny Land Co. No. 2, the assignee of Primeacre Land Corporation under October 5, 1992, assignments), a second-tier subsidiary of the registrant (incorporated herein by reference to Exhibit 10.3 to Ashland Coal, Inc.'s Annual Report on Form 10-K for the year ended December 31, 1995).
10.7	Lease between Dickinson Properties, Inc., the Southern Land Company, and F. B. Nutter, Jr. and F. B. Nutter, Sr., predecessors in interest to Hobet Mining & Construction Co., Inc., an independent operating subsidiary of the registrant that subsequently changed its name to Hobet Mining, Inc. (incorporated herein by reference to Exhibit 10.14 of a Post-Effective Amendment No. 1 to a Registration Statement on Form S-1 (Registration No. 33-22425), as amended, filed by Ashland Coal, Inc. on August 11, 1988).
10.8	Lease Agreement between Fielden B. Nutter, Dorothy Nutter and Hobet Mining & Construction Co., Inc., an independent operating subsidiary of the registrant that subsequently changed its name to Hobet Mining, Inc. (incorporated herein by reference to Exhibit 10.22 of a Post-Effective Amendment No. 1 to a Registration Statement on Form S-1 (Registration No. 33-22425), as amended, filed by Ashland Coal, Inc. on August 11, 1988).
10.9	Lease and Modification Agreement between Horse Creek Coal Land Company, Ashland and Hobet Mining & Construction Co., Inc., an independent operating subsidiary of the registrant that subsequently changed its name to Hobet Mining, Inc. (incorporated herein by reference to Exhibit 10.24 of a Post-Effective Amendment No. 1 to a Registration Statement on Form S-1 (Registration No. 33-22425), as amended, filed by Ashland Coal, Inc. on August 11, 1988).
10.10	Lease Agreement between C. C. Lewis Heirs Limited Partnership and Allegheny Land Company, a second-tier subsidiary of the registrant (incorporated herein by reference to Exhibit 10.25 of a Post-Effective Amendment No 1 to a Registration Statement on Form S-1 (Registration No.33-22425), as amended, filed by Ashland Coal, Inc. on August 11, 1988).
10.11	Sublease between F. B. Nutter, Sr., et al., and Hobet Mining & Construction Co., Inc., an independent operating subsidiary of the registrant that subsequently changed its name to Hobet Mining, Inc. (incorporated herein by reference to Exhibit 10.27 of a Post-Effective Amendment No. 1 to a Registration Statement on Form S-1 (Registration No. 33-22425), as amended, filed by Ashland Coal, Inc. on August 11, 1988).
10.12	Coal Lease Agreement dated as of March 31, 1992, among Hobet Mining, Inc. (successor by merger with Dal-Tex Coal Corporation) as lessee and UAC and Phoenix Coal Corporation, as lessors, and related guarantee (incorporated herein by reference to the Current Report on Form 8-K filed by Ashland Coal, Inc. on [April 6, 1992 filed by Ashland Coal, Inc.]).
10.13	Lease dated as of October 1, 1987, between Pocahontas Land Corporation and Mingo Logan Collieries Company whose name is now Mingo Logan Coal Company (incorporated herein by reference to Exhibit 10.3 to Amendment No. 1 to the Current Report on Form 8-K filed by Ashland Coal, Inc. on February 14, 1990).
10.14	

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Consent, Assignment of Lease and Guaranty dated January 24, 1990, among Pocahontas Land Corporation, Mingo Logan Coal Company, Mountain Gem Land, Inc. and Ashland Coal, Inc. (incorporated herein by reference to Exhibit 10.4 to Amendment No. 1 to the Current Report on Form 8-K filed by Ashland Coal, Inc. on February 14, 1990).

- 10.15 Federal Coal Lease dated as of June 24, 1993 between the United States Department of the Interior and Southern Utah Fuel Company (incorporated herein by reference to Exhibit 10.17 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1998).
- 10.16 Federal Coal Lease between the United States Department of the Interior and Utah Fuel Company (incorporated herein by reference to Exhibit 10.18 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1998).
- 10.17 Federal Coal Lease dated as of July 19, 1997 between the United States Department of the Interior and Canyon Fuel Company, LLC (incorporated herein by reference to Exhibit 10.19 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1998).

