

Interim Management, Discussion & Analysis of

PHOENIX COAL INC.

For the three and nine months ended September 30, 2008

Management's Comments On Management, Discussion & Analysis

The accompanying interim Management, Discussion & Analysis of Phoenix Coal Inc. for the three and nine months ended September 30, 2008 have been prepared by management and approved by the Board of Directors of the Company. This Management, Discussion & Analysis has not been reviewed by the Company's external auditors.

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The following discussion of the results of operations, financial condition and cash flows of Phoenix Coal Inc. (the “Company”) prepared as of November 14, 2008 should be read in conjunction with the Company’s unaudited interim financial statements for the three and nine months ended September 30, 2008, and the Company’s 2007 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 of 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, production, acquisition and sale of coal from the Illinois Basin. The primary customers of the Company are electric utilities and consumers of industrial fuel. The current mining operations and near-term development projects of the Company are located in Western Kentucky, an area that comprises a part of the Illinois Basin. As of September 30, 2008, the Company operated four surface mines – Briar Hill, Graham #5, Jessup and Beech Creek/Beech Creek South (“Beech Creek”).

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Highlights for the first nine months of 2008

During the three and nine months ended September 30, 2008:

- On June 27, 2008 Phoenix Coal Corporation (“Phoenix”) completed a reverse takeover (“RTO”) of Phoenix Coal Inc. (the “Company”), formerly Marimba Capital Corp. (“MCC”), 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 connection with the RTO, each subscription receipt was exchanged for one unit, with each unit consisting of one common share and one half common share purchase warrant exercisable until June 25, 2010 at Cdn\$2.25.
- On September 26, 2008, an environmental activist group protested the U.S. Army Corps of Engineers (“COE”) pending issuance of a Section 404 permit for the Company’s KO Mine. As a result, the Company declared *force majeure* to all its customers.
- A two week vacation was taken in August 2008 to coincide with a portion of the Green River shutdown to perform maintenance on the locks.
- At the end of July, the Company closed the acquisitions of C&R Coal Inc. (“C&R”) and Renfro Equipment, Inc. (“Renfro”).
- On July 29, 2008, the Company’s subsidiary, PACT Resources LLC, received the required permitting from the Kentucky Department of Natural Resources and the COE for the Pratt mine to be able to put it into production.
- During the third quarter of 2008, the Company produced approximately 431,000 tons of clean coal and purchased approximately 109,000 tons of clean coal. For the nine months ended September 30, 2008, the Company produced approximately 1,405,000 tons of clean coal and purchased approximately 305,000 tons of clean coal.
- Coal sales totaled approximately 529,000 tons for the third quarter 2008 and approximately 1,735,000 tons for the nine months ended September 30, 2008.
- Revenue for the three and nine months ended September 30, 2008 was \$18,094,088 and \$57,915,648, respectively, for an average revenue per ton of coal sold of \$34.20 and \$33.38, respectively.
- Cost of goods sold for the three and nine months ended September 30, 2008 was \$17,919,115 and \$56,603,982, respectively, for an average cost per ton of coal sold of \$33.87 and \$32.62, respectively.
- For the third quarter of 2008 and year-to-date September 30, 2008, net loss was \$6,663,895 and \$23,374,993, respectively.
- At September 30, 2008, the Company had \$47,753,914 in cash, cash equivalents and short-term investments.

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RTO

In May, 2008, MCC and Phoenix entered into a definitive merger agreement with respect to the RTO. The RTO was completed on June 27, 2008. Prior to the completion of the RTO, MCC affected a reverse split of its outstanding common shares on the basis of one new share for each 2.35 shares outstanding. Pursuant to the RTO, the Company issued one common share for each outstanding common share of Phoenix. In addition, warrants and options to purchase Phoenix common stock outstanding immediately prior to the RTO were replaced with warrants and options to purchase an equivalent number of common shares of the Company, on economically equivalent terms and conditions.

Summary of Quarterly Results

| (figures in thousands except per unit data) | 2008 | | | 2007 | | | | 2006 |
|--|-----------|------------|-----------|------------|-----------|-----------|-----------|-----------|
| | Q3 | Q2 | Q1 | Q4 | Q3 | Q2 | Q1 | Q4 |
| Clean coal production | 431 | 472 | 502 | 547 | 584 | 495 | 475 | 250 |
| Purchased coal ¹ | 109 | 170 | 27 | - | - | 9 | 43 | - |
| Coal sales..... | 529 | 646 | 560 | 539 | 562 | 521 | 499 | 251 |
| Average revenue per ton | \$34.20 | \$33.00 | \$33.03 | \$31.19 | \$31.62 | \$31.67 | \$32.24 | \$31.02 |
| Average cost of goods sold per ton..... | \$33.87 | \$32.80 | \$31.23 | \$34.40 | \$27.21 | \$29.27 | \$26.21 | \$26.41 |
| Revenue..... | \$18,094 | \$21,326 | \$18,495 | \$16,830 | \$17,764 | \$16,495 | \$16,095 | \$7,780 |
| Cost of goods sold..... | 17,919 | 21,200 | 17,485 | 18,562 | 15,287 | 15,242 | 13,084 | 6,625 |
| Selling expenses | 1,757 | 2,074 | 2,071 | 2,175 | 2,229 | 1,842 | 1,613 | 943 |
| General and administrative .. | 2,541 | 3,813 | 1,599 | 3,118 | 1,206 | 1,583 | 1,155 | 1,052 |
| Depreciation and amortization..... | 2,221 | 2,043 | 1,064 | 1,023 | 837 | 712 | 571 | 325 |
| Asset impairment | - | - | - | 2,873 | - | - | - | - |
| Operating loss..... | (\$6,344) | (\$7,804) | (\$3,724) | (\$10,921) | (\$1,795) | (\$2,884) | (\$328) | (\$1,165) |
| Other expense, net..... | 320 | 2,893 | 2,292 | 4,859 | 3,875 | 431 | 828 | 642 |
| Income tax (benefit) | - | (1) | - | 76 | (7) | 1 | - | 1 |
| Net loss | (6,664) | (\$10,696) | (\$6,016) | (\$15,856) | (\$5,663) | (\$3,316) | (\$1,156) | (\$1,808) |
| Basic net loss per share | (\$0.04) | (\$0.25) | (\$0.16) | (\$0.43) | (\$0.15) | (\$0.09) | (\$0.03) | (\$0.06) |

Generally, the quarterly growth trend in top line revenue, production and sales has been due to the series of acquisitions the Company completed during 2006 and 2007, developing additional reserves for production and adding production capacity at current mine sites. During 2007, the Company operated six surface mines and two coal fines recovery sites, of which only three surface mines were in operation the entire year — Briar Hill, Back-in-Black and Graham #5. The Company depleted the reserve at the Rockcrusher surface mine, shuttered Crittenden County and idled its fines recovery operation at Rockcrusher before selling it on November 30, 2007. In May, 2007 the Company put into production the Stony Point surface mine and restarted the fines recovery operation at Providence I. In addition, the Company opened a second pit at Graham #5 during the summer of 2007. After entering into a management services agreement with C&R Coal Inc. in September 2007, the Company permitted the Beech Creek South mine in the first quarter 2008 and purchased the coal produced from the property.

