ROYAL COAL
CORP.

# Royal Coal Corp.

## Management's Discussion and Analysis
## For the three month's ended March 31, 2011

This Management's Discussion and Analysis ("MD&A") provides a review of the results of operations of Royal Coal Corp. ("Royal Coal" or the "Company"), and should be read in conjunction with the unaudited condensed interim consolidated financial statements and related notes for the three months ended March 31, 2011 and the audited consolidated financial statements and related notes for the years ended December 31, 2010. The audited consolidated financial statements for the year ended December 31, 2010 have been prepared in accordance with Canadian generally accepted accounting principles ("Canadian GAAP"). The unaudited condensed interim consolidated financial statements dated March 31, 2011 have been prepared in accordance with International Financial Reporting Standards (IFRS). All dollar figures included therein and in the following MD&A are quoted in United States dollars unless otherwise specified. The following MD&A is prepared as of June 28, 2011. Additional information relevant to the Company's activities can be found on SEDAR at www.sedar.com or at the Company's website, www.royalcoal.com.

**Cautionary Note on Forward-Looking Statements**

When used in this document, words such as 'estimate', 'expect', 'anticipate', 'believe' and similar expressions are intended to identify forward-looking statements. Such statements are used to describe management's future plans, objects, and goals for Royal Coal and therefore involve inherent risks and uncertainties.

Shareholders and prospective investors should be aware that the financial statements are subject to known and unknown risks, uncertainties and other factors that could cause actual results to differ materially from those suggested by the forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking information. By its nature, forward-looking information involves numerous assumptions, inherent risk and uncertainties, both general and specific, that contribute to the possibility that the predictions, forecasts, projections and various future events will not occur. Royal Coal undertakes no obligation to update publicly or otherwise revise any forward-looking information whether as a result of new information, future events or such factors which affect this information, except as required by law.

## OVERALL PERFORMANCE

**Company Highlights for First Quarter 2011:**

During the first quarter of 2011, the Company generated gross financings of $45.5 million that enabled the repayment and retirement of outstanding debt and accrued interest of $20 million and a significant improvement in our working capital position, largely benefiting our second quarter, given the challenges experienced in the first quarter. The challenges that impacted our results during the first quarter, included:

- Unfavourable weather conditions during the winter months led to operational and production delays;
- Loader and trucking availability was reduced significantly due to downtime from increased maintenance and repair of equipment;
- Equipment was taken out of service for a prolonged period during the quarter for refurbishment and major maintenance as a result of the unfavourable weather, coupled with the Company having the financial capacity to enable these improvements.

*Specifically:*

- On November 26, 2010, the Company entered into a coal purchase agreement with Sandstorm Metals & Energy (US) Inc. ("Sandstorm Energy"), a subsidiary of Sandstorm Metals & Energy Ltd. (TSXV: SND) pursuant to which Sandstorm Energy would acquire 18% of the first six million tons of coal produced, and thereafter 12% of the life of mine coal produced from the Big Branch Project and the Sid Mining Project. Sandstorm Energy made an upfront payment of US$11 million in January 2011, plus Sandstorm Energy is required to pay ongoing fixed payments of US$55/ton, subject to certain adjustments as set out in the coal purchase agreement. The Company provided certain production level guarantees, including that Sandstorm Energy will receive minimum cash flows of US$2 million in calendar year 2011 and minimum cash flows of US$2.5 million in each of calendar years 2012, 2013, 2014 and 2015 as a result of the further sale of the coal purchased from the Company.
- On February 23, 2011, the company issued 138,000,000 Special Warrants for gross proceeds of $34,896,750 (C$34,500,000). Upon the exercise or deemed exercise thereof, each Special Warrant will entitle the holder thereof to receive one unit (a "Unit") without payment of any additional consideration. Each Unit consisted of one common share of the Company and one-half of one common share purchase warrant. Each Warrant entitles the holder to acquire one common share at a price of C$0.335 per common share until February 23, 2013, subject to an adjustment. The Corporation was required to file a prospectus qualifying the distribution of the common shares and warrants and to have a receipt for a final prospectus issued by the Ontario Securities Commission on or before April 24, 2011 (the "Clearance Date"). In the event that the Corporation had not received a receipt for a final prospectus on or before the Clearance Date, the exercise period of the warrants would be extended from an expiration date of February 23, 2012 to February 23, 2016. Subsequent to March 31, 2011 and prior to April 24, 2011, the Company received the receipt for its final prospectus issued by the Ontario Securities Commission
- Coal production was 64,857 tons for the first three months of 2011 compared to 100,183 for the first three months of 2010. This decline was due primarily to equipment down-time for refurbishment and major maintenance, which resulted in higher repair costs and much lower production volumes. The coal produced was from the Big Branch Project. The Company anticipates that the Sid Mining Project will commence production during Q3 2011.
- Revenue decreased to $4.0 million for the first three months of 2011 from $5.8 million for the same period in 2010. Gross losses increased to $5.8 million in the first three months in 2011 as compared to $2.8 million in 2010, due primarily to the equipment down-time, noted above which resulted in higher repair costs and much lower production volumes.

- The average sale price of the Company's coal during the first quarter of 2011 was $61.92 as compared to $52.94 during the first quarter of 2010.

- During the first quarter of 2011, the Company repaid $4.2 million on its convertible debentures and $325,000 was converted into common shares resulting in the repayment or conversion of all of the Company's convertible debentures. Also, during the first quarter of 2011, the Company repaid $7.95 million in principal payments on its notes payable, and paid $6.4 million to retire the royalty, resulting in the repayment of the entire loan and royalties' payable. Accretion and interest on notes payable and loss on extinguishment of debt totaled $7.5 million during the first quarter of 2011. Also, $7.6 million was paid during the quarter to reduce accounts payable, significantly improving our working capital position. Financing expenses will be reduced significantly starting in the second quarter of 2011, subject to any new financings.

- On June 16, 2011, the Company announced that it agreed to a term sheet for a private placement financing (the "Offering") of C$10,000,000 of secured convertible debentures. Under the terms of the Offering, Royal Coal will issue to Mercuria Energy Group Limited or a designated affiliate ("Mercuria") C$10,000,000 of secured convertible debentures, which will bear interest at a rate of 9% per annum, payable semi-annually in arrears and will be due on or about July 1, 2013. The Offering is expected to close in July, 2011, unless otherwise agreed by the parties. The convertible debentures may be converted by the holder at any time and from time to time into common shares of Royal Coal, at a conversion price of C$0.2689 per share, subject to adjustment in certain circumstances. The convertible debentures will be guaranteed by the subsidiaries of Royal Coal, secured by second ranking security over all assets of Royal Coal and its subsidiaries and first security over certain future assets of Royal Coal and its subsidiaries, not be redeemable until maturity and be subject to typical anti-dilution protections. Royal Coal will grant Mercuria a right to participate on a pro-rata basis in its future financings.

**Company Outlook**

**Big Branch & Big Branch Extension Project**

The Company continues to operate its Big Branch mine, near Hazard, Kentucky. The Company remains focused on achieving increased production levels and maximizing prices for its coal products. Since the Company began operations in October 2009, its main challenges have been to achieve targeted production levels at its Big Branch mine, near Hazard, Kentucky. The Company, however, has not been able to meet its target production levels primarily because the availability of its mining fleet was below projected levels. The significant financings completed during Q1 2011, as well as the difficult operating conditions, from poor weather provided an opportunity for the Company to take a significant amount of equipment out of service, for refurbishment and major maintenance. This will provide the basis for higher production levels and improved operating performance for the balance of 2011.

**Sid Mining Project**

Currently all mining operations on the Company's Sid Mining Project, located in Perry and Breathitt Counties in Kentucky are preparing to be put into for production at the Sid Mining Project, which is currently projected to commence production during Q3 2011.

**Laurel Fork Project**

The Company is not currently carrying out any production activities at its Laurel Fork Project located near Hazard, Kentucky and continues to assess whether and when to advance the project to production.

