

PHOENIX COAL INC.

Management's Discussion and Analysis

For the years ended December 31, 2009 and 2008

Phoenix Coal Inc.
Management's Discussion and Analysis
Year Ended December 31, 2009

The following discussion of the results of operations, financial condition and cash flows of Phoenix Coal Inc. (the "Company") prepared as at March 26, 2010 should be read in conjunction with the Company's 2009 and 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. 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. 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 Louisville, 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 Company retained several depleted surface mining properties that were not part of the sale and are in the process of being reclaimed. The results of operations and liquidity and capital resources in management's discussion and analysis primarily pertain to the surface mining operations, which for 2009, included Briar Hill/Radio Hill (two mines at one geographic location), Back in Black, KO, Jessup and Beech Creek. As at December 31, 2009, the Company still owned and controlled surface property and coal mineral rights, among other assets, related to its underground coal reserves in Western Kentucky, consisting of the "Gryphon Reserves" and the "Panama South Reserves" (together, the "Gryphon Mining Complex"). However, as discussed in the Subsequent Events section below, the Panama South Reserves were sold in February 2010 and, in March 2010, the Company entered into a definitive agreement to sell its Gryphon Reserves.

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Financial Overview

<i>(figures in thousands except unit data)</i>		As at 31-Dec-09	As at 31-Dec-08	As at 31-Dec-07
Balance sheet	Total assets	\$50,213	\$155,145	\$72,781
	Short-term financing	-	-	13,321
	Preferred shares	-	-	45,635
	Asset retirement obligation	2,178	4,324	3,757
	Long-term debt	-	21,174	9,687
	Shareholders' equity	46,652	122,694	(9,224)
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		31-Dec-09	31-Dec-08	31-Dec-07
Income statement	Revenue	\$58,754	\$76,724	\$67,184
	Cost of sales	55,388	71,882	62,175
	Selling expenses	5,864	8,189	7,860
	General and administrative expenses	9,774	13,545	7,061
	Depreciation and amortization	3,753	8,412	3,143
	Loss on sale of surface mining operations	36,417	-	-
	Asset impairment write down	21,900	-	2,873
	Sales contract termination cost	3,000	-	-
	Operating loss	(\$77,342)	(\$25,304)	(\$15,928)
	Other expense, net	1,226	6,082	9,993
	Income taxes	57	38	70
	Net loss	(\$78,625)	(\$31,424)	(\$25,991)
	Basic and diluted net loss per share	(\$0.52)	(\$0.33)	(\$0.70)
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Statistics (thousands of tons)	Saleable coal production	1,375	1,932	2,101
	Purchased coal	355	323	52
	Coal sales	1,740	2,303	2,121

Highlights for 2009

During the year ended December 31, 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 Operations section below.
- Due to the sale of its surface mining operations on September 30, 2009, the Company derived no revenue from coal sales, nor did it produce or purchase any coal for the fourth quarter ended December 31, 2009.
- For the twelve months ended December 31, 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 1,740,000 tons for the twelve months ended December 31, 2009.

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- Revenue for the twelve months ended December 31, 2009 was approximately \$58,754,000, for average revenue per ton sold of \$33.77.
- Cost of sales for the twelve months ended December 31, 2009 was approximately \$55,388,000 for an average cost per ton sold of \$31.83.
- For the three and twelve months ended December 31, 2009, the Company's net loss was approximately \$24,466,000 and \$78,625,000, respectively. The loss on the sale of the surface mining operations and an impairment charge related to the Company's underground development projects contributed approximately \$36,417,000 and \$21,900,000 to the total year-to-date loss, respectively.
- At December 31, 2009, the Company had approximately \$13,829,000 in cash and cash equivalents. 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 of approximately \$12,071,000.

Results of Operations

Operating Activity

Due to the sale of its surface mining operations, the Company's operating activity for the fourth quarter 2009 consisted primarily of reclamation work performed at depleted surface mining locations, transition services provided to the purchaser of the surface mining operations, continued development of the Gryphon Mining Complex and the evaluation of strategic alternatives for the Gryphon Mining Complex, including a possible sale to a third party. Revenue generated in the fourth quarter 2009 of approximately \$260,000 was derived almost exclusively from the transition services previously described. The Company also recorded a non-cash asset impairment charge related to its investment in the Gryphon Mining Complex of \$21.9 million

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 recurring revenues were derived from these operations.

