PEABODY ENERGY CORP
Form 10-Q
November 05, 2010

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**WASHINGTON, D.C. 20549**
**FORM 10-Q**

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended September 30, 2010**

**or**

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from __________ to __________**

**Commission File Number: 1-16463**

**PEABODY ENERGY CORPORATION**

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Delaware** | **13-4004153** |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| **701 Market Street, St. Louis, Missouri** | **63101-1826** |
| (Address of principal executive offices) | (Zip Code) |

**(314) 342-3400**

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer þ | Accelerated filer o | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

There were 269,637,635 shares of common stock with a par value of $0.01 per share outstanding at October 29, 2010.

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## PEABODY ENERGY CORPORATION
## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in millions, except per share data) | | | |
| **Revenues** | | | | |
| Sales | $ 1,663.4 | $ 1,537.0 | $ 4,618.3 | $ 4,023.5 |
| Other revenues | 201.3 | 130.0 | 423.4 | 434.7 |
| Total revenues | 1,864.7 | 1,667.0 | 5,041.7 | 4,458.2 |
| **Costs and expenses** | | | | |
| Operating costs and expenses | 1,243.3 | 1,262.5 | 3,526.7 | 3,313.1 |
| Depreciation, depletion and amortization | 116.7 | 108.0 | 327.3 | 305.5 |
| Asset retirement obligation expense | 9.9 | 12.8 | 30.3 | 31.8 |
| Selling and administrative expenses | 54.1 | 54.2 | 163.6 | 145.9 |
| Other operating (income) loss: | | | | |
| Net gain on disposal or exchange of assets | (6.7) | (2.8) | (15.4) | (16.2) |
| (Income) loss from equity affiliates | 2.7 | 12.0 | (2.1) | 22.7 |
| **Operating profit** | 444.7 | 220.3 | 1,011.3 | 655.4 |
| Interest expense | 62.2 | 52.3 | 170.1 | 151.6 |
| Interest income | (2.8) | (2.2) | (5.4) | (6.2) |
| **Income from continuing operations before income taxes** | 385.3 | 170.2 | 846.6 | 510.0 |
| Income tax provision | 147.7 | 57.0 | 257.2 | 165.6 |
| **Income from continuing operations, net of income taxes** | 237.6 | 113.2 | 589.4 | 344.4 |
| Income (loss) from discontinued operations, net of income taxes | (1.3) | (2.4) | (2.2) | 23.6 |
| **Net income** | 236.3 | 110.8 | 587.2 | 368.0 |
| Less: Net income attributable to noncontrolling interests | 12.2 | 4.0 | 23.2 | 12.0 |
| **Net income attributable to common stockholders** | $ 224.1 | $ 106.8 | $ 564.0 | $ 356.0 |
| **Income From Continuing Operations** | | | | |
| **Basic earnings per share** | $ 0.84 | $ 0.41 | $ 2.11 | $ 1.24 |
| **Diluted earnings per share** | $ 0.83 | $ 0.41 | $ 2.09 | $ 1.23 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| **Net Income Attributable to Common Stockholders** | | | | | | | | |
| **Basic earnings per share** | $ | 0.84 | $ | 0.40 | $ | 2.10 | $ | 1.33 |
| **Diluted earnings per share** | $ | 0.83 | $ | 0.40 | $ | 2.08 | $ | 1.32 |
| **Dividends declared per share** | $ | 0.07 | $ | 0.06 | $ | 0.21 | $ | 0.18 |

See accompanying notes to unaudited condensed consolidated financial statements.

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**PEABODY ENERGY CORPORATION**
**CONDENSED CONSOLIDATED BALANCE SHEETS**

| | (Unaudited) September 30, 2010 | December 31, 2009 |
|---|---|---|
| | (Amounts in millions, except per share data) | |
| **ASSETS** | | |
| Current assets | | |
| Cash and cash equivalents | $ 1,367.5 | $ 988.8 |
| Accounts receivable, net of allowance for doubtful accounts of $26.5 at September 30, 2010 and $18.3 at December 31, 2009 | 583.3 | 303.0 |
| Inventories | 396.3 | 325.1 |
| Assets from coal trading activities, net | 170.5 | 276.8 |
| Deferred income taxes | 66.2 | 40.0 |
| Other current assets | 331.6 | 255.3 |
| Total current assets | 2,915.4 | 2,189.0 |
| Property, plant, equipment and mine development | | |
| Land and coal interests | 7,586.7 | 7,557.3 |
| Buildings and improvements | 986.7 | 908.0 |
| Machinery and equipment | 1,560.0 | 1,391.2 |
| Less: accumulated depreciation, depletion and amortization | (2,914.3) | (2,595.0) |
| Property, plant, equipment and mine development, net | 7,219.1 | 7,261.5 |
| Investments and other assets | 838.1 | 504.8 |
| Total assets | $ 10,972.6 | $ 9,955.3 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities | | |
| Current maturities of long-term debt | $ 41.5 | $ 14.1 |
| Liabilities from coal trading activities, net | 51.9 | 110.6 |
| Accounts payable and accrued expenses | 1,317.9 | 1,187.7 |
| Total current liabilities | 1,411.3 | 1,312.4 |
| Long-term debt, less current maturities | 2,714.6 | 2,738.2 |
| Deferred income taxes | 547.9 | 299.1 |
| Asset retirement obligations | 452.5 | 452.1 |
| Accrued postretirement benefit costs | 907.7 | 914.1 |
| Other noncurrent liabilities | 459.7 | 483.5 |
| Total liabilities | 6,493.7 | 6,199.4 |
| Stockholders equity | | |

| | | |
|---|---|---|
| Preferred Stock $0.01 per share par value; 10.0 shares authorized, no shares issued or outstanding as of September 30, 2010 or December 31, 2009 | | |
| Series A Junior Participating Preferred Stock 1.5 shares authorized, no shares issued or outstanding as of September 30, 2010 or December 31, 2009 | | |
| Perpetual Preferred Stock 0.8 shares authorized, no shares issued or outstanding as of September 30, 2010 or December 31, 2009 | | |
| Series Common Stock $0.01 per share par value; 40.0 shares authorized, no shares issued or outstanding as of September 30, 2010 or December 31, 2009 | | |
| Common Stock $0.01 per share par value; 800.0 shares authorized, 278.4 shares issued and 269.6 shares outstanding as of September 30, 2010 and 276.8 shares issued and 268.2 shares outstanding as of December 31, 2009 | 2.8 | 2.8 |
| Additional paid-in capital | 2,109.5 | 2,067.7 |
| Retained earnings | 2,691.3 | 2,183.8 |
| Accumulated other comprehensive loss | (20.4) | (183.5) |
| Treasury shares, at cost: 8.8 shares as of September 30, 2010 and 8.6 shares as of December 31, 2009 | (329.5) | (321.1) |
| Peabody Energy Corporation s stockholders equity | 4,453.7 | 3,749.7 |
| Noncontrolling interests | 25.2 | 6.2 |
| Total stockholders equity | 4,478.9 | 3,755.9 |
| Total liabilities and stockholders equity | $ 10,972.6 | $ 9,955.3 |

See accompanying notes to unaudited condensed consolidated financial statements.

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## PEABODY ENERGY CORPORATION
## UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2010 | 2009 |
| | (Dollars in millions) | |
| **Cash Flows From Operating Activities** | | |
| Net income | $ 587.2 | $ 368.0 |
| (Income) loss from discontinued operations, net of income taxes | 2.2 | (23.6) |
| Income from continuing operations, net of income taxes | 589.4 | 344.4 |
| Adjustments to reconcile income from continuing operations, net of income taxes to net cash provided by operating activities: | | |
| Depreciation, depletion and amortization | 327.3 | 305.5 |
| Deferred income taxes | 178.6 | 99.6 |
| Share-based compensation | 30.1 | 28.0 |
| Net gain on disposal or exchange of assets | (15.4) | (16.2) |
| (Income) loss from equity affiliates | (2.1) | 22.7 |
| Changes in current assets and liabilities: | | |
| Accounts receivable, including securitization | (278.9) | 43.5 |
| Inventories | (71.2) | (81.0) |
| Net assets from coal trading activities | (0.8) | 68.8 |
| Other current assets | 19.4 | 15.3 |
| Accounts payable and accrued expenses | 108.5 | (146.5) |
| Asset retirement obligations | 20.3 | 23.2 |
| Workers compensation obligations | 5.6 | 2.0 |
| Accrued postretirement benefit costs | 18.4 | 5.1 |
| Contributions to pension plans | (23.9) | (37.7) |
| Other, net | (10.2) | (3.2) |
| **Net cash provided by continuing operations** | 895.1 | 673.5 |
| Net cash used in discontinued operations | (11.3) | (6.2) |
| Net cash provided by operating activities | 883.8 | 667.3 |
| **Cash Flows From Investing Activities** | | |
| Additions to property, plant, equipment and mine development | (291.3) | (143.9) |
| Investment in Prairie State Energy Campus | (52.5) | (41.6) |
| Federal coal lease expenditures | | (123.6) |
| Proceeds from disposal of assets, net of notes receivable | 9.7 | 47.5 |
| Investments in equity affiliates and joint ventures | (18.8) | (10.0) |
| Investments in debt and equity securities | (73.6) | |
| Proceeds from sale of debt securities | 10.6 | |
| Other, net | (7.4) | (4.9) |
| Net cash used in investing activities | (423.3) | (276.5) |
| **Cash Flows From Financing Activities** | | |

| | | |
|---|---|---|
| Proceeds from long-term debt | 1,150.0 | |
| Payments of long-term debt | (1,148.5) | (11.4) |
| Dividends paid | (56.5) | (48.1) |
| Payment of debt issuance costs | (32.2) | |
| Proceeds from stock options exercised | 5.9 | 1.1 |
| Other, net | (0.5) | 8.7 |
| Net cash used in financing activities | (81.8) | (49.7) |
| Net change in cash and cash equivalents | 378.7 | 341.1 |
| Cash and cash equivalents at beginning of period | 988.8 | 449.7 |
| Cash and cash equivalents at end of period | $ 1,367.5 | $ 790.8 |

See accompanying notes to unaudited condensed consolidated financial statements.

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## PEABODY ENERGY CORPORATION
## UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY

| | Peabody Energy Corporation s Stockholders Equity | | | | | | |
|---|---|---|---|---|---|---|---|
| | Common Stock | Additional Paid-in Capital | Treasury Stock | Retained Earnings | Accumulated Other Comprehensive Loss | Noncontrolling Interests | Total Stockholders Equity |
| | (Dollars in millions) | | | | | | |
| December 31, 2009 | $ 2.8 | $ 2,067.7 | $ (321.1) | $ 2,183.8 | $ (183.5) | $ 6.2 | $ 3,755.9 |
| Comprehensive income: | | | | | | | |
| Net income | | | | 564.0 | | 23.2 | 587.2 |
| Increase in fair value of cash flow hedges (net of $94.0 tax benefit) | | | | | 135.9 | | 135.9 |
| Postretirement plans and workers compensation obligations (net of $18.5 tax provision) | | | | | 27.2 | | 27.2 |
| Comprehensive income | | | | 564.0 | 163.1 | 23.2 | 750.3 |
| Dividends paid | | | | (56.5) | | | (56.5) |
| Share-based compensation | | 30.1 | | | | | 30.1 |
| Stock options exercised | | 5.9 | | | | | 5.9 |
| Employee stock purchases | | 5.8 | | | | | 5.8 |
| Shares relinquished | | | (8.4) | | | | (8.4) |
| Distributions to noncontrolling interests | | | | | | (4.2) | (4.2) |
| September 30, 2010 | $ 2.8 | $ 2,109.5 | $ (329.5) | $ 2,691.3 | $ (20.4) | $ 25.2 | $ 4,478.9 |

See accompanying notes to unaudited condensed consolidated financial statements.

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Basis of Presentation**

The condensed consolidated financial statements include the accounts of Peabody Energy Corporation (the Company) and its affiliates. All intercompany transactions, profits and balances have been eliminated in consolidation.

The accompanying condensed consolidated financial statements as of September 30, 2010 and for the three and nine months ended September 30, 2010 and 2009, and the notes thereto, are unaudited. However, in the opinion of management, these financial statements reflect all normal, recurring adjustments necessary for a fair presentation of the results of the periods presented. The balance sheet information as of December 31, 2009 has been derived from the Company s audited consolidated balance sheet. The results of operations for the nine months ended September 30, 2010 are not necessarily indicative of the results to be expected for future quarters or for the year ending December 31, 2010.

The Company classifies items within discontinued operations in the unaudited condensed consolidated statements of operations when the operations and cash flows of a particular component (defined as operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity) of the Company have been (or will be) eliminated from the ongoing operations of the Company as a result of a disposal transaction, and the Company will no longer have any significant continuing involvement in the operations of that component. See Note 3 for additional details related to discontinued operations.

Certain amounts in prior periods have been reclassified to conform with the current year presentations with no effect on previously reported net income or stockholders equity.

**(2) Newly Adopted Accounting Standards and Accounting Standards Not Yet Implemented**

In January 2010, the Financial Accounting Standards Board (FASB) issued accounting guidance that requires new fair value disclosures, including significant transfers in and out of Level 1 and Level 2 fair-value measurements and a description of the reasons for the transfers. In addition, the guidance requires new disclosures regarding activity in Level 3 fair value measurements, including a gross basis reconciliation. The new disclosure requirements became effective for interim and annual periods beginning January 1, 2010, except for the disclosure of activity within Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010 (January 1, 2011 for the Company). While the adoption of the guidance had an impact on the Company s disclosures, it did not affect the Company s results of operations, financial condition or cash flows. Further, the adoption of the gross presentation of Level 3 activity will also impact the Company s disclosures, but will not affect its results of operations, financial condition or cash flows.