**Coal Prices**

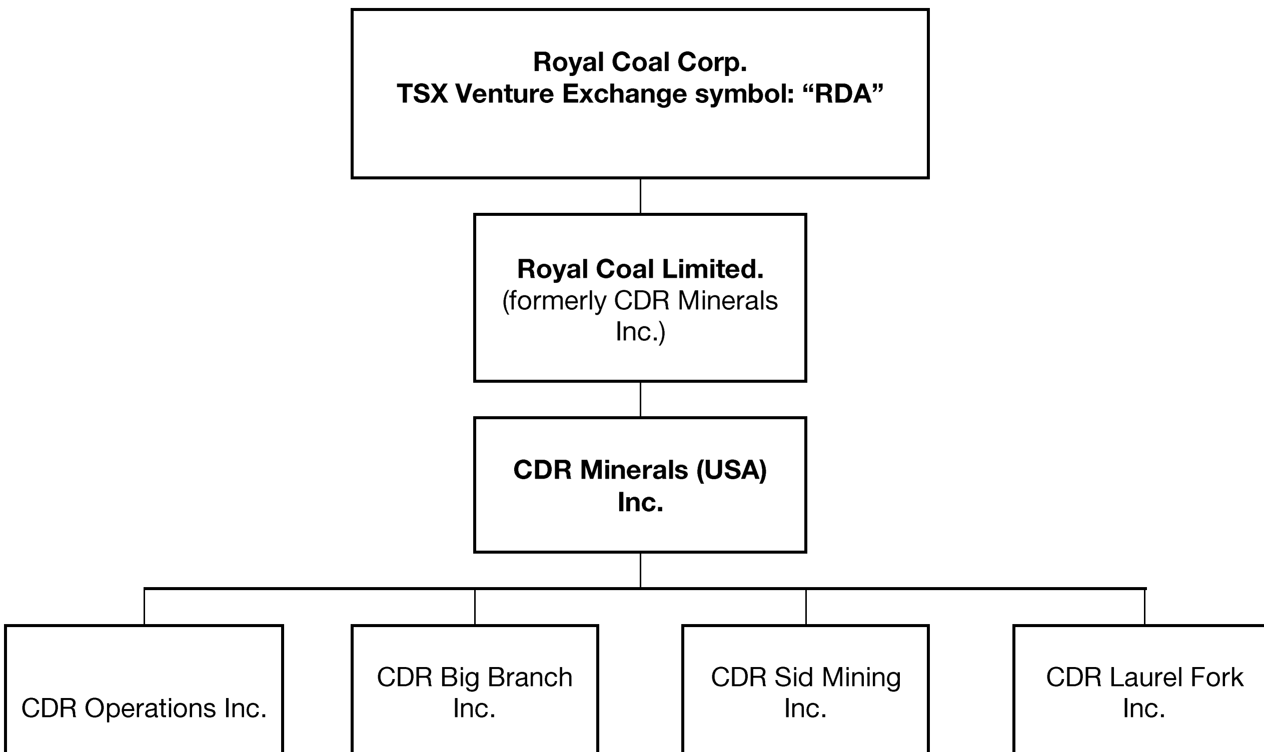
The Company has also seen continued price improvements for its products, thus recovering from the lower price levels experienced during 2010. Average market prices per ton have improved from a range of $50-55/ton during 2010 to $75/ton year to date June 2011. Based on the Central Appalachian Coal Futures Market, at time of writing, coal prices

are trading at a premium to approximately $78/ton for the second half of 2011. In addition, a number of lower priced coal contracts which the Company was committed to when the Big Branch mine was purchased in 2009 terminated during the first half of 2011, thus allowing the Company to now benefit from an improved price environment for the Company's products for the balance of 2011.

**Overview and Corporate Structure**

Royal Coal Corp. is a coal exploration and development company, headquartered in Toronto, Ontario Canada with a regional office in Hazard, Kentucky, U.S.A. whose primary business focus is developing producing surface coal mining operations in the Central Appalachian coal producing region of the United States, which includes parts of West Virginia, Virginia, Kentucky, Ohio and Tennessee. The Company's primary objectives include increasing production at its existing properties while seeking partners and investors to facilitate expanding its properties and coal production capacities. The Central Appalachian's history of producing large volumes of thermal and metallurgical coal, along with the under-utilized coal infrastructure already in place make the area ideal for the implementation of the business model. Coal assets in the area can be acquired and brought into production relatively quickly. The nature of the CAPP region has created a positive and unique environment for aggregation and consolidation of coal assets. Royal Coal believes that it is well positioned to capitalize on these opportunities to acquire additional coal projects to increase shareholder value. The Company may then expand internationally as opportunities allow.

Royal Coal's operations are conducted directly and through its 100% owned subsidiaries as reflected in the chart set out below. Coal mining activities are conducted through CDR Operations Inc., while the mineral properties are held in the separate Kentucky companies; CDR Big Branch Inc., CDR Sid Mining Inc. and CDR Laurel Fork Inc. The mineral exploration properties in Quebec, Canada are owned by Royal Coal Limited.




**Mineral Exploration and Coal Mining Properties in Kentucky, U.S.A**

Royal Coal has concentrated its efforts on developing an asset base in the CAPP coal producing region of the United States. The Company's principal properties are the Big Branch Project, the Sid Mining Project and the Laurel Fork Mining Project.

Set forth in this section are brief descriptions of the Big Branch Project, the Sid Mining Project and the Laurel Fork Project. The information in this section was, in part, summarized and/or extracted from the Big Branch Report, Sid Mining Report, and the Laurel Fork Report, respectively dated April 8, 2011 and from the Short Form Prospectus dated March 29, 2010. The Big Branch Report, Sid Report, and Laurel Fork Report were each dated prepared by Phillip Lucas, P.E., P.L.S as the qualified person at Summit Engineering, Inc. ("Summit") in accordance with NI 43-101. These reports replace the previous reports dated in January 2010 and referred to in the Amalfi Capital Corp. Filing Statement dated March 29, 2010. Portions of this section are based on assumptions, qualifications and procedures which are not fully described herein. Reference should be made to the full text of each of the Big Branch Report, Sid Report, and Laurel Fork Report, and the Short Form Prospectus dated April 8, 2011, which are available for review on the System for Electronic Documents Analysis and Retrieval (SEDAR) at www.sedar.com.

**Estimated Reserves and Resources – Tons**

| | Mineral Resource Tons | | | Mineral Reserve Tons | | |
|---|---|---|---|---|---|---|
| Project | Measured | Indicated | Total | Proven | Probable | Total |
| Big Branch | 5,095,321 | 696,779 | 5,792,100 | 4,331,023 | 592,262 | 4,923,285 |
| Sid Mining | 2,467,000 | 2,662,000 | 5,129,000 | 1,589,000 | 1,676,000 | 3,265,000 |
| Big Branch Extension | - | - | - | 925,664 | - | 925,664 |
| LG Mining Project | 1,852,795 | 694,395 | 2,547,190 | 1,392,065 | 519,543 | 1,911,608 |
| | 9,415,116 | 4,053,174 | 13,468,290 | 8,237,752 | 2,787,805 | 11,025,557 |

***(1) The Measured and Indicated Resources are inclusive of the reported Proven and Probable Reserves.***

**Cash Flow Forecast from Coal Reserves – estimated at June 28, 2011**

**Big Branch & Big Branch Extension Project**

| | 2011 | 2012 | 2013 | 2014 | Total |
|---|---|---|---|---|---|
| Projected Coal Production | 609,000 | 942,000 | 942,000 | 942,000 | **3,435,000** |
| Estimated Coal Sales Price | $73.93 | $86.43 | $87.12 | $87.12 | **$84.42** |
| Estimated Revenue | $45 million | $81 million | $82 million | $82 million | **$290** million |
| Unlevered free cash flow | ($15) million | $11 million | $9 million | $8 million | **$13** million |
| NPV at 10% Discount Rate | | | | | **$8** million |

## Sid Mining Project

| | 2011 | 2012 | 2013 | 2014 | Total |
|---|---|---|---|---|---|
| Projected Coal Production | 125,000 | 620,000 | 720,000 | 720,000 | **2,185,000** |
| Estimated Coal Sales Price | $78.37 | $91.21 | $90.33 | $89.93 | **$89.35** |
| Estimated Revenue | $10 million | $57 million | $65 million | $65 million | **$197** million |
| Unlevered free cash flow | $1 million | $9 million | $11 million | $11 million | **$32** million |
| NPV at 10% Discount Rate | | | | | **$24** million |

## LG Mining Project *

| | 2011 | 2012 | 2013 | 2014 | Total |
|---|---|---|---|---|---|
| Projected Coal Production | 170,000 | 720,000 | 720,000 | 720,000 | **2,330,000** |
| Estimated Coal Sales Price | $78.37 | $91.21 | $90.33 | $89.93 | **$89.35** |
| Estimated Revenue | $13 million | $66 million | $65 million | $65 million | **$209** million |
| Unlevered free cash flow | $5 million | $25 million | $28 million | $32 million | **$90** million |
| NPV at 10% Discount Rate | | | | | **$68** million |

**** The Company intends to acquire, in Q3 of 2011, certain new permitted leases in Kentucky as disclosed in the Company's Short Form Prospectus dated April 8, 2011 (the "LG Mining Project").***

## Total of Three Projects

| | 2011 | 2012 | 2013 | 2014 | Total |
|---|---|---|---|---|---|
| Projected Coal Production | 904,000 | 2,282,000 | 2,382,000 | 2,382,000 | **7,950,000** |
| Estimated Coal Sales Price | $75.20 | $88.46 | $88.76 | $88.60 | **$86.70** |
| Estimated Revenue | $68 million | $204 million | $212 million | $212 million | **$696** million |
| Unlevered free cash flow | ($9) million | $45 million | $48 million | $51 million | **$135** million |
| NPV at 10% Discount Rate | | | | | **$100** million |

**Notes:**

(1) Production and Coal Sales Prices are from pro forma information provided by Royal Coal Corp. to Summit Engineering. Production and sales are measured tons (tons refer to a short ton, which equals 2,000 pounds).
(2) Royalty Rates are from existing leases.
(3) A 10% Discount Rate is used for Net Present Value Estimates.
(4) The Net Present Value estimates for the Coal Reserves mined from 2011 through 2014 as noted above and in the respective NI 43-101 reports would change with revised assumptions regarding estimates of production levels and timing.

