

PEABODY ENERGY CORP

Form 10-Q

November 05, 2010

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

(Mark One)

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

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

or

**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  No

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  No

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  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

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

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



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

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

**Net Income Attributable to Common  
Stockholders**

<b>Basic earnings per share</b>	\$ 0.84	\$ 0.40	\$ 2.10	\$ 1.33
<b>Diluted earnings per share</b>	\$ 0.83	\$ 0.40	\$ 2.08	\$ 1.32
<b>Dividends declared per share</b>	\$ 0.07	\$ 0.06	\$ 0.21	\$ 0.18

See accompanying notes to unaudited condensed consolidated financial statements.

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

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



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

See accompanying notes to unaudited condensed consolidated financial statements.

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

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

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

See accompanying notes to unaudited condensed consolidated financial statements.

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**PEABODY ENERGY CORPORATION**  
**UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY**

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

See accompanying notes to unaudited condensed consolidated financial statements.

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**PEABODY ENERGY CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Basis of Presentation**

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

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

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

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

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

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

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

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

**Table of Contents****PEABODY ENERGY CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(3) Discontinued Operations**

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

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

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

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

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

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

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

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

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

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

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

<b>Year of Expiration</b>	<b>Percentage of Portfolio Total</b>
2010	13%
2011	61%
2012	24%
2013	2%
	100%

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

**(5) Inventories**

Inventories consisted of the following:

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

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

**(6) Income Taxes**

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

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



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

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

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

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

**(7) Long-Term Debt**

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

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

**Credit Facility**

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



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

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

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

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

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

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

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

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

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

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

**Table of Contents****PEABODY ENERGY CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****6.5% Senior Notes**

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

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

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

**Other Long-Term Debt**

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

**(8) Comprehensive Income**

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

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

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



**Table of Contents****PEABODY ENERGY CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(9) Earnings per Share (EPS)**

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

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

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

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

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

Net periodic pension costs included the following components:

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





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

Net periodic postretirement benefit costs included the following components:

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

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

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

**(11) Segment Information**

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

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

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

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

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

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

**(12) Risk Management and Fair Value Measurements*****Risk Management Non Coal Trading***

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

contracts rather than financial instruments.

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

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

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

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

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

<b>Account Classification by</b>			
<b>Cash flow hedge</b>	<b>Fair value hedge</b>	<b>Economic hedge</b>	<b>Fair Value Asset (Liability) (Dollars in millions)</b>

**Foreign Currency**

A\$:US\$ hedge contracts (A\$ millions)	\$4,510.6	\$	\$	\$ 457.0
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**Commodity Contracts**

Diesel fuel hedge contracts (million gallons)	211.4			\$ (2.4)
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U.S. explosives hedge contracts (million MMBtu)	0.7			\$ (2.1)
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*Hedge Ineffectiveness.* The Company assesses both at inception and at least quarterly thereafter, whether the derivatives used in hedging activities are highly effective at offsetting the changes in the anticipated cash flows of the hedged item. The effective portion of the change in the fair value is recorded as a separate component of stockholders equity until the hedged transaction impacts reported earnings, at which time gains and losses are reclassified to the consolidated statements of operations at the time of the recognition of the underlying hedged item. The ineffective portion of the derivative's change in fair value is recorded in the consolidated statements of operations. In addition, if the hedging relationship ceases to be highly effective, or it becomes probable that a forecasted transaction is no longer expected to occur, gains and losses on the derivative are recorded to the consolidated statements of operations.

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

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

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

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

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

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

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

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

<b>Financial Instrument</b>	<b>Gains (Losses) - Realized</b>	<b>Nine Months Ended September 30, 2010</b>			
		<b>Gain (loss) recognized in income on non</b>	<b>Gain (loss) recognized in other comprehensive income on designated</b>	<b>Gain (loss) reclassified from other comprehensive income into effective portion)</b>	<b>Gain (loss) reclassified from other comprehensive income into ineffective portion)</b>
		<b>derivatives<sup>(1)</sup></b>	<b>derivative (effective portion)</b>	<b>(effective portion)</b>	<b>(ineffective portion)</b>
		<b>(Dollars in millions)</b>			



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

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

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

Explosives cash flow hedge contracts:

- Cash flow hedges	Operating costs and expenses		(2.0)	(11.9)
- Economic hedges	Operating costs and expenses	(2.1)		
Foreign currency cash flow hedge contracts	Operating costs and expenses		402.4	(54.0)

Total \$ (3.2) \$ 434.9 \$ (148.3) \$ 1.2

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

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

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

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

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

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

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

**Risk Management - Coal Trading**

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

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

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

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

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

***Nonperformance and Credit Risk***

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

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

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

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

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

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

**Fair Value Measurements**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
	(Dollars in millions)			
Changes in unrealized gains (losses) <sup>(1)</sup>	\$ 1.2	\$ (2.9)	\$ 3.5	\$ (2.3)

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

**Fair Value Other Financial Instruments**

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

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

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



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

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

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

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**Table of Contents****PEABODY ENERGY CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(13) Commitments and Contingencies*****Commitments***

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

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

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

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

***Contingencies***

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

**Table of Contents****PEABODY ENERGY CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Litigation Relating to Continuing Operations*

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

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

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

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

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

*Claims and Litigation Relating to Indemnities or Historical Operations*

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

the crude ore mined in the county.

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

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

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

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

*Environmental Claims and Litigation*

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

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

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

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

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

*Other*

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

*New York Office of the Attorney General Subpoena.* The New York Office of the Attorney General sent a letter to the Company dated June 14, 2007 that referred to the Company's plans to build new coal-fired electric generating units, and said that the increase in CO<sub>2</sub> emissions from the operation of these units, in combination with Peabody Energy's other coal-fired power plants, will subject Peabody Energy to increased financial, regulatory, and litigation risks. The Company currently has no electricity generating capacity in place. The letter included a subpoena issued under New York state law, which seeks information and documents relating to the Company's analysis of the risks associated with climate change and possible climate change legislation or regulations, and its disclosure of such risks to investors. The Company believes that it has made full and proper disclosure of these potential risks.



**Table of Contents****PEABODY ENERGY CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(14) Guarantees and Financial Instruments with Off-Balance-Sheet Risk**

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

**Letters of Credit and Bonding**

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

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

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

The Company owns a 37.5% interest in Dominion Terminal Associates, a partnership that operates a coal export terminal in Newport News, Virginia under a 30-year lease that permits the partnership to purchase the terminal at the



end of the lease term for a nominal amount. The partners have severally (but not jointly) agreed to make payments under various agreements which in the aggregate provide the partnership with sufficient funds to pay rents and to cover the principal and interest payments on the floating-rate industrial revenue bonds issued by the Peninsula Ports Authority, and which are supported by letters of credit from a commercial bank. As of September 30, 2010, the Company's maximum reimbursement obligation to the commercial bank was in turn supported by four letters of credit totaling \$42.7 million.

