

PHOENIX COAL INC.

Management's Discussion and Analysis

For the three and six months ended June 30, 2009

Phoenix Coal Inc.
Management's Discussion and Analysis
Three and Six Months Ended June 30, 2009

The following discussion of the results of operations, financial condition and cash flows of Phoenix Coal Inc. (the "Company") prepared as at August 14, 2009 should be read in conjunction with the Company's unaudited interim financial statements for the three and six months ended June 30, 2009 and its 2008 audited financial statements and the notes thereto. These financial statements, which were prepared in accordance with generally accepted accounting principles in Canada, are available at www.sedar.com. 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 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 utility companies. 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 at June 30, 2009, the Company operated five surface mines – Briar Hill/Radio Hill (two mines at one geographic location), Back in Black, KO, and Jessup. As further discussed, subsequent to the end of the second quarter 2009, the Company entered into a definitive agreement to sell substantially all of the assets associated with its surface mining operations.

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Highlights for the first six months of 2009

During the three and six months ended June 30, 2009:

- Subsequent to the end of the second quarter 2009, the Company entered into a definitive agreement to sell substantially all of its surface coal mining assets to a significant privately-owned, Ohio-based coal producer on terms and conditions detailed in the in the Sale of Surface Mining Assets section below.
- The Company received the required permitting from the Kentucky Department of Natural Resources and the U.S. Army Corps of Engineers for its Winn North, Radio Hill and KO reserves. After receiving all requisite permits, the Company began mining its Radio Hill reserve in January; re-opened the Winn North reserve, part of the Back in Black mine, in February after being idled for eight months; and commenced mining the KO reserve in May.
- On January 26, 2009, a devastating ice storm hit Western Kentucky, destroying electrical infrastructure and seriously crippling the area. Consequently, the Company was unable to produce coal for approximately a week because of the loss of power and inability to access its mine sites. The Company estimated it lost approximately 50,000 to 60,000 tons of production due to the ice storm.
- Heavy rainfall during the second quarter 2009 hampered production at most mine locations. April rainfall was 34% higher than average for the month, while May was 29% higher than average, according to data published by the National Oceanic and Atmospheric Administration.
- On March 3, 2009, the Company entered into a mutual release and settlement agreement with one of its customers to terminate a coal supply agreement for delivery of coal in 2009 and 2010 (the "2009/2010 Supply Agreement"). In consideration for terminating the 2009/2010 Supply Agreement, the Company paid the customer \$3,000,000 in cash. In addition, the Company agreed to make up in 2009 approximately 170,000 tons of shipments that were not delivered in 2008 under a separate coal supply agreement dated January 1, 2008.
- On March 27, 2009, the Company announced it had entered into a sublease agreement with Petersburg Coal, LLC ("Petersburg"). The subleased mineral reserves are contiguous to the Company's Gryphon Mining Complex, formerly known as the Pratt Mine.
- On May 12, 2009, the Company announced it had completed its National Instrument 43-101 technical report on the Gryphon Mining Complex. Based on the report, at the Gryphon Mining Complex the Company controls 68.4 million tons of proven and probable coal mineral reserves, 3.7 million tons of underground measured and indicated coal resources, and 0.2 million tons of inferred coal resources.
- During the second quarter of 2009, the Company produced approximately 450,000 tons of saleable coal and purchased nearly 83,000 tons of saleable coal. For the six months ended June 30, 2009, the Company produced approximately 943,000 tons of saleable coal and purchased nearly 136,000 tons of saleable coal.
- Coal sales totaled approximately 522,000 tons and 1,060,000 tons for the quarter and six months ended June 30, 2009, respectively.
- Revenue for the three months ended June 30, 2009 was approximately \$17,320,000 for an average revenue per ton sold of \$33.20. Revenue for the six months ended June 30, 2009 was approximately \$35,292,000 for an average revenue per ton sold of \$33.30.
- Cost of sales for the three months ended June 30, 2009 was approximately \$17,020,000 for an average cost per ton sold of \$32.62. Cost of sales for the six months ended June 30, 2009 was approximately \$31,763,000 for an average cost per ton sold of \$29.97.

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- For the three and six months ended June 30, 2009, the Company's net loss was approximately \$44,801,000 and \$52,436,000, respectively. These amounts include the write down of assets held for sale of \$38,920,000 described in the Sale of Surface Mining Assets section below.
- Capital expenditures for the six months ended June 30, 2009 were \$7,673,000, which included \$5,821,000 of new equipment that was financed through term loans.
- At June 30, 2009, the Company had approximately \$20,774,000 in cash, cash equivalents and short-term investments.