In June 2009, the FASB issued accounting guidance on consolidations which clarifies that the determination of whether a company is required to consolidate an entity is based on, among other things, an entity s purpose and design and a company s ability to direct the activities of the entity that most significantly impact the entity s economic performance. The guidance also requires an ongoing reassessment of whether a company is the primary beneficiary of a variable interest entity, and additional disclosures about a company s involvement in variable interest entities and any associated changes in risk exposure. The guidance became effective January 1, 2010, at which time there was no impact on the Company s results of operations, financial condition or cash flows. The Company will continue monitoring and assessing its business ventures in accordance with the guidance.

In June 2009, the FASB issued accounting guidance that seeks to improve the relevance, representational faithfulness and comparability of the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. The guidance, which became effective January 1, 2010, had an impact on the Company s disclosures for its accounts receivable securitization program, but did not affect the Company s results of operations, financial condition or cash flows.

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PEABODY ENERGY CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**(3) Discontinued Operations**

Discontinued operations reflect the spin off of Patriot Coal Corporation (Patriot) and operations recently divested, as well as certain non-strategic mining assets held for sale where the Company has committed to the divestiture of such assets.

Revenues resulting from discontinued operations (including assets held for sale) were $17.0 million and $88.6 million for the three months ended September 30, 2010 and 2009, respectively, and $61.7 million and $243.4 million for the nine months ended September 30, 2010 and 2009, respectively. Income (loss) before income taxes from discontinued operations reflects losses of $2.1 million and $5.1 million for the three months ended September 30, 2010 and 2009, respectively; a loss of $3.5 million for the nine months ended September 30, 2010 and income of $37.6 million for the nine months ended September 30, 2009. The income for the nine months ended September 30, 2009 related primarily to a coal excise tax refund. The income tax benefit resulting from discontinued operations was $0.8 million and $2.7 million for the three months ended September 30, 2010 and 2009 respectively; a benefit of $1.3 million for the nine months ended September 30, 2010 and a provision of $14.0 million for the nine months ended September 30, 2009.

Total assets related to discontinued operations were $21.5 million and $40.6 million as of September 30, 2010 and December 31, 2009, respectively. Total liabilities associated with discontinued operations were $23.4 million and $47.1 million as of September 30, 2010 and December 31, 2009, respectively.

**(4) Assets and Liabilities from Coal Trading Activities**

The fair value of assets and liabilities from coal trading activities is set forth below:

| | September 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | (Dollars in millions) | | | |
| | Gross Basis | Net Basis | Gross Basis | Net Basis |
| Assets from coal trading activities | $ 588.1 | $ 170.5 | $ 949.8 | $ 276.8 |
| Liabilities from coal trading activities | (464.8) | (51.9) | (779.3) | (110.6) |
| Subtotal | 123.3 | 118.6 | 170.5 | 166.2 |
| Net margin held [(1)] | (4.7) | | (4.3) | |
| Net fair value of coal trading positions | $ 118.6 | $ 118.6 | $ 166.2 | $ 166.2 |

(1) Represents margin held from counterparties of $4.8 million net of margin posted with counterparties of $0.1 million at September 30, 2010; and margin held from

counterparties of $22.4 million net of margin posted with counterparties of $18.1 million at December 31, 2009.

As of September 30, 2010, forward contracts made up 43% and 37% of the Company s trading assets and liabilities, respectively; financial swaps represent most of the remaining balances. The net fair value of coal trading positions designated as cash flow hedges of anticipated future sales was an asset of $17.7 million and $93.0 million as of September 30, 2010 and December 31, 2009, respectively.

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

As of September 30, 2010, the time of the estimated future realization of the value of the Company s trading portfolio was as follows:

| Year of Expiration | Percentage of Portfolio Total |
|---|---|
| 2010 | 13% |
| 2011 | 61% |
| 2012 | 24% |
| 2013 | 2% |
| | 100% |

At September 30, 2010, 51% of the Company s credit exposure related to coal trading activities with investment grade counterparties and 49% with non-investment grade counterparties. See Note 12 for more information regarding the Company s coal trading activities.

**(5) Inventories**

Inventories consisted of the following:

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| | (Dollars in millions) | |
| Materials and supplies | $ 94.3 | $ 106.5 |
| Raw coal | 74.8 | 80.5 |
| Saleable coal | 227.2 | 138.1 |
| Total | $ 396.3 | $ 325.1 |

The current year increase in saleable coal was driven by increases at certain of the Company s Australian mines mostly due to timing of shipments.

**(6) Income Taxes**

The income tax provision differed from the United States (U.S.) federal statutory rate as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in millions) | | | |
| Federal statutory provision | $ 134.9 | $ 59.6 | $ 296.3 | $ 178.5 |
| Excess depletion | (25.8) | (1.1) | (44.4) | (35.9) |
| Foreign earnings provision differential | (29.8) | (26.7) | (57.1) | (50.4) |
| Foreign earnings repatriation | 84.5 | | 84.5 | |
| Remeasurement of foreign income tax accounts | 42.7 | 22.3 | 28.8 | 69.1 |
| State income taxes, net of U.S. federal tax benefit | 2.1 | 3.0 | 7.0 | 5.0 |
| General business tax credits | (5.6) | 0.3 | (13.1) | (10.0) |
| Changes in valuation allowance for AMT credits | (63.7) | 3.0 | (45.6) | 9.5 |
| Changes in tax reserves | 2.2 | 1.3 | (4.9) | 4.4 |

| | | | | |
|---|---|---|---|---|
| Other, net | 6.2 | (4.7) | 5.7 | (4.6) |
| Total provision | $ 147.7 | $ 57.0 | $ 257.2 | $ 165.6 |

**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During the quarter ended September 30, 2010, the Company recorded tax expense of $84.5 million related to certain earnings of non-U.S. subsidiaries as a result of the Company s intention to repatriate those earnings in the fourth quarter of 2010.

The Company evaluated and assessed the expected utilization of tax credits, future taxable income projections, available tax strategies and the overall deferred tax position to determine the appropriate amount and timing of valuation allowance adjustments. This comprehensive assessment resulted in the removal of valuation allowances totaling $69.3 million during the quarter ended September 30, 2010, of which $63.7 million related to alternative minimum tax credits and $5.6 million related to expected realization of general business credits.

As a result of the completion of the Internal Revenue Service (IRS) examination of the 2005 federal income tax year, the Company reduced its gross unrecognized tax benefits by $15.2 million, which is reflected as a benefit in the income tax provision for the nine months ended September 30, 2010. The Company and the IRS did not reach an agreement on the adjustment of interest income accrued by a foreign subsidiary through the alternative dispute resolution program (Fast Track Settlement) for the 2006 federal income tax year. The Company and the IRS are proceeding with the formal IRS appeals process to resolve the remaining issue, which could take one to two years to complete.

**(7) Long-Term Debt**

The Company s total indebtedness as of September 30, 2010 and December 31, 2009 consisted of the following:

| | September 30, 2010 | December 31, 2009 |
|---|---|---|
| | (Dollars in millions) | |
| Term Loan | $ 500.0 | $ 490.3 |
| 6.875% Senior Notes due March 2013 | | 650.0 |
| 5.875% Senior Notes due March 2016 | 218.1 | 218.1 |
| 7.375% Senior Notes due November 2016 | 650.0 | 650.0 |
| 6.5% Senior Notes due September 2020 | 650.0 | |
| 7.875% Senior Notes due November 2026 | 247.2 | 247.1 |
| 6.34% Series B Bonds due December 2014 | 15.0 | 15.0 |
| 6.84% Series C Bonds due December 2016 | 33.0 | 33.0 |
| Convertible Junior Subordinated Debentures due 2066 | 372.8 | 371.5 |
| Capital lease obligations | 66.6 | 67.5 |
| Fair value hedge adjustment | 2.4 | 8.4 |
| Other | 1.0 | 1.4 |
| Total | $ 2,756.1 | $ 2,752.3 |

***Credit Facility***

On June 18, 2010 the Company entered into an unsecured credit agreement (the Credit Agreement) which established a $2.0 billion credit facility (the Credit Facility) and replaced the Company s third amended and restated credit agreement dated as of September 15, 2006. The Credit Agreement provides for a $1.5 billion revolving credit facility (the Revolver) and a $500.0 million term loan facility (the Term Loan). The Company has the option to request an increase in the capacity of the Credit Facility, provided the aggregate increase for the Revolver and Term Loan does not exceed $250.0 million, the minimum amount of the increase is $25.0 million, and certain other conditions are met under the Credit Agreement. The Revolver also includes a swingline sub-facility under which up to $50.0 million is available for same-day borrowings. The Revolver commitments and the Term Loan under the Credit Facility will mature on June 18, 2015.

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**PEABODY ENERGY CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Revolver replaced the Company s previous $1.8 billion revolving credit facility and the Term Loan replaced the Company s previous term loan facility (the previous term loan had a balance of $490.3 million at the time of replacement and at December 31, 2009). The Company recorded $21.9 million in deferred financing costs, which are being amortized to interest expense over the five year term of the Credit Facility. The Company also recorded refinancing charges of $9.3 million, which is classified as interest expense in the unaudited condensed consolidated statements of operations. The $500.0 million of proceeds from the Term Loan was used to repay the $490.3 million balance due on the Company s previous term loan facility.

All borrowings under the Credit Agreement (other than swingline borrowings and borrowings denominated in currencies other than U.S. dollars) bear interest, at the Company s option, at either a base rate or a eurocurrency rate , as defined in the Credit Agreement, plus in each case, a rate adjustment based on the Company s leverage ratio, as defined in the Credit Agreement, ranging from 2.50% to 1.25% per year for borrowings bearing interest at the base rate and from 3.50% to 2.25% per year for borrowings bearing interest at the eurocurrency rate (such rate added to the eurocurrency rate, the Eurocurrency Margin ). Swingline borrowings bear interest at a BBA LIBOR rate equal to the rate at which deposits in U.S. dollars for a one month term are offered in the interbank eurodollar market, as determined by the administrative agent, plus the Eurocurrency Margin. Borrowings denominated in currencies other than U.S. dollars will bear interest at the eurocurrency rate plus the Eurocurrency Margin.

The Company pays a usage-dependent commitment fee under the Revolver, which is dependent upon the Company s leverage ratio, as defined in the Credit Agreement, and ranges from 0.500% to 0.375% of the available unused commitment. Swingline loans are not considered usage of the revolving credit facility for purposes of calculating the commitment fee. The fee accrues quarterly in arrears.

In addition, the Company pays a letter of credit fee calculated at a rate dependent on the Company s leverage ratio, as defined in the Credit Agreement, ranging from 3.50% to 2.25% per year of the undrawn amount of each letter of credit and a fronting fee equal to 0.125% per year of the face amount of each letter of credit. These fees are payable quarterly in arrears.

The $500.0 million Term Loan is subject to quarterly repayment of 1.25% per quarter commencing on December 31, 2010, with the final payment of all amounts outstanding (including accrued interest) being due on June 18, 2015.

Under the Credit Agreement, the Company must comply with certain financial covenants on a quarterly basis including a minimum interest coverage ratio and a maximum leverage ratio. The Credit Agreement also includes various affirmative and negative covenants that place limitations on the Company s ability to incur debt; make loans, investments, advances and acquisitions; sell assets; make redemptions and repurchase of capital stock; engage in mergers or consolidations; engage in affiliate transactions; and restrict distributions from subsidiaries. When in compliance with the financial covenants and customary default provisions, the Company is not restricted in its ability to pay dividends, sell assets and make redemptions and repurchase capital stock.

Nearly all of the Company s direct and indirect domestic subsidiaries guarantee all loans under the Credit Agreement. Certain of the Company s foreign subsidiaries also, to the extent permitted by applicable law and existing contractual obligations, will be guarantors of loans made to one of the Company s Dutch subsidiaries.

As of September 30, 2010, the Company had $240.7 million of letters of credit outstanding under the Revolver, with a remaining borrowing capacity of $1.3 billion.

The interest rate payable on the Revolver and the Term Loan was LIBOR plus 2.50%, or 2.76%, at September 30, 2010.

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## PEABODY ENERGY CORPORATION
## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

***6.5% Senior Notes***

On August 25, 2010, the Company completed a $650.0 million offering of 6.5% 10-year Senior Notes due September 2020 (the Notes). The Notes are senior unsecured obligations and rank senior in right of payment to any subordinated indebtedness; equally in right of payment with any senior indebtedness; effectively junior in right of payment to the Company s future secured indebtedness, to the extent of the value of the collateral securing that indebtedness; and effectively junior to all the indebtedness and other liabilities of its subsidiaries that do not guarantee the Notes. Interest payments are scheduled to occur on March 15 and September 15 of each year, commencing on March 15, 2011.

The Notes are jointly and severally guaranteed by nearly all of the Company s domestic subsidiaries, as defined in the note indenture. The note indenture contains covenants that, among other things, limit the Company s ability to create liens and enter into sale and lease-back transactions. The Notes are redeemable at a redemption price equal to 100% of the principal amount of the Notes being redeemed plus a make-whole premium and any accrued unpaid interest to the redemption date.

The Company used the net proceeds of $641.9 million from the issuance of the Notes, after deducting underwriting discounts and expenses, and cash on hand to extinguish its previously outstanding $650.0 million aggregate principal 6.875% Senior Notes formerly due in March 2013 (the 2013 Notes). All of the 2013 Notes were either tendered or redeemed as of September 30, 2010. The Company recognized debt extinguishment costs of $8.4 million, which is classified as interest expense in the unaudited condensed consolidated statements of operations. The issuance of the Notes and the extinguishment of the 2013 Notes allowed the Company to extend the maturity of its senior indebtedness and lower the coupon rate.

***Other Long-Term Debt***

There were no other significant changes to the Company s long-term debt since December 31, 2009.

