International Coal Group, Inc.
Form 10-Q
August 11, 2006
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United States

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended June 30, 2006

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 No. 001-32679

International Coal Group, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**20-2641185**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**
300 Corporate Centre Drive	**25560**

Scott Depot, West Virginia
(Address of principal executive offices) **(Zip Code)**
Registrant s telephone number, including area code:

(304) 760-2400

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

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

Large accelerated filer ¨	Accelerated filer ¨	Non-accelerated filer x

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

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes ¨ No ¨

Number of shares of the Registrant s Common Stock, $0.01 par value, outstanding as of August 1, 2006 152,854,948.

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PART I

Item 1. Financial Statements

INTERNATIONAL COAL GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets (Unaudited)

(Dollars in thousands, except per share amounts)

	June 30, 2006	December 31, 2005
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 65,792	$ 9,187
Accounts receivable	76,826	64,841
Inventories, net	34,487	20,667
Deferred income taxes	6,953	4,923
Prepaid insurance	3,269	7,055
Prepaid expenses and other	10,163	14,454
Total current assets	197,490	121,127
PROPERTY, PLANT AND EQUIPMENT, net	635,457	571,484
DEBT ISSUANCE COSTS, net	13,009	6,523
ADVANCE ROYALTIES	11,679	9,344
GOODWILL	343,970	340,736
OTHER NON-CURRENT ASSETS	6,665	6,949
Total assets	$ 1,208,270	$ 1,056,163
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 53,302	$ 52,230
Short-term debt	18,966	4,113
Current portion of long-term debt and capital leases	1,182	1,646
Current portion of reclamation and mine closure costs	4,697	4,697
Current portion of employee benefits	1,524	1,524
Accrued expenses and other	53,248	43,444
Total current liabilities	132,919	107,654
LONG-TERM DEBT AND CAPITAL LEASES	177,532	43,816
RECLAMATION AND MINE CLOSURE COSTS	80,747	79,655
LONG-TERM EMPLOYEE BENEFITS	36,730	33,297
DEFERRED INCOME TAXES	39,443	43,198
BELOW-MARKET COAL SUPPLY AGREEMENTS	68,017	72,376
OTHER NON-CURRENT LIABILITIES	10,319	9,257
Total liabilities	545,707	389,253
MINORITY INTERESTS	1,126	1,038
COMMITMENTS AND CONTINGENCIES		

STOCKHOLDERS EQUITY:		
Preferred stock-par value $0.01, 200,000,000 shares authorized, none issued Common stock-par value $0.01, 2,000,000,000 shares authorized, 152,706,148 and 152,321,908 shares issued and outstanding, respectively	1,527	1,523
Additional paid-in capital	631,264	632,897
Unearned compensation-restricted stock		(4,622)
Retained earnings	28,646	36,074
Total stockholders equity	661,437	665,872
Total liabilities and stockholders equity	$ 1,208,270	$ 1,056,163

See accompanying notes to condensed consolidated financial statements.

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INTERNATIONAL COAL GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Operations (Unaudited)

(Dollars in thousands, except per share amounts)

	Three months ended June 30, 2006	Three months ended June 30, 2005	Six months ended June 30, 2006	Six months ended June 30, 2005
REVENUES:				
Coal sales revenues	$ 212,164	$ 145,566	$ 415,500	$ 289,763
Freight and handling revenues	4,596	1,885	9,193	4,384
Other revenues	6,560	6,581	10,815	13,117
Total revenues	223,320	154,032	435,508	307,264
COSTS AND EXPENSES:				
Cost of coal sales and other revenues (exclusive of items shown separately below)	193,143	117,076	382,343	234,261
Freight and handling costs	4,596	1,885	9,193	4,384
Depreciation, depletion and amortization	16,596	9,785	33,692	18,307
Selling, general and administrative (exclusive of depreciation and amortization shown separately above)	7,971	9,006	17,964	13,941
(Gain) loss on sale of assets	(158)	43	(929)	43
Total costs and expenses	222,148	137,795	442,263	270,936
Income (loss) from operations	1,172	16,237	(6,755)	36,328
INTEREST AND OTHER INCOME (EXPENSE):				
Interest expense, net	(4,328)	(3,534)	(6,383)	(6,610)
Other, net	2,520	883	3,926	1,451
Total interest and other expense	(1,808)	(2,651)	(2,457)	(5,159)
Income (loss) before income taxes and minority interest	(636)	13,586	(9,212)	31,169
INCOME TAX (EXPENSE) BENEFIT	234	(4,494)	2,509	(11,220)
Income (loss) before minority interest	(402)	9,092	(6,703)	19,949
MINORITY INTEREST	(199)		(87)	
Net income (loss)	$ (601)	$ 9,092	$ (6,790)	$ 19,949
Earnings per share:				
Basic	$ (0.00)	$ 0.09	$ (0.04)	$ 0.19
Diluted	$ (0.00)	$ 0.09	$ (0.04)	$ 0.19
Weighted average common shares outstanding:				
Basic	151,992,579	106,725,504	151,936,375	106,669,880
Diluted	151,992,579	106,763,030	151,936,375	106,684,475

