PEABODY ENERGY CORP
Form 10-Q
May 04, 2007

Table of Contents

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 March 31, 2007

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)

(Former name, former address and former fiscal year, if changed since last report)

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer 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 264,970,320 shares of common stock with a par value of $0.01 per share outstanding at April 27, 2007.

Table of Contents

INDEX

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

PEABODY ENERGY CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF EARNINGS

	Three Months Ended March 31, 2007	2006
	(Dollars in thousands, except share and per share data)	
Revenues		
Sales	$ 1,314,815	$ 1,288,906
Other revenues	50,356	22,904
Total revenues	1,365,171	1,311,810
Costs and Expenses		
Operating costs and expenses	1,091,781	1,022,342
Depreciation, depletion and amortization	102,862	80,964
Asset retirement obligation expense	11,375	7,215
Selling and administrative expenses	42,631	46,526
Other operating income:		
Net gain on disposal of assets	(36,649)	(9,226)
Income from equity affiliates	(2,160)	(7,252)
Operating Profit	155,331	171,241
Interest expense	58,778	27,400
Interest income	(5,390)	(2,606)
Income Before Income Taxes and Minority Interests	101,943	146,447
Income tax provision	12,614	11,566
Minority interests	823	4,659
Net Income	$ 88,506	$ 130,222
Earnings Per Share		
Basic	$ 0.34	$ 0.49
Diluted	$ 0.33	$ 0.48
Weighted Average Shares Outstanding		
Basic	263,031,869	263,491,072
Effect of dilutive securities	5,091,593	5,867,656
Diluted	268,123,462	269,358,728
Dividends Declared Per Share	$ 0.06	$ 0.06

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

PEABODY ENERGY CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEET

	(Unaudited) March 31, 2007	December 31, 2006
	(Dollars in thousands, except share and per share data)	
ASSETS		
Current assets		
Cash and cash equivalents	$ 295,327	$ 326,511
Accounts receivable, net of allowance for doubtful accounts of $11,034 at March 31, 2007 and $11,144 at December 31, 2006	278,062	358,242
Inventories	217,563	215,384
Assets from coal trading activities	162,018	150,373
Deferred income taxes	106,967	106,967
Other current assets	120,660	116,863
Total current assets	1,180,597	1,274,340
Property, plant, equipment and mine development		
Land and coal interests	7,275,088	7,127,385
Buildings and improvements	897,200	893,049
Machinery and equipment	1,576,032	1,516,765
Less accumulated depreciation, depletion and amortization	(2,085,299)	(1,985,682)
Property, plant, equipment and mine development, net	7,663,021	7,551,517
Goodwill	240,667	240,667
Investments and other assets	456,068	447,532
Total assets	$ 9,540,353	$ 9,514,056
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities		
Current maturities of long-term debt	$ 33,877	$ 95,757
Liabilities from coal trading activities	123,665	126,731
Accounts payable and accrued expenses	1,110,496	1,104,881
Total current liabilities	1,268,038	1,327,369
Long-term debt, less current maturities	3,170,966	3,201,992
Deferred income taxes	204,822	195,213
Asset retirement obligations	433,290	423,031
Workers compensation obligations	232,814	233,407
Accrued postretirement benefit costs	1,367,726	1,368,686
Other noncurrent liabilities	380,022	392,495
Total liabilities	7,057,678	7,142,193
Minority interests	33,556	33,337
Stockholders equity		

Preferred Stock $0.01 per share par value; 10,000,000 shares authorized, no shares issued or outstanding as of March 31, 2007 or December 31, 2006		
Series A Junior Participating Preferred Stock 1,500,000 shares authorized, no shares issued or outstanding as of March 31, 2007 or December 31, 2006		
Perpetual Preferred Stock 750,000 shares authorized, no shares issued or outstanding as of March 31, 2007 or December 31, 2006		
Series Common Stock $0.01 per share par value; 40,000,000 shares authorized, no shares issued or outstanding as of March 31, 2007 or December 31, 2006		
Common Stock $0.01 per share par value; 800,000,000 shares authorized, 267,508,156 shares issued and 264,800,253 shares outstanding as of March 31, 2007 and 266,554,157 shares issued and 263,846,839 shares outstanding as of December 31, 2006	2,675	2,666
Additional paid-in capital	1,588,774	1,572,614
Retained earnings	1,188,619	1,115,994
Accumulated other comprehensive loss	(227,235)	(249,058)
Treasury shares, at cost: 2,707,903 shares as of March 31, 2007 and 2,707,318 shares as of December 31, 2006	(103,714)	(103,690)
Total stockholders equity	2,449,119	2,338,526
Total liabilities and stockholders equity	$ 9,540,353	$ 9,514,056