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

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

**Table of Contents****PEABODY ENERGY CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)*****Other Guarantees***

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

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

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

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

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

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

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

respectively and \$1.8 million and \$3.4 million for the nine months ended September 30, 2010 and 2009, respectively.

**Table of Contents****PEABODY ENERGY CORPORATION****NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(15) Supplemental Guarantor/Non-Guarantor Financial Information**

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

**Unaudited Supplemental Condensed Consolidated Statements of Operations**

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

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

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

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

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

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

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

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

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



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

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

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

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

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

Nine Months Ended September 30, 2010

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



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

Nine Months Ended September 30, 2009

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

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

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

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

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

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

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

litigation, including claims not yet asserted;

terrorist attacks or threats;

impacts of pandemic illnesses; and

other factors, including those discussed in Legal Proceedings.

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



**Table of Contents****Overview**

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

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

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

**Results of Operations**

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

**Adjusted EBITDA**

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

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

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

Benchmark high quality, hard-coking coal from Australia has maintained quarterly prices between \$200 and \$225 per tonne since April 2010;

Index prices for Australian seaborne thermal coal are 35-40% above prior year levels;

U.S. coal production through September 2010 is approximately 2% below 2009 levels;

U.S. coal consumption for electricity generation has increased nearly 6.5% through September 2010; and

Customer inventories of Powder River Basin coal have been decreasing in 2010 and are at approximately 56 days of use as of September 2010.

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

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

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

**Tons Sold**

The following table presents tons sold by operating segment:

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

**Revenues**

The following table presents revenues by operating segment:

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

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

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

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

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

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

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

**Segment Adjusted EBITDA**

The following table presents segment Adjusted EBITDA by operating segment:

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

Australian Mining operations Adjusted EBITDA increased for both periods compared to the prior year as discussed below:

Australian Mining operations Adjusted EBITDA increase for the three months ended was driven by an increase in our weighted average sales price and increased volumes as discussed above, and lower production costs as prior year costs reflect the realization of higher cost inventory incurred in the first half of 2009. Partially offsetting the above increases to Adjusted EBITDA were increased royalty expense associated with our higher-priced metallurgical coal shipments and adverse weather that impacted production at one of our mines.

Australian Mining operations Adjusted EBITDA increase for the nine months ended was driven by an increase in volumes and pricing as discussed above, productivity improvements at our North Goonyella and Wambo underground mines, improved geological conditions at certain of our mines and fewer longwall moves. Partially offsetting the above improvements were an unfavorable foreign currency impact on operating costs, net of hedging, the impact of adverse weather, increased demurrage costs, and increased royalty expense associated with our higher-priced metallurgical coal shipments.

Western U.S. Mining operations Adjusted EBITDA increased for both periods compared to the prior year due to a higher weighted average sales price as discussed above and a shift in volume to our higher-margin operations, partially offset by increased commodity costs (three months, \$10.1 million; nine months, \$15.6 million). In addition, the nine months ended compared to the prior year includes lower repairs and maintenance costs (\$51.8 million) due to timing of repairs and improved equipment efficiency.

Midwestern U.S. Mining operations Adjusted EBITDA increased for both periods compared to the prior year as the impact of a higher weighted average sales price benefited margins enough to more than offset lower volumes due to decreased demand and lower production.

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Trading and Brokerage operations Adjusted EBITDA decreased for the nine months compared to the prior year primarily due to lower U.S. exports due to the weak Atlantic market, along with vessel timing and overall lower trading levels and reduced trading volatility.

**Income From Continuing Operations Before Income Taxes**

The following table presents income from continuing operations before income taxes:

	Three Months Ended		Increase (Decrease) to Income		Nine Months Ended		Increase (Decrease) to Income	
	September 30, 2010	2009	\$	%	September 30, 2010	2009	\$	%
<b>(Dollars in millions)</b>								
Total Segment Adjusted EBITDA	\$ 660.4	\$ 428.0	\$ 232.4	54.3%	\$ 1,614.7	\$ 1,215.6	\$ 399.1	32.8%
Corporate and Other Adjusted EBITDA <sup>(1)</sup>	(89.1)	(86.9)	(2.2)	(2.5)%	(245.8)	(222.9)	(22.9)	(10.3)%
Depreciation, depletion and amortization	(116.7)	(108.0)	(8.7)	(8.1)%	(327.3)	(305.5)	(21.8)	(7.1)%
Asset retirement obligation expense	(9.9)	(12.8)	2.9	22.7%	(30.3)	(31.8)	1.5	4.7%
Interest expense	(62.2)	(52.3)	(9.9)	(18.9)%	(170.1)	(151.6)	(18.5)	(12.2)%
Interest income	2.8	2.2	0.6	27.3%	5.4	6.2	(0.8)	(12.9)%
Income from continuing operations before income taxes	\$ 385.3	\$ 170.2	\$ 215.1	126.4%	\$ 846.6	\$ 510.0	\$ 336.6	66.0%

(1) Corporate and Other Adjusted EBITDA results include selling and administrative expenses, equity income (loss) from our joint ventures, net gains on asset disposals or exchanges, costs associated with past mining obligations and revenues and expenses related

to our other  
commercial  
activities such  
as generation  
development  
and Btu  
Conversion  
development  
costs.

Income from continuing operations before income taxes was higher for both periods compared to the prior year primarily due to the higher Total Segment Adjusted EBITDA discussed above, partially offset by lower Corporate and Other Adjusted EBITDA and higher depreciation, depletion and amortization expense and interest expense as discussed below:

The decrease in Corporate and Other Adjusted EBITDA for the nine months ended September 30, 2010 compared to the prior year was primarily due to a current year increase in selling and administrative expenses related to an increase in headcount and professional services costs to support our international expansion, acquisition activity and other growth initiatives. We also incurred increased costs related to post mining operations driven by higher retiree healthcare amortization of actuarial losses and interest cost. These decreases to Corporate and Other Adjusted EBITDA were partially offset by improved results from equity affiliates due to prior year operating losses from our joint venture interest in Carbones del Guasare (three months, \$7.8 million; nine months, \$15.2 million) and current year earnings associated with transaction services related to our Mongolian joint venture (nine months, \$10.0 million).

Depreciation, depletion and amortization was higher for the three and nine months ended September 30, 2010 compared to the prior year due to increased production at our Australian mines reflecting higher demand and additional depreciation expense associated with our new Bear Run Mine (commissioned in the second quarter of 2010).

Interest expense was higher for the three and nine months ended September 30, 2010 compared to the prior year primarily due to charges (\$8.4 million) associated with the extinguishment of \$650.0 million of senior notes in the third quarter of 2010. In addition, interest expense was higher for the nine months compared to the prior year due to refinancing charges incurred in the second quarter of 2010 (\$9.3 million) associated with our new five-year Credit Facility.

