PEABODY ENERGY CORP
Form 10-Q
May 06, 2011

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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 March 31, 2011

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 (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 270,736,666 shares of common stock with a par value of $0.01 per share outstanding at April 29, 2011.

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PEABODY ENERGY CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,	
	2011	2010
	(Dollars in millions, except per share data)	
Revenues		
Sales	$ 1,613.7	$ 1,385.1
Other revenues	131.2	130.5
Total revenues	1,744.9	1,515.6
Costs and expenses		
Operating costs and expenses	1,268.1	1,108.7
Depreciation, depletion and amortization	108.8	105.5
Asset retirement obligation expense	13.1	9.5
Selling and administrative expenses	61.6	55.4
Other operating (income) loss:		
Net gain on disposal or exchange of assets	(4.0)	(7.3)
Loss from equity affiliates	3.0	1.6
Operating profit	294.3	242.2
Interest expense	51.0	50.0
Interest income	(4.1)	(1.0)
Income from continuing operations before income taxes	247.4	193.2
Income tax provision	67.8	56.1
Income from continuing operations, net of income taxes	179.6	137.1
Loss from discontinued operations, net of income taxes	(0.9)	(0.4)
Net income	178.7	136.7
Less: Net income attributable to noncontrolling interests	2.2	3.0
Net income attributable to common stockholders	$ 176.5	$ 133.7
Income From Continuing Operations		
Basic earnings per share	$ 0.66	$ 0.50
Diluted earnings per share	$ 0.65	$ 0.50
Net Income Attributable to Common Stockholders		

Basic earnings per share	$	0.66	$	0.50
Diluted earnings per share	$	0.65	$	0.50
Dividends declared per share	$	0.085	$	0.070

See accompanying notes to unaudited condensed consolidated financial statements.

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PEABODY ENERGY CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited) March 31, 2011		December 31, 2010	
	(Amounts in millions, except share and per share data)			
ASSETS				
Current assets				
Cash and cash equivalents	$	1,273.2	$	1,295.2
Short-term investments		100.0		
Accounts receivable, net of allowance for doubtful accounts of $28.2 at March 31, 2011 and $30.3 at December 31, 2010		476.4		558.2
Inventories		362.8		332.9
Assets from coal trading activities, net		166.2		192.5
Deferred income taxes		114.7		120.4
Other current assets		552.9		459.0
Total current assets		3,046.2		2,958.2
Property, plant, equipment and mine development				
Land and coal interests		7,687.5		7,657.0
Buildings and improvements		1,086.5		1,079.8
Machinery and equipment		1,731.6		1,699.3
Less: accumulated depreciation, depletion and amortization		(3,084.1)		(3,010.0)
Property, plant, equipment and mine development, net		7,421.5		7,426.1
Investments and other assets		1,056.2		978.8
Total assets	$	11,523.9	$	11,363.1
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities				
Current maturities of long-term debt	$	261.5	$	43.2
Liabilities from coal trading activities, net		157.4		181.7
Accounts payable and accrued expenses		1,225.8		1,288.8
Total current liabilities		1,644.7		1,513.7
Long-term debt, less current maturities		2,478.9		2,706.8
Deferred income taxes		578.2		539.8
Asset retirement obligations		508.6		501.3
Accrued postretirement benefit costs		965.6		963.9
Other noncurrent liabilities		456.1		448.3
Total liabilities		6,632.1		6,673.8
Stockholders equity				

Preferred Stock $0.01 per share par value; 10,000,000 shares authorized, no shares issued or outstanding as of March 31, 2011 or December 31, 2010				
Series A Junior Participating Preferred Stock 1,500,000 shares authorized, no shares issued or outstanding as of March 31, 2011 or December 31, 2010				
Perpetual Preferred Stock 800,000 shares authorized, no shares issued or outstanding as of March 31, 2011 or December 31, 2010				
Series Common Stock $0.01 per share par value; 40,000,000 shares authorized, no shares issued or outstanding as of March 31, 2011 or December 31, 2010				
Common Stock $0.01 per share par value; 800,000,000 shares authorized, 279,825,706 shares issued and 270,677,543 shares outstanding as of March 31, 2011 and 279,149,028 shares issued and 270,236,256 shares outstanding as of December 31, 2010		2.8		2.8
Additional paid-in capital		2,204.8		2,182.0
Retained earnings		3,031.9		2,878.4
Accumulated other comprehensive loss		(20.9)		(67.9)
Treasury shares, at cost: 9,148,163 shares as of March 31, 2011 and 8,912,772 shares as of December 31, 2010		(349.7)		(334.6)
Peabody Energy Corporation s stockholders equity		4,868.9		4,660.7
Noncontrolling interests		22.9		28.6
Total stockholders equity		4,891.8		4,689.3
Total liabilities and stockholders equity	$	11,523.9	$	11,363.1

See accompanying notes to unaudited condensed consolidated financial statements.

