Arch Coal Inc. Q3 2007 Earnings Call Transcript

Question-and-Answer Session

Operator

[Operator Instructions]

And we'll take our first question from Brett Levy with Jefferies and Company. Please go ahead.

Brett Levy - Jefferies & Co.

Okay. Do you guys said, in revise guidance range that you gave for EBITDA of 460 to 490. Just kind of taking the mid-point of that range, that implies a very significant bump up from 3Q to 4Q and fourth quarter traditionally in this business there are some holiday shipments and that sort of thing that get in the way and usually everyone takes some clean up cost associated with maintenance, can you talk about what biggest sources of Delta positively from 3Q to 4Q might be?

Robert J. Messey - Chief Financial Officer and Senior Vice President

Well, I think the biggest differences is, you know, our start up of our Mountain Laurel operation its any time you expect to start the operation that size, you expect to have start up issues and we have been pleasantly surprised by the start up of this operation. The mine is running very well, we are forecasting about 900,000 tons of production during the fourth quarter, which is quite bit high and what we had previously mentioned. So given that and the attractive market environment we see for domestic met, international met, international PCI, we think that will? cost the biggest part of the EBITDA growth.

Brett Levy - Jefferies & Co.

And you know is it wrong to think of that is, this is a follow-up question, is it wrong to think of that as something in the zip code of $30 million bump from third quarter EBITDA to fourth quarter EBITDA?

Steven F. Leer - Chairman and Chief Executive Officer

This is Steve. I think you can think of it is in the third quarter, we didn't have really any of the high valued coal coming out of our Mingo Logan mine because we have sold it and Mountain Laurel had started up, I don't have a specific EBITDA number in mind, but it is a significant bump because third quarter didn't have the production, fourth quarter will have the production and it should be sold at fairly attractive prices. I think and also need to clarify third quarter in the coal industry typically is a difficult quarter for a variety of reasons but it goes back for decades, what they call mine on vacation, traditionally its held in the third quarter and you see a lot of mines including some bar stack week outages or even two week outages where the miners literally go on vacation and now on top of that, we do very significant maintenance turn around during those periods of time, which typically increase the expense. So even though the fourth quarter has some holidays and third quarter often is the weakest quarter in the industry.

Brett Levy - Jefferies & Co.

All right. I'll get back in queue. Thanks guys.

Steven F. Leer - Chairman and Chief Executive Officer

Thanks.

Operator
Thank you. And we will take our next question from Paul Forward with Stifel Nicolaus. Please go ahead.
Paul Forward - Stifel Nicolaus
Hi. Good morning and congratulations on the Mountain Laurel startup.
Robert J. Messey - Chief Financial Officer and Senior Vice President
Thank you.
Steven F. Leer - Chairman and Chief Executive Officer
Thanks, Paul.
Paul Forward - Stifel Nicolaus
Looking at Black Thunder, can you maybe step us through the next say one to three years as a transition going away from the Southern end of the mine and access to the truck loadout that you sold how a Black Thunder's volumes going to change over time?
Steven F. Leer - Chairman and Chief Executive Officer
Paul we don't give out volumes per mine involved, but you know we will tell you that our production plans are going to be market driven we sold out the South load off to Peabody, they take ownership of that October 1st 2008. We're well in the process of building our new loadout which is a much enhanced loadout that will operational sometime in September 2008. So, I think we're in pretty good shape from that standpoint. Volume wise really it's going to depend on the market.
Paul Forward - Stifel Nicolaus
Okay. So, there's, so we don't have to worry too much about a product mix shift away from Black Thunder and toward coal creek that might diminish I guess the quality of the coal just in aggregate that we'll see out of the PRB from Arch overtime.
Steven F. Leer - Chairman and Chief Executive Officer
Not at all Paul, in fact we see some improvement in qualities we move out, so we don't see that at all.
Paul Forward - Stifel Nicolaus
All right. Very good. Thank you.
Operator
And we'll go to, Ann Kohler with Caris and Company.
Ann Kohler - Caris and Company
Good morning, gentlemen. A question, I was just looking at the absolute cost from the PRB and there was about a? about not better $8 million swing in those? I noted on the unit basis they were flat, but could you provides a little bit of detail as to what that increase was attributable to?
Steven F. Leer - Chairman and Chief Executive Officer
Yes, I think a big challenge in the PRB has been, our tire cost and our diesel cost quite frankly. And we think we're doing a pretty good job in managing those. We've improved our tire life between 50% and 60%. Several things, maintenance on the roads, training and progress slowing a speed of the trucks down so we've had good luck there. We've also got our diesel partially hedge for the balance of this year, in pretty good shape. So, yes, but I would say that those were probably the out liners in terms of our PRB cost.
Ann Kohler - Caris and Company
And then just a follow up, what is your hedge position on diesel going into next year?
Steven F. Leer - Chairman and Chief Executive Officer
Currently we're modestly hedged going into ?08. We're using two techniques, purchase contracts, as well as, the heating oil, our heating fuel hedges and as you know that the heating fuel hedges in the

west have been a lot of whack its been a little difficult. But we're projecting to be in the 70% hedge drained as we go into the year.

Ann Kohler - Caris and Company

Okay. Thank you.

Operator

And we'll now go to Mark Liinamaa with Morgan Stanley

Mark Liinamaa - Morgan Stanley

Good morning, guys.

Steven F. Leer - Chairman and Chief Executive Officer

Good morning

Mark Liinamaa - Morgan Stanley

Can you comment a little more on the nature of developments in the export markets and I'm looking mainly is the growing interest in seaborne metallurgical coal from the international steam makers? And on the thermal side is most of the interest more spot per term in nature and is there any difference in coal qualities that they are looking for? Thanks.