See accompanying notes to condensed consolidated financial statements.

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INTERNATIONAL COAL GROUP, INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)

(Dollars in thousands)

	Six months ended June 30, 2006	Six months ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (6,790)	$ 19,949
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Depreciation, depletion and amortization	33,692	18,307
Write-off and amortization of deferred finance costs included in interest expense	2,253	548
Minority interest	87	
Compensation expense on restricted stock and options	2,993	2,654
(Gain) loss on sale of assets, net	(929)	43
Deferred income taxes	(5,385)	2,888
Changes in operating assets and liabilities:		
Accounts receivable	(11,985)	(7,279)
Inventories	(14,858)	(7,943)
Prepaid expenses and other	8,077	1,250
Other non-current assets	(1,779)	(3,495)
Accounts payable	(62)	6,089
Accrued expenses and other	9,589	3,744
Accrued income tax		(2,232)
Reclamation and mine closure costs	1,692	(791)
Other liabilities	2,174	1,338
Net cash from operating activities	18,769	35,070
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from the sale of assets	3,248	
Net proceeds from sale-leaseback	5,413	
Additions to property, plant and equipment and mine development	(85,262)	(40,266)
Cash paid related to acquisitions, net	(2,892)	
Withdrawals (deposits) of restricted cash	237	(2,034)
Net cash from investing activities	(79,256)	(42,300)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayments on short-term debt	(7,422)	(2,673)
Borrowings on long-term debt	70,000	
Proceeds from senior notes offering	175,000	
Repayments on long-term debt and capital leases	(111,747)	(1,252)
Debt issuance costs	(8,739)	(120)
Net cash from financing activities	117,092	(4,045)
NET CHANGE IN CASH AND CASH EQUIVALENTS	56,605	(11,275)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	9,187	23,967
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 65,792	$ 12,692

Supplemental information:		
Cash paid for interest (net of amount capitalized)	$ 4,380	$ 5,582
Cash paid for income taxes	$	$ 12,000
Supplemental disclosure of non-cash items:		
Purchases of property, plant and equipment through accounts payable	$ 1,135	$ 2,958
Purchases of property, plant and equipment through short-term debt	$ 22,274	$

See accompanying notes to condensed consolidated financial statements.

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INTERNATIONAL COAL GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

June 30, 2006

(Dollars in thousands, except per share amounts)

(1) Basis of Presentation

The accompanying interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial reporting and include the accounts of International Coal Group, Inc. and subsidiaries (the Company) and its controlled affiliates. Significant intercompany transactions, profits and balances have been eliminated in consolidation.

The accompanying interim condensed consolidated financial statements as of June 30, 2006 and for the three and six months ended June 30, 2006 and 2005, and the notes thereto, are unaudited. However, in the opinion of management, these financial statements reflect all normal, recurring adjustments necessary for a fair presentation of the results of the periods presented. The balance sheet information as of December 31, 2005 has been derived from the Company s audited consolidated balance sheet. These statements should be read in conjunction with the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2005. The results of operations for the three and six months ended June 30, 2006 are not necessarily indicative of the results to be expected for future quarters or for the year ending December 31, 2006.

The accompanying condensed consolidated financial statements as of June 30, 2006 and December 31, 2005 and for the three and six months ended June 30, 2006 include the assets, liabilities and results of operations of Anker Coal Group, Inc. (Anker) and CoalQuest Development LLC (CoalQuest), which the Company acquired on November 18, 2005.

(2) Summary of Significant Accounting Policies

Income Taxes In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes,* (FIN 48). FIN 48 increases the relevancy and comparability of financial reporting by clarifying the way companies account for uncertainty in income taxes. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company does not expect the adoption of FIN 48 to have a material impact on the Company s financial position, results of operations or cash flows.