**Table of Contents****Net Income Attributable to Common Stockholders**

The following table presents net income attributable to common stockholders:

	Three Months Ended September 30,		Increase (Decrease) to Income		Nine Months Ended September 30,		Increase (Decrease) to Income	
	2010	2009	\$	%	2010	2009	\$	%
	(Dollars in millions)							
Income from continuing operations before income taxes	\$ 385.3	\$ 170.2	\$ 215.1	126.4%	\$ 846.6	\$ 510.0	\$ 336.6	66.0%
Income tax provision	(147.7)	(57.0)	(90.7)	(159.1)%	(257.2)	(165.6)	(91.6)	(55.3)%
Income from continuing operations, net of income taxes	237.6	113.2	124.4	109.9%	589.4	344.4	245.0	71.1%
Income (loss) from discontinued operations	(1.3)	(2.4)	1.1	45.8%	(2.2)	23.6	(25.8)	(109.3)%
Net income	236.3	110.8	125.5	113.3%	587.2	368.0	219.2	59.6%
Less: Net income attributable to noncontrolling interests	12.2	4.0	(8.2)	(205.0)%	23.2	12.0	(11.2)	(93.3)%
Net income attributable to common stockholders	\$ 224.1	\$ 106.8	\$ 117.3	109.8%	\$ 564.0	\$ 356.0	\$ 208.0	58.4%

Net income attributable to common stockholders increased for both periods compared to the prior year due to the increased income from continuing operations before income taxes as discussed above.

Income tax provision for the three months ended was impacted by the following:

Increased expense due to current year income tax resulting from planned foreign earnings repatriation (\$84.5 million), higher current year earnings (\$75.3 million), and expense associated with the remeasurement of non-U.S. tax accounts as a result of the strengthening Australian dollar against the U.S. dollar compared to the prior year (\$20.4 million; the table below illustrates the foreign currency exchange rate fluctuations), partially offset by

Current year valuation allowance release of \$69.3 million (\$63.7 million for alternative minimum tax credits and \$5.6 million for expected realization of general business credits) and higher current year percentage depletion benefit (\$24.7 million).

Income tax provision for the nine months ended was impacted by the following:

Increased expense due to higher current year earnings (\$117.8 million) and current year income tax resulting from planned foreign earnings repatriation (\$84.5 million), partially offset by



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Lower expense in the current year due to a valuation allowance release (\$69.3 million) as discussed above, lower expense associated with the remeasurement of non-U.S. tax accounts as a result of the larger increase in the Australian exchange rate against the U.S. dollar in the prior year compared to the current year (\$40.3 million), and lower expense in the current year due to the reduction of our gross unrecognized tax benefit resulting from the completion of the Internal Revenue Service examination of the 2005 federal income tax year (\$15.2 million).

	September 30,		June 30,		December 31,	
	2010	2009	2010	2009	2009	2008
Australian dollar to U.S. dollar exchange rate	\$0.9667	\$0.8801	\$0.8523	\$0.8114	\$0.8969	\$0.6928

Income (loss) from discontinued operations for the nine months ended September 30, 2010 was \$25.8 million lower than the prior year due primarily to a coal excise tax refund receivable of approximately \$35 million recorded during the three months ended March 31, 2009. See Note 2 to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2009 for more information related to the excise tax refund receivable.

**Table of Contents****Other**

The fair value of our foreign currency hedges increased approximately \$396 million and \$251 million during the three and nine months ended September 30, 2010, respectively, mostly due to the strengthening of the Australian dollar against the U.S. dollar in the current year. These increases are reflected in Other current assets and Investments and other assets in the condensed consolidated balance sheets.

**Outlook***Near-Term Outlook*

Global economic activity, as measured by gross domestic product (GDP), is forecast to expand 4.8% in 2010 and 4.2% in 2011, according to the International Monetary Fund. Output of emerging and developing economies is expected to outpace advanced economies as are steel production and electricity generation. China's GDP is estimated to rise 10.5% for the calendar year 2010 while India's full year GDP is estimated to grow 9.7%.

The World Steel Association forecasts global steel use will increase 13.1% in 2010, after contracting 6.6% in 2009. China, the world's largest steel consumer, is projected to grow its steel use 6.7% in 2010. India's steel demand is expected to rise 8.2% this year. Similar trends are apparent in steel production. Year to date through September, global steel production is up 19% and on pace to exceed 2009 levels by approximately 14%, and 2008 levels by an estimated 5%. Production in Asia has risen nearly 16%, due to demand from China, India and more developed economies of the region.

Industry reports forecast that, globally, more than 85 gigawatts of new coal-fueled generation are under construction and expected to come on line during 2010. Approximately 75% of these plants are in China and India. New global coal-fueled generation for 2010 is estimated to require approximately 298 million tons of coal annually.

Given the pace of coal demand in the Pacific, prices for seaborne metallurgical and thermal coals have been above prior year levels. The high quality hard coking coal price for the fourth quarter of calendar 2010 was set at \$209 per tonne. Through October 19, 2010, quarterly prices have been between \$200 and \$225 per tonne since April, meaningfully higher than the prior year's \$129 per tonne annual pricing. As of October 19, 2010, index prices for Australian seaborne thermal coal are in the \$95 to \$100 per tonne range, 35 to 40 percent above year-ago levels.

In the U.S., the Energy Information Administration (EIA) forecasts 2010 coal-based electricity generation will grow nearly 7%. Coal consumption is projected to increase 68 million tons. Through September, total U.S. coal production is running approximately 2% below 2009's level. U.S. coal stockpiles have declined approximately 30 million tons since the start of the year, the largest drawdown for the last 15 years. Improving industry fundamentals have led to higher coal prices. Year to date, prompt index coal prices have rebounded in nearly all regions, including 60% for Powder River Basin coal and more than 25% for Illinois Basin products.

Natural gas production in the continental U.S. is expected to rise 3.5% in 2010, according to the EIA. Rising supplies combined with inventory levels above the five-year average have resulted in subdued gas prices. The Henry Hub spot price is projected to average \$4.77 per MMBtu in 2010, above 2009's average \$4.20 per MMBtu yet 40.5% below the prior three-year average. Low natural gas prices in 2009 led to coal-to-gas switching that reduced coal demand by an estimated 40 million tons. Industry analysts estimate approximately 25% of the prior year's switching will be recovered by coal in 2010.

As of October 19, 2010, our full-year 2010 sales targets are approximately 185 to 195 million tons from our U.S. operations and 27 to 29 million tons from our Australian operations, including 9.5 to 10.0 million tons of metallurgical coal. Total 2010 sales are expected to be in a range of 240 to 260 million tons. We may continue to adjust our production levels in response to changes in market demand.

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As of October 19, 2010, we are fully contracted for 2010 at planned production levels. Our unpriced Australia volumes for 2011 include approximately 9 to 10 million tons of metallurgical coal and 8.5 to 9.5 million tons of export thermal coal. For 2012, our unpriced Australia volumes include 11 to 12 million tons of metallurgical coal and 12 to 13 million tons of export thermal coal. In the U.S., our level of committed sales track our expectations for a U.S. recovery. We have approximately 10 percent of our planned 2011 production available to price, growing to 35 to 45 percent of planned production available to price in 2012, and approximately 85 percent available to price in 2013.