Steven F. Leer - Chairman and Chief Executive Officer

Yes. With all, I'll let John do it but I just jump in and I'm giving a little history here, I mean the international coal markets have jumped so greatly and this morning there were quotes that Richard's Bay Panamax were trading at $80 metric ton that would be the bulk and if you go back to January 1st, that was $51 a ton. And delivery in the Rotterdam essentially again on January 1st was about $68, $67-$68, this morning they traded a $125 and someone whispered to me, they've heard about a $130 trade. So the markets have gotten extraordinarily robust. On the steam side the met markets have followed in even bigger numbers if you will. So we're seeing some great things. I'll let John talk specifically perhaps about what we're doing.

John W. Eaves - President and Chief Operating Officer

Yeah, thanks. First on the met side, certainly it's widely known what's going on in Australia with the port issues and the rail issues and the Q in terms of ships in Queensland, we've seen a real increase in interest in U.S. met coal. You know, I think you'll continue to see that as we move out, any time you start an operation like Mount Laurel, you know there's a certain amount of testing that's involved to get tested at various steel consumers. We haven't really seen that lengthy test process right now. We've been able to get some test shipments books and business into 2007. So we're very pleased from that standpoint. I guess on the steam side, if you look at what's going on in South Africa with some of their challenges, some of the challenges in Indonesia and the increased demand within that country you're basically seeing a lot new demand on the steam side and Europe that we haven't seen in years. I think Steve mentioned in his comments, we placed one steam boat on a prompt basis and have a lot of discussions going on for the next year to two years for some term steam business. So, we're very pleased with what we're seeing on the met as well as the steam and we think, our timing with Mountain Laurel is going to be very good as we move into 2008.

Mark Liinamaa - Morgan Stanley

Yes, the timing does look great on that and with that can you comment on what's the volume of met coal between the various grades might be next year?

John W. Eaves - President and Chief Operating Officer

You know, I really wouldn't want to give it by grades again we as a company in 2006 we shipped about 2 million tons of metallurgical/PCI. That number will be comparable in 2007; we hope to at least double that as we move into 2008. Our capabilities on the met side are going to similar between 4 million and 6 million tons as a company in 2008. So, we like what we see as far.

Mark Liinamaa - Morgan Stanley

Looks great. Thank you.

Operator

And we'll now go to John Bridges with JP Morgan.

John Bridges - JP Morgan

Hi, everybody. Congratulations on Mountain Laurel?

Steven F. Leer - Chairman and Chief Executive Officer

Thank you, John.

John Bridges - JP Morgan

You talked about the met and PCI any guidance on the split?

Steven F. Leer - Chairman and Chief Executive Officer

You know I really would I'll be hesitant to give you that split right now because we are in a number of negotiations and some of those could either way, but, you know the advantage I guess on the PCI, John as we have ability to change our yield around the [inaudible] razor ad, so we look that will be market determined. So like I say we are real happy of what we are seeing as far.

John Bridges - JP Morgan

Okay. And just broadly is it 50-50, 75-25?

Steven F. Leer - Chairman and Chief Executive Officer

I'd rather not go there, John.

John Bridges - JP Morgan

Okay.

John W. Eaves - President and Chief Operating Officer

John, I mean the coal itself can go through either markets, it's simply what actually we leave in the coal if you will, so, obviously the goal will be to maximize the met side of it versus the PCI and then met PCI versus steam but the market will determine.

John Bridges - JP Morgan

Okay. I understood. And then internationally, how do you approach a crazy market like the one we've got, how much interest do you are getting on sort of longer term business that you can actually invest capacity?

John W. Eaves - President and Chief Operating Officer

Well, we are approaching with a great big smile, but John, I mean we all get audit and just we had a number of buyers that have come to stay we've actually in the last 60 days put on a new Vice President of Marketing that's going to handle nothing but domestic, international met and PCI. So, it certainly going to be a focus for our company, you know, we haven't seen this kind of interest on the steam size in many, many years, probably since the early to mid 90s. So, we are pretty excited about what we are seeing and it certainly going to be a focus point of our marketing and operations there.

John Bridges - JP Morgan

But presuming you can't invest a capacity until you see longer term business?

John W. Eaves - President and Chief Operating Officer

Well, I mean, I think we are fortunate that we have the mines that are in place right now, I have a cost structure, it allow us going to steam same or the met market and we'll expand those accordingly.

John Bridges - JP Morgan

Yeah, I was thinking in terms of the thermal business that you are see.

John W. Eaves - President and Chief Operating Officer

Well, I mean, I guess in the last week or two, we've seen a number of buyer that will start to see this international market and there has been a number of big requests out, so we are going to evaluate those versus what we see in the international markets whether it would steam or met. So, it’s going to be market driven at this point.

John Bridges - JP Morgan

Interesting?

John W. Eaves - President and Chief Operating Officer

And right now what we see internationally is more attractive than what we are seeing domestically, quite frankly.

John Bridges - JP Morgan

Okay. Thank you very much.

Operator

Our next question comes from Sam Martini with Cobalt Managed? Cobalt Capital.

Sam Martini - Cobalt Capital Management

Hi, guys. Just on that note, can you give us -- can you walk us through or give us roughly a breakeven domestic cap price that you are seeing as you look internationally and make the decision to ship or not to ship and how you and a little bit more upstart process behind, how much of it is purely economic versus how much of it is keeping supply demand type? Thanks so much.