Inventories Effective January 1, 2006, the Company adopted The Emerging Issues Task Force (EITF) Issue 04-6, *Accounting for Stripping Costs in the Mining Industry* (EITF Issue 04-6). EITF Issue 04-6 applies to stripping costs incurred in the production phase of a mine for the removal of overburden or waste materials for the purpose of obtaining access to coal that will be extracted. Under the new EITF, stripping costs incurred during the production phase of the mine are variable production costs that are included in the cost of inventory produced during the period the stripping costs are incurred. The EITF further clarified that inventory produced is intended to mean inventory extracted. Historically, the coal industry has considered coal uncovered at a surface mining operation but not yet extracted to be coal inventory (pit inventory). As a result, the adoption of EITF Issue 04-6 caused a write off of pit inventory which resulted in a decrease of $638 in the Company s retained earnings, net of tax, as of January 1, 2006.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 151, *Inventory Costs, an amendment of ARB No. 43, Chapter 4* (SFAS No. 151). This statement amends the guidance in ARB No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). SFAS No. 151 requires that those items be recognized as current-period charges regardless of whether they meet the criterion of so abnormal. In addition, this statement requires that allocation of fixed production overheads to the cost of conversion be based on the normal capacity of the production facilities. Adoption of this statement did not have a material impact on the Company s consolidated financial position or results of operations.

Stock-Based Compensation Effective January 1, 2006, the Company adopted SFAS No. 123(R), *Share Based Payments* (SFAS No. 123(R)), using the modified prospective application, to account for stock based awards issued under its equity and performance incentive plan. SFAS No. 123(R) revises SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123), and supersedes Accounting Principles Board Opinion No. 25*, Accounting for Stock Issued to Employees* (APB No. 25), and its related implementation guidance. This statement establishes standards of accounting for transactions in which an entity exchanges its equity instruments for goods or services. It also addresses transactions in which an entity incurs liabilities in exchange for goods or services that are based on the fair value of the entity s equity instruments or that may be settled by the issuance of those equity instruments. The adoption of SFAS No. 123(R) did not require a cumulative effect adjustment. Prior to

January 1, 2006, the Company applied the provisions of APB No. 25, to account for stock-based awards issued under its equity and performance incentive plan. Adoption of SFAS No. 123(R) resulted in additional compensation expense related to

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INTERNATIONAL COAL GROUP, INC. AND SUBSIDIARIES

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June 30, 2006

(Dollars in thousands, except per share amounts)

stock option awards, which decreased net income before income taxes and minority interest by $674 and $1,015 for the three and six months ended on June 30, 2006, respectively, and increased net loss by $492 and $741 for the three and six months ended June 30, 2006, respectively. The adoption of SFAS No. 123(R) did not impact basic or diluted earnings per share for the three months ended June 30, 2006 nor did it impact basic earnings per share for the six months ended June 30, 2006, however, diluted earnings per share for the six months ended June 30, 2006 decreased by $0.01 (See Note 12).

If compensation expense for the three and six months ended June 30, 2005 associated with the Company s stock based awards was determined in accordance with SFAS No. 123, the Company s net earnings and earnings per share would have been as follows:

	Three months ended June 30, 2005	Six months ended June 30, 2005
Net income, as reported	$ 9,092	$ 19,949
Add back expense related to stock awards included in net income, net of income taxes	1,645	1,645
Deduct effect of stock-based employee compensation determined under fair-value based method, net of tax effects:	(1,912)	(1,912)
Pro-forma net income	$ 8,825	$ 19,682
Earnings per share:		
As reported-Basic and diluted	$ 0.09	$ 0.19
Pro-forma-Basic and diluted	$ 0.08	$ 0.18

The Black-Scholes option pricing model was used to calculate the estimated fair value of options at the date of grant using the following assumptions: expected life of 5 years, expected volatility of 41%, a risk-free interest rate of 4.1%, and no payment of dividends or forfeitures of options during the term of the options.