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. Asset retirement obligations related to surface mining operations whose reserves had been depleted as at September 30, 2009 were not included in the sale. The Company could potentially receive an additional \$500,000 of cash consideration if, by June 30, 2010, it satisfied certain post-closing obligations ("2010 Fee"). These conditions were subsequently satisfied after December 31, 2009 and the \$500,000 in cash consideration was placed in escrow in January 2010. 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. Of this amount, \$700,000 was replaced by the purchaser in December 2009.

With respect to the cash consideration, \$5.1 million was received by the Company in 2009, and \$2.8 million was placed in escrow. The 2010 Fee was not earned and placed in escrow until January 2010, so it will be reported as income in the Company's first quarter 2010 operating results. 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.

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Impairment of Gryphon Mining Complex

As at December 31, 2009 the Company was evaluating strategic alternatives for its Gryphon Mining Complex, including a possible sale to a third party. During the review of these alternatives, market value evidence indicated that the carrying value of the Gryphon Reserves exceeded their fair value and thus an impairment of these assets was warranted. As a result, the Company recorded an impairment loss of \$21.9 million on the assets related to its Gryphon Reserves which included land, mining rights, mine development costs, and prepaid royalties.

Production and Purchased Coal

As previously discussed, due to the sale of its surface mining operations, the Company did not produce or purchase any coal for the fourth quarter ended December 31, 2009. For the year ended December 31, 2009, the Company produced approximately 1,375,000 of coal from six sources - Briar Hill, Radio Hill, Back in Black, KO, Jessup and Beech Creek. Year-over-year production for the twelve months ended December 31 reflected a negative differential of 557,842 tons due primarily to nine months of production in 2009 compared to twelve months of production in 2008. Briar Hill/Radio Hill led production for 2009 producing a total of 826,887 tons. The addition of the multiple seam Radio Hill pit was a contributing factor to this production level.

Back in Black production was comparable year-over-year, however, this location operated for eight months in 2009 and six months in 2008. This 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. During 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.

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 constraining production. As the year progressed, 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.

Production at the Jessup mine was 180,470 tons for the twelve months ended December 31, 2009, compared to 61,237 for the comparable period in 2008. Production reported for the 2008 period includes only five months of production activity as the Company did not acquire the Jessup mine until August 1, 2008.

With regard to purchased coal, Covol Engineered Fuels' ("Covol") production was slow to start in 2008 due to inclement weather, start-up issues and downtime related to initial capital improvements. By the end of 2008, Covol had finished construction on its new preparation plant and modifications on the Rock Crusher plant resulting in a purchased coal increase of 141,706 tons from this operation for the twelve months ended December 31, 2009 when compared to the comparable time period in 2008.

Prior to its purchase of C&R Coal in July 2008, the Company purchased 224,442 tons of coal from this operation during 2008.

In June 2009, the Company executed a coal supply agreement with American Coal Company to purchase coal from its Illinois operation. The purchased coal had a higher BTU and lower sulfur content than the Company's typical product, thus enabling the Company to produce more raw, saleable coal and fulfill certain customer obligations at a faster rate. The Company purchased 111,572 tons from this operator during the twelve months ended December 31, 2009.

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The following table summarizes Phoenix's production from its owned mines, as well as purchased coal activity, during the twelve months ended December 31, 2009 and 2008.

	YTD 12/31 2009	YTD 12/31 2008	Variance	Variance %
Coal Production				
Briar Hill/Radio Hill	826,887	913,348	(86,461)	-9.5%
Back in Black	125,496	127,637	(2,141)	-1.7%
KO	107,591	-	107,591	0.0%
Jessup	180,470	61,237	119,233	194.7%
Beech Creek	134,094	256,518	(122,424)	-47.7%
Sub-total	1,374,538	1,358,740	15,798	1.2%
Other mines	-	573,640	(573,640)	-100.0%
Total coal production	1,374,538	1,932,380	(557,842)	-28.9%
Purchased Coal				
Covol	240,231	98,525	141,706	143.8%
C&R Coal	-	224,442	(224,442)	-100.0%
American Coal Co.	111,572	-	111,572	0.0%
Cline Mining	3,450	-	3,450	0.0%
Total purchased coal	355,253	322,967	32,286	10.0%

Revenue

For the years ended December 31, 2009 and 2008, the Company primarily derived its revenue from coal sales to electric utility companies. As previously discussed, for the three months ended December 31, 2009, the Company derived no revenue from coal sales. Revenue generated in the fourth quarter 2009 of approximately \$260,000 was almost exclusively from transition services provided to the purchaser of the Company's surface mining operations.

