PEABODY ENERGY CORP
Form 10-Q
November 07, 2012
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2012

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 (X) 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 (X) 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.

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

There were 268,385,935 shares of the registrant's common stock (par value of $0.01 per share) outstanding at November 2, 2012.

Table of Contents

INDEX

	Page
PART I — FINANCIAL INFORMATION	
Item 1. Financial Statements.	1
Unaudited Condensed Consolidated Statements of Income for the Three and Nine Months Ended September 30, 2012 and 2011	1
Unaudited Condensed Consolidated Statements of Comprehensive Income for the Three and Nine Months Ended September 30, 2012 and 2011	2
Condensed Consolidated Balance Sheets as of September 30, 2012 (Unaudited) and December 31, 2011	3
Unaudited Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and 2011	4
Unaudited Consolidated Statements of Changes in Stockholders' Equity for the Nine Months Ended September 30, 2012	5
Notes to Unaudited Condensed Consolidated Financial Statements	6
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	43
Item 3. Quantitative and Qualitative Disclosures About Market Risk	61
Item 4. Controls and Procedures	61
PART II — OTHER INFORMATION	
Item 1. Legal Proceedings	62
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	62
Item 4. Mine Safety Disclosures	63
Item 6. Exhibits	64
SIGNATURE	65
EXHIBIT INDEX	66

EX-10.3
EX-10.4
EX-10.5
EX-31.1
EX-31.2
EX-32.1
EX-32.2
EX-95
EX-101 INSTANCE DOCUMENT
EX-101 SCHEMA DOCUMENT
EX-101 CALCULATION LINKBASE DOCUMENT
EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT
EX-101 DEFINITION LINKBASE DOCUMENT

Table of Contents

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements.
PEABODY ENERGY CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Dollars in millions, except per share data)			
Revenues				
Sales	$1,797.2	$1,682.2	$5,282.0	$5,029.4
Other revenues	261.6	298.4	778.6	636.7
Total revenues	2,058.8	1,980.6	6,060.6	5,666.1
Costs and expenses				
Operating costs and expenses	1,509.0	1,399.4	4,396.8	3,958.7
Depreciation, depletion and amortization	172.5	108.4	470.7	317.6
Asset retirement obligation expenses	21.1	14.6	53.3	43.3
Selling and administrative expenses	68.7	71.2	202.4	191.4
Other operating (income) loss:				
Net gain on disposal or exchange of assets	(0.2)	(1.7)	(7.6)	(31.4)
Loss from equity affiliates	21.2	3.2	50.5	9.0
Operating profit	266.5	385.5	894.5	1,177.5
Interest expense	99.4	59.2	308.3	159.1
Interest income	(5.1)	(4.1)	(19.7)	(11.7)
Income from continuing operations before income taxes	172.2	330.4	605.9	1,030.1
Income tax provision	49.3	39.2	85.5	238.8
Income from continuing operations, net of income taxes	122.9	291.2	520.4	791.3
Loss from discontinued operations, net of income taxes	(81.3)	(9.7)	(92.7)	(38.9)
Net income	41.6	281.5	427.7	752.4
Less: Net (loss) income attributable to noncontrolling interests	(1.3)	7.4	7.4	17.0
Net income attributable to common stockholders	$42.9	$274.1	$420.3	$735.4
Income From Continuing Operations				
Basic earnings per share	$0.46	$1.05	$1.89	$2.86
Diluted earnings per share	$0.46	$1.04	$1.89	$2.84
Net Income Attributable to Common Stockholders				
Basic earnings per share	$0.16	$1.01	$1.55	$2.72
Diluted earnings per share	$0.16	$1.00	$1.55	$2.71
Dividends declared per share	$0.085	$0.085	$0.255	$0.255

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

PEABODY ENERGY CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Dollars in millions)			
Net income	$41.6	$281.5	$427.7	$752.4
Other comprehensive income, net of income taxes:				
Net unrealized holding losses on available-for-sale securities (net of respective tax benefits of $3.0, $2.0, $11.2 and $2.3)				
Unrealized holding losses on available-for-sale securities	(5.1)	(4.4)	(19.2)	(4.2)
Less: Reclassification for realized gains included in net income	—	(0.1)	—	(0.1)
Net unrealized holding losses on available-for-sale securities	(5.1)	(4.5)	(19.2)	(4.3)
Net unrealized gains (losses) on cash flow hedges (net of respective tax provision (benefit) of $36.8, ($140.3), $39.7 and ($66.7))				
Increase (decrease) in fair value of cash flow hedges	111.5	(135.9)	302.0	79.7
Less: Reclassification for realized gains included in net income	(57.7)	(61.5)	(179.2)	(180.3)
Net unrealized gains (losses) on cash flow hedges	53.8	(197.4)	122.8	(100.6)
Postretirement plans and workers' compensation obligations (net of respective tax provisions of $8.1, $6.3, $24.2 and $12.8)				
Net actuarial loss for the period	—	—	—	3.5
Amortization of actuarial loss and prior service cost	13.9	10.2	41.6	30.2
Postretirement plan and workers' compensation obligations	13.9	10.2	41.6	33.7
Foreign currency translation adjustment	13.8	—	20.4	—
Other comprehensive income (loss)	76.4	(191.7)	165.6	(71.2)
Comprehensive income	118.0	89.8	593.3	681.2
Less: Comprehensive (loss) income attributable to noncontrolling interests	(1.3)	7.4	7.4	17.0
Comprehensive income attributable to common stockholders	$119.3	$82.4	$585.9	$664.2

