

**PHOENIX COAL INC.**

Management's Discussion and Analysis

For the three and nine months ended September 30, 2009 and 2008

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

The following discussion of the results of operations, financial condition and cash flows of Phoenix Coal Inc. (the "Company") prepared as at November 10, 2009 should be read in conjunction with the Company's unaudited interim financial statements for the three and nine months ended September 30, 2009 and its 2008 audited financial statements and the notes thereto. These financial statements, which were prepared in accordance with generally accepted accounting principles in Canada, are available at [www.sedar.com](http://www.sedar.com). All amounts disclosed are in United States dollars unless otherwise stated.

This Management Discussion and Analysis contains "forward-looking statements" which may include, but are not limited to, statements with respect to the future financial or operating performance of the Company and its projects, the future price of coal, the estimation of mineral resources, the timing and amount of estimated future production, costs of production, capital, operating and exploration expenditures, costs and timing of the development of new deposits, costs and timing of future exploration, requirements for additional capital, government regulation of mining operations, environmental risks, reclamation expenses, title disputes or claims, limitations of insurance coverage and the timing and possible outcome of regulatory matters. Often, but not always, forward-looking statements can be identified by the use of words such as "plans," "expects," "is expected," "budget," "scheduled," "estimates," "forecasts," "intends," "anticipates," or "believes" or variations (including negative variations) of such words and phrases, or statements that certain actions, events or results "may," "could," "would," "might" or "will" be taken, occur or be achieved. Forward-looking statements are based on the reasonable assumptions, estimates, analysis and opinions of management made in light of its experience and perception of trends, current conditions and expected developments, as well as other factors that management believes to be relevant and reasonable at the date that such statements are made. Forward-looking statements involve known and unknown risks, uncertainties, assumptions and other factors that may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Such factors include, but are not limited to, the factors discussed in the section entitled "Risk Factors" in the prospectus of the Company available on SEDAR at [www.sedar.com](http://www.sedar.com). Although the Company has attempted to identify important factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors that cause actions, events or results to differ from those anticipated, estimated or intended. Forward-looking statements contained herein are made as at the date of this management discussion and analysis. There can be no assurance that forward-looking statements will prove to be accurate, as actual results and future events could differ materially from those anticipated in such statements. Accordingly, readers should not place undue reliance on forward-looking statements. The Company does not undertake to update any forward-looking statements except as required by applicable securities laws.

***Overview***

The Company is headquartered in Madisonville, Kentucky and is engaged in the exploration, acquisition, development and sale of coal from the Illinois Basin. As further discussed, on September 30, 2009, the Company sold substantially all of the assets associated with its surface mining operations. The results of operations and liquidity and capital resources in management's discussion and analysis primarily pertain to the surface mining operations, which include Briar Hill/Radio Hill (two mines at one geographic location), Back in Black, KO, and Jessup. As at September 30, 2009, the Company still owned and controlled surface property and coal mineral rights, among other assets, related to its underground development project, Gryphon Mining Complex. The Company also retained several depleted surface mining properties that were not part of the sale and are in the process of being reclaimed.

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

***Highlights for the first nine months of 2009***

During the three and nine months ended September 30, 2009:

- On September 30, 2009, the Company sold substantially all of its surface coal mining assets to a privately-owned Ohio-based coal producer on terms and conditions detailed in the Sale of Surface Mining Assets section below.
- Heavy rainfall during the third quarter 2009 hampered production at most mine locations. July rainfall was 72% higher than average for the month, while September was 73% higher than average according to data published by the National Oceanic and Atmospheric Administration.
- During the third quarter 2009, the Company produced approximately 432,000 tons of saleable coal and purchased nearly 220,000 tons of saleable coal. For the nine months ended September 30, 2009, the Company produced approximately 1,375,000 tons of saleable coal and purchased approximately 355,000 tons of saleable coal.
- Coal sales totaled approximately 680,000 tons and 1,740,000 tons for the three and nine months ended September 30, 2009, respectively.
- Revenue for the three months ended September 30, 2009 was approximately \$23,202,000 for average revenue per ton sold of \$34.10. Revenue for the nine months ended September 30, 2009 was approximately \$58,494,000, for average revenue per ton sold of \$33.62.
- Cost of sales for the three months ended September 30, 2009 was approximately \$22,768,000 for an average cost per ton sold of \$33.46. Cost of sales for the nine months ended September 30, 2009 was approximately \$54,531,000 for an average cost per ton sold of \$31.34.
- For the three and nine months ended September 30, 2009, the Company's net loss was approximately \$1,307,000 and \$53,040,000, respectively. The loss on the sale of the surface mining operations contributed approximately \$36,242,000 to the total year-to-date loss.
- Capital expenditures for the nine months ended September 30, 2009 were \$7,976,000, which included \$6,630,000 of new equipment that was financed through term loans.
- At September 30, 2009, the Company had approximately \$17,438,000 in cash, cash equivalents and short-term investments. The Company also had restricted cash, cash equivalents and certificates of deposit as collateral for letters of credit for reclamation bonding and escrowed funds from the sale of its surface mining operations in the amount of \$14,420,658.

***Results of Operations***

**Sale of Surface Mining Operations**

On September 30, 2009, the Company sold substantially all of its operating assets and operations associated with its surface coal mining operations in Western Kentucky, including coal and supplies inventories, coal reserves and related prepaid royalties, mining property, plant and equipment, mining rights, coal purchase contracts and coal sales contracts. All of the Company's revenues were derived from these operations.