**(8) Comprehensive Income**

The following table sets forth the after-tax components of comprehensive income:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in millions) | | | |
| Net income | $ 236.3 | $ 110.8 | $ 587.2 | $ 368.0 |
| Increase in fair value of cash flow hedges, net of income taxes | 268.1 | 82.3 | 135.9 | 321.2 |
| Amortization of actuarial loss and prior service cost associated with postretirement plans and workers compensation obligations, net of income taxes | 11.2 | 3.5 | 27.2 | 1.4 |
| Comprehensive income | $ 515.6 | $ 196.6 | $ 750.3 | $ 690.6 |

Comprehensive income differs from net income by the amount of unrealized gain or loss resulting from valuation changes of the Company s cash flow hedges (which include fuel and explosives hedges, currency forwards, traded coal index contracts and interest rate swaps) and the change in actuarial loss and prior service cost during the periods. The values of the Company s cash flow hedging instruments can be affected by changes in interest rates, crude oil, diesel fuel, natural gas and coal prices and the U.S. dollar/Australian dollar exchange rate. The change in the value of the cash flow hedges during the nine months ended September 30, 2010 was primarily due to the strengthening of the Australian dollar against the U.S. dollar.

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**PEABODY ENERGY CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(9) Earnings per Share (EPS)**

The Company uses the two-class method to compute basic and diluted EPS for all periods presented. The following illustrates the earnings allocation method utilized in the calculation of basic and diluted EPS.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (In millions, except per share amounts) | | | |
| EPS numerator: | | | | |
| Income from continuing operations, net of income taxes | $ 237.6 | $ 113.2 | $ 589.4 | $ 344.4 |
| Less: Net income attributable to noncontrolling interests | 12.2 | 4.0 | 23.2 | 12.0 |
| Income from continuing operations attributable to common stockholders before allocation of earnings to participating securities | 225.4 | 109.2 | 566.2 | 332.4 |
| Less: Earnings allocated to participating securities | (1.7) | (0.7) | (4.1) | (2.3) |
| Income from continuing operations attributable to common stockholders [(1)] | 223.7 | 108.5 | 562.1 | 330.1 |
| Income (loss) from discontinued operations, net of income taxes | (1.3) | (2.4) | (2.2) | 23.6 |
| Net income attributable to common stockholders [(1)] | $ 222.4 | $ 106.1 | $ 559.9 | $ 353.7 |
| Weighted average shares outstanding basic | 267.1 | 265.7 | 266.7 | 265.4 |
| Dilutive impact of share-based compensation | 1.5 | 1.6 | 1.7 | 1.9 |
| Weighted average shares outstanding diluted [(2)] | 268.6 | 267.3 | 268.4 | 267.3 |
| Basic EPS attributable to common stockholders: | | | | |
| Income from continuing operations | $ 0.84 | $ 0.41 | $ 2.11 | $ 1.24 |
| Income (loss) from discontinued operations | | (0.01) | (0.01) | 0.09 |
| Net income | $ 0.84 | $ 0.40 | $ 2.10 | $ 1.33 |
| Diluted EPS attributable to common stockholders: | | | | |
| Income from continuing operations | $ 0.83 | $ 0.41 | $ 2.09 | $ 1.23 |
| Income (loss) from discontinued operations | | (0.01) | (0.01) | 0.09 |
| Net income | $ 0.83 | $ 0.40 | $ 2.08 | $ 1.32 |

(1) The reallocation adjustment for participating securities to arrive at the numerator used to calculate diluted EPS was less than $0.1 million for the periods presented.

(2) Weighted average shares outstanding excludes anti-dilutive shares that were less than 0.1 million for the three and nine months ended September 30, 2010 and 0.1 million for the three months ended September 30, 2009 and 0.3 million for the nine months ended September 30, 2009.

**(10) Pension and Postretirement Benefit Costs**

Net periodic pension costs included the following components:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in millions) | | | |
| Service cost for benefits earned | $ 0.4 | $ 0.4 | $ 1.2 | $ 1.1 |
| Interest cost on projected benefit obligation | 12.6 | 12.8 | 37.8 | 38.4 |
| Expected return on plan assets | (14.6) | (15.2) | (43.8) | (45.6) |
| Amortization of prior service cost and actuarial loss | 5.8 | 0.8 | 17.5 | 2.5 |
| Net periodic pension costs (benefit) | $ 4.2 | $ (1.2) | $ 12.7 | $ (3.6) |

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**PEABODY ENERGY CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Net periodic postretirement benefit costs included the following components:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in millions) | | | |
| Service cost for benefits earned | $ 3.5 | $ 2.7 | $ 9.7 | $ 7.9 |
| Interest cost on accumulated postretirement benefit obligation | 14.7 | 13.8 | 43.8 | 41.3 |
| Amortization of prior service cost and actuarial loss | 7.3 | 4.0 | 21.0 | 11.8 |
| Net periodic postretirement benefit costs | $ 25.5 | $ 20.5 | $ 74.5 | $ 61.0 |

During the nine months ended September 30, 2010, the Company made discretionary contributions of approximately $22 million to its defined benefit pension plans. The Company expects to make additional discretionary contributions to such plans of approximately $3 million during 2010. Total minimum and discretionary contributions in 2010 are currently expected to be approximately $28 million.

In March 2010, President Obama signed into law comprehensive health care reform legislation under the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (the Acts). Based on its analyses to date, the Company does not currently believe the Acts will result in a remeasurement of the Company s postretirement health care liabilities. It will continue to assess the accounting implications of the Acts as related regulations and interpretations of the Acts become available. The extent of the impact cannot be actuarially determined until related regulations are promulgated and additional interpretations of the Acts become available. Provisions within the Acts for which financial impacts to the Company s postretirement health care liabilities are possible, but not currently determinable, include application of the excise tax on high-cost employer coverage. The Company does not expect the other provisions of the Acts to materially impact its postretirement health care liabilities or results of operations. The Acts also impact active employees through various changes and/or expansions of healthcare benefits and coverage. While the Company will continue to monitor and assess the effect of the Acts on its active employee population, the Company cannot reasonably predict at this time what the amount of any additional cost may be.

**(11) Segment Information**

The Company reports its operations primarily through the following reportable operating segments: Western U.S. Mining, Midwestern U.S. Mining, Australian Mining, Trading and Brokerage and Corporate and Other. The Company s chief operating decision maker uses Adjusted EBITDA as the primary measure of segment profit and loss. The Company defines Adjusted EBITDA as income from continuing operations before deducting net interest expense, income taxes, asset retirement obligation expense and depreciation, depletion and amortization.

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Operating segment results for the three and nine months ended September 30, 2010 and 2009 were as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in millions) | | | |
| Revenues: | | | | |
| Western U.S. Mining | $ 707.4 | $ 683.6 | $ 2,021.6 | $ 1,972.8 |
| Midwestern U.S. Mining | 317.1 | 327.5 | 949.8 | 978.0 |
| Australian Mining | 733.4 | 537.3 | 1,777.3 | 1,206.6 |
| Trading and Brokerage | 101.8 | 112.9 | 273.7 | 284.8 |
| Corporate and Other | 5.0 | 5.7 | 19.3 | 16.0 |
| Total | $ 1,864.7 | $ 1,667.0 | $ 5,041.7 | $ 4,458.2 |
| Adjusted EBITDA: | | | | |
| Western U.S. Mining | $ 215.7 | $ 208.6 | $ 630.9 | $ 543.9 |
| Midwestern U.S. Mining | 77.2 | 67.0 | 222.7 | 207.4 |
| Australian Mining | 323.2 | 108.2 | 670.1 | 319.1 |
| Trading and Brokerage | 44.3 | 44.2 | 91.0 | 145.2 |
| Corporate and Other | (89.1) | (86.9) | (245.8) | (222.9) |
| Total | $ 571.3 | $ 341.1 | $ 1,368.9 | $ 992.7 |

A reconciliation of Adjusted EBITDA to consolidated income from continuing operations follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in millions) | | | |
| Total Adjusted EBITDA | $ 571.3 | $ 341.1 | $ 1,368.9 | $ 992.7 |
| Depreciation, depletion and amortization | 116.7 | 108.0 | 327.3 | 305.5 |
| Asset retirement obligation expense | 9.9 | 12.8 | 30.3 | 31.8 |
| Interest expense | 62.2 | 52.3 | 170.1 | 151.6 |
| Interest income | (2.8) | (2.2) | (5.4) | (6.2) |
| Income tax provision | 147.7 | 57.0 | 257.2 | 165.6 |
| Income from continuing operations, net of income taxes | $ 237.6 | $ 113.2 | $ 589.4 | $ 344.4 |

**(12) Risk Management and Fair Value Measurements**

***Risk Management Non Coal Trading***

The Company is exposed to various types of risk in the normal course of business, including fluctuations in commodity prices, interest rates and foreign currency exchange rates. These risks are actively monitored in an effort to ensure compliance with the risk management policies of the Company. In most cases, commodity price risk (excluding coal trading activities) related to the sale of coal is mitigated through the use of long-term, fixed-price contracts rather than financial instruments.

**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Interest Rate Swaps.* The Company is exposed to interest rate risk on its fixed rate and variable rate long-term debt. From time to time, the Company manages the interest rate risk associated with the fair value of its fixed rate borrowings using fixed-to-floating interest rate swaps to effectively convert a portion of the underlying cash flows on the debt into variable rate cash flows. The Company designates these swaps as fair value hedges, with the objective of hedging against changes in the fair value of the fixed rate debt that result from market interest rate changes. From time to time, the interest rate risk associated with the Company s variable rate borrowings is managed using floating-to-fixed interest rate swaps. The Company designates these swaps as cash flow hedges, with the objective of reducing the variability of cash flows associated with market interest rate changes. As of September 30, 2010, the Company had no interest rate swaps in place.

*Foreign Currency Hedges.* The Company is exposed to foreign currency exchange rate risk on Australian dollar expenditures made in its Australian Mining segment. This risk is managed by entering into forward contracts and options that the Company designates as cash flow hedges, with the objective of reducing the variability of cash flows associated with forecasted Australian dollar expenditures. As of September 30, 2010, the Company had only forward contracts in place.

*Diesel Fuel and Explosives Hedges.* The Company is exposed to commodity price risk associated with diesel fuel and explosives in the U.S. and Australia. This risk is managed through the use of cost pass-through contracts and derivatives, primarily swaps. The Company has generally designated the swap contracts as cash flow hedges, with the objective of reducing the variability of cash flows associated with the forecasted purchase of diesel fuel and explosives. In Australia, the explosives costs and a portion of the diesel fuel costs are not hedged and they are usually included in the fees paid to the Company s contract miners.

*Notional Amounts and Fair Value.* The following summarizes the Company s foreign currency and commodity positions at September 30, 2010:

| | Notional Amount by Year of Maturity | | | | | | |
|---|---|---|---|---|---|---|---|
| | **Total** | **2010** | **2011** | **2012** | **2013** | **2014** | **2015 and thereafter** |
| **Foreign Currency** | | | | | | | |
| A$:US$ hedge contracts (A$ millions) | $4,510.6 | $446.1 | $1,461.2 | $1,340.2 | $841.6 | $421.5 | $ |
| **Commodity Contracts** | | | | | | | |
| Diesel fuel hedge contracts (million gallons) | 211.4 | 20.0 | 89.5 | 76.2 | 25.7 | | |
| U.S. explosives hedge contracts (million MMBtu) | 0.7 | 0.7 | | | | | |

| | Account Classification by | | | |
|---|---|---|---|---|
| | **Cash flow hedge** | **Fair value hedge** | **Economic hedge** | **Fair Value Asset (Liability) (Dollars in millions)** |

| | | | | |
|---|---|---|---|---|
| **Foreign Currency** | | | | |
| A$:US$ hedge contracts (A$ millions) | $4,510.6 | $ | $ | $ 457.0 |
| | | | | |
| **Commodity Contracts** | | | | |
| Diesel fuel hedge contracts (million gallons) | 211.4 | | | $ (2.4) |
| U.S. explosives hedge contracts (million MMBtu) | 0.7 | | | $ (2.1) |

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**PEABODY ENERGY CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Hedge Ineffectiveness.* The Company assesses both at inception and at least quarterly thereafter, whether the derivatives used in hedging activities are highly effective at offsetting the changes in the anticipated cash flows of the hedged item. The effective portion of the change in the fair value is recorded as a separate component of stockholders equity until the hedged transaction impacts reported earnings, at which time gains and losses are reclassified to the consolidated statements of operations at the time of the recognition of the underlying hedged item. The ineffective portion of the derivative s change in fair value is recorded in the consolidated statements of operations. In addition, if the hedging relationship ceases to be highly effective, or it becomes probable that a forecasted transaction is no longer expected to occur, gains and losses on the derivative are recorded to the consolidated statements of operations.

A measure of ineffectiveness is inherent in hedging future diesel fuel purchases with derivative positions based on crude oil and refined petroleum products as a result of location differences.

The Company s derivative positions for the hedging of future explosives purchases are based on natural gas, which is the primary price component of explosives. However, a small measure of ineffectiveness exists as the contractual purchase price includes manufacturing fees that are subject to periodic adjustments. In addition, other fees, such as transportation surcharges, can result in ineffectiveness, but have historically changed infrequently and comprise a small portion of the total explosives cost.

With respect to the interest rate swaps, there was no hedge ineffectiveness recognized in the unaudited condensed consolidated statements of operations during the three or nine months ended September 30, 2010 and 2009.