Results of Operations

Sale of Surface Mining Assets

Subsequent to the end of the second quarter 2009, the Company entered into a definitive agreement with a privately owned coal producer to sell substantially all of the operating assets and operations, including coal reserves, mining property, plant and equipment, mining rights, coal purchase contracts and coal sales contracts associated with its surface coal mining operations in Western Kentucky. The consideration which will be received upon closing includes \$5.7 million in cash, assumption by the purchaser of all debt associated with the equipment being sold and the assumption of certain reclamation liabilities related to the coal reserves. In addition, the purchaser will replace the Company's letters of credit for assumed reclamation obligations, which, upon transfer of the active mining permits, will release the restrictions on approximately \$5.8 million of restricted cash and certificates of deposit. The Company can potentially receive an additional \$1.0 million, upon satisfaction of certain post-closing obligations. The closing of the transaction is subject to certain closing conditions, including closing conditions related to satisfying the purchaser as to the size and quality of the coal reserves.

Effective June 30, 2009, the property, plant and equipment, mining rights, mine development costs and mineral reserves being sold have been written down to the amount expected to be realized on sale, namely the cash to be received plus the amount of the liabilities being assumed by the purchaser on closing, less costs to sell. This resulted in a write down of assets held for sale in the amount of \$38,920,000 in the three months ended June 30, 2009.

Production

On January 26, 2009, a devastating ice storm hit Western Kentucky, destroying electrical infrastructure and seriously crippling the area. Consequently, the Company lost approximately 50,000 to 60,000 tons of production because of the loss of power and inability to access its mine sites. Heavy rainfall during the second quarter 2009 delayed mining as water had to be pumped from the coal pits. April rainfall was 34% higher than average for the month, and May was 29% higher according to data published by the National Oceanic and Atmospheric Administration.

For the first half of 2009, production from Phoenix's owned mines came from six sources – Briar Hill, Radio Hill, Back in Black, KO, Jessup, and Beech Creek. The closing of the Beech Creek mine and subsequent opening of the KO mine negatively impacted production as a mine at full production was replaced by a mine in its early stages of production during the second quarter 2009. In addition, Back in Black encountered productivity problems due to old works and short pit length. The Graham #5 and Stony Point mines (producing a combined 169,550 tons for the quarter ended June 30, 2008) were depleted during 2008 while Beech Creek mined out in April 2009 after producing 24,393 tons and 134,094 tons for the second quarter and the six months ended June 30, 2009, respectively.

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

	Q2	Q2		%	YTD 6/30	YTD 6/30		%
	2009	2008	Variance	Variance	2009	2008	Variance	Variance
Briar Hill / Radio Hill	296,154	236,586	59,568	25.2%	587,260	474,722	112,538	23.7%
Back in Black	42,583	65,605	(23,022)	-35.1%	72,590	127,637	(55,047)	-43.1%
KO	25,162	-	25,162	0.0%	25,162	-	25,162	0.0%
Jessup	61,852	-	61,852	0.0%	123,568	-	123,568	0.0%
Beech Creek	24,393	-	24,393	0.0%	134,094	-	134,094	0.0%
Sub-total	450,144	302,191	147,953	49.0%	942,674	602,359	340,315	56.5%
Other mines	-	169,550	(169,550)	-100.0%	-	371,804	(371,804)	-100.0%
Total	450,144	471,741	(21,597)	-4.6%	942,674	974,163	(31,489)	-3.2%

Briar Hill/Radio Hill continued to lead production during the second quarter 2009. These two mines produced a total of 296,154 tons for the quarter ended June 30, 2009, a 59,568 ton increase over the 236,586 tons produced for the quarter ended June 30, 2008. Production at this location increased 25% and 24% for the quarter and six months ended June 30, 2009, respectively. Water inflow from portions of Radio Hill's overburden decreased during the quarter, contributing to the production increase at this location.

The Back in Black mine produced 42,583 tons in the quarter ended June 30, 2009, a decrease of 23,022 tons from 65,605 produced tons for the similar period in 2008. The mine had been idled for eight months after it had mined through its permit area in June 2008 and resumed production in February 2009. In the second quarter 2009, Back in Black encountered old works in the west end of its 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. In July 2009, manpower was redeployed to another section of the mine with lower stripping ratios, in an effort to increase production at this location.

KO mine was originally scheduled to begin production in March 2009, but was delayed until late May due to permit issues. As production began, mining was slow as a mud slip and an eighteen inch parting were encountered limiting production to 25,162 tons in the quarter ended June 30, 2009. The mud slip is no longer present and coal quality is improving as the parting in the seam is drier and more friable, creating less contamination as the coal is mined.

The Jessup mine had its highest productivity month, producing 21,882 tons in May 2009 and 61,852 tons for the quarter ended June 30, 2009, making Jessup the second highest producing mine for the second quarter 2009.

Purchased Coal

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

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Prior to the acquisition of C&R at the end of July 2008, the Company managed the Beech Creek property on behalf of C&R and purchased the production from the mine. During the first quarter 2008, the Company developed the mine area for the Beech Creek South permit, which had limited production at the outset. However, after developing a longer, more efficient pit length and acquiring new equipment, the second quarter 2008 production improved to where the Company purchased over 140,000 tons from C&R.