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

PEABODY ENERGY CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

	(Unaudited) September 30, 2012	December 31, 2011
	(Amounts in millions, except per share data)	
ASSETS		
Current assets		
Cash and cash equivalents	$648.0	$799.1
Accounts receivable, net of allowance for doubtful accounts of $15.2 at September 30, 2012 and $17.0 at December 31, 2011	682.2	922.5
Inventories	554.9	444.4
Assets from coal trading activities, net	56.2	44.6
Deferred income taxes	15.8	27.3
Other current assets	697.6	768.0
Total current assets	2,654.7	3,005.9
Property, plant, equipment and mine development		
Land and coal interests	11,875.2	10,630.5
Buildings and improvements	1,268.3	1,084.2
Machinery and equipment	3,175.8	2,857.3
Less: accumulated depreciation, depletion and amortization	(3,808.2)	(3,320.4)
Property, plant, equipment and mine development, net	12,511.1	11,251.6
Investments and other assets	1,684.6	2,475.5
Total assets	$16,850.4	$16,733.0
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities		
Current maturities of long-term debt	$124.8	$101.1
Liabilities from coal trading activities, net	19.9	10.3
Accounts payable and accrued expenses	1,645.1	1,712.3
Total current liabilities	1,789.8	1,823.7
Long-term debt, less current maturities	6,238.3	6,556.4
Deferred income taxes	385.0	523.2
Asset retirement obligations	662.4	615.2
Accrued postretirement benefit costs	1,054.3	1,053.1
Other noncurrent liabilities	743.6	645.6
Total liabilities	10,873.4	11,217.2
Stockholders’ equity		
Preferred Stock — $0.01 per share par value; 10.0 shares authorized; no shares issued or outstanding as of September 30, 2012 or December 31, 2011	—	—
Series A Junior Participating Preferred Stock — $0.01 per share par value; no shares authorized as of September 30, 2012 and 1.5 shares authorized as of December 31, 2011; no shares issued or outstanding as of September 30, 2012 or December 31, 2011	n.a.	—
Perpetual Preferred Stock — 0.8 shares authorized, no shares issued or outstanding	—	—

as of September 30, 2012 or December 31, 2011		
Series Common Stock — $0.01 per share par value; 40.0 shares authorized, no shares issued or outstanding as of September 30, 2012 or December 31, 2011	—	—
Common Stock — $0.01 per share par value; 800.0 shares authorized, 282.0 shares issued and 268.3 shares outstanding as of September 30, 2012 and 280.3 shares issued and 271.1 shares outstanding as of December 31, 2011	2.8	2.8
Additional paid-in capital	2,284.9	2,234.0
Retained earnings	4,095.2	3,744.0
Accumulated other comprehensive income (loss)	23.2	(142.4)
Treasury shares, at cost: 13.7 shares as of September 30, 2012 and 9.2 shares as of December 31, 2011	(461.5)	(353.3)
Peabody Energy Corporation's stockholders' equity	5,944.6	5,485.1
Noncontrolling interests	32.4	30.7
Total stockholders' equity	5,977.0	5,515.8
Total liabilities and stockholders' equity	$16,850.4	$16,733.0

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

PEABODY ENERGY CORPORATION
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended September 30,	
	2012	2011
	(Dollars in millions)	
Cash Flows From Operating Activities		
Net income	$427.7	$752.4
Loss from discontinued operations, net of income taxes	92.7	38.9
Income from continuing operations, net of income taxes	520.4	791.3
Adjustments to reconcile income from continuing operations, net of income taxes to net cash provided by operating activities:		
Depreciation, depletion and amortization	470.7	317.6
Deferred income taxes	(162.6)	48.2
Share-based compensation	34.9	32.4
Net gain on disposal or exchange of assets	(7.6)	(31.4)
Loss from equity affiliates	50.5	9.0
Changes in current assets and liabilities:		
Accounts receivable	259.0	(11.8)
Change in receivable from accounts receivable securitization program	(50.0)	—
Inventories	(117.4)	(12.3)
Net assets from coal trading activities	145.6	71.7
Other current assets	42.7	(42.3)
Accounts payable and accrued expenses	84.6	(15.6)
Asset retirement obligations	55.6	27.2
Accrued postretirement benefit costs	27.7	26.6
Pension costs	26.0	25.5
Contributions to pension plans	(1.3)	(1.3)
Other, net	(5.1)	(18.1)
Net cash provided by continuing operations	1,373.7	1,216.7
Net cash used in discontinued operations	(82.2)	(26.2)
Net cash provided by operating activities	1,291.5	1,190.5
Cash Flows From Investing Activities		
Additions to property, plant, equipment and mine development	(732.1)	(553.4)
Federal coal lease expenditures	(247.9)	(42.4)
Investment in Prairie State Energy Campus	(9.4)	(29.8)
Proceeds from disposal of assets	93.5	12.1
Investments in equity affiliates and joint ventures	—	(39.8)
Proceeds from sales and maturities of debt and equity securities	39.0	53.3
Purchases of debt and equity securities	(23.8)	(44.1)
Purchases of short-term investments	—	(100.0)
Proceeds from sale of short term investments	—	100.0
Investment in shares of Macarthur Coal Limited	—	(45.5)
Contributions to joint ventures	(531.2)	—
Distributions from joint ventures	527.7	—
Repayment of loans from related parties	720.2	—
Advances to related parties	(743.4)	—
Other, net	(3.2)	(4.4)
Net cash used in continuing operations	(910.6)	(694.0)

Net cash used in discontinued operations	(11.2)	(62.8)
Net cash used in investing activities	(921.8)	(756.8)
Cash Flows From Financing Activities		
Payments of long-term debt	(305.7)	(248.4)
Common stock repurchase	(99.9)	—
Acquisition of MCG Coal Holdings Pty Ltd noncontrolling interests	(49.8)	—
Dividends paid	(69.1)	(69.1)
Repurchase of employee common stock relinquished for tax withholding	(8.3)	(16.1)
Excess tax benefits related to share-based compensation	3.6	6.1
Other, net	8.4	0.2
Net cash used in financing activities	(520.8)	(327.3)
Net change in cash and cash equivalents	(151.1)	106.4
Cash and cash equivalents at beginning of period	799.1	1,295.2
Cash and cash equivalents at end of period	$648.0	$1,401.6

