

PEABODY ENERGY CORP

Form 10-K

February 28, 2008

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

Form 10-K

- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the Fiscal Year Ended December 31, 2007
or
 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

Commission File Number 1-16463

Peabody Energy Corporation
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	13-4004153 (I.R.S. Employer Identification No.)
701 Market Street, St. Louis, Missouri (Address of principal executive offices)	63101 (Zip Code)
(314) 342-3400 Registrant's telephone number, including area code	

Securities Registered Pursuant to Section 12(b) of the Act:

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, par value \$0.01 per share	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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
(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

Aggregate market value of the voting stock held by non-affiliates (shareholders who are not directors or executive officers) of the Registrant, calculated using the closing price on June 29, 2007: Common Stock, par value \$0.01 per share, \$12.8 billion.

Number of shares outstanding of each of the Registrant's classes of Common Stock, as of February 15, 2008: Common Stock, par value \$0.01 per share, 271,009,658 shares outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement to be filed with the Securities and Exchange Commission in connection with the Company's 2008 Annual Meeting of Stockholders (the Company's 2008 Proxy Statement) are incorporated by reference into Part III hereof. Other documents incorporated by reference in this report are listed in the Exhibit Index of this Form 10-K.

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. We use words such as anticipate, believe, expect, may, project, should, estimate, or similar words to identify forward-looking statements.

Without limiting the foregoing, all statements relating to our future outlook, 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:

ability to renew sales contracts;

reductions of purchases by major customers;

transportation performance and costs, including demurrage;

geology, equipment and other risks inherent to mining;

impact of weather on demand, production and transportation;

legislation, regulations and court decisions or other government actions;

new environmental requirements affecting the use of coal, including mercury and carbon dioxide related limitations;

availability, timing of delivery and costs of key supplies, capital equipment or commodities such as diesel fuel, steel, explosives and tires;

replacement of coal reserves;

price volatility and demand, particularly in higher-margin products and in our trading and brokerage businesses;

performance of contractors, third-party coal suppliers or major suppliers of mining equipment or supplies;

negotiation of labor contracts, employee relations and workforce availability;

availability and costs of credit, surety bonds and letters of credit;

credit and performance risks associated with customers, suppliers, trading and financial counterparties;

the effects of acquisitions or divestitures, including the spin-off of Patriot Coal Corporation;

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

risks associated with our Btu conversion or generation development initiatives;

risks associated with the conversion of our information systems;

growth of U.S. and international coal and power markets;

coal's market share of electricity generation;

the availability and cost of competing energy resources;

future worldwide economic conditions;

changes in postretirement benefit and pension obligations;

successful implementation of business strategies;

the effects of changes in currency exchange rates, primarily the Australian dollar;

inflationary trends, including those impacting materials used in our business;

interest rate changes;

litigation, including claims not yet asserted;

terrorist attacks or threats;

impacts of pandemic illnesses; and

other factors, including those discussed in Legal Proceedings, set forth in Item 3 of this report and Risk Factors, set forth in Item 1A of this report.

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. These forward-looking statements speak only as of the date on which such statements were made, and we undertake no obligation to update these statements except as required by federal securities laws.

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Note: The words we, our, Peabody or the Company as used in this report, refer to Peabody Energy Corporation or its applicable subsidiary or subsidiaries. Unless otherwise noted herein, disclosures in this Annual Report on Form 10-K relate only to our continuing operations. Our discontinued operations, which were spun-off to stockholders in the fourth quarter of 2007, consist of portions of our Eastern U.S. Mining operations business segment.

PART I

Item 1. *Business.*

Overview

We are the largest private-sector coal company in the world. During the year ended December 31, 2007, we sold 237.8 million tons of coal. During this period, we sold coal to over 340 electricity generating and industrial plants in 19 countries. Our coal products fuel approximately 10% of all U.S. electricity generation and 2% of worldwide electricity generation. At December 31, 2007, we had 9.3 billion tons of proven and probable coal reserves.