The following table summarizes the purchased coal, including C&R, during the second quarter and six months ended June 30, 2009 versus similar periods in the prior year.

	Q2	Q2		YTD 6/30	YTD 6/30	
	2009	2008	Variance	2009	2008	Variance
Covol	82,878	29,269	53,609	135,843	36,776	99,067
C&R Coal	-	140,496	(140,496)	-	159,639	(159,639)
Total	82,878	169,765	(86,887)	135,843	196,415	(60,572)

In June 2009, the Company entered into a coal supply agreement with an Illinois Basin producer to purchase 20,000 tons of coal per month from July 2009 through December 2009 at a purchase price of \$39.00 per ton. Upon mutual agreement of the parties to the coal supply agreement, the term of the agreement may be extended to December 31, 2010. This coal is a higher BTU product than the Company currently produces from its operations. Blending this coal with the Company's coal will reduce the amount of coal that the Company will have to wash from its own operations.

Revenue

The Company primarily derives its revenue from coal sales to electric utility companies. For the three months ended June 30, 2009, the Company's revenue decreased by 19% to \$17,320,379 from \$21,326,102 in the prior year comparative three month period. For the six months ended June 30, 2009, Phoenix's revenue decreased by 11% to \$35,292,271 from \$39,821,562 in the prior year six month period. For the three month periods ended June 30, tons sold decreased 19% from 646,000 tons in 2008 to 522,000 tons in 2009. For the six month periods ended June 30, sold tons decreased 12% from 1.2 million tons in 2008 to 1.1 million tons in 2009. The decrease in revenue was primarily attributable to a decrease in sales volume due to the year over year reductions in produced and purchased coal previously discussed.

For the six months ended June 30, 2009, average revenue per ton sold increased to \$33.30 from \$33.02 in the same period in 2008. The increase of \$0.28 per ton resulted from shipments on several sales contracts which transitioned to 2009 contract pricing after fulfilling 2008 contract commitments. Additionally, due to renegotiating a change in quality specifications with two customers, and deferring tons shipped to another customer with a higher quality requirement into 2010, the Company was able to ship a higher percentage of its sales on contracts which currently provide the highest base price realization of all its sales contracts. Conversely, due to the depletion of the Beech Creek mine, overall BTU quality decreased, reducing the revenue per ton realized by the Company on several of its sales contracts and thus offsetting any of the increase discussed above.

Cost of Sales

Cost of sales consists of all mining related expenses, preparation costs, transportation costs and purchased coal before depreciation and amortization. Diesel fuel had the largest cost decrease during the second quarter 2009 compared to the second quarter 2008. On a cost per ton produced basis, diesel fuel cost was \$5.44 in the second quarter 2009 compared to \$9.10 in the second quarter 2008, a \$3.66 or 40% decrease. Fuel costs decreased from an average of \$3.83 per gallon to an average of \$2.02 per gallon in the quarter ended June 30, 2008 versus 2009. Year

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over year, diesel fuel cost decreased \$3,629,014 for the six months ended June 30, 2009 due primarily to a \$1.38 decrease in the per gallon fuel cost from \$3.39 in 2008 to \$2.01 for the same period in 2009.

Labor and benefits increased 20% from \$3,854,407 in the second quarter 2008 to \$4,643,217 in the second quarter 2009. Cost per ton produced increased from \$8.17 in the second quarter 2008 to \$10.31 in the second quarter 2009. Man hours worked increased for the quarter ended June 30, 2009 primarily due to the excess rainfall and production delays at the KO and Back in Black mines previously discussed.

Purchased coal, a variable cost, accounted for approximately 12% of the cost of sales in the second quarter 2009. For the quarter ended June 30, 2009, purchased coal was \$2,106,623 versus \$5,346,762 for the same period in 2008. For the six months ended June 30, 2009, purchased coal was \$3,461,367 and \$6,160,445 for the same period in 2008. Prior to its purchase of C&R in July 2008, Phoenix was purchasing coal from C&R, thus accounting for the significant cost differential year over year. The cost per ton purchased decreased from \$31.49 for the second quarter ended June 30, 2008 to \$25.41 in 2009. For the six months ended June 30, 2009, the cost per ton purchased decreased from \$31.36 in 2008 to \$25.48 in 2009. In 2009, Covol provided all purchased coal, which was less expensive than the coal purchased from C&R in 2008.

Maintenance costs for the second quarter ended June 30, 2009 were \$2,894,435 and \$1,926,971 for the same period in 2008, an increase of \$967,464. Cost per ton produced was \$6.43 for the second quarter ended June 30, 2009 and \$4.08 for 2008, a 58% increase. Maintenance costs increased for the second quarter 2009 versus the second quarter 2008 due to shovel rebuild work performed that was not anticipated until 2010. Additionally, some older pieces of equipment utilized at Jessup required significant maintenance work during the second quarter 2009 as Jessup increased its production levels.