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

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

	Peabody Energy Corporation's Stockholders' Equity						
	Common Stock	Additional Paid-in Capital	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Noncontrolling Interests	Total Stockholders' Equity
	(Dollars in millions)						
December 31, 2011	$2.8	$2,234.0	$(353.3)	$3,744.0	$ (142.4)	$ 30.7	$ 5,515.8
Net income	—	—	—	420.3	—	7.4	427.7
Net unrealized losses on available-for-sale securities (net of $11.2 tax benefit)	—	—	—	—	(19.2)	—	(19.2)
Increase in fair value of cash flow hedges (net of $39.7 tax provision)	—	—	—	—	122.8	—	122.8
Postretirement plans and workers' compensation obligations (net of $24.2 tax provision)	—	—	—	—	41.6	—	41.6
Foreign currency translation adjustment	—	—	—	—	20.4	—	20.4
Dividends paid	—	—	—	(69.1)	—	—	(69.1)
Share-based compensation	—	34.9	—	—	—	—	34.9
Excess tax benefits related to share-based compensation	—	3.6	—	—	—	—	3.6
Stock options exercised	—	1.7	—	—	—	—	1.7
Employee stock purchases	—	7.1	—	—	—	—	7.1
Repurchase of employee common stock relinquished for tax withholding	—	—	(8.3)	—	—	—	(8.3)
Common stock repurchase	—	—	(99.9)	—	—	—	(99.9)
MCG Coal Holdings Pty Ltd noncontrolling interests at conversion	—	—	—	—	—	53.4	53.4
Acquisition of MCG Coal Holdings Pty Ltd	—	3.6	—	—	—	(53.4)	(49.8)

noncontrolling interests							
Distributions to noncontrolling interests	—	—	—	—	—	(5.7)	(5.7)
September 30, 2012	$2.8	$2,284.9	$(461.5)	$4,095.2	$ 23.2	$ 32.4	$ 5,977.0

See accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

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 unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements and should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's 2011 Annual Report on Form 10-K. In the opinion of management, these financial statements reflect all normal, recurring adjustments necessary for a fair presentation. Balance sheet information presented herein as of December 31, 2011 has been derived from the Company’s audited consolidated balance sheet at that date. The results of operations for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for future quarters or for the year ending December 31, 2012.

The Company classifies items within discontinued operations in the unaudited condensed consolidated financial statements when the operations and cash flows of a particular component of the Company have been (or will be) eliminated from the ongoing operations of the Company as a result of a disposal (by sale or otherwise) and the Company will no longer have any significant continuing involvement in the operation of that component.

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

In December 2011, the Financial Accounting Standards Board (FASB) issued accounting guidance requiring additional information intended to help reconcile existing differences in balance sheet offsetting requirements under U.S. GAAP and International Financial Reporting Standards (IFRS). While this standard leaves existing guidance surrounding the offsetting of financial assets and liabilities unchanged, it requires several additional disclosures, including gross and net information about instruments and transactions eligible for offset in the balance sheet and instruments and transactions subject to a master netting arrangement or similar agreement. The guidance will become effective for annual reporting periods beginning on or after January 1, 2013 and interim periods within those annual periods (January 1, 2013 for the Company). While the adoption of this guidance will impact the Company's disclosures, it will not affect the Company's results of operations, financial condition or cash flows.

In January 2010, the FASB issued accounting guidance that required new fair value disclosures, including disclosures about significant transfers into and out of Level 1 and Level 2 categories of the fair value hierarchy and a description of the reasons for the transfers. In addition, the guidance required new disclosures regarding activity in Level 3 fair value measurements, including a gross basis reconciliation. The Company began complying with the new fair value disclosure requirements beginning January 1, 2010, except for the disclosure of activity within Level 3 fair value measurements, which became effective January 1, 2011. In May 2011, the FASB issued additional fair value measurement disclosure requirements intended to provide a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and IFRS. That update required fair value hierarchy categorization for financial instruments not measured at fair value but for which disclosure of fair value is required, disclosure of all transfers between Level 1 and Level 2 categories and additional disclosures for Level 3 measurements regarding the sensitivity of fair value to changes in unobservable inputs and any interrelationships between those inputs. The guidance became effective for interim and annual periods beginning after December 15, 2011 (January 1, 2012 for the Company). While the adoption of this guidance impacted the Company's disclosures, it did not affect the Company's results of operations, financial condition or cash flows.

(3) Acquisition of Macarthur Coal Limited

On October 23, 2011, PEAMCoal Pty Ltd (PEAMCoal), an Australian company that was then indirectly owned 60% by the Company and 40% by ArcelorMittal, acquired a majority interest in Macarthur Coal Limited (PEA-PCI or the acquiree) through an all cash off-market takeover offer. On October 26, 2011 (the acquisition and control date), the Company appointed its nominees to the acquiree's Board of Directors and executive management team. The acquisition was completed on December 20, 2011 as PEAMCoal acquired all of the acquirees's remaining outstanding shares of common stock for $4.8 billion, net of $261.2 million of acquired cash, of which the Company's share was $2.8 billion (PEA-PCI acquisition). PEAMCoal accounted for share acceptances under the takeover process as a single transaction occurring on October 26, 2011. On December 21, 2011, the Company acquired ArcelorMittal Mining Australasia B.V., an indirect subsidiary of ArcelorMittal that indirectly owned 40% of PEAMCoal, for $2.0 billion resulting in the Company's 100% ownership of PEA-PCI.