We own majority interests in 31 coal mining operations located in the U.S and Australia. Additionally, we own a minority interest in one Venezuelan operating mine through a joint venture arrangement. We shipped 192.3 million tons from our 20 U.S. mining operations and 21.4 million tons from our 11 Australia operations in 2007. We shipped 84% of our U.S. mining operations coal sales volume from the western United States during the year ended December 31, 2007 and the remaining 16% from the eastern United States. Most of our production in the western United States is low-sulfur coal from the Powder River Basin. Our overall Western U.S. coal production has increased from 128.4 million tons in 2002 to 161.5 million tons during 2007, a compounded annual growth rate of 4.7%. In the West, we own and operate mines in Arizona, Colorado, New Mexico and Wyoming. In the East, we own and operate mines in Illinois and Indiana. We own six mines in Queensland, Australia, and five mines in New South Wales, Australia. Our Australian production includes both low-sulfur domestic and export thermal coal and metallurgical coal. The export thermal and metallurgical coal is predominantly shipped to customers in the Asia-Pacific region. We generated 89% of our global production for the year ended December 31, 2007 from non-union mines.

For the year ended December 31, 2007, 85% of our sales (by volume) were to U.S. electricity generators, 13% were to customers outside the United States and 2% were to the U.S. industrial sector. Approximately 94% of our coal sales during the year ended December 31, 2007 were under long-term (one year or greater) contracts. Our sales backlog, including backlog subject to price reopener and/or extension provisions, was nearly one billion tons as of December 31, 2007, representing more than four years of current production in backlog. Contracts in backlog have remaining terms ranging from one to 17 years. We are targeting 2008 production of 220 to 240 million tons and total sales volume of 240 to 260 million tons, including 8 to 10 million tons of metallurgical coal. As of December 31, 2007, our unpriced 2008 volumes for planned produced tonnage were 5 to 10 million U.S. tons and 9 to 10 million Australia tons. Our total unpriced planned production for 2009 is approximately 80 to 90 million tons in the United States and 17 to 20 million tons in Australia.

Our mining operations consist of three principal operating segments: Western U.S. Mining, Eastern U.S. Mining, and Australian Mining. In addition to our mining operations, we market, broker and trade coal through our Trading and Brokerage Operations segment. Our total tons traded were 166.5 million for the year ended December 31, 2007. In response to growing international markets, we established an international trading group in 2006 and added a trading operations office in Europe in early 2007. We also have a business development, sales and marketing office in Beijing, China to pursue potential long-term growth opportunities there. Our other energy-related commercial activities include the development of mine-mouth coal-fueled generating plants, the management of our vast coal reserve and real estate holdings, and Btu Conversion technologies, which are designed to convert coal to natural gas

and transportation fuels.

For financial information regarding each of our operating segments, see Note 24 to our consolidated financial statements.

Discontinued Operations

On October 31, 2007, we spun-off portions of our Eastern U.S. Mining operations business segment to form Patriot Coal Corporation (Patriot). We distributed Patriot stock to our stockholders at a ratio of one share of Patriot stock for every 10 shares of Peabody stock held on the record date of October 22, 2007. Our results for all periods presented reflect Patriot as a discontinued operation. The spin-off included eight company-operated mines, two majority-owned joint venture mines, and numerous contractor operated mines serviced by eight coal preparation facilities along with 1.2 billion tons of proven and probable coal reserves. Prior to the spin-off, we received necessary regulatory approvals including a private letter ruling on the tax-free nature of the transaction from the Internal Revenue Service.

History

Peabody, Daniels and Co. was founded in 1883 as a retail coal supplier, entering the mining business in 1888 as Peabody & Co. with the opening of our first coal mine in Illinois. In 1926, Peabody Coal Company was listed on the Chicago Stock Exchange and, beginning in 1949, on the New York Stock Exchange.

In 1955, Peabody Coal Company, primarily an underground mine operator, merged with Sinclair Coal Company, a major surface mining company. Peabody Coal Company was acquired by Kennecott Copper Company in 1968. The company was then sold to Peabody Holding Company in 1977, which was formed by a consortium of companies.

During the 1980s, Peabody grew through expansion and acquisition, opening the North Antelope Mine in Wyoming's coal-rich Powder River Basin in 1983 and the Rochelle Mine in 1985.

In July 1990, Hanson, PLC acquired Peabody Holding Company. In the 1990s, Peabody continued to grow through expansion and acquisitions. In February 1997, Hanson spun off its energy-related businesses, including Eastern Group and Peabody Holding Company, into The Energy Group, plc. The Energy Group was a publicly traded company in the United Kingdom and its American Depository Receipts (ADRs) were publicly traded on the New York Stock Exchange.