Overall, the Company's cost of sales decreased by 20% to \$17,019,692 in the second quarter 2009 from \$21,199,549 in the similar period for 2008. Comparing the same periods on a cost per ton sold basis, cost of sales was \$32.62 versus \$32.80. For the six months ended June 30, 2009, cost of sales decreased from \$38,684,869 in 2008 to \$31,763,409 in 2009. Cost per ton sold for the six months ended June 30, 2009 was \$29.97 compared to \$32.07 in 2008 for a decrease of 7%.

Selling, General and 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 June 30, 2009, the Company's selling expenses were \$1,852,362 versus \$2,074,001 for the similar period in 2008. For the six months ended June 30, 2009, the Company's selling expenses were \$4,008,043 versus \$4,144,935 for the same period in 2008. The Company's selling costs (royalties and coal taxes described above) are variable with respect to coal sales and ranged from approximately 10% to 11% of coal sales for the above mentioned periods.

General and administrative ("G&A") costs in the second quarter 2009 were \$2,004,939 compared to \$3,813,178 during the similar period in 2008. The primary variance between the 2009 and 2008 quarters is a non-cash charge to employee share-based compensation, which was \$6,000 in 2009 and \$2,151,277 in 2008. Stock option forfeitures and a lower valuation of more recently issued options reduced share-based compensation expense in 2009, while the issuance of 6,847,000 options at a higher valuation significantly increased this expense in 2008. G&A costs for the six months ended June 30, 2009 were \$5,602,583 and \$5,412,290 for the similar period in 2008.

Depreciation and Amortization

Depreciation and amortization expense for the three and six months ended June 30, 2009 was \$1,907,711 and \$3,731,492, respectively, compared to \$2,043,344 and \$3,107,176, respectively, for the similar periods in 2008. Depreciation expense for the first six months of 2009 increased \$1,013,919 when compared to the same period in

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2008. This increase in depreciation expense was primarily related to the significant investment in mining equipment in the fourth quarter 2007 and during the calendar year 2008.

Interest Expense/Foreign Currency Adjustment

Interest expense for the three and six months ended June 30, 2009 was comprised primarily of interest paid on equipment financing. For the three and six months ended June 30, 2008, interest expense included (1) interest on the Company's revolving line of credit, equipment financing, and short-term bridge financing and (2) non-cash costs which included accrued dividends on the preferred shares, accretion of the preferred share offering costs, accretion of loan costs on the short-term bridge financing, and mark to market on an interest rate swap. Interest expense for the three and six months ended June 30, 2009 was \$424,723 and \$784,625, respectively. Interest expense for the three and six months ended June 30, 2008 was \$2,765,589 and \$5,124,968, respectively. Interest expense decreased year-over-year for both the quarter and year to date periods due primarily to the elimination of interest related costs on the preferred shares and the short-term bridge financing which were converted to common share equity in June 2008.

The foreign currency loss of \$103,710 for the three months ended June 30, 2008 and the foreign currency gain of \$129,130 for the six months ended June 30, 2008 was related to mark to market adjustments for the short-term bridge financing which was denominated in Canadian dollars. This financing was converted to common share equity in June 2008.

Interest Income

Interest income for the three months ended June 30, 2009 and 2008 was \$21,789 and \$14,060, respectively. For the six months ended June 30, 2009 interest income was \$98,478, compared to \$26,721 for the comparable period in 2008. The year over year increase in interest income for both the quarter and six month periods was due to higher balances of cash and short-term investments as a result of the capital raised from the prospectus offering in June 2008. Interest income decreased in the first two quarters of 2009, compared to the third and fourth quarters of 2008 primarily due to historically low interest rates on United States Treasury bills, which is the primary investment vehicle utilized by the Company.