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

The consideration received under the terms of the agreement ("Acquisition Agreement") for the surface mining operations included cash, assumption by the purchaser of all debt associated with the equipment being sold and the assumption of certain asset retirement obligations. Reclamation liabilities related to surface mining operations whose reserves had been depleted as at September 30, 2009 were not included in the sale. The Company can potentially receive an additional \$500,000 of cash consideration if, by June 30, 2010, it satisfies certain post-closing obligations ("2010 Fee"). The Company will recognize the 2010 Fee when it is received. In addition, upon completion of the regulatory transfer of the acquired mining permits, the purchaser will replace the Company's letters of credit for assumed reclamation obligations, which will release the restrictions on approximately \$5.6 million of restricted cash and certificates of deposit.

With respect to the cash consideration, \$4.6 million was received by the Company on closing, and \$2.3 million was placed in escrow. The Company will receive from the purchaser an additional \$1.5 million during the 2009 fourth quarter ("2009 Fee") as a result of satisfying certain post-closing obligations, and thus has recorded the 2009 Fee in the consolidated financial statements as at September 30, 2009. Of the \$1.5 million, \$500,000 will be placed in escrow when received. The 2009 Fee will be offset by approximately \$207,000 for the amount of the working capital adjustment that is due the purchaser pursuant to the Acquisition Agreement. Additionally, if earned by the Company, the 2010 Fee will also be placed in escrow. Subject to the indemnification provisions of the Acquisition Agreement, the escrowed funds will be released to the Company with one third of the escrowed balance released March 31, 2010, one half of the remaining escrowed balance released September 30, 2010, and the balance of the escrowed funds released March 31, 2011.

For the nine months ended September 30, 2009, the Company realized a loss on the sale of its surface mining operations of \$36,242,152. For the quarter ended September 30, 2009, the Company recorded an adjustment of \$2,677,848 to the previously estimated loss of \$38,920,000 which was reported in the quarter ended June 30, 2009. The reported loss is a preliminary estimate and may differ from the final loss calculation upon finalization of working capital and other post-closing adjustments that will occur after September 30, 2009.

Production

During the third quarter 2009, Phoenix produced approximately 432,000 tons of coal from five sources - Briar Hill, Radio Hill, Back in Black, KO and Jessup. Year-over-year production for the third quarter was flat with a slight positive differential of nearly 1,000 tons. However, the Company continued a downward quarterly production trend for 2009 as inclement weather persisted, the Briar Hill mine site neared depletion and Back in Black continued to encounter inefficiencies due to old works and permit boundary restrictions. The closing of the Beech Creek mine and subsequent opening of the KO mine in the second quarter 2009 negatively impacted production as a mine at full production was replaced by a mine in its early stages of production. Although KO showed signs of increased productivity in the third quarter, it still had not reached the levels of the mine it replaced, Beech Creek.

The following table summarizes the production from Phoenix's owned mines during the three and nine months ended September 30, 2009 versus comparable time periods in the prior year.

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

	Q3	Q3		%	YTD 9/30	YTD 9/30		%
	2009	2008	Variance	Variance	2009	2008	Variance	Variance
Briar Hill / Radio Hill	239,627	182,438	57,189	31.3%	826,887	657,159	169,728	25.8%
Back in Black	52,906	-	52,906	0.0%	125,496	127,637	(2,141)	-1.7%
KO	82,429	-	82,429	0.0%	107,591	-	107,591	0.0%
Jessup	56,902	18,742	38,160	203.6%	180,470	18,742	161,728	0.0%
Beech Creek	-	111,465	(111,465)	-100.0%	134,094	111,465	22,629	0.0%
<b>Sub-total</b>	<b>431,864</b>	<b>312,645</b>	<b>119,219</b>	<b>38.1%</b>	<b>1,374,538</b>	<b>915,003</b>	<b>459,535</b>	<b>50.2%</b>
Other mines	-	118,222	(118,222)	-100.0%	-	490,026	(490,026)	-100.0%
<b>Total</b>	<b>431,864</b>	<b>430,867</b>	<b>997</b>	<b>0.2%</b>	<b>1,374,538</b>	<b>1,405,029</b>	<b>(30,491)</b>	<b>-2.2%</b>

Briar Hill/Radio Hill continued to lead production during the third quarter 2009. These two mines produced a total of 239,627 tons for the three months ended September 30, 2009. The #11 and #12 coal seams were depleted at these operations during the third quarter 2009, leaving the #10 coal as the remaining seam to be mined.

The Back in Black mine produced 52,906 tons during the three months ended September 30, 2009. This was a 24% increase over the second quarter 2009 production of 42,583 tons. The mine had been idled for eight months after it had mined through its permit area in June 2008 and subsequently resumed production in February 2009. In the second and third quarters 2009, Back in Black encountered old works in the west end of its # 9 seam pit creating a shorter, less productive pit length. These conditions, coupled with permit boundary restrictions, constrained the space available for overburden removal. As a result, additional trucks and manpower were deployed to haul spoil to an old pit to provide relief, generating increases in diesel fuel consumption and labor hours. The production improvement over the second quarter 2009 resulted from opening a second pit to mine the #11 coal seam, which had much better stripping ratios.

KO mine was originally scheduled to begin production in March 2009, but was delayed until late May due to permitting issues. As production began, mining was slow as a mud slip and an eighteen inch parting were encountered limiting production to 25,162 tons in the second quarter ended June 30, 2009. During the third quarter 2009, the mud slip was no longer present and coal quality improved as the parting in the seam was drier and more friable, creating less contamination as the coal was mined. The KO mine became the second highest producing mine in the third quarter 2009 producing 82,429 tons as the pit configuration continued to improve.