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

PEABODY ENERGY CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS

	Three Months Ended March 31,	
	2007	2006
	(Dollars in thousands)	
Cash Flows From Operating Activities		
Net income	$ 88,506	$ 130,222
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion and amortization	102,862	80,964
Deferred income taxes	(2,461)	(12,864)
Amortization of debt discount and debt issuance costs	2,169	1,815
Net gain on disposal of assets	(36,649)	(9,226)
Income from equity affiliates	(2,160)	(7,252)
Dividends received from equity affiliates	12,927	5,442
Stock compensation	6,128	4,102
Changes in current assets and liabilities, net of acquisitions:		
Accounts receivable, net of sale	74,380	10,853
Inventories	(2,179)	(29,918)
Net assets from coal trading activities	(13,736)	240
Other current assets	2,343	(15,708)
Accounts payable and accrued expenses	(8,576)	(97,991)
Asset retirement obligations	5,563	22
Workers compensation obligations	(532)	860
Accrued postretirement benefit costs	7,322	5,360
Obligation to industry fund	3,587	(2,968)
Other, net	7,479	(14,901)
Net cash provided by operating activities	246,973	49,052
Cash Flows From Investing Activities		
Additions to property, plant, equipment and mine development	(134,653)	(87,459)
Federal coal lease expenditures	(59,829)	(59,829)
Additions to advance mining royalties	(2,557)	(2,250)
Proceeds from disposal of assets, net of notes receivable	16,451	11,488
Investments in joint ventures	(622)	
Other acquisitions, net		(44,538)
Net cash used in investing activities	(181,210)	(182,588)
Cash Flows From Financing Activities		
Payments of long-term debt	(93,146)	(12,906)
Dividends paid	(15,881)	(15,869)
Increase of securitized interests in accounts receivable	5,800	
Proceeds from employee stock purchases	3,097	1,772
Excess tax benefit related to stock options exercised	2,510	13,096
Proceeds from stock options exercised	2,378	6,051

Distributions to minority interests	(875)	(1,000)
Payment of debt issuance costs	(830)	
Proceeds from long-term debt		750
Common stock repurchase		(11,476)
Net cash used in financing activities	(96,947)	(19,582)
Net decrease in cash and cash equivalents	(31,184)	(153,118)
Cash and cash equivalents at beginning of year	326,511	503,278
Cash and cash equivalents at end of year	$ 295,327	$ 350,160

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

PEABODY ENERGY CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
MARCH 31, 2007

(1) Basis of Presentation

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

The accompanying condensed consolidated financial statements as of March 31, 2007 and for the three months ended March 31, 2007 and 2006, 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, 2006 has been derived from the Company s audited consolidated balance sheet. The results of operations for the three months ended March 31, 2007 are not necessarily indicative of the results to be expected for future quarters or for the year ending December 31, 2007. Certain amounts in prior periods have been reclassified to conform to the report classifications as of March 31, 2007 and for the three months ended March 31, 2007, with no effect on previously reported net income or stockholders equity.

(2) New Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN No. 48). This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company adopted the provisions of FIN No. 48 on January 1, 2007 with no impact to retained earnings. As a result of adoption, the Company has $135 million of unrecognized tax benefits in its condensed consolidated financial statements. The Company does not expect any significant increases or decreases to its unrecognized tax benefits within 12 months of this reporting date that would affect the Company s effective tax rate, if recognized.

Due to the existence of net operating loss (NOL) carryforwards, the Company has not currently accrued interest on any of its unrecognized tax benefits. The Company has considered the application of penalties on its unrecognized tax benefits and has determined, based on several factors including the existence of its NOL carryforwards, that no accrual of penalties related to its unrecognized tax benefits is required. If the accrual of interest or penalties becomes appropriate, the Company will record an accrual in its income tax provision.