**Big Branch & Big Branch Extension Project**

On September 30, 2009, RCL completed the acquisition of certain assets and commenced the Big Branch Project, being certain coal and surface leases and in addition was named operator under DSMRE permit 860-0393 (the "Big Branch Permit"). An amendment to permit 860-0393 is currently proceeding and estimated to be issued by the end of 2011. The Big Branch Project is located proximate to Hazard, Kentucky and has the necessary permits for initial production. The Big Branch Project is bounded to the north by Troublesome Creek, to the south by the town of Amburgey near Elklick Fork of Lotts Creek, to the east by Kentucky Route 1231, and to the west by Clear Creek and Walter's Branch. The project area is located within Knott County, Kentucky, primarily in the Carrie USGS quadrangle map. The seams to be evaluated include the Hazard #5A, Hazard #7, Hazard #8, Hindman (Hazard#9), Skyline (Hazard #10), and the Hazard #11 seams. The total project area covers approximately 2750 acres. Property lines of the Big Branch Project have already been surveyed.

**Sid Mining Project**

Pursuant to a sale agreement dated October 23, 2008 between Sid Mining LLC and CDR Sid Mining, Inc., CDR acquired the Sid Mining Project for a purchase price of $1,700,000 in cash and a 2% override royalty from all sales of all coal mined or extracted from the Sid Mining Project. RCL is also obligated to replace existing reclamation bonds totaling approximately $160,000. The Sid Mining Project is permitted for mining operations. While currently idle, the area was previously mined by Minnehan Mining, LLC and contains a pre-existing haul road facilitating access to the project.

The Sid Mining Project covers approximately 850 acres and lies within the drainage areas of Cam Johnson Branch and Bowling Creek of the Middle Fork of the Kentucky River, lying in Perry and Breathitt Counties, Kentucky. The seams include the Fireclay (Hazard No. 4), Haddix, Hazard No. 5A, Hazard No. 7, Hazard No. 8, and Hindman (Hazard No. 9). The current permitted area of the Sid Mining Project is 330 acres, with a pending amendment increasing the total to 406.38 acres.

Currently all mining operations on the Sid Mining Project are idle. RCL concluded its drilling program after the drill hole PKM-09-05 was drilled in October 2008 and no further drilling activity was undertaken. Core drilling is, as of this date, not taking place on the Sid Mining Project.

**Laurel Fork Project**

Royal Coal holds a central lease within the Laurel Fork mining project area of interest (the "Laurel Fork AOI"), also located proximate to Hazard, Kentucky. It is expected that the wider Laurel Fork AOI can be leased for minimal coal lease prepayments plus out of pocket expenses. The process of obtaining permits for the Laurel Fork AOI is underway.

The area covered by the Laurel Fork Report (being the entire Laurel Fork AOI) is bounded to the north by Balls Fork, to the south by State Route 80, to the east by Trace Branch, and to the west by Short Fork and Rock Lick. The Laurel Fork Project is located within Knott County, Kentucky, primarily in the Vest and Carrie USGS quadrangle maps. The seams to be evaluated include the Fireclay (Hazard #4), Hazard #5A, Hazard #7, Hazard #8, Hindman (Hazard#9), and Skyline (Hazard #10). The total project area covers approximately 2500 acres.

On December 12, 2008, Royal Coal entered into coal and surface leases with a local property owner (the "Gayheart Leases"), which gave it the right to surface mine certain parcels of property located in Knott County, KY, located within the Laurel Fork AOI. RCL is obligated to pay certain minimum royalties under these agreements. The specifics of these payments as well as other terms of the agreements are summarized in the NI 43-101 report dated April 8, 2011 and filed on www.sedar.com. Royal Coal made a one-time payment of $125,000 for this right. Negotiation is on-going for other properties that also lie within the wider Laurel Fork AOI.

Surface mining permit 460-0015, owned by Lee-Paul Coal Company, exists in the extreme Southwest portion of the Laurel Fork Project but has been inactive since 1991. This permit consists of 19 acres in the Hazard #9 seam, and appears to have no value to the Laurel Fork Project.

## OVERALL PERFORMANCE

## FINANCIAL REVIEW

For the three months ended March 31, 2011 the Company recorded a net loss of $15.6 million or $0.15 loss per share ($0.10 fully diluted loss per share) compared to a net loss of $6.2 million or $0.11 per share, (basic and fully diluted) for the three months ended March 31, 2010. Mining activity began at the Big Branch property in the fourth quarter of 2009.

The Company has an interest in nickel properties in Quebec, Canada and Coal properties in Kentucky, United States of America. The main operations of the Company are with its coal properties and the details in the financial review below are related to the coal properties.

### Result of Operations

### Revenue

Revenue for the first three months of 2011 was $4.0 million as compared to $5.8 million for the first three months of 2010. Revenues are recognized at the point of shipment of coal either at the mine site when trucked directly to customers or at the load-out facility where trains are typically loaded with 8,000 to 12,500 tons of coal. Prices are negotiated based on a specific shipment or a contract for a committed volume of coal, at a specified quality level, that can be shipped over one to three months, or longer. The majority of the Company's coal is classified as CSX-BSK, BTU of 12,500 and less than 1% sulphur. The Company's average selling prices reflect a higher mix of lower priced coal sales tied to sales contracts entered into when market prices were lower and Royal Coal's production volumes were expected to be higher.

The Company expects the average selling price of its coal to continue to increase in 2011, as a result of increased production of compliant coal at higher prices, and increasing market prices. The Company's average blended selling price in Q1 2011 was approximately $62. CSX-BSK coal prices per ton are forecast to increase to approximately: $75.00 - Q2 2011; $80.00 - Q3 2011; $85.00 - Q4 2011. With market prices in 2011 forecast to continue to increase, the company expects its revenue and gross margin to improve during 2011.

### Production Volumes

The Company's coal production for the three months ended March 31, 2011 was 64,857 tons (65,335 tons sold), compared to the Company's 100,183 tons produced (109,125 tons sold) for the first three months of 2010. Coal production decreased for the first three months of 2011, due primarily to excessive equipment down-time which resulted in higher repair costs and much lower production volumes. The Coal produced was from the Big Branch Project. The Company anticipates that the Sid Mining Project will commence production in August 2011.

The Company's production is expected to increase during the balance of 2011, with additional production expected from Big Branch and the Big Branch Extension, coupled with our Sid and LG Mining Project sites coming on-stream during Q3.

The financings completed thus far in 2011 are anticipated to enhance equipment availability and productivity, which will lead to generating improved operating levels for the balance of 2011.

**COSTS AND EXPENSES**

**Costs of Sales**

The cost of sales, including mine operating expenses and the load-out operating expenses, for the three months ended March 31, 2011 was $9,863,598 compared to $8,531,558 for the same period in 2010. The company sold production of 65,335 and 109,125 tons of coal during the three month periods ending March 31, 2011 and 2010, respectively. The decline in sales during first quarter 2011 was due to unfavourable weather conditions during the winter months and the company's decision to take a significant amount of equipment out of service for refurbishment and major maintenance. The decision to cease production during the difficult operating conditions and conduct this refurbishment and major maintenance resulted in a significant increase in costs during the quarter. The overall cost increase is largely attributable to one-time expenditures associated with this maintenance program as well as a significant increase in fuel costs, coupled with additional labour. As a result, on a per ton basis, our cost to produce increased substantially to $150.97 for the three months ended March 31, 2011 an increase of $72.79 from $78.18 for the three months ended March 31, 2010.

