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ASHLAND INC
Form 10-K/A
March 30, 2001

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A
AMENDMENT NO. 1

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

FOR THE FISCAL YEAR ENDED SEPTEMBER 30, 2000

Commission file number 1-2918

ASHLAND INC.
(a Kentucky corporation)

I.R.S. No. 61-0122250
50 E. RiverCenter Boulevard
P. O. Box 391
Covington, Kentucky 41012-0391

Telephone Number: (859) 815-3333

Securities Registered Pursuant to Section 12(b):

Table with 2 columns: Title of each class, Name of each exchange on which registered. Rows include Common Stock and Rights to Purchase Series A Participating Cumulative Preferred Stock.

Securities Registered Pursuant to Section 12(g): None

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

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. []

At October 31, 2000, based on the New York Stock Exchange closing price, the aggregate market value of voting stock held by non-affiliates of the Registrant was approximately \$2,268,150,178. In determining this amount, the Registrant has assumed that its directors and executive officers are affiliates. Such assumption shall not be deemed conclusive for any other purpose.

At October 31, 2000, there were 69,669,072 shares of Registrant's common stock outstanding.

Documents Incorporated by Reference

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Portions of Registrant's Annual Report to Shareholders for the fiscal year ended September 30, 2000 are incorporated by reference into Parts I, II and IV.

Portions of Registrant's definitive Proxy Statement for its January 25, 2001 Annual Meeting of Shareholders are incorporated by reference into Part III.

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EXPLANATORY NOTE

This amendment to the Annual Report on Form 10-K for the fiscal year ended September 30, 2000 of Ashland Inc. ("Ashland") is being filed to include the audited financial statements of Marathon Ashland Petroleum LLC ("MAP") for the fiscal year ended December 31, 2000 and the audited financial statements of Arch Coal, Inc. ("Arch") for the fiscal year ended December 31, 2000 as required by Rule 3-09 of Regulation S-X. Ashland has a 38% equity interest in MAP and held a 58% equity interest in Arch prior to the spinoff by Ashland of most of its Arch Common Stock to Ashland's shareholders in March 2000 and the subsequent sale of Ashland's remaining shares of Arch Common Stock in February 2001. In accordance with Rule 12b-15 under the Securities Exchange Act of 1934, as amended, the text of the amended item is set forth in its entirety in the pages attached hereto.

A consent of PricewaterhouseCoopers LLP, independent accountants for MAP, and a consent of Ernst & Young LLP, independent auditors for Arch, are being filed as exhibits hereto.

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K (A) DOCUMENTS FILED AS PART OF THIS REPORT

(1) and (2) Financial Statements and Financial Schedule

The consolidated financial statements and financial schedule of Ashland presented or incorporated by reference in this report are listed in the index on page 18.

Audited financial statements of Marathon Ashland Petroleum LLC. Financial statement schedules are omitted because they are not applicable as the required information is contained in the applicable financial statements or notes thereto.

Audited financial statements and schedule of Arch Coal, Inc.

(3) Exhibits

- 3.1 - Second Restated Articles of Incorporation of Ashland, as amended to January 30, 1998 (filed as Exhibit 3 to Ashland's Form 10-Q for the quarter ended December 31, 1997 and incorporated herein by reference).
- 3.2 - By-laws of Ashland, as amended to January 26, 2000 (filed as Exhibit 3.2 to Ashland's Form 10-Q for the quarter ended December 31, 1999 and incorporated herein by reference).
- 4.1 - Ashland agrees to provide the SEC, upon request, copies of instruments defining the rights of holders of long-term debt of Ashland and all of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed with the SEC.
- 4.2 - Indenture, dated as of August 15, 1989, as amended and

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restated as of August 15, 1990, between Ashland and Citibank, N.A., as Trustee (filed as Exhibit 4(a) to Ashland's Form 10-K for the fiscal year ended September 30, 1991 and incorporated herein by reference).

- 4.3 - Rights Agreement, dated as of May 16, 1996, between Ashland Inc. and the Rights Agent, together with Form of Right Certificate (filed as Exhibits 4(a) and 4(c), respectively, to Ashland's Form 8-A filed with the SEC on May 16, 1996 and incorporated herein by reference).

The following Exhibits 10.1 through 10.16 are compensatory plans or arrangements or management contracts required to be filed as exhibits pursuant to Item 601(b)(10)(ii)(A) of Regulation S-K.

- 10.1 - Amended Stock Incentive Plan for Key Employees of Ashland Inc. and its Subsidiaries (filed as Exhibit 10.1 to Ashland's Form 10-K for the fiscal year ended September 30, 1999 and incorporated herein by reference).
- 10.2 - Ashland Inc. Deferred Compensation Plan for Non-Employee Directors (filed as Exhibit 10.2 to Ashland's Form 10-K for the fiscal year ended September 30, 1999 and incorporated herein by reference).
- 10.3 - Tenth Amended and Restated Ashland Inc. Supplemental Early Retirement Plan for Certain Employees (filed as Exhibit 10.3 to Ashland's Form 10-K for the fiscal year ended September 30, 1999 and incorporated herein by reference).
- 10.4 - Ashland Inc. Incentive Compensation Program (filed as Exhibit 10.6 to Ashland's Form 10-K for the fiscal year ended September 30, 1993 and incorporated herein by reference).
- 10.5 - Ashland Inc. Salary Continuation Plan (filed as Exhibit 10(c).11 to Ashland's Form 10-K for the fiscal year ended September 30, 1988 and incorporated herein by reference).
- 10.6 - Form of Ashland Inc. Executive Employment Contract between Ashland Inc. and certain executive officers of Ashland (filed as Exhibit 10.6 to Ashland's Form 10-K for the fiscal year ended September 30, 1999 and incorporated herein by reference).
- 10.7 - Form of Indemnification Agreement between Ashland Inc. and each member of its Board of Directors (filed as Exhibit 10(c).13 to Ashland's Form 10-K for the fiscal year ended September 30, 1990 and incorporated herein by reference).
- 10.8 - Ashland Inc. Nonqualified Excess Benefit Pension Plan (filed as Exhibit 10.11 to Ashland's Form 10-K for the fiscal year ended September 30, 1998 and incorporated herein by reference).
- 10.9 - Ashland Inc. Long-Term Incentive Plan.
- 10.10 - Ashland Inc. Directors' Charitable Award.
- 10.11 - Ashland Inc. 1993 Stock Incentive Plan.
- 10.12 - Ashland Inc. 1995 Performance Unit Plan.
- 10.13 - Ashland Inc. Incentive Compensation Plan for Key Executives (filed as Exhibit 10.13 to Ashland's Form 10-K for the fiscal year ended September 30, 1999 and incorporated herein by reference).
- 10.14 - Ashland Inc. Deferred Compensation Plan.
- 10.15 - Ashland Inc. 1997 Stock Incentive Plan.
- 10.16 - Ashland Inc. Incentive Plan (filed as Exhibit 10.1 to Ashland's Form 10-Q for the quarter ended December 31,

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- 1999 and incorporated herein by reference).
- 10.17 - Amended and Restated Limited Liability Company Agreement of Marathon Ashland Petroleum LLC dated as of December 31, 1998 (filed as Exhibit 10.17 to Ashland's Form 10-K for the fiscal year ended September 30, 1999 and incorporated herein by reference).
 - 10.18 - Put/Call, Registration Rights and Standstill Agreement as amended to December 31, 1998 among Marathon Oil Company, USX Corporation, Ashland Inc. and Marathon Ashland Petroleum (filed as Exhibit 10.18 to Ashland's Form 10-K for the fiscal year ended September 30, 1999 and incorporated herein by reference).
 - 11 - Computation of Earnings Per Share (appearing on page 37 of Ashland's Annual Report to Shareholders, incorporated by reference herein, for the fiscal year ended September 30, 2000).
 - 12 - Computation of Ratios of Earnings to Fixed Charges and Earnings to Combined Fixed Charges and Preferred Stock Dividends.
 - 13 - Portions of Ashland's Annual Report to Shareholders, incorporated by reference herein, for the fiscal year ended September 30, 2000.
 - 21 - List of subsidiaries.
 - 23.1 - Consent of Ernst & Young LLP.
 - 23.2* - Consent of PricewaterhouseCoopers LLP.
 - 23.3* - Consent of Ernst & Young LLP.
 - 24 - Power of Attorney, including resolutions of the Board of Directors.
 - 27 - Financial Data Schedule for the fiscal year ended September 30, 2000.

*Filed herewith.

Upon written or oral request, a copy of the above exhibits will be furnished at cost.

(B) REPORTS ON FORM 8-K

No reports on Form 8-K have been filed during the last quarter of the period covered by this report.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Amendment to be signed on its behalf by the undersigned thereunto duly authorized.

ASHLAND INC.

(Registrant)

Date: March 30, 2001

/s/ David L. Hausrath

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Name: David L. Hausrath
Title: Vice President and
General Counsel

MARATHON ASHLAND PETROLEUM LLC AND SUBSIDIARIES

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2000

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PricewaterhouseCoopers LLP
600 Grant Street, Suite 5200
Pittsburgh, PA 15219
(412) 355-6000

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Report of Independent Accountants

February 7, 2001

To the Board of Managers of
Marathon Ashland Petroleum LLC:

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of operations, cash flows and members' capital present fairly, in all material respects, the financial position of Marathon Ashland Petroleum LLC and its subsidiaries (MAP) at December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of MAP's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers

PricewaterhouseCoopers LLP
Pittsburgh, Pennsylvania 15219

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CONSOLIDATED STATEMENT OF OPERATIONS (Dollars in Millions)

MARATHON ASHLAND PETROLEUM LLC AND SUBSIDIARIES

	Year End	
	2000	
Revenues and other income:		
Revenues - Note E	\$ 28,775	\$
Dividend and investee income	24	
Net gains (losses) on disposal of assets	28	
Other income	28	

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Total revenues and other income	28,855	
<hr style="border-top: 1px dashed black;"/>		
Costs and expenses:		
Cost of revenues (excludes items shown below)	22,366	
Selling, general and administrative expenses	394	
Depreciation and amortization	316	
Taxes other than income taxes - Note E	4,474	
Inventory market valuation charges (credits) - Note H	--	
<hr style="border-top: 1px dashed black;"/>		
Total costs and expenses	27,550	
<hr style="border-top: 1px dashed black;"/>		
Income from operations:	1,305	
Net interest and other financial income - Note E	12	
<hr style="border-top: 1px dashed black;"/>		
Income before income taxes:	1,317	
Provision for income taxes - Note G	7	
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Net income	\$ 1,310	\$
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The accompanying notes are an integral part of these consolidated financial statements.

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CONSOLIDATED BALANCE SHEET (Dollars in Millions)
MARATHON ASHLAND PETROLEUM LLC AND SUBSIDIARIES

Assets:

Current assets:

Cash and cash equivalents

Receivables, less allowance for doubtful accounts of \$3
and \$3

Inventories - Note H

Related party receivables - Note D

Other current assets

Total current assets

Investments and long-term receivables - Note I

Property, plant and equipment - net - Note J

Other noncurrent assets

Total assets

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Liabilities:

Current liabilities:

Accounts payable \$
 Accounts payable to related parties - Note D
 Payroll and benefits payable
 Accrued taxes
 Long-term debt due within one year - Note L

Total current liabilities

Long-term debt - Note L
 Deferred income taxes - Note G
 Employee benefits - Note F
 Deferred credits and other liabilities

Total liabilities

Members' Capital (details on page 5)

Members' contributed capital
 Retained earnings
 Accumulated other comprehensive income (losses)

Total members' capital

Total liabilities and members' capital \$

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

CONSOLIDATED STATEMENT OF CASH FLOWS (Dollars in Millions)

MARATHON ASHLAND PETROLEUM LLC AND SUBSIDIARIES

	Year End	
	2000	
Increase (decrease) in cash and cash equivalents		
Operating activities:		
Net income	\$ 1,310	\$
Adjustments to reconcile to net cash provided from operating activities:		
Depreciation and amortization	316	
Inventory market valuation charges (credits)	--	
Pensions and other postretirement benefits	30	
Deferred income taxes	--	
Net (gains) losses on disposal of assets	(28)	
Changes in:		

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Current receivables	(278)	
Inventories	(5)	
Current accounts payable and accrued expenses	378	
Net receivables and payables with related parties	31	
All other - net	(38)	
	-----	-----
Net cash provided from operating activities	1,716	
	-----	-----
Investing activities:		
Capital expenditures	(637)	
Disposal of assets	70	
Loans for Section 1031 transactions - principal loaned	(46)	
- principal collected	42	
Property exchange trust - deposits	(54)	
- withdrawals	53	
Investees - investments	(1)	
- loans and advances	(5)	
- returns and repayments	--	
	-----	-----
Net cash used in investing activities	(578)	
	-----	-----
Financing activities:		
Revolving credit facilities - borrowings - Note D	931	
- repayments - Note D	(931)	
Debt - additions	--	
- repayments	(14)	
Member distributions	(1,104)	
	-----	-----
Net cash used in financing activities	(1,118)	
	-----	-----
Net increase (decrease) in cash and cash equivalents	20	
Cash and cash equivalents at beginning of year	38	
	-----	-----
Cash and cash equivalents at end of year	\$ 58	\$
	=====	=====

See Note M for supplemental cash flow information.