The Jessup mine produced 56,902 tons for the three months ended September 30, 2009. Jessup's primary productivity challenge for the third quarter 2009 was the rainfall levels previously discussed. Production reported for the third quarter 2008 includes two months of production activity as the Company did not acquire the Jessup mine until August 1, 2008.

Purchased Coal

First quarter 2008 was Covol's first full quarter of operation after acquiring the Rock Crusher preparation plant and slurry reserves from the Company at the end of November 2007. Production was slow to start due to inclement weather, start-up issues and downtime related to initial capital improvements. During the second quarter 2008, production increased to nearly 10,000 tons per month. By the end of 2008, Covol had finished construction on its new preparation plant and modifications on the Rock Crusher plant setting the stage for higher production in 2009. Consequently, Covol continued to improve production and quality during the first three quarters of 2009 with the third quarter being the most productive quarter since the commencement of operations.

In June 2009, the Company entered into a coal supply agreement with American Coal Company ("ACC") to

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

purchase 20,000 tons of coal per month from July 2009 through December 2009. Then, during July and August 2009, the Company agreed to purchase approximately 50,000 additional tons from ACC amounting to nearly 112,000 tons of purchased coal from ACC for the three months ended September 30, 2009. The supply agreements call for a coal that has a higher BTU and lower sulfur content than the Company's typical product. The higher BTU and lower sulfur enabled the Company to produce more raw, saleable coal and fulfill certain customer obligations at a faster rate.

The coal supply agreements with Covol and ACC, which were the only coal purchase commitments the Company had as at September 30, 2009, were assigned to the purchaser of the Company's surface mining operations pursuant to the terms of the Acquisition Agreement.

The following table summarizes the Company's purchased coal during the third quarter and nine months ended September 30, 2009 versus similar periods in the prior year.

	<b>Q3</b>	<b>Q3</b>		<b>YTD 9/30</b>	<b>YTD 9/30</b>	
	<b>2009</b>	<b>2008</b>	<b>Variance</b>	<b>2009</b>	<b>2008</b>	<b>Variance</b>
Covol	104,387	44,190	60,197	240,231	80,966	159,265
C&R Coal	-	64,803	(64,803)	-	224,442	(224,442)
American Coal Co.	111,572	-	111,572	111,572	-	111,572
Cline Mining	3,450	-	3,450	3,450	-	3,450
<b>Total</b>	<b>219,409</b>	<b>108,993</b>	<b>110,416</b>	<b>355,253</b>	<b>305,408</b>	<b>49,845</b>

Revenue

The Company primarily derived its revenue from coal sales to electric utility companies. For the three months ended September 30, 2009, the Company's revenue increased by 28% to \$23,201,496 from \$18,094,088 in the prior year comparative three month period. For the nine months ended September 30, 2009, Phoenix's revenue increased to \$58,493,767 from \$57,915,648 in the prior year nine month period. For the three month periods ended September 30, tons sold increased 29% from 529,000 tons in 2008 to 680,000 tons in 2009. For the nine month periods ended September 30, 2009 tons sold remained steady at approximately 1.74 million in 2008 and 2009. The increase in revenue for the comparative third quarters was primarily attributable to the additional tons purchased from ACC.

For the nine months ended September 30, 2009, average revenue per ton sold increased to \$33.62 from \$33.38 in the same period in 2008. The increase of \$0.24 per ton resulted from shipments on several sales contracts which transitioned to 2009 contract pricing after fulfilling 2008 contract commitments. Due to renegotiating a change in quality specifications with two customers, and deferring tons shipped to another customer with a higher quality requirement into 2010, the Company was able to ship a higher percentage of its sales on contracts which currently provide the highest base price realization of all its sales contracts. Additionally, coal purchased from ACC was a higher BTU product than coal produced from Company owned mines and thus generated a higher sales price on this purchased tonnage.

Cost of Sales

Cost of sales consisted of all mining related expenses, preparation costs, transportation costs and purchased coal before depreciation and amortization. Diesel fuel had the largest cost decrease during the third quarter 2009 compared to the third quarter 2008. On a cost per ton produced basis, diesel fuel cost was \$5.90 in the third quarter 2009 compared to \$8.38 in the third quarter 2008, a \$2.48 per ton or 30% decrease. Fuel costs decreased from an average of \$3.69 per gallon to an average of \$2.14 per gallon in the quarter ended September 30, 2008 versus 2009, respectively. Year-over-year, diesel fuel costs decreased \$4,689,994 for the nine months ended September 30, 2009 due primarily to a \$1.50 decrease in the per gallon fuel cost from \$3.55 in 2008 to \$2.05 for the same period in 2009.

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

Labor and benefits increased 32% from \$3,683,934 in the third quarter 2008 to \$4,876,994 in the third quarter 2009. Cost per ton produced increased from \$8.55 in the third quarter 2008 to \$11.29 in the third quarter 2009. Man hours worked increased year-over-year for the third quarter primarily due to the inefficiencies created by the excess rainfall and the production challenges at Back in Black previously discussed.

Purchased coal, a variable cost, accounted for approximately 30% of the cost of sales in the third quarter 2009. For the three months ended September 30, 2009, purchased coal was \$6,843,415 versus \$3,280,879 for the same period in 2008. For the nine months ended September 30, 2009, purchased coal was \$10,304,782 and \$9,441,324 for the same period in 2008. Purchased coal costs increased year-over-year for the third quarter due to the 100% increase in tons purchased for the period. The cost per ton purchased increased from \$30.10 for the three months ended September 30, 2008 to \$31.19 for the comparable period in 2009 resulting from the higher per ton purchase price paid for the ACC product when compared to coal purchased in 2008. For the nine months ended September 30, 2008 and 2009, the cost per ton purchased decreased from \$30.91 in 2008 to \$29.01 in 2009. For the first nine months of 2009, more than 67% of the purchased tons were coal fines from Covol, compared to approximately 25% for 2008. Covol fines represent the lowest per ton price of the Company's purchased coal products.