For the twelve months ended December 31, 2009, Phoenix's revenue decreased to \$58,753,744 from \$76,724,270 in the prior year twelve month period. This decrease was due primarily to the lack of coal production in the fourth quarter 2009.

For the twelve months ended December 31, 2009, average revenue per ton sold increased to \$33.77 from \$33.31 in the same period in 2008. The increase of \$0.46 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 provided the highest base price realization of all its sales contracts. Additionally, coal purchased from American Coal Company 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 year. On a cost per ton produced basis, diesel fuel cost was \$5.15 for the year ended 2009 compared to \$7.53 in 2008 a \$2.38 per ton or 32% decrease. This per ton decrease was primarily attributable to a year-over-year reduction of \$1.28 in the price per gallon for fuel, from \$3.31 in 2008 to \$2.03 for the same period in 2009.

Labor and benefits, on a cost per ton produced basis, increased 21% from \$8.37 for the year ended December 31, 2008 to \$10.15 for the comparable period in 2009. Tons produced per man hour worked decreased year-over-year primarily due to the inefficiencies created by excess rainfall and the production challenges at Back in Black and KO previously discussed.

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Purchased coal costs were \$10,304,782 and \$9,899,922 for the years ended December 31, 2009 and 2008, respectively. This increase was due to the 10% increase in tons purchased for the period. The cost per ton purchased decreased from \$30.65 in 2008, to \$29.01 in 2009. For the year ended December 31, 2009, 68% of the purchased tons were coal fines from Covol, compared to 31% for 2008. Covol fines represent the lowest per ton price of the Company's purchased coal products.

The majority of the Company's cost of sales activity in the fourth quarter 2009 was related to reclamation costs incurred at depleted surface mining locations which were not included in the September 2009 sale.

Maintenance costs for the year ended December 31, 2009 were \$6.07 per ton produced compared to \$4.63 in 2008, an increase of \$1.44 or a 31% increase. Per ton maintenance costs increased year-over-year due primarily to a significant amount of engine rebuild and undercarriage work that was performed in 2009 on equipment that was purchased in the fourth quarter of 2007 and the first quarter of 2008.

Overall, the Company's cost of sales decreased year-over-year by \$16,493,222 from \$71,881,533 in 2008 to \$55,388,311 in 2009. As previously described, this gross cost decrease is due to nine months of coal sales and production in 2009 versus twelve months in 2008. Comparing the same periods on a cost per ton sold basis, cost of sales was \$31.83 in 2009 versus \$31.21 in 2008. This increase of \$0.62 per ton is attributable to per ton cost increases in labor and maintenance costs previously described, an increase in the percentage of sales derived from purchased coal, offset by the decrease in fuel costs.

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 offices. For the year ended December 31, 2009, the Company's selling expenses were \$5,863,681 versus \$8,188,945 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 were 10% of coal sales for the year ended December 31, 2009 and 11% for the comparable period in 2008. The Company realizes lower selling costs, 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 for the years ended December 31, 2009 and 2008 were \$9,774,162 and \$13,545,412, respectively. This year-over-year decrease of \$3,771,250 resulted primarily from a reduction in share-based compensation expense which was \$2,583,842 and \$5,935,289 for 2009 and 2008, respectively. Additional share-based compensation expense was recognized in 2008 due to the voluntary surrender of 5,050,000 options by members of the board of directors and two senior executives.

Depreciation and Amortization

Depreciation and amortization expense for the years ended December 31, 2009 and 2008 was \$3,752,955 and \$8,412,073, respectively. As prescribed by generally accepted accounting principles, due to the classification of the surface mining 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 subsequent to June 30, 2009.

Interest Expense/Foreign Currency Adjustment

For the year ended December 31, 2009, interest expense was comprised primarily of interest paid on equipment financing. For the twelve months ended December 31, 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 years ended December 31, 2009 and 2008 was \$1,344,438 and \$5,767,496, respectively. Interest expense

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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, and the assumption of the Company's long term debt by the purchaser of the surface mining operations.