The following table itemizes each variance analysis for cost of sales per ton for the three month periods ending March 31, 2010 and 2011, respectively:

| Expense Type | Three Months Ended March 31, 2010 | Three Months Ended March 31, 2011 | Unfavorable (Favorable) Variance | Variance Analysis Reference |
|---|---|---|---|---|
| Equipment rental, maintenance and tires | $ 22.71 | $ 54.66 | $ 31.95 | A |
| Fuel and lubricants | 13.87 | 25.99 | 12.11 | B |
| Labour, payroll taxes, and benefits | 10.32 | 19.59 | 9.28 | C |
| Blasting and drilling | 10.27 | 16.60 | 6.33 | D |
| Royalties | 6.79 | 9.91 | 3.12 | E |
| Subcontractors | - | 4.94 | 4.94 | F |
| Severance, excise and reclamation taxes | 3.16 | 3.78 | 0.62 | G |
| Equipment insurance | 1.18 | 2.67 | 1.49 | H |
| Trucking | 1.50 | 2.57 | 1.08 | I |
| Other | 8.38 | 10.26 | 1.87 | J |
| **Total** | **$ 78.18** | **$ 150.97** | **$ 72.79** | |

**Variance Analysis:**

Explanation of each variance per ton is noted below in further detail:

**A.** The unfavourable variance of $31.95 is comprised of the following components:

| | | |
|---|---|---|
| i. | Repairs, maintenance, and rebuild of equipment: | $ 14.20 |
| ii. | New equipment rent agreements: | $ 10.83 |
| iii. | Purchase of new tires | $ 6.92 |
| | | $ 31.95 |

During the three month period ended March 31, 2011, the Company utilized proceeds from new financing agreements to implement much needed improvements and rebuilds in order to increase efficiency of the equipment fleet that will reduce downtime in the future.

In addition, the Company purchased new tires for the entire equipment fleet and started renting two dozers and a loader in the beginning of the three month period ending March 31, 2011, also contributing to the higher costs of sales for the quarter.

**B.** The major factor in the unfavourable variance of $12.11 is the price increase in diesel fuel and crude oil. The Company's fuel cost per gallon, on average, increased by 38% over the same period in 2010. The Company's average fuel cost for the three month period ended March 31, 2011 was $3.29 per gallon in comparison to $2.39 for the same period in 2010.

**C.** On average, the Company employed 54 and 53 mining employees with similar wage rates during the three month periods ended March 31, 2011 and 2010, respectively. The increase in labour and benefits per ton sold is directly a result of the decline in tons produced.

**D.** The Company started renting three drilling machines during the three month period ended March 31, 2011.

**E.** The Company entered into new royalty agreements in addition to the obligations present during the same period in 2010.

**F.** The Company paid for a one-time well closing fee on site that required to be sealed to continue production.

**G.** The Company was assessed one time additional tax liabilities for the amended tax filings on the first year of operations.

**H.** The Company paid additional insurance in comparison to the same period in 2010 related to new equipment purchases and rentals.

**I.** Increase in trucking expense is due to the increase in fuel prices in comparison to the same period in 2010.

**J.** General increases in other various other costs.

The Company's plans to lower its average cost per ton produced include allocating a portion of the proceeds from the 2011 financings to new equipment purchases which will increase production and decrease down time thus increasing efficiency in production. The acquisition of the rail load out facility, anticipated during Q3 2011, which is currently being leased by the Company, will also reduce the cost per ton.

**Accretion and interest on notes payable and loss on extinguishment of debt**

The Company received loan proceeds of $8,950,000 from a company related by virtue of a common officer and director ('Related Company'). The Related Company received the loan proceeds from an unrelated lender for the sole purpose of lending the funds to the Company based on the same terms provided by the unrelated lender to the Related Company, except that the Company issued the Related Party 5,000,000 common shares to provide security for the notes payable. All fees and interest charges imposed by the unrelated lender are charged by the Related Company to the Company.

The value of the debt was being accreted to $17,900,000, representing the loan proceeds of $8,950,000 and a Royalty of $8,950,000.

On January 25, 2011 and February 25, 2011, the Company repaid $4,000,000 and $3,950,000, respectively, of the principal amount outstanding under the note purchase agreement dated September 30, 2009. The Related Company has made a corresponding $4,000,000 and $3,950,000 principal repayments to the third party lender. As a result, the principal amount of the notes was reduced to zero. The royalty payable to the Related Party under the royalty agreement dated September 30, 2009, which provides for a $2.00 per ton royalty, of $6,476,704, inclusive of a $200,000 waiver fee, was paid in full on March 31, 2011. The Related Company has made a corresponding $6,476,704 payment to the third party lender.

Due to the early repayment of the royalty, the Company recorded a loss on repayment of debt of $3,926,188.

**Accretion and interest on convertible debentures**

Accretion expense in the quarter ended March 31, 2011 due to the convertible debentures is $106,911 as compared to $61,180 for the same period in 2010.

(i) Global Capital Convertible Debentures

On December 22, 2010, Global Capital requested conversion of C$75,000 of the principal amount. Subsequent to year end, the Company issued 500,000 shares at a conversion price of C$0.15 per share.

Between January 7, 2011 and February 25, 2011, the Company issued 1,666,666 common shares at a deemed issue price of C$0.15 per share upon the conversion by GC Global Capital Corp. of the entire C$250,000 outstanding principal amount of the convertible debenture dated June 26, 2008, all in accordance with the terms of the debenture. No principal remains outstanding under the debenture.

(ii) Cheyenne Convertible Debentures

On February 25, 2011, the company repaid the $4,200,000 Cheyenne convertible debenture. No principal remains outstanding under the Cheyenne convertible debenture.

**Accretion and interest on bank loan and debt obligation**

The Company received loan proceeds in January 2010 of $516,609 to finance mining equipment acquired and leased. The loan is repayable at $23,005 per month for 24 months and bears interest at 6.5% per annum. The loan is unsecured. At March 31, 2011 $223,918 (December 31, 2010 - $309,444) is outstanding, of which $223,918 is due within 12 months.

In October 2010, the Company entered into new royalty arrangements ("Debt Obligation") with third parties (the "Payees") to provide additional operating capital to the Company of $1,500,000 (the "Debt Obligation Proceeds"). The Company incurred a transaction cost of $71,220 for arranging the Debt Obligation. Subject to the terms of these new royalty arrangements, the Company will pay to the Payees an aggregate royalty equal to $1.50 for each short ton of coal mined, removed, and sold from the Company's Big Branch and Sid Mining Projects and other mines within a defined area (the "Mines") subject to a minimum monthly payment of $50,000, until the Payees have been paid an aggregate amount equal to two times the amount of the Debt Obligation Proceeds received by the Company, and thereafter, $0.60 for each short ton of coal mined, removed, and sold from the Mines. The effective interest rate of the Debt Obligation based on production forecasts resulting in two times the payment of the Debt Obligation Proceeds is approximately 50%. The Company recorded effective interest on the Debt Obligation of $176,575 (December 31, 2010 - $167,449), paid the Payees $150,000 (December 31, 2010 - $69,452) and paid the transaction cost of $nil (December 31, 2010 - $71,220), resulting in a Debt Obligation of $1,624,572 (December 31, 2010 - $1,597,997) at March 31, 2011.

In November 2010, the Company entered into a separate royalty agreement with Sandstorm Metals & Energy (US) Inc. ("Sandstorm") pursuant to which, in exchange for an upfront payment by Sandstorm of $3,000,000 ("Sandstorm Debt Obligation") on December 17, 2010, the Company will pay Sandstorm Energy a royalty equal to 2.7% of revenue from the above Mines until Sandstorm has been paid an aggregate amount of $4,500,000, and thereafter 1.35% of revenue from the Big Branch Mine and the Sid Mining Project. The effective interest rate of the Debt Obligation based on production forecasts resulting in 1.5 times ($4,500,000) the Sandstorm Debt Obligation is 25.87%. The Company recorded effective interest on the Debt Obligation of $193,884 (December 31, 2010 - $35,986) and paid Sandstorm $62,918 (December 31, 2010 - $nil), resulting in a Sandstorm Debt Obligation of $3,166,952 (December 31, 2010 - $3,035,986) at March 31, 2011.

**Financing fees**

Financing fees for the three months ended March 31, 2011 were $54,967 and $580,901 for the same period in 2010. The future trend for financing fees will be consistent with the current period or higher due to the expansion of the operations of the Company.

**General and administrative expenses**

General and administrative expenses for the three months ended March 31, 2011 were $427,057 compared to $400,678 for the same period during 2010. The future trend for G&A expenses will be consistent with the current period or higher due to the expansion of the operations of the Company.

**Management and consulting**

Management and consulting expenses for the three months ended March 31, 2011 were $616,555 compared to $528,610 for the same period during 2010. The future trend of Management and consulting expenses should be consistent with the current period 2011.