Other Expense

For the six months ended June 30, 2008, the Company realized a loss on the sale of assets in the amount of \$214,057 versus a loss of \$1,730 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				2007	
	Q2 '09	Q1 '09	Q4 '08	Q3 '08	Q2 '08	Q1 '08	Q4 '07	Q3 '07
Saleable coal production	450	493	527	431	472	502	547	584
Purchased coal (1)	83	53	18	109	170	27	-	-
Tons sold	522	538	568	529	646	560	539	562
Average revenue per ton	\$ 33.20	\$ 33.40	\$ 33.11	\$ 34.20	\$ 33.00	\$ 33.03	\$ 31.19	\$ 31.62
Average cost of sales per ton	\$ 32.62	\$ 27.40	\$ 26.90	\$ 33.87	\$ 32.80	\$ 31.23	\$ 34.40	\$ 27.21
Revenue	\$ 17,320	\$ 17,972	\$ 18,809	\$ 18,094	\$ 21,326	\$ 18,495	\$ 16,830	\$ 17,764
Cost of sales	17,020	14,744	15,278	17,919	21,200	17,485	18,562	15,287
Selling expenses	1,852	2,156	2,286	1,757	2,074	2,071	2,175	2,229
General and administrative	2,005	3,598	5,593	2,541	3,813	1,599	3,118	1,206
Depreciation and amortization	1,908	1,824	3,084	2,221	2,043	1,064	1,023	837
Write down of assets held for sale	38,920	-	-	-	-	-	-	-
Sales contract termination cost	-	3,000	-	-	-	-	-	-
Asset impairment write down	-	-	-	-	-	-	2,873	-
Loss from operations	\$ (44,385)	\$ (7,350)	\$ (7,432)	\$ (6,344)	\$ (7,804)	\$ (3,724)	\$ (10,921)	\$ (1,795)
Other expense, net	406	285	578	320	2,893	2,292	4,859	3,875
Income taxes	10	-	38	-	(1)	-	76	(7)
Net loss for the period	\$ (44,801)	\$ (7,635)	\$ (8,048)	\$ (6,664)	\$ (10,696)	\$ (6,016)	\$ (15,856)	\$ (5,663)
Basic and diluted net loss per share	\$ (0.30)	\$ (0.05)	\$ (0.05)	\$ (0.04)	\$ (0.25)	\$ (0.16)	\$ (0.43)	\$ (0.15)

(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 the Company acquired C&R.

Production

During 2008, the Company operated the Briar Hill, Graham #5, Stony Point, Back in Black, Beech Creek and Jessup mines. The Stony Point mine effectively depleted at the end of February 2008, only producing approximately 24,500 tons from March through July 2008 while completing a required face-up project for the lessor of the property. As at 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 received the requisite permits for the adjacent property in the first quarter 2009. 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.

The third quarter 2008 results were negatively impacted by a 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. Fourth quarter production was negatively affected by depletion at Graham #5, which depleted in December, and Beech Creek which experienced declining production as it neared the end of its reserve life. These 2008 production losses were somewhat offset by Jessup, which produced nearly 43,000 tons in the fourth quarter 2008 as opposed to approximately 19,000 tons in the third quarter 2008. Please see the Results of Operations section for detail on 2009 production.

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The following table summarizes the quarterly saleable production results for the trailing five quarters:

	<u>Q2 '08</u>	<u>Q3 '08</u>	<u>Q4 '08</u>	<u>Q1 '09</u>	<u>Q2 '09</u>
Briar Hill / Radio Hill	236,586	182,438	256,188	291,106	296,154
Graham #5	154,986	108,251	83,614	-	-
Back in Black	65,605	-	-	30,007	42,583
KO	-	-	-	-	25,162
Stony Point	14,564	9,971	-	-	-
Jessup	-	18,742	42,495	61,716	61,852
Beech Creek	-	111,465	145,053	109,701	24,393
Total production	471,741	430,867	527,350	492,530	450,144

Purchased Coal

Prior to the acquisition of C&R at the end of July 2008, the Company managed the Beech Creek property on behalf of C&R and purchased the production from the mine. The declining trend in purchased coal from C&R from the second quarter 2008 to the third quarter 2008 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 trended upward through the second quarter 2009. The Company only purchased approximately 18,000 tons of coal fines in the fourth quarter 2008 because Covol was not able to meet quality specifications, which has been corrected in 2009. Due to a shortfall in its 2008 commitment to the Company, Covol agreed to make up 124,624 tons of coal that were not delivered in 2008 (the "2008 make-up tons") beginning on April 1, 2009. The Company will pay a reduced price of \$24.00 per ton instead of \$25.50 per ton, until the 2008 make-up tons are completely delivered. Covol had supplied approximately 70% of its 2008 make up tons by June 30, 2009.

The following table summarizes the quarterly production and purchased coal for the trailing five quarters, illustrating the transition of Beech Creek from purchased coal to owned production.

	<u>Q2 '08</u>	<u>Q3 '08</u>	<u>Q4 '08</u>	<u>Q1 '09</u>	<u>Q2 '09</u>
Company production (excl. Beech Creek)	471,741	319,402	382,297	382,829	425,751
Beech Creek (Owned)	-	111,465	145,053	109,701	24,393
Sub-total Company production	471,741	430,867	527,350	492,530	450,144
C&R - Beech Creek (purchased coal)	140,496	64,803	-	-	-
Covol (purchased coal)	29,269	44,190	17,558	52,965	82,878
Sub-total purchased coal	169,765	108,993	17,558	52,965	82,878
Total sources of production	641,506	539,860	544,908	545,495	533,022

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Revenue

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 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.

For the first three months of 2009, average revenue per ton sold increased to \$33.40 from \$33.11 in the fourth quarter of 2008. The increase of \$0.29 per ton resulted from shipments on several sales contracts which transitioned to 2009 contract pricing after fulfilling 2008 contract commitments during the first quarter of 2009.

