

CLOUD PEAK ENERGY INC.

Form 10-Q

October 26, 2012

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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

## FORM 10-Q

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2012

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-34547

Commission File Number: 333-168639

**Cloud Peak Energy Inc.**

**Cloud Peak Energy Resources LLC**

(Exact name of registrant as specified in its charter)

<p><b>Delaware</b>  <b>Delaware</b>                  (State or other jurisdiction of                  incorporation or organization)</p> <p><b>505 S. Gillette Ave., Gillette, Wyoming</b>                  (Address of principal executive offices)</p>	<p><b>26-3088162</b>  <b>26-4073917</b>                  (I.R.S. Employer                  Identification No.)</p> <p><b>82716</b>                  (Zip Code)</p>
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**(307) 687-6000**

(Registrant's telephone number, including area code)

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.

Cloud Peak Energy Inc.	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
Cloud Peak Energy Resources LLC	Yes <input type="checkbox"/> No <input type="checkbox"/>

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Cloud Peak Energy Inc.	Yes <input checked="" type="checkbox"/> No <input type="checkbox"/>
Cloud Peak Energy Resources LLC	Yes <input type="checkbox"/> No <input type="checkbox"/>

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

	Large accelerated filer	Accelerated filer	Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
Cloud Peak Energy Inc.	x	o	o	o
Cloud Peak Energy Resources LLC	o	o	x	o

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Cloud Peak Energy Inc.

Yes  No

Cloud Peak Energy Resources LLC

Yes  No

Number of shares outstanding of Cloud Peak Energy Inc.'s common stock, as of the latest practicable date: Common stock, \$0.01 par value per share, 61,102,969 shares outstanding as of October 18, 2012. 100% of the common membership units of Cloud Peak Energy Resources LLC outstanding as of October 18, 2012 are held by Cloud Peak Energy Inc.

This combined Form 10-Q is separately filed by Cloud Peak Energy Inc. and Cloud Peak Energy Resources LLC. Cloud Peak Energy Resources LLC meets the conditions set forth in General Instruction H(1)(a) and (b) of Form 10-Q and is therefore filing this form with the reduced disclosure format allowed under that General Instruction.

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**CLOUD PEAK ENERGY INC. AND  
CLOUD PEAK ENERGY RESOURCES LLC**

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**Explanatory Note**

This combined Form 10-Q is filed by Cloud Peak Energy Inc. and Cloud Peak Energy Resources LLC. Each Registrant hereto is filing on its own behalf all of the information contained in this report that relates to such Registrant. Each Registrant hereto is not filing any information that does not relate to such other Registrant, and therefore makes no representation as to any such information. Cloud Peak Energy Resources LLC is the sole direct subsidiary of Cloud Peak Energy Inc., providing 100% of Cloud Peak Energy Inc.'s total consolidated revenue for the three and

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nine months ended September 30, 2012 and constituting nearly 100% of Cloud Peak Energy Inc.'s total consolidated assets as of September 30, 2012.

Unless the context indicates otherwise, the terms Cloud Peak Energy, the Company, we, us, and our refer to both Cloud Peak Energy Inc. and Cloud Peak Energy Resources LLC and their subsidiaries. Discussions or areas of this report that either apply only to Cloud Peak Energy Inc. or Cloud Peak Energy Resources LLC are clearly noted in such sections.

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements.****CLOUD PEAK ENERGY INC.****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF  
OPERATIONS AND COMPREHENSIVE INCOME**

(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues	\$ 425,861	\$ 406,950	\$ 1,141,947	\$ 1,151,174
<b>Costs and expenses</b>				
Cost of product sold (exclusive of depreciation, depletion, amortization and accretion, shown separately)	301,945	306,533	850,963	855,551
Depreciation and depletion	24,661	24,289	70,337	58,537
Accretion	3,257	2,984	9,327	9,420
Derivative financial instruments	(1,334)		(19,461)	
Selling, general and administrative expenses	15,698	12,971	43,397	38,905
Total costs and expenses	344,227	346,777	954,563	962,413
Operating income	81,634	60,173	187,384	188,761
<b>Other income (expense)</b>				
Interest income	189	143	948	459
Interest expense	(11,671)	(6,848)	(25,457)	(27,520)
Tax agreement benefit (expense)	29,000	22,878	29,000	(19,855)
Other, net	(335)	(103)	(388)	(34)
Total other income (expense)	17,183	16,070	4,103	(46,950)
Income before income tax provision and earnings from unconsolidated affiliates	98,817	76,243	191,487	141,811
Income tax (expense) benefit	(13,601)	(52,162)	(47,509)	2,025
Earnings from unconsolidated affiliates, net of tax	44	530	1,579	2,142
Net income	85,260	24,611	145,557	145,978
<b>Other comprehensive income</b>				
Retiree medical plan amortization of prior service cost	394	326	1,272	978
Tax on amortization of prior service cost	(142)	(117)	(458)	(352)
Other comprehensive income	252	209	814	626
Total comprehensive income	\$ 85,512	\$ 24,820	\$ 146,371	\$ 146,604
<b>Net income per common share:</b>				
Basic	\$ 1.42	\$ 0.41	\$ 2.43	\$ 2.43
Diluted	\$ 1.39	\$ 0.41	\$ 2.39	\$ 2.41

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Weighted-average shares outstanding - basic	60,044	60,007	60,020	60,003
Weighted-average shares outstanding - diluted	61,142	60,645	60,923	60,606

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

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**CLOUD PEAK ENERGY INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands)

	September 30, 2012 (unaudited)	December 31, 2011 (audited)
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 185,505	\$ 404,240
Investments in marketable securities	80,331	75,228
Restricted cash		71,245
Accounts receivable	106,300	95,247
Due from related parties	2,823	471
Inventories, net	82,083	71,648
Deferred income taxes	37,216	37,528
Derivative financial instruments	20,730	2,275
Other assets	22,114	13,019
Total current assets	537,102	770,901
<b>Noncurrent assets</b>		
Property, plant and equipment, net	1,643,397	1,350,135
Goodwill	35,634	35,634
Deferred income taxes	95,044	132,828
Other assets	33,621	29,821
Total assets	\$ 2,344,798	\$ 2,319,319
<b>LIABILITIES AND EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 69,317	\$ 71,427
Royalties and production taxes	144,811	136,072
Accrued expenses	53,774	65,928
Current portion of tax agreement liability	25,097	19,113
Current portion of federal coal lease obligations	63,191	102,198
Other liabilities	2,669	4,971
Total current liabilities	358,859	399,709
<b>Noncurrent liabilities</b>		
Tax agreement liability, net of current portion	116,539	151,523
Senior notes	596,397	596,077
Federal coal lease obligations, net of current portion	122,928	186,119
Asset retirement obligations, net of current portion	197,732	192,707
Other liabilities	46,098	42,795
Total liabilities	1,438,553	1,568,930
Commitments and Contingencies (Note 11)		
<b>Equity</b>		
Common stock (\$0.01 par value; 200,000 shares authorized; 61,104 and 60,923 shares issued and outstanding at September 30, 2012 and December 31, 2011, respectively)	611	609
Additional paid-in capital	545,784	536,301
Retained earnings	377,650	232,093
Accumulated other comprehensive loss	(17,800)	(18,614)
Total equity	906,245	750,389
Total liabilities and equity	\$ 2,344,798	\$ 2,319,319



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

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## CLOUD PEAK ENERGY INC.

## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	Nine Months Ended September 30,	
	2012	2011
<b>Cash flows from operating activities</b>		
Net income	\$ 145,557	\$ 145,978
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and depletion	70,337	58,537
Accretion	9,327	9,420
Earnings from unconsolidated affiliates	(1,579)	(2,142)
Distributions of income from unconsolidated affiliates	1,000	2,000
Deferred income taxes	36,747	(9,781)
Tax agreement expense	(29,000)	19,855
Stock compensation expense	9,485	6,315
Unrealized derivative income	(19,461)	
Other	8,804	8,920
Changes in operating assets and liabilities:		
Accounts receivable	(11,052)	(32,289)
Inventories	(9,970)	(7,561)
Due to or from related parties	(2,351)	(948)
Other assets	(8,608)	(4,539)
Accounts payable and accrued expenses	7,585	23,561
Asset retirement obligations	(4,867)	(4,851)
Net cash provided by operating activities	201,954	212,475
<b>Investing activities</b>		
Acquisition of Youngs Creek and CX Ranch coal and land assets	(300,377)	
Purchases of property, plant and equipment	(36,445)	(82,050)
Cash paid for capitalized interest	(42,877)	(18,772)
Investments in marketable securities	(58,611)	
Maturity and redemption of investments	53,508	
Initial payments on federal coal leases		(69,407)
Return of restricted cash	71,244	107,887
Partnership escrow deposit	(4,470)	
Other	1,847	545
Net cash used in investing activities	(316,181)	(61,797)
<b>Financing activities</b>		
Principal payments on federal coal leases	(102,198)	(50,902)
Other	(2,310)	(2,317)
Net cash used in financing activities	(104,508)	(53,219)
Net decrease in cash and cash equivalents	(218,735)	97,459
Cash and cash equivalents at beginning of period	404,240	340,101
Cash and cash equivalents at end of period	\$ 185,505	\$ 437,560
<b>Supplemental cash flow disclosures</b>		
Interest paid	\$ 57,911	\$ 36,405
Non-cash interest capitalized	\$ 7,445	\$ 17,168
Income taxes paid	\$ 22,017	\$ 6,161

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

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**CLOUD PEAK ENERGY RESOURCES LLC**  
**(SUBSIDIARY OF CLOUD PEAK ENERGY INC.)**  
**UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF**  
**OPERATIONS AND COMPREHENSIVE INCOME**

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Revenues	\$ 425,861	\$ 406,950	\$ 1,141,947	\$ 1,151,174
<b>Costs and expenses</b>				
Cost of product sold (exclusive of depreciation, depletion, amortization and accretion, shown separately)	301,945	306,533	850,963	855,551
Depreciation and depletion	24,661	24,289	70,337	58,537
Accretion	3,257	2,984	9,327	9,420
Derivative financial instruments	(1,334)		(19,461)	
Selling, general and administrative expenses	15,698	12,971	43,397	38,905
Total costs and expenses	344,227	346,777	954,563	962,413
Operating income	81,634	60,173	187,384	188,761
<b>Other income (expense)</b>				
Interest income	189	143	948	459
Interest expense	(11,671)	(6,848)	(25,457)	(27,520)
Other, net	(335)	(103)	(388)	(34)
Total other expense	(11,817)	(6,808)	(24,897)	(27,095)
Income before income tax provision and earnings from unconsolidated affiliates	69,817	53,365	162,487	161,666
Income tax expense	(3,160)	(45,276)	(37,069)	(6,473)
Earnings from unconsolidated affiliates, net of tax	44	530	1,579	2,142
Net income	66,701	8,619	126,997	157,335
<b>Other comprehensive income</b>				
Retiree medical plan amortization of prior service cost	394	326	1,272	978
Tax on amortization of prior service cost	(142)	(117)	(458)	(352)
Other comprehensive income	252	209	814	626
Total comprehensive income	\$ 66,953	\$ 8,828	\$ 127,811	\$ 157,961

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

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**CLOUD PEAK ENERGY RESOURCES LLC**  
**(SUBSIDIARY OF CLOUD PEAK ENERGY INC.)**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**(in thousands)**

	September 30, 2012 (unaudited)	December 31, 2011 (audited)
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	\$ 185,505	\$ 404,240
Investments in marketable securities	80,331	75,228
Restricted cash		71,245
Accounts receivable	106,300	95,247
Inventories, net	82,083	71,648
Deferred income taxes	28,181	30,648
Derivative financial instruments	20,730	2,275
Other assets	22,009	12,610
Total current assets	525,139	763,141
<b>Noncurrent assets</b>		
Property, plant and equipment, net	1,643,397	1,350,135
Goodwill	35,634	35,634
Deferred income taxes	53,090	78,280
Other assets	33,573	29,773
Total assets	\$ 2,290,833	\$ 2,256,963
<b>LIABILITIES AND EQUITY</b>		
<b>Current liabilities</b>		
Accounts payable	\$ 69,280	\$ 71,377
Royalties and production taxes	144,811	136,072
Accrued expenses	51,697	51,799
Due to related parties	22,790	27,420
Current portion of federal coal lease obligations	63,191	102,198
Other liabilities	2,670	4,971
Total current liabilities	354,439	393,837
<b>Noncurrent liabilities</b>		
Senior notes	596,397	596,077
Federal coal lease obligations, net of current portion	122,928	186,119
Asset retirement obligations, net of current portion	197,732	192,707
Other liabilities	46,099	42,795
Total liabilities	1,317,595	1,411,535
Commitments and Contingencies (Note 11)		
<b>Equity</b>		
Member's equity	991,039	864,042
Accumulated other comprehensive loss	(17,801)	(18,614)
Total member's equity	973,238	845,428
Total liabilities and member's equity	\$ 2,290,833	\$ 2,256,963

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

Table of Contents**CLOUD PEAK ENERGY RESOURCES LLC****(SUBSIDIARY OF CLOUD PEAK ENERGY INC.)****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)**

	Nine Months Ended September 30,	
	2012	2011
<b>Cash flows from operating activities</b>		
Net income	\$ 126,997	\$ 157,335
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and depletion	70,337	58,537
Accretion	9,327	9,420
Earnings from unconsolidated affiliates	(1,579)	(2,142)
Distributions of income from unconsolidated affiliates	1,000	2,000
Deferred income taxes	26,308	972
Unrealized derivative income	(19,461)	
Other, net	8,804	8,920
Changes in operating assets and liabilities:		
Accounts receivable	(11,052)	(32,289)
Inventories	(9,970)	(7,561)
Due to or from related parties	(4,630)	2,853
Other assets	(8,911)	(6,733)
Accounts payable and accrued expenses	19,651	26,177
Asset retirement obligations	(4,867)	(4,851)
Net cash provided by operating activities	201,954	212,638
<b>Investing activities</b>		
Acquisition of Youngs Creek and CX Ranch coal and land assets	(300,377)	
Purchases of property, plant and equipment	(36,445)	(82,050)
Cash paid for capitalized interest	(42,877)	(18,772)
Investments in marketable securities	(58,611)	
Maturity and redemption of investments	53,508	
Initial payments on federal coal leases		(69,407)
Return of restricted cash	71,244	107,887
Partnership escrow deposit	(4,470)	
Other	1,847	545
Net cash used in investing activities	(316,181)	(61,797)
<b>Financing activities</b>		
Principal payments on federal coal leases	(102,198)	(50,902)
Member distributions		(162)
Other	(2,310)	(2,317)
Net cash used in financing activities	(104,508)	(53,381)
Net decrease in cash and cash equivalents	(218,735)	97,460
Cash and cash equivalents at beginning of period	404,240	340,100
Cash and cash equivalents at end of period	\$ 185,505	\$ 437,560
<b>Supplemental cash flow disclosures for continuing operations:</b>		
Interest paid	\$ 57,911	\$ 36,405
Non-cash interest capitalized	\$ 7,445	\$ 17,168

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Income taxes paid	\$	22,017	\$	6,161
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The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.