The Company s Federal income tax returns for the tax years 1999 and beyond remain subject to examination by the Internal Revenue Service. The Company s state income tax returns for the tax years 1991 and beyond remain subject to examination by various state taxing authorities. The Company s foreign income tax returns for the tax years 2003 and beyond remain subject to examination by various foreign taxing authorities.

(3) Business Combinations and Acquisitions

In the second half of 2006, through two separate transactions, the Company acquired 100% of Excel Coal Limited (Excel), an independent coal company in Australia for a total acquisition price of US$1.54 billion in cash plus assumed debt of US$293.0 million, less US$30.0 million of cash acquired in the transaction. The results of operations of Excel are included in the Company s Australian Mining Operations segment beginning in October 2006.

The preliminary purchase accounting allocations related to the acquisition were recorded in the accompanying condensed consolidated financial statements as of, and for periods subsequent to, October 2006. The valuation of the net assets acquired is expected to be finalized once certain third-party appraisals and drilling and reserve studies are completed in mid 2007. The preliminary estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition have not been adjusted since December 31, 2006.

Table of Contents

The following unaudited pro forma financial information presents the combined results of operations of the Company and Excel, on a pro forma basis, as though the companies had been combined as of the beginning of the period presented. The pro forma financial information does not necessarily reflect the results of operations that would have occurred had the Company and Excel constituted a single entity during this period. The Excel acquisition is not expected to be accretive to earnings until the mines under development are fully operational.

	Three Months Ended March 31, 2006 (Dollars in thousands, except per share data)
Revenues:	
As reported	$ 1,311,810
Pro forma	1,410,154
Net income:	
As reported	$ 130,222
Pro forma	119,131
Basic earnings per share net income:	
As reported	$ 0.49
Pro forma	0.45
Diluted earnings per share net income:	
As reported	$ 0.48
Pro forma	0.44

(4) Assets and Liabilities from Coal Trading Activities

The Company s coal trading portfolio included forward and swap contracts as of March 31, 2007 and December 31, 2006. The fair value of coal trading derivatives and related hedge contracts is set forth below:

	March 31, 2007		December 31, 2006	
	Assets	Liabilities	Assets	Liabilities
	(Dollars in thousands)			
Forward contracts	$ 142,965	$ 99,760	$ 142,105	$ 120,718
Financial swaps	19,053	23,905	8,268	6,013
Total	$ 162,018	$ 123,665	$ 150,373	$ 126,731

Of the contracts in the Company s trading portfolio as of March 31, 2007, 99% were valued utilizing prices from over-the-counter market sources, adjusted for coal quality and traded transportation differentials, and 1% of the Company s contracts were valued based on similar market transactions.

As of March 31, 2007, the estimated future realization of the value of the Company s trading portfolio was as follows:

Year of Expiration	Percentage of Portfolio
2007	37%
2008	38%
2009	20%
2010	4%

2011	1%
	100%

Table of Contents

At March 31, 2007, 56% of the Company s credit exposure related to coal trading activities was with investment grade counterparties and 44% was with non-investment grade counterparties. The Company s coal trading operations traded 31.5 million tons and 10.7 million tons for the quarters ended March 31, 2007 and 2006, respectively.

(5) Resource Management and Other Commercial Events

During the three months ended March 31, 2007, the Company sold approximately 35 million tons of non-strategic coal reserves and surface lands located in Kentucky for $13.9 million cash proceeds and a note receivable of $32.2 million with a recognized gain of $34.9 million.