Maintenance costs for the three months ended September 30, 2009 were \$3,045,379 and \$2,247,338 for the same period in 2008, an increase of \$798,041. Cost per ton produced was \$7.05 for the three months ended September 30, 2009 and \$5.22 for 2008, a 35% increase. Maintenance costs increased for the third quarter 2009 versus the third quarter 2008 due primarily to a significant amount of engine rebuild and undercarriage work that was performed during the third quarter 2009.

Overall, the Company's cost of sales increased by 27% to \$22,767,738 in the third quarter 2009 from \$17,919,115 in the similar period for 2008. Comparing the same periods on a cost per ton sold basis, cost of sales was \$33.46 versus \$33.87. For the nine months ended September 30th, cost of sales decreased from \$56,603,982 in 2008 to \$54,531,148 in 2009. Cost per ton sold for the nine months ended September 30, 2009 was \$31.34 compared to \$32.62 in 2008 for a decrease of 4%.

Selling, General and Administrative ("SG&A") Expenses

SG&A expenses primarily consisted of royalty payments to surface and mineral owners, sales commissions, federal excise tax, severance tax, federal reclamation fee and corporate overhead costs in the Company's Madisonville and Louisville offices. For the three months ended September 30, 2009, the Company's selling expenses were \$1,843,778 versus \$1,757,567 for the similar period in 2008. For the nine months ended September 30, 2009, the Company's selling expenses were \$5,851,821 versus \$5,902,502 for the same period in 2008. The Company's selling costs (royalties and coal taxes described above) are variable with respect to coal sales and ranged from approximately 8% to 10% of coal sales for the above mentioned periods. The Company realizes a lower selling cost, as a percentage of sales, in periods where there is a higher percentage of coal sales derived from purchased coal as the Company does not pay royalties and taxes on sales from purchased coal.

General and administrative ("G&A") costs incurred in the third quarter 2009 of \$2,574,881 were comparable to 2008 costs of \$2,540,540.

Depreciation and Amortization

Depreciation and amortization expense for the three and nine months ended September 30, 2009 was \$nil and \$3,731,492, respectively, compared to \$2,220,777 and \$5,327,953, respectively, for the comparative periods in 2008. As prescribed by generally accepted accounting principles, due to the classification of the property and equipment, mine development and mining rights as assets held for sale at June 30, 2009, depreciation and amortization expense was not recorded on these assets for the three months ended September 30, 2009.

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

Interest Expense/Foreign Currency Adjustment

For the three and nine months ended September 30, 2009, interest expense was comprised primarily of interest paid on equipment financing. For the three and nine months ended September 30, 2008, interest expense included (1) interest on the Company's revolving line of credit, equipment financing, and short-term bridge financing and (2) non-cash costs which included accrued dividends on the preferred shares, accretion of the preferred share offering costs, accretion of loan costs on the short-term bridge financing, and mark to market on an interest rate swap. Interest expense for the three and nine months ended September 30, 2009 was \$431,104 and \$1,215,729, respectively. Interest expense for the three and nine months ended September 30, 2008 was \$306,805 and \$5,431,774, respectively. Interest expense decreased year-over-year for the year to date periods due primarily to the elimination of interest related costs on the preferred shares and the short-term bridge financing which were converted to common share equity in June 2008.

The foreign currency gain of \$129,130 for the nine months ended September 30, 2008 was related to mark to market adjustments for the short-term bridge financing which was denominated in Canadian dollars. This financing was converted to common share equity in June 2008.

Interest Income

Interest income for the three months ended September 30, 2009 and 2008 was \$20,687 and \$324,203, respectively. For the nine months ended September 30, 2009 interest income was \$119,165, compared to \$350,924 for the comparable period in 2008. On a quarter-to-quarter basis, interest income decreased in the first three quarters of 2009, compared to the third and fourth quarters of 2008 due to historically low interest rates on United States Treasury bills, and the decrease in the Company's cash and investment balances during these periods.

Other Expense

For the nine months ended September 30, 2008, the Company realized a loss on the sale of assets in the amount of \$551,140 versus a loss of \$790 for the comparable period in 2009. In 2008, the Company disposed of non-core property and equipment.