We continue to manage costs and operating performance in an effort to mitigate external cost pressures, geologic conditions and potential shipping delays resulting from adverse port and rail performance. To mitigate the external cost pressures, we have an ongoing company-wide initiative to instill best practices at all operations. We may have higher per ton costs as a result of below-optimal production levels due to market-driven changes in demand. We may also encounter poor geologic conditions, lower third-party contract miner or brokerage performance or unforeseen equipment problems that limit our ability to produce at forecasted levels. To the extent upward pressure on costs exceeds our ability to realize sales increases, or if we experience unanticipated operating or transportation difficulties, our operating margins would be negatively impacted. Reductions in the relative cost of other fuels, including natural gas, could impact the use of coal for electricity generation. See Cautionary Notice Regarding Forward-Looking Statements and Item 1A. Risk Factors of our Annual Report on Form 10-K for the year ended December 31, 2009 for additional considerations regarding our outlook.

We rely on ongoing access to worldwide financial markets for capital, insurance, hedging and investments through a wide variety of financial instruments and contracts. To the extent these markets are not available or increase significantly in cost, this could have a negative impact on our ability to meet our business goals. Similarly, many of our customers and suppliers rely on the availability of the financial markets to secure the necessary financing and financial surety (letters of credit, bank guarantees, performance bonds, etc.) to complete transactions with us. To the extent customers and suppliers are not able to secure this financial support, it could have a negative impact on our results of operations and/or counterparty credit exposure.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The Dodd-Frank Act includes a number of provisions applicable to us in the areas of corporate governance, executive compensation and mine safety and extractive industries disclosure. In addition, the Dodd-Frank Act imposes additional regulation of financial derivatives transactions that may apply to our hedging and our Trading and Brokerage activities. Although the Dodd-Frank Act became generally effective upon its enactment, many provisions have extended implementation periods and delayed effective dates and require further action by the federal regulatory authorities. As a result, in many respects the ultimate impact of the Dodd-Frank Act on us will not be fully known for an extended period of time. We do expect that the Dodd-Frank Act will increase compliance and transaction costs associated with our hedging and Trading and Brokerage activities.

***Long-Term Outlook***

Our long-term global outlook remains positive. According to the BP Statistical Review of World Energy, coal has been the fastest-growing fuel in the world for the past decade.

The EIA estimates in its International Energy Outlook that world primary energy demand will grow 49% between 2007 and 2035, with demand for coal rising 56% (greater than any other fuel source on a quadrillion Btu basis). China and India alone account for nearly half of the expected incremental energy demand.

Coal is expected to retain its strong presence as a fuel for the power sector worldwide. Coal's share of the power generation mix was 42% in 2007. By 2035, the EIA estimates coal's fuel share is projected to be 43% as it continues to have the largest share of worldwide electric power production. Currently, we estimate more than 475 gigawatts of coal-fueled electricity generating plants are planned or under construction around the world, with expected online dates ranging between 2010 and 2015. When complete, those plants would require more than 1.6 billion tons of annual coal demand. In the U.S., while some planned coal-based plants have been cancelled, 13 gigawatts of new coal-based generating capacity have been completed in 2010 or are under construction, representing approximately 50 million tons of annual coal demand once they become operational.

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The EIA projects global natural gas-fueled electricity generation will increase 2.1% annually, from 3.9 trillion kilowatt hours in 2007 to 6.8 trillion kilowatt hours in 2035. The total amount of electricity generated from natural gas is expected to continue to be less than one-half the total for coal, even in 2035. Generation from liquid fuels is projected to lose the most fuel share, declining from 5% in 2007 to 2% of the total mix in 2035. Renewables, including hydro, is projected to rise four percentage points to 23% of the fuel mix by 2035. Nuclear power is expected to grow in all major regions, but its share in total generation is expected to fall from 14% to 13% between 2007 and 2035.

We believe that Btu Conversion applications such as coal-to-gas (CTG) and coal-to-liquids (CTL) plants represent an avenue for potential long-term industry growth. The EIA continues to project an increase in demand for unconventional sources of transportation fuel such as CTL. In addition, China and India are developing CTG and CTL facilities.

On May 2, 2010, the Australian government released a report on Australia's Future Tax System, which included a recommendation to replace the current resource taxing arrangements imposed on non-renewable resources by the Australian federal and state governments with a uniform resource rent tax (the Resource Tax) imposed and administered by the Australian government. As proposed, the Resource Tax would be profit-based and would apply to non-renewable resources projects, including existing projects. On July 2, 2010, the Australian government announced changes to the Resource Tax and proposed a new minerals resource rent tax (the MRRT). The MRRT would still be profit-based, but measures were introduced to lessen the impact of the MRRT. The Australian government and major industry policy makers are actively engaged to address the detail implementation views outlined in a recently released Issues Paper. The majority of the positions remain consistent with the MRRT accord in July 2010; however, an issue concerning what level of state royalties will be creditable against the MRRT liability is being contested. We expect consultation to continue for several weeks. The MRRT is not yet law in Australia and may not become law. The draft law is expected to be presented to the Australian Parliament in late 2011, and if the MRRT becomes law, it is intended to become effective July 1, 2012. If the MRRT were to become law, it may affect the financial performance of our Australian operations from the effective date forward.

We continue to support clean coal technology development and other initiatives addressing carbon dioxide concerns through our participation in a number of projects in the U.S., China and Australia. In addition, clean coal technology development in the U.S. is being accelerated by funding under the American Recovery and Reinvestment Act of 2009 and by the formation of an Interagency Task Force on Carbon Capture and Storage to develop a comprehensive and coordinated federal strategy to speed the commercial development of clean coal technologies.

Enactment of laws or passage of regulations regarding emissions from the combustion of coal by the U.S. or some of its states or by other countries, or other actions to limit such emissions, could result in electricity generators switching from coal to other fuel sources. The potential financial impact on us of future laws or regulations will depend upon the degree to which any such laws or regulations force electricity generators to diminish their reliance on coal as a fuel source. That, in turn, will depend on a number of factors, including the specific requirements imposed by any such laws or regulations, the time periods over which those laws or regulations would be phased in and the state of commercial development and deployment of carbon capture and storage technologies. In view of the significant uncertainty surrounding each of these factors, it is not possible for us to reasonably predict the impact that any such laws or regulations may have on our results of operations, financial condition or cash flows.

**Liquidity and Capital Resources*****Capital Resources***

Our primary sources of cash include sales of our coal production to customers, cash generated from our trading and brokerage activities, sales of non-core assets and financing transactions.

*Liquidity.* As of September 30, 2010, we had available liquidity of \$2.8 billion, consisting of cash on hand and availability under our revolving credit facility and our accounts receivable securitization program. We currently expect that our cash flow from operations and available liquidity will be sufficient to meet our anticipated capital requirements during the next 12 months and for the foreseeable future, as described below in Capital Requirements.