The foreign currency gain of \$129,130 for the year ended December 31, 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 years ended December 31, 2009 and 2008 was \$134,139 and \$570,378, respectively. Interest income decreased from 2008 to 2009 due to historically low interest rates on United States Treasury bills and money market accounts, and the decrease in the Company's cash and investment balances during these periods.

Other Expense

For the year ended December 31, 2008, the Company realized a loss on the sale of assets in the amount of \$1,012,780 versus a loss of \$11,579 for the comparable period in 2009. In 2008, the Company disposed of non-core property and equipment.

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Summary of Quarterly Results

(figures in thousands except per unit data)	2009				2008			
	Q4 '09	Q3 '09	Q2 '09	Q1 '09	Q4 '08	Q3 '08	Q2 '08	Q1 '08
Saleable coal production	-	432	450	493	527	431	472	502
Purchased coal (1)	-	219	83	53	18	109	170	27
Tons sold	-	680	522	538	568	529	646	560
Average revenue per ton	\$ -	\$ 34.10	\$ 33.20	\$ 33.40	\$ 33.11	\$ 34.20	\$ 33.00	\$ 33.03
Average cost of sales per ton	\$ -	\$ 33.46	\$ 32.62	\$ 27.40	\$ 26.90	\$ 33.87	\$ 32.80	\$ 31.23
Revenue	\$ 260	\$ 23,202	\$ 17,320	\$ 17,972	\$ 18,809	\$ 18,094	\$ 21,326	\$ 18,495
Cost of sales	857	22,768	17,020	14,744	15,278	17,919	21,200	17,485
Selling expenses	12	1,844	1,852	2,156	2,286	1,757	2,074	2,071
General and administrative	1,596	2,575	2,005	3,598	5,593	2,541	3,813	1,599
Depreciation and amortization	21	-	1,908	1,824	3,084	2,221	2,043	1,064
Loss (adjustment to previously estimated loss) on sale of surface mining operations	175	(2,678)	38,920	-	-	-	-	-
Sales contract termination cost	-	-	-	3,000	-	-	-	-
Asset impairment write down	21,900	-	-	-	-	-	-	-
Loss from operations	\$ (24,301)	\$ (1,307)	\$ (44,385)	\$ (7,350)	\$ (7,432)	\$ (6,344)	\$ (7,804)	\$ (3,724)
Other expense, net	125	410	406	285	578	320	2,893	2,292
Income taxes	40	6	10	-	38	-	(1)	-
Net loss for the period	\$ (24,466)	\$ (1,723)	\$ (44,801)	\$ (7,635)	\$ (8,048)	\$ (6,664)	\$ (10,696)	\$ (6,016)
Basic and diluted net loss per share	\$ (0.16)	\$ (0.01)	\$ (0.30)	\$ (0.05)	\$ (0.05)	\$ (0.04)	\$ (0.25)	\$ (0.16)

(1) The Company purchased coal from Covol, American Coal Company, 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 December 31, 2009, the Company had \$13,828,683 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 \$12,070,760 as at December 31, 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.

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Operating Activities

Cash used by operating activities for the twelve months ended December 31, 2009 was \$16,769,730. The Company's operating loss was the primary reason for the use of cash, which, for the year ended December 31, 2009, included the \$3,000,000 payment to terminate a coal sales contract with one of its customers. Changes in non-cash operating assets and liabilities used \$2,581,941 of cash during the year ended December 31, 2009, primarily resulting from the net settlement of accounts payable versus accounts receivable related to the Company's previously owned surface mining operations.

Investing Activities

Investing activities resulted in a net cash decrease of \$3,342,968 for the twelve months ended December 31, 2009. The sale of the Company's surface mining operations generated cash of \$4,632,361. Payments for other assets of \$2,979,545 were primarily for development costs for the Radio Hill, KO, and Back in Black mines, and the Gryphon Mining Complex. The Company's investing activities also included \$6,307,259 incurred to acquire the Petersburg Coal sublease in the first quarter 2009. Moving a portion of the Company's reclamation bonds from a financial institution to a bonding surety company reduced the Company's collateral requirements on these bonds which decreased restricted cash by \$2,368,161.

Capital expenditures for the year ended December 31, 2009 were \$7,997,007 and included \$6,629,614 invested in three trucks, two dozers and a loader that were financed through term loans. The remaining \$1,367,393 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 \$6,584,228 for the year ended December 31, 2009. The majority of the financing activities were payments on equipment financing and bank debt.