Revenue declined in the second quarter 2009 to \$33.20 per ton sold from the first quarter 2009 level of \$33.40 per ton sold due to diesel fuel and BTU quality adjustments. During the first quarter 2009, on one of its customer contracts, the Company was compensated at a higher diesel fuel reimbursement rate while it was completing its 2008 contract obligations. As the 2008 contract obligations were fulfilled, the diesel fuel reimbursement was recalculated using 2009 diesel fuel pricing, creating a reduction in the diesel fuel reimbursement. Additionally, due to the depletion of the Beech Creek mine, overall BTU quality decreased for the quarter, reducing the per ton revenue realization on several of the Company's contracts.

Cost of Sales

The trend in cost of sales has primarily been impacted by maintenance costs and commodity costs. Since the beginning of the fourth quarter 2007, the Company has spent approximately \$33,400,000 on new production equipment, which has increased productivity and lowered maintenance costs through the first quarter 2009.

Rising commodity costs had a significant impact on the Company's diesel fuel and explosives costs through the first three quarters of 2008. After the severe sell-off in commodities during the latter part of 2008, diesel fuel cost per gallon and ammonium nitrate fuel oil ("ANFO") cost per hundred-weight trended downward through the first quarter of 2009.

Diesel fuel and explosives, on a cost per ton produced basis, increased from the first quarter 2009 to the second quarter 2009 primarily due to the additional spoil hauling at the Back in Black mine and challenging mining conditions at the KO location. Additionally, the Jessup mine had to employ a restricted blasting pattern as it neared its permit line, thereby increasing its overall explosives cost.

The following table summarizes the trend in diesel and ANFO/explosives costs through the second quarter 2009.

	Cost per ton produced				
	Q2 '08	Q3 '08	Q4 '08	Q1 '09	Q2 '09
Diesel fuel	\$ 9.10	\$ 8.38	\$ 5.10	\$ 4.39	\$ 5.44
ANFO/Explosives	3.16	2.92	2.43	2.28	3.05
Total	\$ 12.26	\$ 11.30	\$ 7.53	\$ 6.67	\$ 8.49

Selling, General and Administrative Expenses

During 2008, selling expenses, which include coal taxes and royalties, ranged from approximately 10% to 12% of coal sales. The Company does not pay coal taxes or royalties on purchased coal so selling expenses declined as a percentage of coal sales to approximately 10% during the second and third quarters of 2008 when purchased coal was at its highest for the year. During the third quarter, the Company started paying a \$0.60 per ton sold overriding

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royalty to the owners of C&R as part of the acquisition agreement. For the fourth quarter of 2008, selling expenses reached 12% of coal sales as approximately 97% of sales were sourced from the Company's production and it was the first full quarter for paying the overriding royalty to C&R. For the six months ended June 30, 2009, selling expenses were 11% of coal sales. The C&R overriding royalty of \$0.60 per ton ceased in April 2009, as Beech Creek was depleted.

General and administrative expenses have risen as the Company has hired more employees to fill various roles at the middle and senior management levels. The spike in G&A in the second quarter 2008 was because of a non-cash share-based compensation charge related to stock option issuances of \$2,151,277. During the fourth quarter of 2008 and the first quarter of 2009, the Company cancelled certain stock options that the Board of Directors and several officers voluntarily surrendered. This action accelerated the non-cash stock option expense related to these options and increased compensation expense by approximately \$2,250,000 for the fourth quarter 2008 and \$1,441,000 for the first quarter 2009.

Liquidity and Capital Resources

As at June 30, 2009, the Company had \$20,773,655 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 in the amount of \$12,517,297 as at June 30, 2009 versus \$11,638,921 as at December 31, 2008.

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 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 for the three and six months ended June 30, 2009 was \$3,003,436 and \$7,659,492, respectively. The Company's operating loss was the primary reason for the use of cash, which, for the six months ended June 30, 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 provided \$888,388 of cash for the quarter ended June 30, 2009, primarily resulting from a decrease in accounts receivable, as sales in the last half of June 2009 were lower than sales in the last half of March 2009. Trade accounts payable and accrued liabilities increased \$1,773,144 for the six months ended June 30, 2009 primarily due to an increase in purchased coal activity during this period.

Investing Activities

Investing activities resulted in a net cash decrease of \$4,785,003 and \$10,725,937 for the three and six months ended June 30, 2009, respectively. In the second quarter 2009, the Company invested \$2,477,578 in short term certificates of deposit in order to increase the yield on its short term investments. Payments for mine development and mining rights of \$1,182,983 and \$1,720,693 for the three and six months ended June 30, 2009, respectively, were primarily for development costs for the Radio Hill, KO, Back in Black, and Gryphon mines. The Company's investing activities also included \$3,307,259 incurred to acquire the Petersburg Coal sublease in the first quarter 2009.