Coal Supply Agreements Purchase price allocated to coal supply agreements (sales contracts) are capitalized and amortized on the basis of coal to be shipped over the term of the contract. Value is allocated to coal supply agreements based on discounted cash flows attributable to the difference between the above or below-market contract price and the then prevailing market price. The net book value of the Company s above-market coal supply agreement was $3,867 and $4,051 at June 30, 2006 and December 31, 2005, respectively. This amount is recorded in other assets in the accompanying consolidated balance sheets. The net book value of the below-market coal supply agreements was $68,017 and $72,376 at June 30, 2006 and December 31, 2005, respectively. Amortization expense on all above-market coal supply agreements was $92 and $184 for the three and six months ended June 30, 2006, respectively. Amortization income on the below-market coal supply agreements was $3,186 and $4,359 for the three and six months ended June 30, 2006, respectively. There were no above or below-market coal supply agreements at June 30, 2005, nor any amortization for the three and six months ended June 30, 2005. Based on expected shipments related to these contracts, the Company currently expects to record annual amortization expense on the above-market coal supply agreements and annual amortization income on the below-market coal supply agreements in each of the next five years as reflected in the table below.

	Above-market contract	Below-market contracts
2006, including six months amortization above	$ 368	$ 15,651

2007	368	20,759
2008	368	3,386
2009	368	3,386
2010	368	3,386

Amortization income on below market coal supply agreements was lower than expected primarily due to the interruption of shipments on a below market contract assigned to the Sago mine.

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INTERNATIONAL COAL GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

June 30, 2006

(Dollars in thousands, except per share amounts)

(3) Sale-leaseback of Coal Lands

On June 29, 2006, the Company sold coal lands to an unrelated third party for $5,500. The Company subsequently leased back all of the coal lands from the buyer. The estimated gain on the sale-leaseback transaction of $1,500 was deferred and is being amortized over the term of the lease as tons are mined.

(4) Derivative Instruments and Hedging Activities

The Company s hedging policies permit the use of interest rate swaps and caps to manage interest rate risk. The Company does not use derivative financial instruments for trading or speculative purposes. Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended (SFAS No. 133), establishes accounting and reporting standards for derivative instruments and hedging activities. To qualify for hedge accounting under SFAS No. 133, the effectiveness of each hedging relationship is assessed both at hedge inception and at each reporting period thereafter. Also, at the end of each reporting period, ineffectiveness in the hedging relationships is measured as the difference between the change in fair value of the derivative instruments and the change in fair value of either the hedged items (fair value hedges) or expected cash flows (cash flow hedges). Ineffectiveness, if any, is recorded in interest expense.

In May 2006, the Company entered into an Interest Rate Collar Agreement (the Agreement) which will become effective as of March 31, 2007 and will expire on March 31, 2009. The Company will use the Agreement to hedge its interest rate risk on an initial $100,000 of revolving debt (escalating to $200,000 in March 2008). The interest rate collar is designed as a cash flow hedge to offset the impact of changes in the LIBOR interest rate above 5.92% and below 4.80%. The Company has chosen not to designate its derivatives as hedging instruments and recognizes the change in the fair value of its securities in the income statement in the period of change. The Agreement, included in other long-term assets in the Company s condensed consolidated balance sheet at June 30, 2006 was adjusted to its fair value of approximately $189 and resulted in a loss of approximately $111 for three and six months ended June 30, 2006.

(5) Acquisitions

On November 18, 2005, the Company consummated a business combination with each of Anker and CoalQuest pursuant to which each of Anker and CoalQuest became the Company s wholly owned subsidiaries. The results of operations of Anker and CoalQuest are included in the Company s consolidated results of operations since the date of acquisition. The following unaudited pro forma data for the three and six months ended June 30, 2005 reflect the consolidated results of operations of the Company as if the acquisition had taken place on January 1, 2005. The unaudited pro forma information incorporates the accounting for the acquisition, including but not limited to, the application of purchase accounting for coal supply agreements and mineral reserves, employee benefit liabilities and property, plant and equipment. The unaudited pro forma information may not be indicative of actual results.

	Three months ended June 30, 2005	Six months ended June 30, 2005
Revenues	$ 195,011	$ 390,107
Net income	$ 6,786	$ 19,627
Earnings per share:		
Basic	$ 0.05	$ 0.15
Diluted	$ 0.05	$ 0.15

Weighted average shares outstanding:		
Basic	130,816,413	130,760,789
Diluted	130,850,573	130,764,747

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INTERNATIONAL COAL GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

June 30, 2006

(Dollars in thousands, except per share amounts)

(6) Inventories

Inventories consisted of the following:

	June 30, 2006	December 31, 2005
Coal	$ 20,548	$ 9,960
Parts and supplies	14,530	11,018
Reserve for obsolescence, parts and supplies	(591)	(311)
Inventories, net	$ 34,487	$ 20,667