In May 1998, Lehman Brothers Merchant Banking Partners II L.P. and affiliates (Merchant Banking Fund), an affiliate of Lehman Brothers Inc. (Lehman Brothers), purchased Peabody Holding Company and its affiliates, Peabody Resources Limited and Citizens Power LLC in a leveraged buyout transaction that coincided with the purchase by Texas Utilities of the remainder of The Energy Group. In August 2000, Citizens Power, our subsidiary that marketed and traded electric power and energy-related commodity risk management products, was sold to Edison Mission Energy and in January 2001, we sold our Peabody Resources Limited (in Australia) operations to Coal & Allied, a subsidiary of Rio Tinto Limited.

In April 2001, we changed our name to Peabody Energy Corporation, reflecting our position as a premier energy supplier. In May 2001, we completed an initial public offering of common stock, and our shares began trading on the New York Stock Exchange under the ticker symbol **BTU**, the globally recognized symbol for energy.

In April 2004, we acquired coal operations from RAG Coal International AG, expanding our presence in both Australia and Colorado. In December 2004, we completed the purchase of a 25.5% equity interest in Carbones del Guasare from RAG Coal International, S.A. Carbones del Guasare, a joint venture with Anglo American plc and a Venezuelan governmental partner, operates Venezuela's largest coal mine, the Paso Diablo Mine in northwestern Venezuela. In October 2006, we expanded our presence in Australia with the acquisition of Excel Coal Limited

(Excel), an independent coal company in Australia. The Excel acquisition included operating and development-stage mines, along with proven and probable coal reserves of up to 500 million tons.

On October 31, 2007, we spun-off portions of our Eastern U.S. Mining operations business segment to form Patriot Coal Corporation as noted above. The spin-off included eight company-operated mines, two majority-owned joint venture mines, and numerous contractor operated mines serviced by eight coal preparation facilities along with 1.2 billion tons of proven and probable coal reserves.

We have transformed in recent years from a high-sulfur, high-cost coal company to a predominately low sulfur, low-cost coal producer, marketer / trader of coal and manager of vast natural resources through organic growth, acquisitions and strategic operational restructuring. We operate under four core strategies to achieve growth. These include executing the basics of best-in-class safety, operations and marketing; capitalizing on organic growth opportunities; expanding in high-growth global markets; and participating in new generation and Btu Conversion technologies to convert coal into natural gas, liquids and hydrogen. Through these strategies, in 2008, we are focused on several key areas to enhance shareholder value amid the multiple markets we operate: 1) improving productivity and costs, utilizing prior-year investments and ongoing operations improvement programs; 2) expanding access to high-growth, high-margin markets; 3) improving capital efficiency; 4) pursuing long-term operating, trading and joint-venture opportunities in China, Mongolia and Mozambique; and 5) advancing clean coal projects, including Btu Conversion initiatives.

Mining Operations

We conduct our mining business through three principal mining operating segments: Western U.S. Mining, Eastern U.S. Mining, and Australian Mining. Our Western U.S. Mining Operations consist of our Powder River Basin, Southwest and Colorado operations, and our Eastern U.S. Mining Operations consist of our Midwest operations. The principal business of our U.S. Mining segments is the mining, preparation and sale of steam coal, sold primarily to electric utilities. Internationally, we operate metallurgical and steam coal mines in Queensland, Australia and New South Wales, Australia and have a 25.5% investment in a Venezuelan mine. All of our operating segments are discussed in Note 24 to our consolidated financial statements.

The following describes the operating characteristics of the principal mines and reserves of each of our business units and affiliates. The maps below show mine locations as of December 31, 2007. The U.S. map does not include our El Segundo Mine in New Mexico, which is expected to begin operations in mid-2008. All of our mining operations are owned and managed by our subsidiaries. The subsidiary that manages a particular mining operation is not necessarily the same as the subsidiary or subsidiaries which own the assets utilized in that mining operation. Unless otherwise indicated, we own 100% of the subsidiary that manages the respective mining operations or owns the related assets.

U.S. Mining Operations

Powder River Basin Operations

We control approximately 3.3 billion tons of proven and probable coal reserves in the Southern Powder River Basin, the largest and fastest growing major U.S. coal-producing region. We manage three low-sulfur, non-union surface mining complexes in Wyoming that sold 139.8 million tons of coal during the year ended December 31, 2007, or approximately 59% of our total coal sales volume. The North Antelope Rochelle and Caballo Mines are serviced by both major western railroads, the Burlington Northern Santa Fe (BNSF) Railway and the Union Pacific Railroad. The Rawhide Mine is serviced by the BNSF Railway.