Steven F. Leer - Chairman and Chief Executive Officer

Well, Sam, we're always responding to the market. But if you just look at the peer industries for next year domestic steam is in the 50s and international steam is negotiate a deal right now every forth, but we've seen better pricing there than we currently feel available just based on [inaudible] in our contract markets are different. Again, we're not going to give specifics on contracts but we're very pleased with the direction domestically direction and internationally and again they maybe give some contacts around it .I would guess over the third quarter you probably saw the public indices move $4, $5 for the domestic steam market for 2008 delivery and that pressure seems to be continuing to build, which we’ll just be able to bounce back and forth which ever gives us the best value, long-term for our shareholders.

Sam Martini - Cobalt Capital Management

So, Steve is it safe to say then the spot market, the export into the spot market is financially superior to contracts in U.S. market, but contracts slight adjusted are still below the U.S. market contracts?

Steven F. Leer - Chairman and Chief Executive Officer

I’m not sure, but I would say it on contracts but just on the indices and those spots, international sale on a steam, coal and spot domestics sale based on the indices international better at the moment. Contract as you know have a variety of act, other items other than a pure price to go into and so you have to put it all into the equation and right now I guess the trend is across the board.

Sam Martini - Cobalt Capital Management

Right. Above and beyond faith?

Steven F. Leer - Chairman and Chief Executive Officer

Right. Yes.

Sam Martini - Cobalt Capital Management

Thanks so much.

Steven F. Leer - Chairman and Chief Executive Officer

Thank you.

Operator

We’ll now go to Michael Dudas with Bear Stearns.

Michael Dudas - Bear Stearns

Good morning, gentlemen.

Steven F. Leer - Chairman and Chief Executive Officer
Good morning, Michael.
Robert Messey – Senior Vice President and Chief Financial Officer
Michael.
Michael Dudas - Bear Stearns
Steve could you elaborate a little bit more on your views on the Illinois Basin with the third quarter purchase of reserve block. Is this the signal that Arch is feeling bit more comfortable with maybe the market into the next decade or is this more of a play on as you mentioned in your MINER quarter long-term CTL and you still think that maybe Illinois Basin might be able to over supply?
Steven F. Leer - Chairman and Chief Executive Officer
Yes. I think there's a couple things, we have always said that we see the Illinois Basin developing but that was going to be in the second decade of this century not the first. We continue to believe that frankly there will be more scrubbing in the East as those scrubbers, even though some are being delayed, some are coming on, on the current times and once they're built, we think the market will develop for Illinois Basin development. One of the things that really attracted us is this particular reserve base where, if you looked at it, it tied together two large reserves that we already owned control. So now it becomes a basically a 300 million tons contiguous block. It was also low in chlorine which again, unless you get into kind of the detail down on the week that is a very important issue because when you are operating scrubber tire coring coal which are in big parts of Illinois Basin have trouble, cost trouble for the scrubbers. So, we saw that as a huge positive to overall value. And then on top of that we see CTL, CTG being developed in a 300 million tons reserve base really gives the momentum and the critical met for that sort of development. But if you had to pick a time-frame its more seven, eight years from now, it's not in the next two or three years.
Michael Dudas - Bear Stearns
Appreciate the answer. My follow up is regarding maybe your early indications going into 2008. I know you're running through the budget now. Your capital spending program certainly you're ramping your [inaudible] coming out low. I would look other than your LBA payments that capital needs of the company at least for ?08 seem to be somewhat rather limited other than maybe productivity issues. Could you comment on like the direction and how, what could be very reasonable cash flow will be allocated as we go forward?
Steven F. Leer - Chairman and Chief Executive Officer
Michael you don't know our operating guidance at all is out there.
Michael Dudas - Bear Stearns
Got other more projects... I understand.
Steven F. Leer - Chairman and Chief Executive Officer
I'll let John.
John W. Eaves - President and Chief Operating Officer
We're doing better Michael.
Steven F. Leer - Chairman and Chief Executive Officer
You know, I think as we said our maintenance capital is going to earn somewhere between a $150 million and $200 million. I think we're probably closer that $200 million. And in ?08, the big spend is, we've got the $75 million. We've got to spend to finish the loadout at Black Thunder. And we have the ILB payments, other than that; those are the big items as we look the budgetary process. But we spent 25 on the loadout this year and we'll spend the balance next year and then the biggest bulk of the remainder will be the maintenance gap.
Michael Dudas - Bear Stearns

Yes.

Steven F. Leer - Chairman and Chief Executive Officer

And there's always some hotch-potch things, enhancements or productivity improvements that certainly get review. They may get approved, they may not, but that always works through this.

Michael Dudas - Bear Stearns

And as your debt to capital targets, you feel comfortable with right now?

John W. Eaves - President and Chief Operating Officer

Absolutely, I think the balance sheet and the debt-to-cap of the company as strong as it's ever been and as we look to marketplace where we're sitting, we feel very good about next year.

Michael Dudas - Bear Stearns

Appreciate your thoughts, thanks, John.

Operator

And we'll now go to John Hill with Citi Investment Research.

John Hill - Citi Investment Research

Great. Thanks and thanks for all of the detail on the call. You're certainly doing a great job weighing out some of the drivers of the tightening domestic thermal market, stockpile and the supply and demand, etcetera, and signed 5 million tons of contracts so far. Is the change in this data being reflected yet in kind of the stance and behavior and body language from the customers or is it still just the coal industry talking to itself?