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

*Summary of Quarterly Results*

(figures in thousands except per unit data)	2009			2008				2007
	Q3 '09	Q2 '09	Q1 '09	Q4 '08	Q3 '08	Q2 '08	Q1 '08	Q4 '07
Saleable coal production	432	450	493	527	431	472	502	547
Purchased coal (1)	219	83	53	18	109	170	27	-
Tons sold	680	522	538	568	529	646	560	539
Average revenue per ton	\$ 34.10	\$ 33.20	\$ 33.40	\$ 33.11	\$ 34.20	\$ 33.00	\$ 33.03	\$ 31.19
Average cost of sales per ton	\$ 33.46	\$ 32.62	\$ 27.40	\$ 26.90	\$ 33.87	\$ 32.80	\$ 31.23	\$ 34.40
Revenue	\$ 23,202	\$ 17,320	\$ 17,972	\$ 18,809	\$ 18,094	\$ 21,326	\$ 18,495	\$ 16,830
Cost of sales	22,768	17,020	14,744	15,278	17,919	21,200	17,485	18,562
Selling expenses	1,844	1,852	2,156	2,286	1,757	2,074	2,071	2,175
General and administrative	2,575	2,005	3,598	5,593	2,541	3,813	1,599	3,118
Depreciation and amortization	-	1,908	1,824	3,084	2,221	2,043	1,064	1,023
Loss (adjustment to previously estimated loss) on sale of surface mining operations	(2,678)	38,920	-	-	-	-	-	-
Sales contract termination cost	-	-	3,000	-	-	-	-	-
Asset impairment write down	-	-	-	-	-	-	-	2,873
Loss from operations	\$ (1,307)	\$ (44,385)	\$ (7,350)	\$ (7,432)	\$ (6,344)	\$ (7,804)	\$ (3,724)	\$ (10,921)
Other expense, net	410	406	285	578	320	2,893	2,292	4,859
Income taxes	6	10	-	38	-	(1)	-	76
Net loss for the period	\$ (1,723)	\$ (44,801)	\$ (7,635)	\$ (8,048)	\$ (6,664)	\$ (10,696)	\$ (6,016)	\$ (15,856)
Basic and diluted net loss per share	\$ (0.01)	\$ (0.30)	\$ (0.05)	\$ (0.05)	\$ (0.04)	\$ (0.25)	\$ (0.16)	\$ (0.43)

(1) The Company purchased coal from Covol Engineered Fuels ("Covol"), American Coal Company ("ACC"), Cline Mining and C&R - Beech Creek, a mine which it managed from September 2007 through July 2008 before the Company acquired C&R.

**Liquidity and Capital Resources**

As at September 30, 2009, the Company had \$17,438,163 in cash, cash equivalents and short-term investments, compared to \$40,626,316 as at December 31, 2008. The Company also had restricted cash, cash equivalents and certificates of deposit as collateral for letters of credit for reclamation bonding and escrowed funds from the sale of its surface mining operations in the amount of \$14,420,658 as at September 30, 2009 versus \$11,638,921 as at December 31, 2008.

Subsequent to the sale of its surface mining operations at September 30, 2009, the Company's primary sources of cash are sales of assets and financing transactions. The Company's primary uses of cash include costs for development projects, costs related to reclamation obligations and general and administrative costs. The Company's ability to continue to grow its business is dependent on its ability to continue to generate cash from its primary sources in excess of its primary uses or deploy its capital into new assets that can generate positive cash flow.

**Operating Activities**

Cash used by operating activities for the three and nine months ended September 30, 2009 was \$5,390,110 and \$13,049,600, respectively. The Company's operating loss was the primary reason for the use of cash, which, for the nine months ended September 30, 2009, included the \$3,000,000 payment to terminate a coal sales contract with one

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

of its customers. Changes in non-cash operating assets and liabilities used \$1,131,360 of cash during the three months ended September 30, 2009, primarily resulting from an increase in accounts receivable, as sales in the last half of September 2009 were significantly higher than sales in the last half of June 2009. Trade accounts payable and accrued liabilities increased \$2,622,914 for the nine months ended September 30, 2009 primarily due to an increase in purchased coal activity during this period.

Investing Activities

Investing activities resulted in a net cash increase of \$4,792,266 and a net cash decrease of \$5,933,671 for the three and nine months ended September 30, 2009, respectively. In the third quarter 2009, the Company sold its surface mining operations, generating cash of \$4,013,783. Payments for mine development and mining rights of \$928,206 and \$2,648,899 for the three and nine months ended September 30, 2009, respectively, were primarily for development costs for the Radio Hill, KO, Back in Black, and Gryphon mines. The Company's investing activities also included \$3,307,259 incurred to acquire the Petersburg Coal sublease in the first quarter 2009.

Capital expenditures for the three and nine months ended September 30, 2009 were \$303,493 and \$7,976,224, respectively. For the nine months ended September 30, 2009, \$6,629,614 was invested in three trucks, two dozers and a loader that were financed through term loans. The remaining \$1,346,610 was primarily spent on the preparation plant at the Briar Hill mine, and costs for relocating the Company's maintenance and administrative mine operations to a location centrally located to its Western Kentucky surface operations.

Financing Activities

Financing activities used cash of \$2,132,429 and \$6,577,831 for the three and nine months ended September 30, 2009, respectively. The majority of the financing activities were payments on equipment financing and bank debt.

***Outlook***

As at September 30, 2009, the Company's remaining assets and liabilities were primarily cash, assets related to the Gryphon Mining Complex and asset retirement obligations related to depleted surface mining properties that were not part of the sale of the surface mining operations. As previously disclosed, the Company is in the process of evaluating strategic alternatives for the Gryphon Mining Complex, including the possible sale of the asset to a third party. As it evaluates its alternatives, the Company continues to prudently advance the development of the project, respond to solicitations and inquiries from potential customers and obtain the necessary permits for the new portal location at Smith Station Farm. Unless there is a sale of the asset, the measured advancement of the project will require approximately \$3,294,000 through the end of the first quarter 2010, which includes the payment of \$3,000,000 in vendor financing as reported on the Company's consolidated balance sheet.

As mentioned above, the Company retained several previously mined surface properties that require reclamation. As at September 30, 2009, the asset retirement obligations and other long-term liabilities on the balance sheet related to these reclamation obligations totaled approximately \$2,165,000. During the fourth quarter 2009 and the first six months of 2010, the Company expects to spend approximately \$1,686,000 on the necessary reclamation work to enable it to apply for phase I bond release on all but one of the properties, which would return 60% of the outstanding bonding (and thus release the corresponding restricted cash held as collateral) associated with the reclaimed properties. The Company estimates that the phase I bond release would free up approximately \$1,955,000 from its restricted cash account.