(7) Goodwill

The changes in the carrying amount of goodwill for the six months ended June 30, 2006 were as follows:

Balance at December 31, 2005	$ 340,736
Adjustments to purchase price allocation of Horizon	(562)
Bonding royalty	1,981
Anker/CoalQuest acquisitions	1,815
Balance at June 30, 2006	$ 343,970

The adjustments to finalize the purchase price allocation of the Company s acquisition of certain assets from Horizon Natural Resources LLC (Horizon) were due to a refund of legal fees held in escrow and the adjustments for the Anker/CoalQuest acquisition were due to the excess of actual expenses related to the acquisition of the assets of Anker and CoalQuest over management s original estimate to balance sheet accounts for items that were not available at the time of acquisition. The Company has not yet finalized the purchase price allocation associated with the Anker/CoalQuest acquisitions. Therefore, the Company expects adjustments, which could be material, to its purchase price allocation between tangible and intangible assets, including goodwill.

(8) Short-term Debt

In May 2006, the Company entered into a $50,000 revolving credit line with Caterpillar Financial Services, Inc. for the purchase of new Caterpillar equipment. Funds may be borrowed under the revolving credit facility for terms ranging from 12 to 60 months with current interest rates ranging from 2.8% to 7.3%, depending on the terms chosen by the Company. For the period ended June 30, 2006, the Company had $18,966 outstanding under the revolving credit facility for a 12-month term with interests rates ranging from 2.51% to 2.75%.

(9) Long-term Debt and Capital Leases

Long-term debt and capital leases consist of the following:

	June 30, 2006	December 31, 2005
Term notes, due 2010	$	$ 19,563
Revolving credit facility, due 2009		21,280
10.25% Senior notes, due 2014	175,000	
Equipment notes	3,714	4,453
Capital leases		166
Total	178,714	45,462
Less-current portion	(1,182)	(1,646)
Long-term debt and capital leases	$ 177,532	$ 43,816

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INTERNATIONAL COAL GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

June 30, 2006

(Dollars in thousands, except per share amounts)

Senior notes On June 23, 2006, the Company sold $175,000 aggregate principal amount of its 10.25% senior notes due July 15, 2014 (the Notes) in a private placement pursuant to Rule 144A of the Securities Act of 1933, as amended (the Securities Act) and Regulation S of the Securities Act, with net proceeds of approximately $171,500 to the Company after deducting fees and other offering expenses. The net proceeds were used to repay all amounts outstanding under the Company s then existing revolving credit facility of $91,280 and retire the Company s then outstanding term loan facility of $19,521. The Company intends to use the remaining proceeds to fund future capital expenditures as well as for general corporate purposes. Interest on the Notes are payable semi-annually in arrears on July 15 and January 15 of each year, commencing on January 15, 2007. The Notes are senior unsecured obligations of the Company and are guaranteed on a senior unsecured basis by all of the Company s current and future domestic subsidiaries that are material or that guarantee the Company s amended and restated credit facility (the Guarantors). The Notes and the Guarantees rank equally with all of the Company s and the Guarantors existing and future senior unsecured indebtedness, but are effectively subordinated to all of the Company s and the Guarantors existing and future senior secured indebtedness to the extent of the value of the assets securing that indebtedness and to all liabilities of the Company s subsidiaries that are not Guarantors. The Company has the option to redeem all or a portion of the Notes at 100% of the aggregate principal amount at maturity at any time on or after July 15, 2010. At any time prior to July 15, 2010, the Company may also redeem all or a portion of the Notes at a redemption price equal to 100% of the aggregate principal amount of the Notes plus an applicable premium as of, and accrued and unpaid interest and additional interest, if any, to, but not including the date of redemption. At any time before July 15, 2009, the Company may also redeem up to 35% of the aggregate principal amount of the Notes at a redemption price of 110.25% of the principal amount, plus accrued and unpaid interest, if any, to the date of redemption, with the proceeds of certain equity offerings. Upon the happening of a change of control, the Company may be required to offer to purchase the Notes at a purchase price equal to 101% of the principal amount, plus accrued and unpaid interest.