The accompanying notes are an integral part of these consolidated fi

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	Members' Capital			2000
	Year Ended December 31			
	2000	1999	1998	
Members' contributed capital:				
Balance at beginning of year	\$ 4,218	\$ 4,188	\$ 4,361	
Member contributions	26	30	--	
Distribution to members	--	--	(173)	
Balance at end of year	4,244	4,218	4,188	
Retained earnings:				
Balance at beginning of year	395	--	--	
Net income	1,310	1,177	654	\$ 1,310
Distributions to members	(1,104)	(782)	(654)	
Balance at end of year	601	395	--	
Accumulated other comprehensive income (loss):				
Minimum pension liability adjustments:				
Balance at beginning of year	--	(5)	(4)	
Changes during the year	(4)	5	(1)	
Balance at end of year	(4)	--	(5)	
Total comprehensive income				\$ 1,300
Total members' capital	\$ 4,841	\$ 4,613	\$ 4,183	

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARATHON ASHLAND PETROLEUM LLC AND SUBSIDIARIES

NOTE A - BUSINESS DESCRIPTION AND BASIS OF PRESENTATION

On December 12, 1997, Marathon Oil Company (Marathon), a wholly owned subsidiary of USX Corporation (USX), entered into an Asset Transfer and Contribution Agreement with Ashland Inc. (Ashland) providing for the formation of Marathon Ashland Petroleum LLC (MAP). Effective January 1,

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1998, Marathon contributed substantially all of its refining, marketing and transportation (RM&T) operations to MAP. Also, on January 1, 1998, Marathon acquired certain RM&T net assets from Ashland in exchange for a 38% interest in MAP. The purchase price was determined to be \$1.9 billion, based upon an external valuation. The acquisition of Ashland's net assets was accounted for under the purchase method of accounting.

In connection with the formation of MAP, Marathon and Ashland entered into a Limited Liability Company Agreement (LLC Agreement) dated January 1, 1998. The LLC Agreement provides for an initial term expiring on December 31, 2022 (25 years from its formation). The term will automatically be extended for ten-year periods, unless a termination notice is given by either party.

Also in connection with the formation of MAP, the parties entered into a Put/Call, Registration Rights and Standstill Agreement (the Put/Call Agreement). The Put/Call Agreement provides that at any time after December 31, 2004, Ashland will have the right to sell to Marathon all of Ashland's ownership interest in MAP, for an amount in cash and/or Marathon or USX debt or equity securities equal to the product of 85% (90% if equity securities are used) of the fair market value of MAP at that time, multiplied by Ashland's percentage interest in MAP. Payment could be made at closing, or at Marathon's option, in three equal annual installments, the first of which would be payable at closing. At any time after December 31, 2004, Marathon will have the right to purchase all of Ashland's ownership interests in MAP, for an amount in cash equal to the product of 115% of the fair market value of MAP at that time, multiplied by Ashland's percentage interest in MAP.

MAP is engaged in petroleum supply, refining, marketing & transportation operations and includes Speedway SuperAmerica LLC, a wholly owned subsidiary, which operates retail outlets for petroleum products and merchandise. In addition, MAP, through its wholly owned subsidiary, Marathon Ashland Pipe Line LLC, is actively engaged in the pipeline transportation of crude oil and petroleum products.

During 2000, MAP sold 159 Speedway SuperAmerica non-core stores for \$48 million. MAP recorded a pretax gain of \$19 million related to these sales.

In 2000 and 1999, MAP recorded capital contributions from Marathon of \$2 million and \$2 million, respectively, and from Ashland of \$24 million and \$28 million, respectively, for environmental improvements. The LLC Agreement stipulates that ownership interest in MAP will not be adjusted as a result of such contributions.

In 1999, MAP sold Scurlock Permian LLC, its crude oil gathering business, to Plains Marketing, L.P. for \$137 million. In 1999, MAP recorded a pretax loss of \$16 million related to the sale.

In 1999, MAP finalized the transaction with Ultramar Diamond Shamrock ("UDS") to purchase 178 UDS owned and operated convenience stores and 5 product terminals. In addition, MAP was assigned supply contracts with UDS branded jobbers who supplied 242 branded jobber stations in Michigan. This transaction was accounted for under the purchase method of accounting.

NOTE B - SUMMARY OF PRINCIPAL ACCOUNTING POLICIES

Principles applied in consolidation - The consolidated financial statements include the accounts of MAP and the majority-owned subsidiaries which it controls. Investments in undivided interest pipelines are consolidated on a pro rata basis. Investments in other entities over which MAP has

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significant influence are accounted for using the equity method of accounting and are carried at MAP's share of net assets plus advances. Investments in companies whose stocks have no readily determinable fair value are carried at cost.

Dividend and investee income includes MAP's proportionate share of income from equity method investments and dividend income from other investments. Dividend income is recognized when dividend payments are received.

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NOTES TO CONSOLIDATED FINNCIAL STATEMENTS - Continued

NOTE B - SUMMARY OF PRINCIPAL ACCOUNTING POLICIES - Continued

Use of estimates - Generally accepted accounting principles require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at year-end and the reported amounts of revenues and expenses during the year. Significant items subject to such estimates and assumptions include the carrying value of long-lived assets; valuation allowances for receivables and inventories; environmental liabilities; liabilities for potential tax deficiencies and potential litigation claims and settlements; and assets and obligations related to employee benefits.

Additionally, certain estimated liabilities are recorded when management commits to a plan to close an operating facility or to exit a business activity. Actual results could differ from the estimates and assumptions used.

Revenue recognition - Revenues are recognized generally when products are shipped or services are provided to customers, the sales price is fixed and determinable, and collectibility is reasonably assured. Costs associated with revenues, including shipping and other transportation costs, are recorded in cost of revenues. Matching buy/sell transactions settled in cash are recorded in both revenues and cost of revenues as separate sales and purchase transactions, with no net effect on income.

Cash and cash equivalents - Cash and cash equivalents include cash on hand and on deposit and investments with related parties in highly liquid debt instruments with maturities of three months or less. See Note D for information regarding investments with related parties.

Inventories - Inventories are carried at lower of cost or market. Cost of inventories is determined primarily under the last-in, first-out (LIFO) method.

Derivative instruments - MAP uses commodity-based derivative instruments to manage its exposure to price risk. Management is authorized to use futures, forwards, swaps and options related to the purchase or sale of crude oil, refined products and natural gas. While MAP's risk management activities generally reduce market risk exposure due to unfavorable commodity price changes for raw material purchases and products sold, such activities can also encompass strategies which assume price risk.

Commodity-Based Hedging Transactions - For transactions that qualify for hedge accounting, the resulting gains or losses are deferred and subsequently recognized in income from operations, as a component of

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revenues or cost of revenues, in the same period as the underlying physical transaction. To qualify for hedge accounting, derivative positions cannot remain open if the underlying physical market risk has been removed. If such derivative positions remain in place, they would be marked-to-market and accounted for as trading and other activities. Recorded deferred gains or losses are reflected within other current and noncurrent assets or accounts payable and deferred credits and other liabilities, as appropriate.

Commodity-Based Trading and Other Activities - Derivative instruments used for trading and other activities are marked-to-market and the resulting gains or losses are recognized in the current period within income from operations. This category also includes the use of derivative instruments that have no offsetting underlying physical market risk.

Long-lived assets - Property, plant and equipment are depreciated principally by the straight-line method. MAP evaluates impairment of its assets on an individual asset basis or by logical groupings of assets. Assets deemed to be impaired are written down to their fair value, including any related goodwill, using discounted future cash flows and, if available, comparable market values.

When long-lived assets depreciated on an individual basis are sold or otherwise disposed of, any gains or losses are reflected in income. Gains on disposal of long-lived assets are recognized when earned, which is generally at the time of closing. If a loss on disposal is expected, such losses are recognized when long-lived assets are reclassified as assets held for sale. Proceeds from disposal of long-lived assets depreciated on a group basis are credited to accumulated depreciation and amortization with no immediate effect on income.

Major maintenance activities - MAP incurs planned maintenance costs primarily for refinery turnarounds. Such costs are expensed in the same annual period as incurred; however, estimated annual turnaround costs are recognized in income throughout the year on a pro rata basis.

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NOTES TO CONSOLIDATED FINNCIAL STATEMENTS - Continued

NOTE B - SUMMARY OF PRINCIPAL ACCOUNTING POLICIES - Continued

Environmental liabilities - MAP provides for remediation costs and penalties when the responsibility to remediate is probable and the amount of associated costs is reasonably determinable. Generally, the timing of remediation accruals coincides with completion of a feasibility study or the commitment to a formal plan of action. Remediation liabilities are accrued based on estimates of known environmental exposure and could be discounted in certain instances. If recoveries of remediation costs from third parties are probable, a receivable is recorded.

Insurance - MAP is insured for catastrophic casualty and certain property and business interruption exposures, as well as those risks required to be insured by law or contract. Costs resulting from noninsured losses are charged against income upon occurrence.

Income taxes - MAP is a limited liability company, and therefore, except for several small subsidiary corporations, is not subject to U.S. federal

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income taxes. Accordingly, the taxable income or loss resulting from operations of MAP is ultimately included in the U.S. federal income tax returns of USX and Ashland. MAP is, however, subject to income taxes in certain state, local and foreign jurisdictions.

Reclassifications - Certain reclassifications of prior years' data have been made to conform to 2000 classifications. These changes had no impact on previously reported results of operations or members' capital.

NOTE C - NEW ACCOUNTING STANDARDS

In the fourth quarter of 2000, MAP adopted the following accounting pronouncements primarily related to the classification of items in the statement of operations. The adoption of these new pronouncements had no net effect on the financial position or results of operations of MAP, although they required reclassifications of certain amounts in the statement of operations including all prior periods presented.

- o In December 1999, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101 (SAB 101), "Revenue Recognition in Financial Statements," which summarizes the SEC staff's interpretations of generally accepted accounting principles related to revenue recognition and classification.
- o In 2000, the Emerging Issues Task Force of the Financial Accounting Standards Board (EITF) issued EITF Consensus No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent," which addresses whether certain cost items should be reported as a reduction of revenue or as a component of cost of revenues, and EITF Consensus No. 00-10, "Accounting for Shipping and Handling Fees and Costs," which addresses the classification of costs incurred for shipping goods to customers.

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), which later was amended by SFAS Nos. 137 and 138. This Standard requires recognition of all derivatives as either assets or liabilities at fair value. Changes in fair value will be reflected in either current period net income or other comprehensive income, depending on the designation of the derivative instrument. MAP may elect not to designate a derivative instrument as a hedge even if the strategy would be expected to qualify for hedge accounting treatment. The adoption of SFAS No. 133 will change the timing of recognition for derivative gains and losses as compared to previous accounting standards.

MAP will adopt the Standard effective January 1, 2001. The transition adjustment resulting from the adoption of SFAS No. 133 will be reported as a cumulative effect of a change in accounting principle. The unfavorable cumulative effect on net income, net of tax, is expected to approximate \$20 million. The favorable cumulative effect on other comprehensive income, net of tax, will approximate \$6 million. The amounts reported as other comprehensive income will be reflected in income from operations when the anticipated physical transactions are consummated. It is not possible to estimate the effect that this Standard will have on future results of operations, although it is likely that the effects of some derivative transactions will be recognized in different periods than would have been the case under previous accounting standards.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE D - RELATED PARTY TRANSACTIONS

MAP sales in 2000, 1999 and 1998 to Ashland and its affiliates were \$285 million, \$198 million and \$190 million, respectively; and sales to USX and its affiliates were \$145 million, \$50 million and \$10 million, respectively. MAP purchases in 2000, 1999 and 1998 from Ashland and its affiliates totaled \$19 million, \$9 million and \$20 million, respectively; and purchases from USX and its affiliates totaled \$540 million, \$297 million and \$284 million, respectively. Such transactions were in the ordinary course of business and included the purchase, sale and transportation of crude oil and petroleum products. These transactions were conducted under terms comparable to those with unrelated parties.

During the years ended December 31, 2000, 1999 and 1998, Ashland and its affiliates, and USX and its affiliates provided certain information technology and administrative services and facilities to MAP. Billings to MAP for these services and facilities for the years ended December 31, 2000, 1999 and 1998 from Ashland and its affiliates totaled \$7 million, \$13 million and \$27 million, respectively. Billings to MAP for these services and facilities for the years ended December 31, 2000, 1999 and 1998 from USX and its affiliates totaled \$48 million, \$47 million and \$83 million, respectively.