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

***Acquisitions***

Petersburg Coal Sublease

In March 2009, the Company entered into a sublease agreement with Petersburg Coal, LLC ("Petersburg") to sublease mineral reserves which are contiguous to its Gryphon Mining Complex, formerly known as the Pratt Mine. Under the terms of the sublease, the Company paid \$3,000,000 at closing, assumed \$192,178 in liabilities, and will pay an additional \$3,000,000 upon satisfactory completion of certain contingencies, including receipt of all required permits from Petersburg. The Company also incurred transaction costs related to the sublease of \$115,081, bringing the total cost of the sublease to \$6,307,259.

A mineral reserve and mineral resource evaluation prepared in accordance with National Instrument 43-101 ("NI 43-101") of the Gryphon Mining Complex was prepared as at April 1, 2009 by an independent geological and engineering consulting firm. Based on the report, at the Gryphon Mining Complex the Company controls 68.4 million tons of proven and probable coal mineral reserves, 3.7 million tons of underground measured and indicated coal resources, and 0.2 million tons of inferred coal resources.

The costs of the sublease were allocated to the following identifiable assets:

Prepaid royalties .....	\$ 172,413
Mining rights .....	<u>6,134,846</u>
	<u>\$ 6,307,259</u>

***Outstanding Share Data***

As at the filing date, the Company had 150,045,552 common shares issued and outstanding. In addition, there were 11,058,830 stock options, 33,208,580 warrants and 2,514,286 brokers options (which entitle the holder to purchase one common share and one half of one warrant) outstanding as at the filing date. If all options, warrants, and brokers' options (including the subsequent exercise of the warrants purchased) were exercised and issued, it would bring the fully diluted issued common shares to a total of 198,084,391, and would generate cash of approximately \$78,000,000. As at September 30, 2009 all options and warrants are fully exercisable.

***Related Party Transactions***

The Company enters into transactions with shareholders and/or affiliated entities that have some level of common ownership with the Company. A summary of the related party transactions and balances follows for the nine months ended September 30, 2009 and 2008:

	<u>Nine Months Ended</u>	
	<u>September</u>	
	<u>2009</u>	<u>2008</u>
Expenses:		
Consulting fees.....	\$ —	\$ 156,000
Rent and miscellaneous .....	—	32,925
Accounts receivable .....	—	—
Accounts payable .....	—	—

The above expense amounts were paid to MHI Energy Partners, LLC, which amounts were applied towards, among other things, salaries, overhead and benefits for individuals who provided services. These transactions are also in the normal course of business, and are recorded at the consideration established and agreed to by the related parties. David Wiley and Timothy Fogarty were managing directors of MHI Energy Partners, LLC. David Wiley is currently an officer and director of the Company and Phoenix, and Tim Fogarty resigned as a director of Phoenix in September 2008. During the second quarter of 2008, the Company discontinued these payments to MHI.

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

***Commitments and Contingent Liabilities***

In the normal course of business, the Company makes various commitments and incurs certain contingent liabilities including liabilities related to asset retirement obligations and financial obligations in connection with mining permits that are not reflected in the accompanying consolidated balance sheet. The Company does not anticipate any material losses as a result of these transactions. In accordance with Kentucky state law, the Company is required to post reclamation bonds to assure that reclamation work is completed. Outstanding reclamation bonds related to Company owned reclamation operations totaled approximately \$6.2 million as at September 30, 2009 and approximately \$11.0 million as at December 31, 2008. In addition, at September 30, 2009, the Company had approximately \$5.6 million of additional reclamation bonds outstanding related to its previously owned surface mining operations that are in the process of being replaced by the purchaser under the terms of the Acquisition Agreement. These bonds are secured by letters of credit, cash or certificates of deposit issued by a bank equal to the amount of the outstanding reclamation bonds. The letters of credit are collateralized by cash. The restricted cash and certificates of deposit collateralizing the reclamation bonds on the consolidated balance sheet totaled \$11,970,658 and \$11,638,921 as at September 30, 2009 and December 31, 2008, respectively.

The Company leases certain office space under an operating lease running through 2009. Future non-cancelable minimum lease commitments under this lease as at September 30, 2009, payable in 2009, totaled \$57,299.

A significant amount of the Company's surface and underground coal reserves are controlled through leasing arrangements and non-cancellable royalty lease agreements under which future minimum lease payments are due.

The Company had future commitments to purchase fuel, coal, and pay fees for the delivery of certain coal reserves to a third party. These commitments were assumed by the purchaser under the terms of the Acquisition Agreement.

***Business Environment and Risks***

The Company's operations are subject to the risks normally inherent in the operation and development of coal properties. There is no assurance of developing economic coal reserves in commercial quantities. Operational risks include weather, geologic anomalies, competition, potential transportation interruptions, a complex regulatory regime and environmental and safety concerns. Financial and liquidity risks include commodity price fluctuations, interest rates, and the costs of goods and services. The Company uses a variety of means to help minimize its business risks.

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

*Credit Risk:* Credit risk is the risk of a financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligation.

The Company had invested approximately \$28,100,000 of its cash and cash equivalents (including restricted cash and investments) and short-term investments in a U.S. financial institution, which as at September 30, 2009, carried Standard and Poor's investment ratings on their deposits of A-2 to BBB+. The Company has not experienced any losses on its deposits with this financial institution.