The preliminary purchase accounting allocations were recorded in the accompanying unaudited condensed consolidated financial statements as of, and for the periods subsequent to, the acquisition and control date. The Company has not yet finalized the fair value determination of the assets acquired and liabilities assumed, which is expected once third-party valuation appraisals are completed. The Company is evaluating mine lives and reviewing coal reserve studies on the acquired properties, the outcome of which will determine the final fair value allocated to coal reserve assets. The following table summarizes the preliminary estimated fair values of assets acquired and liabilities assumed that were recognized at the acquisition and control date, as well as provisional fair value adjustments made during the first nine months of 2012:

	Preliminary Allocations	Adjustments	Updated Allocations
	(Dollars in millions)		
Accounts receivable, net	$106.6	$8.8	$115.4
Inventories	67.1	(10.5)	56.6
Other current assets	137.5	(3.9)	133.6
Property, plant, equipment and mine development	3,457.0	258.6	3,715.6
Investments and other assets	1,275.1	(184.3)	1,090.8
Current maturities of long-term debt	(11.0)	—	(11.0)
Accounts payable and accrued expenses	(133.8)	(26.1)	(159.9)
Long-term debt, less current maturities	(59.2)	—	(59.2)
Asset retirement obligations	(39.3)	(15.2)	(54.5)
Other noncurrent liabilities	(31.4)	(27.4)	(58.8)
Noncontrolling interests	(2,011.9)	—	(2,011.9)
Total purchase price, net of cash acquired of $261.2	$2,756.7	$—	$2,756.7

The adjustments to the provisional fair values result from additional information obtained about facts in existence at the acquisition and control date. Cumulative adjustments to provisional fair values recorded in the current period are assumed to have been made as of the acquisition and control date. Prior financial statements have not been retroactively adjusted due to immateriality. Accordingly, "Depreciation, depletion and amortization" was decreased by $4.7 million and $12.2 million for the three and nine months ended September 30, 2012, respectively. "Asset retirement obligation expenses" were increased by $3.7 million for the three and nine months ended September 30, 2012. "Operating costs and expenses" were decreased by $10.1 million for the nine months ended September 30, 2012, with the entire impact recognized during the first quarter of 2012.

7

In connection with the PEA-PCI acquisition, the Company acquired contract-based obligations consisting of port, rail and water take-or-pay obligations and recorded a liability for unutilized capacity of $58.5 million, net of tax, which is being amortized based on that unutilized capacity over the terms of the applicable agreements which extend to 2018. As of September 30, 2012, the carrying value of the liability was $47.4 million and the associated amortization (which is classified as a reduction to "Operating costs and expenses" in the unaudited condensed consolidated statements of income) recorded during the three and nine months ended September 30, 2012 was $3.8 million and $11.1 million, respectively. Estimated future amortization of the remaining carrying value of the liability as of September 30, 2012 is expected to be $3.7 million, $18.1 million, $15.6 million and $10.0 million for the years ending December 31, 2012, 2013, 2014 and 2015, respectively. Unutilized capacity is not expected in years 2016 through 2018.

During the three and nine months ended September 30, 2012, PEA-PCI contributed revenues of $182.5 million and $479.5 million, respectively, and income before income taxes of $4.4 million and loss before income taxes of $98.7 million, respectively, which includes results from our equity affiliate investment in the Middlemount Mine. Due to the restructuring of the Company's Australian tax entities during the second quarter of 2012 described in Note 10, it is no longer practicable to calculate the net income of PEA-PCI on a standalone basis. The results of PEA-PCI for the three and nine months ended September 30, 2012 are included in the unaudited condensed consolidated statements of income and are reported in the Australian Mining segment, except for the activity associated with certain equity affiliates which is reflected in the Corporate and Other segment.

The following unaudited pro forma financial information presents the combined results of operations of the Company and PEA-PCI, on a pro forma basis, as though the companies had been combined as of January 1, 2010. The unaudited pro forma financial information does not necessarily reflect the results of operations that would have occurred had the Company and PEA-PCI constituted a single entity during those periods or that may be attained in the future.

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
	(Dollars in millions, except per share amounts)	
Revenue	$2,194.1	$6,154.7
Income from continuing operations, net of income taxes	256.0	727.6
Basic earnings per share	$0.88	$2.48
Diluted earnings per share	0.87	2.48

Pro forma income from continuing operations, net of income taxes, includes adjustments to operating costs and depreciation, depletion and amortization to reflect the additional expense for the estimated impact of fair value adjustments to coal inventory and property, plant and equipment (including mineral rights), respectively, as well as additional expense associated with the estimated impact of reflecting the equity affiliate interest at fair value.

As disclosed in Note 23 to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, a then-outstanding loan receivable balance of $384.6 million was converted to a 90% equity interest in MCG Coal Holdings Pty Ltd. (MCGH) in January 2012, resulting in consolidation of MCGH and recognition of noncontrolling interests of $53.4 million at conversion. In June 2012, the Company acquired the remaining noncontrolling interest in MCGH for total consideration of $49.8 million. This acquisition was accounted for as an equity transaction as the Company previously maintained control of MCGH. Accordingly, the Company recorded an increase to additional paid-in capital of $3.6 million in the second quarter 2012 related to this transaction,

representing the difference in the price paid and the carrying value.

(4) Discontinued Operations

Discontinued operations include certain non-strategic Midwestern U.S. and Australian Mining segment assets held for sale which the Company has committed to divest, Midwestern U.S. Mining segment assets that have ceased production and other previously divested operations.

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

In September 2012, the Company announced it had permanently ceased production at its Air Quality Mine in Indiana due to uneconomic market conditions for the type of coal product previously produced at the site. The results of the mine, which were previously included within the Midwestern U.S. Mining reportable segment, have been reported as a discontinued operation for all periods presented because the operations and cash flows of the mine and related coal product have been eliminated from the ongoing operations of the Company as a result of the mine closure. Loss from discontinued operations for the three and nine months ended September 30, 2012 includes before- and after-tax charges of $116.7 million and $75.0 million, respectively, including a before- and after-tax impairment charge of $108.9 million and $68.8 million, respectively, recognized in connection with the shutdown of this mine.
Results from discontinued operations were as follows during the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Dollars in millions)			
Total revenues	$41.5	$55.3	$171.5	$122.7
Loss from discontinued operations before income taxes	$127.6	$12.1	$146.6	$53.9
Income tax benefit	46.3	2.4	53.9	15.0
Loss from discontinued operations, net of income taxes	$81.3	$9.7	$92.7	$38.9