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**CLOUD PEAK ENERGY INC. AND**

**CLOUD PEAK ENERGY RESOURCES LLC**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. Basis of Presentation**

*Business, Principles of Consolidation, and Use of Estimates*

We are one of the largest producers of coal in the United States of America ( U.S. ) and in the Powder River Basin ( PRB ) based on 2011 coal sales. We operate some of the safest mines in the coal industry. According to Mine Safety and Health Administration ( MSHA ) data, in 2011, we had one of the lowest employee all injury incident rates among the largest U.S. coal producing companies. We currently operate solely in the PRB, the lowest cost region of the major coal producing regions in the U.S., and operate two of the four largest coal mines in the U.S. Our operations include three wholly-owned surface coal mines, two of which, the Antelope mine and the Cordero Rojo mine, are in Wyoming and one of which, the Spring Creek mine, is in Montana. We also own a 50% non-operating interest in a fourth surface coal mine in Montana, the Decker mine. We also own rights to substantial undeveloped coal and complimentary surface assets in the Northern PRB, further building our long-term position to serve Asian export and domestic customers. We produce subbituminous thermal coal with low sulfur content and sell our coal primarily to domestic and foreign electric utilities.

We consolidate the accounts of entities in which we have a controlling financial interest under the voting control model. We account for our 50% non-operating interest in Decker Coal Company ( Decker ) using the proportionate consolidation method, whereby our share of Decker's assets, liabilities, revenues and expenses are included in our consolidated financial statements. Investments in other entities that we do not control but have the ability to exercise significant influence over the investee's operating and financial policies, are accounted for under the equity method. All intercompany balances and transactions have been eliminated in the consolidated financial statements.

The accompanying unaudited condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the U.S. ( U.S. GAAP ). The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect reported amounts. These estimates and assumptions are based on information available as of the date of the financial statements. Accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results of operations for the three months and nine months ended September 30, 2012 are not necessarily indicative of results that can be expected for the full year. Please refer to the section entitled Critical Accounting Policies and Estimates of Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2011 ( 2011 Form 10-K ) for a discussion of our critical accounting policies and estimates.

Cloud Peak Energy, we, us, our or the Company refer collectively to Cloud Peak Energy Inc. ( CPE Inc. ), Cloud Peak Energy Resources LLC ( CPE Resources ) and their subsidiaries. Unless separately stated, the notes herein relate to both CPE Inc. and CPE Resources.

*Basis of Presentation*

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CPE Inc. conducts all of its business through CPE Resources and its subsidiaries. CPE Inc.'s consolidated financial statements are substantially identical to CPE Resources' consolidated financial statements, with the following exceptions:

- Tax Receivable Agreement (see Note 7) and deferred tax assets relating thereto (see Note 10)
- Earnings per share (see Note 14)
- Equity-based compensation (see Note 16)
- Supplemental guarantor information (see Note 17)

The year-end condensed consolidated balance sheet data was derived from audited consolidated financial statements, but does not include all footnote disclosures required by U.S. GAAP. In accordance with U.S. GAAP for interim financial statements, these unaudited condensed consolidated financial statements do not include certain information and note disclosures that are normally included in annual financial statements prepared in conformity with U.S. GAAP. Accordingly, these unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements as of December 31, 2011 and 2010, and for each of the three years ended December 31, 2011, included in our 2011 Form 10-K. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, which are of a normal and recurring nature, necessary to present fairly the financial position as of September 30, 2012, and the results of operations and comprehensive income for the three and nine months

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**CLOUD PEAK ENERGY INC. AND**

**CLOUD PEAK ENERGY RESOURCES LLC**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

ended September 30, 2012 and 2011, and the cash flows for the nine months ended September 30, 2012 and 2011, in conformity with U.S. GAAP.

Due to the tabular presentation of rounded amounts, certain tables reflect insignificant rounding differences.

**2. Accounting Policies and Standards Update**

*Recently Issued Accounting Pronouncements*

From time to time, the Financial Accounting Standards Board ( FASB ) or other standard setting bodies issue new accounting pronouncements. Updates to the FASB Accounting Standards Codification are communicated through issuance of an Accounting Standards Update ( ASU ). Unless otherwise discussed, we believe that the impact of recently issued guidance, whether adopted or to be adopted in the future, is not expected to be material to our condensed consolidated financial statements upon adoption.

*Other Comprehensive Income*

In June 2011, the FASB issued ASU 2011-05, *Presentation of Comprehensive Income*, which amends current comprehensive income guidance. The update eliminates the option to present the components of other comprehensive income as part of the statement of stockholders' equity. Instead, an entity is required to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance is now effective for us. The guidance impacts our disclosures, but it does not impact our results of operations, financial condition, or cash flows.

**3. Asset Acquisitions**

On June 29, 2012, we completed our acquisition of the Youngs Creek Mining Company, LLC ( Youngs Creek ) joint venture and other related coal and surface assets, including CX Ranch, from Chevron U.S.A. Inc. ( Chevron ) and CONSOL Energy Inc. ( CONSOL ) for \$300 million. The acquisition expands our mineral assets to serve the domestic and international markets. This was an asset acquisition. The full amount of the

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consideration paid is recorded within the Land, Surface Rights, and Mineral Rights line item of Property, Plant, and Equipment. We utilized available cash on hand to fund the acquisition.

Future development timing and production levels are expected to depend largely on the availability of additional export terminal capacity on the West Coast and continued strong Asian demand for thermal coal.

Securities and Exchange Commission Industry Guide 7 provides guidance for economic modeling to support classification of coal assets as proven and probable reserves. The completion of such a model for Youngs Creek will require additional exploration and market factors to support a definitive mine plan for the development of the property. At present, there are a number of alternatives we are considering with respect to the development of this property. Consequently, we are unable to complete a definitive mine plan for the property at this time. As a result, we are not able to classify the coal assets as proven and probable reserves; we are not in a position to reasonably estimate any additional taxable income attributable to the development and operation of a mine; and no update was made to the tax agreement liability during the nine months ended September 30, 2012 relating to this acquisition (see Note 7). We will continue to evaluate the many development options for these assets and expect to update our proven and probable reserves and the tax agreement liability when definitive mine plans are sufficiently advanced.

As Youngs Creek is an undeveloped, greenfield surface mine project, there are no revenues or income related to the acquired properties.

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**4. Inventories**

Inventories, net, consisted of the following (in thousands):

	September 30, 2012	December 31, 2011
Materials and supplies	\$ 76,449	\$ 67,461
Less: Obsolescence allowance	(947)	(643)
Material and supplies, net	75,502	66,818
Coal inventory	6,581	4,830
Inventories, net	\$ 82,083	\$ 71,648

**5. Derivatives**

We are exposed to various types of risk in the normal course of business, including fluctuations in commodity prices. During 2011, we commenced the use of commodity contracts to manage certain exposures to international coal prices.

In addition, during the second quarter of 2012, we commenced the use of costless collars to help manage our exposure to market changes in diesel fuel prices. The collars are indexed to the West Texas Intermediate ( WTI ) crude oil price as quoted on the New York Mercantile Exchange. As such, the nature of the collar does not directly offset market changes to our diesel costs. Under a collar agreement, we pay the difference between the index price and a floor price if the index price is below the floor, and we receive the difference between the ceiling price and the index price if the index price is above the ceiling price. No amounts are paid or received if the index price is between the floor and ceiling prices. While we would not receive the full benefit of extreme price decreases, the collars mitigate the risk of extreme crude oil price increases and thereby increased diesel costs that would otherwise have a negative impact on our cash flow.

All of our derivative financial instruments are recognized in the balance sheet at fair value. As mark-to-market accounting is applied, unrealized changes in the fair value of the derivative financial instruments are included in Operating income on the condensed consolidated statements of operations and comprehensive income each period.

We held derivative financial instruments for risk management purposes as follows (in thousands except per barrel amounts):

**International Coal Forward Contracts**

Year of Settlement	Notional Amount (tons)	September 30, 2012		December 31, 2011		
		Asset	Liability	Notional Amount (tons)	Asset	Liability
2012	255	\$ 5,760	\$	215	\$ 1,090	\$
2013	712	11,350		322	1,185	
2014	198	2,028				
2015	212	1,242				
<b>Total</b>	<b>1,377</b>	<b>\$ 20,381</b>	<b>\$</b>	<b>537</b>	<b>\$ 2,275</b>	<b>\$</b>

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**WTI Collars**

Period	Notional Amount (barrels)	September 30, 2012		Asset	Liability
		Floor	Weighted-Average Ceiling		
October 2012 to March 2013	258	\$ 66.24	\$ 105.47	\$ 228	\$
April 2013 to June 2013	126	70.30	110.43	121	
Total	384	\$ 67.58	\$ 107.10	\$ 349	\$

As of December 31, 2011, there were no WTI collars.

Unrealized and realized gains (losses) on derivative financial instruments consisted of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Unrealized gains (losses)(1)	\$ 1,334	\$ 38	\$ 19,461	\$ 38
Realized gains (losses)(2)	\$ 483	\$	\$ 1,007	\$

(1) Derivative mark-to-market gains and losses reflected on the statement of operations.

(2) Derivative cash settlement gains and losses reflected within operating cash flows.

See Note 6 for a discussion related to the fair value of derivative financial instruments.

## 6. Fair Value of Financial Instruments

Due to the short term nature of certain of our financial instruments, including cash and cash equivalents, restricted cash, accounts receivable, amounts due from related parties, accounts payable, and certain current liabilities, we believe that their historical cost approximated fair value.

We also held investments in marketable securities and derivative financial instruments that we assessed and reported on our balance sheet at fair value as of September 30, 2012 and December 31, 2011. We use a three-level fair value hierarchy that categorizes assets and liabilities measured at fair value based on the observability of the inputs utilized in the valuation. The levels of the hierarchy, as defined below, give the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

- Level 1 is defined as observable inputs such as quoted prices in active markets for identical assets. Level 1 assets include investments in trading securities, primarily asset-backed securities.
- Level 2 is defined as observable inputs other than Level 1 prices. These include quoted prices for similar assets or liabilities in an active market, quoted prices for identical assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Our Level 2 assets and liabilities include derivative financial instruments with fair values derived from quoted prices in over-the-counter markets or from prices received from direct broker quotes.
- Level 3 is defined as unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions. We had no Level 3 investments as of September 30, 2012 or December 31, 2011.



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The tables below set forth, by level, our financial assets and liabilities that are recorded at fair value in the accompanying condensed consolidated balance sheets (in thousands). As required by accounting guidance, assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Description	Fair Value at September 30, 2012			Total
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Money market funds(1)	\$ 145,307	\$	\$	\$ 145,307
Commercial paper and short-term marketable securities(1)	\$	\$	\$	\$
Derivative financial instruments	\$	\$ 20,730	\$	\$ 20,730
Investments in marketable securities	\$	\$ 80,331	\$	\$ 80,331

Description	Fair Value at December 31, 2011			Total
	Level 1	Level 2	Level 3	
<b>Assets</b>				
Money market funds(1)	\$ 238,812	\$	\$	\$ 238,812
Commercial paper and short-term marketable securities(1)	\$	\$ 45,897	\$	\$ 45,897
Derivative financial instruments	\$	\$ 2,275	\$	\$ 2,275
Investments in marketable securities	\$	\$ 75,228	\$	\$ 75,228

(1) Included in cash and cash equivalents in the consolidated balance sheets along with \$40.2 million and \$119.5 million of demand deposits at September 30, 2012 and December 31, 2011, respectively.

We did not have any transfers between levels during the three and nine months ended September 30, 2012. Our policy is to value all transfers between levels using the beginning of period valuation.

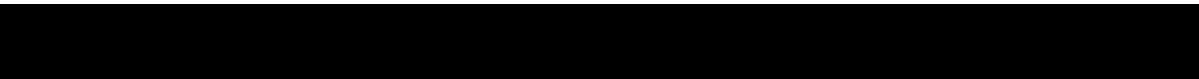
**7. Tax Receivable Agreement (CPE Inc. only)**

In connection with the initial public offering ( IPO ), CPE Inc. entered into a Tax Receivable Agreement with Rio Tinto Energy America Inc. ( Rio Tinto ), our former parent, and recognized a liability for the undiscounted amounts that CPE Inc. estimated will be paid to Rio Tinto under this agreement. The amounts to be paid will be determined based on an annual calculation of future income tax savings that CPE Inc. actually realizes as a result of the tax basis increase that resulted from the IPO and Secondary Offering transactions. Generally, CPE Inc. retains 15% of the realized tax savings generated from the tax basis step-up and Rio Tinto is entitled to the remaining 85%. Periodically, CPE Inc. adjusts the

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estimated liability to reflect updated forecasts of future taxable income, and these adjustments, which could be significant, are reflected in CPE Inc.'s operating results. The estimated liability is based on forecasts of future taxable income over the anticipated life of the mining operations and reclamation activities, assuming no additional proven and probable coal reserves are acquired. The assumptions reflected in CPE Inc.'s estimates involve significant judgment and are subject to substantial uncertainty about future business operations. As such, the actual amount and timing of payments that are required to be made under the Tax Receivable Agreement could differ materially from our estimates.