Our Wyoming Powder River Basin reserves are classified as surface mineable, subbituminous coal with seam thickness varying from 60 to 115 feet. The sulfur content of the coal in current production ranges from 0.2% to 0.4% and the heat value ranges from 8,300 to 8,800 Btu s per pound.

North Antelope Rochelle Mine

The North Antelope Rochelle Mine is located 65 miles south of Gillette, Wyoming. This mine is the largest in the world, selling 91.5 million tons of compliance coal (defined as having sulfur dioxide content of 1.2 pounds or less per million Btu) during 2007. The North Antelope Rochelle Mine produces premium quality coal with a sulfur content averaging 0.2% and a heat value ranging from 8,600 to 8,800 Btu per pound. The North Antelope Rochelle Mine produces the lowest sulfur coal in the United States, using three draglines along with five overburden truck-and-shovel fleets. During 2007 we erected a new dragline and completed an in-pit crusher/conveyor at North Antelope Rochelle. These projects, combined with the completion of new blending and loading facilities in the first half of 2008, are designed to lower our cost structure by reducing reliance on truck fleets, while also increasing capacity.

Caballo Mine

The Caballo Mine is located 20 miles south of Gillette, Wyoming. During 2007, it sold 31.2 million tons of compliance coal. Caballo is a cast/dozer/truck-and-shovel assist operation with a coal handling system that includes two 12,000-ton silos and two 11,000-ton silos. The Caballo Mine produces compliance coal with a sulfur content averaging 0.36% and a heat value averaging 8,500 Btu per pound.

Rawhide Mine

The Rawhide Mine is located 10 miles north of Gillette, Wyoming. During 2007, it sold 17.1 million tons of compliance coal. Rawhide is a cast/dozer-push/truck-and-shovel assist operation with a coal handling system that includes two 12,000-ton silos and four 11,000-ton silos. The Rawhide Mine produces compliance coal with a sulfur content averaging 0.37% and a heat value averaging 8,300 Btu per pound.

Southwest Operations

We own four coal mines in our Southwest operations, two in Arizona and two in New Mexico. Kayenta, in Arizona, and Lee Ranch, in New Mexico, are both in operation. The Black Mesa Mine in Arizona suspended operations as of December 31, 2005 and the El Segundo Mine in New Mexico is scheduled to begin production in mid-2008. We control 1.0 billion tons of proven and probable coal reserves in our Southwest operations.

Kayenta Mine

The Kayenta Mine, located on the Navajo Nation and Hopi Tribe lands in Arizona, uses four draglines in three mining areas. It sold approximately 7.9 million tons of coal during 2007 and supplies primarily bituminous compliance coal under a long-term coal supply agreement to an electricity generating station in the region. The Kayenta Mine coal is crushed, then carried 17 miles by conveyor belt to storage silos where it is loaded onto a private rail line and transported 83 miles to the Navajo Generating Station, operated by the Salt River Project near Page, Arizona. The mine and railroad were designed to deliver coal exclusively to the power plant, which has no other source of coal. The Navajo coal supply agreement extends until 2011. Hourly workers at this mine are members of the United Mine Workers of America (UMWA) under a contract that extends through 2013.

Lee Ranch Mine

The Lee Ranch Mine, located near Grants, New Mexico, sold approximately 5.8 million tons of subbituminous medium sulfur coal during 2007. Lee Ranch shipped the majority of its coal to two customers in Arizona and New Mexico under coal supply agreements extending until 2020 and 2014, respectively. Lee Ranch is a non-union surface mine that uses a combination of dragline and truck-and-shovel mining techniques and ships coal to its customers via the BNSF Railway.

El Segundo Mine

The El Segundo Mine, located near Grants, New Mexico, is currently under development and is expected to start producing subbituminous medium sulfur coal in mid-2008. We executed a 19 year coal supply agreement that serves as the mine's base-load contract. El Segundo is expected to be a non-union surface mine that uses truck-and-shovel mining techniques and ships coal to its customers via the BNSF Railway.

Colorado Operations

We control approximately 0.2 billion tons of proven and probable coal reserves and currently have one operating mine in the Colorado Region.