As of December 31, 2000 and 1999, related party receivables included \$35 million and \$26 million, respectively, of accounts receivable due from Ashland and its affiliates; and accounts payable to related parties included \$2 million and \$2 million, respectively, due to Ashland and its affiliates. As of December 31, 2000 and 1999, related party receivables included \$8 million and \$13 million, respectively, of accounts receivable due from USX and its affiliates; and accounts payable to related parties included \$64 million and \$31 million, respectively, due to USX and its affiliates.

In connection with the formation of MAP, certain Marathon debt was assigned to MAP. Marathon agreed to reimburse MAP for this debt and related interest expense. During 2000, 1999 and 1998, Marathon reimbursed MAP \$6 million, \$0 million and \$24 million, respectively, for debt repayments. Related party receivables at December 31, 1999, included \$6 million due from Marathon for future debt payment reimbursements. For details relating to debt repayments, see Note L.

A revolving credit agreement was entered into as of January 1, 1998, among Ashland and Marathon (collectively the Lenders) and MAP (Borrower). This agreement provides that the Lenders may loan to the Borrower up to \$500 million at defined short-term market rates. At December 31, 2000 and 1999, there were no borrowings against this facility. During 2000 and 1999, MAP borrowed and repaid \$931 million and \$386 million, respectively, under this revolving credit facility. The weighted average borrowings outstanding under this revolving credit facility during the years 2000 and 1999 were \$14 million and \$4 million, respectively. During the year ended December 31, 2000, interest expense paid on these borrowings was \$1 million to Marathon.

On November 16, 1998, MAP entered into agreements with USX and Ashland, which allow MAP to invest its surplus cash balances on a daily basis at

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competitive interest rates with USX and Ashland in proportion up to their ownership interests in MAP. These agreements, as previously extended, expired on March 15, 2000 and have been subsequently amended and extended with an expiration date of March 15, 2001. At December 31, 2000 and 1999, there was no cash invested under these agreements. During the years ended December 31, 2000, 1999 and 1998, interest income earned from these investments was \$6 million, \$4 million and \$1 million, respectively, from Ashland and \$7 million, \$5 million and \$0 million, respectively, from USX.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE E - OTHER ITEMS

	Ye

	2000

Net interest and other financial income	
Interest and other financial income:	
Interest income - third parties	\$ 9
Interest income - related parties	13

Total	22

Interest and other financial costs:	
Interest incurred	3
Other	7

Total	10

Net interest and other financial income	\$ 12
	=====

Consumer excise tax - Included in revenues and costs and expenses for 2000, 1999 and 1998 were \$4,344 million, \$3,973 million and \$3,824 million, respectively, representing consumer excise taxes on petroleum products and merchandise.

NOTE F - PENSIONS AND OTHER POSTRETIREMENT BENEFITS

MAP has a noncontributory defined benefit pension plan and several related excess benefit plans covering substantially all employees. Benefits under

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its final pay formula are based primarily upon age, years of service and the highest three years earnings during the last ten years before retirement. Benefits under its pension equity formula are based primarily upon age, years of service and the final three years of earnings at retirement.

MAP also has defined benefit retiree health and life insurance plans (other benefits) covering most employees upon their retirement. Health benefits are provided, for the most part, through comprehensive hospital, surgical and major medical benefit provisions subject to various cost sharing features. Life insurance benefits are provided to certain nonunion and union represented retiree beneficiaries primarily based on employees' annual base salary at retirement. Other benefits have not been prefunded.

	Pension Benefits	
	2000	1999
Change in projected benefit obligation:		
Benefit obligation at January 1	\$ 482	\$ 525
Service cost	36	41
Interest cost	38	33
Plan amendments	4	19
Actuarial (gains) losses	64	(110)
Acquisition and merger	--	14
Benefits paid	(56)	(38)
Settlement, curtailment and termination benefits	--	(2)
	-----	-----
Benefit obligations at December 31	\$ 568	\$ 482

(Mil

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE F - PENSIONS AND OTHER POSTRETIREMENT BENEFITS - Continued

	Pension Benefits	
	2000	1999
Change in plan assets:		
Fair value of plan assets at January 1	\$ 560	\$ 528
Actual return on plan assets	(4)	55
Acquisition and merger	--	13
Employer contributions	1	2

(Mil

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Benefits paid		(55)	(38)
		-----	-----
Fair value of plan assets at December 31	\$	502	\$ 560
		=====	=====
Funded status of plans at December 31: (a)	\$	(66)	\$ 78
Unrecognized net gain from transition		(9)	(10)
Unrecognized prior service costs (credits)		25	24
Unrecognized actuarial (gains) losses		(5)	(127)
Additional minimum liability (b)		(6)	(1)
		-----	-----
Accrued benefit cost	\$	(61)	\$ (36)
		=====	=====
(a) Includes several small plans that have accumulated benefit obligations and no plan assets:			
Accumulated benefit obligation	\$	(12)	\$ (6)
Projected benefit obligation		(17)	(14)
(b) Additional minimum liability recorded was offset by the following:			
Intangible asset	\$	2	\$ 1
		-----	-----
Accumulated other comprehensive income (loss):			
Beginning of year	\$	--	\$ (5)
Change during year		(4)	5
		-----	-----
Balance at end of year	\$	(4)	\$ --
		=====	=====

	Pension Benefits			
	2000	1999	1998	(Millions)
	-----	-----	-----	-----
Components of net periodic benefit cost:				
Service cost	\$ 36	\$ 41	\$ 26	\$
Interest cost	38	33	20	
Expected return on plan assets	(51)	(46)	(32)	
Amortization of prior service costs	2	1	--	
Amortization of actuarial losses	(4)	1	--	
Amortization of transition gain	(2)	(2)	--	
Other plans	1	2	2	
Settlement, curtailment and termination benefits	3	2	--	
	-----	-----	-----	-----
Net periodic benefit cost	\$ 23	\$ 32	\$ 16	\$
	=====	=====	=====	=====

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Actuarial assumptions at December 31:	Pension Benefits	
	2000	1999
Discount rate	7.5%	8.0%
Expected annual return on plan assets	9.5%	9.5%
Increase in compensation rate	5.0%	5.0%

For measurement purposes, an 8% annual rate of increase in the per capita cost of covered health care benefits was assumed for 2001. The rate was assumed to decrease gradually to 5% for 2007 and remain at that level thereafter.

A one-percentage-point change in assumed health care cost trend rates would have the following effects:

	1-Percentage Point Increase		
Effect on total of service and interest cost components	\$	4	(Mill)
Effect on postretirement benefit obligation		28	

NOTE G - INCOME TAXES

The taxable income or loss resulting from operations of MAP, except for several small subsidiary corporations, is ultimately included in the federal income tax returns of USX and Ashland. MAP is, however, subject to taxation in certain state, local and foreign jurisdictions.

Provisions (credits) for income taxes:

	Year Ended December 31					
	2000			(Millions) 1999		
	Current	Deferred	Total	Current	Deferred	Total
Federal	\$ --	\$ --	\$ --	\$ --	\$ (1)	\$ (1)
State and local	5	--	5	1	--	1
Foreign	2	--	2	2	--	2
Total	\$ 7	\$ --	\$ 7	\$ 3	\$ (1)	\$ 2

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Deferred tax liabilities at December 31, 2000 and 1999 of \$4 million and \$5 million, respectively, principally arise from differences between the book and tax basis of inventories and property, plant and equipment. Pretax income in 2000, 1999 and 1998 included \$0 million, \$3 million and \$1 million, respectively, attributable to foreign sources.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE H - INVENTORIES

Inventories consist of the following:

	December 31	
	(Millions)	
	2000	1999
	-----	-----
Crude oil and natural gas liquids	\$ 674	\$ 688
Refined products and merchandise	1,074	1,051
Supplies and sundry items	76	81
	-----	-----
Total (at cost)	1,824	1,820
Less inventory market valuation reserve	--	--
	-----	-----
Net inventory carrying value	\$ 1,824	\$ 1,820
	=====	=====

Inventories of crude oil and refined products are valued by the LIFO method. The LIFO method accounted for 95% and 93% of total inventory at December 31, 2000 and 1999, respectively. Current acquisition costs were estimated to exceed the above inventory values at December 31 by approximately \$476 million and \$194 million in 2000 and 1999, respectively. Cost of revenues was reduced and income from operations was increased by \$14 million in 2000 as a result of liquidations of LIFO inventories.

The inventory market valuation reserve reflects the extent that the recorded LIFO cost basis of crude oil and refined products inventories exceeds net realizable value. The reserve is decreased to reflect increases in market prices and inventory turnover and increased to reflect decreases in market prices. Changes in the inventory market valuation reserve result in noncash charges or credits to costs and expenses. During 2000, there were no charges or credits to costs and expenses.

NOTE I - INVESTMENTS AND LONG-TERM RECEIVABLES

	December 31	
	(Millions)	
	2000	1999
	-----	-----
Equity method investments	\$ 104	\$ 101

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Receivables due after one year	6	5
Property exchange trust	3	2
	-----	-----
Total	\$ 113	\$ 108
	=====	=====

The following represents summarized financial information of investees accounted for by the equity method of accounting:

	Year Ended December 31		

	2000	(Millions) 1999	1998
	-----	-----	-----
Income data:			
Revenues	\$ 239	\$ 207	\$ 171
Operating income	95	78	61
Net income	57	44	31

	December 31	

	2000	(Millions) 1999
	-----	-----
Balance sheet data:		
Current assets	\$ 99	\$ 76
Noncurrent assets	605	614
Current liabilities	93	76
Noncurrent liabilities	418	441

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE I - INVESTMENTS AND LONG-TERM RECEIVABLES - Continued

Dividends and partnership distributions received from equity investees were \$25 million, \$18 million and \$14 million in 2000, 1999 and 1998, respectively. MAP purchases from equity investees totaled \$61 million, \$50 million and \$63 million in 2000, 1999 and 1998, respectively. MAP sales to equity investees were immaterial in each year.

NOTE J - PROPERTY, PLANT AND EQUIPMENT

	December 31	

	2000	(Millions) 1999
	-----	-----
Refining	\$ 2,555	\$ 2,208
Marketing	2,270	2,184
Transportation	1,296	1,271
Other	20	11
	-----	-----
Total	6,141	5,674
Less accumulated depreciation and amortization	2,119	1,963

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Net	----- \$ 4,022 =====	----- \$ 3,711 =====
-----	----------------------------	----------------------------

Property, plant and equipment at December 31, 2000 and 1999, includes gross assets acquired under capital leases of \$8 million and \$20 million, respectively, with no related material amounts in accumulated depreciation and amortization.

NOTE K - SHORT-TERM DEBT

MAP has a \$100 million short-term revolving credit facility with a group of banks that terminates in July 2001. Interest is based on defined short-term market rates. During the term of the agreement, MAP is required to pay a variable facility fee on total commitments, which at December 31, 2000 was 0.11%. At December 31, 2000, there were no borrowings against this facility.

NOTE L - LONG-TERM DEBT

	December 31	
	(Millions)	
	2000	1999
	-----	-----
Capital lease obligations	\$ 7	\$ 15
Variable rate Michigan Underground Storage Tank Interest Rate Subsidy Loan due 2000 (a)	--	6
5% Promissory Note due 2009	1	1
Revolving credit facilities (b) (c)	--	--
	-----	-----
Total (d)	8	22
Less amount due within one year	--	7
	-----	-----
Long-term debt due after one year	\$ 8	\$ 15
	=====	=====

(a) This program was created in connection with the Michigan Underground Storage Tank Assurance Act to assist owners in the clean up of underground storage tank systems. MAP paid interest monthly, based on a monthly LIBOR rate plus 5/8%. An interest subsidy is received quarterly from the State of Michigan calculated at a rate of 6.1% per annum. The effective rate of this loan during 2000 and 1999, including the effect of the interest subsidy, was 5.7% and 3.3%, respectively. Marathon was obligated to reimburse MAP for all payments with respect to this debt and the debt was repaid during 2000.

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NOTE L - LONG-TERM DEBT - Continued

- (b) MAP has a \$400 million revolving credit facility with a group of banks that terminates in July 2003. Interest is based on defined short-term market rates. During the term of the agreement, MAP is required to pay a variable facility fee on total commitments, which at December 31, 2000, was 0.125%. At December 31, 2000, the unused and available credit was \$352 million, which reflects reductions for outstanding letters of credit. In the event that MAP defaults on indebtedness (as defined in the agreement) in excess of \$100 million, USX has guaranteed the payment of any outstanding obligations.
- (c) In 1998, MAP entered into a revolving credit agreement with Marathon and Ashland for \$500 million that terminated on December 31, 1998, and which was renewed on an uncommitted basis for 1999. This agreement expired on December 31, 1999, but has been extended with an expiration date of March 15, 2001. Interest is based on defined short-term market rates. At December 31, 2000, the unused and available credit was \$500 million.
- (d) Required payment of long-term debt for the year 2005 is \$1 million. No other significant payments of long-term debt are required in other years.