Assets and liabilities classified as discontinued operations included in our condensed consolidated balance sheets were as follows:

	(Unaudited) September 30, 2012	December 31, 2011
	(Dollars in millions)	
Assets:		
Other current assets	$48.4	$24.6
Investments and other assets	135.2	232.2
Total assets classified as discontinued operations	$183.6	$256.8
Liabilities:		
Accounts payable and accrued expenses	$33.4	$63.9
Other noncurrent liabilities	59.8	59.6
Total liabilities classified as discontinued operations	$93.2	$123.5

(5) Investments

The Company’s short-term investments are defined as those investments with original maturities of greater than three months and up to one year included in "Other current assets" in the condensed consolidated balance sheets. Long-term investments are defined as those investments with original maturities greater than one year included in "Investments and other assets" in the condensed consolidated balance sheets.
The Company classifies its investments in debt securities as either held-to-maturity or available-for-sale at the time of purchase and reevaluates such designation periodically. Such investments are classified as held-to-maturity when the Company has the intent and ability to hold the securities to maturity.

9

Investments in debt securities not classified as held-to-maturity and investments in marketable equity securities are classified as available-for-sale. Available-for-sale securities are carried at fair value, with unrealized gains and losses, net of income taxes, reported in “Accumulated other comprehensive income (loss)” in the condensed consolidated balance sheets. Realized gains and losses, determined on a specific identification method, are included in “Interest income” in the condensed consolidated statements of income.
The Company did not have any held-to-maturity securities as of September 30, 2012 or December 31, 2011.
Investments in available-for-sale securities at September 30, 2012 were as follows:

Available-for-sale securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(Dollars in millions)			
Current:				
Federal government securities	$0.8	$—	$—	$0.8
U.S. corporate bonds	3.4	—	—	3.4
Noncurrent:				
Marketable equity securities	66.5	—	(40.0)	26.5
Federal government securities	23.2	0.3	—	23.5
U.S. corporate bonds	12.9	0.2	—	13.1
Total	$106.8	$0.5	$(40.0)	$67.3

Investments in available-for-sale securities at December 31, 2011 were as follows:

Available-for-sale securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
		(Dollars in millions)		
Current:				
Federal government securities	$3.3	$—	$—	$3.3
U.S. corporate bonds	3.9	—	—	3.9
Noncurrent:				
Marketable equity securities	66.5	—	(9.5)	57.0
Federal government securities	11.3	0.2	—	11.5
U.S. corporate bonds	7.7	0.1	—	7.8
Total	$92.7	$0.3	$(9.5)	$83.5

Contractual maturities for available-for-sale investments in debt securities at September 30, 2012 were as shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

Contractual maturities for available-for-sale securities	Cost	Fair Value
	(Dollars in millions)	
Due in one year or less	$4.2	$4.2
Due in one to five years	36.1	36.6
Total	$40.3	$40.8

The Company’s investments in marketable equity securities consist of an investment in Winsway Coking Coal Holdings Limited (Winsway).

Proceeds from sales and maturities of securities amounted to zero and $9.8 million for the three and nine months ended September 30, 2012, respectively. The Company realized net gains of less than $0.1 million during the nine months ended September 30, 2012 associated with those sales and maturities.

In addition to the securities described above, the Company previously held an investment in debt securities related to the Company's pro-rata share of funding in the Newcastle Coal Infrastructure Group (NCIG), which was included in "Investments and other assets" in the condensed consolidated balance sheets. These debt securities were recorded at cost, which approximated fair value, and denominated in U.S. dollars. The Company sold $11.4 million and $29.2 million of debt securities related to NCIG during the three and nine months ended September 30, 2012, respectively. The Company recognized no loss on the sale during the three months ended September 30, 2012 and a loss of $0.2 million on the sale for the nine months ended September 30, 2012. There were no NCIG securities held at September 30, 2012.

At each reporting date, the Company performs separate evaluations of debt and equity securities to determine if any unrealized losses are other-than-temporary. After evaluating the length of time the market value has been less than cost and the financial condition and near-term prospects of Winsway, the Company deemed the impairment associated with its Winsway equity securities to be temporary as of September 30, 2012. The Company has the ability to hold the securities until recovery and has no current intention to divest the securities. Accordingly, the Company did not recognize other-than-temporary losses on its investments during the three or nine months ended September 30, 2012.

(6) Inventories

Inventories consisted of the following:

	September 30, 2012	December 31, 2011
	(Dollars in millions)	
Materials and supplies	$157.0	$123.7
Raw coal	162.2	108.1
Saleable coal	235.7	212.6
Total	$554.9	$444.4

(7) Derivatives and Fair Value Measurements

Risk Management — Non-Coal Trading Activities

The Company is exposed to various types of risk in the normal course of business, including price risk on commodities utilized in the Company's mining operations, interest rate risk on long-term debt and foreign currency exchange rate risk for non-U.S. dollar expenditures. 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, with a small percentage mitigated through the use of financial instruments. In order to manage our exposure related to price risk on certain commodities used in production, as well as for interest rate and foreign currency exchange rate risk, the Company utilizes derivative financial instruments. These risks are actively monitored in an effort to ensure compliance with the risk management policies of the Company.

Foreign Currency Hedges. The Company is exposed to foreign currency exchange rate risk, primarily on Australian dollar expenditures made in its Australian Mining segment. This risk is managed through the use of 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 foreign currency expenditures.

11

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

Diesel Fuel and Explosives Hedges. The Company is exposed to commodity price risk associated with diesel fuel and explosives utilized in production in the U.S. and Australia. This risk is managed through the use of cost pass-through contracts and derivatives, primarily swaps. The Company generally designates the swap contracts as cash flow hedges, with the objective of reducing the variability of cash flows associated with forecasted diesel fuel and explosives purchases.