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PEABODY ENERGY CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31,	
	2011	2010
	(Dollars in millions)	
Cash Flows From Operating Activities		
Net income	$ 178.7	$ 136.7
Loss from discontinued operations, net of income taxes	0.9	0.4
Income from continuing operations, net of income taxes	179.6	137.1
Adjustments to reconcile income from continuing operations, net of income taxes to net cash provided by operating activities:		
Depreciation, depletion and amortization	108.8	105.5
Deferred income taxes	23.4	49.8
Share-based compensation	10.9	11.4
Net gain on disposal or exchange of assets	(4.0)	(7.3)
Loss from equity affiliates	3.0	1.6
Changes in current assets and liabilities:		
Accounts receivable	82.4	(25.1)
Change in receivable from accounts receivable securitization program		23.1
Inventories	(30.0)	(18.1)
Net assets from coal trading activities	(72.8)	(6.2)
Other current assets	(8.7)	4.1
Accounts payable and accrued expenses	(91.4)	(84.7)
Asset retirement obligations	7.5	6.7
Workers compensation obligations	7.1	2.5
Accrued postretirement benefit costs	6.3	5.4
Contributions to pension plans	(0.4)	(16.5)
Other, net	(0.9)	(10.9)
Net cash provided by continuing operations	220.8	178.4
Net cash used in discontinued operations	(0.2)	(6.6)
Net cash provided by operating activities	220.6	171.8
Cash Flows From Investing Activities		
Additions to property, plant, equipment and mine development	(107.2)	(88.4)
Investment in Prairie State Energy Campus	(8.9)	(12.2)
Proceeds from disposal of assets	5.5	4.4
Investments in equity affiliates and joint ventures	(1.1)	(15.7)
Proceeds from sale of debt securities	15.5	
Purchases of debt securities	(14.6)	
Purchases of short-term investments	(100.0)	
Other, net	(0.4)	(0.8)
Net cash used in investing activities	(211.2)	(112.7)

Cash Flows From Financing Activities		
Payments of long-term debt	(10.0)	(2.6)
Dividends paid	(23.0)	(18.8)
Repurchase of employee common stock relinquished for tax with holding	(15.1)	(7.8)
Excess tax benefits related to share-based compensation	4.9	
Proceeds from stock options exercised	4.0	2.0
Other, net	7.8	4.7
Net cash used in financing activities	(31.4)	(22.5)
Net change in cash and cash equivalents	(22.0)	36.6
Cash and cash equivalents at beginning of period	1,295.2	988.8
Cash and cash equivalents at end of period	$ 1,273.2	$ 1,025.4

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, 2010	$ 2.8	$ 2,182.0	$ (334.6)	$ 2,878.4	$ (67.9)	$ 28.6	$ 4,689.3
Comprehensive income:							
Net income				176.5		2.2	178.7
Unrealized gains on available-for-sale securities, net of income taxes					1.0		1.0
Increase in fair value of cash flow hedges (net of $34.3 tax provision)					32.5		32.5
Postretirement plans and workers compensation obligations (net of $0.2 tax benefit)					13.5		13.5
Comprehensive income				176.5	47.0	2.2	225.7
Dividends paid				(23.0)			(23.0)
Share-based compensation		10.9					10.9
Excess tax benefits related to share-based compensation		4.9					4.9
Stock options exercised		4.0					4.0
Employee stock purchases		3.0					3.0
Repurchase of employee common stock relinquished for tax withholding			(15.1)				(15.1)
Distributions to noncontrolling interests						(7.9)	(7.9)

March 31, 2011	$ 2.8	$ 2,204.8	$ (349.7)	$ 3,031.9	$ (20.9)	$ 22.9	$ 4,891.8

See accompanying notes to unaudited condensed consolidated financial statements.

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 March 31, 2011 and for the three months ended March 31, 2011 and 2010, 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, 2010 has been derived from the Company s audited consolidated balance sheet. The results of operations for the three months ended March 31, 2011 are not necessarily indicative of the results to be expected for future quarters or for the year ending December 31, 2011.

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.

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 December 2010, the Financial Accounting Standards Board (FASB) issued an update to guidance on accounting for business combinations that clarified a public entity s disclosure requirements for pro forma presentation of revenue and earnings related to a business combination. The new guidance, which became effective on January 1, 2011, requires that if comparative statements are presented, the public entity should disclose revenue and earnings of the combined entity as though the business combination that occurred during the year had occurred as of the beginning of the comparable prior annual reporting period only. The guidance also requires the supplemental pro forma disclosures to include a description of the nature and amount of material nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The guidance, should it become applicable, will impact the Company s disclosures but it will not impact the Company s results of operations, financial condition or cash flows.

In January 2010, the FASB issued accounting guidance that requires new fair value disclosures, including disclosures about significant transfers into 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 became effective January 1, 2011. 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.

(3) Investments

The Company s short-term investments are defined as those investments with original maturities of greater than three months, but less than one year, and long-term investments are defined as those investments with original maturities greater than one year. Short-term investments consist of time deposits with highly-rated financial institutions, while the long-term portfolio primarily consists of investments in debt securities.

The Company classifies its investments as either held-to-maturity or available-for-sale at the time of purchase and reevaluates such designation periodically. Investments are classified as held-to-maturity when the Company has the intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost. Interest earned on the time deposits is reported as Interest income in the unaudited condensed consolidated statements of operations.

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

Investments in securities not classified as held-to-maturity are classified as available-for-sale. Available-for-sale securities are carried at fair value, with unrealized gains and losses, net of income taxes, reported in Accumulated other comprehensive loss in the condensed consolidated balance sheets. Realized gains and losses, determined on a specific identification method, are included in Interest income in the unaudited condensed consolidated statements of operations.