**Other expenses**

Professional fees which include legal and accounting costs increased from $116,631 for the three months ended March 31, 2010 to $207,279 for the same period in 2011. Professional fees increased in 2011 primarily due to closing an equity financing of $34.5 million, the Sandstorm deferred revenue advance of $11 million, costs associated with the repayment of indebtedness and increased audit costs. The Company expects Professional fees to increase in 2011 as a result of continued financings and agreements. Travel expenses increased from $26,186 to $40,843 from 2010 to 2011. Overall, travel expenses are expected to be consistent with first quarter of 2011.

**Foreign exchange loss**

Foreign exchange loss for the three months ended March 31, 2011 was $74,010 compared to a loss of $147,541 for the same period in 2010. The foreign exchange loss result from holding net Canadian dollar denominated liabilities while the Canadian dollar strengthened against the United States dollar, and from the timing of conversions of Canadian dollars obtained via private placements. These gains and losses are a result of fluctuations in the US and Canadian dollar, and any exchange gain or loss that arises on translation is included in the determination of net income or loss for the period.

## SUMMARY OF QUARTERLY RESULTS (UNAUDITED)

**Summary of Quarterly Financial Information**

| For the three months ended | $ 31 Mar 11 | $ 31 Dec 10 | $ 30 Sep 10 | $ 30 Jun 10 |
|---|---|---|---|---|
| Revenues | 4,045,649 | 5,500,619 | 5,403,845 | 4,593,994 |
| Cost of sales | 9,863,598 | 7,886,330 | 8,534,772 | 6,798,168 |
| Gross losses | (5,817,949) | (2,385,711) | (3,130,927) | (2,204,174) |
| Net loss for the period | (15,642,221) | (9,001,436) | (7,027,853) | (5,878,829) |
| Basic loss per share | (0.15) | (0.07) | (0.08) | (0.10) |
| Diluted loss per share | (0.10) | (0.07) | (0.08) | (0.10) |
| Coal – tons produced | 64,857 | 91,262 | 112,678 | 89,533 |
| Coal – tons sold | 65,335 | 93,146 | 97,638 | 87,150 |
| Average cost per ton sold | 150.97 | 92.33 | 75.94 | 75.93 |
| Average price per ton sold | 61.92 | 59.05 | 55.31 | 52.71 |

| For the three months ended | $ 31 Mar 10 | $ 31 Dec 09 | $ 30 Sep 09 | $ 30 Jun 09 |
|---|---|---|---|---|
| Revenues | 5,756,212 | 2,891,301 | - | - |
| Cost of sales | 8,531,558 | 5,692,672 | - | - |
| Gross losses | (2,775,346) | (2,801,371) | - | - |
| Net (loss) for the period | (6,214,065) | (5,049,073) | (813,921) | (682,286) |
| Basic & diluted loss per share | (0.11) | (0.10) | (0.02) | (0.02) |
| | | | | |
| Coal – tons produced | 100,183 | 57,255 | - | |
| Coal – tons sold | 109,125 | 50,741 | - | |
| Average cost per ton produced | 85.16 | 99.43 | - | |
| Average price per ton sold | 52.75 | 56.98 | - | |

**Liquidity**

The Company had a working capital deficit of $4,206,368 as at March 31, 2011 (compared to a working capital deficit of $23,952,430 as at December 31, 2010. Included in the working capital for March 2011 is $8,049,752 in cash, $2,512,814 in accounts payable, $1,545,941 in bank loan and debt obligation, $1,914,812 in current portion of deferred revenue (Sandstorm) and $7,877,229 as liability for derivative financial instruments, related to a valuation of all warrants outstanding, due to the change in IFRS reporting. The Company's operations have not generated sufficient cash flow in 2011 to sustain its business. The Company's ability to continue as a going concern is dependent upon its ability to obtain additional financing to support the business until production volumes increase to levels that generate revenue in excess of the costs incurred.

In January 2011, Sandstorm Energy made an upfront payment of US$11 million of deferred revenue to Royal Coal on a coal purchase agreement, plus Sandstorm Energy is required to pay ongoing fixed payments of US$55/ton, subject to certain adjustments as set out in the coal purchase agreement. The Company provided certain production level guarantees, including that Sandstorm Energy will receive minimum cash flows of US$2 million in calendar year 2011 and minimum cash flows of US$2.5 million in each of calendar years 2012, 2013, 2014 and 2015 as a result of the further sale of the coal purchased from the Company.

The Company entered into a separate royalty agreement with Sandstorm Energy pursuant to which, in exchange for an upfront payment by Sandstorm Energy of US$3 million which was paid on December 17, 2010. The Company will pay Sandstorm Energy a royalty equal to 2.7% of revenue from the above Big Branch Project and the Sid Mining Project until Sandstorm has been paid an aggregate amount of US$4.5 million, and thereafter 1.35% of revenue from the above Mines.

On February 23, 2011, the Company completed an equity financing of special warrants raising gross proceeds of $34.5 million through a syndicate of agents led by Cormark Securities Inc. and including Haywood Securities Inc. and Northern Securities Inc. Upon the exercise or deemed exercise thereof, each Special Warrant will entitle the holder thereof to receive one unit (a "Unit") without payment of any additional consideration. Each Unit will consist of one common share of the Company (a "Common Share") and one-half of one Common Share purchase warrant (each whole warrant a "Warrant"). Each Warrant will entitle the holder to acquire one Common Share at a price of $0.335 per Common Share until February 23, 2013.

The Company used the proceeds from the Sandstorm Energy transactions and Cormark financing to reduce its working capital deficit by making payments against accounts payable, convertible debentures and the retirement of all of the notes payable. The Company is also using the proceeds to finance its current operating losses. The Company anticipates that it will have positive monthly cash flow from the Big Branch operations by the end of the second quarter of 2011.

As detailed in the Company Outlook on Page 3 of this MD&A, the Company has opportunities for acquisitions of coal properties, equipment and a rail load out facility and will use its current capital or future financings to finance these opportunities if the Company proceeds with them.

**Capital Resources**

The Company does not have any capital expenditure commitments as of the date of this MD&A. Detailed on page 5 of this MD&A are potential opportunities and capital expenditures that the Company may pursue.

**Subsequent events**

On June 16, 2011, the Company announced that it agreed to a term sheet for a private placement financing (the "Offering") of C$10,000,000 of secured convertible debentures. Under the terms of the Offering, Royal Coal will issue to Mercuria Energy Group Limited or a designated affiliate ("Mercuria") C$10,000,000 of secured convertible debentures, which will bear interest at a rate of 9% per annum, payable semi-annually in arrears and will be due on or about July 1, 2013. The Offering is expected to close on or about July 1, 2011, unless otherwise agreed by the parties. The convertible debentures may be converted by the holder at any time and from time to time into common shares of Royal Coal, at a conversion price of C$0.2689 per share, subject to adjustment in certain circumstances. The convertible debentures will be guaranteed by the subsidiaries of Royal Coal, secured by second ranking security over all assets of Royal Coal and its subsidiaries and first security over certain future assets of Royal Coal and its subsidiaries, not be redeemable until maturity and be subject to typical anti-dilution protections. Royal Coal will grant Mercuria a right to participate on a pro-rata basis in its future financings.

## Commitments and Contractual Obligations

The Company, in connection with the acquisition of the Big Branch property, entered into an agreement to lease mining equipment for $232,677 per month for the two years ending September 29, 2011. The Company has five individual leases for mining equipment for $25,000 per month per lease, all of which expire during 2011. At March 31, 2011, the Company's equipment and premises lease commitments totaled $1,922,658 (December 31, 2010 - $2,620,689) for 2011. None of these commitments extend beyond 2011.

On December 22, 2010, the company signed a Letter of Intent to acquire 80 percent ownership of a coal loading and unloading terminal located on the Big Sandy River in Catlettsburg, Eastern Kentucky (the "River Terminal"). The purchase includes the equipment used to operate the River Terminal, which is currently in operation and has the capacity to load over 100,000 tons per month. The total purchase price shall be the payment of $8,250,000 of the seller's bank debt. The Company shall have an option to purchase the remaining 20% of the River Terminal for a price to be negotiated with the vendor.

Stringent health and safety standards have been in effect since Congress enacted the Coal Mine Health and Safety Act of 1969. The Federal Mine Safety and Health Act of 1977 significantly expanded the enforcement of safety and health standards and imposed safety and health standards on all aspects of mining operations. Kentucky has a state program for mine safety and health regulation and enforcement. In the aftermath of several fatal mining accidents in early 2006, Kentucky enacted a new mine safety legislation. The Mine Safety and Health Administration issued an emergency temporary standard addressing emergency mine evacuation, training and underground oxygen supplies on March 9, 2006 and the Federal Mine Improvement and New Emergency Response (MINER) Act of 2006 was signed into law on June 15, 2006. Management does not believe this will have a significant impact on the Company's operating costs due to the Company having primarily surface operations; however, the MINER Act could lead to further regulatory changes that will impact operating costs

## Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements.