John W. Eaves - President and Chief Operating Officer

Well you know I think John, you know the last couple of weeks as I mentioned, we've seen some interest in some of the domestic buyers in securing some long-term coal. So, and if you look at the fundamentals on what's going on internationally, you look at where Arch's is positioned, I think you need to look at it three different ways. I mean, we've talked about the Mount Laurel, in 2008 you're going to have a full year of met/PCI, you're also going to have contract low off in Western Bit and we're seeing some pretty significant step up in prices. And then if you look at the PRB in the last week or two weeks, we've seen some pretty good movements in the PRB prices as you move out in '08. I mean, you know, there in the $12 to $13 range, so, is that where we like them? No, but as they start to move up we'll start layering in business. So, I think Arch has really positioned itself very well as we move into 2008. So, it's really hard to ignore the fundamentals right now. You've seen inventories come down a little bit certainly we think Central App is going to be challenged with their production. So, you know we like where we're positioned.

John Hill - Citi Investment Research

Great. And would you say that that the pricing on what you could do today is significantly above what you did last quarter? It was always similar small five contracts included, so is it safe to say we've tracked indices higher there?

John W. Eaves - President and Chief Operating Officer

Yeah, I think that's a safe assumption right now.

John Hill - Citi Investment Research

And then next what you would be thinking about, brokerage and re-sale kind of just as we go forward?

John W. Eaves - President and Chief Operating Officer

I mean, you know we typically do about 1.5 million to 2 million a quarter. I mean we're always looking for opportunities. We set up a trading company. I mean we're very active. And when we see opportunities to create margins we're going to do that. But I think if you use that 1.5 million to 2 million ton a quarter range, that's probably a pretty good number.

John Hill - Citi Investment Research

What are some of the opportunities you're seeing in terms of disconnection and blending opportunities?

John W. Eaves - President and Chief Operating Officer

Well, I mean obviously we're looking for opportunities on exports where maybe we can blend in some lower quality coals. We see some opportunities in Central App to do maybe bring in some lower quality coals to some of our facilities where people won't have rail real loadout etcetera. And we've also seen some opportunities in the PRB that we got a little bit early and took advantage before these prices start moving, although we're looking at all reach.

John Hill - Citi Investment Research

Got it. Thank you.

Operator

Next is Jeremy Sussman with Natexis Bleichroeder.

Jeremy Sussman - Natexis Bleichroeder

Yes. Good morning.

Steven F. Leer - Chairman and Chief Executive Officer

Good morning.

Jeremy Sussman - Natexis Bleichroeder

You guys talked about steam coal going out of the east stock towards [inaudible] a very crisis any update on PRB coal potentially going west and sort of also around the subject of the PRB, is there a level that you would feel comfortable being contracted or uncontracted with going into 2008 at year-end?

Steven F. Leer - Chairman and Chief Executive Officer

Well, we're comfortable being uncontracted with our current levels.

Jeremy Sussman - Natexis Bleichroeder

Okay.

Steven F. Leer - Chairman and Chief Executive Officer

So I guess that's answers that question. We can do you look at the western movements. I think there's going to be some I don't know how much appendage, we have made around if you will in Asia, talked about it. You've seen some export coal out of Utah go to the west coast and but so far we've heard some rumors about PRB, but we haven't done any. But given the world market it's a mater of time before it happens.

Jeremy Sussman - Natexis Bleichroeder

Thanks. And then just as a follow up, the stockpiles you mentioned of a 135 million tons, certainly a bullish indicator, I think that the markets have turned so good sign there. Can you tell us there was a big difference kind of across different reason, the reasons in terms of inventory days or is it pretty equal all around?

Steven F. Leer - Chairman and Chief Executive Officer

I think it's pretty equal, I mean every utility unique and they keep it somewhat confidential on what actual stockpiles are. So we do individual unit modeling and I don't have that in front of me and I think, the errors in our own models on a per unit basis end up offsetting each other. We tend to be pretty good on the aggregate number, but I wouldn't want to claim victory on knowing each one of the individual units numbers.

Jeremy Sussman - Natexis Bleichroeder

Sure, okay. Thanks very much.

Operator

Our next question comes from Brian Gamble with Simmons and Company International

Brian Gamble - Simmons and Company International

Yes. Good morning, guys.

Steven F. Leer - Chairman and Chief Executive Officer

Good morning, Brian.

Brian Gamble - Simmons and Company International

I thought, I talk a little bit about PRB pricing and kind of the moves we're seeing recently. Do you think that is just a, there is too much due to the railroads that we've seen in the east or is it a more fundamental shift? And how has the increased rail capacity which I know, the rails are talking about having put in capacity to move what anticipated probably just next year, so there's kind of an incremental supply, if you wanted to put it on the market. How is that affected the price as well?

John W. Eaves - President and Chief Operating Officer

Well, I mean certainly the railroads of course have done a pretty good job, first half of the year there were certainly some challenges with weather, derailments and etcetera. But I think there is some catch up going on right now in terms of people behind on their shipments. But if you look at the pricing, I truly believe a lot of the buyers that understand what's going on primarily in the east, that's driving some of the buying right now. I really do. I think if you look at Central App and decline in production forecasted there, you look at the imports that are basically flat year-to-date. That's part of the driver in the PRB, we continue to think the railroads are going to move the goal as they make good money at that. But you know we think the fundamentals as such that the PRB prices will continue to move up.

Steven F. Leer - Chairman and Chief Executive Officer

And they have the incremental basis too, [inaudible] there are challenges with the railroad and they've seem to overcome those with their expansions and their investments but there are still challenges that determines in terms of real increase steam production, new equipment has to be added in many cases, additional loadout capacity has to be added. So, those days the 90s when we all have access capacity or certainly Arch's excess capacity and was easily added just don't exist today and it's not that they can't extent because they can overtime but it takes time and it takes money.