Investments in available-for-sale and held-to-maturity securities at March 31, 2011 were as follows:

Available-for-sale securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)			
Current:				
Federal government securities	$ 2.2	$	$	$ 2.2
U.S. corporate bonds	3.9			3.9
Noncurrent:				
Federal government securities	16.0		0.1	15.9
U.S. corporate bonds	10.3			10.3
Total	$ 32.4	$	$ 0.1	$ 32.3

Held-to-maturity securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)			
Time deposits	$ 100.0	$	$	$ 100.0

Investments in available-for-sale securities at December 31, 2010 were as follows:

Available-for-sale securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)			
Current:				
Federal government securities	$ 0.5	$	$	$ 0.5
U.S. corporate bonds	1.9			1.9
Noncurrent:				
Federal government securities	9.2			9.2
U.S. corporate bonds	6.3			6.3

Total	$	17.9	$		$		$	17.9

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

Contractual maturities for available-for-sale investments at March 31, 2011 were as shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(Dollars in millions)	
Due in one year or less	$ 6.1	$ 6.1
Due in one to five years	26.3	26.2
Total	$ 32.4	$ 32.3

Contractual maturities for held-to-maturity investments were all less than one year at March 31, 2011.

The Company did not sell any of its long-term investments described above during the three months ended March 31, 2011 and, thus, had no proceeds, realized gains or realized losses related to these securities.

In addition to the securities described above, the Company holds investments in debt and equity securities related to the Company s pro-rata share of funding in the Newcastle Coal Infrastructure Group (NCIG). The debt securities are recorded at cost, which approximates fair value, in Australian dollars adjusted for changes in the U.S. dollar to Australian dollar exchange rates. The equity securities are recorded at cost, which approximates fair value. During the three months ended March 31, 2011, the Company sold $15.5 million of the debt securities related to NCIG.

The Company did not recognize any other than temporary losses on any of its investments during the three months ended March 31, 2011.

(4) Inventories

Inventories consisted of the following:

	March 31, 2011	December 31, 2010
	(Dollars in millions)	
Materials and supplies	$ 101.3	$ 97.1
Raw coal	58.6	55.4
Saleable coal	202.9	180.4
Total	$ 362.8	$ 332.9

(5) Derivatives and Fair Value Measurements

Risk Management Non Coal Trading Activities

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 March 31, 2011, the Company had no interest rate swaps in place.

Foreign Currency Hedges. The Company is exposed to foreign currency exchange rate risk, primarily 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.

Diesel Fuel and Explosives Hedges. The Company is exposed to commodity price risk associated with diesel fuel and explosives in the United States (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 as 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 March 31, 2011:

	Notional Amount by Year of Maturity						
	Total	2011	2012	2013	2014	2015	2016 and thereafter
Foreign Currency							
A$:US$ hedge contracts (A$ millions)	$ 4,033.7	$ 1,139.9	$ 1,402.7	$ 1,022.6	$ 468.5	$	$
Commodity Contracts							
Diesel fuel hedge contracts (million gallons)	179.2	67.1	76.2	35.9			
U.S. explosives hedge contracts (million MMBtu)	6.5	2.6	2.7	1.2			

	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)	$ 4,033.7	$	$	$ 687.2

Commodity Contracts			
Diesel fuel hedge contracts (million gallons)	179.2	$	133.5
U.S. explosives hedge contracts (million MMBtu)	6.5	$	(0.1)

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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. To the extent that the periodic changes in the fair value of the derivatives exceed the changes in the hedged item, the ineffective portion of the periodic non-cash changes are recorded in the consolidated statements of operations in the period of the change. If the hedge ceases to qualify for hedge accounting, the Company prospectively recognizes the mark-to-market movements in the consolidated statements of operations in the period of the change.

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 and product 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.

The Company s derivative positions relating to foreign currency expenditures contain a small measure of ineffectiveness due to timing differences between the hedge settlement and the purchase transaction, which could differ by less than a day and up to a maximum of 30 days.

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 months ended March 31, 2011 and 2010:

		Three Months Ended March 31, 2011			
Financial Instrument	Income Statement Classification Gains (Losses) Realized	Loss recognized in income on non-designated derivatives	Gain recognized in other comprehensive income on derivative (effective portion)	Gain 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	$	$ 98.9	$ 8.1	$ 2.4
Explosives cash flow hedge contracts:					
Cash flow hedges	Operating costs and expenses		0.1		(0.1)
Foreign currency cash flow hedge contracts	Operating costs and expenses		119.8	72.7	

Total		$	$ 218.8	$ 80.8	$ 2.3

Financial Instrument	Income Statement Classification Gains (Losses) Realized	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 reclassified from other comprehensive income into income (ineffective portion)
		Three Months Ended March 31, 2010 (Dollars in millions)			
Interest rate swaps:					
Cash flow hedges	Interest Expense	$	$ 0.9	$ (1.2)	$
Diesel fuel hedge contracts:					
Cash flow hedges	Operating costs and expenses		8.4	(7.1)	1.0
Explosives cash flow hedge contracts:					
Cash flow hedges	Operating costs and expenses		(3.8)	(2.3)	
Foreign currency cash flow hedge contracts	Operating costs and expenses		82.0	38.8	
Total		$	$ 87.5	$ 28.2	$ 1.0

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

Based on the net fair value of the Company s non-coal trading positions held in Accumulated other comprehensive loss at March 31, 2011, unrealized gains to be reclassified from comprehensive income to earnings over the next 12 months associated with the Company s foreign currency and diesel fuel hedge programs are expected to be approximately $319 million and $65 million, respectively. The unrealized gains to be realized under the explosives hedge program are expected to be less than $1 million. As these unrealized gains are associated with derivative instruments that represent hedges of forecasted transactions, the amounts reclassified to earnings may partially offset the realized transactions in the condensed consolidated statements of operations.