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 adverse changes in the fair value of the fixed rate debt that results from market interest rate changes. In addition, from time to time, 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, 2012, the Company had no interest rate swaps in place.

Notional Amounts and Fair Value. The following summarizes the Company's foreign currency and commodity positions at September 30, 2012:

	Notional Amount by Year of Maturity				
	Total	2012	2013	2014	2015
Foreign Currency					
A$:US$ hedge contracts (A$ millions)	$4,832.3	$566.1	$2,173.6	$1,513.5	$579.1
Commodity Contracts					
Diesel fuel hedge contracts (million gallons)	215.4	27.0	102.1	63.6	22.7
U.S. explosives hedge contracts (million MMBtu)	4.6	0.8	2.6	1.2	—

	Account Classification by			
	Cash Flow Hedge	Fair Value Hedge	Economic Hedge	Fair Value Asset (Liability) (Dollars in millions)
Foreign Currency				
A$:US$ hedge contracts (A$ millions)	$4,832.3	$—	$—	$511.7
Commodity Contracts				
Diesel fuel hedge contracts (million gallons)	215.4	—	—	30.9
U.S. explosives hedge contracts (million MMBtu)	4.6	—	—	(5.9)

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 in "Accumulated other comprehensive income (loss)" until the hedged transaction impacts reported earnings, at which time any gain or loss is reclassified to earnings. To the extent that periodic changes in the fair value of derivatives deemed highly effective exceeds such changes in the hedged item, the ineffective portion of the periodic non-cash changes are recorded in earnings in the period of the change. If the hedge ceases to qualify for hedge accounting, the Company prospectively recognizes changes in the fair value of the instrument in earnings in the period of the change.

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

12

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

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

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

The tables below show the classification and amounts of pre-tax gains and losses related to the Company’s non-coal trading hedges during the three and nine months ended September 30, 2012 and 2011:

		Three Months Ended September 30, 2012			
Financial Instrument	Income Statement Classification Gains (Losses) - Realized	Gain recognized in income on non-designated derivatives	Gain recognized in other comprehensive income on derivatives (effective portion)	Gain reclassified from other comprehensive income into income (effective portion)	Gain reclassified from other comprehensive income into income (ineffective portion)
		(Dollars in millions)			
Commodity swap contracts	Operating costs and expenses	$—	$ 49.6	$ 11.2	$ 2.2
Foreign currency forward and option contracts	Operating costs and expenses	—	169.2	82.0	—
Total		$—	$ 218.8	$ 93.2	$ 2.2

		Three Months Ended September 30, 2011			
Financial Instrument	Income Statement Classification Gains (Losses) - Realized	Gain recognized in income on non-designated derivatives	Loss recognized in other comprehensive income on derivatives (effective portion)	Gain reclassified from other comprehensive income into income (effective portion)	Loss reclassified from other comprehensive income into income (ineffective portion)
		(Dollars in millions)			
Commodity swap contracts	Operating costs and expenses	$—	$ (51.2)	$ 8.5	$ (1.2)
Foreign currency forward and option contracts:					
— Operating costs	Operating costs and expenses	—	(269.1)	92.2	—

— Capital expenditures	Depreciation, depletion and amortization	—	(0.5	) —	—
Total		$—	$ (320.8	) $ 100.7	$ (1.2)

13

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

Financial Instrument	Income Statement Classification Gains (Losses) - Realized	Nine Months Ended September 30, 2012			
		Gain recognized in income on non-designated derivatives	Gain recognized in other comprehensive income on derivatives (effective portion)	Gain reclassified from other comprehensive income into income (effective portion)	Loss reclassified from other comprehensive income into income (ineffective portion)
		(Dollars in millions)			
Commodity swap contracts	Operating costs and expenses	$—	$ 28.7	$ 39.0	$ (2.3)
Foreign currency forward and option contracts	Operating costs and expenses	—	297.5	276.6	—
Total		$—	$ 326.2	$ 315.6	$ (2.3)

Financial Instrument	Income Statement Classification Gains (Losses) - Realized	Nine Months Ended September 30, 2011			
		Gain recognized in income on non-designated derivatives	Gain (loss) recognized in other comprehensive income on derivatives (effective portion)	Gain reclassified from other comprehensive income into income (effective portion)	Gain reclassified from other comprehensive income into income (ineffective portion)
		(Dollars in millions)			
Commodity swap contracts	Operating costs and expenses	$—	$ 20.9	$ 28.4	$ 0.4
Foreign currency forward and option contracts:					
— Operating costs	Operating costs and expenses	—	33.8	261.1	—
— Capital expenditures	Depreciation, depletion and amortization	—	(0.7)	—	—
Total		$—	$ 54.0	$ 289.5	$ 0.4

Based on the net fair value of the Company's non-coal trading positions held in "Accumulated other comprehensive income (loss)" at September 30, 2012, unrealized gains to be reclassified from comprehensive income to earnings over the next 12 months associated with the Company's foreign currency and diesel fuel hedge programs are expected to be approximately $287 million and $30 million, respectively, while the unrealized losses to be realized under the explosives hedge program are expected to be approximately $4 million. As these unrealized gains are associated with derivative instruments that represent hedges of forecasted transactions, the amounts reclassified to earnings will partially offset the realized transactions, while the unrealized losses will add incremental expense to the unaudited

condensed consolidated statements of income.

The classification and amount of derivatives presented on a gross basis as of September 30, 2012 and December 31, 2011 were as follows:

Financial Instrument	Fair Value as of September 30, 2012			
	Current Assets	Noncurrent Assets	Current Liabilities	Noncurrent Liabilities
	(Dollars in millions)			
Commodity swap contracts	$32.8	$5.2	$6.1	$6.9
Foreign currency forward and option contracts	286.7	225.0	—	—
Total	$319.5	$230.2	$6.1	$6.9

Financial Instrument	Fair Value as of December 31, 2011			
	Current Assets	Noncurrent Assets	Current Liabilities	Noncurrent Liabilities
	(Dollars in millions)			
Commodity swap contracts	$43.4	$11.7	$7.1	$15.0
Foreign currency forward and option contracts	270.4	229.0	4.3	4.5
Total	$313.8	$240.7	$11.4	$19.5

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.