Brian Gamble - Simmons and Company International

Right now I was wondering when you think about what you guys have already spend in the east on each regulation, also one of you qualify that number for the year and then potentially talk about anything that might be left over for next year whether be things that more or other operations that you might be on hand doing some incremental there?

Steven F. Leer - Chairman and Chief Executive Officer

Well, you know, first of all Mountain Laurel I mean our goal this year was about 110 million, I think we'll come in that range as we move out, I mean, at least some ongoing maintenance capital but the bulk of the capital on that project is being on stand and will be stand between there in end of the year. I guess in terms of, some of the regulatory the cost we've seen, certainly with the MINER Act to seal challenges, it's been pretty costly on the industry, I think we plan over the next 24 months we'll spent about $20 million to $ 30 million on the MINER Act and various things and that is pretty inclusive could be a little more than that. In terms of seals, we built a few new seals in the east, the cost on the seals is probably almost double. Most of those seals have been the 50 PSI where you still have to monitor behind the seal. The seals that we constructed in west are a 120 plus PCI, the PSI instead seals that you don't have to monitor. So you know there is a cost to that, we are managing through that we think we are building that into our budgetary models for 2008, but you know it has been costly.

Brian Gamble - Simmons and Company International

And quickly if I can speak of ton, the tonnage, you committed for ’08, if I look at it by region should I think of it on a percentage basis, you know, kind of layered in even with production as far as on what’s on committed?

Steven F. Leer - Chairman and Chief Executive Officer

You just need to look our [inaudible] basis 45 to 55.

Brian Gamble - Simmons and Company International

Okay. Perfect. Thank you very much.

Steven F. Leer - Chairman and Chief Executive Officer

You’re welcome.

Operator

And we will now go to William Egan with Raymond James.

William Egan - Raymond James

Good morning, guys.

Steven F. Leer - Chairman and Chief Executive Officer

Good morning, William.

William Egan - Raymond James

Looking at the fourth quarter can you give us a range of the tax benefit that you are expecting?

Robert Messey – Senior Vice President and Chief Financial Officer

Well it will be 20 million to 30 million.

William Egan - Raymond James

Okay. Thank you very much.

Operator

We’ll now go to Luther Lu with Friedman Billings Ramsey.

Luther Lu - Friedman Billings Ramsey

Hi, good morning Steve and John.

Steven F. Leer - Chairman and Chief Executive Officer

Luther, how are you?

Luther Lu - Friedman Billings Ramsey

Good, good for you John and for a nice cost control.

John W. Eaves - President and Chief Operating Officer

Thank you, Luther

Luther Lu - Friedman Billings Ramsey

Yeah, and speaking over cost, could you John elaborate a little bit how the MINER Act has affected the productivity in the East and the Utah?

John W. Eaves - President and Chief Operating Officer

You know obviously, Luther it’s been a challenge but I think if you look at our reserves and our geology, I mean, I think we are well positioned to deal with it. If you look at our cost and since it’s always implement, I think we’ve done a pretty good job in managing our cost, they’ve basically been flat quarter-over-quarter. You know, as we move forward, I mean we got to deal with this $20 million to $30 million, but I think with our geology, reserve base area infrastructure and really operating thing. I think we’ll do pretty well.

Luther Lu - Friedman Billings Ramsey

Okay, okay. And my next question is Steve since you mentioned there hasn’t been permit in last seven months I was just curious when does the Arch get next permits in the Central App region?

Steven F. Leer - Chairman and Chief Executive Officer

Yes, I think it's actually almost nine months for the permits but our only surface operation is really a Coal-Mac operation and we are fortunate in the sense that they probably don't really need any permit until the 2009 timeframe.

Luther Lu - Friedman Billings Ramsey

Okay.

Steven F. Leer - Chairman and Chief Executive Officer

We just happened to hit that unlucky, unlike Judge Hayden decision where we need one within six months of the decision. So, I think that's representative of how Central App is people all over the place on their needs for the next permit and you certainly can do things to extend yourself, you take a higher ratio cut, you do something that you would normally doing with my plan which you do because that is better than shutting down or closing of equipments but eventually it catches you and I think, we are starting to see the initial impact right now and as we progress into 2008 they will become more pronounced.

Luther Lu - Friedman Billings Ramsey

Right. And any update on the Spruce mine?

Steven F. Leer - Chairman and Chief Executive Officer

Normally we continue to build some roads and ponds but that will be a market driven decision and certainly that permit we have has been to a pretty intensive reviews so we feel pretty good long-term, but it's basically going to be market driven and it's not in our short-term plan right now.

Luther Lu - Friedman Billings Ramsey

Okay. Great. Thank you, guys.

Steven F. Leer - Chairman and Chief Executive Officer

Thank you.

John W. Eaves - President and Chief Operating Officer

Let's go back to that tax question I got a long ago, we have got there's two components there's an effective tax rate on the book, which is basically 10% to 12% offset by that benefit that I just mentioned 20 to 30, which gives you a net income tax benefit of 13 million as low as 1 million to 13 million, just wanted to clarify that? Thanks Steve.

Operator

Thank you. We'll now go to Dhaval Patel with Columbus Hill

Dhaval Patel - Columbus Hill

Good morning guys.

Steven F. Leer - Chairman and Chief Executive Officer

Good morning.

John W. Eaves - President and Chief Operating Officer

Good morning.

Dhaval Patel - Columbus Hill

Can you tell us sort of race you talk about what's unpriced but how much are you committed for '08?

Steven F. Leer - Chairman and Chief Executive Officer

Dhaval, you know, we've a fair amount that would be unpriced in but committed and that is delta doing those two maybe a few million tons but it's not much.

Dhaval Patel - Columbus Hill

So there is not big delta between...