(6) Inventories

Inventories consisted of the following:

	March 31, 2007	December 31, 2006
	(Dollars in thousands)	
Materials and supplies	$ 89,075	$ 85,242
Raw coal	40,240	42,693
Saleable coal	88,248	87,449
Total	$ 217,563	$ 215,384

(7) Long-Term Debt

The Company s total indebtedness as of March 31, 2007 and December 31, 2006, consisted of the following:

	March 31, 2007	December 31, 2006
	(Dollars in thousands)	
Term Loan under Senior Unsecured Credit Facility	$ 528,662	$ 547,000
Convertible Junior Subordinated Debentures due 2066	732,500	732,500
7.375% Senior Notes due 2016	650,000	650,000
6.875% Senior Notes due 2013	650,000	650,000
7.875% Senior Notes due 2026	246,913	246,897
5.875% Senior Notes due 2016	218,090	231,845
5.0% Subordinated Note		59,504
6.84% Series C Bonds due 2016	43,000	43,000
6.34% Series B Bonds due 2014	21,000	21,000
6.84% Series A Bonds due 2014	10,000	10,000
Capital lease obligations	95,950	96,869
Fair value of interest rate swaps	(13,898)	(13,784)
Other	22,626	22,918
Total	$ 3,204,843	$ 3,297,749

Long-Term Debt Repayments

During the three months ended March 31, 2007, the Company repaid portions of its long-term debt, which included a $60.0 million retirement of its 5.0% Subordinated Note; an $18.3 million repayment of its outstanding balance of the Term Loan under the Senior Unsecured Credit Facility; and an open-market purchase for $13.8 million in face value of its 5.875% Senior Notes. As of March 31, 2007, the Revolving Credit Facility s remaining available borrowing capacity under the Senior Unsecured Credit Facility was $1.38 billion.

7

Table of Contents

Capital Lease Obligations

As of December 31, 2006, Capital lease obligations reflects an additional $40.2 million that was previously classified as Accounts payable and accrued expenses on the Company s consolidated balance sheet in its Annual Report on Form 10-K for the fiscal year ended December 31, 2006. The reclassification relates to a capital lease transaction structure that was finalized during the three months ended March 31, 2007. The lease term is 7 years with annual payments of approximately $6.7 million over the term of the lease.

Interest Rate Swaps

During the three months ended March 31, 2007, the Company entered into several fixed-to-floating interest rate swaps. The first group of three interest rate swaps had combined notional amounts totaling $200.0 million and was designated to hedge changes in fair value of the 6.875% Senior Notes due 2013. Under the swaps, the Company pays a floating rate that resets each March 15 and September 15 based upon the six-month LIBOR rate for a period of six years ending March 15, 2013 and receives a fixed rate of 6.875%. The second group of two interest rate swaps had combined notional amounts totaling $100.0 million and was designated to hedge changes in fair value of the 5.875% Senior Notes due 2016. Under the swaps, the Company pays a floating rate that resets each April 15 and October 15 based upon the six-month LIBOR rate for a period of nine years ending April 15, 2016 and receives a fixed rate of 5.875%.

The above interest rate swaps were in addition to those the Company entered into in previous years, including the following: five fixed-to-floating interest rate swaps with combined notional amounts totaling $220.0 million that were designated to hedge changes in fair value of the 6.875% Senior Notes due 2013; and a $120.0 million notional amount floating-to-fixed interest rate swap with a fixed rate of 6.25% and a floating rate of LIBOR plus 1.0% that was designated to hedge changes in expected cash flows on the Term Loan under the Senior Unsecured Credit Facility.

(8) Comprehensive Income

The following table sets forth the after-tax components of comprehensive income for the three months ended March 31, 2007 and 2006:

	Three Months Ended March 31,	
	2007	2006
	(Dollars in thousands)	
Net income	$ 88,506	$ 130,222
Increase in fair value of cash flow hedges, net of tax provision of $8,857 and $1,242 for the three months ended March 31, 2007 and 2006, respectively	14,261	1,864
Amortization of actuarial loss and prior service cost realized in net income, net of tax provision of $3,387	7,562	
Comprehensive income	$ 110,329	$ 132,086

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 during the periods (which include fuel and natural gas hedges, currency forwards, traded coal index contracts and interest rate swaps) and the amortization of actuarial loss and prior service cost associated with the adoption of Statement of Financial Accounting Standard No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. The values of the Company s cash flow hedging instruments are affected by changes in interest rates, crude oil, heating oil and natural gas prices, the price of coal delivered into Europe and the U.S. dollar/Australian dollar exchange rate.