The tables below show the classification and amounts of pre-tax gains and losses related to the Company s non-trading hedges during the three and nine months ended September 30, 2010 and 2009:

| | | Three Months Ended September 30, 2010 | | | |
|---|---|---|---|---|---|
| **Financial Instrument** | **Income Statement Classification Gains (Losses) - Realized** | **Gain (loss) recognized in income on non designated derivatives** | **Gain (loss) recognized in other comprehensive income on derivative (effective portion)** | **Gain (loss) reclassified from other comprehensive income into income (effective portion)** | **Gain (loss) reclassified from other comprehensive income into income (ineffective portion)** |
| | | (Dollars in millions) | | | |
| Diesel fuel hedge contracts: | | | | | |
| - Cash flow hedges | Operating costs and expenses | $ | $ 22.3 | $ (10.9) | $ 0.7 |
| Explosives cash flow hedge contracts: | | | | | |
| - Cash flow hedges | Operating costs and expenses | | (1.1) | (2.5) | |
| Foreign currency cash flow hedge contracts | Operating costs and expenses | | 434.7 | 38.5 | |
| Total | | $ | $ 455.9 | $ 25.1 | $ 0.7 |

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

| Financial Instrument | Income Statement Classification Gains (Losses) - Realized | Gain (loss) recognized in income on non designated derivatives (1) | Gain (loss) recognized in other comprehensive income on derivative (effective portion) | Gain (loss) reclassified from other comprehensive income into income (effective portion) | Gain (loss) reclassified from other comprehensive income into income (ineffective portion) |
|---|---|---|---|---|---|
| | | Three Months Ended September 30, 2009 (Dollars in millions) | | | |
| Interest rate swaps: | | | | | |
| - Cash flow hedges | Interest expense | $ | $ (1.2) | $ (3.4) | $ |
| Diesel fuel hedge contracts: | | | | | |
| - Cash flow hedges | Operating costs and expenses | | (5.7) | (20.0) | 1.0 |
| - Economic hedges | Operating costs and expenses | (0.4) | | | |
| Explosives cash flow hedge contracts: | | | | | |
| - Cash flow hedges | Operating costs and expenses | | 2.2 | (1.6) | |
| - Economic hedges | Operating costs and expenses | (1.3) | | | |
| Foreign currency cash flow hedge contracts | Operating costs and expenses | | 151.9 | 5.6 | |
| Total | | $ (1.7) | $ 147.2 | $ (19.4) | $ 1.0 |

(1) Amounts relate to derivatives that were de-designated and settled in 2009.

| | Income Statement Classification | Gain (loss) recognized in income on non designated | Gain (loss) recognized in other comprehensive | Gain (loss) reclassified from other comprehensive | Gain (loss) reclassified from other comprehensive income |
|---|---|---|---|---|---|
| | | Nine Months Ended September 30, 2010 | | | |

| Financial Instrument | Gains (Losses) - Realized | derivatives [2] | income on derivative (effective portion) | income into income (effective portion) | into income (ineffective portion) |
|---|---|---|---|---|---|
| | | (Dollars in millions) | | | |
| Interest rate swaps: | | | | | |
| - Cash flow hedges | Interest expense | $ (8.5) | $ 0.8 | $ (0.5) | $ |
| Diesel fuel hedge contracts: | | | | | |
| - Cash flow hedges | Operating costs and expenses | | (7.5) | (27.3) | |
| Explosives cash flow hedge contracts: | | | | | |
| - Cash flow hedges | Operating costs and expenses | | (4.7) | (7.4) | |
| Foreign currency cash flow hedge contracts | Operating costs and expenses | | 355.3 | 104.4 | |
| Total | | $ (8.5) | $ 343.9 | $ 69.2 | $ |

(2) Amounts relate to swaps that were de-designated and terminated in conjunction with the refinancing of the Company s previous credit facility.

| | | Nine Months Ended September 30, 2009 | | | |
|---|---|---|---|---|---|
| Financial Instrument | Income Statement Classification Gains (Losses) - Realized | Gain (loss) recognized in income on non designated derivatives [1] | Gain (loss) recognized in other comprehensive income on derivative (effective portion) | Gain (loss) reclassified from other comprehensive income into income (effective portion) | Gain (loss) reclassified from other comprehensive income into income (ineffective portion) |
| | | (Dollars in millions) | | | |
| Interest rate swaps: | | | | | |
| - Cash flow hedges | Interest expense | $ | $ (1.1) | $ (9.7) | $ |
| Diesel fuel hedge contracts: | | | | | |
| - Cash flow hedges | Operating costs and expenses | | 35.6 | (72.7) | 1.2 |
| - Economic hedges | Operating costs and expenses | (1.1) | | | |

| | | | | | |
|---|---|---|---|---|---|
| Explosives cash flow hedge contracts: | | | | | |
| - Cash flow hedges | Operating costs and expenses | | (2.0) | (11.9) | |
| - Economic hedges | Operating costs and expenses | (2.1) | | | |
| Foreign currency cash flow hedge contracts | Operating costs and expenses | | 402.4 | (54.0) | |
| Total | | $ (3.2) | $ 434.9 | $ (148.3) | $ 1.2 |

(1) Amounts relate to derivatives that were de-designated and settled in 2009.

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**PEABODY ENERGY CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The classification and amount of derivatives presented on a gross basis as of September 30, 2010 and December 31, 2009 are as follows:

| | Fair Value as of September 30, 2010 | | | |
|---|---|---|---|---|
| **Financial Instrument** | **Current Assets** | **Noncurrent Assets** | **Current Liabilities** | **Noncurrent Liabilities** |
| | | **(Dollars in millions)** | | |
| Diesel fuel cash flow hedge contracts | $ 8.1 | $ 11.6 | $ 20.7 | $ 1.4 |
| Explosives cash flow hedge contracts | | | 2.1 | |
| Foreign currency cash flow hedge contracts | 208.2 | 248.8 | | |
| Total | $ 216.3 | $ 260.4 | $ 22.8 | $ 1.4 |

| | Fair Value as of December 31, 2009 | | | |
|---|---|---|---|---|
| **Financial Instrument** | **Current Assets** | **Noncurrent Assets** | **Current Liabilities** | **Noncurrent Liabilities** |
| | | **(Dollars in millions)** | | |
| Interest rate swaps: | | | | |
| - Fair value hedges | $ | $ 1.5 | $ | $ |
| - Cash flow hedges | | | | 9.8 |
| Diesel fuel cash flow hedge contracts | 6.7 | 18.0 | 31.3 | 15.6 |
| Explosives cash flow hedge contracts | 0.1 | | 4.9 | |
| Foreign currency cash flow hedge contracts | 110.6 | 100.2 | 1.6 | 3.1 |
| Total | $ 117.4 | $ 119.7 | $ 37.8 | $ 28.5 |

After netting by counterparty where permitted, the fair values of the respective derivatives are reflected in Other current assets, Investments and other assets, Accounts payable and accrued expenses, and Other noncurrent liabilities in the condensed consolidated balance sheets.

The Company elected the trading exemption under U.S. generally accepted accounting principles (GAAP) for its coal trading transactions which allows for reduced disclosure since it is the Company s policy to include these instruments as a part of its trading book. For further information, see Risk Management Coal Trading below.

***Risk Management Coal Trading***

The Company engages in trading activities which include over-the-counter direct and brokered trading of coal and the related ocean freight along with the related fuel commodities (coal trading), some of which is subsequently exchange-cleared and some of which is bilaterally-cleared. Except those for which the Company has elected to apply a normal purchases and normal sales exception, derivative coal trading contracts are accounted for on a fair value basis. For derivative trading contracts, the Company establishes fair values using bid/ask price quotations or other market assessments obtained from multiple, independent third-party brokers to value its trading positions from the over-the-counter market. Prices from these sources are then averaged to obtain trading position values. While the Company does not anticipate any decrease in the number of third-party brokers or market liquidity, such events could erode the quality of market information and therefore negatively impact the Company s ability to value its market positions. For its exchange-cleared positions, the Company utilizes exchange-published settlement prices. See Note 4 for information related to the maturity and valuation of the Company s trading portfolio.

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Trading revenues are recorded in Other revenues in the unaudited condensed consolidated statements of operations and include realized and unrealized gains and losses on derivative instruments, including those under the normal purchases and normal sales exception. The tables below show the trading revenues during the three and nine months ended September 30, 2010 and 2009:

| Trading Revenue by Type of Instrument | Three Months Ended September 30, 2010 | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2010 | Nine Months Ended September 30, 2009 |
|---|---|---|---|---|
| | (Dollars in millions) | | | |
| Commodity swaps and options | $ 38.9 | $ 52.6 | $ 29.5 | $ 138.6 |
| Physical commodity purchase / sale contracts | 23.2 | 11.9 | 141.5 | 69.3 |
| Total trading revenue | $ 62.1 | $ 64.5 | $ 171.0 | $ 207.9 |

*Hedge Ineffectiveness.* In some instances, the Company has designated an existing coal trading derivative as a hedge and, thus, the derivative has a non-zero fair value at hedge inception. The off-market nature of these derivatives, which is best described as an embedded financing element within the derivative, is a source of ineffectiveness. In other instances, the Company uses a coal trading derivative that settles at a different time or has a different location basis than the occurrence of the cash flow being hedged. The time and location basis differences yield ineffectiveness to the extent the periodic changes in the fair value of the derivatives exceed the changes in the hedged item. The ineffective portion of the derivative s change in fair value is recorded in the consolidated statements of operations.

***Nonperformance and Credit Risk***

The fair value of the Company s assets and liabilities reflects adjustments for nonperformance and credit risk. The concentration of nonperformance and credit risk is substantially with electric utilities, energy producers and energy marketers. The Company s policy is to independently evaluate each customer s creditworthiness prior to entering into transactions and to regularly monitor the credit extended. If the Company engages in a transaction with a counterparty that does not meet its credit standards, the Company seeks to protect its position by requiring the counterparty to provide an appropriate credit enhancement. Also, when appropriate (as determined by its credit management function), the Company has taken steps to reduce its exposure to customers or counterparties whose credit has deteriorated and who may pose a higher risk of failure to perform under their contractual obligations. These steps include obtaining letters of credit or cash collateral (margin), requiring prepayments for shipments or the creation of customer trust accounts held for the Company s benefit to serve as collateral in the event of a failure to pay or perform. To reduce its credit exposure related to trading and brokerage activities, the Company seeks to enter into netting agreements with counterparties that permit the Company to offset receivables and payables with such counterparties and, to the extent required, will post or receive margin amounts associated with exchange-cleared positions.

The Company conducts its hedging activities related to foreign currency, interest rate, and fuel and explosives exposures with a variety of highly-rated commercial banks and closely monitors counterparty creditworthiness.

Certain of the Company s derivative trading instruments require the parties to provide additional performance assurances whenever a material adverse event jeopardizes one party s ability to perform under the instrument. If the Company were to sustain a material adverse event (using commercially reasonable standards), the counterparties could request collateralization on derivative trading instruments in net liability positions which, based on an aggregate fair value at September 30, 2010 and December 31, 2009, would have amounted to collateral postings of approximately $47 million and $84 million, respectively, to its counterparties.

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Certain of the Company s other derivative trading instruments require the parties to provide additional performance assurances whenever a credit downgrade occurs below a certain level as specified in each underlying contract. The terms of such derivative trading instruments typically require additional collateralization, which is commensurate with the severity of the credit downgrade. If a credit downgrade were to occur below contractually specified levels, the Company s additional collateral requirements owed to its counterparties would have been zero at September 30, 2010 and approximately $16 million at December 31, 2009 based on the aggregate fair value of all derivative trading instruments with such features that are in a net liability position. No collateral was posted as of September 30, 2010 while $0.8 million was posted at December 31, 2009.

The Company is required to post collateral on its net liability positions with an exchange, which was $0.1 million as of September 30, 2010 and $18.1 million as of December 31, 2009. In addition, the Company had posted $21.7 million and $29.7 million of collateral to meet the requirements of the respective exchanges at September 30, 2010 and December 31, 2009, respectively (reflected in Other current assets ).

***Fair Value Measurements***

The Company uses a three-level fair value hierarchy that categorizes assets and liabilities measured at fair value based on the observability of the inputs utilized in the valuation. These levels include: Level 1, inputs are quoted prices in active markets for the identical assets or liabilities; Level 2, inputs other than quoted prices included in Level 1 that are directly or indirectly observable through market-corroborated inputs; and Level 3, inputs are unobservable, or observable but cannot be market-corroborated, requiring the Company to make assumptions about pricing by market participants.

The following tables set forth the hierarchy of the Company s net financial asset (liability) positions for which fair value is measured on a recurring basis:

| | September 30, 2010 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | (Dollars in millions) | | | |
| Investment in debt securities | $ 18.9 | $ | $ | $ 18.9 |
| Commodity swaps and options coal trading activities | (4.4) | 73.4 | | 69.0 |
| Commodity swaps and options diesel fuel | | (2.4) | | (2.4) |
| Commodity swaps and options explosives | | (2.1) | | (2.1) |
| Physical commodity purchase/sale contracts coal trading activities | | 33.4 | 16.2 | 49.6 |
| Foreign currency hedge contracts | | 457.0 | | 457.0 |
| Total net financial assets | $ 14.5 | $ 559.3 | $ 16.2 | $ 590.0 |

| | December 31, 2009 | | | |
|---|---|---|---|---|
| | Level 1 | Level 2 | Level 3 | Total |
| | (Dollars in millions) | | | |
| Commodity swaps and options coal trading activities | $ (1.7) | $ 80.7 | $ | $ 79.0 |
| Commodity swaps and options diesel fuel | | (22.2) | | (22.2) |
| Commodity swaps and options explosives | | (4.8) | | (4.8) |
| Physical commodity purchase/sale contracts coal trading activities | | 70.2 | 17.0 | 87.2 |
| Interest rate swaps | | (8.3) | | (8.3) |

| | | | | |
|---|---|---|---|---|
| Foreign currency hedge contracts | | 206.1 | | 206.1 |
| Total net financial assets (liabilities) | $ (1.7) | $ 321.7 | $ 17.0 | $ 337.0 |

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

For Level 1 and 2 financial assets and liabilities, the Company utilizes both direct and indirect observable price quotes, including interest rate yield curves, exchange indices, broker quotes, published indices, and other market quotes. Below is a summary of the Company s valuation techniques for Level 1 and 2 financial assets and liabilities:

Investment in debt securities: valued based on quoted prices in active markets (Level 1).

Commodity swaps and options coal trading activities: generally valued based on unadjusted quoted prices in active markets (Level 1) or a valuation that is corroborated by the use of market-based pricing (Level 2).

Commodity swaps and options other than coal: generally valued based on a valuation that is corroborated by the use of market-based pricing (Level 2).

Physical commodity purchase/sale contracts coal trading activities: purchases and sales at locations with significant market activity corroborated by market-based information (Level 2).

Interest rate swaps: valued based on modeling observable market data and corroborated with statements from counterparties (Level 2).

Foreign currency hedge contracts: valued utilizing inputs obtained in quoted public markets (Level 2).