## Related Party Transactions

Paid administration fees of $63,898 for the quarter ended March 31, 2011 (March 31, 2010 - $60,523) of which $64,978 (December 31, 2010 - $147,193) remains unpaid to a company related by virtue a common officer and director of the Company. These amounts are included in management and consulting expense.

As of March 31, 2011, included in accounts payable are $nil (December 31, 2010 - $650,000) in fees, $nil (December 31, 2010 - $660,671) in interest payable and $nil (December 31, 2010 - $210,853) in royalties that are payable to Juno.

The Note Payable detailed in note 7 in the March 31, 2011 financial statements was from a company related by virtue of a common officer and director (the "related lender") who received the loan proceeds from an unrelated lender for the sole purpose of lending the funds to the Company based on the same terms provided by the unrelated lender to the related lender. The related lender also guaranteed the loan for the Company and as compensation received a royalty, at a rate of $0.50 per ton, of $27,846 for the quarter ended March 31, 2011 (March 31, 2010 - $24,865) and $22,152 (December 31, 2010 - $211,010) is included in accounts payable and accrued liabilities.

The Company received proceeds of a Debt Obligation of $750,000 in October 2010 from a related party by virtue of a common officer and director as part of the total Debt Obligation Proceeds of $1,500,000. Effective December 1, 2010 the related party reduced its interest in the Debt Obligation to $495,000 by selling $255,000 of the obligation to unrelated parties. Accretion expense incurred on the Debt Obligation owed to the related party was $49,500 for the quarter ended March 31, 2011 (March 31, 2010 - $nil), of which $33,000 (December 31, 2010 - $16,500) was payable as at March 31, 2011. These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties

## Conversion to IFRS

(i) Overview

IFRS replaced Canadian GAAP for publicly accountable enterprises for financial periods beginning on and after January 1, 2011. These are the Company's first unaudited condensed interim consolidated financial statements prepared in accordance with IAS 34, using accounting policies consistent with IFRS.

The accounting policies described in note 2 have been selected to be consistent with IFRS as is expected to be effective on March 31, 2011, the Company's first annual IFRS reporting date. These policies have been applied in the preparation of these unaudited condensed interim financial statements, including all comparative information.

(ii) First-time adoption of IFRS

The adoption of IFRS requires the application of IFRS 1, which provides guidance for an entity's initial adoption of IFRS. IFRS 1 generally requires retrospective application of IFRS as effective at the end of its first annual IFRS reporting period. However, IFRS 1 also provides certain optional exemptions and mandatory exceptions to this retrospective treatment.

The Company has elected to apply the following optional exemptions in its preparation of an opening IFRS statement of financial position as at January 1, 2010, the Company's "Transition Date".

- To apply IFRS 2 Share based Payments only to equity instruments that were issued after April 18, 2005 and had not vested by the Transition Date.
- To apply IAS 23 Borrowing Costs prospectively from the transition date. IAS 23 requires the capitalization of borrowing costs directly attributable to the acquisition, production or construction of certain assets.
- To elect not to apply retrospective treatment to certain aspects of IAS 21, The Effect of Changes in Foreign Exchange Rates, and deem the cumulative translation differences for all foreign operations to be zero at the transition date.
- To apply the transition provisions of IFRIC 4, Determining whether an Arrangement Contains a Lease, to determine if arrangements existing at the transition date contain a lease based on the circumstances existing at the transition date, rather than the historical date.

IFRS 1 does not permit changes to estimates that have been made previously. Accordingly, estimates used in the preparation of the Company's opening IFRS statement of financial position as at the Transition Date are consistent with those that were made under Canadian GAAP.

The Company's Transition Date IFRS unaudited condensed interim consolidated balance sheet is included as comparative information in the unaudited condensed interim consolidated balance sheets in these financial statements.

(iii) Reconciliations of Canadian GAAP to IFRS

IFRS 1 requires the Company to reconcile equity, comprehensive income and cash flows for prior periods. The changes made to the consolidated statements of financial position and consolidated statements of comprehensive income have resulted in reclassifications of various amounts on the consolidated statements of cash flows, however as there have been no changes to the net cash flows from operating investing and financing activities, no reconciliations have been presented.

| *Reconciliation of equity* | Jan 1 2010 | Mar 31 2010 | Dec 31 2010 |
|---|---|---|---|
| Shareholders' equity under Canadian GAAP | $ 5,184,492 | $ 235,306 | $ (10,969,798) |
| IFRS Adjustments | (63,513) | (55,696) | (6,328,545) |
| Total equity under IFRS | $ 5,120,979 | $ 179,610 | $ (17,298,343) |

| *Reconciliation of operations and comprehensive loss* | Mar 31 2010 | Dec 31 2010 |
|---|---|---|
| Net loss and comprehensive loss under Canadian GAAP | $ (6,512,097) | $ (24,004,702) |
| IFRS adjustments | 298,032 | (4,117,479) |
| Net loss and comprehensive loss under IFRS | $ (6,214,065) | $ (28,122,181) |

(iv) Changes to accounting policies

The Company has changed certain accounting policies to be consistent with IFRS as is expected to be effective on March 31, 2011, the Company's first annual IFRS reporting date. The changes to its accounting policies have resulted in certain changes to the recognition and measurement of assets, liabilities, equity, revenue and expenses within its financial statements.

The following summarizes the significant changes to the Company's accounting policies on adoption of IFRS.

(a) Inventory

Under IFRS, Coal inventory is valued when it is probable that the future economic benefits will flow to the Company. The Company had pit inventory with an estimated value of $nil on January 1, 2010, $nil on March 31, 2010 and $146,200 on December 31, 2010.

Impact on Condensed Interim Consolidated Balance Sheets

| | Jan 1 2010 | Mar 31 2010 | Dec 31 2010 |
|---|---|---|---|
| Adjustment to inventory | $ - | $ - | $ 146,200 |
| Adjustment to deficit | $ - | $ - | $ (146,200) |

Impact on Condensed Interim Consolidated Statements of Loss and Comprehensive Loss

| | Mar 31 2010 | Dec 31 2010 |
|---|---|---|
| Adjustment to cost of goods sold | $ - | $ 146,200 |
| Adjustment to deficit | $ - | $ (146,200) |

(b) Mineral properties

On transition to IFRS, the Company elected to capitalize exploration and evaluation expenditures as incurred, which is consistent with the Company's Canadian GAAP policy. There is no impact on the unaudited condensed interim consolidated financial statements.

(c) Impairment of non-financial assets

IFRS requires a write down of assets if the higher of the fair market value and the value in use of a group of assets is less than its carrying value. Value in use is determined using discounted estimated future cash flows. Current Canadian GAAP requires a write down to estimated fair value only if the undiscounted estimated future cash flows of a group of assets are less than its carrying value.

The Company's accounting policies related to impairment of non-financial assets have been changed to reflect these differences. There is no impact on the unaudited condensed interim consolidated financial statements.

(d) Asset Retirement Obligations

IFRS requires the recognition of a decommissioning liability for legal or constructive obligations, while current Canadian GAAP only requires the recognition of such liabilities for legal obligations. A constructive obligation exists when an entity has created reasonable expectations that it will take certain actions.

The Company's accounting policies related to decommissioning liabilities have been changed to reflect these differences. There is no impact on the unaudited condensed interim consolidated financial statements.

(e) Flow-through shares

Under IFRS proceeds from shares are allocated between the offering of the common shares and the sale of tax benefits when the common shares are offered. The allocation is made based on the difference between the quoted price of the common shares and the amount the investor pays for the flow-through shares. A future tax liability is recognized for the premium paid by the investors and is then recognized as a future income tax recovery in the period of renunciation. If flow-through shares are sold at a discount, this policy does not apply and the flow-through shares issued follow applicable IFRS guidance. Previously, the Company's Canadian GAAP policy was to adopt the recommendations of EIC 146 with respect to the accounting for flow through shares. This resulted in the Company reducing the net proceeds of the flow through share issuance by the future tax liability of the Company resulting from the renunciation of the exploration and development expenditures in favour of the flow through share subscribers. This future income tax liability was calculated net of any benefit resulting from unrecorded income tax loss carry forwards and income tax pools in excess of the accounting value available for deduction.

Impact on Condensed Interim Consolidated Balance Sheets

| | Jan 1 2010 | Mar 31 2010 | Dec 31 2010 |
|---|---|---|---|
| Adjustment to common shares | $ 98,167 | $ 98,167 | $ 98,167 |
| Adjustment to deficit | $ (98,167) | $ (98,167) | $ (98,167) |

(f) Share based payments

Under IFRS each tranche in an award is considered a separate award with its own vesting period and grant date fair value. The fair value of each tranche is measured at the date of grant using the Black-Scholes option pricing model. Compensation expense is recognized over the tranche's vesting period, based on the number of awards expected to vest, by increasing contributed surplus. Canadian GAAP allowed for the expensing of options over the vesting period on a straight line basis.