Twentymile Mine

The Twentymile Mine is located in Routt County, Colorado, and sold 7.9 million tons of compliance, low-sulfur, steam coal to customers throughout the United States during 2007. This mine uses both longwall and continuous mining equipment. Our Twentymile Mine is non-union and has been one of the largest underground mines in the United States. Approximately 75% of all coal shipped is loaded on the Union Pacific railroad; the remainder is hauled by truck to the nearby Hayden Generating Station, operated by the Public Service of Colorado, under a coal supply agreement that extends until 2011.

Midwest Operations

Our Midwest operations consist of 13 mines in the Illinois Basin. We control approximately 3.7 billion tons of proven and probable coal reserves in the Midwest. In 2007, these operations collectively sold 30.9 million tons of coal, more than any other Midwestern coal producer. We ship coal from these mines primarily to electricity generators in the Midwest and to industrial customers for power generation.

Gateway Mine

The Gateway Mine is a non-union underground mine located in Randolph County, Illinois. During 2007, the Gateway Mine sold 2.7 million tons of steam coal.

Air Quality Mine

The Air Quality Mine is an underground mine located near Monroe City, Indiana that sold 2.0 million tons of compliance coal in 2007. The Air Quality Mine has a non-union workforce.

Farmersburg Mine

The Farmersburg Mine is a surface mine located in Vigo and Sullivan counties in Indiana that sold 3.5 million tons of medium sulfur coal in 2007. The Farmersburg Mine has a non-union workforce.

Francisco Mine Complex

The Francisco Mine Complex, which has both an underground and surface mine, is located in Gibson County, Indiana and sold 3.0 million tons of medium sulfur coal in 2007. The Francisco Mine Complex has a non-union workforce.

Somerville Mine Complex

The Somerville Mine Complex consists of three surface mines located in Gibson County, Indiana. These mines collectively sold 8.5 million tons of medium sulfur coal in 2007. The Somerville Mine Complex has a non-union workforce.

Viking Mine

The Viking Mine is a surface mine located in Indiana that sold 1.7 million tons of medium sulfur coal in 2007. The Viking Mine has a non-union workforce.

Miller Creek Mine

The Miller Creek Mine is a surface mine located in Indiana that sold 1.6 million tons of medium sulfur coal in 2007. The Miller Creek Mine has a non-union workforce.

Vermilion Grove-Riola Mine Complex

Vermilion Grove is a portal of the Riola Mine, an underground mine located in east central Illinois that sold 1.4 million tons of medium sulfur coal in 2007. Vermilion Grove has a non-union workforce.

Wildcat Hills Mine Complex

The Wildcat Hills Mine Complex, which has both an underground and surface mine, is located in Gallatin and Saline counties in southern Illinois. During 2007, these mines sold 2.9 million tons of medium sulfur coal that is primarily shipped by barge to downriver utility plants. The Wildcat Hills Mine Complex has a non-union workforce.

Willow Lake Mine

The Willow Lake Mine is an underground mine in Southern Illinois. During 2007, the mine sold 3.6 million tons of medium sulfur coal that is primarily shipped by barge to downriver utility plants. The hourly workforce at the Willow Lake Mine is represented under an International Brotherhood of Boilermakers labor agreement. A new labor agreement was signed in 2007, which will expire April 15, 2011.

Australian Mining Operations

We manage six mines in Queensland, Australia, and five mines in New South Wales, Australia. During 2007, our Australian operations sold 21.4 million tons of coal, 8.7 millions tons of which were metallurgical coal. Coal from the Queensland mines is shipped via rail and truck from the mine to the Dalrymple Bay Coal Terminal and the Ports of Gladstone and Brisbane, where the coal is loaded onto ocean-going vessels. Coal from the New South Wales mines is shipped via rail and truck from the mine to domestic customers and to the Ports of Newcastle and Kembla. The majority of sales from our Australian mines are denominated in U.S. dollars. Our Australian mines operate with site-specific collective bargaining labor agreements. Our Australian operations control 1.1 billion tons of proven and probable coal reserves.

Wilkie Creek Mine

The Wilkie Creek Mine, located in Queensland, Australia, is a surface, truck-and-shovel operation. In 2007, the Wilkie Creek Mine sold 2.4 million tons of steam coal, all of which was sold to the Asia export market through the Port of Brisbane.