The following table summarizes 2012 tax agreement liability activity (in thousands):

			
Beginning balance, December 31, 2011	\$	170,636	\$ 61,429
Annual update		(29,000)	(10,440)
Ending balance, September 30, 2012	\$	141,636	\$ 50,989

During the three months ended September 30, 2012, CPE Inc. completed its annual update of its operating plans, inclusive of market and cash cost forecasts, and calculation of the resulting amount and timing of estimated future taxable income. Because of the reduced future tax value expected to be received, there was a decrease in the estimated liability due to Rio Tinto under the Tax Receivable Agreement, resulting in a benefit to non-operating income for the three months ended September 30, 2012. Related adjustments to the net value of deferred tax assets were recorded through income tax expense.

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The coal acquired as part of the Youngs Creek acquisition, as discussed in Note 3, is not anticipated to be classified as proven and probable reserves at December 31, 2012; therefore, no adjustment was made to the liability for this coal asset acquisition as we are unable to make a reasonable estimate of the expected additional taxable income resulting from the development of these assets until definitive mine plans are sufficiently advanced. The TRA will be adjusted in the period when sufficient certainty is achieved for Youngs Creek coal classification as proven and probable reserves.

Based on our estimates as of September 30, 2012, CPE Inc. is expected to make payments to Rio Tinto of \$25.1 million in 2012, payments averaging approximately \$15 million each year during 2013 to 2016, and additional payments in subsequent years. CPE Inc. is obligated to make these payments and expects to obtain funding for these payments by causing CPE Resources to distribute cash to CPE Inc. CPE Inc.'s payments under the Tax Receivable Agreement would be greater if CPE Resources generates taxable income significantly in excess of its current estimated future taxable income over the anticipated life of its mines; for example, if CPE Resources's proven and probable coal reserves increase beyond its existing tonnage and, as a result, CPE Inc. realizes the full tax benefit of such increased tax bases (or an increased portion thereof). Required payments under the Tax Receivable Agreement also may increase or become accelerated as a result of certain asset transfers outside the ordinary course of business, a change in control of CPE Resources, or a default by CPE Inc.

**8. Long-Term Debt**

Long-term debt consisted of the following (in thousands):

	September 30, 2012			December 31, 2011		
	Principal	Carrying Value	Fair Value(1)	Principal	Carrying Value	Fair Value(1)
8.25% Senior Notes due 2017, net of unamortized discount	\$ 300,000	\$ 298,411	\$ 326,064	\$ 300,000	\$ 298,237	\$ 327,750
8.50% Senior Notes due 2019, net of unamortized discount	300,000	297,986	329,250	300,000	297,841	327,750
Total long-term debt	\$ 600,000	\$ 596,397	\$ 655,314	\$ 600,000	\$ 596,077	\$ 655,500

(1) The fair value of the senior notes was based on observable market inputs, which are considered Level 2 in the fair value hierarchy.

**9. Other Long-Term Obligations***Federal Coal Lease Obligations*

Federal coal lease obligations consisted of (in thousands):

	September 30, 2012	December 31, 2011
Federal coal lease obligations, current	\$ 63,191	\$ 102,198
Federal coal lease obligations, noncurrent	122,928	186,119
Total federal coal lease obligations	\$ 186,119	\$ 288,317

Our federal coal lease obligations, as reflected in the consolidated balance sheets, consist of obligations payable to the Bureau of Land Management of the U.S. Department of the Interior (the BLM ) discounted at an imputed interest rate. Imputed interest is included in accrued expenses.

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We have federal coal lease payments, as follows (dollars in thousands):

Payment Dates	Annual Payment	Imputed Interest Rate	September 30, 2012		December 31, 2011	
			Carrying Value	Fair Value(1)	Carrying Value	Fair Value(1)
August 1, 2008 - 2012	\$ 50,160	7.50%	\$ 8,852	\$ 9,433	\$ 46,661	\$ 48,867
May 1, 2009 - 2013	\$ 9,620	8.70%	8,852	9,433	16,998	18,517
July 1, 2011 - 2015	\$ 59,545	8.50%	152,079	165,934	192,892	215,796
September 1, 2011 - 2015	\$ 9,862	8.50%	25,189	27,286	31,766	35,293
			\$ 186,119	\$ 202,653	\$ 288,317	\$ 318,473

(1) The fair value of estimates for federal coal lease obligations were determined by discounting the remaining lease payments using the then current estimate of the credit-adjusted, risk-free rate based on our then current credit rating, which are considered Level 2 in the fair value hierarchy.

Future payments on federal coal leases are as follows (in thousands):

Year Ended December 31,	
2013	79,027
2014	69,407
2015	69,407
Total	217,841
Less: imputed interest	31,722
Total principal payments	186,119
Less: current portion	63,191
Long-term federal coal leases payable	\$ 122,928

**Other**

Other long-term obligations include liabilities incurred in connection with the acquisition of land and mineral rights. We had the following purchase obligations with parties other than the BLM (dollars in thousands):

September 30,

December 31,

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	2012		2011	
Purchase obligations, total	\$	4,257	\$	6,567
Interest rate		6% - 8%		6% - 8%

The fair value of other long-term obligations approximated its carrying amount at September 30, 2012 and December 31, 2011.

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Our income from continuing operations before income tax provision and earnings from unconsolidated affiliates is earned solely in the U.S. The following table summarizes income taxes (dollars in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Income tax benefit (expense) (CPE Inc.)	\$ (13,601)	\$ (52,162)	\$ (47,509)	\$ 2,025
Effective tax rate (CPE Inc.)	13.8%	68.4%	24.8%	(1.4)%
Income tax benefit (expense) (CPE Resources)	\$ (3,160)	\$ (45,276)	\$ (37,069)	\$ (6,473)
Effective tax rate (CPE Resources)	4.5%	84.8%	22.8%	4.0%

Our statutory income tax rate, including state income taxes, is 36%. The difference between the statutory income tax rate and our effective tax rate for the three and nine months ended September 30, 2012 and 2011 is due primarily to changes in our deferred tax valuation allowance resulting from the third quarter annual calculation of our estimate of future taxable income.

**11. Commitments and Contingencies***Commitments**Purchase Commitments*

As of September 30, 2012, we had outstanding capital purchase commitments which consisted of (in thousands):

September 30, 2012	December 31, 2011
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<b>Capital commitments</b>			
Equipment	\$	18,069	\$ 8,637
Land		23,700	23,700
<b>Supplies and services</b>			
Coal purchase commitments	\$	31,874	\$ 5,652
Transportation agreements		161,414	135,080
Materials and supplies		22,871	29,641

**Contingencies**

*Litigation*

On July 9, 2012, our wholly-owned indirect subsidiary, Western Minerals LLC ( Western Minerals ), filed a lawsuit in the U.S. District Court for the District of Montana (Billings Division), against KCP Inc. ( KCP ), its 50% joint-venture partner in the Decker mine in Montana. Western Minerals also named as defendants KCP's parent companies, Ambre Energy North America, Inc. ( Ambre N.A. ) and Ambre Energy Limited ( Ambre Limited and together with Ambre N.A. Ambre ). In its complaint, Western Minerals alleges that KCP and Ambre are engaging in self-dealing and other wrongful conduct in breach of the Decker joint venture agreement and other legal duties owed to the joint venture and its 50/50 owners. Western Minerals asserts claims for breach of contract, breach of implied covenant of good faith and fair dealing, breach of fiduciary duty, aiding and abetting breach of fiduciary duty, civil conspiracy, and a request for an accounting of, among other things, unauthorized Decker expenditures and Ambre's proposed self-dealing transactions concerning sales of Decker coal to Ambre and its affiliates. Western Minerals seeks both unspecified monetary damages and injunctive relief.

On August 23, 2012, KCP and Ambre N.A., filed an amended answer to Western Minerals' complaint, replacing the original answer they filed on July 30, 2012. In their amended answer, KCP and Ambre N.A. deny the principal allegations of



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Western Minerals. Additionally, KCP asserted six counterclaims against Western Minerals: breach of contract, breach of the covenant of good faith and fair dealing, breach of fiduciary duty, dissolution of the joint venture, civil conspiracy and a request for declaratory judgment. KCP also asserted two third-party claims against CPE Inc. for tortious interference of economic relations and civil conspiracy involving unnamed John Doe defendants. In general, KCP alleges that Western Minerals is frustrating the operation of the Decker mine to benefit Cloud Peak Energy's Spring Creek mine and export opportunities. Aside from the request that the court disassociate and expel Western Minerals from the Decker mine joint venture, KCP also seeks unspecified monetary damages in its counterclaims. Western Minerals and Cloud Peak Energy believe KCP's claims are without merit and intend to vigorously defend them. On September 14, 2012, Ambre Limited filed a motion to dismiss arguing that it was not subject to the jurisdiction of the Montana federal court. Western Minerals has filed a response to that motion and the court has not yet issued a ruling.

*Other Legal Proceedings*

We are involved in other legal proceedings arising in the ordinary course of business and may become involved in additional proceedings from time to time. We believe that there are no other legal proceedings pending that are likely to have a material adverse effect on our consolidated financial condition, results of operations or cash flows. Nevertheless, we cannot predict the impact of future developments affecting our claims and lawsuits, and any resolution of a claim or lawsuit, or an accrual within a particular fiscal period may adversely impact our results of operations for that period. In addition to claims and lawsuits against us, our leases by application (LBAs), permits and other industry regulatory processes and approvals may also be subject to legal challenges that may adversely impact our mining operations and results. For example, the leases we acquired for the West Antelope II LBAs are subject to pending legal challenges filed against the BLM and the Secretary of the Interior by environmental organizations.

*Tax Contingencies*

Our income tax calculations are based on application of the respective U.S. federal or state tax law. Our tax filings, however, are subject to audit by the respective tax authorities. Accordingly, we recognize tax benefits when it is more likely than not a position will be upheld by the tax authorities. To the extent the final tax liabilities are different from the amounts originally accrued, the increases or decreases are recorded as income tax expense or benefit.

Several audits involving our non-income based taxes currently are in progress. We have provided our best estimate of taxes and related interest and penalties due for potential adjustments that may result from the resolution of such tax audits.

*Concentrations of Risk and Major Customers*

Approximately 87% of our revenue for the nine months ended September 30, 2012 was under multi-year contracts compared to 82% for the nine months ended September 30, 2011. While the majority of the contracts are fixed-price, certain contracts have adjustment provisions for determining periodic price changes. For the nine months ended September 30, 2012 and 2011, there was no single customer that represented more than 10% of consolidated revenue. We generally do not require collateral or other security on accounts receivable because our customers are comprised primarily of investment grade electric utilities. We seek to mitigate credit risk through credit approvals and monitoring procedures.

*Guarantees and Off-Balance Sheet Risk*

In the normal course of business, we are party to guarantees and financial instruments with off-balance sheet risk, such as bank letters of credit, performance or surety bonds and indemnities, which are not reflected on the consolidated balance sheet. In our past experience, virtually no claims have been made against these financial instruments. Management does not expect any material losses to result from these guarantees or off-balance-sheet instruments.

U.S. federal and state laws require we secure certain of our obligations to reclaim lands used for mining and to secure coal lease obligations. The primary method we have used to meet these reclamation obligations and to secure coal lease obligations is to provide a third-party surety bond, typically through an insurance company, or provide a letter of credit, typically through a bank. Specific bond and/or letter of credit amounts may change over time, depending on the activity at the respective site and any specific requirements under federal or state laws. As of September 30, 2012, we had no standby

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letters of credit and \$610.3 million of performance bonds outstanding (including our proportional share of the Decker mine) to secure certain of our obligations to reclaim lands used for mining and to secure coal lease obligations.

*Amended Credit Agreement*

On June 3, 2011, CPE Resources entered into an Amended and Restated Credit Agreement (the *Amended Credit Agreement*) which establishes a commitment to provide us with a \$500 million senior secured revolving credit facility that can be used to borrow funds or issue letters of credit. The Amended Credit Agreement matures on June 3, 2016. We may request incremental term loans or increase the revolving commitments in an aggregate amount of up to \$200 million subject to compliance with certain conditions. The Amended Credit Agreement imposes limitations on the ability of CPE Resources and its subsidiaries to make distributions and/or extend loans to CPE Inc.

On June 14, 2012, CPE Resources entered into Amendment No. 1 to the Amended Credit Agreement, which provides for amendments to certain covenants to provide CPE Resources with incremental flexibility regarding foreign subsidiaries, among other things.

**12. Postretirement Medical Plan**

We maintain an unfunded postretirement medical plan to provide certain postretirement medical benefits to eligible employees, which does not include employees at the Decker mine. Net periodic postretirement benefit costs included the following components (in thousands):

	Three Months Ended			Nine Months Ended				
		September 30,			September 30,			
	2012	2011	2011	2012	2011	2011		
Service Cost	\$	1,053	\$	754	\$	3,160	\$	2,262
Interest Cost		356		320		1,068		961
Amortization of prior service cost		394		326		1,181		978
Net periodic benefit cost	\$	1,803	\$	1,400	\$	5,409	\$	4,201

**13. Related Party Transactions**

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Related party activity consists of coal sales to our 50% owned coal marketing company and equity method investment, Venture Fuels Partnership (in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2012		2011		2012		2011	
Related party transactions:								
Sales of coal to Venture Fuels Partnership	\$	9,177	\$	7,448	\$	13,867	\$	17,037

### 14. Earnings per Share (CPE Inc. only)

Dilutive potential shares of common stock may include restricted shares, options and performance units issued under our Long Term Incentive Plan ( LTIP ). We apply the treasury stock method to determine dilution from restricted stock, options, and performance units.