Comparison of 2008 to 2007

Net Loss

For 2008, the company incurred a net loss of \$31,423,943, or \$0.33 per basic and diluted share, compared to a net loss of \$25,991,135, or \$0.70 per basic and diluted share in 2007.

Revenue

For the 2008 year, the Company's revenue increased by 14.2% to \$76,724,270 from \$67,184,104 in the prior year. Sales volume was up 8.6%, increasing from approximately 2,121,000 tons in 2007 to approximately 2,303,000 tons in 2008. Revenue per ton sold grew 5.2% year-over-year, from \$31.67 to \$33.31. The increase over 2007 was primarily due to contractual price increases from existing sales contracts and new sales contracts with better pricing terms.

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Cost of Sales

For the years 2008 and 2007, the Company produced approximately 1,932,000 tons and 2,101,000 tons, respectively. The year-over-year decrease of 8.0% is primarily attributable to depletion at the Graham #5 and Back in Black mines, delay in state and federal permit issuance, and Beech Creek's production prior to August 2008 being accounted for as purchased coal during the management of C&R Coal. From that production, the Company purchased 224,442 tons to service its sales contracts before acquiring C&R at the end of July 2008. In addition to the purchased coal from C&R, the Company purchased nearly 100,000 tons of coal fines from Covol during 2008. For 2007, the Company purchased approximately 52,000 tons.

The Company's cost of sales increased by 15.6% to \$71,881,533 in 2008 from \$62,175,073 in 2007. Comparing the same periods on a cost per ton sold basis, cost of sales was \$31.21 versus \$29.31 for an increase of 6.5%. The 8.6% year-over-year increase in sales volume contributed to higher total cost of sales. Trucking, a variable cost, increased 31.5% from \$5,184,533 in 2007 to \$6,817,771 in 2008. Purchased coal, another variable cost, accounted for approximately 14% of the cost of sales in 2008. For the 2008 year, purchased coal was \$9,899,922 versus \$1,614,430 for the same period in 2007. Diesel fuel and explosives costs also increased in 2008 compared to 2007 as the unit costs for these commodities increased significantly year-over-year.

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

For 2008, the Company's selling expenses were \$8,188,945 compared to \$7,859,571 in 2007. The Company's selling costs (primarily royalties and coal taxes) are variable with respect to coal sales and were 10.8% of coal sales for 2008 and 11.7% in 2007. The Company does not pay coal taxes or royalties on purchased coal so selling expenses declined as a percentage of coal sales from year to year as the volume of purchased tonnage increased.

G&A costs for 2008 were \$13,545,412 compared to \$7,061,280 in 2007. The primary variance is a non-cash charge to employee stock-based compensation, which was \$5,935,289 in 2008 versus \$1,448,859 in 2007. Additional share-based compensation expense was recognized in 2008 due to the voluntary surrender of 5,050,000 options by members of the board of directors and two senior executives. G&A costs also increased due to the addition of corporate staff in 2008 to support field operations, sales and corporate development.

Depreciation and Amortization

Depreciation and amortization expense in 2008 was \$8,412,073 versus \$3,143,365 in 2007. Depreciation expense for 2008 increased \$1,712,108 primarily because of approximately \$31,100,000 invested in mining equipment from September 30, 2007 to December 31, 2008. Mining rights and mine development amortization expense increased year-over-year by \$3,591,916 mainly due to the amortization of mining rights in 2008.

Interest Expense

Interest expense for 2008 and 2007 was comprised of (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. Total interest expense for 2008 was \$5,767,496 versus \$7,783,908 in 2007. Interest expense decreased year-over-year 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.

Interest Income

For 2008, interest income was \$570,378 compared to \$106,692 in the prior year. The increase of \$463,686 in interest income from 2007 to 2008 resulted from the increase in cash and short-term investments in 2008 due to the prospectus offering.

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Other Expense

For 2008, the Company had a loss on the sale of assets in the amount of \$1,012,780 versus a loss of \$1,810,137 for 2007. During these periods in 2008 and 2007, the Company disposed of non-core property and equipment.