Commodity swaps and options and physical commodity purchase/sale contracts transacted in less liquid markets or contracts, such as long-term arrangements with limited price availability were classified in Level 3. These instruments or contracts are valued based on quoted inputs from brokers or counterparties, or reflect methodologies that consider historical relationships among similar commodities to derive the Company s best estimate of fair value. The Company has consistently applied these valuation techniques in all periods presented, and believes it has obtained the most accurate information available for the types of derivative contracts held.

The Company did not have any transfers between Level 1 and Level 2 during the three or nine months ended September 30, 2010. The Company s policy is to value all transfers between levels using the beginning of period valuation. This represents a change in policy from those in effect at December 31, 2009. Previously, the end of the period values were used for transfers into Level 3 and beginning of period values for transfers out of Level 3.

The following table summarizes the changes in the Company s recurring Level 3 net financial assets (liabilities):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in millions) | | | |
| Beginning of period | $ 13.8 | $ 2.4 | $ 17.0 | $ 37.8 |
| Total gains or losses (realized/unrealized): | | | | |
| Included in earnings | 2.1 | (3.2) | (0.6) | (16.9) |
| Included in other comprehensive income | 0.2 | 2.8 | 0.3 | (8.3) |
| Purchases, issuances and settlements | (0.7) | (4.3) | (1.4) | (5.6) |
| Transfers in (out) | 0.8 | 6.5 | 0.9 | (2.8) |
| End of period | $ 16.2 | $ 4.2 | $ 16.2 | $ 4.2 |

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes the changes in unrealized gains (losses) relating to Level 3 net financial assets still held at the end of the period:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| | (Dollars in millions) | | | |
| Changes in unrealized gains (losses) [1] | $ 1 . 2 | $ (2 .9) | $ 3 .5 | $ (2.3) |

(1) Within the unaudited condensed consolidated statements of operations for the periods presented, unrealized gains and losses from Level 3 items are combined with unrealized gains and losses on positions classified in Level 1 or 2, as well as other positions that have been realized during the applicable periods.

***Fair Value Other Financial Instruments***

The following methods and assumptions were used by the Company in estimating fair values for other financial instruments as of September 30, 2010 and December 31, 2009:

Cash and cash equivalents, accounts receivable, including accounts receivable within the Company s securitization program, and accounts payable and accrued expenses have carrying values which approximate fair value due to the short maturity or the financial nature of these instruments.

Investments and other assets in the condensed consolidated balance sheet includes the Company s investments in debt and equity securities related to the Company s pro-rata share of funding in the Newcastle Coal Infrastructure Group (NCIG). The investments are recorded at cost, which approximate fair value. See Note 13 to the Company s unaudited condensed consolidated financial statements for additional information related to NCIG.

Long-term debt fair value estimates are based on observed prices for securities with an active trading market when available, and otherwise on estimated borrowing rates to discount the cash flows to their present value. The carrying amounts of the 7.875% Senior Notes due 2026 and the Convertible Junior Subordinated Debentures due 2066 are net of the respective unamortized note discounts.

The carrying amounts and estimated fair values of the Company s debt are summarized as follows:

| | September 30, 2010 | | December 31, 2009 | |
|---|---|---|---|---|
| | Carrying Amount | Estimated Fair Value | Carrying Amount | Estimated Fair Value |
| | (Dollars in millions ) | | | |
| Long-term debt | $ 2,756.1 | $ 2,955.3 | $ 2,752.3 | $ 2,828.8 |

**PEABODY ENERGY CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(13) Commitments and Contingencies**

***Commitments***

As of September 30, 2010, purchase commitments for capital expenditures were $74.4 million.

The Company controls a 17.7% interest in NCIG, a coal transloading facility in Newcastle, Australia that is backed by take or pay agreements. The total loading capacity for stage one is 33 million tons per year, of which the Company s share is 5.8 millions tons. In the second quarter of 2010, stage one of construction was substantially completed and operations commenced. NCIG is currently operating at a reduced rate as part of its ramp-up to full capability, which is anticipated to occur by mid-2011. Phase one of stage two construction has been approved and is under way. When complete, it is expected to provide the Company with approximately 2 million tons of additional annual throughput capacity beginning in mid-year 2012. Financing for phase one of stage two of construction closed in the third quarter of 2010 with the Company providing its pro-rata share of funding of $59.7 million Australian dollars ($54.8 million U.S. dollars) where the Company received underlying debt and equity securities of NCIG for its contributions. Subsequent to the funding, the Company sold a portion of the debt securities for $10.6 million.

A subsidiary of the Company owns a 5.06% undivided interest in the Prairie State Energy Campus (Prairie State), a 1,600 megawatt coal-fuel electricity generation project currently under construction. The Company invested $52.5 million during the nine months ended September 30, 2010 representing its 5.06% share of the construction costs. Included in Investments and other assets in the condensed consolidated balance sheets as of September 30, 2010 and December 31, 2009, are costs of $179.1 million and $126.6 million, respectively. The Company s share of total construction costs for Prairie State is expected to be approximately $250 million.

The Company is an equity partner in GreenGen, a partnership to fund the construction in China of a near-zero emissions coal-fueled power plant with carbon capture and storage. During the nine months ended September 30, 2010, the Company spent $3.1 million representing its 6.0% share of the construction costs, which is reflected as capitalized development costs as part of Investments and other assets in the condensed consolidated balance sheet. There were no expenditures for GreenGen for 2009. The Company s share of total construction costs for GreenGen is expected to be approximately $60 million U.S. dollars.

***Contingencies***

From time to time, the Company or its subsidiaries are involved in legal proceedings arising in the ordinary course of business or related to indemnities or historical operations. The Company believes it has recorded adequate reserves for these liabilities and that there is no individual case pending that is likely to have a material adverse effect on the Company s financial condition, results of operations or cash flows. The Company discusses its significant legal proceedings below.

**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Litigation Relating to Continuing Operations*

*Navajo Nation Litigation.* On June 18, 1999, the Navajo Nation served three of the Company s subsidiaries, including Peabody Western Coal Company (Peabody Western), with a complaint that had been filed in the U.S. District Court for the District of Columbia. The Navajo Nation alleged 16 claims, including Civil Racketeer Influenced and Corrupt Organizations Act (RICO) violations and fraud. On April 12, 2010, the Navajo Nation filed an amended complaint to substantially narrow the scope of the Navajo Nation s claims by removing the RICO allegations but leaving the other 12 common law tort and contractual claims. The complaint alleges that the defendants jointly participated in unlawful activity to obtain favorable coal lease amendments. The plaintiff is seeking various remedies including actual damages of at least $600 million, punitive damages of at least $1 billion, a determination that Peabody Western s two coal leases terminated due to Peabody Western s breach of these leases and a reformation of these leases to adjust the royalty rate to 20%. The court has allowed the Hopi Tribe to intervene in this lawsuit and the Hopi Tribe is also seeking unspecified actual damages, punitive damages and reformation of its coal lease. One of the Company s subsidiaries named as a defendant is now a subsidiary of Patriot. However, the Company is responsible for this litigation under the Separation Agreement entered into with Patriot in connection with the spin-off. The U.S. Supreme Court has ruled against the Navajo Nation in a related case against the U.S. government, and remanded that case to the lower court to dismiss the complaint. The U.S. Supreme Court said that none of the sources relied on by the Navajo Nation provided a basis for its breach-of-trust lawsuit against the U.S. government, which undermines some of the claims the Navajo Nation asserts in its litigation against the Company.

In October 2010, the Company and the other defendants settled the Hopi claims and those claims have been dismissed by the court. The court ordered the Navajo Nation and the defendants to mediate the case.

The outcome of this litigation is subject to numerous uncertainties. Based on the Company s evaluation of the issues and their potential impact, the amount of any future loss cannot be reasonably estimated. However, based on current information, the Company believes this matter is likely to be resolved without a material adverse effect on the Company s financial condition, results of operations or cash flows.

*Gulf Power Company Litigation.* On June 22, 2006, Gulf Power Company (Gulf Power) filed a breach of contract lawsuit against a Company subsidiary in the U.S. District Court, Northern District of Florida, contesting the force majeure declaration by the Company s subsidiary under a coal supply agreement with Gulf Power and seeking damages for alleged past and future tonnage shortfalls of nearly five million tons under the agreement, which expired on December 31, 2007. Gulf Power filed a motion for partial summary judgment on liability, and the Company subsidiary filed a motion for summary judgment seeking complete dismissal. On June 30, 2009, the court granted Gulf Power s motion for partial summary judgment and denied the Company subsidiary s motion for summary judgment. The damages portion of the trial was held in February 2010. On September 30, 2010, the court entered its order on damages, awarding Gulf Power zero dollars in damages and the Company its costs to defend the lawsuit. The Company is also seeking its reasonable attorney s fees incurred since October 15, 2008. On November 1, 2010, Gulf Power filed a motion to alter or amend the judgement, contesting the trial court s damages order.

The outcome of this litigation is subject to numerous uncertainties. Based on the Company s evaluation of the issues and their potential impact, the amount of any future loss cannot reasonably be estimated. However, based on current information, the Company believes this matter is likely to be resolved without a material adverse effect on its financial condition, results of operations or cash flows.

*Claims and Litigation Relating to Indemnities or Historical Operations*

*Oklahoma Lead Litigation.* Gold Fields Mining, LLC (Gold Fields) is a dormant, non-coal producing entity that was previously managed and owned by Hanson PLC, the Company s predecessor owner. In a February 1997 spin-off, Hanson PLC transferred ownership of Gold Fields to the Company, despite the fact that Gold Fields had no ongoing operations and the Company had no prior involvement in its past operations. Gold Fields is currently one of the Company s subsidiaries. The Company indemnified TXU Group with respect to certain claims relating to a former affiliate of Gold Fields. A predecessor of Gold Fields formerly operated two lead mills near Picher, Oklahoma prior to the 1950s and mined, in accordance with lease agreements and permits, approximately 0.15% of the total amount of the crude ore mined in the county.

**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Gold Fields and several other companies are defendants in two property damage lawsuits arising from past operations near Picher, Oklahoma. The plaintiffs are seeking compensatory damages for diminution in property values and punitive damages. These cases were originally filed as putative class actions, but the court has denied class certification and the cases were subsequently amended to include a number of individual plaintiffs. In December 2003, the Quapaw Indian tribe and certain Quapaw land owners filed a lawsuit against Gold Fields, five other companies and the U.S. The plaintiffs are seeking compensatory and punitive damages based on a variety of theories. In December 2007, the court dismissed the tribe s medical monitoring claim. In July 2008, the court dismissed the tribe s claim for interim and lost use damages under the Comprehensive Environmental Response, Compensation and Liability Act without prejudice to refile at the point the U.S. Environmental Protection Agency (EPA) selects a final remedy for the site. Gold Fields has filed a third-party complaint against the U.S. and other parties. In February 2005, the state of Oklahoma on behalf of itself and several other parties sent a notice to Gold Fields and other companies regarding a possible natural resources damage claim. All of the lawsuits are pending in the U.S. District Court for the Northern District of Oklahoma.

In October 2010, the Company settled the Quapaw Indian tribe claims, and those claims have been dismissed by the court.

The outcome of litigation and these claims are subject to numerous uncertainties. Based on the Company s evaluation of the issues and their potential impact, the amount of any future loss cannot be reasonably estimated. However, based on current information, the Company believes this matter is likely to be resolved without a material adverse effect on its financial condition, results of operations or cash flows.

*Environmental Claims and Litigation*

Environmental claims have been asserted against Gold Fields related to activities of Gold Fields or a former affiliate. Gold Fields or the former affiliate has been named a potentially responsible party (PRP) at five national priority list sites based on the Superfund Amendments and Reauthorization Act of 1986. Claims were asserted at 13 additional sites, bringing the total to 18, which have since been reduced to 11 by completion of work, transfer or regulatory inactivity. The number of PRP sites in and of itself is not a relevant measure of liability because the nature and extent of environmental concerns varies by site, as does the estimated share of responsibility for Gold Fields or the former affiliate. Undiscounted liabilities for environmental cleanup-related costs for all of the sites noted above were $47.5 million as of September 30, 2010 and $49.5 million as of December 31, 2009, $5.3 million and $7.9 million of which was reflected as a current liability, respectively. These amounts represent those costs that the Company believes are probable and reasonably estimable. In June 2005, Gold Fields and other PRPs received a letter from the U.S. Department of Justice alleging that the PRP s mining operations caused the EPA to incur approximately $125 million in residential yard remediation costs at Picher, Oklahoma and will cause the EPA to incur additional remediation costs relating to historical mining sites. In June 2008, Gold Fields and other PRPs received letters from the U.S. Department of Justice and the EPA re-initiating settlement negotiations. Gold Fields continues to participate in the settlement discussions. Gold Fields believes it has meritorious defenses to these claims.

Gold Fields is involved in other litigation in the Picher area, and the Company indemnified TXU Group with respect to a defendant as is more fully discussed under the Oklahoma Lead Litigation caption above. Gold Fields has also been contacted by the state of Kansas (Kansas Department of Health and Environment) and is in negotiations for final resolution of natural resource damages claims at two sites. Significant uncertainty exists as to whether claims will be pursued against Gold Fields in all cases, and where they are pursued, the amount of the eventual costs and liabilities, which could be greater or less than the liabilities recorded in the condensed consolidated balance sheets. Based on the Company s evaluation of the issues and their potential impact, the total amount of any future loss cannot be reasonably estimated. However, based on current information, the Company believes these claims and litigation are likely to be resolved without a material adverse effect on its financial condition, results of operations or cash flows.