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The following table summarizes the calculation of diluted earnings per share (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Numerator for calculation of diluted earnings per share:				
Net income	\$ 85,260	\$ 24,611	\$ 145,557	\$ 145,978
Denominator for basic income per share weighted-average shares outstanding	60,044	60,007	60,020	60,003
Dilutive effect of stock equivalents	1,098	638	903	603
Denominator for diluted earnings per share	61,142	60,645	60,923	60,606
Diluted earnings per share	\$ 1.39	\$ 0.41	\$ 2.39	\$ 2.41

For the periods presented, the following items were excluded from the diluted earnings per share calculation because they were anti-dilutive (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
Restricted stock		1	58	15
Options outstanding	48	78	70	76
Employee stock purchase plan	19	3	25	3

**15. Segment Information**

Our management reviews, manages, and operates our business as a single operating segment - the production of low sulfur, thermal coal from surface mines, located in the Western region of the U.S. within the PRB, which is sold to electric utilities and industrial customers.

The following table presents a summary of total revenues from external customers by geographic location (in thousands):

Three Months Ended September 30,	Nine Months Ended September 30,
-------------------------------------	------------------------------------

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	2012		2011		2012		2011	
United States	\$	320,845	\$	315,220	\$	892,475	\$	919,975
Asia		100,809		87,895		243,962		223,630
Other		4,207		3,835		5,510		7,569
Total revenues from external customers	\$	425,861	\$	406,950	\$	1,141,947	\$	1,151,174

All of our revenues originated in the U.S. We attribute revenue to individual countries based on the location of the customer.

As of September 30, 2012 and December 31, 2011, all of our long-lived assets were located in the U.S.

**16. Equity-Based Compensation (CPE Inc. only)**

During the first quarter of each year, we grant restricted stock, restricted stock units, performance-based share units, and/or non-qualified stock options ( shares ) to eligible employees and directors. Generally, these shares fully vest on the third anniversary of the grant date. In addition, performance-based share units include a stock performance vesting criteria. However, they will pro-rata vest sooner if a grantee terminates employment or stops providing services because of death,

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disability, redundancy or retirement. Shares will fully vest if an employee is terminated without cause within two years after a change in control occurs, as such term is defined in the LTIP. Restricted stock units granted to our directors vest upon their resignation or retirement. All other shares will be forfeited if the grantee terminates employment for any other reason than those noted above and non-qualified stock options expire if not exercised within ten years of the date of grant.

***Restricted Stock***

Restricted stock activity for the nine months ended September 30, 2012 is as follows (in thousands, except per share amounts):

	Number		Weighted Average Grant-Date Fair Value (per share)
Non-vested shares at January 1, 2012	936	\$	15.75
Granted	153		17.41
Forfeited	(16)		15.58
Vested	(14)		18.09
Non-vested shares at September 30, 2012	1,058	\$	15.96

***Performance-Based Share Units***

Performance-based share units granted represent the number of shares of common stock to be awarded based on the achievement of targeted performance levels related to pre-established total stockholder return goals over a three-year period and may range from 0% to 200% of the targeted amount. The grant date fair value of the awards is based upon a Monte Carlo simulation and is amortized over the performance period. We utilized U.S. Treasury yields as of the grant date for our risk-free interest rate assumption, matching the treasury yield terms to the expected life of the performance-based share units.

Performance-based share unit award activity for the nine months ended September 30, 2012 is as follows (in thousands, except per unit amounts):

**Weighted**

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	Number	Average Grant-Date Fair Value (per unit)
Non-vested units at January 1, 2012	159	\$ 20.12
Granted	220	17.61
Forfeited	(2)	18.58
Vested		
Non-vested units at September 30, 2012	376	\$ 18.66

The assumptions used to estimate the fair value of the performance-based share units are as follows:

Risk-free interest rate	0.5%
Expected volatility	48.2%
Term	3 years
Fair value	\$ 17.61



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*Non-Qualified Stock Options*

Non-qualified stock option activity for the nine months ended September 30, 2012 is as follows (in thousands, except per option amounts):

	Number		Weighted- Average Exercise Price (per option)		Weighted- Average Remaining Contractual Term (years)		Aggregate Intrinsic Value (1)
Options outstanding at January 1, 2012	1,138	\$	15.77		8.06	\$	4,240
Granted	207		17.00		10.00		
Forfeited	(8)		16.74				26
Options outstanding at September 30, 2012	1,337	\$	15.95		7.62	\$	3,258
Exercisable at September 30, 2012							

(1) The intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the exercise price of the option at period-end.

We used the Black-Scholes option pricing model to determine the fair value of stock options. Determining the fair value of equity-based awards requires judgment, including estimating the expected term that stock options will be outstanding prior to exercise, and the associated volatility. As we have no historical exercise history, expected option life assumptions were developed using the simplified method as outlined in Topic 14, Share-Based Payment, of the Staff Accounting Bulletin Series. We utilized U.S. Treasury yields as of the grant date for our risk-free interest rate assumption, matching the treasury yield terms to the expected life of the option. We utilized a 6.5 year peer historical lookback, weighted with our own volatility since the IPO, to develop our expected volatility.

The assumptions used to estimate the fair value of options granted on March 15, 2012 are as follows:

Risk-free interest rate	1.7%
Expected option life	6.5 years
Expected volatility	53.6%
Fair value (per option)	\$ 9.05

**17. Supplemental Guarantor/Non-Guarantor Financial Information (CPE Resources only)**

In accordance with the indentures governing the 8.25% Senior Notes due 2017 ( 2017 notes ) and the 8.50% Senior Notes due 2019 ( 2019 notes ), collectively the senior notes, certain wholly-owned U.S. subsidiaries of CPE Resources (the Guarantor Subsidiaries ) have fully and unconditionally guaranteed these senior notes on a joint and several basis. Separate financial statements and other disclosures concerning the Guarantor Subsidiaries are not presented because management believes that such information is not material to the senior note holders. The following historical financial statement information is provided for the Guarantor/Non-Guarantor Subsidiaries:

Table of Contents**CLOUD PEAK ENERGY INC. AND****CLOUD PEAK ENERGY RESOURCES LLC****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Supplemental Condensed Consolidating Statement of Operations and Comprehensive Income**

(in thousands)

	Three Months Ended September 30, 2012				
	Parent Company (CPE Resources)	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	\$	\$ 419,356	\$ 6,505	\$	\$ 425,861
<b>Costs and expenses</b>					
Cost of product sold (exclusive of depreciation, depletion, amortization and accretion, shown separately)	(1)	295,368	6,578		301,945
Depreciation and depletion	595	23,156	911		24,661
Amortization and accretion		2,330	927		3,257
Derivative financial instruments	(285)	(1,049)			(1,334)
Selling, general and administrative expenses	13,942	1,756			15,698
Total costs and expenses	14,251	321,560	8,416		344,227
Operating income (loss)	(14,251)	97,796	(1,910)		81,634
<b>Other income (expense)</b>					
Interest income and other, net	189	(336)			(146)
Interest expense	(10,585)	(1,069)	(16)		(11,671)
Total other expense	(10,396)	(1,405)	(16)		(11,817)
Income (loss) from continuing operations before income tax provision and earnings (losses) from affiliates	(24,647)	96,391	(1,926)		69,817
Income tax benefit (expense)	(7,737)	3,901	674		(3,160)
Earnings from unconsolidated affiliates, net of tax	5	40			44
Earnings (losses) from consolidated affiliates, net of tax	99,079	(1,253)		(97,827)	
Net income (loss)	66,701	99,079	(1,253)	(97,827)	66,701
<b>Other comprehensive income</b>					
Retiree medical plan amortization of prior service cost, net of tax	252	252		(252)	252
Other comprehensive income	252	252		(252)	252
Total comprehensive income (loss)	\$ 66,953	\$ 99,331	\$ (1,253)	\$ (98,079)	\$ 66,953



Table of Contents**CLOUD PEAK ENERGY INC. AND****CLOUD PEAK ENERGY RESOURCES LLC****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Supplemental Condensed Consolidating Statement of Operations and Comprehensive Income**

(in thousands)

	Three Months Ended September 30, 2011				
	Parent Company (CPE Resources)	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	\$ 39	\$ 400,891	\$ 6,020	\$	\$ 406,950
<b>Costs and expenses</b>					
Cost of product sold (exclusive of depreciation, depletion, amortization and accretion, shown separately)	243	299,081	7,209		306,533
Depreciation and depletion	494	23,372	423		24,289
Amortization and accretion		2,018	966		2,984
Selling, general and administrative expenses	11,310	1,661			12,971
Total costs and expenses	12,047	326,132	8,598		346,777
Operating income (loss)	(12,008)	74,759	(2,578)		60,173
<b>Other income (expense)</b>					
Interest income and other, net	142	(102)			40
Interest expense	(6,586)	(247)	(15)		(6,848)
Total other expense	(6,444)	(349)	(15)		(6,808)
Income (loss) from continuing operations before income tax provision and earnings (losses) from affiliates	(18,452)	74,410	(2,593)		53,365
Income benefit (expense)	5,372	(45,442)	(5,206)		(45,276)
Earnings from unconsolidated affiliates, net of tax		530			530
Earnings (losses) from consolidated affiliates, net of tax	21,699	(7,799)		(13,900)	
Net income (loss)	8,619	21,699	(7,799)	(13,900)	8,619
<b>Other comprehensive income</b>					
Retiree medical plan amortization of prior service cost, net of tax	209	209		(209)	209
Other comprehensive income	209	209		(209)	209
Total comprehensive income (loss)	\$ 8,828	\$ 21,908	\$ (7,799)	\$ (14,109)	\$ 8,828

Table of Contents**CLOUD PEAK ENERGY INC. AND****CLOUD PEAK ENERGY RESOURCES LLC****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Supplemental Condensed Consolidating Statement of Operations and Comprehensive Income**

(in thousands)

	Nine Months Ended September 30, 2012				
	Parent Company (CPE Resources)	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	\$	\$ 1,125,669	\$ 16,278	\$	\$ 1,141,947
<b>Costs and expenses</b>					
Cost of product sold (exclusive of depreciation, depletion, amortization and accretion, shown separately)	2	830,766	20,195		850,963
Depreciation and depletion	1,615	65,901	2,821		70,337
Amortization and accretion		6,989	2,337		9,327
Derivative financial instruments	(349)	(19,112)			(19,461)
Selling, general and administrative expenses	41,872	1,525			43,397
Total costs and expenses	43,139	886,069	25,354		954,563
Operating income (loss)	(43,139)	239,600	(9,076)		187,384
<b>Other income (expense)</b>					
Interest income and other, net	947	(388)			560
Interest expense	(23,648)	(1,761)	(48)		(25,457)
Total other expense	(22,700)	(2,149)	(48)		(24,897)
Income (loss) from continuing operations before income tax provision and earnings (losses) from affiliates	(65,840)	237,451	(9,124)		162,487
Income tax benefit (expense)	7,116	(47,419)	3,234		(37,069)
Earnings from unconsolidated affiliates, net of tax	17	1,562			1,579
Earnings (losses) from consolidated affiliates, net of tax	185,703	(5,890)		(179,813)	
Net income (loss)	126,997	185,703	(5,890)	(179,813)	126,997
<b>Other comprehensive income</b>					
Retiree medical plan amortization of prior service cost, net of tax	814	814	58	(872)	814
Other comprehensive income	814	814	58	(872)	814
Total comprehensive income (loss)	\$ 127,811	\$ 186,517	\$ (5,832)	\$ (180,685)	\$ 127,811

Table of Contents**CLOUD PEAK ENERGY INC. AND****CLOUD PEAK ENERGY RESOURCES LLC****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Supplemental Condensed Consolidating Statement of Operations and Comprehensive Income**

(in thousands)

	Nine Months Ended September 30, 2011				
	Parent Company (CPE Resources)	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Revenues	\$ 39	\$ 1,134,454	\$ 16,681	\$	\$ 1,151,174
<b>Costs and expenses</b>					
Cost of product sold (exclusive of depreciation, depletion, amortization and accretion, shown separately)	255	836,873	18,423		855,551
Depreciation and depletion	1,458	56,038	1,041		58,537
Amortization and accretion		6,520	2,900		9,420
Selling, general and administrative expenses	34,099	4,806			38,905
Total costs and expenses	35,812	904,237	22,364		962,413
Operating income (loss)	(35,773)	230,217	(5,683)		188,761
<b>Other income (expense)</b>					
Interest income and other, net	457	(33)	1		425
Interest expense	(26,751)	(725)	(44)		(27,520)
Total other expense	(26,294)	(758)	(43)		(27,095)
Income (loss) from continuing operations before income tax provision and earnings (losses) from affiliates	(62,067)	229,459	(5,726)		161,666
Income tax benefit (expense)	19,363	(29,717)	3,881		(6,473)
Earnings from unconsolidated affiliates, net of tax	18	2,124			2,142
Earnings (losses) from consolidated affiliates, net of tax	200,021	(1,845)		(198,176)	
Net income (loss)	157,335	200,023	(1,845)	(198,176)	157,335
<b>Other comprehensive income</b>					
Retiree medical plan amortization of prior service cost, net of tax	626	626		(626)	626
Other comprehensive income	626	626		(626)	626
Total comprehensive income (loss)	\$ 157,961	\$ 200,649	\$ (1,845)	\$ (198,804)	\$ 157,961