Reverse Takeover

On June 27, 2008 Phoenix Coal Corporation ("Phoenix") completed a reverse takeover ("RTO") of the Company, formerly Marimba Capital Corp., which was previously listed on the TSX Venture Exchange. Concurrent with the RTO, the Company raised \$97,784,678, net of issuance costs, in a prospectus offering of 62,857,160 subscription receipts priced at Cdn\$1.75. In conjunction with the RTO, the outstanding preferred shares and a short-term bridge loan were converted into common shares of the Company.

Outlook

Subsequent to December 31, 2009, the Company sold its Panama South Reserves and entered into a definitive agreement to sell its Gryphon Reserves. These assets, together referred to as the Gryphon Mining Complex, were the last remaining material coal assets of the Company. Upon closing of the sale of the Gryphon Reserves, the Company will no longer be a developer or operator of coal assets in the Illinois Basin. The Company is expected to have nearly \$56.2 million in cash (restricted and unrestricted), reclamation liabilities and other general and administrative costs primarily related to salaries, professional services and the wind down of the coal business. The Company plans to redeploy its capital into opportunities in the natural resources and mining sectors and has begun the process of evaluating potential acquisitions. Most acquisitions involve inherent risks, including assumption of transaction costs, risk of non-completion, undisclosed liabilities, assimilation and successfully managing growth. There is no assurance that the Company will be able to identify, acquire and integrate appropriate assets or companies for acquisition or obtain financing for such acquisitions on satisfactory terms. There can also be no assurance that competition for acquisition candidates will not escalate, thereby increasing the costs of making acquisitions.

As mentioned previously, the Company retained several previously mined surface properties that require reclamation. As at December 31, 2009, the asset retirement obligations and other long-term liabilities on the balance sheet related to these reclamation obligations totaled approximately \$2.6 million. During 2010, the Company expects to spend approximately \$1.5 million on the necessary reclamation work, which is projected to free up approximately \$1.9 million from restricted cash that was posted as collateral against the Company's obligations. If the assumptions underlying the Company's accruals are inaccurate, it could be required to expend greater amounts than anticipated. The *Surface Mining Control and Reclamation Act of 1977* establishes operational, reclamation and closure standards for all aspects of surface mining as well as most aspects of deep mining. The Company accrued the costs of final mine closure, including the cost of treating mine water discharge where necessary. Estimates of the Company's total reclamation and mine closure liabilities are based upon permit requirements and its experience. If these accruals are insufficient or the Company's liability in a particular year is greater than currently anticipated, the Company's future cash requirements related to reclamation could be greater than previously estimated.

Of the \$56.2 million in cash expected at closing of the sale of the Gryphon Reserves, approximately \$5.7 million will be restricted. In addition to the \$1.9 million that will be released from restriction over the course of 2010 for reclamation activities, the Company expects to have another approximately \$2.7 million freed up as a result of contractual obligations from the sale of its surface mining operations and the Gryphon Reserves. The amount and timing of these releases of cash from restriction is subject to the provisions of certain contractual arrangements and state regulatory authorities, and thus could change.

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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 the Gryphon Reserves. Under the terms of the sublease, the Company paid \$6,000,000 to Petersburg and assumed \$192,178 in liabilities. The Company also incurred transaction costs related to the sublease of \$115,081, bringing the total cost of the sublease to \$6,307,259.

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>

As detailed in the Subsequent Events section, the Company sold its Panama South Reserves in February 2010, and in March 2010, entered into a definitive agreement to sell its Gryphon Reserves.

Outstanding Share Data

As at the filing date, the Company had 150,545,552 common shares issued and outstanding. In addition, there were 10,168,330 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 197,693,891, and would generate cash of approximately \$81 million. As at December 31, 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 years ended December 31, 2009 and 2008:

	<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.

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

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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 \$6.3 million and \$11.0 million as at December 31, 2009 and 2008, respectively. In addition, at December 31, 2009, the Company had approximately \$4.9 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, certificates of deposit or surety bonds. The surety bonds and letters of credit are collateralized by cash. The restricted cash and certificates of deposit collateralizing the reclamation bonds on the consolidated balance sheet totaled \$9,270,700 and \$11,638,921 as at December 31, 2009 and 2008, respectively.

A significant amount of the Company's 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 invests its cash and cash equivalents and short-term investments in a U.S. financial institution, which at December 31, 2009, carried Standard and Poor's investment ratings on their short-term deposits of A-2. At December 31, 2009, approximately \$13.6 million of the cash and cash equivalents balance was invested in a money market fund managed by this financial institution. The Company has not experienced any losses on its deposits with this financial institution.