**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

*Comer, et al v. Murphy Oil Co., et al.* In April 2006, residents and owners of land and property along the Mississippi Gulf coast filed a purported class action lawsuit in the U.S. District Court in the Southern District of Mississippi against more than 45 oil, chemical, utility and coal companies, including the Company. The plaintiffs alleged that defendants greenhouse gas emissions were a proximate and direct cause of the increase in the destructive capacity of Hurricane Katrina, and sought damages based on several legal theories. The defendants filed motions to dismiss on the grounds of lack of personal and subject matter jurisdiction. In August 2007, the court granted defendants motion to dismiss for lack of subject matter jurisdiction finding that plaintiffs claims are barred by the political question doctrine and for lack of standing. In October 2009, a three-judge panel of the U.S. Court of Appeals for the Fifth Circuit (Fifth Circuit) reversed in part the decision of the trial court, holding that the plaintiffs had standing to assert their public and private nuisance, trespass and negligence claims. The court held that plaintiffs did not satisfy the prudential standing requirement for their unjust enrichment, fraudulent misrepresentation and civil conspiracy claims and dismissed those claims and ordered that the case be remanded to the district court for further proceedings. In March 2010, the Fifth Circuit vacated the panel opinion and ordered a hearing en banc before the full Fifth Circuit to consider plaintiffs appeal. After the en banc court was properly constituted, a recusal by one of the judges resulted in the en banc court losing its quorum. On May 28, 2010, the Fifth Circuit issued an order indicating that the court had no authority to reinstate the panel decision and directing the clerk to dismiss the appeal. Plaintiffs have filed a Petition for Mandamus with the United States Supreme Court. The Company believes that this lawsuit is without merit and intends to defend against and oppose it vigorously, but cannot predict its outcome. Based on the Company s evaluation of the issues and their potential impact, the amount of any future loss cannot be reasonably estimated. However, based on current information, the Company believes this matter is likely to be resolved without a material adverse effect on its financial condition, results of operations or cash flows.

*Native Village of Kivalina and City of Kivalina v. ExxonMobil Corporation, et al.* In February 2008, the Native Village of Kivalina and the City of Kivalina filed a lawsuit in the U.S. District Court for the Northern District of California against the Company, several owners of electricity generating facilities and several oil companies. The plaintiffs are the governing bodies of a village in Alaska that they contend is being destroyed by erosion allegedly caused by global warming that the plaintiffs attribute to emissions of greenhouse gases by the defendants. The plaintiffs assert claims for nuisance, and allege that the defendants have acted in concert and are jointly and severally liable for the plaintiffs damages. The suit seeks damages for lost property values and for the cost of relocating the village. The defendants filed motions to dismiss on the grounds of lack of personal and subject matter jurisdiction. In June 2009, the court granted defendants motion to dismiss for lack of subject matter jurisdiction finding that plaintiffs federal claim for nuisance is barred by the political question doctrine and for lack of standing. The plaintiffs are appealing the court s dismissal to the U.S. Court of Appeals for the Ninth Circuit. The plaintiffs and the defendants have filed their briefs with the court.

*Other*

In addition, at times the Company becomes a party to other claims, lawsuits, arbitration proceedings and administrative procedures in the ordinary course of business in the U.S., Australia and other countries where the Company does business. Based on current information, the Company believes that the ultimate resolution of such other pending or threatened proceedings is not reasonably likely to have a material adverse effect on its financial position, results of operations or liquidity.

*New York Office of the Attorney General Subpoena.* The New York Office of the Attorney General sent a letter to the Company dated June 14, 2007 that referred to the Company s plans to build new coal-fired electric generating units, and said that the increase in $CO_2$ emissions from the operation of these units, in combination with Peabody Energy s other coal-fired power plants, will subject Peabody Energy to increased financial, regulatory, and litigation risks. The Company currently has no electricity generating capacity in place. The letter included a subpoena issued under New York state law, which seeks information and documents relating to the Company s analysis of the risks associated with climate change and possible climate change legislation or regulations, and its disclosure of such risks to investors. The Company believes that it has made full and proper disclosure of these potential risks.

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PEABODY ENERGY CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**(14) Guarantees and Financial Instruments with Off-Balance-Sheet Risk**

In the normal course of business, the Company is a party to guarantees and financial instruments with off-balance-sheet risk, such as bank letters of credit, performance or surety bonds and other guarantees and indemnities, which are not reflected in the accompanying condensed consolidated balance sheets. Such financial instruments are valued based on the amount of exposure under the instrument and the likelihood of required performance. In the Company s past experience, virtually no claims have been made against these financial instruments. Management does not expect any material losses to result from these guarantees or off-balance-sheet instruments.

***Letters of Credit and Bonding***

The Company has letters of credit, bank guarantees, surety bonds and corporate guarantees (such as self bonds) in support of the Company s reclamation, coal lease and workers compensation obligations as follows as of September 30, 2010:

| | Reclamation Obligations | Lease Obligations | Workers Compensation Obligations | Other (1) | Total |
|---|---|---|---|---|---|
| | | | (Dollars in millions) | | |
| Self bonding | $ 899.0 | $ | $ | $ | $ 899.0 |
| Surety bonds | 577.3 | 110.3 | 7.3 | 9.3 | 704.2 |
| Bank guarantees | 109.5 | | | 120.2 | 229.7 |
| Letters of credit | 0.1 | | 37.3 | 207.9 | 245.3 |
| | $ 1,585.9 | $ 110.3 | $ 44.6 | $ 337.4 | $ 2,078.2 |

(1) Other includes letters of credit obligations described below and an additional $129.5 million in letters of credit, bank guarantees, and surety bonds related to collateral for surety companies, road maintenance, performance guarantees and other operations.

The Company owns a 37.5% interest in Dominion Terminal Associates, a partnership that operates a coal export terminal in Newport News, Virginia under a 30-year lease that permits the partnership to purchase the terminal at the end of the lease term for a nominal amount. The partners have severally (but not jointly) agreed to make payments under various agreements which in the aggregate provide the partnership with sufficient funds to pay rents and to cover the principal and interest payments on the floating-rate industrial revenue bonds issued by the Peninsula Ports Authority, and which are supported by letters of credit from a commercial bank. As of September 30, 2010, the Company s maximum reimbursement obligation to the commercial bank was in turn supported by four letters of credit totaling $42.7 million.

The Company is party to an agreement with the Pension Benefit Guaranty Corporation (PBGC) and TXU Europe Limited, an affiliate of the Company s former parent corporation, under which the Company is required to make special contributions to two of the Company s defined benefit pension plans and to maintain a $37.0 million letter of credit in favor of the PBGC. If the Company or the PBGC gives notice of an intent to terminate one or more of the covered pension plans in which liabilities are not fully funded, or if the Company fails to maintain the letter of credit, the PBGC may draw down on the letter of credit and use the proceeds to satisfy liabilities under the Employee Retirement Income Security Act of 1974, as amended. The PBGC, however, is required to first apply amounts received from a $110.0 million guarantee in place from TXU Europe Limited in favor of the PBGC before it draws on the Company s letter of credit. On November 19, 2002, TXU Europe Limited was placed under the administration process in the United Kingdom (a process similar to bankruptcy proceedings in the U.S.) and continues under this process as of September 30, 2010. As a result of these proceedings, TXU Europe Limited may be liquidated or otherwise reorganized in such a way as to relieve it of its obligations under its guarantee.

At September 30, 2010, the Company has a $128.2 million letter of credit issued with respect to certain reclamation and performance obligations related to some of the Company s Australian mines.

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

***Other Guarantees***

The Company has a liability recorded of $52.3 million as of September 30, 2010 and December 31, 2009 related to reclamation and bonding commitments associated with the purchase of approximately 427 million tons of coal reserves and surface lands in the Illinois Basin in 2007.

The Company is the lessee under numerous equipment and property leases. It is common in such commercial lease transactions for the Company, as the lessee, to agree to indemnify the lessor for the value of the property or equipment leased, should the property be damaged or lost during the course of the Company s operations. The Company expects that losses with respect to leased property would be covered by insurance (subject to deductibles). The Company and certain of its subsidiaries have guaranteed other subsidiaries performance under their various lease obligations. Aside from indemnification of the lessor for the value of the property leased, the Company s maximum potential obligations under its leases are equal to the respective future minimum lease payments, and the Company assumes that no amounts could be recovered from third parties.

In connection with the development of Prairie State, each owner, including the Company s subsidiary, has issued a guarantee for its proportionate share (5.06% for the Company) of obligations to pay its percentage of the construction costs under the Target Price Engineering, Procurement and Construction Agreement with Bechtel Power Corporation.

The Company has provided financial guarantees under certain long-term debt agreements entered into by its subsidiaries, and substantially all of the Company s subsidiaries provide financial guarantees under long-term debt agreements entered into by the Company. The maximum amounts payable under the Company s debt agreements are equal to the respective principal and interest payments.

*Accounts Receivable Securitization.* The Company has an accounts receivable securitization program (securitization program) through its wholly-owned, bankruptcy-remote subsidiary (Seller). Under the securitization program, beginning in 2010, the Company contributes, on a revolving basis, trade receivables of most of the Company s U.S. subsidiaries to the Seller, which then sells the receivables in their entirety to a consortium of unaffiliated asset-backed commercial paper conduits (the Conduits). After the sale, the Company, as servicer of the assets, collects the receivables on behalf of the Conduits for a nominal servicing fee. The Company utilizes proceeds from the sale of its accounts receivable as an alternative to short-term borrowings under the Company s Credit Facility, effectively managing its overall borrowing costs and providing an additional source for working capital. The securitization program was renewed in May 2009 and amended in December 2009 in order to qualify for sale accounting under a newly adopted accounting standard related to financial asset transfers. Prior to amending the securitization program, the Company sold senior undivided interests in certain of its accounts receivable and retained subordinated interests in those receivables. The current securitization program extends to May 2012, while the letter of credit commitment that supports the commercial paper facility underlying the securitization program must be renewed annually.

The Seller is a separate legal entity whose assets are available first and foremost to satisfy the claims of its creditors. Of the receivables sold to the Conduits, a portion of the amount due to the Seller is deferred until the ultimate collection of the underlying receivables. During the nine months ended September 30, 2010, the Company received total consideration of $3,381.9 million related to accounts receivable sold under the securitization program, including $1,517.3 million of cash up front from the sale of the receivables, an additional $1,650.8 million of cash upon the collection of the underlying receivables, and $213.8 million that had not been collected at September 30, 2010 and was recorded at fair value which approximates carrying value. The reduction in accounts receivable as a result of securitization activity with the Conduits was $100.0 million at September 30, 2010 and $254.6 million at December 31, 2009.

The securitization activity has been reflected in the unaudited condensed consolidated statements of cash flows as operating activity because both the cash received from the Conduits upon sale of receivables as well as the cash received from the Conduits upon the ultimate collection of receivables are not subject to significantly different risks given the short-term nature of the Company s trade receivables. The Company recorded expense associated with securitization transactions of $0.6 million and $1.1 million for the three months ended September 30, 2010 and 2009, respectively and $1.8 million and $3.4 million for the nine months ended September 30, 2010 and 2009, respectively.

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**PEABODY ENERGY CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(15) Supplemental Guarantor/Non-Guarantor Financial Information**

In accordance with the indentures governing the 6.875% Senior Notes due March 2013 (extinguished in the third quarter of 2010), the 5.875% Senior Notes due March 2016, the 7.375% Senior Notes due November 2016, the 6.5% Senior Notes due September 2020 and the 7.875% Senior Notes due November 2026 (collectively the Senior Notes), certain wholly-owned U.S. subsidiaries of the Company have fully and unconditionally guaranteed these Senior Notes, on a joint and several basis. Separate financial statements and other disclosures concerning the Guarantor Subsidiaries are not presented because management believes that such information is not material to the holders of the Senior Notes. The following historical financial statement information is provided for the Guarantor/Non-Guarantor Subsidiaries.

**Unaudited Supplemental Condensed Consolidated Statements of Operations**

| | Three Months Ended September 30, 2010 | | | | |
|---|---|---|---|---|---|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| | (Dollars in millions) | | | | |
| Total revenues | $ | $ 1,059.9 | $ 1,045.3 | $ (240.5) | $ 1,864.7 |
| Costs and expenses | | | | | |
| Operating costs and expenses | (24.8) | 763.9 | 744.7 | (240.5) | 1,243.3 |
| Depreciation, depletion and amortization | | 76.2 | 40.5 | | 116.7 |
| Asset retirement obligation expense | | 7.1 | 2.8 | | 9.9 |
| Selling and administrative expenses | 5.5 | 47.3 | 1.3 | | 54.1 |
| Other operating (income) loss: | | | | | |
| Net (gain) loss on disposal or exchange of assets | | (7.1) | 0.4 | | (6.7) |
| (Income) loss from equity affiliates | (248.5) | 1.3 | 1.4 | 248.5 | 2.7 |
| Interest expense | 61.6 | 13.9 | 3.7 | (17.0) | 62.2 |
| Interest income | (4.0) | (5.2) | (10.6) | 17.0 | (2.8) |
| Income from continuing operations before income taxes | 210.2 | 162.5 | 261.1 | (248.5) | 385.3 |
| Income tax provision (benefit) | (14.8) | 55.1 | 107.4 | | 147.7 |
| Income from continuing operations, net of income taxes | 225.0 | 107.4 | 153.7 | (248.5) | 237.6 |
| Loss from discontinued operations, net of income taxes | (0.9) | (0.4) | | | (1.3) |
| Net income | 224.1 | 107.0 | 153.7 | (248.5) | 236.3 |
| Less: Net income attributable to noncontrolling interests | | | 12.2 | | 12.2 |
| Net income attributable to common stockholders | $ 224.1 | $ 107.0 | $ 141.5 | $ (248.5) | $ 224.1 |