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**CLOUD PEAK ENERGY INC. AND**  
**CLOUD PEAK ENERGY RESOURCES LLC**  
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Supplemental Condensed Consolidating Balance Sheet**

(in thousands)

	September 30, 2012				
	Parent Company (CPE Resources)	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
<b>Current assets</b>					
Cash and cash equivalents	\$ 182,214	\$ 2	\$ 3,289	\$	\$ 185,505
Investments in marketable securities	80,331				80,331
Accounts receivable		101,758	4,541		106,300
Inventories, net	6,160	71,839	4,083		82,083
Due from related parties		362,515	1,984	(364,499)	
Derivative financial instruments	349	20,381			20,730
Deferred income taxes and other assets	214	49,853	124		50,190
Total current assets	269,268	606,348	14,022	(364,499)	525,139
<b>Noncurrent assets</b>					
Property, plant and equipment, net	9,616	1,631,164	2,617		1,643,397
Goodwill		35,634			35,634
Deferred income taxes	39,309		15,039	(1,258)	53,090
Investments and other assets	1,657,646		4,470	(1,628,544)	33,573
Total assets	\$ 1,975,840	\$ 2,273,146	\$ 36,148	\$ (1,994,301)	\$ 2,290,833
<b>LIABILITIES AND MEMBER S EQUITY</b>					
<b>Current liabilities</b>					
Accounts payable and accrued expenses	\$ 18,792	\$ 93,435	\$ 8,751	\$	\$ 120,977
Royalties and production taxes		142,423	2,388		144,811
Due to related parties	387,289			(364,499)	22,790
Current portion of federal coal lease obligations		63,191			63,191
Other liabilities	48	1,654	966		2,670
Total current liabilities	406,128	300,703	12,106	(364,499)	354,439
<b>Noncurrent liabilities</b>					
Senior notes	596,397				596,397
Federal coal lease obligations, net of current portion		122,928			122,928
Asset retirement obligations, net of current portion		131,531	66,201		197,732
Deferred income taxes		1,258		(1,258)	
Other liabilities	76	78,967	6,022	(38,965)	46,099
Total liabilities	1,002,601	635,386	84,329	(404,722)	1,317,595



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Commitments and Contingencies (Note 11)

Total member s equity	973,238	1,637,760	(48,181)	(1,589,579)	973,238
Total liabilities and member s equity	\$ 1,975,840	\$ 2,273,146	\$ 36,148	\$ (1,994,301)	\$ 2,290,833

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**CLOUD PEAK ENERGY INC. AND  
CLOUD PEAK ENERGY RESOURCES LLC**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Supplemental Condensed Consolidating Balance Sheet**

(in thousands)

	December 31, 2011				
	Parent Company (CPE Resources)	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
<b>ASSETS</b>					
<b>Current assets</b>					
Cash and cash equivalents	\$ 401,087	\$ 2	\$ 3,151	\$	\$ 404,240
Investments in marketable securities	75,228				75,228
Restricted cash	71,245				71,245
Accounts receivable	130	92,936	2,181		95,247
Inventories, net	5,753	61,677	4,219		71,648
Due from related parties		256,460		(256,460)	
Derivative financial instruments		2,275			2,275
Deferred income taxes and other assets		43,257		1	43,258
Total current assets	553,443	456,608	9,550	(256,460)	763,141
<b>Noncurrent assets</b>					
Property, plant and equipment, net	6,684	1,338,839	4,612		1,350,135
Goodwill		35,634			35,634
Deferred income taxes	34,307	28,931	15,042		78,280
Investments and other assets	1,134,791			(1,105,018)	29,773
Total assets	\$ 1,729,225	\$ 1,860,012	\$ 29,204	\$ (1,361,478)	\$ 2,256,963
<b>LIABILITIES AND MEMBER S EQUITY</b>					
<b>Current liabilities</b>					
Accounts payable and accrued expenses	\$ 4,895	\$ 111,527	\$ 6,754	\$	\$ 123,176
Royalties and production taxes		133,349	2,723		136,072
Due to related parties	282,661		1,219	(256,460)	27,420
Current portion of federal coal lease obligations		102,198			102,198
Other liabilities	45	3,960	966		4,971
Total current liabilities	287,601	351,034	11,662	(256,460)	393,837
<b>Noncurrent liabilities</b>					
Senior notes	596,077				596,077
Federal coal lease obligations, net of current portion		186,119			186,119
Asset retirement obligations, net of current portion		126,267	66,440		192,707
Other liabilities	119	84,201	6,021	(47,546)	42,795
Total liabilities	883,797	747,621	84,123	(304,006)	1,411,535

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Commitments and Contingencies (Note 11)

Total member s equity		845,428		1,112,391		(54,919)		(1,057,472)		845,428
Total liabilities and member s equity	\$	1,729,225	\$	1,860,012	\$	29,204	\$	(1,361,478)	\$	2,256,963

Table of Contents**CLOUD PEAK ENERGY INC. AND****CLOUD PEAK ENERGY RESOURCES LLC****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****Supplemental Condensed Consolidating Statement of Cash Flows**

(in thousands)

	Nine Months Ended September 30, 2012				
	Parent Company (CPE Resources)	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Eliminations	Consolidated
Net cash provided by (used in) operating activities	\$ 21,275	\$ 188,597	\$ (7,918)	\$	\$ 201,954
<b>Investing activities</b>					
Acquisition of Youngs Creek and CX Ranch coal and land assets		(300,377)			(300,377)
Purchases of property, plant and equipment	(5,861)	(30,540)	(44)		(36,445)
Cash paid for capitalized interest		(42,877)			(42,877)
Investments in marketable securities	(58,611)				(58,611)
Maturity and redemption of investments	53,508				53,508
Return of restricted cash	71,244				71,244
Partnership escrow deposit			(4,470)		(4,470)
Contributions made to subsidiary	(300,377)	(12,570)		312,947	
Other	(51)	1,898			1,847
Net cash used in investing activities	(240,148)	(384,466)	(4,514)	312,947	(316,181)
<b>Financing activities</b>					
Principal payments of federal coal leases		(102,198)			(102,198)
Contributions received from parent		300,377	12,570	(312,947)	
Other		(2,310)			(2,310)
Net cash provided by (used in) financing activities		195,869	12,570	(312,947)	(104,508)
Net increase (decrease) in cash and cash equivalents	(218,873)		138		(218,735)
Cash and cash equivalents at beginning of year	401,087	2	3,151		404,240
Cash and cash equivalents at the end of year	\$ 182,214	\$ 2	\$ 3,289	\$	\$ 185,505

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**CLOUD PEAK ENERGY INC. AND  
CLOUD PEAK ENERGY RESOURCES LLC**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**Supplemental Condensed Consolidating Statement of Cash Flows**

(in thousands)

	Nine Months Ended September 30, 2011			
	Parent Company (CPE Resources)	Guarantor Subsidiaries	Non- Guarantor Subsidiaries	Consolidated
Net cash provided by (used in) operating activities	\$ 5,947	\$ 212,225	\$ (5,534)	\$ 212,638
<b>Investing activities</b>				
Purchases of property, plant and equipment	(8,166)	(73,652)	(232)	(82,050)
Cash paid for capitalized interest		(18,772)		(18,772)
Initial payments on federal coal leases		(69,407)		(69,407)
Return of restricted cash	107,887			107,887
Other		545		545
Net cash provided by (used in) investing activities	99,721	(161,286)	(232)	(61,797)
<b>Financing activities</b>				
Principal payments on federal coal leases		(50,902)		(50,902)
Distributions	(162)			(162)
Other	(2,279)	(38)		(2,317)
Net cash used in financing activities	(2,441)	(50,940)		(53,381)
Net increase (decrease) in cash and cash equivalents	103,227	(1)	(5,766)	97,460
Cash and cash equivalents at beginning of year	322,010	4	18,086	340,100
Cash and cash equivalents at the end of year	\$ 425,237	\$ 3	\$ 12,320	\$ 437,560

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**CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS**

This report contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, plan, potential, should, will, would. You should read statements that contain these words carefully because they discuss our current plans, strategies, prospects, and expectations concerning our business, operating results, financial condition, and other similar matters. While we believe that these forward-looking statements are reasonable as and when made, there may be events in the future that we are not able to predict accurately or control, and there can be no assurance that future developments affecting our business will be those that we anticipate. Additionally, all statements concerning our expectations regarding future operating results are based on current forecasts for our existing operations and do not include the potential impact of any future acquisitions. The factors listed under Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2011 (our 2011 Form 10-K), as well as any cautionary language in this report, describe the known material risks, uncertainties and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. Additional factors or events that may emerge from time to time, or those that we currently deem to be immaterial, could cause our actual results to differ, and it is not possible for us to predict all of them. You are cautioned not to place undue reliance on the forward-looking statements contained herein. We undertake no obligation to update or revise publicly any forward-looking statements, whether as a result of new information, future events, or otherwise, except as required by law. The following factors are among those that may cause actual results to differ materially and adversely from our forward-looking statements:

- the prices we receive for our coal;
  
- competition with other producers of coal;
  
- competition with natural gas and other non-coal energy resources, which may be increased as a result of energy policies, regulations and subsidies or other government incentives that encourage or mandate use of alternative energy sources;
  
- coal-fired power plant capacity, including the impact of environmental regulations, energy policies and other factors that may cause utilities to phase out or close existing coal-fired power plants or reduce construction of any new coal-fired power plants;
  
- market demand for domestic and foreign coal, electricity and steel;
  
- our ability to maintain and grow our export sales;
  
- railroad, export terminal and other transportation performance, costs and availability, including development of additional terminal capacity;

- domestic and international economic conditions;
- timing of reductions or increases in customer coal inventories;
- weather conditions or weather-related damage that impacts demand for coal, our mining operations, our customers or transportation infrastructure;
- risks inherent to surface coal mining;
- our ability to successfully acquire new coal deposits and surface rights at attractive prices and in a timely manner and our ability to effectively resolve issues with conflicting mineral development that may impact our mine plans;
- our ability to produce coal at existing and planned volumes and to effectively manage the costs of our operations;
- our plans and objectives for future operations and the development of additional coal deposits or acquisition opportunities, including risks associated with acquisitions;
- the impact of current and future environmental, health, safety and other laws, regulations, treaties or governmental policies, or changes in interpretations thereof, and third-party regulatory challenges, including those affecting our

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coal mining operations or our customers coal usage, carbon and other gaseous emissions or ash handling, as well as related costs and liabilities;

- the impact of required regulatory processes and approvals to lease and obtain permits for coal mining operations or to transport coal to domestic and foreign customers, including third-party legal challenges;
- any increases in rates or changes in regulatory interpretations with respect to royalties or severance and production taxes;
- inaccurately estimating the costs or timing of our reclamation and mine closure obligations;
- disruptions in delivery or increases in pricing from third-party vendors of raw materials and other consumables which are necessary for our operations, such as explosives, petroleum-based fuel, tires, steel, and rubber;
- our assumptions concerning coal reserve estimates;
- our relationships with, and other conditions affecting, our customers and other counterparties, including economic conditions and the credit performance and credit risks associated with our customers and other counterparties, such as lenders under our credit agreement and financial institutions with whom we maintain accounts or enter hedging arrangements;
- the terms and restrictions of our indebtedness;
- liquidity constraints, including those resulting from the cost or unavailability of financing due to credit market conditions;
- our assumptions regarding payments arising under the Tax Receivable Agreement and other agreements related to the initial public offering of Cloud Peak Energy Inc.;
- our ability to maintain effective internal controls and to meet the systems and resource demands that we must incur as a public company;



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- our liquidity, results of operations, and financial condition generally, including amounts of working capital that are available; and
- other factors, including those discussed in Item 1A of our 2011 Form 10-K.

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**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

**Explanatory Note**

Cloud Peak Energy Resources LLC ( CPE Resources ) is the sole direct subsidiary of Cloud Peak Energy Inc. ( CPE Inc. ), providing 100% of CPE Inc.'s total consolidated revenue for the three and nine months ended September 30, 2012 and constituting nearly 100% of CPE Inc.'s total consolidated assets as of September 30, 2012.

Unless the context indicates otherwise, the terms Cloud Peak Energy, the Company, we, us, and our refer to both CPE Inc. and CPE Resources and their subsidiaries. Discussions or areas of this report that either apply only to CPE Inc. or CPE Resources are clearly noted in such sections.

This Item 2 may contain forward-looking statements that involve substantial risks and uncertainties. When considering these forward-looking statements you should keep in mind the cautionary statements in this report and our other Securities and Exchange Commission ( SEC ) filings, including Risk Factors in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2011 ( 2011 Form 10-K ). Please see Cautionary Notice Regarding Forward-Looking Statements elsewhere in this document.

This Item 2 is intended to help the reader understand our results of operations and financial condition. This discussion should be read in conjunction with our unaudited condensed consolidated financial statements in Item 1 of this report and our other SEC filings, including our audited consolidated financial statements in Item 8 of our 2011 Form 10-K.

**Overview**

We are one of the largest producers of coal in the United States ( U.S. ) and in the Powder River Basin ( PRB ), based on 2011 coal sales. As of December 31, 2011, we controlled approximately 1.37 billion tons of proven and probable coal reserves. We operate some of the safest mines in the coal industry. According to Mine Safety and Health Administration ( MSHA ) data, in 2011, we had one of the lowest employee all injury incident rates among the largest U.S. coal producing companies. We currently operate solely in the PRB, the lowest cost region of the major coal producing regions in the U.S., and operate two of the four largest coal mines in the U.S. Our operations include three wholly-owned surface coal mines, two of which, the Antelope mine and the Cordero Rojo mine, are in Wyoming and one of which, the Spring Creek mine, is in Montana. We also own rights to substantial undeveloped coal and complimentary surface assets in the Northern PRB, further building our long-term position to serve Asian export and domestic customers. We also own a 50% non-operating interest in a fourth surface coal mine in Montana, the Decker mine. We produce subbituminous thermal coal with low sulfur content and sell our coal primarily to domestic and foreign electric utilities.