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

The Revolver replaced our previous \$1.8 billion revolving credit facility and the Term Loan replaced our previous term loan facility (the previous term loan had a balance of \$490.3 million at the time of replacement and at December 31, 2009). In the second quarter of 2010, we recorded \$21.9 million in deferred financing costs which are being amortized to interest expense over the five year term of the Credit Facility. Also during the second quarter of 2010, we incurred refinancing charges of \$9.3 million, which is classified as interest expense in the unaudited condensed consolidated statements of operations.

See Note 7 to our unaudited condensed consolidated financial statements for additional information on the new Credit Facility.

As of September 30, 2010, there were no borrowings outstanding under the Revolver. However, we had approximately \$240.7 million of outstanding letters of credit as of September 30, 2010, which effectively reduced our borrowing capacity under the Revolver by the same amount.

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

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

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

See Note 7 to our unaudited condensed consolidated financial statements for additional information on the Notes.

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*Total Indebtedness.* Our total indebtedness as of September 30, 2010 and December 31, 2009, consisted of the following:

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

**Capital Requirements**

Our primary uses of cash include our cash costs of coal production, capital expenditures, coal reserve lease and royalty payments, debt service costs (interest and principal), lease obligations, take or pay obligations and costs related to past mining obligations. Future dividends and share repurchases, among other restricted items, are subject to limitations imposed in the covenants of certain of our debt instruments. We generally fund our capital expenditure requirements with cash generated from operations.

The following are updates of our uses of cash disclosures to our Annual Report on Form 10-K for the year ended December 31, 2009.

*Capital Expenditures.* Capital expenditures for 2010 are anticipated to be between \$600 million to \$650 million. The planned expenditures include the completion of our Bear Run Mine, sustaining capital at our existing mines, expansion of our metallurgical and thermal coal export platform in Australia to serve the growth markets in Asia and funding of our Prairie State investment.

*Pension Contributions.* During the nine months ended September 30, 2010, we made discretionary contributions of approximately \$22 million. We expect to make discretionary contributions of approximately \$3 million during the fourth quarter of 2010, and are evaluating the potential for additional contributions by year end. Total minimum and discretionary contributions in 2010 are currently expected to be approximately \$28 million.

*Share Repurchase Program.* At September 30, 2010, our available capacity for share repurchases was \$700.4 million, and our Chairman and Chief Executive Officer has authority to direct us to repurchase up to \$100 million of our common stock outside the share repurchase program. While no such share repurchases have been made in 2010, repurchases may be made from time to time based on an evaluation of our outlook and general business conditions, as well as alternative investment and debt repayment options.

*NCIG.* Financing for phase one of stage two of construction closed in the third quarter of 2010 with us providing our pro-rata share of funding of \$59.7 million Australian dollars (\$54.8 million U.S. dollars). NCIG may further expand the coal transloading facility's capacity which could require us to fund our pro-rata share in a similar manner.

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*Prairie State Energy Campus (Prairie State).* A subsidiary of ours owns a 5.06% undivided interest in Prairie State, a 1,600 megawatt coal-fuel electricity generation project currently under construction. We spent \$52.5 million during the nine months ended September 30, 2010 representing our 5.06% share of the construction costs. Included in

Investments and other assets in the condensed consolidated balance sheets as of September 30, 2010 and December 31, 2009, are costs of \$179.1 million and \$126.6 million, respectively. Our share of total construction costs for Prairie State is expected to be approximately \$250 million.

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

*Dividends.* We paid quarterly dividends of \$0.07 per share for the first three quarters of 2010. In October 2010, our Board of Directors approved a 21 percent increase in the regularly quarterly dividend to \$0.085 per share of common stock. The increased dividend is payable on November 26, 2010 to stockholders of record on November 4, 2010.

**Historical Cash Flows**

	<b>Nine Months Ended</b>		<b>Increase (Decrease)</b>	
	<b>September 30,</b>		<b>\$</b>	<b>%</b>
	<b>2010</b>	<b>2009</b>	<b>(Dollars in millions)</b>	
Net cash provided by operating activities	\$ 883.8	\$ 667.3	\$ 216.5	32.4%
Net cash used in investing activities	(423.3)	(276.5)	(146.8)	53.1%
Net cash used in financing activities	(81.8)	(49.7)	(32.1)	64.6%

*Operating Activities.* The increase compared to the prior year was driven by the following:

Increased operating cash flows generated from our Australian Mining operations driven by higher volumes and pricing; and

Decreased cash usage for accounts payable and accrued expenses driven in part by the higher foreign income tax payments in 2009 that were associated with 2008 earnings; partially offset by

Reduced borrowings under our accounts receivable securitization program in the current year.

*Investing Activities.* The increase compared to the prior year was driven by the following:

Higher current year capital spending of \$147.4 million related primarily to our Bear Run Mine;

Current year net cash outflows related to our pro-rata share of funding for the NCIG coal transloading facility; and

The collection of a note receivable of \$30.0 million in the prior year; partially offset by

Federal coal lease expenditures of \$123.6 million in the prior year.

*Financing Activities.* The increase compared to the prior year was primarily due to the payment of debt issuance costs of \$32.2 million in the current year related to our Credit Facility refinancing and the offering of the Notes. The \$1,150.0 million of proceeds from long-term debt include \$500.0 million from the Term Loan and \$650.0 million from the issuance of the Notes. These proceeds were used to pay off the \$490.3 million balance due on our previous term loan facility and the previously outstanding \$650.0 million 2013 Notes.

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### **Contractual Obligations**

As discussed above in *Liquidity and Capital Resources* and in Note 7 to our unaudited condensed consolidated financial statements, we entered into a new Credit Facility during the second quarter of 2010, which had the following material changes to our contractual obligations:

We repaid the then outstanding balance of \$490.3 million on our previous term loan facility, which was due in September 2011;

Our new Term Loan, with an initial principal balance of \$500.0 million, will be repaid quarterly at a rate of 1.25% per quarter commencing on December 31, 2010 (\$25.0 million for the next 12 months), with the final payment of \$387.5 million due in June 2015; and

Based on the September 30, 2010 interest rate of LIBOR plus 2.5%, or 2.76%, total interest payments over the five-year period will be approximately \$63 million for the Credit Facility.

Also, as discussed above in *Liquidity and Capital Resources* and in Note 7 to our unaudited condensed consolidated financial statements, we completed the Notes offering during the third quarter of 2010, which had the following material changes to our contractual obligations:

We extinguished our previously outstanding \$650.0 million aggregate principal 2013 Notes formerly due in March 2013 and issued the Notes, under which we now have \$650.0 million aggregate principal due September 2020; and

Semiannual interest payments on the Notes are scheduled to commence on March 15, 2011.

There were no other significant changes to our contractual obligations since December 31, 2009.