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**Unaudited Supplemental Condensed Consolidated Statements of Operations**

| | Three Months Ended September 30, 2009 | | | | |
|---|---|---|---|---|---|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| | (Dollars in millions) | | | | |
| Total revenues | $ | $ 1,212.5 | $ 702.2 | $ (247.7) | $ 1,667.0 |
| Costs and expenses | | | | | |
| Operating costs and expenses | 19.5 | 921.5 | 569.2 | (247.7) | 1,262.5 |
| Depreciation, depletion and amortization | | 72.6 | 35.4 | | 108.0 |
| Asset retirement obligation expense | | 10.9 | 1.9 | | 12.8 |
| Selling and administrative expenses | 7.1 | 46.0 | 1.1 | | 54.2 |
| Other operating (income) loss: | | | | | |
| Net gain on disposal or exchange of assets | | (2.6) | (0.2) | | (2.8) |
| (Income) loss from equity affiliates | (155.4) | 1.6 | 10.4 | 155.4 | 12.0 |
| Interest expense | 51.2 | 14.6 | 6.6 | (20.1) | 52.3 |
| Interest income | (3.8) | (8.1) | (10.4) | 20.1 | (2.2) |
| Income from continuing operations before income taxes | 81.4 | 156.0 | 88.2 | (155.4) | 170.2 |
| Income tax provision (benefit) | (28.5) | 53.2 | 32.3 | | 57.0 |
| Income from continuing operations, net of income taxes | 109.9 | 102.8 | 55.9 | (155.4) | 113.2 |
| Income (loss) from discontinued operations, net of income taxes | (3.1) | (0.9) | 1.6 | | (2.4) |
| Net income | 106.8 | 101.9 | 57.5 | (155.4) | 110.8 |
| Less: Net income attributable to noncontrolling interests | | | 4.0 | | 4.0 |
| Net income attributable to common stockholders | $ 106.8 | $ 101.9 | $ 53.5 | $ (155.4) | $ 106.8 |

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**Unaudited Supplemental Condensed Consolidated Statements of Operations**

| | Nine Months Ended September 30, 2010 | | | | |
|---|---|---|---|---|---|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| | | | (Dollars in millions) | | |
| Total revenues | $ | $ 3,123.9 | $ 2,530.5 | $ (612.7) | $ 5,041.7 |
| Costs and expenses | | | | | |
| Operating costs and expenses | (65.7) | 2,286.2 | 1,918.9 | (612.7) | 3,526.7 |
| Depreciation, depletion and amortization | | 221.3 | 106.0 | | 327.3 |
| Asset retirement obligation expense | | 22.1 | 8.2 | | 30.3 |
| Selling and administrative expenses | 23.0 | 133.8 | 6.8 | | 163.6 |
| Other operating (income) loss: | | | | | |
| Net (gain) loss on disposal or exchange of assets | | (15.6) | 0.2 | | (15.4) |
| (Income) loss from equity affiliates | (639.6) | 5.0 | 4.4 | 628.1 | (2.1) |
| Interest expense | 168.6 | 39.4 | 11.2 | (49.1) | 170.1 |
| Interest income | (11.6) | (16.1) | (26.8) | 49.1 | (5.4) |
| Income from continuing operations before income taxes | 525.3 | 447.8 | 501.6 | (628.1) | 846.6 |
| Income tax provision (benefit) | (39.6) | 143.0 | 153.8 | | 257.2 |
| Income from continuing operations, net of income taxes | 564.9 | 304.8 | 347.8 | (628.1) | 589.4 |
| Loss from discontinued operations, net of income taxes | (0.9) | (1.3) | | | (2.2) |
| Net income | 564.0 | 303.5 | 347.8 | (628.1) | 587.2 |
| Less: Net income attributable to noncontrolling interests | | | 23.2 | | 23.2 |
| Net income attributable to common stockholders | $ 564.0 | $ 303.5 | $ 324.6 | $ (628.1) | $ 564.0 |

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**Unaudited Supplemental Condensed Consolidated Statements of Operations**

| | Nine Months Ended September 30, 2009 | | | | |
|---|---|---|---|---|---|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Eliminations | Consolidated |
| | (Dollars in millions) | | | | |
| Total revenues | $ | $ 3,313.5 | $ 1,647.8 | $ (503.1) | $ 4,458.2 |
| Costs and expenses | | | | | |
| Operating costs and expenses | 142.4 | 2,493.7 | 1,180.1 | (503.1) | 3,313.1 |
| Depreciation, depletion and amortization | | 216.0 | 89.5 | | 305.5 |
| Asset retirement obligation expense | | 28.1 | 3.7 | | 31.8 |
| Selling and administrative expenses | 21.2 | 120.0 | 4.7 | | 145.9 |
| Other operating (income) loss: | | | | | |
| Net gain on disposal or exchange of assets | | (10.0) | (6.2) | | (16.2) |
| (Income) loss from equity affiliates | (514.1) | 4.9 | 17.8 | 514.1 | 22.7 |
| Interest expense | 149.0 | 50.5 | 12.2 | (60.1) | 151.6 |
| Interest income | (11.5) | (29.1) | (25.7) | 60.1 | (6.2) |
| Income from continuing operations before income taxes | 213.0 | 439.4 | 371.7 | (514.1) | 510.0 |
| Income tax provision (benefit) | (115.9) | 123.5 | 158.0 | | 165.6 |
| Income from continuing operations, net of income taxes | 328.9 | 315.9 | 213.7 | (514.1) | 344.4 |
| Income (loss) from discontinued operations, net of income taxes | 27.1 | (2.1) | (1.4) | | 23.6 |
| Net income | 356.0 | 313.8 | 212.3 | (514.1) | 368.0 |
| Less: Net income attributable to noncontrolling interests | | | 12.0 | | 12.0 |
| Net income attributable to common stockholders | $ 356.0 | $ 313.8 | $ 200.3 | $ (514.1) | $ 356.0 |

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**Unaudited Supplemental Condensed Consolidated Balance Sheets**

| | September 30, 2010 | | | | |
|---|---|---|---|---|---|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Reclassifications/ Eliminations | Consolidated |
| | (Dollars in millions) | | | | |
| **Assets** | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | $ 481.3 | $ 0.1 | $ 886.1 | $ | $ 1,367.5 |
| Accounts receivable, net | 1.0 | 8.6 | 573.7 | | 583.3 |
| Inventories | | 176.6 | 219.7 | | 396.3 |
| Assets from coal trading activities, net | | 30.2 | 140.3 | | 170.5 |
| Deferred income taxes | 11.6 | 68.0 | | (13.4) | 66.2 |
| Other current assets | 231.5 | 27.1 | 73.0 | | 331.6 |
| Total current assets | 725.4 | 310.6 | 1,892.8 | (13.4) | 2,915.4 |
| Property, plant, equipment and mine development | | | | | |
| Land and coal interests | | 4,823.5 | 2,763.2 | | 7,586.7 |
| Buildings and improvements | | 856.4 | 130.3 | | 986.7 |
| Machinery and equipment | | 1,249.3 | 310.7 | | 1,560.0 |
| Less: accumulated depreciation, depletion and amortization | | (2,307.0) | (607.3) | | (2,914.3) |
| Property, plant, equipment and mine development, net | | 4,622.2 | 2,596.9 | | 7,219.1 |
| Deferred income taxes | 11.6 | | | (11.6) | |
| Investments and other assets | 9,998.7 | 175.8 | 100.4 | (9,436.8) | 838.1 |
| Total assets | $ 10,735.7 | $ 5,108.6 | $ 4,590.1 | $ (9,461.8) | $ 10,972.6 |
| **Liabilities and Stockholders Equity** | | | | | |
| Current liabilities | | | | | |
| Current maturities of long-term debt | $ 25.0 | $ | $ 16.5 | $ | $ 41.5 |
| Payables to (receivables from) affiliates, net | 2,671.9 | (2,681.6) | 9.7 | | |
| Liabilities from coal trading activities, net | | 22.5 | 29.4 | | 51.9 |
| Deferred income taxes | | | 13.4 | (13.4) | |
| Accounts payable and accrued expenses | 91.5 | 752.1 | 474.3 | | 1,317.9 |
| Total current liabilities | 2,788.4 | (1,907.0) | 543.3 | (13.4) | 1,411.3 |

| | | | | | |
|---|---|---|---|---|---|
| Long-term debt, less current maturities | 2,615.5 | 0.1 | 99.0 | | 2,714.6 |
| Deferred income taxes | | 275.4 | 284.1 | (11.6) | 547.9 |
| Notes payable to (receivables from) affiliates, net | 819.1 | (841.7) | 22.6 | | |
| Other noncurrent liabilities | 59.0 | 1,654.1 | 106.8 | | 1,819.9 |
| Total liabilities | 6,282.0 | (819.1) | 1,055.8 | (25.0) | 6,493.7 |
| Peabody Energy Corporation s stockholders equity | 4,453.7 | 5,927.7 | 3,509.1 | (9,436.8) | 4,453.7 |
| Noncontrolling interests | | | 25.2 | | 25.2 |
| Total stockholders equity | 4,453.7 | 5,927.7 | 3,534.3 | (9,436.8) | 4,478.9 |
| Total liabilities and stockholders equity | $ 10,735.7 | $ 5,108.6 | $ 4,590.1 | $ (9,461.8) | $ 10,972.6 |

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**Unaudited Supplemental Condensed Consolidated Balance Sheets**

| | December 31, 2009 | | | | |
|---|---|---|---|---|---|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Reclassifications/ Eliminations | Consolidated |
| | (Dollars in millions) | | | | |
| **Assets** | | | | | |
| Current assets | | | | | |
| Cash and cash equivalents | $ 368.4 | $ 0.2 | $ 620.2 | $ | $ 988.8 |
| Accounts receivable, net | 0.6 | 55.5 | 246.9 | | 303.0 |
| Inventories | | 152.5 | 172.6 | | 325.1 |
| Assets from coal trading activities, net | | 92.8 | 184.0 | | 276.8 |
| Deferred income taxes | 11.6 | 56.5 | | (28.1) | 40.0 |
| Other current assets | 133.9 | 30.7 | 90.7 | | 255.3 |
| Total current assets | 514.5 | 388.2 | 1,314.4 | (28.1) | 2,189.0 |
| Property, plant, equipment and mine development | | | | | |
| Land and coal interests | | 4,807.3 | 2,750.0 | | 7,557.3 |
| Buildings and improvements | | 783.4 | 124.6 | | 908.0 |
| Machinery and equipment | | 1,117.3 | 273.9 | | 1,391.2 |
| Less: accumulated depreciation, depletion and amortization | | (2,096.6) | (498.4) | | (2,595.0) |
| Property, plant, equipment and mine development, net | | 4,611.4 | 2,650.1 | | 7,261.5 |
| Deferred income taxes | 124.0 | | | (124.0) | |
| Investments and other assets | 8,893.5 | 110.5 | 32.0 | (8,531.2) | 504.8 |
| Total assets | $ 9,532.0 | $ 5,110.1 | $ 3,996.5 | $ (8,683.3) | $ 9,955.3 |
| **Liabilities and Stockholders Equity** | | | | | |
| Current liabilities | | | | | |
| Current maturities of long-term debt | $ | $ | $ 14.1 | $ | $ 14.1 |
| Payables to (receivables from) affiliates, net | 1,937.2 | (1,975.9) | 38.7 | | |
| Liabilities from coal trading activities, net | | 45.1 | 65.5 | | 110.6 |
| Deferred income taxes | | | 28.1 | (28.1) | |
| Accounts payable and accrued expenses | 106.6 | 661.7 | 419.4 | | 1,187.7 |
| Total current liabilities | 2,043.8 | (1,269.1) | 565.8 | (28.1) | 1,312.4 |

| | | | | | |
|---|---|---|---|---|---|
| Long-term debt, less current maturities | 2,635.4 | 0.1 | 102.7 | | 2,738.2 |
| Deferred income taxes | | 173.3 | 249.8 | (124.0) | 299.1 |
| Notes payable to (receivables from) affiliates, net | 1,032.5 | (1,035.0) | 2.5 | | |
| Other noncurrent liabilities | 70.6 | 1,667.8 | 111.3 | | 1,849.7 |
| Total liabilities | 5,782.3 | (462.9) | 1,032.1 | (152.1) | 6,199.4 |
| Peabody Energy Corporation s stockholders equity | 3,749.7 | 5,573.0 | 2,958.2 | (8,531.2) | 3,749.7 |
| Noncontrolling interests | | | 6.2 | | 6.2 |
| Total stockholders equity | 3,749.7 | 5,573.0 | 2,964.4 | (8,531.2) | 3,755.9 |
| Total liabilities and stockholders equity | $ 9,532.0 | $ 5,110.1 | $ 3,996.5 | $ (8,683.3) | $ 9,955.3 |

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**Unaudited Supplemental Condensed Consolidated Statements of Cash Flows**

| | Nine Months Ended September 30, 2010 | | | |
|---|---|---|---|---|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidated |
| | (Dollars in millions) | | | |
| **Cash Flows From Operating Activities** | | | | |
| **Net cash provided by (used in) continuing operations** | $ (331.4) | $ 1,002.7 | $ 223.8 | $ 895.1 |
| Net cash used in discontinued operations | (9.5) | (1.8) | | (11.3) |
| Net cash provided by (used in) operating activities | (340.9) | 1,000.9 | 223.8 | 883.8 |
| **Cash Flows From Investing Activities** | | | | |
| Additions to property, plant, equipment and mine development | | (238.1) | (53.2) | (291.3) |
| Investment in Prairie State Energy Campus | | (52.5) | | (52.5) |
| Proceeds from disposal of assets, net of notes receivable | | 8.5 | 1.2 | 9.7 |
| Investment in equity affiliates and joint ventures | | (15.0) | (3.8) | (18.8) |
| Investments in debt and equity securities | | | (73.6) | (73.6) |
| Proceeds from sale of debt securities | | | 10.6 | 10.6 |
| Other, net | | (7.2) | (0.2) | (7.4) |
| Net cash used in investing activities | | (304.3) | (119.0) | (423.3) |
| **Cash Flows From Financing Activities** | | | | |
| Proceeds from long-term debt | 1,150.0 | | | 1,150.0 |
| Payments of long-term debt | (1,140.3) | | (8.2) | (1,148.5) |
| Dividends paid | (56.5) | | | (56.5) |
| Payment of debt issuance costs | (32.2) | | | (32.2) |
| Proceeds from stock options exercised | 5.9 | | | 5.9 |
| Other, net | 5.8 | | (6.3) | (0.5) |
| Transactions with affiliates, net | 521.1 | (696.7) | 175.6 | |
| Net cash provided by (used in) financing activities | 453.8 | (696.7) | 161.1 | (81.8) |
| Net change in cash and cash equivalents | 112.9 | (0.1) | 265.9 | 378.7 |
| Cash and cash equivalents at beginning of period | 368.4 | 0.2 | 620.2 | 988.8 |
| Cash and cash equivalents at end of period | $ 481.3 | $ 0.1 | $ 886.1 | $ 1,367.5 |