The Company was also subject to credit risk from its accounts receivable from coal sales. While economic factors affect credit risk, the Company managed risk by providing credit terms on a case by case basis. Customers were primarily investment grade companies and quasi-governmental agencies. As a result, the Company did not experience any instances of non-payment. Subsequent to December 31, 2009, the Company collected all of its outstanding accounts receivable as at that date.

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.

At December 31, 2009, the total fair value of assets subject to credit risk, including cash and cash equivalents (including restricted cash and investments), short-term investments, and accounts receivable totaled \$25,946,812.

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-

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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. At December 31, 2009, the Company had approximately \$20.6 million of cash, cash equivalents, short-term investments, and short-term restricted cash.

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 investments in marketable securities 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. The Company's long-term debt consisted of only fixed rate notes and was assumed by the purchaser of its surface mining operations.

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. At December 31, 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 1 of the Company's December 2009 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.

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

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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 2006 through 2009 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 recognized an obligation for contemporaneous reclamation liabilities incurred as a result of surface mining. Contemporaneous reclamation consisted primarily of grading, topsoil replacement, and revegetation of backfilled pit areas.

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

	<u>2009</u>	<u>2008</u>
Balance at beginning of year	\$ 4,324,000	\$ 3,757,353
Liabilities acquired	—	1,131,000
Liabilities incurred.....	964,608	166,083
Accretion	230,632	189,132
Liabilities assumed by purchaser of surface mining operations	(2,764,276)	—
Liabilities settled.....	<u>(576,964)</u>	<u>(919,568)</u>
Total asset retirement obligations	2,178,000	4,324,000
Less current portion	<u>1,454,700</u>	<u>1,958,000</u>
	<u>\$ 723,300</u>	<u>\$ 2,366,000</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.

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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: Effective January 1, 2009, the Company adopted CICA Section 3064, Goodwill and Intangible assets, which establishes revised standards for recognition, measurement, presentation and disclosure of goodwill and intangible assets. 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: Effective January 20, 2009, the Company adopted 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. This standard has had no material impact on the Company's consolidated financial statements.

Amendment to Financial Instruments: During 2009, CICA Section 3862, Financial Instruments – Disclosures, was amended to require disclosures about the inputs to fair value measurements, including their classification within a hierarchy that prioritizes the inputs to fair value measurement. The three levels of the fair value hierarchy are: Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities; Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and Level 3 – Inputs that are not based on observable market data.

Mining Exploration Costs: Effective March 27, 2009, the Company adopted 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. This standard has had no material impact on the Company's consolidated financial statements.

Future Accounting Changes

Business Combinations: CICA Section 1582 amends standards for the measurement, presentation and disclosure of a business combination. A number of changes are specified, including: an expanded definition of a business, a requirement to measure all business acquisitions at fair value, a requirement to measure non-controlling interests at fair value, and a requirement to recognize acquisition-related costs as expenses. These standards will require a change in the measurement of non-controlling interest and will require the non-controlling interest to be presented as part of shareholders' equity on the balance sheet. These new standards are harmonized with international standards. The Company is currently assessing the impact of these new accounting standards on its financial statements.

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 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.

In the fourth quarter 2009, the Company's initial IFRS project plan was re-scoped to determine the standards now applicable to the Company due to the significant changes in the Company's balance sheet and operations resulting from the sale of its surface mining operations. The initial project plan, coupled with the effects of the scope changes, have been included in the formal project plan documentation. Personnel internally and externally were

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engaged to work on the project analysis. These personnel have expertise in the Company's business, GAAP and IFRS.

Formal impact assessment work performed to date has included:

1. Reviewing draft IFRS policies for all applicable standards.
2. Analyzing underlying financial data to support conclusions and decisions concerning policy development, disclosure controls, and internal controls.
3. Performing a detailed qualitative and quantitative impact assessment on all applicable standards. Each policy element was reviewed in detail and notes and analysis were documented along with supporting financial and engineering analytical data.
4. Documenting and accumulating details of work performed in a formal repository to be used for generating project progress reports.
5. Presenting project decisions and supporting documentation to senior management and the Audit Committee for their approval.

Ongoing work is being performed to determine the financial impact of IFRS on the opening balance sheet at January 1, 2010. No exact quantification is available at this time. Material impacts may arise in IAS 36, Impairment, due to the differing treatment for costs to sell under IFRS as compared to GAAP.