Table of Contents

(9) Pension and Postretirement Benefit Costs

Net periodic pension costs included the following components:

	Three Months Ended March 31,	
	2007	2006
	(Dollars in thousands)	
Service cost for benefits earned	$ 2,250	$ 3,059
Interest cost on projected benefit obligation	11,975	11,509
Expected return on plan assets	(14,075)	(13,647)
Amortization of actuarial loss and other	4,175	5,663
Net periodic pension costs	$ 4,325	$ 6,584

Net periodic postretirement benefit costs included the following components:

	Three Months Ended March 31,	
	2007	2006
	(Dollars in thousands)	
Service cost for benefits earned	$ 2,229	$ 1,879
Interest cost on accumulated postretirement benefit obligation	21,372	18,464
Amortization of prior service cost	(842)	(1,334)
Amortization of actuarial loss	10,816	8,012
Net periodic postretirement benefit costs	$ 33,575	$ 27,021

Table of Contents

(10) Segment Information

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

Operating segment results for the three months ended March 31, 2007 and 2006 were as follows:

	Three Months Ended March 31,	
	2007	2006
	(dollars in thousands)	
Revenues:		
Western U.S. Mining	$ 480,633	$ 432,090
Eastern U.S. Mining	518,216	514,463
Australian Mining	286,991	152,999
Trading and Brokerage	76,064	207,015
Corporate and Other	3,267	5,243
Total	$ 1,365,171	$ 1,311,810
Adjusted EBITDA:		
Western U.S. Mining	$ 139,648	$ 127,793
Eastern U.S. Mining	81,043	132,544
Australian Mining	62,561	47,756
Trading and Brokerage	36,835	16,179
Corporate and Other [1]	(50,519)	(64,852)
Total	$ 269,568	$ 259,420

[1] Corporate and Other results include the gains on the disposal of assets discussed in Note 5.

A reconciliation of Adjusted EBITDA to consolidated income before income taxes and minority interests follows:

	Three Months Ended March 31,	
	2007	2006
	(dollars in thousands)	
Total Adjusted EBITDA	$ 269,568	$ 259,420
Depreciation, depletion and amortization	102,862	80,964
Asset retirement obligation expense	11,375	7,215

Interest expense	58,778	27,400
Interest income	(5,390)	(2,606)
Income before income taxes and minority interests	$ 101,943	$ 146,447

Table of Contents

(11) Commitments and Contingencies

Commitments

As of March 31, 2007, purchase commitments for capital expenditures were $75.0 million and federal coal reserve lease payments due over the next three years totaled $419.9 million.

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 has alleged 16 claims, including Civil Racketeer Influenced and Corrupt Organizations Act (RICO) violations and fraud. 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, which could be trebled under the RICO counts, punitive damages of at least $1 billion, a determination that Peabody Western s two coal leases have terminated due to Peabody Western s breach of these leases and a reformation of these leases to adjust the royalty rate to 20%. Subsequently, the court 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. On March 4, 2003, the U.S. Supreme Court issued a ruling in a companion lawsuit involving the Navajo Nation and the United States rejecting the Navajo Nation s allegation that the United States breached its trust responsibilities to the Tribe in approving the coal lease amendments. On February 9, 2005, the U.S. District Court for the District of Columbia granted a consent motion to stay the litigation until further order of the court. Peabody Western, the Navajo Nation, the Hopi Tribe and the owners of the power plants served by the suspended Black Mesa mine and the Kayenta mine are in mediation with respect to this litigation and other business issues.

The outcome of this litigation, or the current mediation, 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, 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.

Salt River Project Agricultural Improvement and Power District Mine Closing and Retiree Health Care

Salt River Project and the other owners of the Navajo Generating Station filed a lawsuit on September 27, 1996, in the Superior Court of Maricopa County in Arizona seeking a declaratory judgment that certain costs relating to final reclamation, environmental monitoring work and mine decommissioning and costs primarily relating to retiree health care benefits are not recoverable by the Company s subsidiary, Peabody Western, under the terms of a coal supply agreement dated February 18, 1977. The contract expires in 2011. The trial court subsequently ruled that the mine decommissioning costs were subject to arbitration but that the retiree health care costs were not subject to arbitration. The Company has recorded a receivable for mine decommissioning costs of $77.3 million and $76.8 million included in Investments and other assets in the condensed consolidated balance sheets as of March 31, 2007 and December 31, 2006, respectively.