Impact on Condensed Interim Consolidated Balance Sheets

| | Jan 1 2010 | Mar 31 2010 | Dec 31 2010 |
|---|---|---|---|
| Adjustment to contributed surplus | $ - | $ (290,215) | $ - |
| Adjustment to deficit | $ - | $ 290,215 | $ - |

Impact on Condensed Interim Consolidated Statements of Loss and Comprehensive Loss

| | Mar 31 2010 | Dec 31 2010 |
|---|---|---|
| Adjustment to stock based compensation | $ (290,215) | $ - |

(g) Derivative financial liabilities

Under IAS 32, warrants denominated in a foreign currency, which have not been issued on a pro-rata basis to all holders of the same class of shares are classified as liabilities. The Company has derivative financial instruments in the form of warrants issued in Canadian dollars. Such derivative financial instruments are initially recognized at fair value at the date at which the derivatives are issued and are subsequently re-measured at fair value. These derivatives do not qualify for hedge accounting and changes in fair value are recognized immediately in profit and loss.

Impact on Condensed Interim Consolidated Balance Sheets

| | Jan 1 2010 | Mar 31 2010 | Dec 31 2010 |
|---|---|---|---|
| Adjustment to warrants | $ (143,469) | $ (143,469) | $ (2,291,022) |
| Adjustment to derivative financial instruments | 63,513 | 55,696 | 6,474,745 |
| Adjustment to deficit | $ 79,956 | $ 87,773 | $ (4,183,743) |

Impact on Condensed Interim Consolidated Statements of Loss and Comprehensive Loss

| | Mar 31 2010 | Dec 31 2010 |
|---|---|---|
| Adjustment to gain (loss) in fair value of derivative instruments | $ 7,817 | $ (4,103,767) |

(h) Debt covenants

IAS 1 requires that if the Company is in breach of a debt covenant and the Company does not have an unconditional right to defer settlement of a liability for at least twelve months after the reporting period then the liability must be classified as a current liability. As at January 1, 2010 and December 31, 2010 the Company was in breach of its notes payable.

Impact on Condensed Interim Consolidated Balance Sheets

| | Jan 1 2010 | Mar 31 2010 | Dec 31 2010 |
|---|---|---|---|
| Adjustment to notes payable, current | $ 860,792 | $ - | $ 3,570,530 |
| Adjustment to notes payable, long term | $ (860,792) | $ - | $ (3,570,530) |

(i) Cumulative translation differences

To elect not to apply retrospective treatment to certain aspects of IAS 21, The Effect of Changes in Foreign Exchange Rates, and deem the cumulative translation differences for all foreign operations to be zero at the transition date.

Impact on Condensed Interim Consolidated Balance Sheets

| | Jan 1 2010 | Mar 31 2010 | Dec 31 2010 |
|---|---|---|---|
| Adjustment to accumulated and other comprehensive loss | $ 542,103 | $ 542,103 | $ 542,103 |
| Adjustment to deficit | $ (542,103) | $ (542,103) | $ (542,103) |

**Future Accounting Changes**

IFRS 9, Financial Instruments: Classification and Measurement, effective for annual periods beginning on or after January 1, 2013, with early adoption permitted, introduces new requirements for the classification and measurement of financial instruments. Management anticipates that this standard will be adopted in the Company's financial statements for the period beginning January 1, 2013, and has not yet considered the potential impact of the adoption of IFRS 9.

IFRS 13, Fair Value Measurement is a comprehensive standard for fair value measurement and disclosure requirements for use across all IFRS standards. The new standard clarifies that fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants, at the measurement date. It also establishes disclosures about fair value measurement. Under existing IFRS, guidance on measuring and disclosing fair value is dispersed among the specific standards requiring fair value measurements and in many cases does not reflect a clear measurement basis or consistent disclosures. The Company has not yet considered the potential impact of the adoption of IFRS 13.

**Uncertainties and Risk Factors**

The mining business is inherently risky in nature. Exploration activities rely on professional judgments and statistically based tests and calculations and often yield few rewarding results. Mineral properties are often non-productive for reasons that cannot be anticipated in advance and operations may be subject to risks including labour disputes, environmental requirements and hazards, safety issues, geological issues, weather conditions, and changing regulatory requirements as examples. Royal Coal is subject to competitive risk as its ability to finance its activities and generate profitable operations or proceeds from disposal of assets are subject to the world price for the precious metals and the economic forces that influence capital markets. As a result, Royal Coal considers the following uncertainties and risk factors:

**Financing Risks**

Royal Coal has limited financial resources, has negative operating cash flow from its Big Branch mine in Kentucky, and has no assurance that additional funding will be available to it for further capital equipment expenditures, exploration and development work or to fulfill its obligations under any applicable agreements. Failure to obtain such additional financing could result in delay or indefinite postponement of further coal mining, exploration and development plans.

**Credit risk**

Credit risk is the risk of a loss should a counterparty to a financial instrument fails to meet its contractual obligations. The Company's exposure to credit risk is limited to cash and accounts receivables. The Company limits its exposure to credit risk on cash by holding most of its cash in deposits with high credit quality Canadian financial institutions. The Company manages its credit risk on accounts receivable by utilizing a well-qualified and experienced coal sales agent and reviewing available customer financial information and references.

**Fair value**

Fair value estimates of financial instruments are made at a specific point in time, based on relevant information about financial markets and specific financial instruments. As these estimates are subjective in nature, involving uncertainties and matters of significant judgment, they cannot be determined with precision. Changes in assumptions can significantly affect estimated fair values.

The carrying value of cash, accounts receivables, accounts payable, accrued liabilities, bank loan, notes payable and convertible debentures approximates fair value due to the short-term nature of these financial instruments.

The Company's financial instruments are exposed to certain financial risks, including currency risk, credit risk, liquidity risk and interest rate risk. It is management's opinion that the Company is not exposed to significant currency, credit or interest rate.

**Interest rate risk**

Interest rate risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Company's exposure to interest rate risk is limited due to the short-term nature of its financial instruments.

**Commodity Prices**

The Company's future revenues are expected to be in large part derived from the mining and sale of coal. The price of coal has fluctuated in recent years, and is affected by numerous factors beyond the Company's control including international economic and political conditions, expectations of inflation, international currency exchange rates, interest rates, global or regional consumption patterns, speculative activities, levels of supply and demand, increased production due to new mine developments and improved mining and production methods. The effect of these factors on commodity prices makes it difficult to predict the economic viability of the Company's operations.

**Foreign Currency Risks**

The Company's U.S.A. operations generate 100% of the revenue and incur its operating costs and capital expenditures in American dollars. The Company's future revenue is expected to be denominated in United States dollars, while the Company's Canadian head office operates in Canadian dollars and may raise future equity in either Canadian or American dollars. As a result, the Company's has some exposure to the currency fluctuations relative to these two currencies.

### Exploration and Development

Exploration for coal and other minerals is highly speculative in nature, involves many risks and frequently is unsuccessful. There can be no assurance that exploration efforts will result in the discovery of mineralization or that any mineralization discovered will result in the definition reserves. If reserves are developed, it may take a number of years and substantial expenditures from the initial phases of drilling until production is possible, during which time the economic feasibility of production may change. No assurance can be given that exploration programs will result in the definition of reserves or that reserves may be economically mined.

The long-term profitability of the Company's operations will be in part directly related to the cost and success of its exploration programs, which may be affected by a number of factors, which are beyond the control of the Company.

All exploration and development evaluation expenditures incurred by Royal Coal, prior to establishing that a property has economically recoverable reserves are capitalized according its significant accounting policy.

### Operating Hazards and Risks

Mineral exploration and mining involves many risks, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. The work that the Company proposes to undertake will be subject to all the hazards and risks normally incidental to exploration, development and production, any of which could result in work stoppages and damage to persons or property or the environment and possible legal liability for any and all damage. Fires, power outages, labour disruptions, flooding, explosions and cave-ins, are all the risks involved in the operation of mines and the conduct of exploration programs. Although the Company has secured liability insurance and will, when appropriate, secure property insurance in an amount which it considers adequate, the nature of these risks is such that liabilities might exceed policy limits, the liabilities and hazards might not be insurable, or the Company might elect not to insure itself against such liabilities due to high premium costs or other reasons, in which event the Company could incur significant costs or uninsured losses that could have a material adverse effect upon its financial condition.