As of the date of this filing, the Company has evaluated and performed impact assessment on the following standards:

- IAS 16 - Property Plant and Equipment
- IAS 18 - Revenue
- IAS 19 - Employee Benefits
- IAS 33 - Earnings Per Share
- IAS 36 - Impairment
- IAS 37 - Provisions
- IAS 39 - Financial Instruments: Measurement and Recognition
- IFRS 1 - First-Time Adoption of IFRS
- IFRS 2 - Share-Based Compensation
- IFRS 5 - Assets Held for Sale and Discontinued Operations
- IFRS 6 - Exploration and Evaluation of Mineral Resources

Other standards were reviewed and analyzed as part of the impact assessment and determined to be inapplicable to the Company at this time. This analysis has been included in the project documentation.

The Company will review other presentation and disclosure standards as part of its 2010 project work to assure that presentation and disclosure changes will be properly adopted. These are instructional standards and have been adopted as written. Review of guidance from the Canadian Securities Administrators is also part of the project regarding appropriate presentation under IFRS.

The Company began formal IFRS training for its staff in June of 2009. Continued familiarization with the standards and changes is occurring by working on the transition and assisting on the impact assessment of the standards. This allows staff to become familiar with the standards as they work on the project and are required to document portions of the standards that apply to the Company and compile applicable portions of the standards as part of the conversion project.

Internal controls over the IFRS transition are in place to assure an appropriate and accurate transition as well as a process which is appropriately documented and approved. This includes additional processes in the financial reporting areas with new procedures including approvals over IFRS adjustments. Changes in impairment policy and asset retirement obligation and procedures require updates to internal controls. Changes in asset retirement obligations require updates in procedures and controls due to changes in calculations of asset retirement obligations.

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As of the date of this filing, the Company's assessment of the impact of IFRS on IT systems is minimal. IT systems are adequate to accommodate current transaction levels. Should this change, new IT systems would be considered in property plant and equipment, share-based compensation and financial reporting.

The investor relations function is part of the transition project. Changes and impacts in key areas have been documented and all areas that must be communicated to investors are part of the project plan. Education for investor relations personnel in key areas has been planned. These areas include financial instruments, impairment and reclamation liabilities.

Disclosure controls are being updated to accommodate the changes in disclosure requirements for IFRS. For all standards that apply, the Company has an inventory of disclosures that are required. This inventory is updated as disclosures change. Pro forma financial statements with disclosures are part of the ongoing project plan. At this time, the disclosures for property, plant and equipment, asset retirement obligation and share based compensation have been updated. Other disclosures are being updated and are part of the project plan for 2010.

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

Subsequent Events

In February 2010, the Company sold its Panama South Reserves to a major U.S. coal producer for \$10 million in cash. As of the date of sale, the carrying value of the assets associated with the Panama South Reserves approximated \$940,000.

In March 2010, the Company announced it had entered into a definitive agreement to sell the Gryphon Reserves to a major U.S. coal producer for \$23 million in cash. As at December 31, 2009, the carrying value of the assets associated with the Gryphon Reserves approximated \$23 million. This sale is subject to the approval of the Company's shareholders. The Company's board of directors has unanimously approved the terms of the sale and will recommend that the Company's shareholders approve the sale. The sale is expected to be completed following the Company's annual meeting of shareholders, which is planned for late April 2010. Upon the closing of this sale, the Company will have divested of all its material coal properties.

Upon closing of the sale of the Gryphon Reserves, the Company will have sold substantially all of its assets after taking into account the sale of the surface mining operations in September 2009 and the Panama South Reserves in February 2010 (the "Divestiture Events"). Pursuant to employment agreements for certain officers of the Company (the "Contracted Officers"), the Divestiture Events cause the Contracted Officers to be entitled to a total change of control payment of approximately \$3.1 million payable within 30 days of the closing of the sale of the Gryphon Reserves.

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, 2009, 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, the Company's CEO and CFO have concluded as at December 31, 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

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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, 2009, 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, the CEO and CFO have concluded that the design and operation of the Company's internal controls over financial reporting were effective as at December 31, 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.

There were no changes to the Company's internal controls over financial reporting that occurred during the year ended December 31, 2009 that materially affected the Company's internal controls over financial reporting.