### **Off-Balance Sheet Arrangements**

In the normal course of business, we are a party to certain off-balance sheet arrangements. These arrangements include guarantees, indemnifications, financial instruments with off-balance sheet risk, such as bank letters of credit, bank guarantees and performance or surety bonds and our accounts receivable securitization. Assets and liabilities related to these arrangements are not reflected in our condensed consolidated balance sheets, and we do not expect any material adverse effects on our financial condition, results of operations or cash flows to result from these off-balance sheet arrangements.

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

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



securitization activity with the Conduits was \$100 million at September 30, 2010 and \$254.6 million at December 31, 2009.

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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 our trade receivables. We recorded expense associated with securitization transactions of \$0.6 million and \$1.1 million for the three months ended September 30, 2010 and 2009, respectively, and \$1.8 million and \$3.4 million for the nine months ended September 30, 2010 and 2009, respectively.

*Other Off-Balance Sheet Arrangements.* In 2010, we added standalone credit facilities with multiple banks to allow us to obtain letters of credit and bank guarantees in support of the operations of certain offices outside the U.S. As of September 30, 2010, the total capacity under these facilities, both committed and uncommitted, was approximately \$311 million, of which approximately \$126 million was utilized (based on the U.S. dollar exchange rate at September 30, 2010).

There were no other material changes to our off-balance sheet arrangements during the three months ended September 30, 2010. See Note 14 to our unaudited condensed consolidated financial statements for a discussion of our guarantees. Our off-balance sheet arrangements are discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations and in Note 19 to our consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2009.

**Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition, results of operations, liquidity and capital resources is based upon our financial statements, which have been prepared in accordance with U.S. GAAP. We are also required under U.S. GAAP to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an ongoing basis, we evaluate our estimates. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Our critical accounting policies are discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2009. Our critical accounting policies remained unchanged at September 30, 2010. The following provides additional information about Level 3 fair value measurements.

*Level 3 Fair Value Measurements.* In accordance with the Fair Value Measurements and Disclosures topic of the Financial Accounting Standards Board Accounting Standards Codification, we evaluate the quality and reliability of the assumptions and data used to measure fair value in the three level hierarchy, Levels 1, 2 and 3. 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, these instruments or contracts are valued using internally generated models that include forward pricing curve quotes from one to three reputable brokers. Our valuation techniques also include basis adjustments for heat rate, sulfur and ash content, port and freight costs, and credit and nonperformance risk. We validate our valuation inputs with third-party information and settlement prices from other sources where available. We also consider credit and nonperformance risk in the fair value measurement by analyzing the counterparty's exposure balance, credit rating and average default rate, net of any counterparty credit enhancements (e.g., collateral), as well as our own credit rating for financial derivative liabilities.

We have consistently applied these valuation techniques in all periods presented, and believe we have obtained the most accurate information reasonably available for the types of derivative contracts held. Valuation changes from period to period for each level will increase or decrease depending on: (i) the relative change in fair value for positions held, (ii) new positions added, (iii) realized amounts for completed trades, and (iv) transfers between levels. Our coal trading strategies utilize various swaps and derivative physical contracts. Periodic changes in fair value for purchase and sale positions, which are executed to lock in coal trading spreads, occur in each level and therefore the overall change in value of our coal-trading platform requires consideration of valuation changes across all levels.



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Our Level 3 net financial assets represented 2.7% and 5.0% of our total net financial assets as of September 30, 2010 and December 31, 2009, respectively. See Note 12 to our unaudited condensed consolidated financial statements for additional information regarding fair value measurements.

**Newly Adopted Accounting Standards and Accounting Standards Not Yet Implemented**

See Note 2 to our unaudited condensed consolidated financial statements for a discussion of newly adopted accounting standards and accounting standards not yet implemented.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Except as noted below, there have been no material changes in market risk from the information provided in Item 7A. Quantitative and Qualitative Disclosures About Market Risk of our Annual Report on Form 10-K for the year ended December 31, 2009.

In 2010, we modified our value at risk (VaR) methodology to be in line with our global trading strategy. The previous methodology used an additive approach whereby the domestic portfolio and the international portfolio were calculated separately and then added together to arrive at our total global VaR. The new methodology explicitly considers correlation measures between the domestic and the international portfolios to consolidate our total global VaR. The high, low and average VaR for the year ended December 31, 2009 and nine months ended September 30, 2010 under the previous methodology and the high, low and average VaR for the nine months ended September 30, 2010 under the new methodology are set forth in the table below:

		(Dollars in millions)	
	Low	High	Average
Year ended December 31, 2009 - Previous Methodology	\$2.7	\$ 15.9	\$8.7
Nine months ended September 30, 2010 - Previous Methodology	4.5	13.0	7.4
Nine months ended September 30, 2010 - New Methodology	3.4	11.1	5.9

**Item 4. Controls and Procedures.**

Our disclosure controls and procedures are designed to, among other things, provide reasonable assurance that material information, both financial and non-financial, and other information required under the securities laws to be disclosed is accumulated and communicated to senior management, including the principal executive officer and principal financial officer, on a timely basis. Our Chief Executive Officer and our Chief Financial Officer have evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of September 30, 2010, and have concluded that such controls and procedures are effective to provide reasonable assurance that the desired control objectives were achieved.

Additionally, during the most recent fiscal quarter, there have been no changes to our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION****Item 1. Legal Proceedings.**

See Note 13 to the unaudited condensed consolidated financial statements included in Part I, Item 1 of this report relating to certain legal proceedings, which information is incorporated by reference herein.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

Our Board of Directors has authorized a share repurchase program of up to \$1 billion of the then outstanding shares of our common stock. The repurchases may be made from time to time based on an evaluation of our outlook and general business conditions, as well as alternative investment and debt repayment options. Our Chairman and Chief Executive Officer also has the authority to direct us to repurchase up to \$100 million of our common stock outside the share repurchase program. The repurchase program does not have an expiration date and may be discontinued at any time. Through September 30, 2010, we have made repurchases of 7.7 million shares at a cost of \$299.6 million (\$199.8 million and \$99.8 million in 2008 and 2006, respectively), leaving \$700.4 million available for share repurchases under the program.

<b>Period</b>	<b>Total Number of Shares Purchased<sup>(1)</sup></b>	<b>Average Price per Share</b>	<b>Total Number of Shares Purchased as Part of Publicly Announced Program</b>	<b>Maximum Dollar Value that May Yet Be Used to Repurchase Shares Under the Publicly Announced Program (In Millions)</b>
July 1 through July 31, 2010		\$		\$ 700.4
August 1 through August 31, 2010				700.4
September 1 through September 30, 2010	8,379	47.24		700.4
<b>Total</b>	<b>8,379</b>	<b>\$ 47.24</b>		

(1) Represents shares withheld to cover the withholding taxes upon the vesting of restricted stock, which are not part of the share repurchase program.