See Note 8 for information related to the Company’s coal trading activities.

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 are 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.

Financial Instruments Measured on a Recurring Basis. The following tables set forth the hierarchy of the Company's net financial asset positions for which fair value is measured on a recurring basis:

	September 30, 2012			
	Level 1	Level 2	Level 3	Total
	(Dollars in millions)			
Investments in debt and equity securities	$67.3	$—	$—	$67.3
Commodity swap contracts	—	25.0	—	25.0
Foreign currency forward and option contracts	—	511.7	—	511.7
Total net financial assets	$67.3	$536.7	$—	$604.0

	December 31, 2011			
	Level 1	Level 2	Level 3	Total
	(Dollars in millions)			
Investments in debt and equity securities	$83.5	$—	$—	$83.5
Commodity swap contracts	—	33.0	—	33.0
Foreign currency forward and option contracts	—	490.6	—	490.6
Total net financial assets	$83.5	$523.6	$—	$607.1

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:

- Investments in debt and equity securities: valued based on quoted prices in active markets (Level 1).
- Commodity swap contracts — diesel fuel and explosives: valued based on a valuation that is corroborated by the use of market-based pricing (Level 2).
- Foreign currency forward and option contracts: valued utilizing inputs obtained in quoted public markets (Level 2).

The Company did not have any transfers between levels during the three or nine months ended September 30, 2012 or 2011 for its non-coal trading positions. The Company's policy is to value transfers between levels using the beginning of period valuation.

Other Financial Instruments. The following methods and assumptions were used by the Company in estimating fair values for other financial instruments as of September 30, 2012 and December 31, 2011:

- Cash and cash equivalents, accounts receivable, including those within the Company's accounts receivable securitization program, and accounts payable and accrued expenses have carrying values which approximate fair value due to the short maturity or the liquid nature of these instruments.
- The Company's investment in debt securities related to its pro-rata share of funding in NCIG were included in "Investments and other assets" in the condensed consolidated balance sheets as of December 31, 2011, at which time the debt securities were recorded at cost, which approximated fair value. The Company disposed of its remaining investment in debt securities related to NCIG during the nine months ended September 30, 2012.
- Long-term debt fair value estimates are based on observed prices for securities with an active trading market when available (Level 2), and otherwise on estimated borrowing rates to discount the cash flows to their present value (Level 3). The carrying amounts of the 7.875% Senior Notes due December 2026 and the Convertible Junior Subordinated Debentures due 2066 (the Debentures) are net of the respective unamortized note discounts.

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

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

	September 30, 2012		December 31, 2011	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(Dollars in millions)			
Long-term debt	$6,363.1	$6,393.0	$6,657.5	$6,922.7

Nonperformance and Credit Risk

The fair value of the Company's non-coal trading derivative assets and liabilities reflects adjustments for nonperformance and credit risk. The Company manages its counterparty risk through established credit standards, diversification of counterparties, utilization of investment grade commercial banks and continuous monitoring of counterparty creditworthiness. To reduce its credit exposure for these hedging activities, the Company seeks to enter into netting agreements with counterparties that permit the Company to offset asset and liability positions with such counterparties in the event of default.

(8) Coal Trading

The Company engages in direct and brokered trading of coal, ocean freight and fuel-related commodities in over-the-counter markets (coal trading), some of which is subsequently exchange-cleared and some of which is bilaterally settled. Except those for which the Company has elected to apply a normal purchases and normal sales exception, all derivative coal trading contracts are accounted for at fair value.

The Company's policy is to include instruments associated with coal trading transactions as a part of its trading book. Trading revenues from such transactions are recorded in "Other revenues" in the unaudited condensed consolidated statements of income and include realized and unrealized gains and losses on derivative instruments, including coal deliveries related to contracts accounted for under the normal purchases and normal sales exception. Therefore, the Company has elected the trading exemption surrounding disclosures related to its coal trading activities.

Trading revenues recognized during the three and nine months ended September 30, 2012 and 2011 were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
Trading Revenues by Type of Instrument	2012	2011	2012	2011
	(Dollars in millions)			
Commodity swaps and options	$60.3	$(0.6)	$110.9	$(26.6)
Physical commodity purchase/sale contracts	(20.0)	29.6	21.9	60.9
Total trading revenues	$40.3	$29.0	$132.8	$34.3

Risk Management

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 in "Accumulated other comprehensive income" until the hedged transaction impacts reported earnings, at which time gains and losses are also reclassified to earnings. To the extent that periodic changes in the fair value of a derivative exceeds the changes in the hedged item to which it has been designated, the ineffective portion is recorded in earnings in the period of the change. If the hedge ceases to qualify for hedge accounting, the Company prospectively recognizes the changes in fair value of the instrument in earnings in the period of the change.

In some instances, the Company has designated an existing coal trading derivative as a hedge and, thus, the derivative has a non-zero fair value at hedge inception. The "off-market" nature of these derivatives, which is best described as an embedded financing element within the derivative, is a source of ineffectiveness. In other instances, the Company uses a coal trading derivative that settles at a different time, has different quality specifications or has a different location basis than the occurrence of the cash flow being hedged. These collectively yield ineffectiveness to the extent that the derivative hedge contract does not exactly offset changes in the fair value or expected cash flows of the hedged item.

Forecasted Transactions No Longer Probable. During the nine months ended September 30, 2012, the Company reclassified net gains of $7.1 million out of "Accumulated other comprehensive income (loss)" to earnings as the underlying forecasted transactions were deemed no longer probable of occurring. Approximately $4.5 million of this amount relates to disruptions to forecasted transactions due to the bankruptcy declaration of a counterparty to certain of our physical purchase contracts during the third quarter of 2012.