On June 23, 2006, the Company and the Guarantors also entered into registration rights agreement with the initial purchasers pursuant to which they agreed (i) to file a registration statement by January 19, 2007 enabling holders to exchange the privately placed Notes for publicly registered notes with substantially identical terms, (ii) to use commercially reasonable efforts to cause such registration statement to be declared effective by the Securities and Exchange Commission (the SEC) by March 20, 2007 and (iii) to use commercially reasonable efforts to cause the exchange offer to be completed 30 business days after March 20, 2007. The indenture governing the Notes contains covenants that limit the Company s ability to, among other things, incur additional indebtedness, issue preferred stock, pay dividends, repurchase, repay or redeem our capital stock, make certain investments, sell assets, and incur liens. As of June 30, 2006, the Company was in compliance with its covenants under the indenture.

Credit facility On June 23, 2006, the Company entered into a second amended and restated credit agreement consisting of a revolving credit facility of $325,000, of which up to a maximum of $125,000 may be used for letters of credit, and matures on June 23, 2011. As of June 30, 2006, the Company had letters of credit totaling $59,925 outstanding leaving $265,075 available for future borrowing capacity. Interest on the borrowings under the credit facility is payable, at the Company s option, at either the base rate plus an applicable margin based on the Company s leverage ratio of 0.75% to 1.25% or LIBOR plus an applicable margin based on the Company s leverage ratio of 1.75% to 2.25%. The Company must pay an unused commitment fee based on its leverage ratio of 0.375% or 0.50%. The Company must also pay a letter of credit participation fee with respect to outstanding letters of credit in an amount equal to the interest rate margin applicable to LIBOR borrowings under the revolving credit facility and letter of credit fronting fee of 0.20% per annum. The credit facility contains customary affirmative and negative covenants, including, but not limited to, limitations on the incurrence of indebtedness, asset dispositions, acquisitions, investments, dividends and other restricted payments, liens and transactions with affiliates. The credit facility also requires the Company to meet certain financial tests, including a maximum leverage ratio, a minimum interest coverage ratio and a limit on capital expenditures. As of June 30, 2006, the Company was in compliance with its covenants under the credit facility. The credit facility contains customary events of default, including, but not limited to, failure to pay principal or interest, breach of covenants or representations and warranties, cross-default to other indebtedness, judgment default and insolvency. If an event of default occurs under the credit facility, the lenders under the agreement will be entitled to take various actions, including demanding payment for all amounts outstanding thereunder and foreclosing on any collateral.

As a result of amending and restating its prior credit agreement, the Company incurred a write-off of $1,369 of deferred financing expenses related to the prior credit agreement.

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INTERNATIONAL COAL GROUP, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

June 30, 2006

(Dollars in thousands, except per share amounts)

Future maturities of long-term debt and capital leases are as follows as of June 30, 2006:

Year or period ended December 31:	
2006 (from July 1, 2006 to December 31, 2006)	$ 627
2007	1,068
2008	1,051
2009	886
2010	82
2011 and thereafter	175,000
Total	$ 178,714

(10) Income Taxes

The change in the effective income tax rate to 37% for the three months ended June 30, 2006 from 33% for the three months ended June 30, 2005 was due to the result of favorable tax deductions for depletion of mineral rights offset by an adjustment to reflect the expected full year 2006 effective income tax rate. The change in the effective income tax rate to 27% for the six months ended June 30, 2006 from 36% for the six months ended June 30, 2005 was primarily the result of favorable tax deductions for depletion of mineral rights.

(11) Postretirement Benefits Other Than Pensions

The following table details the components of the net periodic benefit cost for postretirement benefits other than pensions:

	Three months ended June 30,		Six months ended June 30,	
	2006	**2005**	**2006**	**2005**
Service cost	$ 324	$ 226	$ 648	$ 452
Interest cost	167	117	334	234
Amortization of net loss	14		28	
Net periodic benefit cost	$ 505	$ 343	$ 1,010	$ 686

The plan is unfunded, therefore, no contributions were made by the Company for the three and six months ended June 30, 2006 and 2005.

(12) Employee Stock Awards

The Company s 2005 Equity and Performance Incentive Plan (the Plan) permits the grant of share options, restricted shares, stock appreciation rights, restricted share units, performance shares or performance units to its employees for up to 8,000,000 shares of common stock. Option awards are generally granted with an exercise price equal to the market price of the Company s stock at the date of grant and have 10 year contractual terms. The option and restricted stock awards generally vest at 25% in equal annual installments over a four year period. The Company recognizes expense related to the awards on a straight line basis over the vesting period. The Company issues new shares upon the exercise of option awards.