The classification and amount of derivatives presented on a gross basis as of March 31, 2011 and December 31, 2010 are as follows:

	Fair Value as of March 31, 2011			
Financial Instrument	Current Assets	Noncurrent Assets	Current Liabilities	Noncurrent Liabilities
	(Dollars in millions)			
Diesel fuel cash flow hedge contracts	$ 69.5	$ 68.7	$ 4.7	$
Explosives cash flow hedge contracts	0.4	0.1	0.1	0.5
Foreign currency cash flow hedge contracts	319.0	368.2		
Total	$ 388.9	$ 437.0	$ 4.8	$ 0.5

	Fair Value as of December 31, 2010			
Financial Instrument	Current Assets	Noncurrent Assets	Current Liabilities	Noncurrent Liabilities
	(Dollars in millions)			
Diesel fuel cash flow hedge contracts	$ 25.3	$ 26.9	$ 11.9	$
Explosives cash flow hedge contracts	0.5	0.1	0.1	0.6
Foreign currency cash flow hedge contracts	273.5	366.6		
Total	$ 299.3	$ 393.6	$ 12.0	$ 0.6

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.

See Note 6 for information related to the Company s coal trading activities and the instruments that are part of its trading book.

Fair Value Measurements

Fair Value Measured on a Recurring Basis. 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.

PEABODY ENERGY CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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:

	March 31, 2011			
	Level 1	Level 2	Level 3	Total
	(Dollars in millions)			
Investment in debt securities	$ 32.3	$	$	$ 32.3
Commodity swaps and options diesel fuel		133.5		133.5
Commodity swaps and options explosives		(0.1)		(0.1)
Foreign currency hedge contracts		687.2		687.2
Total net financial assets	$ 32.3	$ 820.6	$	$ 852.9

	December 31, 2010			
	Level 1	Level 2	Level 3	Total
	(Dollars in millions)			
Investment in debt securities	$ 17.9	$	$	$ 17.9
Commodity swaps and options diesel fuel		40.3		40.3
Commodity swaps and options explosives		(0.1)		(0.1)
Foreign currency hedge contracts		640.1		640.1
Total net financial assets	$ 17.9	$ 680.3	$	$ 698.2

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 diesel fuel and explosives: generally valued based on a valuation that is corroborated by the use of market-based pricing (Level 2).

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

The Company did not have any transfers between levels during the three months ended March 31, 2011 or 2010 for its non-coal trading positions. The Company s policy is to value all transfers between levels using the beginning of period valuation.

Other Financial Instruments. The following methods and assumptions were used by the Company in estimating fair values for other financial instruments as of March 31, 2011 and December 31, 2010:

Cash and cash equivalents, accounts receivable, including those within the Company s accounts receivable 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 consolidated balance sheets includes the Company s investments in debt and equity securities related to the Company s pro-rata share of funding in NCIG. The debt securities are recorded at cost, which approximates fair value, in Australian dollars adjusted for changes in the U.S. dollar

to Australian dollar exchange rates. The equity securities are recorded at cost, which approximates fair value.

PEABODY ENERGY CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 (the Debentures) are net of the respective unamortized note discounts.

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

	March 31, 2011		December 31, 2010	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(Dollars in millions)			
Long-term debt	$ 2,740.4	$ 2,941.8	$ 2,750.0	$ 2,960.0

Nonperformance and Credit Risk

The fair value of the Company s non-coal trading derivative assets and liabilities reflects adjustments for nonperformance and credit risk. The Company conducts its hedging activities related to foreign currency, interest rate, fuel and explosives exposures with a variety of highly-rated commercial banks and closely monitors counterparty creditworthiness. To reduce its credit exposure for these hedging activities, the Company seeks to enter into netting agreements with counterparties that permit the Company to offset asset and liability positions with such counterparties.

(6) Coal Trading

Risk Management Coal Trading

The Company engages in direct and brokered trading of coal, ocean freight and fuel-related commodities in over-the-counter markets (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, all derivative coal trading contracts are accounted for on a fair value basis.

The Company s policy is to include instruments associated with coal trading transactions as a part of its trading book. Trading revenues are recorded in Other revenues in the unaudited 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. Therefore, the Company has elected the trading exemption to reflect the disclosures for its coal trading activities.

Trading Revenue by Type of Instrument	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010
	(Dollars in millions)	
Commodity swaps and options	$ (31.8)	$ 27.4
Physical commodity purchase / sale contracts	21.9	28.6
Total trading revenue	$ (9.9)	$ 56.0

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, has different quality specifications, or has a different location basis than the occurrence of the cash flow being hedged. These collectively yield ineffectiveness to the extent that the derivative hedge contract does not exactly offset changes in the fair value or expected cash flows of the hedged item.