During the first nine months of 2008, the Company operated the Briar Hill, Graham #5, Stony Point, Back in Black, Beech Creek and Jessup mines (See Production discussion below). The Stony Point mine effectively depleted at the end of February 2008, only producing approximately 24,500 tons from March through July 2008. As of the beginning of June 2008, the Company had mined through its Back in Black mine permit area and production at Back in Black was idled until the Company receives the next

¹ The Company purchased coal from Covol Engineered Fuels (“Covol”) and C&R – Beech Creek, a mine which it managed from September 2007 through July 2008 before Phoenix acquired C&R.

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permit for the property, which had not been issued as of September 30, 2008. The equipment and manpower had been moved to Beech Creek to maintain similar Company-wide production levels. At the end of July 2008, the Company closed the acquisitions of C&R and Renfro, which added the Beech Creek and Jessup mines to the Company's owned portfolio.

Prior to the acquisition of C&R, the Company managed the Beech Creek property and purchased the production from the mine. The declining trend in purchased coal from the second quarter to the third quarter is due to the acquisition and accounting for the tonnage from August and September as production and no longer as purchased coal. Since the first quarter 2008, the Company has been purchasing coal fines from Covol, whose production has been trending upward since the beginning of the year. However, the Company does not expect to purchase as much coal as it had during the second and third quarters unless it enters into a new agreement with a third party other than Covol.

During the second quarter of 2007, the Company restructured one of its coal sales contracts so that the utility paid for the trucking cost. The effect of the restructuring was to reduce the average revenue per ton sold and average cost of coal sales per ton produced for 2007 by approximately \$1.00. Revenue per ton sold growth in 2008 was due to contractual price increases on existing contracts and servicing new contracts with higher negotiated sales prices. The incremental revenue per ton sold realized in the third quarter 2008, compared to the second quarter of 2008, was due to additional transportation and loading fees paid to the Company to ship coal to customers from alternate dock facilities during the Green River lock maintenance shutdown, which occurred in August and September.

The trend in cost of goods sold has primarily been impacted by maintenance costs, coal preparation costs and rising commodity costs. Throughout 2006 and 2007, the Company struggled with older equipment that required more maintenance than normal, thus lowering availability and driving up costs. Since the fourth quarter 2007, the Company has spent approximately \$25,100,000 on new production equipment, which has increased productivity and lowered maintenance costs in 2008. Over a similar period from 2007 through the first quarter 2008, the Company could not produce or purchase enough coal fines to use as a blending feedstock with the Company's raw coal. Consequently, the Company was forced to wash more raw coal to meet contract specifications, thus increasing wash costs and shipping fees. As discussed above, Covol continues to increase production, enabling the Company to purchase more coal fines for blending and reducing its need to wash coal.

Rising commodity costs have had a significant impact on the Company's diesel fuel and explosives costs. Since the first quarter 2007 through the second quarter 2008, diesel fuel prices have increased from approximately \$1.80 per gallon to \$3.83 per gallon. In the third quarter 2008, the Company experienced a moderate softening of diesel fuel prices, which averaged \$3.69 per gallon. However, ammonium nitrate, a key ingredient in explosives, increased approximately 63% since early 2007 without any material price decreases. Consequently, diesel fuel and explosives costs increased \$3.99 per ton produced from \$7.31 per ton for the third quarter 2007 to \$11.30 per ton for the same period in 2008.

On an aggregate basis, revenue and operating expenses for the third quarter 2008 were lower than the second quarter 2008 because of less run days as a result of a two-week vacation shutdown. The Company chose to schedule vacation in August to coincide with a portion of the shutdown of the Green River. The Green River was closed for approximately six weeks during August and September to perform maintenance on the lock system. The vacation and Green River shutdown impacted productivity resulting in higher unit costs. With less run days, the Company had less production output over which to spread its fixed costs. More over, the Green River shutdown stretched trucking capacity in the Western Kentucky area. Several of the Company's customers and its competitors' customers agreed to reimburse suppliers for additional transportation and loading costs to ship coal out of alternate facilities located on the Ohio River, which are further than shipping points on the Green River. Because the local trucking outfits had longer hauls and no additional trucks to put in service, the Company could not move coal off its properties at its usual rate. Consequently, logistics were compromised, coal stockpiles built up and productivity suffered.

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Selling expenses, which are variable with coal sales, have trended upward quarter over quarter as sales have increased. General and administrative expenses (“G&A”) have risen as the Company has hired more employees to fill various roles at the middle and senior management level. The spike in G&A in the fourth quarter 2007 and the second quarter 2008 was for a non-cash stock-based compensation charge of \$1,448,859 and \$2,151,277, respectively.

Results of Operations

Production

For the third quarter ended September 30, 2008 and the nine months ended September 30, 2008, the Company produced approximately 431,000 tons and 1,405,000 tons, respectively. The year over year decrease of 26.2% and 9.6%, respectively, is primarily attributable to the two-week vacation shutdown, higher surface mining ratios and depletion. The following table summarizes the production from the Company’s owned mines during the third quarter ended September 30, 2008 and the nine months ended September 30, 2008 versus the prior year.