Steven F. Leer - Chairman and Chief Executive Officer

Yes. I mean no, I mean they are not.

Dhaval Patel - Columbus Hill

Okay.

Steven F. Leer - Chairman and Chief Executive Officer

It's maybe about 4 tons or 5 tons but it's really not a big delta.

Dhaval Patel - Columbus Hill

Okay. Thank you.

Operator

And we'll now go to David Gagliano with Credit Suisse.

David Gagliano - Credit Suisse

Hi, I just, I wanted focusing on Powder River Basin volumes. It looks like you had a very strong volume number in the third quarter. And I am wondering actually I have a couple of question one, on the run rate basis it looks like your PRB volumes are about 104 million tons. So my first question is just as we got '08 with the loadout in Black Thunder and perhaps a railroad capacity, what is your capacity, in terms of your production capacity in Powder River Basin as we get to, you know, say this time next year?

John W. Eaves - President and Chief Operating Officer

Again, I think one quarter, one month type 12 is, you didn't get a very nicely in answer, I've often said, that we think we could do around a 100 million ton if everything work perfectly, and it never works perfectly, as an honest answer you know that with either the equipment of the railroads there is a loadout and whether so, I think and the practical capacity is around that 95 to 100 range depending on really the last 5 million tons of hoping to operate. The day that really to go much higher than that and then we have got to go with a truck special spread and there is lead times and its going to be take time, yes, we can do it, but its going to take 8 months to 12 months minimum just to secure that equipment get it in and getting operated, so I think Steve is right at 95 to100 run rate is probably a good number.

David Gagliano - Credit Suisse

Is that for Black Thunder or for all of??

John W. Eaves - President and Chief Operating Officer

Of course Black Thunder.

David Gagliano - Credit Suisse

Okay. And then what would be the capacity at coal creek?

John W. Eaves - President and Chief Operating Officer

You know, coal creek, obviously it's got an air quality permit for 25, but we've running that mine about 10, we can probably do a little bit better than that but much more than that we've got to spend some capital to get it, significantly higher than that 10 to 11 range.

David Gagliano - Credit Suisse

Okay. Great. Thanks. And then just on somewhat related question, you are bigger obviously you are larger in terms of just volume competitor out there as already given us some numbers for, second half versus first half PRB production and it does show about, if I am not mistaken about a 15% to that is much 20% sequential increase and then it looks like a near numbers that run rate in PRB's is running at about 8%, increase versus say 2006, I am just wondering do you think, production is in line with above or below demand coming out of business at this point?

John W. Eaves - President and Chief Operating Officer

Right now supply and demand balance would say that we are pretty much meeting the market needs and we are seeing improving pricing and I think one of the big issues that are very hard for any body to model and therefore its hard for us in the industry to have our hands around too as we saw in 2001 and we saw in 2003 the problems that occurred in the eastern markets ended up manifesting themselves in terms of demand in the western markets and we saw the eastern guys reached the Western Bit and buy that up and spent about a week and then reach into the PRB and it looks like its turning up to do that again and the time will tell but it's certainly every, if you go back and look at each of the components say in 2003 and look at today its all occurring except that the international markets even more robust than it was in 2003.

David Gagliano - Credit Suisse

Okay, fair enough. Should we expect any change in the Utah in sort of sequential change in your volumes out of the PRB in Q4?

John W. Eaves - President and Chief Operating Officer

Yes, we again don't give specific projections for the quarter, but you can do the math but it all comes down to how well things run, I mean we had a good operating quarter in the third quarter and the railroads operated well and under that assumption not much of a change.

David Gagliano - Credit Suisse

Okay, thanks.

John W. Eaves - President and Chief Operating Officer

Thanks.

Operator

And we'll go to Lawrence [inaudible] with Lehman Brothers.

Unidentified Analyst

Good morning.

Steven F. Leer - Chairman and Chief Executive Officer

Good morning.

Unidentified Analyst

I think a little comment around $120 or $125 per metric ton in terms of the European export, the market, can you help us get a sense after you factor in the metric conversion and metrification cost what that would be kind of that will be mine in Central App that 60 bucks ton, 65 bucks a ton?

Steven F. Leer - Chairman and Chief Executive Officer

You know, it depends on a couple of things. It depends on the trans-loading rates, which vary on the East coast from owner-to-owner and also the rail rates, the 125 numbers move around so quickly, I would be hesitant to give you that and that is a metrics, so you got to take 10% of that number and then take your trans-loading on the port and you rail out of it, but you I mean you are probably reasonably close on your net back that you mentioned.

Unidentified Analyst

Okay. And can you guys help us get some color around how much you guys have historically exported out of Central App on the steam side, I mean, if you have, I know that you guys did 13 million tons at the Central App you had couple million in the met, you guys export from the steam perspective, 200,000 tons, 500,000 tons and where do you guys seem you can, what do you guys think you can do in a way?

Steven F. Leer - Chairman and Chief Executive Officer

You know, really historically we haven't exported much steam coal. We exported a couple 100,000 tons of PRB coal to Spain over the last five years, but it's probably been 10 years or so since we are really exporting meaningful steam of the East coast. In terms of what we can do next year, I think there again it depends on the price and what we are seeing domestically versus internationally, so it will be market driven but we've done some prompt steam business and we are very pleased with and that materialize in this interim agreements, the attractive prices and we would be very happy with that.

Unidentified Analyst

Okay, thanks a lot.

Operator

And we now go to Justin Fisher with Goldman Sachs.

Justin Fisher - Goldman Sachs

Good morning.

Steven F. Leer - Chairman and Chief Executive Officer

Good morning, Justin.