Fair Value Measurements

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

	March 31, 2011		December 31, 2010	
	(Dollars in millions)			
	Gross Basis	Net Basis	Gross Basis	Net Basis
Assets from coal trading activities	$ 1,589.2	$ 166.2	$ 1,706.2	$ 192.5
Liabilities from coal trading activities	(1,787.3)	(157.4)	(1,843.5)	(181.7)
Subtotal	(198.1)	8.8	(137.3)	10.8
Net margin posted [1]	206.9		148.1	
Net value of coal trading positions	$ 8.8	$ 8.8	$ 10.8	$ 10.8

[1] Represents margin posted with counterparties of $206.9 million at March 31, 2011; and margin posted with counterparties of $148.2 million, net of margin held of $0.1 million at December 31, 2010. In addition, at March 31, 2011 and December 31, 2010, the Company held letters of credit of $5.5 million and $5.0 million, respectively, from counterparties in lieu of margin posted. Of the margin posted at March 31, 2011, approximately 85% related to cash flow hedges.

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 U.S. interest rate curves, LIBOR yield curves, New York Mercantile Exchange (NYMEX), Intercontinental Exchange indices (ICE), NOS Clearing ASA, LCH.Clearnet (formerly known as the London Clearing House), 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:

Commodity swaps and options 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).

Physical commodity purchase/sale contracts purchases and sales at locations with significant market activity corroborated by market-based information (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. Indicators of less liquid markets are those with periods of low trade activity or when broker quotes reflect wide pricing spreads. Generally, the Company s Level 3 instruments or contracts are valued using internally generated models that include bid/ask price quotations, other market assessments obtained from multiple, independent third-party brokers or other transactional data. 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 the valuing of its market positions should the number of third-party brokers decrease or if market liquidity is reduced. The Company s valuation techniques also include basis adjustments for heat rate, sulfur and ash content, port and freight costs, and credit and nonperformance risk. The Company validates its valuation inputs with third-party information and settlement prices from other sources where available. 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 following tables set forth the hierarchy of the Company s net financial asset (liability) coal trading positions for which fair value is measured on a recurring basis:

	March 31, 2011			
	Level 1	Level 2	Level 3	Total
	(Dollars in millions)			
Commodity swaps and options	$ 15.0	$ (87.6)	$	$ (72.6)
Physical commodity purchase/sale contracts		68.9	12.5	81.4
Total net financial assets (liabilities)	$ 15.0	$ (18.7)	$ 12.5	$ 8.8

	December 31, 2010			
	Level 1	Level 2	Level 3	Total
	(Dollars in millions)			
Commodity swaps and options	$ 10.7	$ (76.2)	$	$ (65.5)
Physical commodity purchase/sale contracts		57.7	18.6	76.3
Total net financial assets (liabilities)	$ 10.7	$ (18.5)	$ 18.6	$ 10.8

The Company did not have any significant transfers between Level 1 and Level 2 during the three months ended March 31, 2011 or 2010. During the three months ended March 31, 2011, certain of the Company s physical

commodity purchase/sale contracts were transferred from Level 3 to Level 2 as the settlement dates entered a more liquid market. There were no significant transfers in or out of Level 3 during the three months ended March 31, 2010. The Company s policy is to value all transfers between levels using the beginning of period valuation.

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

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

	Three Months Ended March 31,	
	2011	2010
	(Dollars in millions)	
Beginning of period	$ 18.6	$ 17.0
Total gains or losses (realized/unrealized):		
Included in earnings	10.1	(4.7)
Included in other comprehensive income		0.3
Settlements	3.0	(0.1)
Transfers out	(19.2)	
End of period	$ 12.5	$ 12.5

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

	Three Months Ended March 31,	
	2011	2010
	(Dollars in millions)	
Changes in unrealized gains (losses) [1]	$ 10.0	$ (1.2)

(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.

The Company s trading assets and liabilities are generally made up of forward contracts, financial swaps and margin. The net fair value of coal trading positions designated as cash flow hedges of anticipated future sales was a liability of $248.7 million and $174.2 million as of March 31, 2011 and December 31, 2010, respectively.

Based on the net fair value of the Company s coal trading positions held in Accumulated other comprehensive loss at March 31, 2011, unrealized losses to be reclassified from comprehensive income to earnings over the next 12 months are expected to be approximately $124 million. As these unrealized losses are associated with derivative instruments that represent hedges of forecasted transactions, the amounts reclassified to earnings may partially offset the realized transactions in the condensed consolidated statements of operations.

As of March 31, 2011, the timing of the estimated future realization of the value of the Company s trading portfolio was as follows:

Year of Expiration	Percentage of Portfolio Total
2011	64%
2012	25%
2013	4%
2014	5%
2015	2%
	100%

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

At March 31, 2011, 46% of the Company s credit exposure related to coal trading activities was with investment grade counterparties and 54% was with non-investment grade counterparties.

Nonperformance and Credit Risk. The fair value of the Company s coal derivative assets and liabilities reflects adjustments for nonperformance and credit risk. The Company s exposure 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 asset and liability positions with such counterparties and, to the extent required, will post or receive margin amounts associated with exchange-cleared positions.

Performance Assurances and Collateral. 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 was 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 March 31, 2011 and December 31, 2010, would have amounted to collateral postings of approximately $150 million and $160 million, respectively, to its counterparties. As of March 31, 2011, $11.0 million of collateral was posted to counterparties for such positions while $5.8 million was posted at December 31, 2010 (reflected in Liabilities from coal trading activities, net).