| | <u>Q3</u> <u>2008</u> | <u>Q3</u> <u>2007</u> | <u>Variance</u> | <u>%</u> <u>Variance</u> | <u>YTD 9/30</u> <u>2008</u> | <u>YTD 9/30</u> <u>2007</u> | <u>Variance</u> | <u>%</u> <u>Variance</u> |
|------------------|--------------------------|--------------------------|------------------|-----------------------------|--------------------------------|--------------------------------|------------------|-----------------------------|
| Briar Hill | 182,438 | 250,335 | (67,897) | -27.1% | 657,159 | 710,952 | (53,793) | -7.6% |
| Graham #5 | 108,251 | 179,297 | (71,046) | -39.6% | 409,534 | 425,768 | (16,234) | -3.8% |
| Back in Black | 0 | 56,782 | (56,782) | -100.0% | 127,637 | 161,915 | (34,278) | -21.2% |
| Stony Point | 9,971 | 63,636 | (53,665) | -84.3% | 80,492 | 85,488 | (4,996) | -5.8% |
| Jessup | 18,742 | 0 | 18,742 | 0.0% | 18,742 | 0 | 18,742 | 0.0% |
| Beech Creek | 111,465 | 0 | 111,465 | 0.0% | 111,465 | 0 | 111,465 | 0.0% |
| Sub-total | 430,867 | 550,050 | (119,183) | -21.7% | 1,405,029 | 1,384,123 | 20,906 | 1.5% |
| Other mines | 0 | 33,538 | (33,538) | -100.0% | 0 | 169,534 | (169,534) | -100.0% |
| Total | 430,867 | 583,588 | (152,721) | -26.2% | 1,405,029 | 1,553,657 | (148,628) | -9.6% |

The third quarter results were impacted by the two-week vacation shutdown taken in August. Typically, vacation is scheduled for the end of June and the beginning of July, thus spreading the effect over the second and third quarters, not just one quarter.

Briar Hill remained the largest contributor with 182,438 tons and 657,159 tons for the third quarter ended September 30, 2008 and the nine months ended September 30, 2008, respectively. Briar Hill continued the trend of washing less coal with only 55,273 tons going to the third party preparation plant at Rock Crusher. This represents about half of the amount of coal sent to Rock Crusher during the second quarter and about one-third of the amount sent during the first quarter. However, higher surface mining ratios and low availability with its truck fleet, coupled with vacation, caused Briar Hill to produce approximately 27% less coal in the third quarter 2008 versus the third quarter 2007. Because it was ahead of its previous year’s production through the second quarter 2008, the year-to-date September 30, 2008 variance from the same prior year period is only negative 7.6%.

For the nine months ended September 30, 2008, Graham #5 produced 409,534 tons of coal, only 16,234 tons less than the same period in 2007. For the third quarter ended September 30, 2008, not only was the vacation period a contributing factor to the 39.6% year over year decline in production, but also the fact that Graham #5 is approaching the end of its reserve life. Through the end of July 2008, Graham #5 averaged over 50,000 tons of production per month during 2008. It produced approximately 17,000 tons in August 2008 (vacation month) and approximately 37,000 tons in September 2008. As the reserve nears depletion, the pit length is becoming shorter and the surface mining ratio is increasing, both of which play a role in lower productivity.

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The Back in Black mine was idled in early June due to a delay in permit issuances and had not returned to production as of September 30, 2008. Certain manpower and equipment were moved from Back in Black to the Beech Creek mine to increase production at that location. During the third quarter ended September 30, 2008, Beech Creek produced approximately 191,400 tons, of which nearly 111,500 were produced in August and September when the Company owned C&R. See the Purchased Coal section below for a further discussion of Beech Creek.

The remaining mines, Stony Point and Jessup, contributed approximately 28,700 tons during the third quarter ended September 30, 2008. Stony Point mined some residual coal while it continued its reclamation efforts. Jessup, purchased at the end of July 2008, produced nearly 19,000 tons of coal as it ramped up from approximately 7,200 in August to approximately 11,500 in September.

Purchased Coal

During the third quarter of 2008 and the nine months ended September 30, 2008, the Company purchased 108,993 tons and 305,408 tons, respectively, from Covol and C&R. Covol's coal fines production increased from approximately 7,500 tons and 29,000 tons in the first and second quarter 2008, respectively, to approximately 44,200 tons in the third quarter 2008. Covol's slow start in the first quarter (its first full quarter of operation after acquiring the Rock Crusher preparation plant and slurry reserves from the Company at the end of November 2007) was due to inclement weather, start-up issues and downtime related to capital improvements. The increased tonnage in the second and third quarters positively impacted the Company as it had more coal fines to blend with its raw coal production and did not have to resort to washing as much raw coal in the second and third quarters as it did in the first quarter.

During the third quarter 2008 and the nine months ended September 30, 2008, the Company produced 191,416 tons and 383,884 tons, respectively, from Beech Creek. From that production, the Company purchased 64,803 tons and 224,442 tons, respectively, to service its own sales contracts before purchasing C&R at the end of July 2008. The difference between what was produced and what was purchased represented the production from Beech Creek under the Company's ownership after July 31, 2008 (See Production Summary above) and tons that were shipped on C&R's own coal sales contract while the Company managed the property. The following table summarizes the purchased coal during the quarter ended September 30, 2008 and the nine months ended September 30, 2008 versus the prior year.

| | <u>Q3</u> <u>2008</u> | <u>Q3</u> <u>2007</u> | <u>Variance</u> | <u>YTD 9/30</u> <u>2008</u> | <u>YTD 9/30</u> <u>2007</u> | <u>Variance</u> |
|--------------|--------------------------|--------------------------|-----------------|--------------------------------|--------------------------------|-----------------|
| Covol | 44,190 | 0 | 44,190 | 80,966 | 0 | 80,966 |
| C&R Coal | <u>64,803</u> | <u>0</u> | <u>64,803</u> | <u>224,442</u> | <u>0</u> | <u>224,442</u> |
| Total | 108,993 | 0 | 108,993 | 305,408 | 0 | 305,408 |
| Other mines | <u>0</u> | <u>0</u> | <u>0</u> | <u>0</u> | <u>52,420</u> | <u>(52,420)</u> |
| Total | 108,993 | 0 | 108,993 | 305,408 | 52,420 | 252,988 |

Through the first three quarters of 2008, the Company consistently increased production at Beech Creek from 45,900 tons in the first quarter to approximately 191,400 tons in the third quarter. Mine development of the new Beech Creek South permit in the first quarter limited production at the outset. However, after constructing a longer, more efficient pit length and acquiring new equipment, the second quarter production reached nearly 147,000 tons. For the third quarter, the Company moved manpower and equipment from the idled Back in Black mine to Beech Creek to maintain company-wide production levels, resulting in over 191,000 tons produced.