NOTE M - SUPPLEMENTAL CASH FLOW INFORMATION

		----- 2000 -----
Cash provided from operating activities includes:		
Interest and other financial costs paid	\$	(3)
Income taxes paid		(5)
Non-cash investing and financing activities:		
Liabilities assumed in acquisitions		--

NOTE N - LEASES

Future minimum commitments for capital and operating leases having noncancelable lease terms in excess of one year are as follows:

	Capital Leases		Operating Leases
	-----		-----
	(Millions)		
2001	\$	1	\$ 43
2002		1	34
2003		1	23
2004		1	17
2005		1	9
Later years		5	13

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Sublease rentals	--	(2)
	-----	-----
Total minimum lease payments	10	\$ 137
		=====
Less imputed interest costs:	(3)	

Present value of minimum lease payments included in long-term debt	\$ 7	
	=====	

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE N - LEASES - Continued

Operating lease rental expense:

	Year Ended December 31		
	2000	(Millions) 1999	1998
	-----	-----	-----
Minimum rental	\$ 73	\$ 66	\$ 74
Contingent rental	10	11	11
Sublease rentals	(6)	(6)	(1)
	-----	-----	-----
Net rental expense	\$ 77	\$ 71	\$ 84
	=====	=====	=====

MAP leases a wide variety of facilities and equipment under operating leases, including land and building space, office equipment, production facilities and transportation equipment. Most long-term leases include renewal options and, in certain leases, purchase options.

NOTE O - DERIVATIVE INSTRUMENTS

MAP remains at risk for possible changes in the market value of derivative instruments; however, such risk should be mitigated by price changes in the underlying hedged item. MAP is also exposed to credit risk in the event of nonperformance by counterparties. The credit-worthiness of counterparties is subject to continuing review, including the use of master netting agreements to the extent practical, and full performance is anticipated.

The following table sets forth quantitative information by class of derivative instrument:

Fair Value Assets	Carrying Amount Assets	Recogniz Tradin Gain o (Loss) f
-------------------------	------------------------------	--

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(Millions) -----	(Liabilities) (a) (b) -----	(Liabilities) -----	the Ye -----
December 31, 2000:			
Exchange-traded commodity futures:			
Trading	\$ --	\$ --	\$
Other than trading	--	--	
Exchange-traded commodity options:			
Trading	--	--	
Other than trading	(6) (d)	(6)	
OTC commodity swaps (e):			
Trading	--	--	
Other than trading	--	--	
OTC commodity options:			
Trading	--	--	
Other than trading	(20) (f)	(20)	
	-----	-----	-----
Total commodities	\$ (26)	\$ (26)	\$
	=====	=====	=====

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE O - DERIVATIVE INSTRUMENTS - Continued

December 31, 1999:			
Exchange-traded commodity futures:			
Trading	\$ --	\$ --	\$
Other than trading	--	--	
Exchange-traded commodity options:			
Trading	--	--	
Other than trading	(6) (d)	(6)	
OTC commodity swaps (e):			
Trading	--	--	
Other than trading	(3) (g)	(3)	
OTC commodity options:			
Trading	--	--	
Other than trading	--	--	
	-----	-----	-----
Total commodities	\$ (9)	\$ (9)	\$
	=====	=====	=====

- (a) The fair value amounts for OTC positions are based on various indices or dealer quotes. The exchange-traded futures contracts and certain option contracts do not have a corresponding fair value since changes in the market prices are settled on a daily basis.
- (b) The aggregate average fair values of all trading activities for 2000 and 1999 were \$(5) million and \$3 million, respectively.
- (c) Contract or notional amounts do not quantify risk exposure, but are used in the calculation of cash settlements under the contracts. The contract or notional amounts do not reflect the extent to which positions may offset one another.

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- (d) Includes fair values as of December 31, 2000 and 1999, for assets of \$10 million and \$7 million and for liabilities of \$(16) million and \$(13) million, respectively.
- (e) The OTC swap arrangements vary in duration with certain contracts extending into mid-2001.
- (f) Includes fair value as of December 31, 2000, for assets of \$1 million and for liabilities of \$(21) million.
- (g) Includes fair values as of December 31, 1999, for assets of \$0 million and for liabilities of \$(3) million.

NOTE P - FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying value of most financial instruments are based on historical costs. The carrying values of cash and cash equivalents, receivables, payables, long-term receivables and long-term debt approximate their fair value.

MAP's unrecognized financial instruments consist of financial guarantees and commitments to extend credit. It is not practicable to estimate the fair value of these forms of financial instrument obligations because there are no quoted market prices for transactions which are similar in nature. For details relating to financial guarantees, see Note Q.

NOTE Q - CONTINGENCIES AND COMMITMENTS

MAP is the subject of, or party to, a number of pending or threatened legal actions, contingencies and commitments involving a variety of matters, including laws and regulations relating to the environment. Certain of these matters are discussed below. The ultimate resolution of these contingencies could, individually or in the aggregate, be material to the MAP financial statements. However, management believes that MAP will remain a viable and competitive enterprise even though it is possible that these contingencies could be resolved unfavorably.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS - Continued

NOTE Q - CONTINGENCIES AND COMMITMENTS - Continued

Environmental matters - MAP is subject to federal, state, local and foreign laws and regulations relating to the environment. These laws generally provide for control of pollutants released into the environment and require responsible parties to undertake remediation of hazardous waste disposal sites. Penalties may be imposed for noncompliance. Marathon and Ashland have retained the liabilities, subject to certain thresholds, for costs associated with remediating properties conveyed to MAP for conditions existing prior to January 1, 1998. The costs associated with these thresholds are not expected to be material to the MAP financial statements. At December 31, 2000 and 1999, MAP's accrued liabilities for remediation totaled \$10 million and \$6 million, respectively. It is not presently possible to estimate the ultimate amount of all remediation costs that might be incurred or the penalties that may be imposed. Receivables for

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recoverable costs from certain states, under programs to assist companies in clean up efforts related to underground storage tanks at retail marketing outlets, were \$4 million and \$3 million at December 31, 2000 and 1999, respectively.

MAP has made substantial capital expenditures to bring existing facilities into compliance with various laws relating to the environment. In 2000, 1999 and 1998, such capital expenditures for environmental controls totaled \$47 million, \$24 million and \$42 million, respectively. MAP anticipates making additional such expenditures in the future; however, the exact amounts and timing of such expenditures are uncertain because of the continuing evolution of specific regulatory requirements.

Guarantees - At December 31, 2000 and 1999, MAP's pro rata share of obligations of LOCAP INC. and Southcap Pipe Line Company secured by throughput and deficiency agreements totaled \$14 million and \$19 million, respectively. Under the agreements, MAP is required to advance funds if the investees are unable to service debt. Any such advances are treated as prepayments of future transportation charges.

Commitments - At December 31, 2000 and 1999, MAP's contract commitments for capital expenditures for property, plant and equipment totaled \$89 million and \$14 million, respectively.

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ARCH COAL, INC. AND SUBSIDIARIES

AUDITED CONSOLIDATED FINANCIAL STATEMENTS

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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.

REPORT OF INDEPENDENT AUDITORS

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TO THE STOCKHOLDERS AND BOARD OF DIRECTORS
ARCH COAL, INC.

We have audited the accompanying consolidated balance sheets of Arch Coal, Inc. and subsidiaries as of December 31, 2000 and 1999 and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2000. 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 auditing standards generally accepted in the 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, 2000 and 1999, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 3 to the financial statements, in 1999, the Company changed its method of accounting for depreciation of its preparation plants and loadouts.

/s/ Ernst & Young LLP
St. Louis, Missouri
January 24, 2001

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CONSOLIDATED STATEMENTS OF OPERATIONS

Year ended December 31
(in thousands of dollars except per share data)

REVENUES

Coal sales	\$ 1,
Income from equity investment	
Other revenues	

	1,

COSTS AND EXPENSES

Cost of coal sales	1,
Selling, general and administrative expenses	
Amortization of coal supply agreements	
Write-down of impaired assets	
Other expenses	

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	1,
Income (loss) from operations	
Interest expense, net:	
Interest expense	
Interest income	
Income (loss) before income taxes, extraordinary loss and cumulative effect of accounting change	
Benefit from income taxes	
Income (loss) before extraordinary loss and cumulative effect of accounting change	
Extraordinary loss from the extinguishment of debt, net of taxes	
Cumulative effect of accounting change, net of taxes	
NET INCOME (LOSS)	\$
Basic and diluted earnings (loss) per common share:	
Income (loss) before extraordinary item and cumulative effect of accounting change	\$
Extraordinary loss from the extinguishment of debt, net of taxes	
Cumulative effect of accounting change, net of taxes	
Basic and diluted earnings (loss) per common share	\$

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

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CONSOLIDATED BALANCE SHEETS

December 31	2000	1999
(in thousands of dollars except share and per share data)		
=====		
ASSETS		
Current assets		
Cash and cash equivalents	\$ 6,028	\$ 3,283
Trade accounts receivable	141,727	162,802
Other receivables	38,540	25,659
Inventories	47,930	62,382
Prepaid royalties	2,262	1,310
Deferred income taxes	27,440	21,600
Other	13,963	8,916
Total current assets	277,890	285,952

Property, plant and equipment		
Coal lands and mineral rights	1,106,547	1,170,956
Plant and equipment	1,006,452	1,042,128

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Deferred mine development	104,579	92,265
	2,217,578	2,305,349
Less accumulated depreciation, depletion and amortization	(787,525)	(826,178)
Property, plant and equipment, net	1,430,053	1,479,171
Other assets		
Prepaid royalties	17,500	--
Coal supply agreements	108,884	151,978
Deferred income taxes	179,343	182,500
Investment in Canyon Fuel	188,700	199,760
Other	30,244	33,013
Total other assets	524,671	567,251
Total assets	\$ 2,232,614	\$ 2,332,374
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$ 103,014	\$ 109,359
Accrued expenses	152,303	145,561
Current portion of debt	60,129	86,000
Total current liabilities	315,446	340,920
Long-term debt	1,090,666	1,094,993
Accrued postretirement benefits other than pension	336,663	343,993
Accrued reclamation and mine closure	118,928	129,869
Accrued workers' compensation	78,593	105,190
Accrued pension cost	19,287	22,445
Obligations under capital leases	11,348	--
Other noncurrent liabilities	41,809	53,669
Total liabilities	2,012,740	2,091,079
Stockholders' equity		
Common stock, \$.01 par value, authorized 100,000,000 shares, issued 39,714,333 and 39,705,628 shares	397	397
Paid-in capital	473,428	473,335
Retained deficit	(234,980)	(213,466)
Less treasury stock, at cost, 1,541,146 shares	(18,971)	(18,971)
Total stockholders' equity	219,874	241,295
Total liabilities and stockholders' equity	\$ 2,232,614	\$ 2,332,374

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

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

Three years ended December 31, 2000

Common

Paid-In

Retained
Earnings

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(in thousands of dollars except share and per share data)	Stock	Capital	(Def
BALANCE AT DECEMBER 31, 1997	\$ 397	\$ 472,425	\$ 138
Net income			30
Dividends paid (\$.46 per share)			(18)
Issuance of 47,635 shares of common stock under the stock incentive plan		691	
Treasury stock purchases (333,952 shares)			
BALANCE AT DECEMBER 31, 1998	397	473,116	150
Net loss			(346)
Dividends paid (\$.46 per share)			(17)
Issuance of 95 shares of common stock under the stock incentive plan		1	
Treasury stock purchases (1,396,700 shares) net of issuances (189,506 shares)		218	
BALANCE AT DECEMBER 31, 1999	397	473,335	(213)
Net loss			(12)
Dividends paid (\$.23 per share)			(8)
Issuance of 8,705 shares of common stock under the stock incentive plan		93	
BALANCE AT DECEMBER 31, 2000	\$ 397	\$ 473,428	\$ (234)

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended December 31 (in thousands of dollars)	2000
OPERATING ACTIVITIES	
Net income (loss)	\$ (12,736)
Adjustments to reconcile to cash provided by operating activities:	
Depreciation, depletion and amortization	201,512
Prepaid royalties expensed	7,322
Net gain on disposition of assets	(20,444)
Income from equity investment	(12,837)
Net distributions from equity investment	23,897
Cumulative effect of accounting change	-
Write-down of impaired assets	-
Changes in operating assets and liabilities	(29,420)
Other	(21,522)
Cash provided by operating activities	135,772

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INVESTING ACTIVITIES

Payments for acquisition	-
Addition to property, plant and equipment	(115,080)
Proceeds from coal supply agreements	8,512
Additions to prepaid royalties	(25,774)
Additions to notes receivable	-
Proceeds from disposition of property, plant and equipment	24,846
<hr/>	
Cash used in investing activities	(107,496)

FINANCING ACTIVITIES

Proceeds from (payments on) revolver and lines of credit	(30,198)
Net proceeds from (payments on) term loans	-
Payments on notes	-
Payments for debt issuance costs	-
Proceeds from sale and leaseback of equipment	13,352
Dividends paid	(8,778)
Proceeds from sale of common stock	93
Proceeds from sale of treasury stock	-
Purchases of treasury stock	-
<hr/>	
Cash provided by (used in) financing activities	(25,531)

Increase (decrease) in cash and cash equivalents	2,745
Cash and cash equivalents, beginning of year	3,283

Cash and cash equivalents, end of year	\$ 6,028	\$
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SUPPLEMENTAL CASH FLOW INFORMATION:

Cash paid during the year for interest	\$ 85,339	\$
Cash paid (received) during the year for income taxes (refunds)	\$ (1,316)	\$

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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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 operates one reportable segment: 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 central Appalachian and western regions of the United States. All subsidiaries (except as noted below) are wholly owned. Significant intercompany transactions and accounts have been eliminated in consolidation.