**Item 5. Other Information.****Mine Safety Disclosures**

Our goal is to provide a workplace that is incident free. We believe that it is our responsibility to our employees to provide a superior safety and health environment. We seek to implement this goal by: training employees in safe work practices; openly communicating with employees; establishing, following and improving safety standards; involving employees in safety processes; and recording, reporting and investigating accidents, incidents and losses to avoid reoccurrence. As part of our training, we collaborate with the Mine Safety and Health Administration (MSHA) and other government agencies to identify and test promising safety technologies.

We are also partnering with several companies and governmental agencies to pursue new technologies that have the potential to improve our safety performance and provide better safety protections for our miners. We have signed letters of intent to field test a new mine emergency vehicle under development by outside companies. We will begin installation of a new communications and tracking system at our U.S. underground mines, which will allow persons on the surface to determine the location of and communicate with all persons underground. In addition, we are exploring the use of proximity detection and collision avoidance systems to enhance the safety around our large equipment fleets.

In the second and third quarters of 2010, we voluntarily idled our mines for one day to allow for interactive safety discussions with our employees, local and federal agency representatives and management, and to provide additional comprehensive training on accident prevention, violation awareness and reduction and emergency preparedness.

In October 2010, the U.S. Department of Labor awarded Peabody's Farmersburg Mine with the 2009 Sentinels of Safety Award as the nation's safest large surface coal mine.

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Through our safety tracking system, one of the ways we monitor safety performance is by incidence rate. We compute the incidence rate as the number of injuries (MSHA injury degree code 1 to 6) divided into employee hours worked, multiplied by 200,000 hours. Our incidence rate excludes the injuries and hours associated with office workers. The following table reflects our incidence rates.

	<b>Nine months ended September 30,</b>	
	<b>2010</b>	<b>2009</b>
<b>U.S.</b>	2.07	1.98
<b>Australia</b>	4.40	4.50
<b>Total Peabody Energy Corporation</b>	2.89	2.81

For the U.S., the comparable MSHA incidence rate is from MSHA's Mine Injury and Worktime Operators report and represents the all incidence rate for all U.S. coal mines, excluding the impact of office workers ( All Incidence Rate ). As of November 3, 2010, MSHA's Mine Injury and Worktime Operators for the nine months ended September 30, 2010 had not been published. For 2009, MSHA no longer makes publicly available the All Incidence Rate for the nine months ended September 30, 2009. As such, the All Incidence Rate for full year 2009 was 4.14.

We monitor MSHA compliance using violations per inspection day (in the U.S. only). We measure one inspection day for each visit to one of our mines by a MSHA inspector. For the nine months ended September 30, 2010 and 2009, our U.S. violations per inspection day were 1.29 and 1.59, respectively.

Following passage of The Mine Improvement and New Emergency Response Act of 2006, MSHA significantly increased the enforcement of safety and health standards and imposed safety and health standards on all aspects of mining operations. There has also been an increase in the dollar penalties assessed for citations issued over the past two years.

The following disclosures are provided pursuant to the recently enacted Dodd-Frank Act, which requires certain disclosures by companies required to file periodic reports under the Securities Exchange Act of 1934, as amended, that operate coal mines regulated under the U.S. Federal Mine Safety and Health Act of 1977 (the Mine Act). Under the Dodd-Frank Act, the SEC is authorized to issue rules and regulations to carry out the purposes of these provisions, but has not done so as of the date of this report. While we believe the following disclosures meet the requirements of the Dodd-Frank Act, it is possible that any rule making by the SEC will require disclosures to be presented in a form that differs from the following. The disclosures reflect U.S. mining operations only as the requirements of the Dodd-Frank Act do not apply to our mines operated outside the U.S.

*Mine Safety Information.* Whenever MSHA believes that a violation of the Mine Act, any health or safety standard, or any regulation has occurred, it may issue a citation which describes the violation and fixes a time within which the operator must abate the violation. In some situations, such as when MSHA believes that conditions pose a hazard to miners, MSHA may issue an order removing miners from the area of the mine affected by the condition until hazards are corrected. Whenever MSHA issues a citation or order, it generally proposes a civil penalty, or fine, as a result of the violation, that the operator is ordered to pay. Citations and orders can be contested and appealed, and as part of that process, are often reduced in severity and amount, and are sometimes dismissed. The number of citations, orders and proposed assessments vary depending on the size and type (underground or surface) of the mine as well as by the MSHA inspector(s) assigned to that mine. Since MSHA is a branch of the U.S. Department of Labor, its jurisdiction only applies to our U.S. mines. While our Australian mines are not required to report safety information to MSHA, in 2008 we modified our injury reporting processes such that our Australian operations began capturing safety data using the same criteria as that of our U.S. operations. However, MSHA information related to issued citations, orders and proposed assessments is not applicable to our Australian mines.

The table that follows reflects citations and orders issued to us by MSHA during the three months ended September 30, 2010, as reflected in our safety tracking system. Due to timing and other factors, our data may not

agree with the mine data retrieval system maintained by MSHA. The proposed assessments for the three months ended September 30, 2010 were taken from the MSHA system as of November 3, 2010.

Additional information follows about MSHA references used in the table.



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*Section 104 Citations:* The total number of violations received from MSHA under section 104 of the Mine Act, which includes citations for health or safety standards that could significantly and substantially contribute to a serious injury if left unabated.

*Section 104(b) Orders:* The total number of orders issued by MSHA under section 104(b) of the Mine Act, which represents a failure to abate a citation under section 104(a) within the period of time prescribed by MSHA. This results in an order of immediate withdrawal from the area of the mine affected by the condition until MSHA determines that the violation has been abated.

*Section 104(d) Citations and Orders:* The total number of citations and orders issued by MSHA under section 104(d) of the Mine Act for unwarrantable failure to comply with mandatory health or safety standards.

*Section 110(b)(2) Violations:* The total number of flagrant violations issued by MSHA under section 110(b)(2) of the Mine Act.

*Section 107(a) Orders:* The total number of orders issued by MSHA under section 107(a) of the Mine Act for situations in which MSHA determined an imminent danger existed.

**Three Months Ended September 30, 2010**

Mine <sup>(1)</sup>	Section	Section	Section	Section	Section	(\$)	Fatalities
	104 Citations	104(b) Orders	104(d) and Orders	110(b)(2) Violations	107(a) Orders	Proposed MSHA Assessments (in thousands)	
<b>Western U.S. Mining</b>							
Caballo	6					4.3	
El Segundo	9						
Kayenta	12				1	11.5	
Lee Ranch	14					26.4	
North Antelope							
Rochelle	9					1.4	
Rawhide	3				1		
Twentymile (Foidel Creek)	90					58.6	
<b>Midwestern U.S. Mining</b>							
Air Quality	163		2			74.0	
Bear Run							
Cottage Grove (Wildcat Hills-Cottage Grove Pit)	4					1.0	
Farmersburg	9					15.2	
Francisco Underground	157	1	3			169.4	
Francisco Surface <sup>(2)</sup>	5					5.5	
Gateway	181		1			152.1	
Midwest Repair Facility (Columbia Maintenance Services)							

Somerville Central	4			38.3	
Somerville North					
Somerville South					
Viking (Viking-Corning and Knot Pit)					
Wildcat Hills					
Underground	68			14.5	
Willow Lake (Willow Lake Portal and Central Preparation Plant)	317	1	10	529.5	1

(1) The definition of mine under section 3 of the Mine Act includes the mine, as well as other items used in, or to be used in, or resulting from, the work of extracting coal, such as land, structures, facilities, equipment, machines, tools, and coal preparation facilities. Unless otherwise indicated, any of these other items associated with a single mine have been aggregated in the totals for that mine. Also, there are instances where the mine name per the MSHA system differs from the mine name utilized by us. Where applicable, we have parenthetically listed the

name(s) of the  
mine per the  
MSHA system.