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Revenue

The Company primarily derives its revenue from coal sales to electric utility companies. For the three months ended September 30, 2008, the Company's revenue increased by 1.9% to \$18,094,088 from \$17,764,442 in the prior year comparative three month period. The growth in revenue was attributable to an 8.2% increase in revenue per ton sold in the third quarter 2008 versus 2007. For the nine months ended September 30, 2008, the Company's revenue increased by 15.0% to \$57,915,648 from \$50,354,257 in the prior year nine month period. Sales volume was up 9.7% and revenue per ton sold grew 4.9% from 2007 to 2008. For the third quarter ended September 30, 2008 and the nine months ended September 30, 2008, revenue per ton sold was \$34.20 and \$33.38, respectively. The increase over 2007 was due to contractual price increases from existing sales contracts and new sales contracts with better pricing terms. Specifically, for the third quarter 2008, the Company was paid additional compensation from certain customers for extra transportation costs incurred by the Company to transport coal to and load coal at dock facilities on the Ohio River during the Green River shutdown in August and September.

At September 30, 2008, the Company had coal sales contract commitments of approximately 7.8 million tons at a weighted average price of \$34.57 that extended through 2011. Approximately 90% of those commitments would be fulfilled by the end of 2010, pursuant to the contract terms. These legacy contracts were entered into before the recent rise in coal prices and cost of inputs. Consequently they are negatively impacting the Company's revenues and profitability. As the contracts are fulfilled and assuming current coal prices continue to prevail, the Company expects significant increases in revenue and resultant improved operating performances as it enters into new contracts at current market prices.

Cost of Goods Sold

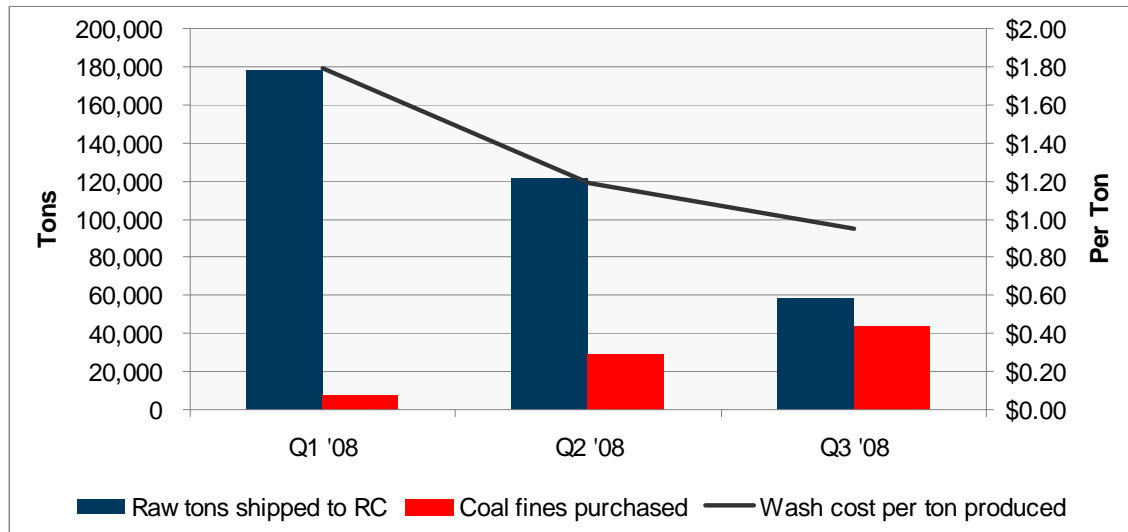
Cost of goods sold consists of all mining related expenses, preparation costs, transportation costs and purchased coal before depreciation and amortization. Diesel fuel and explosives had the largest impact on operating costs during the first nine months of 2008. For the third quarter ended September 30, 2008 and the nine months ended September 30, 2008, the Company's average cost per gallon for diesel fuel was \$3.69 and \$3.48, respectively. When comparing diesel fuel to the same periods in 2007 on a cost per ton produced basis, the Company's cost increased approximately \$3.50 per ton resulting in approximately a 71% increase in diesel fuel costs. Due to the ammonium nitrate component of explosives, the Company also experienced a sharp rise in explosives costs. On a cost per ton produced basis, explosives increased approximately 21%, or \$0.50 per ton, in the third quarter 2008 versus the same period in 2007, and approximately 23%, or \$0.55 per ton, for the nine months ended September 30, 2008 versus the same period in 2007. Together, diesel fuel and explosives increased \$3.99 per ton produced from \$7.31 per ton for the third quarter 2007 to \$11.30 per ton for the same period in 2008.

Rising diesel fuel and explosives costs were somewhat offset by lower maintenance and coal preparation costs. New equipment purchases played a significant role in decreasing maintenance costs and improving productivity. For the third quarter ended September 30, 2008, maintenance parts and supplies expense was \$2,247,338 compared to \$3,372,866 in 2007 for a 33.4% reduction. The third quarter 2008 expenses include maintenance performed during the two-week vacation shutdown. Year over year, on a per ton produced basis, maintenance parts and supplies expense lowered from \$5.78 to \$5.22 for the three month periods ended September 30, 2007 and 2008, respectively. For the nine months ended September 30, 2008, maintenance parts and supplies expense was \$6,582,747 versus \$8,574,578 in 2007, or \$4.69 per ton produced compared to \$5.52 per ton produced.

Coal preparation costs decreased as well with the help of higher coal fines production from Covol and drier weather, both of which enabled the Company to wash less raw coal in the third quarter. For the third quarter ended September 30, 2008, the Company incurred washing costs and transportation related costs of \$407,829 or \$0.95 per ton produced, compared to \$561,580 (\$1.19 per ton) and \$901,171 (\$1.79 per ton) in the second quarter and first quarter, respectively. The following graph depicts the relationship

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between the number of raw tons shipped to the Rock Crusher preparation plant and the amount of coal fines purchased from Covol.



For the third quarter ended September 30, 2008, purchased coal from Covol and C&R totaled \$3,280,879, comprising approximately 18% of cost of goods sold. For the nine months ended September 30, 2008, purchased coal was \$9,441,324 versus \$1,614,430 for the same period in 2007. The Company's cost per ton purchased for the third quarter ended September 30, 2008 and the nine month period ended September 30, 2008 was \$30.10 and \$30.91, respectively.