The outcome of this litigation and arbitration 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, 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.

Gulf Power Company Litigation

On June 21, 2006, the Company s subsidiary filed a complaint in the U.S. District Court, Southern District of Illinois, seeking a declaratory judgment upholding its declaration of a permanent force majeure under a coal supply agreement with Gulf Power Company. On June 22, 2006, Gulf Power Company filed a breach of contract lawsuit against the Company s subsidiary in the U.S. District Court, Northern District of Florida, contesting the force majeure declaration and seeking damages for alleged past and future tonnage shortfalls of nearly 5 million tons under the coal supply agreement, which would have expired on December 31, 2007. The parties filed motions to determine which court will hear the lawsuits. On October 6, 2006, the Florida District Court stayed Gulf Power s lawsuit until the Illinois court decided whether it had jurisdiction. On February 23, 2007, the Illinois District Court ruled that it had jurisdiction but exercised its discretion to dismiss the declaratory judgment action. On March 26, 2007, the Florida District Court lifted the stay of the Florida lawsuit. We have filed a motion to dismiss the Florida lawsuit or to transfer it to Illinois.

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, 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. Today Gold Fields is 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.

Gold Fields and two other companies are defendants in two class action lawsuits allegedly involving the operations near Picher, Oklahoma. The plaintiffs have asserted claims predicated on allegations of intentional lead exposure by the defendants and are seeking compensatory damages, punitive damages and the implementation of medical monitoring and relocation programs for the affected individuals. Gold Fields is also a defendant, along with other companies, in personal injury lawsuits involving over 50 children, arising out of the same lead mill operations. Plaintiffs in these actions are seeking compensatory and punitive damages for alleged personal injuries from lead exposure. Gold Fields, along with the former affiliate, has reached a confidential agreement in principle to settle most of the claims in the personal injury lawsuits. Plaintiffs counsel are in the process of having the final settlement documentation executed. In December 2003, the Quapaw Indian tribe and certain Quapaw land owners filed a class action lawsuit against Gold Fields and five other companies. The plaintiffs are seeking compensatory and punitive damages based on a variety of theories. Gold Fields has filed a third-party complaint against the United States, 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.

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, 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) based on CERCLA at five sites, and claims have been asserted at 18 other sites, which have since been reduced to 12 by 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 $42.6 million as of March 31, 2007 and $43.0 million as of December 31, 2006, $14.0 million and $14.4 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 September 2005, Gold Fields and other PRPs received a letter from the U.S. Department of Justice alleging that the PRPs mining operations caused the Environmental Protection Agency (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. Gold Fields has participated in the ongoing settlement discussions. 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. 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. 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 this provision.

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. 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.

(12) Guarantees

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.

The Company owns a 30.0% interest in a partnership that leases a coal export terminal from the Peninsula Ports Authority of 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 March 31, 2007, the Company s maximum reimbursement obligation to the commercial bank was in turn supported by a letter of credit totaling $42.8 million.

The Company is party to an agreement with the Pension Benefit Guarantee 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 United States) and continues under this process as of March 31, 2007. 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.

Other Guarantees

As part of arrangements through which the Company obtains exclusive sales representation agreements with small coal mining companies (the Counterparties), the Company issued financial guarantees on behalf of the Counterparties. These guarantees facilitate the Counterparties efforts to obtain financing or bonding. The Company issued financial guarantees on behalf of a certain Counterparty to facilitate its efforts in obtaining financing for equipment purchases and guaranteed bonding for a partnership in which the Company formerly held an interest. The Company also issued a guarantee for certain equipment lease arrangements on behalf of one of the sales representation parties. The aggregate amount guaranteed by the Company for all such Counterparties was $14.6 million, and the fair value of the guarantees recognized as a liability was $0.4 million as of March 31, 2007. The Company s obligations under the guarantees extend to September 2015.

Table of Contents

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 assumes that no amounts could be recovered from third parties.