The membership interest in Canyon Fuel, LLC ("Canyon Fuel") are owned 65% by the Company and 35% by a subsidiary of ITOCHU Corporation, a Japanese

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corporation. The agreement which governs the management and operations of Canyon Fuel provides for a Management Board to manage its business and affairs. Generally, the Management Board acts by affirmative vote of the representatives of the members holding more than 50% of the membership interests. However, significant participation rights require either the unanimous approval of the members or the approval of representatives of members holding more than 70% of the membership interests. Those matters which are considered significant participation rights include the following:

- . approval of the Annual Business Plan;
- . approval of significant capital expenditures;
- . approval of significant coal sales contracts;
- . approval of the institution of or the settlement of litigation;
- . approval of incurrence of indebtedness;
- . approval of significant mineral reserve leases;
- . selection and removal of the CEO, CFO, or General Counsel;
- . approval of any material change in the business of Canyon Fuel;
- . approval of any disposition whether by sale, exchange, merger, consolidation, license or otherwise, and whether directly or indirectly, of all or any portion of the assets of Canyon Fuel other than in the ordinary course of business; and
- . approval of a request that a member provide additional services to Canyon Fuel.

The Canyon Fuel agreement also contains various restrictions on the transfer of membership interest in Canyon Fuel. As a result of these super-majority voting rights, the Company's 65% ownership of Canyon Fuel is accounted for on the equity method in the consolidated financial statements. Income from Canyon Fuel is reflected in the consolidated statements of operations as income from equity investments. (See additional discussion in "Investment in Canyon Fuel" in Note 5.)

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.

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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.

CASH AND CASH EQUIVALENTS

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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.

INVENTORIES

Inventories are comprised of the following:

December 31 (in thousands)	2000	1999
Coal	\$ 21,185	\$ 28,183
Supplies, net of allowance	26,745	34,199
	\$ 47,930	\$ 62,382

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 \$19.8 million and \$23.5 million at December 31, 2000 and 1999, respectively.

COAL ACQUISITION AND PREPAID ROYALTIES

Coal lease rights obtained through acquisitions 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 occur 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 market contract price and the then-prevailing market price. Accumulated amortization for sales contracts was \$171.2 million and \$131.4 million at December 31, 2000 and 1999, respectively.

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EXPLORATION COSTS

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

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are recorded at cost. Interest costs

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applicable to major asset additions are capitalized during the construction period. Expenditures which extend the useful lives of existing plant and equipment are capitalized. Costs of purchasing rights to coal reserves and developing new mines or significantly expanding the capacity of existing mines are capitalized. These costs are amortized using the units-of-production method over the estimated recoverable reserves that are associated with the property being benefited. At December 31, 2000, all mineral reserves of the Company that are capitalized are being amortized on the units-of-production method through Company operations or through sublease transactions (for which the Company receives royalty revenue) except for a block of 197 million tons located adjacent to its Hobet 21 operations. The current value associated with this property is \$177.8 million which the Company plans to recover via mining operations in the future. Except for preparation plants and loadouts, plant and equipment are depreciated principally on the straight-line method over the estimated useful lives of the assets, which range from three to 20 years. Effective January 1, 1999, preparation plants and loadouts are depreciated using the units-of-production method over the estimated recoverable reserves subject to a minimum level of depreciation (see additional discussion in Note 3, "Change in Accounting Method"). Prior to January 1, 1999, preparation plants and loadouts were depreciated on a straight-line basis over their estimated useful lives.

Leased property 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.

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. (See additional discussion in Note 2, "Changes in Estimates and Other Non-Recurring Revenues and Expenses.")

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. Revenues from sources other than coal sales, including gains and losses from dispositions of long-term assets, are included in other revenues and are recognized as performed or otherwise earned.

INTEREST-RATE SWAP AGREEMENTS

The Company enters into 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. The fair values of

the swap agreements are not recognized in the financial statements. Gains and losses on terminations of interest-rate swap agreements are deferred on the balance sheets (in other long-term liabilities) and amortized as an adjustment to interest expense over the remaining original term of the terminated swap agreement.

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"). 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, Accounting for Stock Issued to Employees ("APB 25"), and related Interpretations.

2. CHANGES IN ESTIMATES AND OTHER NON-RECURRING REVENUES AND EXPENSES

The Company's operating results in 2000 include income from the recovery of \$31.0 million in partial insurance settlements under the Company's property and business interruption insurance policy. The payments offset a portion of the loss incurred at the West Elk mine in Gunnison County, Colorado, which was idled from January 28, 2000 to July 12, 2000 following the detection of combustion-related gases in a portion of the mine. The Company expects to receive additional insurance payments under its property and business interruption policy. Any additional recovery, however, will depend on resolution of the claim with the insurance carrier, the timing of which is uncertain. As a result of permit revisions at its idle mine properties in Illinois, the Company reduced its reclamation liability at Arch of Illinois by \$7.8 million during 2000. In addition, the Internal Revenue Service ("IRS") issued a notice during 2000 outlining the procedures for obtaining tax refunds on certain excise taxes paid by the industry on export sales tonnage. The notice is a result of a 1998 federal district court decision that found such taxes to be unconstitutional. The Company recorded \$12.7 million of income related to these excise tax recoveries. As a result of adjustments to employee postretirement medical benefits, the Company was able to recognize \$9.8 million of pre-tax curtailment gains resulting from previously unrecognized postretirement benefit changes which occurred from plan amendments in previous years. The Company also settled certain workers' compensation liabilities with the State of West Virginia resulting in pre-tax gains of \$21.8 million. This was partially offset by adjustments to other workers' compensation liabilities resulting from changes in estimates which caused increases to the liability of \$13.5 million.

In 1999, the Company recorded pre-tax charges of \$23.1 million related to (i) the restructuring of its administrative workforce; (ii) the closure of its Dal-Tex mining operation in West Virginia due to the inability to secure the necessary permits to continue ongoing mining; and (iii) the closure of several mines in Kentucky (Coal-Mac) and the one remaining underground mine in Illinois (Arch of Illinois) due to depressed coal

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prices, caused in part by increased competition from western coal mines. Of the \$23.1 million charge, \$20.3 million was recorded in cost of coal sales, \$2.3 million was recorded in selling, general and administrative expenses and \$0.5 million was recorded in other expenses in the Company's consolidated statement of operations. The restructuring of the administrative workforce

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included the elimination of 81 administrative jobs which was part of a corporate-wide effort to reduce general and administrative expenses. The mine closures included the termination of 161 employees. As of December 31, 1999, 74 administrative and 65 mine employees had been terminated, with the remainder being terminated during 2000. The following are the components of severance and other exit costs included in the restructuring charge along with related 1999 and 2000 activity:

(in thousands)	1999 Charge	Utilized in 1999	Balance December 31, 1999	Ut i
Employee costs	\$ 7,354	\$ 704	\$ 6,650	\$
Obligations for non-cancelable lease payments	9,858	484	9,374	
Reclamation liabilities	3,667	1,200	2,467	
Depreciation acceleration	2,172	2,172	-	
	\$23,051	\$ 4,560	\$ 18,491	\$

Except for the charge related to depreciation acceleration, all of the 1999 restructuring charge will require the Company to use cash. Also, except for amounts attributable to retiree healthcare, the Company utilized the balance of the amounts reserved for employee costs in 2000.

In addition, during the fourth quarter of 1999, the Company determined that significant changes were necessary in the manner and extent in which certain central Appalachia coal assets would be deployed. The anticipated changes were determined during the Company's annual planning process and were necessitated by the adverse legal and regulatory rulings related to surface mining techniques, as well as the continued negative pricing trends related to central Appalachia coal production experienced by the Company. As a result of the planned changes in the deployment of its long-lived assets in the central Appalachia region and pursuant to FAS 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, the Company evaluated the recoverability of its active mining operations and its coal reserves for which no future mining plans existed. This evaluation indicated that the future undiscounted cash flows of three mining operations, Dal-Tex, Hobet 21 and Coal-Mac, and certain coal reserves with no future mining plans were below the carrying value of such long-lived assets. Accordingly, during the fourth quarter of 1999, the Company adjusted the operating assets and coal reserves to their estimated fair value of approximately \$99.7 million, resulting in a non-cash impairment charge of \$364.6 million (including \$50.6 million relating to operating assets and \$314.0 million relating to coal reserves). The estimated fair value for the three mining operations was based on

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anticipated future cash flows discounted at a rate commensurate with the risk involved. The estimated fair value for the coal reserves with no future mining plans was based upon the fair value of these properties to be derived from subleased operations. The impairment loss has been recorded as a loss from the write-down of impaired assets in the consolidated statements of operations.

3. CHANGE IN ACCOUNTING METHOD

Through December 31, 1998, plant and equipment had principally been depreciated on the straight-line method over the estimated useful lives of the assets, which ranged from three to 20 years. Effective January 1, 1999, depreciation on the Company's preparation plants and loadouts was computed using the units-of-production method, which is based upon units produced, subject to a minimum level of depreciation. These assets are usage-based assets, and their economic lives are typically based and measured on coal throughput. The Company believes the units-of-production method is preferable to the method previously used because the new method recognizes

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that depreciation of this equipment is related substantially to physical wear due to usage and also to the passage of time. This method, therefore, more appropriately matches production costs over the lives of the preparation plants and loadouts with coal sales revenue and results in a more accurate allocation of the cost of the physical assets to the periods in which the assets are consumed. The cumulative effect of applying the new method for years prior to 1999 is an increase to income of \$3.8 million net-of-tax (\$6.3 million pre-tax) reported as a cumulative effect of accounting change in the consolidated statement of operations for the year ended December 31, 1999. In addition, the net loss of the Company, excluding the cumulative effect of accounting change, for the year ended December 31, 1999 is \$0.2 million less, or \$.01 per share less, than it would have been if the Company had continued to follow the straight-line method of depreciation of equipment for preparation plants and loadouts.

4. ACQUISITION

On June 1, 1998, the Company acquired the Colorado and Utah coal operations of Atlantic Richfield Company ("ARCO") and simultaneously combined the acquired ARCO operations and the Company's Wyoming operations with ARCO's Wyoming operations in a new joint venture named Arch Western Resources, LLC ("Arch Western"). The principal operating units of Arch Western are Thunder Basin Coal Company, L.L.C., owned 100% by Arch Western, which operates two coal mines in the Powder River Basin in Wyoming; Mountain Coal Company, L.L.C., owned 100% by Arch Western, which operates a coal mine in Colorado; Canyon Fuel Company, LLC ("Canyon Fuel"), 65% owned by Arch Western and 35% by ITOCHU Coal International Inc., a subsidiary of ITOCHU Corporation, which operates three coal mines in Utah; and Arch of Wyoming, LLC, owned 100% by Arch Western, which operates two coal mines in the Hanna Basin of Wyoming.

Arch Western is 99% owned by the Company and 1% owned by ARCO. The transaction was valued at approximately \$1.14 billion and a wholly owned subsidiary of the Company is the managing member of Arch Western. The transaction was accounted for under the purchase method of accounting.

Results of operations of the acquired operations are included in the

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consolidated statements of operations effective June 1, 1998. The acquired ARCO operations continue to produce low-sulfur coal for sale to primarily domestic utility customers.

5. INVESTMENT IN CANYON FUEL

The following tables present unaudited summarized financial information for Canyon Fuel which, as part of the June 1, 1998 Arch Western transaction (described in Note 4), was acquired by the Company and is accounted for on the equity method.