Overall, for the three months ended September 30, 2008, the Company's cost of goods sold increased by 17% to \$17,919,115 from \$15,287,346 for the same period in 2007. Comparing the same periods on a cost per ton sold basis, cost of goods sold was \$33.87 versus \$27.21 for an increase of nearly 25%. However, for the quarter ended September 30, 2008, the Company incurred \$425,000 of additional costs that were reimbursable (See Revenue discussion above), or \$0.80 per ton sold, related to transporting to and loading coal at alternate dock facilities on the Ohio River due to the Green River closure. For the nine months ended September 30, 2008, cost of goods sold was \$56,603,982 versus \$43,612,921 for the same period in 2007, or \$32.62 per ton sold compared to \$27.57.

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

SG&A expenses primarily consist 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, 2008, the Company's SG&A expenses were \$4,298,107 versus \$3,435,031 for the same period in 2007. For the nine months ended September 30, 2008, the Company's SG&A expenses were \$13,855,331 versus \$9,627,436 for the same period in 2007. The Company's selling costs (royalties and coal taxes described above) are variable with respect to coal sales and were approximately 10% of coal sales during 2008.

G&A costs in the third quarter 2008 and nine months ended September 30, 2008 were \$2,540,540 and \$7,952,829, respectively compared to \$1,205,797 and \$3,942,521, respectively, during similar periods in 2007. The primary variance is a non-cash charge to employee stock-based compensation, which was \$640,000 for the third quarter 2008 and \$2,931,277 for the nine-month period ended September 30, 2008. On June 27, 2008, the board of directors granted 6,847,000 employee stock options, of which one-third vested on the grant date. On a cash basis, for the nine months ended September 30, 2008 and 2007, G&A

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costs were \$5,021,552 and \$3,942,521, respectively, or \$2.89 per ton sold and \$2.49 per ton sold, respectively, which is year over year increase of approximately 16%. This cost increase is primarily attributable to the addition of corporate staff to support field operations.

Depreciation and Amortization

Depreciation and amortization expense in the third quarter 2008 and nine months ended September 30, 2008 were \$2,220,777 and \$5,327,953, respectively compared to \$836,946 and \$2,120,511, respectively, during similar periods in 2007. Depreciation expense for 2008 increased \$372,925 for the quarter ended September 30 and \$916,169 for the nine months ended September 30 when compared to 2007. This increase in depreciation expense is directly related to approximately \$25,100,000 invested in mining equipment since September 30, 2007. Mining rights and mine development amortization expense increased year over year by \$1,046,223 for the quarter and \$2,326,589 for the nine-month period ended September 30 primarily due to the amortization of mining rights resulting from the reclassification of goodwill to mining rights as explained more fully in note A to the Company's September 30, 2008 unaudited interim financial statements.

EBITDA²

EBITDA in the third quarter 2008 and nine months ended September 30, 2008 were (\$4,833,234) and (\$13,374,351), respectively compared to (\$999,317) and (\$2,099,863), respectively, during similar periods in 2007. The Company's revenue per ton has averaged between \$31 and \$34 per ton over the last several quarters as it has been shipping on contract commitments that were entered into before the recent rise in coal prices and cost of inputs. As discussed under Revenue above, the Company expects to realize higher revenue per ton of coal sold and improved profitability as the legacy contracts are fulfilled and it enters into new contracts at current market prices.

During 2008, the Company incurred costs related to shuttered properties and the winding down of operations that have depleted. For the third quarter of 2008 and the nine months ended September 30, 2008, the Company incurred costs of \$190,365 and \$730,681, respectively, for post-mining reclamation cash expenses for three properties – Providence I, Tex No. 1 and Rock Crusher surface mine. In addition, Crittenden County incurred a \$250,000 one-time royalty charge in May to its lessor, Kimball International, before terminating the lease. Lastly, Stony Point essentially depleted its reserves by the end of February 2008, only producing approximately 24,500 tons from March through July as it reclaimed property and fulfilled an obligation to the lessor to leave a face-up to a potential underground mine. For the third quarter of 2008 and the nine months ended September 30, 2008, Stony Point incurred cash operating losses of \$436,479 and \$1,518,159, respectively. These properties, which will not be part of the Company's operations going forward, collectively incurred cash operating losses of \$626,844 and \$2,498,840 for the third quarter ended September 30, 2008 and the nine months ended September 30, 2008, respectively. In addition to the above mentioned non-recurring losses, the Company booked non-cash stock-based compensation expenses of \$640,000 for the third quarter 2008 and \$2,931,277 for the nine-month period ended September 30, 2008.

² EBITDA is defined as net income (loss) before deducting net interest expense, income taxes, asset retirement obligation expense and depreciation, depletion and amortization. Because EBITDA does not have a standardized meaning, it is not calculated identically by all companies, and our calculation may not be comparable to similarly titled measures of other companies.

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Adjusting for these items, the Company's adjusted EBITDA would be (\$3,566,390) and (\$7,944,234) for the third quarter 2008 and the nine months ended September 30, 2008, respectively. The following table summarizes the adjusted EBITDA calculation.

| | Q3 | YTD 9/30 |
|--------------------------------|----------------------|-----------------------|
| | <u>2008</u> | <u>2008</u> |
| EBITDA | (\$4,833,234) | (\$13,374,351) |
| Non-recurring operating losses | 626,844 | 2,498,840 |
| Stock-based compensation | <u>640,000</u> | <u>2,931,277</u> |
| Adjusted EBITDA | (\$3,566,390) | (\$7,944,234) |

Interest Expense/Foreign Currency Adjustment

Interest expense is 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 include accrued dividends on the preferred stock, accretion of the preferred stock offering costs, accretion of loan costs on the short-term bridge financing, and mark to market on the interest rate swap. Total interest expense for the three and nine-month periods ended September 30, 2008 was \$306,805 and \$5,431,774, respectively. Non-cash costs, as described above, included in interest expense totaled (\$209,537) and \$3,559,998 for the three and nine months period ended September 30, 2008, respectively.

Interest expense for the three and nine-month periods ended September 30, 2007 was \$3,442,197 and \$5,572,843, respectively. The primary reason for the year over year increase in interest expense was the interest costs associated with the August 2007 preferred stock offering.

The foreign currency gain of \$0 and \$129,130 for the three and nine month periods ended September 30, 2008 were 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

For the three months ended September 30, 2008, interest income was \$324,203 compared to \$26,553 in the prior year comparative period. The increase of \$297,650 in interest income from 2007 to 2008 resulted from the increase in cash and short term investments in 2008 due to the prospectus offering.

Other Expense

For the three months ended September 30, 2008, the Company had a loss on the sale of assets in the amount of \$337,083 versus a loss of \$41,292 for the same period in 2007. During these periods in 2008 and 2007, the Company disposed of non-core equipment.