On June 29, 2012, we completed our acquisition of the Youngs Creek Mining Company, LLC ( Youngs Creek ) joint venture and other related coal and surface assets, including CX Ranch, from Chevron U.S.A. Inc. ( Chevron ) and CONSOL Energy Inc. ( CONSOL ) for \$300 million. We utilized available cash on hand to fund the acquisition. We believe the location of the coal and surface lands, as well as the quality of the

acquired coal, position us well for future growth in our Asian exports as additional terminal capacity becomes available. As Youngs Creek is an undeveloped greenfield surface mine project, there are no revenues or income related to the acquired properties. Future development timing and production levels are expected to depend largely on the availability of additional export terminal capacity on the West Coast and continued strong Asian demand for thermal coal.

*Decker Mine*

We hold a 50% non-operating interest in the Decker mine in Montana. The other 50% mine owner has responsibility for the day-to-day operations of the Decker mine. We account for our pro-rata share of assets and liabilities in our undivided interest in the joint venture using the proportionate consolidation method, whereby our share of assets, liabilities, revenues and expenses are included in the appropriate classification in our consolidated financial statements.

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***Core Business Operations***

Our key business drivers include the following:

- the volume of coal sold domestically and internationally;
  
- the price for which we sell our coal;
  
- the costs of mining, including labor, repairs and maintenance, fuel, explosives, depreciation of capital equipment, and depletion of coal leases;
  
- the costs for logistic services and rail and port charges for coal sales on a delivered basis; and
  
- capital expenditures to acquire property, plant and equipment.

The volume of coal that we sell in any given year is driven by the amount of global and domestic demand for coal-generated electric power. Demand for coal-generated electric power may be affected by many factors including weather patterns, natural gas prices, coal-fired generating capacity and utilization, environmental and legal challenges, political and regulatory factors, energy policies, international and domestic economic conditions, and other factors discussed in this Item 2 and in our 2011 Form 10-K.

The price at which we sell our coal is a function of the demand relative to the supply for coal, domestically and internationally. As the demand within a region increases, prices are also subject to increase. Significant increases in demand can allow our coal to compete in new markets. We typically enter into multi-year contracts with our customers which helps mitigate the risks associated with any short-term imbalance in supply and demand. In addition, international demand has increased, enabling us to increase exports of coal during the past few years. We enter into coal forward contracts that are scheduled to settle at various dates between 2012 and 2015 to hedge a portion of our export coal sales.

We typically seek to enter each year with expected production effectively fully sold. This strategy helps us deliver our expected tonnages and run our mines at predictable production rates, which helps us control operating costs.

As is common in the PRB, coal seams at our existing mines naturally deepen, resulting in additional overburden to be removed at additional cost. In line with the worldwide mining industry, we have experienced increased operating costs for mining equipment, diesel fuel and supplies,

and employee wages and salaries. Changes in the cost of commodities related to our production process, such as diesel fuel, will result in changes in the cost of coal production. During the second quarter of 2012, we commenced the use of costless collars to help manage certain exposures to diesel fuel prices.

For some of our coal sales, including our sales to Asian customers, we arrange and pay for logistic services, rail and/or port charges. Our costs for transportation are affected by volume and negotiated freight rates.

We incur significant capital expenditures to update or expand our mining equipment, surface land holdings and coal deposits. In line with the worldwide mining industry, generally the cost of capital equipment and lead times are increasing. In addition, in recent years, the costs of acquiring federal coal leases and associated surface rights have increased. As we mine these more expensive leases in the future, our depletion costs will increase.

### *Current Considerations*

The hot summer increased coal burn and gas prices, which led to strong shipments and initial reductions in stockpiles of coal held by utilities. Stockpiles, while still high, are within the five-year average. The outlook for coal demand for the rest of the year will depend on the intensity and timing of the winter season and the price of natural gas.

The operations successfully controlled their costs this quarter helped by the increased shipment rates. For the third quarter 2012, the average cost of product sold was \$9.14 per ton compared to \$9.17 per ton in the third quarter of 2011. These cost controls along with increased realized price per ton of \$13.28 compared to \$12.91 in 2011, resulted in a margin expansion to \$4.14 per ton from \$3.74 per ton in the third quarter 2011.

As reported last quarter a small number of our customers had contacted us to request shipment deferrals. At this time, we have renegotiated 1.7 million tons, mostly to 2013, and continue discussions with a small number of customers about additional deferrals.

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On August 8, 2011, the U.S. Environmental Protection Agency ( EPA ) published the Cross-State Air Pollution Rule ( CSAPR ) intended to replace the Clean Air Interstate Rule ( CAIR ). CSAPR was expected to take effect on January 1, 2012 and was intended to reduce pollutants from upwind states by requiring 28 states to reduce power plant emissions of sulfur dioxide and nitrogen oxide. On August 21, 2012, the U.S. Court of Appeals issued a split ruling that vacated CSAPR, remanding it back to the EPA and leaving CAIR in effect until the EPA revises CSAPR. On October 5, 2012, the EPA filed a petition for an en banc rehearing of the August 21, 2012 ruling, and a court decision on that petition is pending.

On July 20, 2012, the EPA announced that it is reviewing pollution limits for new power plants under the Mercury and Air Toxics Standards ( MATS ). MATS imposes maximum achievable control technology emission limits on hazardous air emissions from new and existing coal- and oil-fired electric generating plants, as well as revised new source performance standards for nitrogen oxides, sulfur dioxides and particulate matter from such plants. In addition, on April 13, 2012, the EPA published for comment proposed new source performance standards for emissions of carbon dioxide for new and modified fossil fuel-fired electric utility generating units. The standards, if promulgated along the lines proposed, would pose significant challenges for the construction of any new coal-fired electric utility generating units in the U.S. without the use of carbon capture and storage technologies and could result in a decrease in U.S. demand for steam coal. It is possible that any final rules issued by the EPA in this area will be challenged.

**Adjusted EBITDA and Adjusted EPS (CPE Inc. only)**

The discussion of our results of operations below includes the non-GAAP financial measures of (1) Adjusted EBITDA and (2) Adjusted Earnings Per Share ( Adjusted EPS ). Adjusted EBITDA and Adjusted EPS are intended to provide additional information only and do not have any standard meaning prescribed by generally accepted accounting principles in the United States of America ( U.S. GAAP ). A quantitative reconciliation of historical net income to Adjusted EBITDA and EPS (as defined below) to Adjusted EPS is found within this Item 2.

EBITDA represents net income before (1) interest income (expense) net, (2) income tax provision, (3) depreciation and depletion, (4) amortization, and (5) accretion. Adjusted EBITDA represents EBITDA as further adjusted for specifically identified items that management believes do not directly reflect our core operations. The specifically identified items are the impacts, as applicable, of: (1) the Tax Receivable Agreement including tax impacts of CPE Inc.'s 2009 initial public offering ( IPO ) and 2010 Secondary Offering, (2) adjustments for derivative financial instruments including unrealized mark-to-market amounts and cash settlements realized, and (3) our significant broker contract that expired in the first quarter of 2010.

Adjusted EPS represents diluted earnings (loss) per common share ( EPS ) adjusted to exclude the estimated per share impact of the same specifically identified items used to calculate Adjusted EBITDA and described above, adjusted at the statutory tax rate of 36%.

Because not all companies use identical calculations, our presentations of Adjusted EBITDA and Adjusted EPS may not be comparable to other similarly titled measures of other companies. Moreover, our presentation of Adjusted EBITDA is different than EBITDA as defined in our debt financing agreements.

See Item 6 of our 2011 Form 10-K for additional information regarding Adjusted EBITDA and Adjusted EPS and their limitations compared to U.S. GAAP financial measures.

**Three Months Ended September 30, 2012 Compared to Three Months Ended September 30, 2011***Summary*

The following table summarizes key results (in millions):

	Three Months Ended September 30,		Amount	Change	
	2012	2011		Amount	Percent
Total revenue	\$ 425.9	\$ 407.0	\$ 18.9	4.6	
Net income	85.3	24.6	60.7	246.7	
Adjusted EBITDA(1)	108.4	87.9	20.5	23.3	
Adjusted EPS(1)	\$ 0.80	\$ 0.61	\$ 0.19	30.5	
Asian export tons	1.5	1.4	0.1	7.5	
Total tons sold	25.1	25.2	(0.2)	(0.6)	

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(1) Non-GAAP measure; please see definition above and reconciliation below.

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*Adjusted EBITDA and Adjusted EPS (CPE Inc. only)*

The following tables present a reconciliation of net income to Adjusted EBITDA and diluted earnings (loss) per common share to Adjusted EPS (in millions, except per share amounts):

	<b>Three Months Ended</b>				
	<b>2012</b>		<b>September 30,</b>		<b>2011</b>
Net income	\$	85.3	\$	24.6	
Interest income		(0.2)		(0.1)	
Interest expense		11.7		6.8	
Income tax expense		13.6		52.2	
Depreciation and depletion		24.7		24.3	
Accretion		3.3		3.0	
EBITDA		138.3		110.8	
Tax agreement benefit(1)		(29.0)		(22.9)	
Derivative financial instruments(2)		(0.9)			
Expired significant broker contract					
Adjusted EBITDA	\$	108.4	\$	87.9	

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- (1) Changes to related deferred taxes are included in income tax expense.
- (2) Derivative financial instruments including unrealized mark-to-market amounts and cash settlements realized.

	<b>Three Months Ended</b>				
	<b>2012</b>		<b>September 30,</b>		<b>2011</b>
Diluted earnings per common share	\$	1.39	\$	0.41	
Tax agreement expense including tax impacts of IPO and Secondary Offering		(0.58)		0.20	
Derivative financial instruments(1)		(0.01)			
Expired significant broker contract					
Adjusted EPS	\$	0.80	\$	0.61	
Weighted-average dilutive shares outstanding (in millions)		61.1		60.6	

- 
- (1) Derivative financial instruments including unrealized mark-to-market amounts and cash settlements realized.

*Results of Operations*

Owned and operated mines refers to our three surface coal mines and excludes our 50% non-operating interest in the Decker mine. We include our share of results from operations at the Decker mine along with broker coal sales and services for both domestic and export sale



transportation and delivery as Other operations.

*Revenues*

The following table presents revenues (in millions except per ton amounts):

	Three Months Ended September 30,		Amount	Change	
	2012	2011		Amount	Percent
<b>Owned and operated mines</b>					
Revenue	\$ 323.7	\$ 314.6	\$ 9.2	2.9	
Realized price per ton sold	\$ 13.28	\$ 12.91	\$ 0.37	2.9	
Tons sold	24.4	24.4			
<b>Other operations</b>					
Revenue	\$ 102.2	\$ 92.4	\$ 9.8	10.6	

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The increase in revenue from our owned and operated mines was the result of an increase to our realized price per ton sold in 2012 compared to 2011. This increase is the result of prices committed and fixed in earlier years. Since the fourth quarter of 2011, coal prices have fallen due to a warm winter and low natural gas prices. This will negatively impact our future realized prices.

Revenues from other operations increased primarily as a result of higher realized prices on the Asian export tons sold. Coal sold on a delivered basis, both domestic and export sales, have delivered pricing terms that include logistic services and rail and port charges. We arranged and paid for the logistic services and rail and port charges and charged our customers for providing this service. This increase was offset by fewer broker coal sales in 2012 as compared to 2011. Revenues from the Decker mine were not significantly different between the respective periods.

*Cost of Product Sold*

The following table presents cost of product sold (in millions except per ton amounts):

	Three Months Ended September 30,		Amount	Change	
	2012	2011		Amount	Percent
<b>Owned and operated mines</b>					
Cost of product sold	\$ 222.9	\$ 223.5	\$ (0.7)	(0.3)	
Average cost per ton sold	\$ 9.14	\$ 9.17	\$ (0.03)	(0.4)	
<b>Other operations</b>					
Cost of product sold	\$ 79.1	\$ 83.0	\$ (3.9)	(4.7)	

Cost of product sold decreased slightly as a result of lower diesel consumption, explosives and outside services expenditures, partially offset by higher labor and tire costs.

Cost of product sold from other operations decreased primarily due to lower rail and port charges incurred and lower broker costs.

*Operating Income*

The following table presents operating income (in millions):

	Three Months Ended September 30,		Amount	Change	
	2012	2011		Amount	Percent

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Operating income	\$	81.6	\$	60.2	\$	21.5	35.7
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The increase in operating income was primarily due to the higher revenues and lower costs noted above. These were partially offset by higher selling, general and administrative costs due to additional labor related costs including health insurance and stock-based compensation, and additional governmental affairs and community relations expenditures.

*Other Income (Expense)*

The following table presents other income (expense) (in millions):

	Three Months Ended		Amount	Change			
	2012	September 30, 2011		Amount	Percent		
Other income (CPE Inc.)	\$	17.2	\$	16.1	\$	1.1	6.9
Other expense (CPE Resources)	\$	(11.8)	\$	(6.8)	\$	(5.0)	73.6

Other income for CPE Inc. was primarily impacted by a reduction in our tax agreement liability. In the third quarter of each year, we update our estimates of the undiscounted liability over the remaining lives of our mines owed to Rio Tinto

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Energy America, Inc. ( Rio Tinto) under the Tax Receivable Agreement. In the three months ended September 30, 2012, this resulted in a \$29.0 million benefit as compared to a \$22.9 million benefit for the three months ended September 30, 2011. See Note 7 of notes to unaudited condensed consolidated financial statements in Item 1. In addition, other income was partially offset by a \$4.9 million increase in interest expense due to a reduction in the amount of interest capitalized in the current period.