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 have occurred below contractually specified levels, the Company s additional collateral requirement owed to its counterparties would have been approximately $5 million at March 31, 2011 and zero at December 31, 2010 based on the aggregate fair value of all derivative trading instruments with such features that were in a net liability position. As of March 31, 2011, the Company had posted $1.0 million for such instruments in a net liability position. As of December 31, 2010, $5.0 million of margin was posted with a counterparty due to timing and market fluctuations (reflected in Liabilities from coal trading activities, net).

The Company is required by an exchange to post certain collateral, known as initial margin, which represents an estimate of potential future adverse price movements across the Company s portfolio under normal market conditions. As of March 31, 2011 and December 31, 2010, the Company had posted initial margin of $35.0 million and $39.5 million, respectively (reflected in Other current assets). In addition, the Company had posted $0.1 million and $4.4 million of margin in excess of the exchange-required variation (discussed below) and initial margin as of March 31, 2011 and December 31, 2010, respectively (also reflected in Other current assets).

The Company is required to post collateral on positions that are in a net liability position with an exchange, known as variation margin, which was $194.9 million as of March 31, 2011 and $137.4 million as of December 31, 2010 (reflected in Liabilities from coal trading activities, net).

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PEABODY ENERGY CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(7) Income Taxes

The following is a reconciliation of the expected statutory federal income tax provision to the Company s actual income tax provision:

	Three Months Ended March 31,	
	2011	2010
	(Dollars in millions)	
Expected income tax provision at federal statutory rate	$ 86.6	$ 67.6
Excess depletion	(10.8)	(9.7)
Foreign earnings provision differential	(16.3)	(14.8)
Remeasurement of foreign income tax accounts	6.4	5.4
State income taxes, net of U.S. federal tax benefit	1.8	2.4
General business tax credits	(3.1)	(3.6)
Changes in valuation allowance	1.3	5.2
Changes in tax reserves	2.0	1.8
Other, net	(0.1)	1.8
Total provision	$ 67.8	$ 56.1

(8) Pension and Postretirement Benefit Costs

Net periodic pension costs included the following components:

	Three Months Ended March 31,	
	2011	2010
	(Dollars in millions)	
Service cost for benefits earned	$ 0.4	$ 0.4
Interest cost on projected benefit obligation	12.4	12.6
Expected return on plan assets	(16.1)	(14.2)
Amortization of prior service cost	0.3	0.3
Amortization of actuarial loss	7.5	5.5
Net periodic pension costs	$ 4.5	$ 4.6

As of March 31, 2011, the Company s qualified defined benefit pension plans were at or above the thresholds of the Pension Protection Act of 2006 to avoid benefit restrictions and at-risk penalties for 2011. No contributions to the qualified plans are expected during 2011. However, the Company does expect to make contributions to its non-qualified defined benefit pension plans during 2011 totaling less than $2 million. During the three months ended March 31, 2010, the Company made discretionary contributions of approximately $16 million to its defined benefit pension plans.

Net periodic postretirement benefit costs included the following components:

Three Months Ended March 31,	
2011	2010
(Dollars in millions)	

Service cost for benefits earned	$	3.3	$	3.1
Interest cost on accumulated postretirement benefit obligation		14.4		14.5
Amortization of prior service cost		0.5		0.5
Amortization of actuarial loss		6.7		6.4
Net periodic postretirement benefit costs	$	24.9	$	24.5

PEABODY ENERGY CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(9) Comprehensive Income

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

	Three Months Ended March 31,	
	2011	2010
	(Dollars in millions)	
Net income	$ 178.7	$ 136.7
Net increase in fair value of cash flow hedges, net of income taxes	32.5	55.0
Unrealized gains on available-for sale securities, net of income taxes	1.0	
Amortization of actuarial loss and prior service cost associated with postretirement plans and workers compensation obligations, net of income taxes	13.5	7.5
Comprehensive income	$ 225.7	$ 199.2

Comprehensive income differs from net income by the amount of unrealized gains or losses resulting from valuation changes of the Company s cash flow hedges (see Note 5 and Note 6) or its available-for-sale securities (see Note 3) and the change in actuarial loss and prior service cost (see Note 8) during the periods. None of the reconciling items between net income and comprehensive income relates to the Company s noncontrolling interest for either period presented.

(10) Earnings per Share (EPS)

The Company s restricted stock awards are considered participating securities because holders are entitled to receive non-forfeitable dividends during the vesting term. As such, the Company uses the two-class method to compute basic and diluted EPS. Diluted EPS includes securities that could potentially dilute basic EPS during a reporting period, which for the Company includes the Debentures and share-based compensation awards.

A conversion of the Debentures may result in settlement of the Company s common stock for any conversion value in excess of the principal amount of the Debentures. For diluted EPS purposes, potential common stock is calculated based on whether the market price of the Company s common stock at the end of each reporting period is in excess of the conversion price of the Debentures. For a full discussion of the conditions under which the Debentures may be converted, the conversion rate to common stock and the conversion price, see Note 8 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

For all but the performance units, the potentially dilutive impact of the Company s share-based compensation awards is determined using the treasury stock method. With the contingent features of the performance unit awards, the assessment for any potential common stock to be included in the diluted EPS is done using the end of the reporting period as if it were the end of the contingency period for all units granted. For a full discussion of the Company s share-based compensation awards, see Note 14 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

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

The following illustrates the earnings allocation method utilized in the calculation of basic and diluted EPS.