Liquidity and Capital Resources

As of September 30, 2008, the Company had \$47,753,914 in cash, cash equivalents and short-term investments, compared to \$534,474 at December 31, 2007. The Company also had restricted cash, cash equivalents and certificates of deposit as collateral for letters of credit for reclamation bonding in the amount of \$11,399,125 at September 30, 2008 versus \$2,312,500 at December 31, 2007. As of September 30, 2008, the Company's current assets exceeded its current liabilities by \$38,168,704.

The Company's primary sources of cash include sales of coal production to customers, sales of non-core assets and financing transactions. The Company's primary uses of cash include cash costs of coal

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production, capital expenditures, costs for development projects, debt service costs and costs related to reclamation obligations. 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.

Operating Activities

Cash used by operating activities during the three months and nine months ended September 30, 2008 was \$7,529,333 and \$11,263,438, respectively. For the three months ended September 30, 2008, the primary differences between the net loss of (\$6,663,895) and the cash used in operating activities relate to depreciation/amortization of \$2,220,777, stock-based compensation of \$640,000 and the reduction of accounts payable and accrued liabilities of \$3,686,048. The performance of reclamation obligations and the pay-off of an interest rate swap used cash in the amount of \$372,717 and \$209,536, respectively. For the nine months ended September 30, 2008, depreciation/amortization, stock-based compensation and accrued dividends on preferred stock were the principal drivers for the difference between net loss and cash used from operating activities.

Investing Activities

Investing activities resulted in a net cash decrease of \$49,783,803 and \$75,091,670 for the three months and nine months ended September 30, 2008, respectively. The Company's investing activities in the third quarter 2008 and the nine months ended September 30, 2008 primarily related to the final payment in the amount of \$25,000,000 for the acquisition of Pact Resources LLC ("PACT"), the increase of restricted cash in the amount of approximately \$8,600,000 to fully collateralize all outstanding reclamation bonds and the transfer of nearly \$37,000,000 of cash to short-term securities not considered cash or cash equivalents

Capital expenditures for the three months ended September 30, 2008 were \$9,549,792, which included \$7,763,713 of new equipment that was financed through term loans. The remaining \$1,786,079 was primarily spent on the construction of a preparation plant at the Briar Hill mine, which was operational beginning in October 2008, and a track hoe. For the nine months ended September 30, 2008, capital expenditures totaled \$16,852,941. The majority of the capital, \$14,852,350, was spent on new equipment and was financed through term loans. During the nine months ended September 30, 2008, the Company continued its capital expenditures program to replace high maintenance, low productivity equipment. It purchased a Hitachi shovel, eight Caterpillar 777-F trucks and two Caterpillar D-11 bulldozers.

Financing Activities

Financing activities used net cash of \$3,068,459 for the three months ended September 30, 2008 and generated net cash of \$96,746,240 for the nine months ended September 30, 2008. Net proceeds from the prospectus offering generated cash of \$97,784,678 after agents' fees, other out-of-pocket expenses and converting the proceeds from Canadian to US dollars. The Company also generated net proceeds of \$4,891,890 from a loan from a finance company after conversion from Canadian to US dollars. On June 30, 2008, the Company paid off the balance on its \$3,050,000 revolving line of credit facility. On July 7, 2008, there was no balance owing on the line of credit facility when the Company terminated the line of credit. The collateral has since been released. Equipment financing and long-term debt principal payments totaled \$5,313,989, of which \$2,890,774 were during the third quarter of 2008.

Acquisitions

In July 2008, the Company's subsidiary, R&L Winn Inc. ("R&L Winn"), purchased all of the outstanding common shares of C&R. Under the terms of the agreement, R&L Winn assumed all assets and liabilities of C&R and will pay the former owners \$0.60 per ton for each ton of coal sold from the C&R mines. This contingent consideration will be charged to operations when incurred. The current mining

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area, Beech Creek and Beech Creek South, contained approximately 450,000 reserve tons (697,000 reserves tons as of December 31, 2007 per the Company's National Instrument 43-101 revised technical report less coal mined in the first seven months of 2008) as of July 31, 2008. R&L Winn also acquired other leases in the transaction from C&R and R&G Leasing, LLC, a company that is affiliated with C&R through common ownership. Based on exploration completed to date by the Company, management estimates the leases contain approximately 2,300,000 tons of coal. The potential quantity is conceptual in nature as there has been insufficient exploration to define a mineral resource and it is uncertain that further exploration will result in the delineation of a mineral resource. The Company has engaged a third party engineering firm to issue a technical report that is compliant with National Instrument 43-101.

In July 2008, the Company purchased all of the outstanding common shares of Renfro for total cash consideration of \$1,770,000, less any net working capital deficiency assumed by the Company as of July 31, 2008. The purchase includes all assets and liabilities of Renfro, except certain equipment and associated debt specifically excluded from the purchase. As of September 30, 2008, the net working capital deficiency assumed was estimated at \$587,000 resulting in total cash paid of \$1,183,000. Based on exploration completed to date by the Company, management estimates Renfro controls approximately 1,000,000 tons of coal reserves and 587,000 resource tons via lease. The potential quantity is conceptual in nature as there has been insufficient exploration to define a mineral resource and it is uncertain that further exploration will result in the delineation of a mineral resource. The Company has engaged a third party engineering firm to issue a technical report that is compliant with National Instrument 43-101. Additionally, if by the second anniversary of the closing date, Phoenix acquires at least 1,500,000 reserve tons as defined by National Instrument 43-101 due to the direct efforts of the sellers (the "Additional Reserves"), the Company will pay the sellers \$1,000,000 for the first 1.5 million tons of reserves, plus \$0.50 per ton for each reserve ton in excess of 1.5 million. The share purchase agreement defines a specific territory from which the Additional Reserves can be acquired. The acquisition of the Additional Reserves is on terms and conditions acceptable to the Company in its sole, reasonable discretion.

In June 2008, the Company and the former owners of PACT entered into an agreement to clarify and amend certain terms of their Buy-out Agreement dated March 31, 2008 ("Buy-out Agreement"), pursuant to which the Company was required to pay the former owners of PACT \$25 million ("Buy-out Payment") within three days of MCC's receipt of the proceeds of the public offering. On June 27, the Company completed the RTO and subsequently paid \$25 million to the former owners of PACT on June 30, 2008.