CONDENSED INCOME STATEMENT INFORMATION

(in thousands)	Year Ended December 31, 2000	Year December 1998
Revenues	\$ 259,101	\$ 243,226
Total costs and expenses	243,226	230,000
Net income	15,875	13,226
65% of Canyon Fuel net income	10,319	8,597
Effect of purchase adjustments	2,518	4,629
Arch Coal's income from its equity investment in Canyon Fuel	\$ 12,837	\$ 13,226

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CONDENSED BALANCE SHEET INFORMATION

December 31, 2000 (in thousands)	Canyon Fuel Basis	Arch Ownership of Canyon Fuel Basis	Arch Purchase Adjustments	Arch Coal's Share
Current assets	\$ 67,075	\$ 43,599	\$ (3,614)	\$ 107,060
Noncurrent assets	411,146	267,245	(84,765)	593,626
Current liabilities	33,766	21,948	-	55,714
Noncurrent liabilities	20,658	13,428	(1,611)	33,675
Members' equity	\$ 423,797	\$ 275,468	\$ (86,768)	\$ 612,497

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December 31, 1999

Current assets	\$ 61,212	\$ 39,788	\$ (3,615)	\$
Noncurrent assets	441,330	286,865	(83,511)	
Current liabilities	37,065	24,092	-	
Noncurrent liabilities	20,789	13,513	2,162	
Members' equity	\$ 444,688	\$ 289,048	\$ (89,288)	\$

The Company's income from its equity investment in Canyon Fuel represents 65% of Canyon Fuel's net income after adjusting for the effect of 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.

6. ACCRUED EXPENSES

Accrued expenses consist of the following:

December 31 (in thousands)	2000	1999
Accrued payroll and related benefits	\$ 22,500	\$ 27,830
Accrued taxes other than income taxes	50,267	47,727
Accrued postretirement benefits other than pension	16,629	14,755
Accrued workers' compensation	10,438	11,144
Accrued interest	13,078	6,285
Accrued reclamation and mine closure	16,126	26,540
Other accrued expenses	23,265	11,280
	\$ 152,303	\$ 145,561

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7. INCOME TAXES

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

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December 31 (in thousands)	2000	1999	1998
Current:			
Federal	\$ (4,882)	\$ 6,796	\$ 8,077
State	-	-	(260)
Total current	(4,882)	6,796	7,817
Deferred:			
Federal	3,067	(54,135)	(12,583)
State	(2,185)	(18,361)	(334)
Total deferred	882	(72,496)	(12,917)
	\$ (4,000)	\$ (65,700)	\$ (5,100)

A reconciliation of the statutory federal income tax expense (benefit) on the Company's pretax income (loss) before extraordinary loss and cumulative effect of accounting change to the actual provision (benefit) for income taxes follows:

Year ended December 31 (in thousands)	2000	1999	1998
Income tax expense (benefit) at statutory rate	\$ (5,858)	\$ (145,526)	\$ 9,240
Percentage depletion allowance	(9,063)	(15,000)	(14,437)
State taxes, net of effect of federal taxes	(1,797)	(18,361)	(594)
Change in valuation allowance	5,515	112,345	-
AMT credit adjustment due to IRS exam	6,704	-	-
Other, net	499	842	691
	\$ (4,000)	\$ (65,700)	\$ (5,100)

During 1998, the Company settled its protest of certain issues with the IRS for the federal income tax returns for the years 1990 and 1991. A final payment of \$0.5 million was paid in June 1998 and charged against previously recorded reserves. The IRS audit of the federal income tax returns for the years 1992 through 1994 was completed during 1998 and agreed to at the examination level. A payment of \$15.5 million was made in December 1998 in settlement of all issues. A significant number of the issues were timing in nature, and the tax paid related to these temporary differences is accounted for as a deferred tax asset, and the remaining tax and interest paid was charged against previously recorded reserves. A portion of the payment related to items that were settled in the 1987 through 1991 audits previously discussed. Permanent differences included a reduction in percentage depletion and a decrease in cost depletion related to the settlement for the adjustment in fair market value of certain coal reserves.

During 1999, the Company settled an audit of former Ashland Coal, Inc. for the years January 1995 through June 1997. A payment of \$0.1 million was

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made in January 1999 in settlement of all issues.

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On January 10, 2000, the Company received notice from the IRS of its proposed adjustments for tax years 1995 and 1996. The Company has agreed to pay \$6.0 million including accrued interest to partially settle the audit but will continue to contest additional tax adjustments of \$0.8 million with the IRS. The Company expects to pay the \$6.0 million during the first quarter of 2001, which will be charged against previously recorded reserves.

The following is a summary of additional taxes paid for IRS audits and the related financial statement impact, none of which resulted in additional expense in the statements of operations subsequent to the tax years to which they relate:

(in millions)	Net Deferred Tax Asset	Taxes Payable	Income Tax Reserves	Cash Paid
1998	\$ 6.1	\$ 4.6	\$ 5.3	\$ 16.0
1999	0.2	-	(0.1)	0.1
2000	-	-	-	-
Totals	\$ 6.3	\$ 4.6	\$ 5.2	\$ 16.1

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.

Significant components of the Company's deferred tax assets and liabilities that result from carry forwards and temporary differences between the financial statement basis and tax basis of assets and liabilities are summarized as follows:

December 31 (in thousands)	2000	1999
DEFERRED TAX ASSETS:		
Postretirement benefits other than pension	\$ 136,268	\$ 139,796
Alternative minimum tax credit carryforward	80,017	91,604
Workers' compensation	30,301	43,029
Reclamation and mine closure	25,019	30,016
Net operating loss carryforwards	28,338	11,507
Plant, equipment, coal lands and mineral rights	17,784	40,104
Advance royalties	15,976	24,064
Other	55,035	25,514
Gross deferred tax assets	388,738	405,634
Valuation allowance	(117,860)	(112,345)

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Total deferred tax assets	270,878	293,289

DEFERRED TAX LIABILITIES:		

Leases	20,371	21,990
Coal supply agreements	19,796	36,750
Other	23,928	30,449

Total deferred tax liabilities	64,095	89,189

Net deferred tax asset	206,783	204,100
Less current asset	27,440	21,600

Long-term deferred tax asset	\$ 179,343	\$ 182,500
=====		

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The Company has a net operating loss carryforward for regular income tax purposes of \$28.3 million which will expire in the years 2008 to 2014. The Company has an alternative minimum tax credit carryforward of \$80.0 million which may carry forward indefinitely to offset future regular tax in excess of alternative minimum tax.

During 1999, the Company 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. Such valuation allowance consisted of the following components at December 31 on the years indicated:

December 31 (in thousands)	2000	1999
=====		
Unrealized future deductible temporary differences	\$ 85,372	\$ 66,992
Unutilized alternative minimum tax credits	32,488	45,353

Valuation allowance at December 31	\$ 117,860	\$ 112,345
=====		

8. DEBT AND FINANCING ARRANGEMENTS

Debt consists of the following:

December 31 (in thousands)	2000
=====	
Indebtedness to banks under revolving credit agreement, expiring May 31, 2003 (weighted average rate at December 31, 2000-8.00%, December 31, 1999-7.61%)	\$ 332,100
Variable rate fully amortizing term loan payable quarterly from July 1, 2001 through May 31, 2003 (weighted average rate at December 31, 2000-8.29%, December 31, 1999-7.49%)	135,000
Variable rate non-amortizing term loan due May 31, 2003 (weighted average rate at December 31, 2000-8.03%, December 31, 1999-7.85%)	675,000

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Other	8,695

	1,150,795
Less current portion	60,129

Long-term debt	\$1,090,666
=====	

The Company has two five-year credit facilities: a \$675 million non-amortizing term loan in the name of Arch Western, the entity owning the right to the coal reserves and operating assets acquired in the Arch Western transaction, and a \$900 million credit facility in the name of the Company, including a \$300 million fully amortizing term loan and a \$600 million revolver. The \$675 million term loan is secured by Arch Western's membership interests in its subsidiaries. The Arch Western credit facility is not guaranteed by the Company. The rate of interest on the borrowings under the agreements is, at the Company's option, the PNC Bank base rate or a rate based on LIBOR. The revolving credit agreement provides borrowing up to \$600 million less any outstanding letters of credit. At December 31, 2000, the Company had \$32.3 million in letters of credit outstanding which when combined with borrowings under the revolver allowed for \$235.6 million of available borrowings under the revolver.

On August 23, 1999, the Company prepaid \$105 million, or seven required quarterly installments, on the \$300 million fully amortizing term loan. The next required quarterly installment will be July 1, 2001. The prepayments were funded by additional borrowings under the \$600 million revolver.

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The Company periodically establishes uncommitted lines of credit with banks. These agreements generally provide for short-term borrowings at market rates. At December 31, 2000, there were \$20 million of such agreements in effect, of which no borrowings were outstanding.

Except for amounts expected to be repaid in 2001, amounts borrowed under the revolving credit agreement and the bank lines of credit are classified as long-term as the Company has the intent and the ability to maintain these borrowings on a long-term basis. Aggregate required maturities of debt at December 31, 2000 for the next five years are \$33.6 million in 2001, \$60.5 million in 2002, \$1.1 billion in 2003, \$0.6 million in 2004, \$0.6 million in 2005 and \$2.9 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 required the pledging of assets to collateralize the term loan and the \$600 million revolver. The assets pledged include equity interests wholly owned subsidiaries, certain real property interest, 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 these financial covenants at December 31, 2000.

The Company enters into interest-rate swap agreements to modify the interest characteristics of the Company's outstanding debt. At December 31, 2000, the Company had interest-rate swap agreements having a total notional

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value of \$767.5 million. These swap agreements are used to convert variable-rate debt to fixed-rate debt. Under these swap agreements, the Company pays a weighted-average fixed rate of 6.16% (before the credit spread over LIBOR) and is receiving a weighted-average variable rate based upon 30-day and 90-day LIBOR. At December 31, 2000, the remaining terms of the swap agreements ranged from 20 to 54 months.

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: The carrying amounts of the Company's borrowings under its revolving credit agreement, lines of credit, variable rate term loans and other long-term debt approximate their fair value.

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, 2000 and 1999, the fair value of these swaps is a liability and an asset of \$7.9 million and \$27.4 million respectively.

10. ACCRUED WORKERS' COMPENSATION

The Company is liable under the federal Mine Safety and Health Act of 1977, as amended, to provide for pneumoconiosis (black lung) benefits to eligible employees, former employees, and dependents with respect to claims filed by such persons on or after July 1, 1973. 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

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service. In addition, the Company is liable for workers' compensation benefits for traumatic injuries which are accrued as injuries are incurred. Workers' compensation costs (credits) include the following components:

Year ended December 31 (in thousands)	2000	1999	1998
Self-insured black lung benefits:			
Service cost	\$ 1,273	\$ 1,671	\$ 1,022
Interest cost	3,620	3,522	3,173
Net amortization and deferral	(1,486)	327	111
	3,407	5,520	4,306
Other workers' compensation benefits	6,942	13,241	19,396
	\$ 10,349	\$ 18,761	\$ 23,702

The actuarial assumptions used in the determination of black lung benefits included a discount rate of 7.75% as of December 31, 2000 (7.50% and 7.00%

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as of December 31, 1999 and 1998, respectively) and a black lung benefit cost escalation rate of 4% in 2000, 1999 and 1998. In 2000, the Company settled several of its mining operations' self-insured workers' compensation and black lung liabilities with the State of West Virginia, resulting in pre-tax gains of \$21.8 million. This was partially offset by adjustments to other workers' compensation liabilities resulting from changes in estimates which caused increases to the liability of \$13.5 million.

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

December 31 (in thousands)	2000	1999
=====		
Actuarial present value for self-insured black lung:		
Benefits contractually recoverable from others	\$ 2,144	\$ 3,254
Benefits for Company employees	35,710	48,267

Accumulated black lung benefit obligation	37,854	51,521
Unrecognized net gain (loss)	6,252	4,890

	44,106	56,411
Traumatic and other workers' compensation	44,925	59,923

Accrued workers' compensation	89,031	116,334
Less amount included in accrued expenses	10,438	11,144

	\$ 78,593	\$ 105,190
=====		

Receivables related to benefits contractually recoverable from others of \$2.1 million in 2000 and \$3.3 million in 1999 are recorded in other long-term assets.

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11. ACCRUED RECLAMATION AND MINE CLOSING COSTS

The federal Surface Mining Control and Reclamation Act of 1977 and similar state statutes require that mine property be restored in accordance with specified standards and an approved reclamation plan. The Company accrues for the costs of final mine closure reclamation over the estimated useful mining life of the property. These costs relate to reclaiming the pit and support acreage at surface mines and sealing portals at deep mines. Other costs of final mine closure common to both types of mining are related to reclaiming refuse and slurry ponds. The Company also accrues for significant reclamation that is completed during the mining process prior to final mine closure. The establishment of the final mine closure reclamation liability and the other ongoing reclamation liability is based upon permit requirements and requires various estimates and assumptions, principally associated with costs and productivities. The Company accrued \$10.4 million, \$12.9 million and \$12.5 million in 2000, 1999 and 1998, respectively, for current and final mine closure reclamation, excluding reclamation recosting adjustments identified below. Cash payments for final mine closure reclamation and current disturbances approximated \$18.2 million, \$15.8 million and \$15.0 million for 2000, 1999 and 1998 respectively. Periodically, the Company reviews its entire environmental liability and makes necessary adjustments for permit changes as granted by state authorities, additional costs resulting from accelerated mine

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closures, and revisions to costs and productivities, to reflect current experience. These recosting adjustments are recorded in cost of coal sales. Adjustments included a net decrease in the liability of \$9.2 million in 2000 and a net increase in the liability of \$4.3 million and \$4.9 million in 1999 and 1998, respectively. The Company's management believes it is making adequate provisions for all expected reclamation and other costs associated with mine closures.