Other expense for CPE Resources increased due to a \$4.9 million increase in interest expense caused by a reduction in the amount of interest capitalized in the current period.

*Income Tax Provision*

The following table presents income tax provision (in millions):

	Three Months Ended September 30,		Amount	Change	
	2012	2011		Amount	Percent
Income tax benefit (expense) (CPE Inc.)	\$ (13.6)	\$ (52.2)	\$ 38.6	(73.9)	
Effective tax rate (CPE Inc.)	13.8%	68.4%	(54.7)	(79.9)	
Income tax benefit (expense) (CPE Resources)	\$ (3.2)	\$ (45.3)	\$ 42.1	(93.0)	
Effective tax rate (CPE Resources)	4.5%	84.8%	(80.3)	(94.7)	

Our statutory income tax rate, including state income taxes, is 36%. The difference between the statutory income tax rate and our effective tax rate for the three months ended September 30, 2012 and 2011 is due primarily to changes in our deferred tax valuation allowance resulting from the third quarter annual calculation of our estimate of future taxable income.

**Nine Months Ended September 30, 2012 Compared to Nine Months Ended September 30, 2011**

*Summary*

The following table summarizes key results (in millions):

	Nine Months Ended September 30,		Amount	Change	
	2012	2011		Amount	Percent
Total revenue	\$ 1,141.9	\$ 1,151.2	\$ (9.2)	(0.8)	
Net income	145.6	146.0	(0.4)	(0.3)	

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Adjusted EBITDA(1)		249.8		258.8		(9.0)		(3.5)
Adjusted EPS(1)	\$	1.62	\$	1.78	\$	(0.16)		(9.2)
Asian export tons		3.5		3.7		(0.2)		(5.0)
Total tons sold		68.7		72.8		(4.0)		(5.6)

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(1) Non-GAAP measure; please see definition in Adjusted EBITDA and Adjusted EPS section above and reconciliation below.

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#### *Adjusted EBITDA and Adjusted EPS (CPE Inc. only)*

The following tables present a reconciliation of net income to Adjusted EBITDA and diluted earnings (loss) per common share to Adjusted EPS (in millions, except per share amounts):

	Nine Months Ended September 30,	
	2012	2011
Net income	\$ 145.6	\$ 146.0
Interest income	(0.9)	(0.5)
Interest expense	25.5	27.5
Income tax expense (benefit)	47.5	(2.0)
Depreciation and depletion	70.3	58.5
Accretion	9.3	9.4
EBITDA	297.2	238.9
Tax agreement expense(1)	(29.0)	19.9
Derivative financial instruments(2)	(18.5)	
Expired significant broker contract		
Adjusted EBITDA	\$ 249.8	\$ 258.8

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- (1) Changes to related deferred taxes are included in income tax expense.
- (2) Derivative financial instruments including unrealized mark-to-market amounts and cash settlements realized.

	Nine Months Ended September 30,	
	2012	2011
Diluted earnings per common share	\$ 2.39	\$ 2.41
Tax agreement expense including tax impacts of IPO and Secondary Offering	(0.58)	(0.63)
Derivative financial instruments(1)	(0.19)	
Expired significant broker contract		
Adjusted EPS	\$ 1.62	\$ 1.78
Weighted-average dilutive shares outstanding (in millions)	60.9	60.6

- 
- (1) Derivative financial instruments including unrealized mark-to-market amounts and cash settlements realized.

#### *Results of Operations*

Owned and operated mines refers to our three surface coal mines and excludes our 50% non-operating interest in the Decker mine. We include our share of results from operations at the Decker mine along with broker coal sales and services for both domestic and export sale

transportation and delivery as Other operations.

*Revenues*

The following table presents revenues (in millions except per ton amounts):

	Nine Months Ended September 30,		Amount	Change	
	2012	2011		Amount	Percent
<b>Owned and operated mines</b>					
Revenue	\$ 887.0	\$ 907.3	\$ (20.4)	(2.2)	
Realized price per ton sold	\$ 13.24	\$ 12.88	\$ 0.36	2.8	
Tons sold	67.0	70.5	(3.4)	(4.9)	
<b>Other operations</b>					
Revenue	\$ 254.9	\$ 243.9	\$ 11.0	4.5	

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The decrease in revenue from our owned and operated mines was the result of 3.4 million fewer tons of coal sold in 2012 compared to 2011, reflecting the lower demand for PRB coal due to domestic utility customers working through higher stockpiles that resulted from the warmer-than-average winter, as well as competitive pressures of low natural gas prices. This decrease was partially offset by an increase to our realized price per ton sold in 2012 compared to 2011, reflecting prices committed and fixed in earlier years. Since the fourth quarter of 2011, coal prices have fallen due to a warm winter and low natural gas prices. This will negatively impact our future realized prices.

Revenues from other operations increased primarily as a result of higher realized prices on Asian export tons offsetting the decreased volume. Coal sold on a delivered basis, both domestic and export sales, have delivered pricing terms that include logistic services and rail and port charges. We arranged and paid for the logistic services and rail and port charges and charged our customers for providing this service. This increase was partially offset by a reduction in broker coal sales. Revenues from the Decker mine activity were not significantly different between the respective periods.

*Cost of Product Sold*

The following table presents cost of product sold (in millions except per ton amounts):

	Nine Months Ended September 30,		Amount	Change	
	2012	2011			Percent
<b>Owned and operated mines</b>					
Cost of product sold	\$ 646.0	\$ 642.3	\$ 3.7		0.6
Average cost per ton sold	9.64	9.12	0.52		5.8
<b>Other operations</b>					
Cost of product sold	\$ 205.0	\$ 213.3	\$ (8.3)		(3.9)

The cost of product sold increased marginally primarily as a result of higher labor and tire costs partially offset by lower non-income based taxes and explosive costs. The increase in the average cost per ton of coal sold is primarily the result of the impact of fixed costs on fewer tons sold.

Cost of product sold from other operations decreased primarily due to 0.2 million fewer Asian export tons, which resulted in lower rail and port charges incurred, and a reduction in costs associated with the lower broker coal sales.

*Operating Income*

The following table presents operating income (in millions):



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	Nine Months Ended				Change		
	2012	September 30,	2011		Amount	Percent	
Operating income	\$	187.4	\$	188.8	\$	(1.4)	(0.7)

In addition to the revenue and cost of product sold factors previously discussed, during 2012, our international coal forward contracts had a \$19.1 million favorable mark-to-market impact as a result of declining international coal market prices. Also during 2011, a \$15.7 million reduction of depreciation and depletion expense was recognized when the asset retirement obligation for our Antelope mine was adjusted as a result of the successful West Antelope II coal tract bids. In addition, selling, general and administrative costs increased during 2012 by \$4.5 million due primarily to additional labor related costs, including health insurance and stock-based compensation, and additional governmental affairs and community relations expenditures.

Table of Contents*Other Income (Expense)*

The following table presents other income (expense) (in millions):

	Nine Months Ended September 30,		Amount	Change	
	2012	2011		Amount	Percent
Other income (expense) (CPE Inc.)	\$ 4.1	\$ (47.0)	\$ 51.1	(108.7)	
Other expense (CPE Resources)	\$ (24.9)	\$ (27.1)	\$ 2.2	(8.1)	

The decrease in other expense for CPE Inc. is primarily the result of the 2011 tax agreement expense of \$19.9 million as compared to a benefit of \$29.0 million recognized during 2012. See Note 7 of notes to unaudited condensed consolidated financial statements in Item 1. In addition, other income increased due to a \$2.1 million decrease in interest expense due to an increase in the amount of interest capitalized in the current period.

The decrease in other expense for CPE Resources is due to a \$2.1 million decrease in interest expense caused by an increase in the amount of interest capitalized in the current period.

*Income Tax Provision*

The following table presents income tax provision (in millions):

	Nine Months Ended September 30,		Amount	Change	
	2012	2011		Amount	Percent
Income tax benefit (expense) (CPE Inc.)	\$ (47.5)	\$ 2.0	\$ (49.5)	*	
Effective tax rate (CPE Inc.)	24.8%	(1.4)%	26.2	*	
Income tax benefit (expense) (CPE Resources)	\$ (37.1)	\$ (6.5)	\$ (30.6)	*	
Effective tax rate (CPE Resources)	22.8%	4.0%	18.8	*	

\* Not meaningful

Our statutory income tax rate, including state income taxes, is 36%. The difference between the statutory income tax rate and our effective tax rate for the nine months ended September 30, 2012 and 2011 is due primarily to changes in our valuation allowance resulting from the third

quarter annual calculation of our estimate of future taxable income.

### Liquidity and Capital Resources

	September 30, 2012	December 31, 2011
	(in millions)	
Cash and cash equivalents	\$ 185.5	\$ 404.2
Investments in marketable securities	80.3	75.2
Total	\$ 265.8	\$ 479.5

In addition to our cash and cash equivalents, our primary sources of liquidity are cash from our operations, investments in marketable securities and borrowing capacity under CPE Resources' \$500 million revolving credit facility. Cash from operations depends on a number of factors beyond our control, such as the market price for our coal, the quantity of coal required by our customers, coal-fired electricity demand, regulatory changes and energy policies impacting our business, our costs of operating including the market price we pay for diesel fuel and other input costs, as well as costs of logistics including rail and port charges, and other risks and uncertainties, including those discussed in Item 1A Risk Factors in our 2011 Form 10-K.

Investments in marketable securities include highly-liquid securities which are generally investment grade. Our investment policy has the objective of minimizing the potential risk of principal loss and is intended to limit our credit

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exposure to any single issuer. Individual securities have various maturity dates; however, it is our expectation that we could sell any individual security in the secondary market allowing for improved liquidity.

On June 29, 2012, we completed our acquisition of the Youngs Creek joint venture and other related coal and surface assets, including CX Ranch, from Chevron and CONSOL for \$300 million. We utilized available cash on hand to fund the acquisition.

On June 3, 2011, CPE Resources entered into an Amended and Restated Credit Agreement (the "Amended Credit Agreement") which establishes a commitment to provide us with a \$500 million senior secured revolving credit facility that can be used to borrow funds or issue letters of credit. The Amended Credit Agreement matures on June 3, 2016. We may request incremental term loans or increase the revolving commitments in an aggregate amount of up to \$200 million subject to compliance with certain conditions. The Amended Credit Agreement imposes limitations on the ability of CPE Resources and its subsidiaries to make distributions and/or extend loans to CPE Inc.

On June 14, 2012, CPE Resources entered into Amendment No. 1 to the Amended Credit Agreement, which provides for amendments to certain covenants to provide CPE Resources with incremental flexibility regarding foreign subsidiaries, among other things.

The indenture governing the senior notes also imposes limitations on the ability of CPE Resources and its subsidiaries to make distributions, and to extend loans and advances, to CPE Inc. Such limitations, taken as a whole, are less restrictive than those contained in the Amended Credit Agreement. CPE Resources is required to make semi-annual interest payments on its senior notes, which commenced on June 15, 2010.

The limitations in both the Amended Credit Agreement and the indenture have not had, nor are they expected to have, a negative impact upon our ability to fund cash obligations.

The borrowing capacity under the Amended Credit Agreement is reduced by the amount of letters of credit issued. As of September 30, 2012, our borrowing capacity under the Amended Credit Agreement was \$500 million. Our ability to borrow under our revolving credit facility is subject to the terms and conditions of the facility, including our compliance with financial and non-financial covenants.

We believe these sources will be sufficient to fund our primary ordinary course uses of cash for the next 12 months, which include our costs of coal production, coal lease installment payments for LBAs and other coal tracts, capital expenditures, interest on our debt, and payments to Rio Tinto under our Tax Receivable Agreement.

In the first three quarters of 2012, we made payments of \$129.2 million on committed LBAs. No payments are due in the fourth quarter of 2012 related to committed coal leases. We will continue to explore opportunities to increase our reserve base by acquiring additional coal and surface rights. If we are successful in future bids for coal rights and other growth strategies, our cash flows could be significantly impacted as we would be required to make associated payments.

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Our anticipated capital expenditures (excluding capitalized interest and federal lease payments), which we expect will be between \$50 million and \$60 million in 2012, include our estimates of expenditures necessary to keep our current equipment fleets updated to maintain our mining productivity and competitive position and the addition of new equipment as necessary.

In connection with the IPO, CPE Inc. entered into a Tax Receivable Agreement with Rio Tinto and recognized a liability for the undiscounted amounts that CPE Inc. estimated will be paid to Rio Tinto under this agreement. The amounts to be paid will be determined based on a calculation of future income tax savings that CPE Inc. actually realizes as a result of the tax basis increase that resulted from the IPO and Secondary Offering transactions. Generally, CPE Inc. retains 15% of the realized tax savings generated from the tax basis step-up and Rio Tinto is entitled to the remaining 85%, which is remitted to Rio Tinto on an annual basis. Based on our estimates, we expect to make payments of \$25.1 million in 2012, payments averaging approximately \$15 million each year during 2013 to 2016, and additional payments in subsequent years.

If we do not have sufficient resources from ongoing operations to satisfy our obligations or the timing of payments on our obligations does not coincide with cash inflows from operations, we may need to use our cash on hand and marketable securities or borrow under our line of credit. If the obligation is in excess of these amounts, we may need to seek additional borrowing sources or take other actions. Depending upon existing circumstances at the time, we may not be able to obtain additional funding on acceptable terms or at all. In addition, our existing debt instruments contain restrictive covenants, which may prohibit us from borrowing under our revolving credit facility or pursuing certain alternatives to obtain additional funding.