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. See Note 7 for the descriptions of the Company s (and its subsidiaries) debt. Supplemental guarantor/non-guarantor financial information is provided in Note 13.

(13) Supplemental Guarantor/Non-Guarantor Financial Information

In accordance with the indentures governing the 6.875% Senior Notes due March 2013, the 5.875% Senior Notes due March 2016, the 7.375% Senior Notes due November 2016 and the 7.875% Senior Notes due November 2026, certain wholly-owned U.S. subsidiaries of the Company have fully and unconditionally guaranteed these Senior Notes, on a joint and several basis. The following historical financial statement information is provided for the Guarantor/Non-Guarantor Subsidiaries.

Peabody Energy Corporation
Unaudited Supplemental Condensed Consolidated Statements of Operations

	Three Months Ended March 31, 2007				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(Dollars in thousands)				
Total revenues	$	$ 1,023,373	$ 366,405	$ (24,607)	$ 1,365,171
Costs and expenses:					
Operating costs and expenses	(610)	824,570	292,428	(24,607)	1,091,781
Depreciation, depletion and amortization		75,693	27,169		102,862
Asset retirement obligation expense		11,037	338		11,375
Selling and administrative expenses	6,157	35,672	802		42,631
Other operating income:					
Net (gain) loss on disposal of assets		(36,744)	95		(36,649)
(Income) loss from equity affiliates		1,517	(3,677)		(2,160)
Interest expense	70,091	13,526	6,284	(31,123)	58,778
Interest income	(4,680)	(24,024)	(7,809)	31,123	(5,390)
Income (loss) before income taxes and minority interests	(70,958)	122,126	50,775		101,943
Income tax provision (benefit)	(25,985)	33,568	5,031		12,614
Minority interests			823		823

Net income (loss)	$ (44,973)	$	88,558	$	44,921	$	$	88,506

Table of Contents

Peabody Energy Corporation
Unaudited Supplemental Condensed Consolidated Statements of Operations

	Three Months Ended March 31, 2006				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(Dollars in thousands)				
Total revenues	$	$ 1,026,857	$ 311,520	$ (26,567)	$ 1,311,810
Costs and expenses:					
Operating costs and expenses	(4,950)	808,915	244,944	(26,567)	1,022,342
Depreciation, depletion and amortization		69,095	11,869		80,964
Asset retirement obligation expense		6,982	233		7,215
Selling and administrative expenses	4,546	41,305	675		46,526
Other operating income:					
Net gain on disposal of assets		(9,015)	(211)		(9,226)
Income from equity affiliates		(3,766)	(3,486)		(7,252)
Interest expense	40,092	15,140	3,951	(31,783)	27,400
Interest income	(5,902)	(20,980)	(7,507)	31,783	(2,606)
Income (loss) before income taxes and minority interests	(33,786)	119,181	61,052		146,447
Income tax provision (benefit)	(9,724)	12,225	9,065		11,566
Minority interests			4,659		4,659
Net income (loss)	$ (24,062)	$ 106,956	$ 47,328	$	$ 130,222

Peabody Energy Corporation
Unaudited Supplemental Condensed Consolidated Balance Sheets

	March 31, 2007				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(Dollars in thousands)				
Assets					
Current assets					
Cash and cash equivalents	$ 230,894	$ 9,469	$ 54,964	$	$ 295,327
Accounts receivable	522	(14,290)	291,830		278,062
Inventories		158,396	59,167		217,563
Assets from coal trading activities		162,018			162,018
Deferred income taxes		106,967			106,967
Other current assets	59,630	41,567	19,463		120,660
Total current assets	291,046	464,127	425,424		1,180,597
Property, plant, equipment and mine development at cost		7,091,360	2,656,960		9,748,320
Less accumulated depreciation, depletion and amortization		(1,869,918)	(215,381)		(2,085,299)
Goodwill			240,667		240,667
Investments and other assets	7,390,929	65,858	62,433	(7,063,152)	456,068
Total assets	$ 7,681,975	$ 5,751,427	$ 3,170,103	$ (7,063,152)	$ 9,540,353
Liabilities and Stockholders Equity					
Current liabilities					
Current maturities of long-term debt	$ 26,433	$ 1,282	$ 6,162	$	$ 33,877
Payables and notes payable to affiliates, net	2,048,771	(2,141,975)	93,204		
Liabilities from coal trading activities		123,665			123,665
Accounts payable and accrued expenses	58,927	701,617	349,952		1,110,496
Total current liabilities	2,134,131	(1,315,411)	449,318		1,268,038
Long-term debt, less current maturities	2,985,835	11,634	173,497		3,170,966
Deferred income taxes	37,951	(24,150)	191,021		204,822
Other noncurrent liabilities	17,782	2,307,717	88,353		2,413,852
Total liabilities	5,175,699	979,790	902,189		7,057,678
Minority interests			33,556		33,556