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 years of service 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. Summaries of the changes in the benefit obligations, plan assets (primarily listed stocks and debt securities) and funded status of the plans are as follows:

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(in thousands)	Pension Benefits		Postret
	2000	1999	2000
<hr/>			
CHANGE IN BENEFIT OBLIGATIONS			
Benefit obligations at January 1	\$ 131,783	\$ 139,433	\$ 330,846
Service cost	6,817	7,118	1,901
Interest cost	9,546	8,980	24,416
Benefits paid	(15,111)	(13,462)	(16,636)
Plan amendments	642	(435)	(13,658)
Other-primarily actuarial (gain) loss	5,387	(9,851)	(27,437)
<hr/>			
Benefit obligations at December 31	\$ 139,064	\$ 131,783	\$ 299,432
<hr/>			
CHANGE IN PLAN ASSETS			
Value of plan assets at January 1	\$ 147,217	\$ 127,274	\$ -
Actual return on plan assets	(2,915)	31,308	-
Employer contributions	9,673	2,097	16,636
Benefits paid	(15,111)	(13,462)	(16,636)
<hr/>			
Value of plan assets at December 31	\$ 138,864	\$ 147,217	\$ -
<hr/>			
FUNDED STATUS OF THE PLANS			

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Accumulated obligations less plan assets	\$ 200	\$ (15,434)	\$ 299,432
Unrecognized actuarial gain	16,908	37,513	41,304
Unrecognized net transition asset	491	689	-
Unrecognized prior service gain	1,886	2,815	12,556
Net liability recognized	\$ 19,485	\$ 25,583	\$ 353,292
BALANCE SHEET LIABILITIES			
Prepaid benefit costs	\$ -	\$ -	\$ -
Accrued benefit liabilities	19,485	25,583	353,292
Net liability recognized	19,485	25,583	353,292
Less current portion	198	3,138	16,629
Long term liability	\$ 19,287	\$ 22,445	\$ 336,663

The reduction in the postretirement benefit obligation in 2000 associated with the \$13.7 million plan amendment resulted from: the July 2000 amendment changing some of the cost sharing provisions of the plan for salaried and non-union hourly participants; and an October 2000 plan amendment changing eligibility requirements to 10 years of service after reaching age 45 for salaried and non-union hourly participants. The latter plan change triggered a curtailment that resulted in the recognition of \$9.8 million in previously unrecognized prior service gains. The \$25 million increase in the 2000 unrecognized actuarial gain from 1999 resulted from plan assumption changes.

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The actuarial loss in the 2000 pension benefit obligation resulted from changes in plan assumptions. The decrease in funded status in year 2000 resulted from decreased earnings on plan assets during the year, which also contributed to the reduction in the unrecognized actuarial gain as compared to the prior year.

December 31	Pension Benefits	
	2000	1999
Weighted average assumptions		
Discount rate	7.75%	7.50%
Rate of compensation increase	4.75%	5.25%
Expected return on plan assets	9.00%	9.00%
Health care cost trend on covered charges	N/A	N/A

The following table details the components of pension and other post-retirement benefit costs.

Year ended December 31 (in thousands)	Pension Benefits			Other 2000
	2000	1999	1998	

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Service cost	\$ 6,817	\$ 7,118	\$ 5,841	\$ 1,901
Interest cost	9,546	8,980	8,137	24,416
Expected return on plan assets	(10,915)	(9,929)	(7,521)	-
Other amortization and deferral	(3,047)	(1,122)	790	(5,382)
Curtailments	-	-	-	(9,756)

	\$ 2,401	\$ 5,047	\$ 7,247	\$ 11,179
=====				

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, 2000 by \$35.7 million, or 11.9%, and the net periodic postretirement benefit cost for 2000 by \$2.7 million, or 24.2%.

MULTI-EMPLOYER PENSION AND BENEFIT PLANS

Under the labor contract with the UMWA, the Company made payments of \$0.1 million, \$0.2 million and \$1.3 million in 2000, 1999 and 1998, respectively, 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 paid. 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 benefit (withdrawal liability). At December 31, 2000, the Company has been informed by the UMWA Health and Retirement Funds that the UMWA 1950 and 1974 Pension Plans do not have any unfunded vested benefits. Therefore, there is no withdrawal liability to the Company. The Company is not aware of any circumstances which would require it to reflect its share of unfunded vested pension benefits in its financial statements. At December 31, 2000, approximately 17% of the Company's workforce was represented by the UMWA. The current UMWA collective bargaining agreement expires at December 31, 2002.

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 recognizes expense as premiums are paid. The Company recognized \$3.3 million in 2000, \$2.7 million in 1999 and \$3.7 million in 1998, in expense relative to premiums paid pursuant to the Benefit Act.

OTHER PLANS

The Company sponsors savings plans which were established to assist

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eligible employees in providing for their future retirement needs. The Company's contributions to the plans were \$8.0 million in 2000, \$8.4 million in 1999 and \$6.8 million in 1998.

13. CAPITAL STOCK

Subsequent to the end of the year, the Company completed a public offering of 9,927,765 shares of its common stock. The offering consisted of 5,170,797 shares sold directly by the Company (including 1,541,146 shares held in the Company's treasury) and the remaining 4,756,968 shares held by its then largest stockholder, Ashland Inc. The net proceeds of \$93.2 million from the shares sold directly by the Company were used to pay down debt.

On September 29, 1998, the Company's Board of Directors authorized the Company to repurchase up to 2 million shares of Company common stock. The timing of the purchases and the number of shares to be purchased are dependent on market conditions. Through December 31, 1999, the Company had acquired 1,726,900 shares under the repurchase program at an average price of \$12.29 per share. There were no treasury share purchases during 2000.

On February 25, 1999, the Company's Board of Directors authorized the Company to amend its Automatic Dividend Reinvestment Plan to provide, among other things, that dividends may be reinvested in the Company's common stock by purchasing authorized but unissued shares (including treasury shares) directly from the Company, as well as by purchasing shares in the open market. On May 4, 1999, the Company filed a Form S-3 with the Securities and Exchange Commission to register 2,000,000 shares of the Company's common stock for issuance under the amended Plan. As reflected in the Prospectus filed therewith, the amended Plan provides that the Company determines whether the Plan's administrator should reinvest dividends in shares purchased in the open market or in shares acquired directly from the Company. The Company authorized and directed its Plan administrator (for all shareholders who had elected to reinvest their dividends in Company stock) to reinvest the June 15, 1999 and September 15, 1999 dividends in the Company's treasury stock. As of December 31, 2000 and 1999, approximately \$2.5 million of the Company's dividends were reinvested in 189,506 shares of treasury stock. In accordance with the terms of the amended Plan, the treasury stock was reissued by the Company at the average of the high and low per share sales prices as reported by the New York Stock Exchange on the date of the dividend, which averaged \$13.446 per share. The Company accounts for the issuance of the treasury stock using the average cost method.

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

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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

On April 22, 1998, the stockholders ratified the adoption of the 1997 Stock Incentive Plan (the "Company Incentive Plan"), reserving 6,000,000 shares of Arch Coal common stock 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 (SARs), 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 elect to pay out in cash do not count against the 6,000,000 shares authorized in the 1997 Stock Incentive Plan.

Stock options generally become exercisable in full or in part 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 grant. SARs entitle employees to receive a payment equal to the appreciation in market value of the stated number of common shares from the SARs' exercise price to the market value of the shares on the date of its exercise. Unexercised options and SARs lapse 10 years after the date of grant. Restricted stock awards and restricted stock units entitle employees to purchase shares or stock units at a nominal cost. Such awards entitle employees to vote shares acquired and to receive any dividends thereon, but such shares cannot be sold or transferred and are subject to forfeiture if employees terminate their employment prior to the prescribed period, which can be from one to five years. Restricted stock units generally carry the same restrictions and potential forfeiture, but are generally paid in cash upon vesting. Merit awards are grants of stock without restriction and at a nominal cost. 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. Phantom stock awards are based on the appreciation of hypothetical underlying shares or the earnings performance of such shares and may be paid in cash or in shares of common stock.

As of December 31, 2000, performance units and stock options were the only types of awards granted. As of December 31, 2000, 2.1 million performance units had been granted under the plan. The performance awards will be earned by participants based on Company performance for .4 million and 1.7 million performance units for the years 1998 through 2001 and 2000 through 2003, respectively. The Company accrues for anticipated awards to be paid out in cash over the life of the award. Information regarding stock options under the Company Incentive Plan is as follows for the years ended December 31, 2000, 1999 and 1998:

		2000 Weighted Average Price		1999 Weighted Average Price
(in thousands except per share data)	Common Shares		Common Shares	
=====				

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Options outstanding at January 1	1,809	\$ 19.33	1,128	\$ 24.86
Granted	62	9.44	744	10.69
Exercised	(9)	10.69	-	-
Canceled	(273)	18.61	(63)	16.28

Options outstanding at December 31	1,589	19.11	1,809	19.33
=====				
Options exercisable at December 31	965	\$ 23.57	837	\$ 24.77
Options available for grant at December 31	4,305		4,094	

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The Company applies APB 25, Accounting for Stock Issued to Employees, 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. Had compensation expense for the fixed stock option portion of the Company Incentive Plan been determined based on the fair value at the grant dates for awards under this plan consistent with the method of FAS 123, Accounting for Stock-Based Compensation, the Company's net income (loss) and earnings (loss) per common share would have been changed to the pro forma amounts as indicated in the table below. The after-tax fair value of options granted in 2000, 1999 and 1998 was determined to be \$0.2 million, \$2.9 million and \$2.3 million, respectively, using the Black-Scholes option pricing model and the weighted average assumptions noted below. For purposes of these pro forma disclosures, the estimated fair value of the options is recognized as compensation expense over the options' vesting period. The stock options granted in 2000, 1999 and 1998 vest ratably over three, four and three years, respectively.

Year ended December 31 (in millions except per share data)	2000	1999	1998
=====			
As reported			
Net income (loss)	\$ (12.7)	\$ (346.3)	\$ 30.0
Basic and diluted earnings (loss) per share	(.33)	(9.02)	.76
Pro forma (unaudited)			
Net income (loss)	\$ (14.1)	\$ (347.7)	\$ 29.3
Basic and diluted earnings (loss) per share	(.37)	(9.06)	.74
Weighted average fair value per share of options granted	\$ 4.06	\$ 4.13	\$ 7.22
Assumptions (weighted average)			
Risk-free interest rate	5.1%	6.6%	6.0
Expected dividend yield	2.0%	2.0%	2.0
Expected volatility	51.2%	41.4%	31.8
Expected life (in years)	5.0	5.0	5.0

The table below shows pertinent information on options outstanding at December 31, 2000:

(Options in thousands)	Options Outstanding		
	Number	Weighted Average Remaining Contractual	Weighted Average
Range of			

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Exercise Prices	Outstanding	Life (Years)	Exercise Price	Exerci
\$ 8 - \$11	662	8.29	\$10.58	
\$22 - \$23	479	5.68	22.56	
\$25 - \$35	448	4.57	28.05	
<hr/>				
\$ 8 - \$35	1,589	6.46	\$19.11	

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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 foreign countries are immaterial. As of December 31, 2000 and 1999, accounts receivable from electric utilities located in the United States totaled \$112.2 million and \$120.2 million, 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 105.5 million tons of coal in 2000. Approximately 79% of this tonnage was sold under long-term contracts (contracts having a term of greater than one year) accounting for 78% of the Company's total revenue. Prices for coal sold under long-term contracts ranged from \$3.45 to \$52.95 per ton. Long-term contracts ranged in remaining life from one to 18 years. Some of these contracts include pricing which is above and, in some cases, materially above current market prices. The Company currently supplies coal under long-term coal supply contracts with one customer which have price renegotiation or modification provisions that take effect in mid-2001. The prices for coal shipped under these contracts are materially above the current market price for similar type coal. For the year ended December 31, 2000, approximately \$18.4 million of the Company's operating income related to these contracts. The Company expects income from operations to be reduced by approximately one-half of the operating income attributable to these contracts in 2001 and by the full amount of this operating income in 2002. These amounts are predicated on current market pricing and will change with market conditions. Sales (including spot sales) to major customers were as follows:

Year ended December 31 (in thousands)	2000	1999	1998
AEP	\$188,129	\$157,278	\$195,682
Southern Company	161,553	163,826	170,452

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17. EARNINGS (LOSS) PER SHARE

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

Year ended December 31 (in thousands except per share data)	2000
=====	
Numerator:	
Income (loss) before extraordinary loss and cumulative effect of accounting change	\$ (12,73
Extraordinary loss from the extinguishment of debt, net of taxes	
Cumulative effect of accounting change, net of taxes	

Net income (loss)	\$ (12,73
=====	
Denominator:	
Weighted average shares-denominator for basic	38,16
Dilutive effect of employee stock options	

Adjusted weighted average shares-denominator for diluted	38,16
=====	
Basic and diluted earnings (loss) per common share before extraordinary loss and cumulative effect of accounting change	\$ (.3
=====	
Basic and diluted earnings (loss) per common share	\$ (.3
=====	

At December 31, 2000, 1999 and 1998, 1.6 million, 1.8 million and 1.1 million shares, respectively, were not included in the diluted per share calculation since the exercise price is greater than the average market price.