In January 2007, the Company acquired 100% of the membership interest in Charolais Coal Sales, LLC and other assets ("Charolais Assets") from the Charolais Corporation, Charolais No. 1, LLC, Charolais Coal Resources, LLC, Mark Energy, Inc., Mark One, Inc., and Donald Bowles, (collectively, "Charolais Group"), for consideration of \$21,735,000 (plus the assumption of reclamation liabilities estimated as of December 31, 2007 at \$495,967), of which \$12,003,000 was paid in cash, \$543,300 was paid by issuing 434,640 shares of common stock of the Company and the remaining \$9,188,700 was satisfied by the issuance of a seller's note. The Charolais Assets included active surface mining operations (the Graham #5 mine) and Greenfield surface reserves with permits, coal and surface leases, land, a workforce, surface mining equipment, a preparation plant and the Island Dock facility on the Green River.

Prospectus Offering

Concurrent with the RTO in June 2008, 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 for gross proceeds of Cdn\$110,000,030. The subscription receipts were converted into units in connection with the RTO, with each unit consisting of one common share and one half common share purchase warrant exercisable until June 25, 2010 at Cdn\$2.25.

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Pursuant to an agreement among MCC, Phoenix and the Offering agents, the agents received a cash commission equal to 6% of the gross proceeds of the Offering plus compensation options equal to 4% of the Subscription Receipts sold pursuant to the Offering.

A summary of the gross proceeds received and Offering costs incurred is as follows:

| | |
|--|---------------------|
| Gross proceeds (C\$110,000,030 converted to U.S. dollars at a conversion rate of 0.99007 U.S. to Cdn)..... | \$108,908,500 |
| Agents' fees..... | (6,534,510) |
| Other out-of-pocket costs | <u>(4,589,312)</u> |
| Net proceeds | <u>\$97,784,678</u> |

In addition to the Offering costs, the Company incurred an estimated \$408,000 in costs related to the RTO, which have been treated as a capital transaction and charged to accumulated deficit.

Outstanding Share Data

At November 14, 2008, the Company had 150,045,552 common shares issued and outstanding. In addition, there were 13,433,392 stock options 33,239,283 warrants and 2,514,286 brokers options (which entitle the holder to purchase one common share and one half of one warrant) outstanding at November 14, 2008. If all options, warrants, 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 200,489,656, and would generate cash of approximately \$83,000,000.

Subsequent Events

On October 6, 2008, the Company provided notice of force majeure to all its customers due to permitting delays. The U.S. Army Corps of Engineers ("COE") advised the Company on September 26, 2008, that certain environmental groups filed a protest with the COE with respect to one of the Company's three pending permit applications under Section 404 of the Clean Water Act. It is anticipated that there will be similar protests to the Company's two other pending permits. As a result, the Company will be unable to bring into production the coal reserves associated with these permits to satisfy a portion of its contractual obligations until this situation is resolved and the necessary permits are received. The Company and its consultants are currently working with regulators to address issues raised in the protests and expedite the permitting process. While the Company believes it will be successful in obtaining all pending permits, there is no assurance that the process will not delay the receipt of permitting and negatively impact the Company's ability to increase production in the near-term. The protest does not impact any of the permits that the Company currently has, including the recently issued permit for the Pratt mine underground development project. The Company is currently evaluating the extent of the ongoing force majeure events and the impact to the total tonnage to be delivered. Until the outstanding permits are received, pursuant to its current coal sales agreements, the Company will deliver the coal that is available from its existing permits on a pro rata basis to all customers and work with the customers to reach an optimal outcome for all parties given the circumstances.

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Related Party Transactions

The Company enters into transactions with stockholders 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, 2008 and 2007:

| | Nine months ended Sept. 30, 2008 | Nine months ended Sept. 30, 2007 |
|------------------------------|--|--|
| Expenses: | | |
| Consulting fees | \$156,000 | \$485,000 |
| Rent and miscellaneous | 32,925 | 59,297 |
| Accounts receivable..... | — | — |
| Accounts payable | — | 7,166 |

These transactions 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 reclamation costs and financial obligations in connection with mining permits that are not reflected in the accompanying 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 totaled approximately \$10 million at September 30, 2008 and approximately \$9 million at December 31, 2007. These bonds are secured by letters of credit or certificates of deposit issued by a bank equal to the amount of the outstanding reclamation bonds. The letters of credit are collateralized by general business assets of the Company and the restricted cash and certificates of deposit on the balance sheet of \$11,399,125 and \$2,312,500 at September 30, 2008 and December 31, 2007, respectively. In July 2008, the Company agreed to increase its restricted cash collateral securing its letters of credit with its bank to 100% of the reclamation bonds outstanding. As a result, the letters of credit are only collateralized by the restricted cash balance, and the general business assets of the Company have been released.

The Company leases certain office space and mining equipment over long-term operating leases running through 2010. Future minimum lease commitments under non-cancelable operating leases as of September 30, 2008, are as follows:

| | |
|------------|-----------|
| 2008 | \$252,330 |
| 2009 | 338,160 |
| | \$590,490 |

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.

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As of, and subsequent to, September 30, 2008, the Company has committed to purchase approximately \$10,400,000 of mining equipment for its operations, with delivery scheduled during the last calendar quarter of 2008 and the first quarter of 2009. The Company has received commitments from equipment finance companies to finance the purchase of the equipment, with interest rates ranging from 6.75% to 7.50%, terms of 36 to 48 months, and down payments of 10% to 25%. The notes will be collateralized by the equipment purchased.

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.

Financial instruments that potentially subject the company to credit risk are trade receivables from unrelated parties. 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 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.

Liquidity Risk: Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall 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 committed credit facilities and access to capital markets. At September 30, 2008, the Company had \$47.8 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 investments in marketable securities. 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 previously maintained a credit facility which bore variable interest rate based on LIBOR. This facility was retired on July 7, 2008.

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

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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.

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 interim 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 annually for impairment. This impairment testing is based on estimated future discounted 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 U.S. federal income tax as well as income tax of multiple state jurisdictions. The tax years 2005 through 2007 remain open to examination for U.S. federal income tax and various state income tax matters.

The expense for income taxes includes federal and state income taxes currently payable or receivable 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.