Capital expenditures for the three and six months ended June 30, 2009 were \$1,720,315 and \$7,672,731, respectively. For the six months ended June 30, 2009, \$5,821,290 was invested in three trucks, a dozer and a loader that were financed through term loans. The remaining \$1,851,441 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.

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Financing Activities

Financing activities used cash of \$2,115,250 and \$4,445,400 for the three and six months ended June 30, 2009, respectively. The majority of the financing activities were payments on equipment financing and bank debt.

Coal Sales Contract Revisions

As at June 30, 2009, the Company had coal sales contract commitments of approximately 5.3 million tons at a weighted average price of \$34.65 that extend through 2012. As at the filing of the MD&A, the Company's coal sales commitments before adjustments for BTU or transportation (if applicable in the contract) are detailed in the table below. The timing of the commitments is based on renegotiated contracts, proposed terms and preliminary discussions with customers about deferring some additional tonnage.

	<u>Q3 – Q4</u>				
	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>	<u>Total</u>
Commitments (tons)	1,069,062	2,319,866	1,629,287	288,473	5,306,688
Avg. sales price	\$34.20	\$34.90	\$34.95	\$32.66	\$34.65
% of 11,500 BTU contracts	49%	43%	54%	74%	49%

Acquisitions

Petersburg Coal Sublease

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

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

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

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

The Company is in the process of finalizing its valuation of the assets acquired and liabilities assumed for this sublease. The above allocations are preliminary estimates of fair value and may differ from the final allocation and the differences may be material. The Company will finalize the allocations within one year of the execution of the sublease.

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Outstanding Share Data

As at August 14, 2009, the Company had 150,045,552 common shares issued and outstanding. In addition, there were 11,058,830 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 as at August 14, 2009. If all options, warrants, and brokers' options (including the subsequent exercise of the warrants purchased) were exercised and issued, it would bring the fully diluted issued common shares to a total of 198,115,094, and would generate cash of approximately \$74,000,000. With regard to the outstanding stock options, under the terms of the Company's stock option plan, the sale of the surface mining assets and associated liabilities previously discussed could, depending on the final valuation of the sale, cause all options outstanding to become fully vested.

Subsequent Events

On July 28, 2009, the Company executed an amendment to a coal sales contract with one of its customers. Under the original terms of the contract, shipments to this customer were for 11,500 BTU quality coal and scheduled to be completed by December 31, 2009. The amendment terms extend the period of time to fulfill the contracted tonnage shipments to December 31, 2012 and decrease the minimum BTU guarantee to 11,400 BTU for coal shipped in 2009 and 2010.

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 six months ended June 30, 2009 and 2008:

	<u>Six Months Ended</u>	
	<u>2009</u>	<u>2008</u>
Expenses:		
Consulting fees.....	\$ —	\$ 156,000
Rent and miscellaneous.....	—	32,925
Accounts receivable	—	16,858
Accounts payable	—	3,741

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 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 surface mining operations totaled approximately \$12.5 million as at June 30, 2009 and approximately \$11.0 million as at December 31, 2008. 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 the restricted cash and certificates of deposit on the consolidated balance sheet of \$12,517,297 and 11,638,921 as at

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June 30, 2009 and December 31, 2008, respectively. Pursuant to the surface mining operation sale detailed in note 2, approximately \$5,849,000 of the Company's cash-collateralized reclamation bonds will be replaced by the purchaser. As a result, as at June 30, 2009, the Company has classified \$5,849,000 of the restricted cash and certificates of deposit as a current asset.

The Company leases certain office space under a long-term operating lease running through 2009. Future non-cancelable minimum lease commitments under this lease as at June 30, 2009, payable in 2009, totaled \$114,597. This lease is not related to the surface mining operations held for sale.

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

In the ordinary course of business, the Company enters into contracts to purchase diesel fuel from local suppliers for physical delivery at specified prices. Pursuant to these contracts, the Company does not own a futures or options position in the purchased fuel. As at, and subsequent to, June 30, 2009, the Company has executed purchase contracts for a total of 2,562,000 gallons to be delivered in 2009 and 2010 at a total cost of \$5,672,407, or an average weighted price of \$2.21 per gallon. These fuel contracts are exclusively related to the surface mining operations held for sale.

In 2007, the Company entered into a master coal purchase and sale agreement (the "Master Agreement") to purchase coal fines recovered and processed by Covol Fuels No. 2, LLC ("Covol") from two coal slurry reserve areas in Muhlenberg County, Kentucky. On July 6, 2009 the Company executed an amendment to the Master Agreement (the "Amended Master Agreement") revising the annual purchase and sale tonnage commitments. The term of the Amended Master Agreement runs through the exhaustion of the reserves (the "Term"). During the Term of the Amended Master Agreement, by July 1 of each year, the Company and Covol will agree to the annual tonnage commitment (the "Commitment") that Covol will produce and that the Company will purchase for the next calendar year. For the calendar year 2010 the Commitment cannot be less than 360,000 tons and for subsequent years the Commitment cannot be less than 400,000 tons. The price to be paid by the Company for the coal fines is dependent on the price at which the fines are sold by the Company to its customer, but not less than \$24.50 per ton. Additionally, the Company has the first right of refusal to purchase any tons produced by Covol in excess of the Commitment, but up to 720,000 tons annually. This Master Agreement is exclusively related to the surface mining operations held for sale.