18. SALE AND LEASEBACK

On June 30, 2000, the Company sold several shovels and continuous miners for \$14.9 million and leased back the equipment under operating and capital leases. The proceeds of the sales were used to pay down debt and for general corporate purposes. The shovels have been leased over a period of five years, while the continuous miners have been leased with terms ranging from two to five 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 of \$1.5 million was deferred and is being amortized over the base term of the lease as a reduction of lease expense.

On January 29, 1998, the Company sold mining equipment for approximately \$74.2 million and leased back the equipment under an operating lease with a term of three years. This included the sale and leaseback of equipment purchased under an existing operating lease that expired on the same day. The proceeds of the sale were used to purchase the equipment under the expired lease for \$28.3 million and to pay down debt. At the end of the lease term, the Company had the option to renew the lease for two additional one-year periods or purchase the equipment. Alternatively, the equipment could have been sold to a third party. The gain on the sale and

leaseback of \$10.7 million was deferred and is being amortized over the base term of the lease as a reduction of rental expense. Effective April 1, 1999 and February 4, 2000, the Company purchased for \$14.4 million and \$10.3 million, respectively, several pieces of equipment under lease that were included in this transaction. A pro-rata portion of the deferred gain, or \$3.4 million, was offset against the cost of the assets. On May 17, 2000, the Company purchased the remaining assets under the lease for \$34.7 million, which resulted in the termination of the lease. The remaining deferred gain of \$1.2 million was offset against the cost of the assets.

19. RELATED PARTY TRANSACTIONS

In the ordinary course of business, the Company receives certain services and purchases fuel, oil and other products on a competitive basis from subsidiaries of Ashland Inc., which totaled \$3.6 million in 2000, \$4.8 million in 1999 and \$7.2 million in 1998. Management believes that charges between the Company and Ashland Inc. for services and purchases were transacted on terms equivalent to those prevailing among unaffiliated parties. At December 31, 2000, Ashland Inc. owned approximately 12% of the Company's outstanding shares of common stock. On August 3, 2000, the Company received a written notice from Ashland Inc. pursuant to which Ashland Inc. exercised its demand registration rights under a Registration Rights Agreement, dated April 4, 1997, by and among the Company, Ashland Inc., Carboex International, Limited (now Carboex, S.A.) and the certain Hunt entities and requested that its remaining 4,756,968 shares be sold by means of an underwritten offering. Such shares were sold subsequent to year-end.

As described in Note 1, the Company has a 65% ownership interest in Canyon Fuel which is accounted for on the equity method. The Company receives administration and production fees from Canyon Fuel for managing the Canyon Fuel operations. The fee arrangement is calculated annually and is approved by the Canyon Fuel Management Board. The production fee is calculated on a per-ton basis, while the administration fee represents the costs incurred by Arch Coal employees related to Canyon Fuel administrative matters. The fees recognized as other income by the Company and as expense by Canyon Fuel were \$7.4 million, \$7.0 million and \$4.1 million for the years ended December 31, 2000, 1999 and 1998, respectively.

20. COMMITMENTS AND CONTINGENCIES

The Company leases equipment, land and various other properties under noncancelable long-term leases, expiring at various dates. Rental expense related to these operating leases amounted to \$22.7 million in 2000, \$42.2 million in 1999 and \$28.0 million in 1998. The decrease in rental expense is the result of the purchase of several assets during 2000 out of a sale and leaseback arrangement entered into in 1998 (see additional discussion in Note 18, "Sale and Leaseback"). In addition, the Company recorded an obligation for non-cancelable lease payments at its Dal-Tex operation during 1999 (see additional discussion in Note 2, "Changes in Estimates and Other Non-recurring Revenues and Expenses"). 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 October 1, 1998, the Company was the successful bidder in a federal auction of certain mining rights in the 3,546-acre Thundercloud tract in the Powder River Basin of Wyoming. The Company's lease bonus bid amounted to \$158 million for the tract, of which \$31.6 million was paid on October 1, 1998 and \$31.6 million was paid on January 3, 2000. The remaining lease bonus payments are

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reflected below under the caption "Royalties." The tract contains approximately 412 million tons of demonstrated coal reserves and is contiguous with the Company's Black Thunder mine. Geological surveys performed by outside consultants indicate that there are sufficient reserves relative to these properties to permit recovery of the Company's investment.

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Minimum payments due in future years under these agreements in effect at December 31, 2000 are as follows:

(in thousands)	Leases	Operating Leases and Royalties	
2001	\$ 16,990	\$ 60,050	\$
2002	12,431	62,773	
2003	10,556	62,603	
2004	6,619	30,205	
2005	6,506	26,807	
Thereafter	15,616	177,089	
	\$ 68,718	\$419,527	\$
Less amount representing interest			\$
Present value of net minimum lease payments under capital leases			
Current portion			
Long-term capitalized lease obligations			\$

Property, plant and equipment at year-end include the following amounts for capitalized leases:

December 31 (in thousands)	
Plant and equipment	\$
Accumulated amortization	
	\$

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. As of December 31, 2000, the Company had accrued \$2.5 million related to a settlement with the U.S. Department of the Interior associated with the 1996 impoundment failure at Lone

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Mountain. The Company expects to make the settlement payment during the first quarter of 2001. After conferring with counsel, it is the opinion of management that the ultimate resolution of these claims, to the extent not previously provided for, 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 \$10.9 million at December 31, 2000 (included in other noncurrent liabilities). Future payments for fixed operating costs and debt service are estimated to approximate \$3.3 million annually through 2015 and \$26.0 million in 2016.

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In connection with the Arch Western transaction, the Company entered into an agreement pursuant to which the Company agreed to indemnify another member of Arch Western against certain tax liabilities in the event that such liabilities arise as a result of certain actions taken prior to June 1, 2013, 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 Arch Western transaction. Depending on the time at which any such indemnification obligation was to arise, it could have a material adverse effect on the business, results of operations and financial condition of the Company.

21. CASH FLOW

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

Year ended December 31 (in thousands)	2000	1999	1998
=====			
Decrease (increase) in operating assets:			
Receivables	\$ 8,194	\$ 38,356	\$ (35,464)
Inventories	14,452	5,188	6,723
Increase (decrease) in operating liabilities:			
Accounts payable and accrued expenses	(4,515)	(15,593)	30,229
Income taxes	(2,683)	(76,952)	(35,057)
Accrued postretirement benefits other than pension	(7,330)	440	6,813
Accrued reclamation and mine closure	(10,941)	(20,767)	1,936
Accrued workers' compensation	(26,597)	(143)	149

Changes in operating assets and liabilities	\$ (29,420)	\$ (69,471)	\$ (24,671)
=====			

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22. ACCOUNTING DEVELOPMENT

In June 1998, the Financial Accounting Standards Board issued FAS 133, Accounting for Derivative Instruments and Hedging Activities, which is required to be adopted in years beginning after June 15, 2000. FAS 133 permits early adoption as of the beginning of any fiscal quarter after its issuance. FAS 133 will require the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of the derivative will either be offset against the change in fair value of the hedged assets, liabilities, or firm commitments through earnings or recognized in other comprehensive income until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value will be immediately recognized in earnings. FAS 133 will not have a significant impact on the financial position or results of operations of the Company.

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23. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Quarterly financial data for 2000 and 1999 is summarized below:

(in thousands)	March 31/(1)/	June 30/(1)/
2000:		
Coal sales, equity income and other revenues	\$ 357,801	\$ 340,153
Income from operations	2,898	19,966/(2) (3) /
Net income (loss)	(15,027)	(2,125)
Basic and diluted earnings (loss) per common share/(9)/	(0.39)	(0.06)
1999:		
Coal sales, equity income and other revenues	\$ 421,126	\$ 391,292
Income (loss) from operations	13,983/(6) /	20,739
Income (loss) before cumulative effect of accounting change	(2,380)	2,459
Net income (loss)	1,433/(7) /	2,459
Basic and diluted earnings (loss) per common share before cumulative effect of accounting change	(0.06)	0.06
Basic and diluted earnings (loss) per common share/(9)/	0.04	0.06

(1) At the West Elk underground mine in Gunnison County, Colorado, following the detection of combustion-related gases in a portion of the mine, the Company idled its operation on January 28, 2000. While it was idled, the Company incurred between \$4 million and \$6 million per month in after-tax losses at that mine. On July 12, 2000, after controlling the combustion-related gases, the Company resumed production at the West Elk mine and started to ramp up to normal levels of production. During the ramp-up process, the mine experienced geological conditions that hindered production during the fourth quarter. The Company recognized partial pre-tax insurance settlements of \$12.0 million during each of the second and third quarters of 2000 and \$7.0 million during the fourth quarter of 2000 which covered a

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portion of the losses incurred at West Elk during 2000. The Company expects to receive additional insurance payments under its property and business interruption policy. However, any additional recovery will depend on resolution of the claim with the insurance carrier, the timing of which is uncertain.

- (2) During the second quarter of 2000, as a result of permit revisions at Arch of Illinois, the Company reduced its reclamation liability at Arch of Illinois by \$7.8 million (pre-tax).
- (3) During the second quarter of 2000, the IRS issued a notice outlining the procedures for obtaining tax refunds on certain excise taxes paid by the industry on export sales tonnage. The notice was the result of a 1998 federal court decision that found such taxes to be unconstitutional. The Company recorded \$12.7 million of pre-tax income related to these excise tax recoveries.
- (4) During the fourth quarter of 2000, as a result of adjustments to employee postretirement medical benefits, the Company recognized \$9.8 million of pre-tax curtailment gains resulting from previously unrecognized postretirement benefit changes which occurred in prior years.
- (5) During the fourth quarter of 2000, the Company settled certain workers' compensation liabilities with the State of West Virginia partially offset by adjusting other workers' compensation liabilities resulting in a net pre-tax gain of \$13.0 million.
- (6) During the first quarter of 1999, the Company recorded a charge of \$6.5 million related to severance costs, obligations for non-cancelable lease payments and a change in the reclamation liability due to the shut-down of the Company's Dal-Tex operation.
- (7) During the first quarter of 1999, the Company changed its depreciation method on preparation plants and loadouts and recorded a cumulative effect adjustment which increased income by \$3.8 million (net of tax) from applying the new method for years prior to 1999.
- (8) During the fourth quarter of 1999, the Company recorded a one-time pre-tax charge of \$380.9 million to write-down the assets at its Dal-Tex, Hobet 21 and Coal-Mac operations and write-down certain other coal reserves in central Appalachia. Included in this charge was a \$16.3 million pre-tax charge related to the restructuring of the Company's administrative work force and the closure of mines in Illinois, Kentucky and West Virginia.
- (9) 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.

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SCHEDULE II--VALUATION AND QUALIFYING ACCOUNTS
(In thousands)

Description -----	Balance at Beginning of Year	Additions Charged to Costs and Expenses	Deductions(1)	Other(2)	Balance at End of Year -----
Year Ended December 31, 2000.....					
Reserves Deducted from Asset Accounts.....					
Other Assets--Other Notes and Accounts Receivable.....	541	--	482	--	59
Current Assets-- Supplies Inventory...	23,542	4,223	7,926	--	19,839
Year Ended December 31, 1999.....					
Reserves Deducted from Asset Accounts.....					
Other Assets--Other Notes and Accounts Receivable.....	582	325	366	--	541
Current Assets-- Supplies Inventory...	23,901	5,966	6,325	--	23,542
Year Ended December 31, 1998.....					
Reserves Deducted from Asset Accounts.....					
Other Assets--Other Notes and Accounts Receivable.....	471	306	195	--	582
Current Assets-- Supplies Inventory...	17,681	2,292	5,999	9,927	23,901

(1) Reserves utilized, unless otherwise indicated.

(2) Balances acquired in the Arch Western transaction.

EXHIBIT INDEX

Exhibit No. -----	Description -----
23.2	Consent of PricewaterhouseCoopers LLP
23.3	Consent of Ernst & Young LLP