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Asset Retirement Obligations

The Company's asset retirement obligations ("ARO") primarily consists of estimates related to reclaiming surface land and support facilities at its mining operations in accordance with federal and state reclamation laws as defined by each mining permit. The ARO, calculated using estimates of the timing and amount of third party cash flows required for reclamation, is discounted to its present value using the Company's credit adjusted risk-free rate and the corresponding amount is recognized by increasing the carrying amount of mining related assets. The carrying amount is amortized over the life of the proven and probable coal reserves. The liability amount is increased each reporting period due to the passage of time and the amount of accretion is charged to expense. Any change in the timing or amount of the cash flows subsequent to initial recognition results in a change in the asset and liability, which then impacts amortization and accretion charges. A progression of the reclamation liability recorded on the balance sheet is as follows:

| | <u>September 30, 2008</u> | <u>December 31, 2007</u> |
|------------------------------------|---------------------------|--------------------------|
| Balance at beginning of year | \$3,757,353 | \$1,536,948 |
| Acquisitions..... | 1,106,000 | 821,000 |
| Accruals..... | --- | 1,339,052 |
| Payments | (420,000) | --- |
| Accretion | 141,849 | 60,353 |
| Balance at end of period | <u>\$4,585,202</u> | <u>\$3,757,353</u> |

Stock-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 Stockholders' Equity. In determining the fair value, the Company makes estimates for expected volatility of the stock as well as an estimated discount rate. Changes to these estimates could result in the fair-value of the stock-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"). There were no changes in accounting policies during the 2007 fiscal year. The following financial reporting standards will be applicable to the Company in 2008.

Business Combinations: Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 1581 establishes standards for the recognition, measurement and disclosure of business combinations including criteria for the recognition of intangible assets of the acquired enterprise apart from goodwill. Initially, in all of the Company's previous acquisitions, including the acquisition of Pact Resources LLC ("Pact"), a development-stage enterprise, as described in note E in the interim consolidated financial statements, the amount of the purchase price in excess of the fair value of identifiable tangible assets was allocated in its entirety to goodwill. The Company has determined that in each of these acquisitions, the excess should have been allocated to mining rights. Consequently, on the June 30, 2008 and subsequent balance sheets, the Company has reclassified \$32,393,227, previously shown as goodwill at December 31, 2007, to Mining Rights and Mine Development Costs. Other than this reclassification, the change in the purchase allocation in the Pact and other acquisitions has had no material impact on the reported financial position or results of operations of any prior or current period. Mining rights are being amortized on a units-of-production basis.

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Capital Disclosures and Financial Instruments – Disclosures and Presentation: On December 1, 2006, the CICA issued three new accounting standards: Capital Disclosures (Handbook Section 1535), Financial Instruments – Disclosures (Handbook Section 3862), and Financial Instruments – Presentation (Handbook Section 3863). These new standards became effective for the Company on January 1, 2008.

Capital Disclosures: Handbook Section 1535 specifies the disclosure of (i) an entity’s objectives, policies and processes for managing capital; (ii) quantitative data about what the entity regards as capital; (iii) whether the entity has complied with any capital requirements; and (iv) if it has not complied, the consequences of such noncompliance. The Company has included disclosures recommended by the new Handbook section in note C to the interim consolidated financial statements.

Financial Instruments: Handbook Sections 3862 and 3863 replace Handbook Section 3861, Financial Instruments – Disclosure and Presentation, revising and enhancing its disclosure requirements, and carrying forward unchanged its presentation requirements. These new sections place increased emphasis on disclosures about the nature and extent of risks arising from financial instruments and how the entity manages those risks. The Company has included disclosures recommended by the new Handbook section in note I to the interim consolidated financial statements.

Inventories: Effective January 1, 2008, the Company adopted new accounting recommendations from the CICA, Handbook Section 3031, “Inventories,” which supersedes the previously issued standard on inventory. The new standard introduces significant changes to the measurement and disclosure of inventory. The measurement changes include: the elimination of LIFO, the requirement to measure inventories at the lower of cost and net realizable value method, for inventories that are not ordinarily interchangeable and goods or services produced for specific purposes, the requirement for an entity to use a consistent cost formula for inventory of a similar nature and use, and the reversal of previous write-downs to net realizable value when there is a subsequent increase in the value of inventories. Disclosures of inventories have also been enhanced. Inventory policies, carrying amounts, amounts recognized as an expense, write-downs and the reversals of write-downs are required to be disclosed. This standard has had no material impact on the Company’s consolidated financial statements.

Future Accounting Changes

Goodwill and Intangible Assets: The CICA has issued a new standard which may affect the financial disclosures and results of operations of the Company for interim and annual periods beginning January 1, 2009. Section 3064, Goodwill and intangible assets, 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. The Company is currently assessing the impact of this new accounting standard on its consolidated 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. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 will be the changeover date for publicly listed companies to use IFRS, which will replace Canadian GAAP. The transition date is for interim and annual financial statements for fiscal years beginning on or after January 1, 2011. This transition date will require the restatement for comparative purposes of amounts reported by the Company for the fiscal year ending December 31, 2010. The Company is currently assessing the impact of IFRS on its financial statements.

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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. The Company's CEO and CFO have concluded, based on their evaluation as of September 30, 2008, 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.

The Company's management, including the CEO and CFO, has assessed the design of the Company's internal control over financial reporting procedures. 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. 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.

Financial Instruments

The Company has invested \$36,981,408, including accreted discount, in a United States Treasury bill which will be held to its maturity date of October 16, 2008. Based on its discounted purchase price, the bill will provide an annualized investment yield of 1.26%. The fair value of the Treasury bill at September 30, 2008 was \$36,981,870.

In 2006, the Company entered into an interest rate swap transaction whereby the interest payments on an original notional dollar amount of \$7,000,000 converted to a fixed rate of 8.10% compared to a variable rate of LIBOR re-measured on a quarterly basis. The notional amount decreased over the life of the swap agreement, which was due to expire in December 2011. The notional amount of the agreement was \$5,483,333 at December 31, 2007. Under the agreement, the Company paid or received the net interest amount monthly, with the monthly settlements included in interest expense.

In 2006, management designated the interest rate swap agreement as a cash flow hedging instrument, and determined the agreement met the requirements for hedge accounting under GAAP. For 2006, the agreement was recorded at its fair value with subsequent changes in fair value included in comprehensive income. In August, 2007, the debt to which this swap was related was retired. As a result, the amount previously recorded in other comprehensive income was charged to interest expense in October 2007 and any future changes to the fair value of the swap either increased or decreased interest expense as the contract no longer qualified as an accounting hedge.

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On July 15, 2008 the Company paid \$237,200 to terminate the swap. The fair value of the derivative was \$224,696 at December 31, 2007, and was included in accrued liabilities on the consolidated balance sheet.