Justin Fisher - Goldman Sachs

The first question that I have is just about your exports again on the Central App next year you said that about a proportionate ratio of the 45 million, 45 to 55 million unpriced funds is in Central App, so I am guessing that's the kind of 4 to 5? 4.5 million tons to 5.5 million tons of Central App is unpriced, is that all kind of amount rolls that basically what your potential for exporters, if you export it all at the Central App next year?

John W. Eaves - President and Chief Operating Officer

Well, I mean treat our Eastern properties as kind of portfolio products, so we don't really go to one operations, but I will tell you since Mountain Laurel fairly new you can assume that large portion of that's uncommitted and we are in, pretty serious negotiations right now for metallurgical and PCI agreements out of that operation.

Justin Fisher - Goldman Sachs

And so that's pretty much where your ability to take advantage of the international markets is coming from?

John W. Eaves - President and Chief Operating Officer

You know, I mean, there again, I mean, we have the flexibility to move things around from mine-to-mine but certainly Mountain Laurel would be cost structure has an ability go steam on met it's an attractive source for European buyers.

Justin Fisher - Goldman Sachs

And so then I guess to extend this notion to the bottom market, its interesting because on the one end we are hearing a lot of companies say that they want to take advantage of the export market but I think you guys are unique and that you have this big Mountain Laurel complex that's coming in a mine but most of the other larger U.S. players have either paid back some of their expansion plans and they are mostly committed on the Central App site for next year. So I am wondering as far as the argument that exports will help tighten up the U.S. coal supply. Do you think that there is much capacity for that to happen with other companies given the most of their existing production is committed and the fact they appeared their expansion plans?

John W. Eaves - President and Chief Operating Officer

Well, you know, you've got the demand, the word demand entering the U.S. markets, so whatever the Eastern market is able to produce, you are right, it's out there in the marketplace people are trying to sell whatever they have or they are trying to buy additional coals to take advantage of some of the demand that are showing up. So we think we are sitting almost perfectly with introduction of Mountain Laurel and you have seen other things occurred at the if you have seen I mean there is some import guys who are trying to buy U.S. domestic coal, we assume they are going to try to replace their import coals with U.S. domestic coal and then take their traditionally imported coal and move to Europe there is a marketplace better. So there is a lot of moving dynamics out there, but I think you've touched on adjusting, you basically have supply declining in the East for a variety of reasons whether regulatory or permits are people are already committed and push their mine as far as they can and then you have demand manifesting and so from the international markets, so it's you know what gives this fact and much been uncommitted that's a good feeling.

Justin Fisher - Goldman Sachs

And then a question about the freight cost of sending the coal to Europe. First of all, who pays the freight you guys or the buyers I know your rates factored into it, but I want to know who actually pays for them and second of all would you and some other exporters in the this fuel industry such as there is extremely no vessels available for spot avoided which given the fact that most of them are trying to jump in on the times of business, is it too surprising but what sought of vessel availability are you seeing as far as efforts to capitalize on extra market?

John W. Eaves - President and Chief Operating Officer

Well, first on that question, I mean they are building the vessels but yeah, I mean if you look at the keys in Australia and the ocean freight rates that you are seeing across the world certainly there is a shortage of ships right now. Your question about who handles the freight, typically we handle the freight to the east coast put it in the ship and then the buyer handles the ocean freight and most of the buyers, a lot of them have hedged, some of that freight forward, so hopefully they are not paying the stock market ocean freight rates.

Justin Fisher - Goldman Sachs

I hope for them they are not. And then the last question is just on the cost in the Western Bit region, you said that you are thinking you are going to be $19 to $20 of ton going forward that's a legalized thought I heard in it, it seems to be a lot higher than previously, so I was wondering first of all what the driver is abandoned and second of all to what degree are you guys seeing a fall out from the Utah mine collapse as far as the operating cost and what's in it going forward, I mean, everyone is talking about centralized but it seems that so that's going to be the next focus through regulators?

John W. Eaves - President and Chief Operating Officer

Well, I mean, certainly, you know, we have seen an increase in inspections we think we run safe coal mines in our Western Bit region if you look at our safety records versus the industry average, we are about a third, that will continue to be a focus of ours, we had good geology for the most part for that region. In terms of your question on cost, I think I have said $19 to $21 of cost, first of all cost and obviously, we'll try to do better than that but if you look at the cost the MINER Act the new seals as we go through the budgetary process we think that range is probably pretty indicative of what we are going to see. I think previously we've said high teens to low 20. So I think the 19 to 21 range is a good cost range but what you need to think about Western Bit is we've got a lot of contract roll off over the next year or two, and that price is going to average up pretty significantly. I mean as we indicated in the second quarter release we had placed 9 millions tons between $30 and $35 a ton. So, as we have tons roll off, we are going to replace some of it pretty good numbers. So our average price even as we move into '08 is going to be a pretty significant.

Justin Fisher - Goldman Sachs

Okay. And so I actually had one last clarification. For the LBS, I know that you guys haven't said how much dollar amount you are going to spend on those, at least for the ones that are coming up this year and as far as I know it's a competitive bidding process. But if we want to draw own analysis as to how much that could cost, could you tell us how many tons your bidding, of course then we can put dollar, cent amount perk kind of reserves?

John W. Eaves - President and Chief Operating Officer

You know, just given the rules and the way those bids are structured you have seen we just don't, we can't talk about that, I apologize for that, but it's extraordinarily strict.

Operator

And next is Gwen Ifill with North Street Capital.

Gwen Ifill - North Street Capital

Good morning.

Steven F. Leer - Chairman and Chief Executive Officer

Good morning Gwen.