- (2) The Francisco  
Surface Mine  
was closed in  
the fourth  
quarter of 2009.

*Pattern or Potential Pattern of Violations.* During the three months ended September 30, 2010, none of the mines operated by us received written notice from MSHA of (a) a pattern of violations of mandatory health or safety standards that are of such nature as could have significantly and substantially contributed to the cause and effect of coal mine health or safety hazards under section 104(e) of the Mine Act or (b) the potential to have such a pattern.

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*Pending Legal Actions.* The Federal Mine Safety and Health Review Commission (the Commission) is an independent adjudicative agency that provides administrative trial and appellate review of legal disputes arising under the Mine Act. These cases may involve, among other questions, challenges by operators to citations, orders and penalties they have received from MSHA, or complaints of discrimination by miners under Section 105 of the Mine Act. The following is a brief description of the types of legal actions that may be brought before the Commission.

*Contests of Citations and Orders* A contest proceeding may be filed with the Commission by operators, miners or miners' representatives to challenge the issuance of a citation or order issued by MSHA.

*Contests of Proposed Penalties (Petitions for Assessment of Penalties)* A contest of a proposed penalty is an administrative proceeding before the Commission challenging a civil penalty that MSHA has proposed for the violation contained in a citation or order.

*Complaints for Compensation* A complaint for compensation may be filed with the Commission by miners entitled to compensation when a mine is closed by certain withdrawal orders issued by MSHA. The purpose of the proceeding is to determine the amount of compensation, if any, due miners idled by the orders.

*Complaints of Discharge, Discrimination or Interference* A discrimination proceeding is a case that involves a miner's allegation that he or she has suffered a wrong by the operator because he or she engaged in some type of activity protected under the Mine Act, such as making a safety complaint.

*Temporary Reinstatement Proceedings* Temporary reinstatement proceedings involve cases in which a miner has filed a complaint with MSHA stating he or she has suffered discrimination and the miner has lost his or her position.

*Emergency Response Plan (ERP) Dispute Proceedings* ERP dispute proceedings are cases brought before the Commission when an operator is issued a citation because it has not agreed to include a certain provision in its ERP.

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The table that follows presents information by mine regarding pending legal actions before the Commission at September 30, 2010. Each legal action is assigned a docket number by the Commission and may have as its subject matter one or more citations, orders, penalties or complaints.

<b>Mine</b> <sup>(1)</sup>	<b>Legal Actions</b>
<b>Western U.S. Mining</b>	
Caballo	1
El Segundo	
Kayenta	5
Lee Ranch	
North Antelope Rochelle	12
Rawhide	
Twentymile (Foidel Creek)	40
<b>Midwestern U.S. Mining</b>	
Air Quality	20
Bear Run	
Cottage Grove (Wildcat Hills-Cottage Grove Pit)	
Farmersburg	
Francisco Underground	4
Francisco Surface <sup>(2)</sup>	1
Gateway	3
Midwest Repair Facility (Columbia Maintenance Services)	
Somerville Central	2
Somerville North	
Somerville South	
Viking (Viking-Corning and Knot Pit)	
Wildcat Hills Underground	1
Willow Lake (Willow Lake Portal and Central Preparation Plant)	26

(1) The definition of mine under section 3 of the Mine Act includes the mine, as well as other items used in, or to be used in, or resulting from, the work of extracting coal, such as land, structures, facilities, equipment, machines, tools, and coal preparation facilities. Unless otherwise

indicated, any of these other items associated with a single mine have been aggregated in the totals for that mine. Also, there are instances where the mine name per the MSHA system differs from the mine name utilized by us. Where applicable, we have parenthetically listed the name(s) of the mine per the MSHA system.

- (2) The Francisco Surface Mine was closed in the fourth quarter of 2009.

**Item 6. Exhibits.**

See Exhibit Index at page 57 of this report.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**PEABODY ENERGY CORPORATION**

Date: November 5, 2010

By: /s/ MICHAEL C. CREWS  
Michael C. Crews  
Executive Vice President and Chief Financial  
Officer  
(On behalf of the registrant and as Principal  
Financial Officer)

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**EXHIBIT INDEX**

The exhibits below are numbered in accordance with the Exhibit Table of Item 601 of Regulation S-K.

Exhibit No.	Description of Exhibit
3.1	Third Amended and Restated Certificate of Incorporation of the Registrant, as amended (Incorporated by reference to Exhibit 3.1 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2008).
3.2	Amended and Restated By-Laws of the Registrant (Incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed on September 16, 2008).
4.1	Thirty-Third Supplemental Indenture dated as of August 25, 2010 among Peabody Energy Corporation, the guarantors named therein and U.S. Bank National Association, as trustee, relating to the 6.500% Senior Notes due 2020 (Incorporated by reference to Exhibit 4.1 of the Registrant's Current Report on Form 8-K filed on August 27, 2010).
10.1*	Third Amendment to Third Amended and Restated Receivables Purchase Agreement, dated as of September 16, 2010, by and among P&L Receivables Company, LLC, Peabody Energy Corporation, the various Sub-Servicers listed on the signature pages thereto, all Conduit Purchasers listed on the signature pages thereto, all Related Committed Purchasers listed on the signature pages thereto, all Purchaser Agents listed on the signature pages thereto, all LC Participants listed on the signature pages thereto, and PNC Bank, National Association, as Administrator and as LC Bank.
31.1*	Certification of periodic financial report by Peabody Energy Corporation's Chief Executive Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of periodic financial report by Peabody Energy Corporation's Chief Financial Officer pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934, as amended pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certification of periodic financial report pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Peabody Energy Corporation's Chief Executive Officer.
32.2*	Certification of periodic financial report pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Peabody Energy Corporation's Chief Financial Officer.
101**	Interactive Data File (Form 10-Q for the quarterly period ended September 30, 2010 furnished in XBRL). Users of this data are advised in accordance with Rule 406T of Regulation S-T promulgated by the Securities and Exchange Commission that this Interactive Data File is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections. The financial information contained in the XBRL-related documents is unaudited and unreviewed.

\* Filed herewith.



\*\* Submitted  
herewith.

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