	Three Months Ended March 31,	
	2011	2010
	(In millions, except per share amounts)	
EPS numerator:		
Income from continuing operations, net of income taxes	$ 179.6	$ 137.1
Less: Net income attributable to noncontrolling interests	2.2	3.0
Income from continuing operations attributable to common stockholders, before allocation of earnings to participating securities	177.4	134.1
Less: Earnings allocated to participating securities	(0.9)	(0.9)
Income from continuing operations attributable to common stockholders, after earnings allocated to participating securities [1]	176.5	133.2
Loss from discontinued operations, net of income taxes	(0.9)	(0.4)
Net income attributable to common stockholders, after earnings allocated to participating securities [1]	$ 175.6	$ 132.8
EPS denominator:		
Weighted average shares outstanding basic	268.9	266.5
Impact of dilutive securities	3.9	1.7
Weighted average shares outstanding diluted [2]	272.8	268.2
Basic EPS attributable to common stockholders:		
Income from continuing operations	$ 0.66	$ 0.50
Income (loss) from discontinued operations		
Net income	$ 0.66	$ 0.50
Diluted EPS attributable to common stockholders:		
Income from continuing operations	$ 0.65	$ 0.50
Income (loss) from discontinued operations		
Net income	$ 0.65	$ 0.50

(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 of approximately 0.1 million for the three months ended March 31, 2011 and 2010.

(11) Financial Instruments and Guarantees 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, which are not reflected in the accompanying 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.

PEABODY ENERGY CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Financial Instruments with Off-Balance Sheet Risk

The Company had various financial instruments with off-balance sheet risk in support of the Company s reclamation, coal lease and workers compensation obligations as follows as of March 31, 2011:

	Reclamation Obligations	Lease Obligations	Workers Compensation Obligations	Other[1]	Total
			(Dollars in millions)		
Self bonding	$ 938.4	$	$	$	$ 938.4
Surety bonds	613.7	110.3	6.2	10.4	740.6
Bank guarantees	129.4			130.8	260.2
Letters of credit			79.7	2.7	82.4
Bilateral cash collateralization agreements				79.7	79.7
	$ 1,681.5	$ 110.3	$ 85.9	$ 223.6	$ 2,101.3

(1) Other includes letter of credit and bilateral cash collateralization agreement obligations described below and an additional $141.2 million in 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 March 31, 2011, 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 has a bilateral cash collateralization agreement for these letters of credit whereby the Company posted cash collateral in lieu of utilizing the Company s unsecured credit facility (Credit Facility). See Note 8 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2010 for more information on the Company s Credit Facility. Such cash collateral is classified within cash and cash equivalents given the Company has the ability to substitute letters of credit at any time for this cash collateral and it is therefore readily available to the Company.

The Company is party to an agreement with the 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. The Company has a bilateral cash collateralization agreement for this letter of credit whereby the Company posted cash collateral in lieu of utilizing the Company s unsecured credit agreement. Such cash collateral is classified within cash and cash equivalents given the Company has the ability to substitute a letter of credit at any time for this cash collateral and it is therefore readily available to the Company. 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 March 31, 2011. 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 March 31, 2011, the Company had a $2.7 million letter of credit for collateral for bank guarantees 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)

Accounts Receivable Securitization

The Company has an accounts receivable securitization program (securitization program) with a maximum capacity of $275.0 million through its wholly-owned, bankruptcy-remote subsidiary (Seller). At March 31, 2011, the Company had $20.4 million available under the securitization program, net of outstanding letters of credit and amounts drawn. Under the securitization program, 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 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 three months ended March 31, 2011, the Company received total consideration of $1,186.1 million related to accounts receivable sold under the securitization program, including $952.4 million of cash up front from the sale of the receivables, an additional $76.7 million of cash upon the collection of the underlying receivables, and $157.0 million that had not been collected at March 31, 2011 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 $150.0 million at March 31, 2011 and December 31, 2010.

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 $0.7 million for the three months ended March 31, 2011 and 2010, respectively.

Other

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 the Prairie State Energy Campus (Prairie State), a 1,600 megawatt coal-fuel electricity generation project currently under construction, each owner, including one of the Company s subsidiaries, has issued a guarantee for its proportionate share (5.06% for the Company) 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.

PEABODY ENERGY CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(12) Commitments and Contingencies

Commitments

As of March 31, 2011, purchase commitments for capital expenditures were $535.4 million, all of which is obligated within the next three years with $517.5 million obligated in the next 12 months.

A subsidiary of the Company owns a 5.06% undivided interest in Prairie State. The Company invested $8.9 million and $12.2 million during the three months ended March 31, 2011 and 2010, respectively, representing its 5.06% share of the construction costs for those periods. Included in Investments and other assets in the condensed consolidated balance sheets as of March 31, 2011 and December 31, 2010 are costs of $211.4 million and $202.5 million, respectively. The Company s share of total construction costs for Prairie State is expected to be approximately $250 million with most of the remaining funding expected in 2011.

There were no other material changes to the Company s commitments from the information provided in Note 20 to the Consolidated Financial Statements in the Company s Annual Report on Form 10-K for the year ended December 31, 2010.

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.

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 its 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 allowed the Hopi Tribe to intervene in this lawsuit, and the Hopi Tribe sought 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 the court dismissed those claims. The court ordered the Navajo Nation and the defendants to mediate the case. Mediation commenced in November 2010 and the parties continue the mediation.

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.