Stockholders equity	2,506,276	4,771,637	2,234,358	(7,063,152)	2,449,119
Total liabilities and stockholders equity	$ 7,681,975	$ 5,751,427	$ 3,170,103	$ (7,063,152)	$ 9,540,353

16

Table of Contents

Peabody Energy Corporation
Supplemental Condensed Consolidated Balance Sheets

	December 31, 2006				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(Dollars in thousands)				
Assets					
Current assets					
Cash and cash equivalents	$ 272,226	$ 3,652	$ 50,633	$	$ 326,511
Accounts receivable		41,199	317,043		358,242
Inventories		146,920	68,464		215,384
Assets from coal trading activities		150,373			150,373
Deferred income taxes		106,967			106,967
Other current assets	54,007	41,221	21,635		116,863
Total current assets	326,233	490,332	457,775		1,274,340
Property, plant, equipment and mine development at cost		6,964,886	2,572,313		9,537,199
Less accumulated depreciation, depletion and amortization		(1,794,823)	(190,859)		(1,985,682)
Goodwill			240,667		240,667
Investments and other assets	7,235,765	34,195	100,115	(6,922,543)	447,532
Total assets	$ 7,561,998	$ 5,694,590	$ 3,180,011	$ (6,922,543)	$ 9,514,056
Liabilities and Stockholders Equity					
Current liabilities					
Current maturities of long-term debt	$ 27,350	$ 60,522	$ 7,885	$	$ 95,757
Payables and notes payable to affiliates, net	2,025,605	(2,170,567)	144,962		
Liabilities from coal trading activities		126,731			126,731
Accounts payable and accrued expenses	46,748	759,002	299,131		1,104,881
Total current liabilities	2,099,703	(1,224,312)	451,978		1,327,369
Long-term debt, less current maturities	3,017,107	12,373	172,512		3,201,992
Deferred income taxes	29,094	(25,077)	191,196		195,213
Other noncurrent liabilities	20,411	2,294,247	102,961		2,417,619
Total liabilities	5,166,315	1,057,231	918,647		7,142,193
Minority interests			33,337		33,337

Stockholders equity	2,395,683	4,637,359	2,228,027	(6,922,543)	2,338,526
Total liabilities and stockholders equity	$ 7,561,998	$ 5,694,590	$ 3,180,011	$ (6,922,543)	$ 9,514,056

Table of Contents

Peabody Energy Corporation
Unaudited Supplemental Condensed Consolidated Statements of Cash Flows

	Three Months Ended March 31, 2007			
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidated
	(Dollars in thousands)			
Cash Flows From Operating Activities				
Net cash provided by (used in) operating activities	$ (24,085)	$ 137,901	$ 133,157	$ 246,973
Cash Flows From Investing Activities				
Additions to property, plant, equipment and mine development		(72,565)	(62,088)	(134,653)
Federal coal lease expenditures		(59,829)		(59,829)
Additions to advance mining royalties		(2,557)		(2,557)
Proceeds from disposal of assets, net of notes receivable		16,337	114	16,451
Investment in joint venture		(622)		(622)
Net cash used in investing activities		(119,236)	(61,974)	(181,210)
Cash Flows From Financing Activities				
Payments of long-term debt	(31,475)	(60,472)	(1,199)	(93,146)
Dividends paid	(15,881)			(15,881)
Increase of securitized interests in accounts receivable			5,800	5,800
Proceeds from employee stock purchases	3,097			3,097
Excess tax benefit related to stock options exercised				