During the first half of 2006, the Company granted stock options and restricted stock awards to certain employees of the Company under the Plan. Stock options were granted to purchase 584,040 shares of common stock at a weighted average exercise price of $9.38 per share with a fair value of $2,613. Restricted stock awards of 389,360 shares were granted with a fair value of $3,652. The stock option and restricted stock awards vest 25% on June 30, 2006 and 25% in equal annual installments on June 30, 2007, 2008 and 2009. The Black-Scholes option pricing model was used to calculate the estimated fair value of the options at the date of grant using the following assumptions: expected lives of 5 years, expected volatility of 48.1 % and risk-free interest rates ranging from 4.6 % to 5.2%. The Company assumed that no dividends will be paid and estimated a forfeiture rate of 1.0 %. Due to the Company s limited operating history, the expected lives and volatility are estimated based on other companies in the coal industry. The risk-free interest rates are based on the rates of zero coupon U.S. Treasury bonds with similar maturities on the date of grant. The forfeiture rate was determined based on the Company s employee turnover rate over the previous year. Stock-based employee compensation expense of $1,379 and $2,177, net of tax of $516 and $815, related to the issuance of all stock awards outstanding as of June 30, 2006 was

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included in net income for the three and six months ended June 30, 2006, respectively.

Compensation expense of $1,645, net of tax of $1,009, related to stock awards outstanding as of June 30, 2005, was included in net income for the three and six months ended June 30, 2005.

A summary of the Company s outstanding option grants as of June 30, 2006, and changes during the six months then ended is as follows:

Options	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (thousands)
Outstanding at January 1, 2006	644,052	$ 10.99		
Granted	584,040	9.38		
Exercised				
Forfeited or expired	(7,680)	9.51		
Outstanding at June 30, 2006	1,220,412	$ 10.23	9.2	$ (3,723)
Exercisable at June 30, 2006	466,116	$ 10.49	9.1	$ (1,537)

The weighted-average grant-date fair value of options granted during the six months ended June 30, 2006 and 2005 was $4.47 and $5.74, respectively.

A summary of the status of the Company s nonvested restricted stock awards as of June 30, 2006 and changes during the six months ended June 30, 2006 is as follows:

Nonvested Shares	Shares	Weighted-Average Grant-Date Fair Value
Nonvested at January 1, 2006	450,000	$ 13.48
Granted	389,360	9.38
Vested	(246,060)	11.88
Forfeited	(5,120)	9.51
Nonvested at June 30, 2006	588,180	$ 11.47

The weighted-average grant-date fair value of restricted stock granted during the six month period ended June 30, 2006 was $9.38. The weighted-average fair value of restricted stock vested during the six month period ended June 30, 2006 was $2,923.

As of June 30, 2006, there was $9,809 of total unrecognized compensation cost related to non-vested stock-based awards, that is expected to be recognized over a weighted-average period of 2.5 years.

On July 1, 2006, the Company granted stock options and restricted stock awards to certain employees under the Plan. Stock options were granted to purchase 542,000 shares of common stock at an exercise price of $7.19 per share with a fair value of $1,886. Restricted stock awards of 148,000 were granted with a fair value of $1,064. The stock option and restricted stock awards vest 25% on June 30, 2007 and 25% in equal annual installments on June 30, 2008, 2009 and 2010.

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(13) Earnings Per Share

Basic earnings per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding during the period, excluding restricted common stock subject to continuing vesting requirements. Diluted earnings per share is calculated based on the weighted average number of common shares outstanding during the period and, when dilutive, potential common shares from the exercise of stock options and restricted common stock subject to continuing vesting requirements, pursuant to the treasury stock method.

	Three months ended June 30,		Six months ended June 30,	
	2006	2005	2006	2005
Net income (loss)	$ (601)	$ 9,092	$ (6,790)	$ 19,949
Average common shares outstanding-Basic	151,992,579	106,725,504	151,936,375	106,669,880
Incremental shares arising from stock options		22,081		7,408
Incremental shares arising from restricted shares		15,445		7,187
Average common shares outstanding-Diluted	151,992,579	106,763,030	151,936,375	106,684,475
Earnings Per Share:				
Basic	$ (0.00)	$ 0.09	$ (0.04)	$ 0.19
Diluted	$ (0.00)	$ 0.09	$ (0.04)	$ 0.19

Due to a net loss for the three and six months ended June 30, 2006, options to purchase 1,220,412 shares of common stock and 588,180 restricted common stock were not included in the computation of diluted earnings per share because the effect would be antidilutive. Options to purchase restricted common stock of 243,750 were not included in the computation of earnings per share for the three and six months periods ended June 30, 2005, respectively, because to do so would have been antidilutive.