In June 2009, the Company entered into a coal supply agreement with an Illinois Basin producer to purchase 20,000 tons of coal per month from July 2009 through December 2009 at a purchase price of \$39.00 per ton. Upon mutual agreement of the parties to the coal supply agreement, the term of the agreement may be extended to December 31, 2010. This coal supply agreement is exclusively related to the surface mining operations held for sale.

As part of the Renfro Equipment Inc. acquisition in July 2008, the Company agreed that if, by July 31, 2010, it acquires at least 1.5 million reserve tons as defined by National Instrument 43-101 ("NI 43-101") due to the direct efforts of the sellers ("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 acquisition closing documents define a specific territory from which the Additional Reserves can be acquired. The acquisition of the Additional Reserves must be on terms and conditions acceptable to the Company in its sole, reasonable discretion. As at June 30, 2009, the sellers had provided several mineral leases to the Company. However, the analysis and drilling that is required to qualify these properties as reserve tons under the definition of NI 43-101 is in its early stages. Therefore, it is not yet probable that the sellers will deliver 1.5 million reserve tons to the Company, so no liability has been currently accrued on the consolidated balance sheet to the sellers. This commitment is exclusively related to the surface mining operations held for sale.

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Business Environment and Risks

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

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

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

The Company had invested approximately \$15,630,000 of its cash and cash equivalents (including restricted cash and investments) and short-term investments in a U.S. financial institution, which as at June 30, 2009, carried Standard and Poor's investment ratings on their deposits of A-2 to BBB+. As at June 30, 2009, approximately \$3,343,000 of the cash and cash equivalents balance was invested in a money market fund managed by this financial institution, which is guaranteed until September 18, 2009 by the U.S. Treasury Department under the Temporary Guarantee Program for Money Market Funds. The Company has not experienced any losses on its deposits with this financial institution.

The Company is also subject to credit risk from its trade accounts receivable. 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.

As at June 30, 2009, the total fair value of assets subject to credit risk, including cash and cash equivalents (including restricted cash and investments), short-term investments, and trade accounts receivable is their carrying value of \$36,579,666.

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

Management forecasts cash flows for its current and subsequent fiscal years to predict future financing requirements. Future requirements are met through a combination of credit commitments and access to capital markets. As at June 30, 2009, the Company had \$20.8 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 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 consists of only fixed rate notes.

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

Critical Accounting Estimates

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

Mining Rights, Mineral Reserves and Mine Development

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

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

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

Future Income Taxes

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

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

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Asset Retirement Obligations

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

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

Total asset retirement obligations as at December 31, 2007.....	\$ 3,757,353
Liabilities acquired	1,131,000
Liabilities incurred.....	166,083
Accretion	189,132
Liabilities settled.....	<u>(919,568)</u>
Total asset retirement obligations as at December 31, 2008.....	4,324,000
Liabilities incurred.....	670,000
Accretion	146,805
Liabilities settled.....	<u>(214,754)</u>
Total asset retirement obligations as at June 30, 2009	4,926,051
Less current portion	2,300,000
Less asset retirement obligations associated with assets held for sale	2,587,981
	<u>\$ 38,070</u>

Share-Based Compensation

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

Initial Adoption and Changes in Accounting Policies

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

New Accounting Policies

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

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

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

Future Accounting Changes

International Financial Reporting Standards ("IFRS"): In 2006, the Canadian Accounting Standards Board ("AcSB") published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. In February 2008, the AcSB announced that Canadian GAAP for publicly accountable enterprises will be converged with IFRS effective in calendar year 2011. The Company will adopt IFRS for the fiscal year beginning January 1, 2011, with restatement for comparative purposes of amounts reported by the Company for the fiscal year beginning January 1, 2010.

The Company is currently in the planning phase of the conversion, which includes identifying potential differences between GAAP and existing IFRS as at June 30, 2009, as well as proposed IFRS which may be in effect in 2011. The Company is utilizing both internal and external resources to identify and ultimately quantify these differences and the impact that they will have on accounting policies, information technology and data systems, internal control over financial reporting, disclosure controls and procedures, financial reporting, and business activities. Employees responsible for financial reporting have attended IFRS training, have begun IFRS accounting policy development, and initiated development of an IFRS project timeline. Quantification of GAAP and IFRS differences has not yet been determined due to the need to evaluate internal data and make final policy choices and elections.

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

Disclosure Controls and Procedures

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

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Internal Controls over Financial Reporting

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

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