Table of Contents*Overview of Cash Transactions*

We started 2012 with \$479.5 million of unrestricted cash and cash equivalents and investments in marketable securities. The \$300 million Youngs Creek acquisition was funded utilizing available cash on hand. After capital expenditures and generating cash from our operating activities, we concluded the nine months ended September 30, 2012 with cash and cash equivalents and investments in marketable securities of \$265.8 million. During the nine months ended September 30, 2012, we were able to negotiate lower collateral requirements with the remainder of our surety bond providers thereby releasing the remaining \$71.2 million of restricted cash. Additionally, we replaced our \$10.5 million letter of credit that we used to secure our 50% share of additional reclamation obligations at the Decker mine with a \$4.5 million deposit to a Decker reclamation trust, included within other long-term assets.

*Cash Flows*

	Nine Months Ended September 30,		Amount	Change	
	2012	2011 (dollars in millions)			Percent
Beginning balance - cash and cash equivalents	\$ 404.2	\$ 340.1	\$ 64.1	18.8	
Net cash provided by operating activities	202.0	212.5	(10.5)	(4.9)	
Net cash used in investing activities	(316.2)	(61.8)	(254.4)	411.7	
Net cash used in financing activities	(104.5)	(53.2)	(51.3)	96.4	
Ending balance - cash and cash equivalents	\$ 185.5	\$ 437.6	\$ (252.1)	(57.6)	
Beginning balance - marketable securities	\$ 75.2	\$	\$ 75.2	*	
Ending balance - marketable securities	\$ 80.3	\$	\$ 80.3	*	

\* Not meaningful

The decrease in cash provided by operating activities for the nine months ended September 30, 2012 as compared to the same period in 2011 was primarily due to a \$7.9 million decrease in net income adjusted for noncash items, specifically unrealized derivative income partially offset by higher depreciation expense in 2012. The remainder of the difference is due to a larger decrease in working capital of \$2.6 million in 2012 as compared to 2011, primarily caused by the timing of payments on accounts payable and accrued expenses and the timing of receipts of accounts receivable.

The increase in cash used in investing activities for the nine months ended September 30, 2012 as compared to the same period in 2011 was primarily related to our \$300 million Youngs Creek acquisition. In addition, we negotiated the release of the remaining \$71.2 million of restricted cash in the nine months ended September 30, 2012 compared to net restricted cash releases of \$107.9 million in the nine months ended September 30, 2011. This increase in cash used in investing activities was offset by decreased purchases of property, plant and equipment, including the initial payments on the West Antelope II federal coal leases, which were made during the nine months ended September 30, 2011. Purchases during the nine months ended September 30, 2011 for property, plant and equipment included payments for haul trucks received in 2010 and payments for surface land associated with federal and privately held mineral rights.

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The increase in cash used in financing activities for the nine months ended September 30, 2012 as compared to the same period in 2011 was due to the second installment payments on the West Antelope II federal coal leases made in the nine months ended September 30, 2012.

### **Global Climate Change**

Enactment of laws or passage of regulations regarding emissions from the combustion of coal by the U.S. or some of its states or by other countries, or other actions to limit such emissions, could result in electricity generators switching from coal to other fuel sources. Additionally, the creation and issuance of subsidies designed to encourage use of alternative energy sources could decrease the demand of coal as an energy source. The potential financial impact on us of future laws, regulations, or subsidies will depend upon the degree to which electricity generators diminish their reliance on coal as a fuel source as a result of the laws, regulations or subsidies. That, in turn, will depend on a number of factors, including the appeal and design of the subsidies being offered, the specific requirements imposed by any such laws or regulations such as mandating use by utilities of renewable fuel sources, the time periods over which those laws or regulations would be phased in and the state of commercial development and deployment of carbon capture and storage technologies. In view of the significant uncertainty surrounding each of these factors, it is not possible for us to reasonably predict the impact that any

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such laws or regulations may have on our results of operations, financial condition or cash flows. See Item 1, *Business Environmental and Other Regulatory Matters Global Climate Change* and Item 1A, *Risk Factors* in our 2011 Form 10-K for additional discussion regarding how climate change and other environmental regulatory matters may materially adversely impact our business.

**Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect reported amounts. These estimates and assumptions are based on information available as of the date of the financial statements. Accounting measurements at interim dates inherently involve greater reliance on estimates than at year-end. The results of operations for the three and nine months ended September 30, 2012 are not necessarily indicative of results that can be expected for the full year. Please refer to the section entitled *Critical Accounting Policies and Estimates of Management's Discussion and Analysis of Financial Condition and Results of Operations* in our 2011 Form 10-K for a discussion of our critical accounting policies and estimates.

**Newly Adopted Accounting Standards and Recently Issued Accounting Pronouncements**

See Note 2 to our notes to unaudited condensed consolidated financial statements in Item 1 for a discussion of newly adopted accounting standards and recently issued accounting pronouncements.

**Item 3. *Quantitative and Qualitative Disclosures About Market Risk.***

We define market risk as the risk of economic loss as a consequence of the adverse movement of market rates and prices or credit standings. We believe our principal market risks are commodity price risk, interest rate risk and credit risk.

**Commodity Price Risk**

Market risk includes the potential for changes in the market value of our coal portfolio. Due to the lack of quoted market prices and the long-term nature of our forward sales position, we have not quantified the market risk related to our coal supply agreements. Historically, we have principally managed the commodity price risk for our coal contract portfolio through the use of long-term coal supply agreements of varying terms and durations. As of September 30, 2012, we had committed to sell approximately 92.4 million tons during 2012, of which 92.0 million tons are under fixed-price contracts. A \$1 change to the average coal sales price per ton for these 0.4 million unpriced tons would result in an approximate \$0.4 million change to the coal sales revenue. In addition, we entered into certain forward contracts to help manage our exposure to variability in future international coal prices. As of September 30, 2012, we held coal forward contracts for approximately 1.4 million tons which will settle between 2012 and 2015. A \$1 change to the market index price per ton for these coal forward contracts would result in an approximate \$1.4 million change to other income (expense).



We also face price risk involving other commodities used in our production process, primarily diesel fuel. Based on our projections of our usage of diesel fuel for the next 12 months, and assuming that the average cost of diesel fuel increases by 10%, we would incur additional fuel costs of approximately \$10.8 million over the next 12 months. In addition, during the second quarter of 2012, we commenced the use of costless collars to manage certain exposures to diesel fuel prices. As the band of the costless collar is greater than 10%, it had no impact on this calculation. The terms of the program are disclosed in Note 5 to our notes to unaudited condensed consolidated financial statements in Item 1. While we would not receive the full benefit of extreme price decreases, the collars mitigate the risk of extreme crude oil price increases and thereby increased diesel costs that would otherwise have a negative impact on cash flow.

#### **Interest Rate Risk**

Our Amended Credit Agreement is subject to an adjustable interest rate. See Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Senior Secured Revolving Credit Facility in our 2011 Form 10-K. We had no outstanding borrowings under our credit facility as of September 30, 2012. If we borrow funds under the revolving credit facility, we may be subject to increased sensitivity to interest rate movements. Any future debt arrangements that we enter into may also have adjustable interest rates that may increase our sensitivity to interest rate movements.

#### **Credit Risk**

We are exposed to credit loss in the event of non-performance by our counterparties, which may include end-use customers, trading houses, brokers, and financial institutions that serve as counterparties to our derivative financial

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instruments and hold our investments. We attempt to manage this exposure by entering into agreements with counterparties that meet our credit standards and that are expected to fully satisfy their obligations under the contracts. These steps may not always be effective in addressing counterparty credit risk.

When appropriate (as determined by our credit management function), we have taken steps to reduce our credit exposure to customers that do not meet our credit standards or whose credit has deteriorated. These steps include obtaining letters of credit and requiring prepayments for shipments.

**Item 4. Controls and Procedures.**

*Disclosure Controls and Procedures*

CPE Inc. and CPE Resources each maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports they file or submit under the Securities Exchange Act of 1934 (the Exchange Act) is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. These disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that the information required to be disclosed by CPE Inc. and CPE Resources in the reports they file or submit under the Exchange Act is accumulated and communicated to senior management, including the principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure. The management of each of CPE Inc. and CPE Resources, with the participation of the Chief Executive Officer and Chief Financial Officer of each entity, has evaluated the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) of each entity as of September 30, 2012, and has concluded that such disclosure controls and procedures are effective at the reasonable assurance level.

*Internal Control over Financial Reporting*

During the most recent fiscal quarter there have been no changes to the internal control over financial reporting of either CPE Inc. or CPE Resources that materially affected, or are reasonably likely to materially affect, either entity's internal control over financial reporting.

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**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

See Note 11 to the unaudited condensed consolidated financial statements included in Part I, Item 1 of this report relating to certain legal proceedings, which information is incorporated by reference herein.

**Item 1A. Risk Factors.**

In addition to the other information set forth in this report, you should carefully consider the risks and uncertainties described in Item 1A of our 2011 Form 10-K. The risks described in our 2011 Form 10-K are not the only risks we may face. If any of those risk factors, as well as other risks and uncertainties that are not currently known to us or that we currently believe are not material, actually occur, our business, financial condition, results of operations and cash flows could be materially and adversely affected. In our judgment, there were no material changes in the risk factors as previously disclosed in Item 1A of our 2011 Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

None.

**Item 3. Defaults Upon Senior Securities.**

None.

**Item 4. Mine Safety Disclosures.**

The information concerning mine safety violations or other regulatory matters required by Section 1503(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act and Item 104 of Regulation S-K is included in Exhibit 95.1 to this Form 10-Q.

**Item 5. Other Information.**

None.

**Item 6. Exhibits.**

See Exhibit Index at page 45 of this report.

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**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrants have duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CLOUD PEAK ENERGY INC.

Date: October 25, 2012

By: */s/ MICHAEL BARRETT*  
Michael Barrett  
*Executive Vice President and Chief Financial Officer*  
*(Principal Financial Officer and Duly Authorized Officer)*

CLOUD PEAK ENERGY RESOURCES LLC

Date: October 25, 2012

By: */s/ MICHAEL BARRETT*  
Michael Barrett  
*Executive Vice President and Chief Financial Officer*  
*(Principal Financial Officer and Duly Authorized Officer)*

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**EXHIBIT INDEX**

The exhibits below are numbered in accordance with the Exhibit Table of Item 601 of Regulation S-K.

<b>Exhibit Number</b>	<b>Description of Documents</b>
2.1	Purchase and Sale Agreement, dated as of June 29, 2012, among Arrowhead I LLC, Chevron USA Inc., CONSOL Energy Inc., Consolidation Coal Company and Reserve Coal Properties Company (incorporated by reference to Exhibit 2.1 to Cloud Peak Energy Inc. s Current Report on Form 8-K filed on July 2, 2012)
2.2	Purchase and Sale Agreement, dated as of June 29, 2012, among Chevron USA Inc. and Arrowhead I LLC (incorporated by reference to Exhibit 2.2 to Cloud Peak Energy Inc. s Current Report on Form 8-K filed on July 2, 2012)
2.3	Purchase and Sale Agreement, dated as of June 29, 2012, among CONSOL Energy Inc., Consolidation Coal Company, Reserve Coal Properties Company and Arrowhead I LLC (incorporated by reference to Exhibit 2.3 to Cloud Peak Energy Inc. s Current Report on Form 8-K filed on July 2, 2012)
3.1	Amended and Restated Certificate of Incorporation of Cloud Peak Energy Inc. effective as of November 25, 2009 (incorporated by reference to Exhibit 3.2 to Amendment No. 3 to Cloud Peak Energy Inc. s Form S-1 filed on November 2, 2009)
3.2	Amended and Restated Bylaws of Cloud Peak Energy Inc. effective as of November 25, 2009 (incorporated by reference to Exhibit 3.1 of Cloud Peak Energy Inc. s Current Report on Form 8-K filed on December 2, 2009)
3.3	Amended and Restated Certificate of Formation of Cloud Peak Energy Resources LLC (incorporated herein by reference to Exhibit 3.1 to Cloud Peak Energy Resources LLC s Registration Statement on Form S-4/A filed on August 17, 2010)
3.4	Third Amended and Restated Limited Liability Company Agreement of Cloud Peak Energy Resources LLC, dated as of November 19, 2009, by and among Cloud Peak Energy Inc., Rio Tinto Energy America Inc. and Kennecott Management Services Company (incorporated herein by reference to Exhibit 10.5 to Cloud Peak Energy Inc. s Current Report on Form 8-K filed on November 25, 2009)
4.1	Form of stock certificate of Cloud Peak Energy Inc. (incorporated by reference to Exhibit 4.1 of the Amendment No. 5 to Cloud Peak Energy Inc. s Form S-1 filed on November 16, 2009)
4.2	Indenture, dated as of November 25, 2009, by and among Cloud Peak Energy Resources LLC (and its subsidiaries listed on the signature page), Cloud Peak Energy Finance Corp., Wilmington Trust Company and Citibank, N.A. (incorporated herein by reference to Exhibit 4.1 to Cloud Peak Energy Inc. s Current Report on Form 8-K filed on December 2, 2009)
4.3	Form of Exchange Notes (included in Exhibit 4.2 hereto)
12.1*	Computation of Ratio of Earnings to Fixed Charges
31.1*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Cloud Peak Energy Inc.
31.2*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Cloud Peak Energy Inc.
31.3*	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Cloud Peak Energy Resources LLC
31.4*	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 for Cloud Peak Energy Resources LLC
32.1*	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Cloud Peak Energy Inc.
32.2*	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Cloud Peak Energy Inc.

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<b>Exhibit Number</b>	<b>Description of Documents</b>
32.3*	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Cloud Peak Energy Resources LLC
32.4*	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 for Cloud Peak Energy Resources LLC
95.1*	Mine Safety Disclosure
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Calculation Linkbase Document
101.LAB*	XBRL Taxonomy Label Linkbase Document
101.PRE*	XBRL Taxonomy Presentation Linkbase Document
101.DEF*	XBRL Taxonomy Definition Document

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\* Filed or furnished herewith, as applicable