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**PEABODY ENERGY CORPORATION**
**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**
**Unaudited Supplemental Condensed Consolidated Statements of Cash Flows**

| | Nine Months Ended September 30, 2009 | | | |
|---|---|---|---|---|
| | Parent Company | Guarantor Subsidiaries | Non-Guarantor Subsidiaries | Consolidated |
| | (Dollars in millions) | | | |
| **Cash Flows From Operating Activities** | | | | |
| **Net cash provided by (used in) continuing operations** | $ (114.0) | $ 445.9 | $ 341.6 | $ 673.5 |
| Net cash provided by (used in) discontinued operations | 1.4 | (3.4) | (4.2) | (6.2) |
| Net cash provided by (used in) operating activities | (112.6) | 442.5 | 337.4 | 667.3 |
| **Cash Flows From Investing Activities** | | | | |
| Additions to property, plant, equipment and mine development | | (112.1) | (31.8) | (143.9) |
| Investment in Prairie State Energy Campus | | (41.6) | | (41.6) |
| Federal coal lease expenditures | | (123.6) | | (123.6) |
| Proceeds from disposal of assets, net of notes receivable | | 37.5 | 10.0 | 47.5 |
| Investments in equity affiliates and joint ventures | | | (10.0) | (10.0) |
| Other, net | | (4.8) | (0.1) | (4.9) |
| Net cash used in investing activities | | (244.6) | (31.9) | (276.5) |
| **Cash Flows From Financing Activities** | | | | |
| Payments of long-term debt | | | (11.4) | (11.4) |
| Dividends paid | (48.1) | | | (48.1) |
| Proceeds from stock options exercised | 1.1 | | | 1.1 |
| Other, net | 5.1 | | 3.6 | 8.7 |
| Transactions with affiliates, net | 160.6 | (199.6) | 39.0 | |
| Net cash provided by (used in) financing activities | 118.7 | (199.6) | 31.2 | (49.7) |
| Net change in cash and cash equivalents | 6.1 | (1.7) | 336.7 | 341.1 |
| Cash and cash equivalents at beginning of period | 161.2 | 4.5 | 284.0 | 449.7 |
| Cash and cash equivalents at end of period | $ 167.3 | $ 2.8 | $ 620.7 | $ 790.8 |

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**Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.**
**Cautionary Notice Regarding Forward-Looking Statements**

This report includes statements of our expectations, intentions, plans and beliefs that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are intended to come within the safe harbor protection provided by those sections. These statements relate to future events or our future financial performance, including, without limitation, the section captioned Outlook in Management s Discussion and Analysis of Financial Condition and Results of Operations. We use words such as anticipate, believe, expect, may, project, should, estimate, or plan or other similar wo forward-looking statements.

Without limiting the foregoing, all statements relating to our future operating results, anticipated capital expenditures, future cash flows and borrowings, and sources of funding are forward-looking statements and speak only as of the date of this report. These forward-looking statements are based on numerous assumptions that we believe are reasonable, but are subject to a wide range of uncertainties and business risks and actual results may differ materially from those discussed in these statements. Among the factors that could cause actual results to differ materially are:

- demand for coal in United States (U.S.) and the Pacific Rim thermal and metallurgical coal seaborne markets;
- price volatility and demand, particularly in higher-margin products and in our trading and brokerage businesses;
- reductions and/or deferrals of purchases by major customers and ability to renew sales contracts;
- credit and performance risks associated with customers, suppliers, co-shippers, trading, banks and other financial counterparties;
- geologic, equipment, permitting and operational risks related to mining;
- transportation availability, performance and costs;
- availability, timing of delivery and costs of key supplies, capital equipment or commodities such as diesel fuel, steel, explosives and tires;
- impact of weather on demand, production and transportation;
- successful implementation of business strategies, including our Btu Conversion and generation development initiatives;
- negotiation of labor contracts, employee relations and workforce availability;
- changes in postretirement benefit and pension obligations and funding requirements;
- replacement and development of coal reserves;
- access to capital and credit markets and availability and costs of credit, margin capacity, surety bonds, letters of credit, and insurance;
- effects of changes in interest rates and currency exchange rates (primarily the Australian dollar);
- effects of acquisitions or divestitures;

economic strength and political stability of countries in which we have operations or serve customers;

legislation, regulations and court decisions or other government actions, including new environmental requirements, changes in income tax regulations or other regulatory taxes;

litigation, including claims not yet asserted;

terrorist attacks or threats;

impacts of pandemic illnesses; and

other factors, including those discussed in Legal Proceedings.

When considering these forward-looking statements, you should keep in mind the cautionary statements in this document and in our other Securities and Exchange Commission (SEC) filings, including the more detailed discussion of these factors, as well as other factors that could affect our results, contained in Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2009. These forward-looking statements speak only as of the date on which such statements were made, and we undertake no obligation to update these statements except as required by federal securities laws.

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## Overview

We are the world s largest private sector coal company, with majority interests in 28 coal mining operations in the U.S. and Australia. In 2009, we produced 210.0 million tons of coal and sold 243.6 million tons of coal.

We typically sell coal to utility customers under long-term contracts (those with terms longer than one year). During 2009, approximately 93% of our worldwide sales (by volume) were under long-term contracts. For the year ended December 31, 2009, 81% of our total sales (by volume) were to U.S. electricity generators, 17% were to customers outside the U.S. and 2% were to the U.S. industrial sector. We conduct business through four principal operating segments: Western U.S. Mining, Midwestern U.S. Mining, Australian Mining, and Trading and Brokerage. Our fifth segment, Corporate and Other, includes mining and export/transportation joint ventures, energy-related commercial activities, as well as the management of our vast coal reserve and real estate holdings.

We continue to explore Btu Conversion projects designed to expand the uses of coal through coal-to-liquids and coal gasification technologies. We are also participating in the advancement of clean coal technologies, including carbon capture and storage, in the U.S., China and Australia.

## Results of Operations

The results of operations for all periods presented reflect the assets, liabilities and results of operations from subsidiaries spun off as Patriot Coal Corporation as discontinued operations. We also have classified as discontinued operations those operations recently divested, as well as certain non-strategic mining assets held for sale where we have committed to the divestiture of such assets.

## Adjusted EBITDA

The discussion of our results of operations below includes references to and analysis of our segments Adjusted EBITDA results. We define Adjusted EBITDA as income from continuing operations before deducting net interest expense, income taxes, asset retirement obligation expense and depreciation, depletion and amortization. Adjusted EBITDA is used by management to measure our segments operating performance, and management also believes it is a useful indicator of our ability to meet debt service and capital expenditure requirements. Because Adjusted EBITDA is not calculated identically by all companies, our calculation may not be comparable to similarly titled measures of other companies. Adjusted EBITDA is reconciled to its most comparable measure, under U.S. generally accepted accounting principles (GAAP), in Note 11 to our unaudited condensed consolidated financial statements.

## Three and Nine Months Ended September 30, 2010 Compared to Three and Nine Months Ended September 30, 2009

### *Summary*

According to industry reports filed through September 2010, demand for seaborne metallurgical and thermal coal products continued to strengthen in the Pacific, averaging 15% above prior year levels due to increased demand in China, India and other Asian nations that continue to recover from the recession. In the U.S., coal market fundamentals have improved due to a combination of weather-related demand, new coal-fueled facilities, less coal-to-gas switching and increased exports. Our analyses of general business conditions indicate the following:

- Benchmark high quality, hard-coking coal from Australia has maintained quarterly prices between $200 and $225 per tonne since April 2010;
- Index prices for Australian seaborne thermal coal are 35 40% above prior year levels;
- U.S. coal production through September 2010 is approximately 2% below 2009 levels;
- U.S. coal consumption for electricity generation has increased nearly 6.5% through September 2010; and
- Customer inventories of Powder River Basin coal have been decreasing in 2010 and are at approximately 56 days of use as of September 2010.

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We continue to focus on productivity improvements and increasing contributions from our high-margin operations. We ended the quarter with total available liquidity of $2.8 billion, consisting of cash on hand and available capacity under our revolving credit facility and our accounts receivable securitization program.

Revenue increased for both periods compared to the prior year (three months, $197.7 million; nine months, $583.5 million) and Segment Adjusted EBITDA increased over the prior year (three months, $232.4 million; nine months, $399.1 million) led by higher Australian sales volumes and higher pricing secured in the second and third quarters of the current year.

Income from continuing operations, net of income taxes, increased for both periods compared to the prior year (three months, $124.4 million; nine months, $245.0 million) due to the increase in Segment Adjusted EBITDA discussed above, partially offset by increased income taxes, decreased Corporate and Other Adjusted EBITDA, and increased depreciation, depletion and amortization and interest expense.

***Tons Sold***

The following table presents tons sold by operating segment:

| | Three Months Ended September 30, | | Increase (Decrease) | | Nine Months Ended September 30, | | Increase (Decrease) | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | 2009 | Tons | % | 2010 | 2009 | Tons | % |
| | (Tons in millions) | | | | | | | |
| Western U.S. Mining | 41.9 | 42.0 | (0.1) | (0.2)% | 121.7 | 121.5 | 0.2 | 0.2% |
| Midwestern U.S. Mining | 7.2 | 7.9 | (0.7) | (8.9)% | 21.6 | 24.0 | (2.4) | (10.0)% |
| Australian Mining | 7.4 | 6.5 | 0.9 | 13.8% | 20.0 | 15.9 | 4.1 | 25.8% |
| Trading and Brokerage | 7.5 | 7.1 | 0.4 | 5.6% | 18.7 | 21.0 | (2.3) | (11.0)% |
| Total tons sold | 64.0 | 63.5 | 0.5 | 0.8% | 182.0 | 182.4 | (0.4) | (0.2)% |

***Revenues***

The following table presents revenues by operating segment:

| | Three Months Ended September 30, | | Increase (Decrease) to Revenues | | Nine Months Ended September 30, | | Increase (Decrease) to Revenues | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | 2009 | $ | % | 2010 | 2009 | $ | % |
| | (Dollars in millions) | | | | | | | |
| Western U.S. Mining | $ 707.4 | $ 683.6 | $ 23.8 | 3.5% | $ 2,021.6 | $ 1,972.8 | $ 48.8 | 2.5% |
| Midwestern U.S. Mining | 317.1 | 327.5 | (10.4) | (3.2)% | 949.8 | 978.0 | (28.2) | (2.9)% |
| Australian Mining | 733.4 | 537.3 | 196.1 | 36.5% | 1,777.3 | 1,206.6 | 570.7 | 47.3% |
| Trading and Brokerage | 101.8 | 112.9 | (11.1) | (9.8)% | 273.7 | 284.8 | (11.1) | (3.9)% |
| Corporate and Other | 5.0 | 5.7 | (0.7) | (12.3)% | 19.3 | 16.0 | 3.3 | 20.6% |
| Total revenues | $ 1,864.7 | $ 1,667.0 | $ 197.7 | 11.9% | $ 5,041.7 | $ 4,458.2 | $ 583.5 | 13.1% |

Australian Mining operations revenues were higher for both periods compared to the prior year as discussed below:

The revenue increase for the three months ended was driven by a 21.7% increase in our weighted average sales price reflecting higher pricing secured in the second and third quarters for both thermal and metallurgical coal. Total volumes increased 13.8% over the prior year driven by a 1.2 million ton increase in domestic and seaborne thermal coal shipments while our metallurgical coal shipments of 2.4 million tons were 0.3 million tons below prior year.

The revenue increase for the nine months ended was due to a 25.8% increase in volumes driven by increased demand for metallurgical coal during the first half of the year (metallurgical coal shipments of 6.9 million tons were 2.3 million tons, or 50%, greater than the prior year). The metallurgical coal demand increase reflects the current year market recovery as discussed above, coupled with prior year customer destocking of inventory and lower capacity utilization at steel customers. Our weighted average sales price increased 17.3%, led by a higher mix of metallurgical coal shipments and increased pricing on seaborne metallurgical and thermal coals.

Western U.S. Mining operations revenues increased for both periods compared to the prior year driven by a higher weighted average sales price (three months, 3.6%; nine months, 2.4%) due to higher committed prices and a favorable change in sales mix. Overall volumes for both periods were relatively flat compared to the prior year.

Midwestern U.S. Mining operations revenues were lower for both periods compared to the prior year due to decreased shipments on lower demand. Partially offsetting the impact of the decreased shipments was an increase in weighted average sales price (three months, 5.3%; nine months, 7.6%) driven by contractual price increases.

Trading and Brokerage revenues decreased for both periods compared to the prior year due to overall lower transaction volume (nine months) led by lower price volatility in the current year and revenue realized in the prior year on an international brokerage arrangement.

***Segment Adjusted EBITDA***

The following table presents segment Adjusted EBITDA by operating segment:

| | Three Months Ended September 30, | | Increase (Decrease) to Segment Adjusted EBITDA | | Nine Months Ended September 30, | | Increase (Decrease) to Segment Adjusted EBITDA | |
|---|---|---|---|---|---|---|---|---|
| | 2010 | 2009 | $ | % | 2010 | 2009 | $ | % |
| | (Dollars in millions) | | | | | | | |
| Western U.S. Mining | $ 215.7 | $ 208.6 | 7.1 | 3.4% | $ 630.9 | $ 543.9 | $ 87.0 | 16.0% |
| Midwestern U.S. Mining | 77.2 | 67.0 | 10.2 | 15.2% | 222.7 | 207.4 | 15.3 | 7.4% |
| Australian Mining | 323.2 | 108.2 | 215.0 | 198.7% | 670.1 | 319.1 | 351.0 | 110.0% |
| Trading and Brokerage | 44.3 | 44.2 | 0.1 | 0.2% | 91.0 | 145.2 | (54.2) | (37.3)% |
| Total Segment Adjusted EBITDA | $ 660.4 | $ 428.0 | $ 232.4 | 54.3% | $ 1,614.7 | $ 1,215.6 | $ 399.1 | 32.8% |