Burton Mine

The Burton Mine, located in Queensland, Australia, is a surface mine using the truck-and-shovel terrace mining technique. We own 95% of the Burton operation and the remaining 5% interest is owned by the contract miner that operates on reserves we control. During 2007, we sold 3.0 million tons of metallurgical coal and 0.2 million tons of steam coal from the Burton Mine through the Dalrymple Bay Coal Terminal.

Millennium Mine

The Millennium Mine, located in Queensland, Australia, is a new surface operation utilizing truck-and-shovel mining methods which began operations in early 2007. We own an 85% interest in the Millennium Mine and manage the operations utilizing a contract miner. In January 2008, we formed a joint venture that provides an additional 35 million tons of high quality metallurgical coal reserves and grants to our joint venture partner a 50% ownership position in our preparation facility and associated infrastructure assets. During 2007, the Millennium Mine sold 1.0 million tons of metallurgical coal through the Dalrymple Bay Coal Terminal.

North Goonyella Mine

The North Goonyella Mine, located in Queensland, Australia, is a longwall underground operation. The North Goonyella Mine operates in a difficult geologic environment and produces a high-quality metallurgical coal product. During 2007, the North Goonyella Mine sold 1.3 million tons of metallurgical coal through the Dalrymple Bay Coal Terminal.

Eaglefield Mine

The Eaglefield Mine, located in Queensland, Australia, is a surface operation utilizing truck-and-shovel mining methods. It is adjacent to, and fulfills contract tonnages in conjunction with the North Goonyella underground mine. Coal is mined by a contractor from reserves that we control. During 2007, the Eaglefield Mine sold 1.2 million tons of metallurgical coal through the Dalrymple Bay Coal Terminal.

Baralaba Mine

The Baralaba Mine, located in Queensland, Australia, is a surface operation utilizing truck-and-shovel mining methods. The mine produces primarily pulverized coal injection (PCI) product, a substitute for metallurgical coal used primarily by steel makers. During 2007, the Baralaba Mine sold 0.4 million tons of PCI product. We own a 62.5% interest in the Baralaba Mine and manage the operations utilizing a contract miner.

Wambo Open-Cut Mine

The Wambo Open-Cut Mine, located in New South Wales, Australia, is a surface operation utilizing truck-and-shovel mining methods. During 2007, the Wambo Open-Cut Mine sold 4.4 million tons of steam coal. The coal from this mine was shipped through the Port of Newcastle. We own a 75% interest in the Wambo Open-Cut Mine and manage the operations utilizing a contract miner.

North Wambo Underground Mine

The North Wambo Underground Mine, located in New South Wales, Australia, is a longwall underground mine which was commissioned in the fourth quarter of 2007. During 2007, the North Wambo Underground Mine sold 0.3 million tons of steam coal. The coal from this mine was shipped through the Port of Newcastle. We own a 75% interest in the

Wambo Underground Mine.

Metropolitan Mine

The Metropolitan Mine, located in New South Wales, Australia, is a longwall underground operation. In 2007, the Metropolitan Mine sold 1.6 million tons of hard and semi-hard metallurgical coal. Coal shipments from this mine are to export customers through Port Kembla and to an Australian customer.

Wilpinjong Mine

The Wilpinjong Mine, located in New South Wales, Australia, is a new open-cut mine that was commissioned in late 2006. The mine produces thermal coal for export customers through the Port of Newcastle in addition to serving an Australian electricity generator. Coal is mined by a contractor from reserves that we control. During 2007, the Wilpinjong Mine sold 5.1 million tons of steam coal.

Chain Valley Mine

The Chain Valley Mine located in New South Wales, Australia, is a room and pillar underground operation. The Chain Valley Mine produces thermal coal which is sold locally to power authorities and to export customers through the Port of Newcastle. During 2007, the Chain Valley Mine sold 0.6 million tons of thermal coal for the year. We own 80% of the Chain Valley Mine.

Venezuelan Mining Operations

Our Venezuelan Operations consist of two joint ventures, including one operating mine and one coal mine development project.

Pasa Diablo Mine

We own a 25.5% interest in Carbones del Guasare, S.A., a joint venture that includes Anglo American plc and a Venezuelan governmental partner. Carbones del Guasare operates the Paso Diablo Mine in Venezuela. The Paso Diablo Mine is a surface operation in northwestern Venezuela that produces approximately 6 to 8 million tons of steam coal annually for export primarily to the United States and Europe. We are responsible for marketing our pro-rata share of sales from Paso Diablo; the joint venture is responsible for production, processing and transportation of coal to ocean-going vessels for delivery to customers.