The Company is also subject to credit risk from its trade accounts receivable and amounts due from the sale of its surface mining operations. While economic factors can affect credit risk, the Company manages risk by providing credit terms on a case by case basis. Customers are primarily investment grade companies and quasi-governmental agencies. As a result, the Company has not experienced any instances of non-payment. The amounts due from the sale of its surface mining operations are payable by a privately-owned coal company with over thirty-five years of mining history. Of the total amount due of \$1,500,000, \$1,000,000 was received in October 2009.

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

The Company also invests in short-term investments issued by the United States government, such as Treasury bills and Treasury notes. Historically, these types of investments have been AAA rated, so the Company does not anticipate any risk related to default on these investments by the issuer.

As at September 30, 2009, the total fair value of assets subject to credit risk, including cash and cash equivalents (including restricted cash and investments), short-term investments, trade accounts receivable, and amounts due from the sale of surface mining operations approximates their carrying value of \$39,502,644.

*Liquidity Risk:* Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they come due. The Company manages its liquidity by ensuring that there is sufficient capital to meet short and long-term business requirements, after taking into account cash flows from operations and the Company's holdings of cash, cash equivalents and short-term investments. The Company also strives to maintain sufficient financial liquidity at all times in order to participate in investment opportunities as they arise, as well as to withstand sudden adverse changes in economic circumstances.

Management forecasts cash flows for its current and subsequent fiscal years to predict future financing requirements. Future requirements are met through a combination of credit commitments and access to capital markets. As at September 30, 2009, the Company had \$17.4 million of cash, cash equivalents, and short-term investments.

*Interest Rate Risk:* Interest rate risk is the risk borne by an interest-bearing asset or liability as a result of fluctuations in interest rates. Financial assets and financial liabilities with variable interest rates expose the Company to cash flow interest rate risk. The Company's most significant interest rate risk arises from its short-term investments and cash equivalents. However, the maturity on these instruments is generally less than ninety days, thereby mitigating the exposure to the impact of changing interest rates.

*Currency Risk:* The Company's functional currency is the U.S. dollar and the Company's sales are denominated in U.S. dollars. As the Company operates in an international environment, some of the Company's financial instruments and transactions are denominated in currencies other than the U.S. dollar. The results of the Company's operations are subject to currency transaction risk and currency translation risk. As at September 30, 2009, the Company had no material financial instruments that were denominated in non U.S. currencies.

### ***Critical Accounting Estimates***

The Company's consolidated financial statements are prepared in accordance with generally accepted accounting principles in Canada and, in preparing these statements, management must make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. The estimates and assumptions are believed to be reasonable under the circumstances and are based on historical experience and current conditions. The use of other assumptions could result in different estimates, and actual results may vary from results based on these estimates. As events occur and additional information is obtained, these estimates may be subject to change. Estimates are deemed critical when the Company's financial condition or results of operations could be materially impacted by a change in estimate. The Company's significant accounting policies are discussed in note A of the Company's December 2008 consolidated financial statements. The following is a discussion of the critical accounting estimates used to determine the financial results of the Company.

#### **Mining Rights, Mineral Reserves and Mine Development**

Mining rights, mineral properties and development assets include expenditures to acquire and develop mineral reserves, as well as development costs incurred to develop new reserves in advance of production. Depletion of producing properties, and amortization of mining rights and development costs, are based on units of production over the estimated proven and probable reserves of the respective coal properties.

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

The determination of coal reserves requires a number of assumptions and estimates, including geological sampling and modeling as well as estimates of future coal prices and future production costs. Estimates of the reserves may change based on additional information obtained subsequent to the assessment date. This may include data obtained from exploration drilling, significant changes in the price of coal and changes in estimates of the cost of production. A change in the estimate of reserves could result in a change in the rate of depletion, development amortization, or impairment of the reserves, resulting in a write down.

Mining rights and mine development are tested for impairment when events or changes in circumstances indicate that their carrying amount may not be recoverable. This impairment testing is based on estimated future undiscounted cash flows to be realized from the Company's mining operations. These future cash flows are developed using assumptions that reflect the long-term operating plans given management's best estimate of future economic conditions, such as revenues, production costs, and reserve estimates. A change in these factors could result in a modification of the impairment calculation.

Future Income Taxes

The Company is subject to Canadian tax and U.S. federal income tax as well as income tax of multiple state jurisdictions. The tax years 2005 through 2008 remain open to examination for Canadian, U.S. federal income tax and various state income tax matters.

The expense for income taxes includes federal and state income taxes currently payable and those deferred or prepaid because of temporary differences between the financial statement and the tax basis of assets and liabilities. As a result of losses from operations, the Company has recorded a valuation allowance against its future tax assets as it does not believe it is more likely than not these assets will be realized. Should these tax assets be realized, the valuation allowance would be reduced accordingly.

Asset Retirement Obligations

The Company estimates its ARO liabilities for final reclamation and mine closure based upon detailed engineering calculations of the amount and timing of the future cash spending for a third party to perform the required work. Spending estimates are escalated for inflation and then discounted at the credit-adjusted risk-free rate. The Company records an ARO asset associated with the discounted liability for final reclamation and mine closure. The obligation and corresponding asset are recognized in the period in which the liability is incurred. The ARO asset is amortized on the units-of-production method and the ARO liability is accreted to the projected spending date. As changes in estimates occur (such as mine plan revisions, changes in estimated costs or changes in timing of the performance of reclamation activities), the revisions to the obligation and asset are recognized at the appropriate credit-adjusted risk-free rate. The Company also recognizes an obligation for contemporaneous reclamation liabilities incurred as a result of surface mining. Contemporaneous reclamation consists primarily of grading, topsoil replacement, and revegetation of backfilled pit areas.