(14) Commitments and Contingencies

Guarantees and Financial Instruments with Off-balance Sheet Risk In the normal course of business, the Company is a party to certain guarantees and financial instruments with off-balance sheet risk, such as bank letters of credit and performance or surety bonds. No liabilities related to these arrangements are reflected in the Company s consolidated balance sheets. Management does not expect any material losses to result from these guarantees or off-balance sheet financial instruments. The Company has outstanding surety bonds with third parties of approximately $101,659 as of June 30, 2006 to secure reclamation and other performance commitments. As of June 30, 2006, the Company has bank letters of credit outstanding of $59,925 under its revolving credit facility.

Legal Matters From time to time, the Company is involved in legal proceedings arising in the ordinary course of business. In the opinion of management the Company has recorded adequate reserves for these liabilities and there is no individual case or group of related cases pending that is likely to have a material adverse effect on the financial condition, results of operations or cash flows of the Company.

On July 19, 2006, J. Davitt McAteer, special advisor to West Virginia Governor Joe Manchin III, released a preliminary report relating to the January 2, 2006 fatal explosion at the Sago mine, operated by the Company s subsidiary Wolf Run Mining Company (f/k/a Anker West Virginia Mining Company, Inc.). The report concluded that, consistent with the Company s initial findings announced on March 14, 2006, the explosion was caused by an ignition of methane within a previously abandoned and sealed area of the mine and that the ignition was probably caused by lightning. Final results of the investigations will not be known until federal and state safety officials conclude their investigations and issue their reports.

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(15) Related Party Transactions and Balances

Under an Advisory Services Agreement, dated as of October 1, 2004 between the Company and WL Ross & Co. LLC, (WLR), WLR has agreed to provide advisory services to the Company (consisting of consulting and advisory services in connection with strategic and financial planning, investment management and administration and other matters relating to the business and operation of the Company of a type customarily provided by sponsors of U.S. private equity firms to companies in which they have substantial investments, including any consulting or advisory services which the Board of Directors reasonably requests). WLR is paid a quarterly fee of $500 and reimbursed for any reasonable out of pocket expenses (including expenses of third-party advisors retained by WLR). The agreement is for a period of seven years; however, it may be terminated upon the occurrence of certain events.

On October 1, 2004, ICG entered into an agreement with Insuratex, LTD, a wholly owned subsidiary of funds controlled by WLR, to administer and pay workers compensation claims incurred by the Company. The Company paid an initial $2,500 premium to fund such claims and continued to pay monthly installments of $208 until a total premium of $5,000 was paid by the Company. This agreement was cancelled on September 30, 2005 and after deducting for actual claims paid, the Company received a refund of $4,295.

(16) Segment Information

The Company extracts, processes and markets steam and metallurgical coal from deep and surface mines for sale to electric utilities and industrial customers primarily in the eastern United States. The Company operates only in the United States with mines in the Central Appalachian, Northern Appalachian and Illinois basin regions. The Company has three reportable business segments: Central Appalachian, Northern Appalachian and Illinois Basin. The Company s operations in Central Appalachia are located in southern West Virginia and eastern Kentucky and include seven underground mines and nine surface mines. The Company s operations in Northern Appalachia are located in northern West Virginia, Pennsylvania and Maryland and include five underground mines and six surface mines. The Company s operations in Illinois include one underground mine. The Company also has an Ancillary category which includes the Company s brokered coal functions, corporate overhead, contract highwall mining services and land activities.

The difference between segment assets and consolidated assets in the following tables is the elimination of intercompany transactions including inter-segment revenues and investment in subsidiaries reflected in the elimination category. Prior to the acquisition of Anker and CoalQuest, the Company had two reportable business segments: Central Appalachia and Illinois Basin. Operating segment results for the three and six months ended June 30, 2006 and 2005 are presented below:

Three months ended June 30, 2006

	Central Appalachian	Northern Appalachian	Illinois Basin	Ancillary	Eliminations	Consolidated
Revenue	$ 138,548	$ 34,213	$ 10,504	$ 42,685	$ (2,630)	$ 223,320
EBITDA	26,098					