Las Carmelitas Coal Mine Project

We own a 51.0% interest in Excelven Pty Ltd., which holds a 96.7% interest in Cosila Complejo Siderurgico Del Lago S.A. (Cosila). Cosila owns the Las Carmelitas Coal Mine Project, which has approximately 46 million tons of reserves in Venezuela. The other partners in this project include Alpha Natural Resources and Triangle Resource Fund. This project is currently in the exploratory stage. This interest was acquired in October 2006 as part of the Excel acquisition.

Export Facilities

We own a 30% interest in Dominion Terminal Associates, a coal transloading facility in Newport News, Virginia. The facility has a rated throughput capacity of approximately 20 million tons of coal per year and ground storage capacity of approximately 1.7 million tons. The facility exports both metallurgical and steam coal to primarily European and Brazilian markets. The terminal does not currently operate at its capacity.

We own a 17.7% interest in the Newcastle Coal Infrastructure Group (NCIG), which is currently constructing a coal transloading facility in New South Wales, Australia. The facility, which is expected to be completed in 2010, will have an initial stage capacity of 30 million tonnes per annum of which our share is 5.3 million tonnes, with expansion capacity of up to 60 million tonnes per annum.

Resource Management

We hold approximately 9.3 billion tons of proven and probable coal reserves and more than 475,000 acres of surface property. Our resource development group constantly reviews these reserves for opportunities to generate revenues through the sale of non-strategic coal reserves and surface land. In addition, we generate revenue through royalties from coal reserves and oil and gas rights leased to third parties, coalbed methane production and farm income from surface land under third-party contracts.

Trading and Brokerage Operations

Through our Trading and Brokerage Operations segment, we sell coal produced by our diverse portfolio of operations, broker coal sales of other coal producers both as principal and agent, trade coal, and trade freight contracts and provide transportation-related services in support of our coal trading strategy. As of December 31, 2007, we had 90 employees in our sales, trading, brokerage, marketing and transportation operations, including personnel dedicated to performing market research and contract administration.

International Expansion

In response to growing international markets, we expanded our international trading group in 2006 and added a trading operations office in Europe in 2007. The sales and marketing operations include our COALTRADE Australia operation that brokers coal in the Australia and Pacific Rim markets, and is based in Newcastle, Australia. We also have a business development, sales and marketing office in Beijing, China to pursue potential long-term growth opportunities in this market.

Long-Term Coal Supply Agreements

We currently have a sales backlog of almost one billion tons of coal, including backlog subject to price reopener and/or extension provisions, representing more than four years of current production in backlog. Contracts in backlog have remaining terms ranging from one to 17 years. In the same period in 2006, we had a sales backlog in excess of one billion tons of coal. For 2007, we sold approximately 94% of our sales volume under long-term coal supply agreements. In 2007, we sold coal to over 340 electricity generating and industrial plants in 19 countries. Our primary customer base is in the United States, although customers in the Pacific Rim and other international locations represent an increasing portion of our revenue stream.

We expect to continue selling a significant portion of our coal under long-term supply agreements. Our strategy is to selectively renew, or enter into new, long-term coal supply contracts when we can do so at prices we believe are favorable. Long-term contracts are attractive for regions where market prices are expected to remain stable, for

cost-plus arrangements serving captive electricity generating plants and for the sale of high-sulfur coal to scrubbed generating plants. To the extent we do not renew or replace expiring long-term coal supply agreements, our future sales will be subject to market fluctuations.

In January 2006, we signed a 19-year, 65-million-ton coal supply agreement with Arizona Public Service Company (APS). The contract is expected to generate revenue in excess of \$1 billion. When our planned 6 million ton per year El Segundo Mine begins production in mid-2008, it will serve APS's Cholla Generating

Station near Joseph City, Arizona, and other customers. In December 2006, we signed a 10-year coal supply agreement with Tennessee Valley Authority to supply 6 million tons per year of Illinois Basin coal, some of which will be supplied by Patriot under contract with us. Coal sales under the first five years of the agreement are expected to be in excess of \$1 billion. We also have a long-term coal supply agreement with Macquarie Generation in Australia, which runs through 2025 and will supply approximately 127 million tons in total.