Fair Value Measurements

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

	September 30, 2012		December 31, 2011	
	Gross Basis	Net Basis	Gross Basis	Net Basis
	(Dollars in millions)			
Assets from coal trading activities	$444.8	$56.2	$170.4	$44.6
Liabilities from coal trading activities	(216.6)	(19.9)	(84.0)	(10.3)
Subtotal	228.2	36.3	86.4	34.3
Net margin held [1]	(191.9)	—	(52.1)	—
Net value of coal trading positions	$36.3	$36.3	$34.3	$34.3

(1) Represents margin held from exchanges of $191.9 million and $52.1 million at September 30, 2012 and December 31, 2011, respectively. Approximately $100 million and $23 million of the margin held at September 30, 2012 and December 31, 2011, respectively, related to cash flow hedges.

The Company's trading assets and liabilities are generally comprised of forward contracts, financial swaps and margin. The gross fair value of coal trading positions designated as cash flow hedges of forecasted sales was an asset of $185.1 million and $22.4 million as of September 30, 2012 and December 31, 2011, respectively. The increase in the fair value of coal trading positions designated as cash flow hedges of forecasted sales was predominantly driven by a decrease in the associated price levels in international thermal coal markets during the period.

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

	September 30, 2012			
	Level 1	Level 2	Level 3	Total
	(Dollars in millions)			
Commodity swaps and options	$2.0	$31.9	$—	$33.9
Physical commodity purchase/sale contracts	—	1.5	0.9	2.4
Total net financial assets	$2.0	$33.4	$0.9	$36.3

	December 31, 2011			
	Level 1	Level 2	Level 3	Total
	(Dollars in millions)			
Commodity swaps and options	$21.2	$(1.9)	$—	$19.3
Physical commodity purchase/sale contracts	—	6.3	8.7	15.0
Total net financial assets	$21.2	$4.4	$8.7	$34.3

For Level 1 and 2 financial assets and liabilities, the Company utilizes both direct and indirect observable price quotes, including U.S. interest rate curves, LIBOR yield curves, Chicago Mercantile Exchange (CME), Intercontinental Exchange indices (ICE), NOS Clearing ASA, LCH.Clearnet (formerly known as the London Clearing House), Singapore Exchange (SGX), broker quotes, published indices and other market quotes. Below is a summary of the Company’s valuation techniques for Level 1 and 2 financial assets and liabilities:

- Commodity swaps and options: generally valued based on unadjusted quoted prices in active markets (Level 1) or a valuation that is corroborated by the use of market-based pricing (Level 2).
- Physical commodity purchase/sale contracts: purchases and sales at locations with significant market activity corroborated by market-based information (Level 2).

Physical commodity purchase/sale contracts transacted in less liquid markets or contracts, such as long-term arrangements with limited price availability, are classified in Level 3. Indicators of less liquid markets are those with periods of low trade activity or wide pricing spreads between broker quotes.

The Company's risk management function, which is independent of the Company's commercial trading function, is responsible for valuation policies and procedures, with oversight from executive management. Generally, the Company's Level 3 instruments or contracts are valued using bid/ask price quotations and other market assessments obtained from multiple, independent third-party brokers or other transactional data incorporated into internally-generated discounted cash flow models. While the Company does not anticipate any decrease in the number of third-party brokers or market liquidity, the occurrence of such events could erode the quality of market information and therefore the valuation of its market positions. The Company's valuation techniques include basis adjustments to the foregoing price inputs for quality, such as heat rate, sulfur content and ash content; location differentials, expressed as port and freight costs, and credit and nonperformance risk. The Company's risk management function independently validates the Company's valuation inputs, including unobservable inputs, with third-party information and settlement prices from other sources where available. A daily process is performed to analyze market price changes and changes to the portfolio. Further periodic validation occurs at the time contracts are settled with the counterparty. These valuation techniques have been consistently applied in all periods presented, and the Company believes it has obtained the most accurate information available for the types of derivative contracts held.

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

The following table summarizes the quantitative unobservable inputs utilized by the Company's internally-developed valuation models for physical commodity purchase/sale contracts classified as Level 3 as of September 30, 2012:

	Range		Weighted
	Low	High	Average
Quality adjustments	2 %	22 %	14 %
Location differentials	6 %	40 %	25 %
Non-performance adjustments	4 %	4 %	4 %

Significant increases or decreases in the inputs in isolation could result in a significantly higher or lower fair value measurement. The unobservable inputs do not have a direct interrelationship; therefore, a change in one unobservable input would not necessarily correspond with a change in another unobservable input.

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Dollars in millions)			
Beginning of period	$2.9	$9.9	$8.7	$18.6
Total net gains (losses) realized/unrealized:				
Included in earnings	2.4	(1.4)	12.8	10.7
Settlements	(4.4)	(1.3)	(20.6)	(3.1)
Transfers out	—	1.0	—	(18.0)
End of period	$0.9	$8.2	$0.9	$8.2

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(Dollars in millions)			
Changes in net unrealized gains [1]	$0.2	$(1.1)	$(3.5)	$8.7

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

The Company did not have any significant transfers in its coal trading positions between Level 1 and Level 2 during the nine months ended September 30, 2012 or 2011. There were no transfers in or out of Level 3 during the three and nine months ended September 30, 2012. During the three and nine months ended September 30, 2011, certain of the Company's physical commodity purchase/sale contracts were transferred from Level 3 to Level 2 as the settlement dates entered a more liquid market. The Company's policy is to value transfers between levels using the beginning of period valuation.

Based on the net fair value of the Company's coal trading positions held in "Accumulated other comprehensive income (loss)" at September 30, 2012, unrealized gains to be reclassified from comprehensive income to earnings over the next 12 months are expected to be approximately $137 million. As these unrealized gains are associated with derivative instruments that represent hedges of forecasted transactions, the amounts reclassified to earnings may partially offset the realized transactions in the unaudited condensed consolidated statements of income.

20

As of September 30, 2012