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

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 judgment, contesting the trial court s damages order, to which the Company objected. The court has not yet ruled on the motion.

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.

Gold Fields and several other companies are defendants in two property damage lawsuits pending in the U.S. District Court for the Northern District of Oklahoma 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 denied class certification and the cases were subsequently amended to include a number of individual plaintiffs.

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.

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.

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

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 $50.9 million as of March 31, 2011 and $51.1 million as of December 31, 2010, $6.1 million and $6.3 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 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.

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 parties have filed their respective briefs with the court. The Ninth Circuit has stayed the case until June 15, 2011.

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. In June 2007, the New York Office of the Attorney General served a letter and subpoena on the Company, seeking information and documents relating to the Company s disclosure to investors of risks associated with possible climate change and related legislation and regulations. The Company believes that it has made full and proper disclosure of these potential risks.

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.

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PEABODY ENERGY CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(13) 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.

Operating segment results were as follows:

	Three Months Ended March 31,	
	2011	2010
	(Dollars in millions)	
Revenues:		
Western U.S. Mining	$ 703.7	$ 662.1
Midwestern U.S. Mining	367.0	309.4
Australian Mining	580.6	446.5
Trading and Brokerage	83.9	90.1
Corporate and Other	9.7	7.5
Total	$ 1,744.9	$ 1,515.6
Adjusted EBITDA:		
Western U.S. Mining	$ 179.4	$ 207.9
Midwestern U.S. Mining	109.9	74.1
Australian Mining	190.5	123.3
Trading and Brokerage	26.8	32.4
Corporate and Other	(90.4)	(80.5)
Total	$ 416.2	$ 357.2

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

	Three Months Ended March 31,	
	2011	2010
	(Dollars in millions)	
Total Adjusted EBITDA	$ 416.2	$ 357.2
Depreciation, depletion and amortization	108.8	105.5
Asset retirement obligation expense	13.1	9.5
Interest expense	51.0	50.0
Interest income	(4.1)	(1.0)
Income tax provision	67.8	56.1
Income from continuing operations, net of income taxes	$ 179.6	$ 137.1

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PEABODY ENERGY CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(14) Supplemental Guarantor/Non-Guarantor Financial Information

In accordance with the indentures governing the 6.875% Senior Notes due March 2013 (redeemed in the third quarter of 2010), the 5.875% Senior Notes due March 2016 (redeemed subsequent to March 31, 2011 as discussed in Note 15), 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 Consolidating Statements of Operations

	Three Months Ended March 31, 2011				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	(Dollars in millions)				
Total revenues	$	$ 976.9	$ 897.0	$ (129.0)	$ 1,744.9
Costs and expenses					
Operating costs and expenses	(82.8)	686.2	793.7	(129.0)	1,268.1
Depreciation, depletion and amortization		74.2	34.6		108.8
Asset retirement obligation expense		9.8	3.3		13.1
Selling and administrative expenses	8.5	50.0	3.1		61.6
Other operating (income) loss:					
Net (gain) loss on disposal or exchange of assets		(4.9)	0.9		(4.0)
(Income) loss from equity affiliates	(159.9)	1.9	1.1	159.9	3.0
Interest expense	51.1	13.2	3.4	(16.7)	51.0
Interest income	(4.3)	(5.3)	(11.2)	16.7	(4.1)
Income from continuing operations before income taxes	187.4	151.8	68.1	(159.9)	247.4
Income tax provision	10.3	41.2	16.3		67.8
Income from continuing operations, net of income taxes	177.1	110.6	51.8	(159.9)	179.6
Loss from discontinued operations, net of income taxes	(0.6)	(0.3)			(0.9)
Net income	176.5	110.3	51.8	(159.9)	178.7
Less: Net income attributable to noncontrolling interests			2.2		2.2
Net income attributable to common stockholders	$ 176.5	$ 110.3	$ 49.6	$ (159.9)	$ 176.5

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

	Three Months Ended March 31, 2010				
	Parent Company	Guarantor Subsidiaries	Non-Guarantor Subsidiaries (Dollars in millions)	Eliminations	Consolidated
Total revenues	$	$ 1,103.5	$ 597.9	$ (185.8)	$ 1,515.6
Costs and expenses					
Operating costs and expenses	(28.3)	828.8	494.0	(185.8)	1,108.7
Depreciation, depletion and amortization		72.4	33.1		105.5
Asset retirement obligation expense		7.0	2.5		9.5
Selling and administrative expenses	9.1	44.6	1.7		55.4
Other operating (income) loss:					
Net gain on disposal or exchange of assets		(7.3)			(7.3)
(Income) loss from equity affiliates	(150.6)	1.8	1.2	149.2	1.6
Interest expense	49.5	12.8	3.7	(16.0)	50.0
Interest income	(3.8)	(5.4)	(7.8)	16.0	(1.0)
Income from continuing operations before income taxes	124.1	148.8	69.5	(149.2)	193.2
Income tax provision (benefit)	(9.6)	48.9	16.8		56.1
Income from continuing operations, net of income taxes	133.7	99.9	52.7	(149.2)	137.1
Loss from discontinued operations, net of income taxes		(0.4)			(0.4)
Net income	133.7	99.5	52.7	(149.2)	136.7
Less: Net income attributable to noncontrolling interests			3.0		3.0
Net income attributable to common stockholders	$ 133.7	$ 99.5	$ 49.7	$ (149.2)	$ 133.7

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

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