Gwen Ifill - North Street Capital

Good afternoon. There is a lot of exciting things happening in coal, we are trying and becoming that importer, demand picking up in the end and the dollar weakening, could you go over your strategic plan for the next five years, what you would like to look at and can you do any foreign initiatives?

Steven F. Leer - Chairman and Chief Executive Officer

Well, I don't think we have that much time, Gwen, you know, you are right, we see a very robust world market, you know the coal worldwide is the fastest growing energy source out there, we continue to look internationally at different things as they come available we obviously look domestically we don't try to limit ourselves but we do believe that for Arch to go internationally, we would like to do with partners, we would probably take small steps I suppose, of course baby steps that will be opportunistic. Domestically we will continue to build of our strong positions and PRB, Central App and Western Bit, I think beyond the five years, within that 5 to 10 years you get to see Illinois Basins start to play into our decision mix. So, we see and all coming together and then from an international perspective, is all we have been interest in and we are always look and talking but so far haven't done anything.

Gwen Ifill - North Street Capital

Thank you.

Steven F. Leer - Chairman and Chief Executive Officer

Thank you.

Operator

And we will now go to [inaudible] with Stifano Asset Management.

Unidentified Analyst

Yeah, just on the domestic front, you mentioned positively on generator stockpiles coming down, but do you see the demand is going from domestic market or you just talking about that you think good export demand, so you would be exporting out there in the international markets?

Steven F. Leer - Chairman and Chief Executive Officer

Well, its not a multiple of different markets in the mail and the tie and decline with each other, but yes, our U.S. generation, likely generation is almost 3%, I think its 2.8%, 2.9% this year, U.S. coal productions down somewhere around and it doesn't take an account of if that continues a line across at some point in time. We have seen more normal weather patterns the economy continues to expand and add normality to 2006 where we had the extraordinary mild weather and depress generating demand and just the opposite this year as we are seeing pretty regular weather patterns and as an example, September, August, September timeframe we saw I think in August it was the highest demand for coal fire electricity that has even been and its approach to 100 million ton, that we are just under 100 million tons and assume that month. So again all of filling and all the time they are go into right way.

Unidentified Analyst

You mean to say demand picked up for coal or you think that the demand will pick up for coal and going into the fourth quarter you mean to say?

Steven F. Leer - Chairman and Chief Executive Officer

Demand has picked up for coal, all throughout this year compared to a year ago and we saw some very robust, I think demand in the last part of the summer, now as we just into the fourth quarter, I mean quarter-to-quarter demand probably get driven by weather pattern more than the economy but the economy itself has a steady underline forward to that, that overall electric whole demand.

Unidentified Analyst

Okay. On the export market you talked about of course export is one of the big area for thinking of that, how would margins fair for if you have to export coals in the international market and primary would be China I think how would your margins compare with what their margin tried in the domestic market?

Steven F. Leer - Chairman and Chief Executive Officer

But again on the stock base is right now as John said on just taken thermal coal out of the east coast, we've seen an improvement, there a better margin in the U.S. domestic price, but traditionally those who move in relationship to each other and if that continues you will see U.S. domestic margins improved.

Operator

And we will now go to Aaron Marsh with Duquesne Capital.

Aaron Marsh - Duquesne Capital

Hi, could you please talk a little about the probably in the coal little more compact lets maybe this spread between the different characteristics and with the thermal content would be and their production?

John W. Eaves - President and Chief Operating Officer

Yeah. I mean the steam product typically is a 12.3 to 12.5 we have ability to make a higher BCU coal which is less than 10% ash, you know, so far is well below on a 1%, the metallurgical properties domestic good liquidity, good request since good revenue, if you look at highwall met coals like classify on this is a rank A and a rank B, this would be pretty highwall rank B, highwall coal in the world markets. So it's pretty well received most places in the world.

Aaron Marsh - Duquesne Capital

And the 45 million annual terms capacity there, what do you think, what's the, what do you see as the slip being for adverse on that?

John W. Eaves - President and Chief Operating Officer

I think really it depends on the market, I mean we have ability, we have a state our preparation plan there, we can adjust our yields as needed and if we seen attractive met market that's where we target our volumes, if the PCI becomes attractive it will be a combination of both. So I think its just going to be market dependent.

Aaron Marsh - Duquesne Capital

Great, thanks.

John W. Eaves - President and Chief Operating Officer

Thank you.

Operator

And our final question today comes from Karen Oslen [ph] with PSO and Associates.

Karen Oslen - PSO and Associates

Actually that was the pre final question on met coal. Thank you very much. I am done.

John W. Eaves - President and Chief Operating Officer

Okay, that was an easy one. Okay request.

Operator

Thank you. I'll turn the call back to Steve Leer for any additional or closing remarks.

Steven F. Leer - Chairman and Chief Executive Officer

Again I want to thank everybody who joined us on the call today and for your time and your interest in Arch, but I wanted to just take an additional moment to emphasize that while we are witnessing what we think is a significant strengthening in the coal market and something that we talked about that we are seeing the initial time last quarter really the second quarter call. I want to say that Arch remains committed and we are focused and as gradually have a passion if you will for tightly controlling our cost. I think you saw some of that in the third quarter, there are cost pressures and we would, certainly wouldn't want, forecast that we can keep cost flat quarter-to-quarter-to-quarter-to-quarter, but at the same time we have the passion for safety and a passion for cost control and really that manifest itself and in creating long-term shareholder value. So, we are going to run this company tightly. We are going to meet market demand and we are going to run safe operations. So, again thank you for your interest and I appreciate your time. Good bye.

Operator

Thank you very much. And that does conclude our conference for today.