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

A progression of the asset retirement obligations recorded on the consolidated balance sheet is as follows:

Total asset retirement obligations as at December 31, 2007.....	\$ 3,757,353
Liabilities acquired .....	1,131,000
Liabilities incurred.....	166,083
Accretion .....	189,132
Liabilities settled.....	(919,568)
Total asset retirement obligations as at December 31, 2008.....	4,324,000
Liabilities incurred.....	846,295
Accretion .....	188,719
Liabilities settled.....	(832,938)
Liabilities assumed by purchaser of surface mining operations .....	(2,764,276)
Total asset retirement obligations as at September 30, 2009 .....	1,761,800
Less current portion .....	1,259,800
	<u>\$ 502,000</u>

Share-Based Compensation

Compensation cost attributable to all share options granted is measured at fair-value at the grant date using the Black-Scholes model and expensed over the vesting period with a corresponding increase to stock options and warrants in shareholders' equity. In determining the fair value, the Company makes estimates for expected volatility of the shares as well as an estimated discount rate. Changes to these estimates could result in the fair-value of the share-based compensation to be less than or greater than the amount recorded.

***Initial Adoption and Changes in Accounting Policies***

All accounting policies adopted by the Company are in accordance with Canadian generally accepted accounting principles ("GAAP"). The following financial reporting standards are applicable to the Company in 2009.

New Accounting Policies

*Goodwill and Intangible Assets:* The CICA has issued a new standard, CICA Section 3064, Goodwill and Intangible assets, which establishes revised standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets and is effective January 1, 2009. Concurrent with the introduction of this standard, the CICA withdrew EIC-27, Revenues and Expenses during the pre-operating period. This standard has had no material impact on the Company's consolidated financial statements.

*Financial Instruments:* The EIC has issued EIC-173, Credit Risk and the Fair Value of Financial Assets and Financial Liabilities, which clarifies the application of credit risk when determining the fair value of financial assets and liabilities. EIC-173 is effective for interim and annual financial statements for periods ending on or after January 20, 2009. This standard has had no material impact on the Company's consolidated financial statements.

*Mining Exploration Costs:* The EIC has issued EIC-174, Mining Exploration Costs, which discusses the circumstances under which exploration costs may be capitalized. Additionally, EIC-174 clarifies the timing for testing capitalized exploration costs for impairment. EIC-174 is effective for interim and annual financial statements issued after March 27, 2009. This standard has had no material impact on the Company's consolidated financial statements.

Future Accounting Changes

*International Financial Reporting Standards ("IFRS"):* In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian

**Phoenix Coal Inc.**  
**Management's Discussion and Analysis**  
**Three and Nine Months Ended September 30, 2009**

companies. In February 2008, the AcSB announced that Canadian GAAP for publicly accountable enterprises will be converged with IFRS effective in calendar year 2011. The Company will adopt IFRS for the fiscal year beginning January 1, 2011, with restatement for comparative purposes of amounts reported by the Company for the fiscal year beginning January 1, 2010.

The Company is in the planning and evaluation phase of the conversion, which includes the identification and analytical review of potential differences between GAAP and existing IFRS as at September 30, 2009, as well as proposed IFRS which may be in effect in 2011. Detailed review of these differences has been performed in several financial statement areas, including property and equipment, asset retirement obligations and share-based compensation. Employees responsible for financial reporting have completed IFRS training. Quantification of GAAP and IFRS differences has not yet been determined as the Company finalizes its policy choices and elections.

*Reclassifications:* Certain of the 2008 figures have been reclassified to conform to the 2009 financial statement presentation.

***Disclosure Controls and Procedures***

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Company is accumulated and communicated to the Company's management as appropriate to allow timely decisions regarding required disclosure. For the fiscal year ended December 31, 2008, an evaluation was commissioned by the Company under the supervision of the CEO and CFO and with the participation of management of the effectiveness of the Company's disclosure controls and procedures as defined under the rules adopted by the Canadian securities regulatory authorities. Based on this evaluation, and that there have been no material changes in disclosure controls and procedures in 2009, the Company's CEO and CFO have concluded as at September 30, 2009, that the Company's disclosure controls and procedures provide reasonable assurance that material information related to the Company is made known to them for disclosure in these financial statements. It should be noted that while the Company's CEO and CFO believe that the Company's disclosure controls and procedures provide a reasonable level of assurance that they are effective, they do not expect that the disclosure controls and procedures or internal controls over financial reporting will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

***Internal Controls over Financial Reporting***

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external reporting purposes in accordance with generally accepted accounting principles in Canada. Management is responsible for establishing and maintaining adequate internal controls over financial reporting appropriate to the nature and size of the business to provide reasonable assurance regarding the reliability of financial reporting for the Company. However, any system of internal control over financial reporting has inherent limitations and can provide only reasonable assurance with respect to financial statement preparation and presentation.

The Company uses the COSO control framework. For the fiscal year ended December 31, 2008, an evaluation was commissioned by the Company under the supervision of the CEO and CFO and with the participation of management of the effectiveness of the Company's internal control over financial reporting. Based on this evaluation, and that there have been no material changes in internal controls over financial reporting in 2009, the CEO and CFO have concluded that the design and operation of the Company's internal controls over financial reporting were effective as at September 30, 2009. Management is continually monitoring and revising its control procedures and processes. Due to the size of its finance staff, there is not complete segregation of duties in the Company. However, for more complex areas of accounting and accounting estimates, the CFO and Controller review each other's work.