### Regulations and Mining Law

Mining operations and exploration activities are subject to extensive local (Canada and U.S.A.) and overseas laws and regulations governing exploration, development, production, taxes, labour standards, occupational health, waste disposal, protection and remediation of the environment, reclamation, mine safety, toxic substances and other matters. Compliance with such laws and regulations increases the costs of planning, designing, developing, constructing, operating and closing mines and other facilities. It is possible that the costs and delays associated with compliance with such laws and regulations could become such that the Company would not proceed with or would postpone the development and operation of a mine or mines.

### Environmental Factors

All phases of the Company's operations are subject to environmental regulation in the various jurisdictions in which they operate. Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects, and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect Royal Coal's operations or result in substantial costs and liabilities in the future.

### Permits and Licenses

The operations of the Company may require licenses and permits from various governmental authorities. The Company has obtained permits and licenses identified in the NI 43-101 reports pertaining to the Big Branch, Sid and Laurel Fork projects and believes it complies with present requirements for operating the Big Branch mine. Obtaining the necessary governmental permits is a complex and time-consuming process involving numerous jurisdictions. There can be no

assurance that Royal Coal will be able to obtain all necessary licenses and permits that may be required to carry out exploration, development and mining operations at its projects.

**Title to Assets**

Although the Company believes that it holds valid title to properties in which it has a material interest, there is no guarantee that title to such properties will not be challenged or impugned.

**Governmental Regulation**

Exploration, development and mining of the properties will be affected to varying degrees by: (i) government regulations relating to such matters as environmental protection, health, safety and labour; (ii) mining law; (iii) restrictions on production; price controls; and tax increases; (iv) maintenance of claims; (v) tenure; and (vi) expropriation of property. There is no assurance that future changes in such regulation, if any, will not adversely affect the Company's operations.

Government approvals and permits are required in connection with the exploration activities proposed for the properties. To the extent such approvals are required and not obtained, the Company's planned exploration, development and production activities may be delayed, curtailed, or cancelled entirely.

Failure to comply with applicable laws, regulations and requirements may result in enforcement action against the Company, including orders calling for the curtailment or termination of operations on the properties, or calling for corrective or remedial measures requiring considerable capital investment. Parties engaged in mineral exploration and mining activities may be subject to civil and criminal liability as a result of failure to comply with applicable laws and regulations.

Amendments to current laws, regulations and permitting requirements affecting mineral exploration and mining activities could have a material adverse impact on the Company's operations and prospects.

**No Dividends**

Royal Coal has not paid any dividends on its Common Shares. Any decision to pay dividends on its shares in the future will be dependent upon the financial requirements of the Company to finance future growth, the financial condition of the Company and other factors which the board of directors of the Company may consider appropriate in the circumstances.

**Dependence on Key Employees**

Royal Coal's future growth and its ability to develop depend, to a significant extent, on its ability to attract and retain highly qualified personnel. The Company is highly dependent on the principal members of its senior management group and the loss of their services might impede the Company's business strategy and growth. The loss of one or more key employees could have an adverse effect on the growth and profitability of Royal Coal.

**Conflicts Of Interest**

Certain of the Company's directors and officers serve or may agree to serve as directors or officers of other reporting companies or may have significant shareholdings in other reporting companies and, to the extent that such other companies may participate in ventures in which the Company may participate, the directors of the Company may have a conflict of interest in negotiating and concluding terms respecting the extent of such participation. In the event that such a conflict of interest arises at a meeting of the Company's directors, a director who has such a conflict will abstain from voting for or against the approval of such participation or such terms.

**Competition**

The mineral industry is intensely competitive in all its phases. Royal Coal competes with many companies possessing greater financial resources and technical facilities than itself for the acquisition of mineral concessions, claims, leases and other mineral interests as well as for the recruitment and retention of qualified employees.

**Share Price Fluctuations**

In recent years, the securities markets in Canada have experienced a high level of price and volume volatility, and the market price of securities of many companies, particularly those considered development stage companies, have experienced wide fluctuations in price which would have not necessarily been related to the operating performance, underlying asset values or prospect of such companies. There can be no assurance that continual fluctuation in share price will not occur.

## OUTSTANDING SHARE DATA

As at June 28, 2011, the following were the undiluted and fully diluted common shares outstanding:

| | |
|---|---|
| **Common shares outstanding as at June 28, 2011** | 241,619,495 |
| Shares issuable on exercise of options | 9,755,000 |
| Shares issuable on exercise of warrants | 117,624,055 |
| **Fully diluted shares outstanding as at June 28, 2011** | 368,998,550 |

A summary of the Company's warrants outstanding listed by expiry date is presented below:

| | Expiry date | Warrants outstanding |
|---|---|---|
| $0.50 | June 25, 2011 | 833,334 |
| $0.50 | July 7, 2011 | 50,000 |
| $0.50 | July 10, 2011 | 30,000 |
| $0.50 | July 15, 2011 | 2,241,111 |
| $0.50 | October 13, 2011 | 284,511 |
| $0.50 | October 15, 2011 | 1,200,000 |
| C$0.50 | October 21, 2011 | 1,000,000 |
| $0.50 | November 2, 2011 | 20,300 |
| C$0.20 | August 12, 2012 | 1,519,499 |
| C$0.20 | August 12, 2015 | 32,850,300 |
| C$0.20 | December 23, 2015 | 315,000 |
| C$0.335 | February 23, 2013 | 69,000,000 |
| C$0.25 | February 23, 2013 | 8,280,000 |
| | | 117,624,055 |

A summary of the Company's outstanding stock options as at June 28, 2011 is presented below:

| Exercise price | Expiry date | Options outstanding | Options Exercisable |
|---|---|---|---|
| C$0.20 | August 11, 2011 | 446,500 | 446,500 |
| $0.25 | October 25, 2012 | 1,225,000 | 1,225,000 |
| C$0.25 | October 25, 2012 | 2,400,000 | 2,400,000 |
| C$0.20 | November 30, 2012 | 133,500 | 133,500 |
| C$0.50 | August 14, 2013 | 1,475,000 | 1,475,000 |
| C$0.50 | November 6, 2014 | 1,500,000 | 1,500,000 |
| C$0.20 | November 6, 2014 | 500,000 | 500,000 |
| C$0.50 | November 16, 2014 | 1,250,000 | 1,250,000 |
| C$0.50 | December 10, 2014 | 825,000 | 825,000 |
| | | 9,755,000 | 9,755,000 |

**General**

The Company also discloses information related to its activities on SEDAR at www.sedar.com and on its website www.royalcoal.com.

**Forward-Looking Information**

In the past, Royal Coal has not had and does not currently have positive cash flow from operations. Royal Coal's available cash has been used and will continue to be used, to the extent required, to fund its negative cash flow. No assurance can be given that Royal Coal will ever generate a positive cash flow from operations. Royal Coal may and is seeking additional equity or debt financing in order to fund certain of its potential acquisitions and its production targets, in each case, as and when Royal Coal determines that any such financings are available to it when needed and on terms that are favourable. However, additional financing may not be available when needed or, even, if available, the terms of such financing might not be favourable to Royal Coal.

*This management discussion and analysis ("MD&A") contains "forward-looking information" that includes information relating to future events and future financial and operating performance, including management's assessment of Royal Coal's future outlook, potential financings, potential acquisitions and production. Specifically, this MD&A contains forward-looking information related to increases in production capacity as the results of additional capital expenditures and permitted mines, additional reserves that have been leased or acquired, future development of reserves or properties, potential financings and potential acquisitions. Forward-looking information should not be read as a guarantee of future performance or results and will not necessarily be accurate indications of the times at, or by which, that performance or those results will be achieved. Forward-looking information is based on information available at the time it is made and/or management's good faith belief as of that time with respect to future events, and such information is subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed in or suggested by the forward-looking information. Important factors that could cause these differences include but are not limited to: changes in contracted sales, the business of the Company may suffer as a result of uncertainty surrounding the coal market; the Company may be adversely affected by other economic, business, and/or competitive factors; the worldwide demand for coal; the price of coal; the price of alternative fuel sources; the supply of coal and other competitive factors; the costs to mine and transport coal; the ability to obtain new mining permits; the costs of reclamation of previously mined properties; the risks of expanding coal production; the ability to bring new mines on line on schedule; industry competition; the Company's ability to continue to execute its growth strategies; the Company's ability to secure additional financing; the Company's ability to complete planned acquisitions; and general economic conditions. These and other risks are more fully described in the Company's filings with the Canadian Securities Administrators, including its Annual Information Form for the year ended December 31, 2010, available on SEDAR at www.sedar.com. You should not put undue reliance on any forward-looking information. We assume no obligation to update forward-looking information to reflect actual results, changes in assumptions or changes in other factors affecting forward looking information, except to the extent required by applicable securities laws. If we do update one or more forward-looking information, no inference should be drawn that we will make additional updates with respect to those or other forward-looking information.*"