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Exhibit	Description
10.18	Federal Coal Lease dated as of January 24, 1996 between the United States Department of the Interior and the Thunder Basin Coal Company (incorporated herein by reference to Exhibit 10.20 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1998).
10.19	Federal Coal Lease Readjustment dated as of November 1, 1967 between the United States Department of the Interior and the Thunder Basin Coal Company (incorporated herein by reference to Exhibit 10.21 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1998).
10.20	Federal Coal Lease effective as of May 1, 1995 between the United States Department of the Interior and Mountain Coal Company (incorporated herein by reference to Exhibit 10.22 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1998).
10.21	Federal Coal Lease dated as of January 1, 1999 between the Department of the Interior and Ark Land Company (incorporated herein by reference to Exhibit 10.23 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1998).
10.22	Federal Coal Lease dated as of October 1, 1999 between the United States Department of the Interior and Canyon Fuel Company, LLC (incorporated herein by reference to Exhibit 10 of the registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1999).
10.23	Federal Coal Lease effective as of March 1, 2005 by and between the United States of America and Ark Land LT, Inc. covering the tract of land known as "Little Thunder" in Campbell County, Wyoming (incorporated by reference to Exhibit 99.1 to the Current Report on Form 8-K filed by the registrant on February 10, 2005).
10.24	Modified Coal Lease (WYW71692) executed January 1, 2003 by and between the United States of America, through the Bureau of Land Management, as lessor, and Triton Coal Company, LLC, as lessee, covering a tract of land known as "North Rochelle" in Campbell County, Wyoming (incorporated by reference to Exhibit 10.24 to the registrant's Annual Report on Form 10-K for the year ended December 31, 2004).
10.25	Coal Lease (WYW71692) executed January 1, 1998 by and between the United States of America, through the Bureau of Land Management, as lessor, and Triton Coal Company, LLC, as lessee, covering a tract of land known as "North Roundup" in Campbell County, Wyoming (incorporated by reference to Exhibit 10.24 to the registrant's Annual Report on Form 10-K for the year ended December 31, 2004).
10.26	Form of Indemnity Agreement between Arch Coal, Inc. and Indemnatee (as defined therein) (incorporated herein by reference to Exhibit 10.15 of the Registration Statement on Form S-4 (Registration No. 333-28149) filed by the registrant on May 30, 1997).
10.27	Arch Coal, Inc. Incentive Compensation Plan For Executive Officers (incorporated herein by reference to Exhibit 99.1 of the Current Report on Form 8-K filed by the registrant on February 28, 2005).

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- 10.28 Arch Coal, Inc. (formerly Arch Mineral Corporation) Deferred Compensation Plan (incorporated herein by reference to Exhibit 4.1 of the Registration Statement on Form S-8 (Registration No. 333-68131) filed by the registrant on December 1, 1998).
- 10.29 Arch Coal, Inc. 1997 Stock Incentive Plan (as Amended and Restated on February 28, 2002) (incorporated herein by reference to Exhibit 10.1 to the registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2002).
- 10.30 Arch Mineral Corporation 1996 ERISA Forfeiture Plan (incorporated herein by reference to Exhibit 10.20 to the Registration Statement on Form S-4 (Registration No. 333-28149) filed by the registrant on May 30, 1997).
- 10.31 Arch Coal, Inc. Outside Directors' Deferred Compensation Plan effective January 1, 1999 (incorporated herein by reference to Exhibit 10.30 of the registrant's Annual Report on Form 10-K for the year ended December 31, 1998).
- 10.32 Second Amendment to the Arch Mineral Corporation Supplemental Retirement Plan effective January 1, 1998 (incorporated herein by reference to Exhibit 10.31 of the registrant's Annual

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Exhibit	Description
	Report on Form 10-K for the year ended December 31, 1998).
10.33	Purchase and Sale Agreement, dated as of December 31, 2005, by and between Arch Coal, Inc. and Magnum Coal Company (incorporated herein by reference to Exhibit 10.1 of the registrant's Current Report on Form 8-K filed on January 6, 2006).
13.1	Portions of the registrant's Annual Report to Stockholders for the year ended December 31, 2004.
21.1	Subsidiaries of the registrant.
23.1	Consent of Ernst & Young LLP.
24.1	Power of Attorney (incorporated herein by reference to Exhibit 21.1 of the registrant's Annual Report on Form 10-K for the year ended December 31, 2004).
31.1	Rule 13a-14(a)/15d-14(a) Certification of Steven F. Leer.
31.2	Rule 13a-14(a)/15d-14(a) Certification of Robert J. Messey.
32.1	Section 1350 Certification of Steven F. Leer.
32.2	Section 1350 Certification of Robert J. Messey.
*	Exhibits 10.27, 10.28, 10.29, 10.30 and 10.32 are executive compensation plans.

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Signatures

Pursuant to the requirements of Section 13 and 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Arch Coal, Inc.

By: /s/ Steven M. Leer

Steven M. Leer
President and Chief Executive Officer

January 6, 2006

Signatures	Capacity
/s/ Steven F. Leer	President and Chief Executive Officer and Director (Principal Executive Officer)
Steven F. Leer	
/s/ Robert J. Messey	Senior Vice President and Chief Financial Officer (Principal Financial Officer)
Robert J. Messey	
/s/ John W. Lorson	Controller (Principal Accounting Officer)
John W. Lorson	
*	Director
James R. Boyd	
*	Director
Frank M. Burke	
*	Director
Patricia Fry Godley	
*	Director
Douglas H. Hunt	
*	Director
Thomas A. Lockhart	
*	Director
A. Michael Perry	

* Director

Robert G. Potter

* Director

Theodore D. Sands

* Director

Wesley M. Taylor

*By: /s/ Robert G. Jones

Robert G. Jones
Attorney-in-fact

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