Typically, customers enter into coal supply agreements to secure reliable sources of coal at predictable prices, while we seek stable sources of revenue to support the investments required to open, expand and maintain or improve productivity at the mines needed to supply these contracts. The terms of coal supply agreements result from competitive bidding and extensive negotiations with customers. Consequently, the terms of these contracts vary significantly in many respects, including price adjustment features, price reopener terms, coal quality requirements, quantity parameters, permitted sources of supply, treatment of environmental constraints, extension options, force majeure, and termination and assignment provisions.

Each contract sets a base price. Some contracts provide for a predetermined adjustment to the base price at times specified in the agreement. Base prices may also be adjusted quarterly, annually or at other periodic intervals for changes in production costs and/or changes due to inflation or deflation. Changes in production costs may be measured by defined formulas that may include actual cost experience at the mine as part of the formula. The inflation/deflation adjustments are measured by public indices, the most common of which for U.S. coal is the implicit price deflator for the gross domestic product as published by the U.S. Department of Commerce. In most cases, the components of the base price represented by taxes, fees and royalties which are based on a percentage of the selling price are also adjusted for any changes in the base price and passed through to the customer. Some contracts allow the base price to be adjusted to reflect the cost of capital.

Most contracts contain provisions to adjust the base price due to new statutes, ordinances or regulations that impact our cost of performance under the agreement. Additionally, most contracts contain provisions that allow for the recovery of costs impacted by the modifications or changes in the interpretation or application of any existing statute by local, state or federal government authorities. Some agreements provide that if the parties fail to agree on a price adjustment caused by cost increases due to changes in applicable laws and regulations, either party may terminate the agreement.

Price reopener provisions are present in many of our multi-year coal contracts. These provisions may allow either party to commence a renegotiation of the contract price at various intervals. In a limited number of agreements, if the parties do not agree on a new price, the purchaser or seller has an option to terminate the contract. Under some contracts, we have the right to match prices offered to our customers by other suppliers.

Quality and volumes for the coal are stipulated in coal supply agreements, and in some limited instances buyers have the option to vary annual or monthly volumes if necessary. Variations to the quality and volumes of coal may lead to adjustments in the contract price. Most coal supply agreements contain provisions requiring us to deliver coal within certain ranges for specific coal characteristics such as heat (Btu), sulfur, and ash content, and for grindability and ash fusion temperature. Failure to meet these specifications can result in economic penalties, suspension or cancellation of shipments or termination of the contracts. Coal supply agreements typically stipulate procedures for quality control, sampling and weighing. In the eastern United States, some of our customers require that the coal is sampled and weighed at the destination, whereas in the western United States samples and weights are usually taken at the shipping source.

Contract provisions in some cases set out mechanisms for temporary reductions or delays in coal volumes in the event of a force majeure, including events such as strikes, adverse mining conditions or serious transportation problems that affect the seller or unanticipated plant outages that may affect the buyer. More recent contracts stipulate that this

tonnage can be made up by mutual agreement. Buyers often negotiate similar clauses covering changes in environmental laws. We often negotiate the right to supply coal that complies with a new environmental requirement to avoid contract termination. Coal supply agreements typically contain termination clauses if either party fails to comply with the terms and conditions of the contract, although most termination provisions provide the opportunity to cure defaults.

In some of our contracts, we have a right of substitution, allowing us to provide coal from different mines, including third-party production, as long as the replacement coal meets the contracted quality specifications and will be sold at the same delivered cost per million Btu.

Transportation

Coal consumed in the U.S. is usually sold at the mine and transportation costs are borne by the purchaser. Export coal is usually sold at the loading port, with purchasers paying ocean freight. Producers usually pay shipping costs from the mine to the port, including any demurrage costs (fees paid to third-party shipping companies for loading time that exceeded the stipulated time).

The majority of our sales volume is shipped by rail in the U.S., but a portion of our production is shipped by other modes of transportation, including barge, truck and ocean-going vessels. Our transportation department manages the loading of coal via these transportation modes.

Our Australian export volume (17 to 20 million tons annually) is shipped via ocean going vessels to customers. The majority of this coal reaches the loading port via rail. Our Australian domestic volume (4 to 6 million tons annually) is shipped via rail.

Approximately 12,000 unit trains are loaded each year to accommodate the coal shipped by our mines overall. A unit train generally consists of 100 to 150 cars, each of which can hold 100 to 120 tons of coal. We believe we have good relationships with rail carriers and barge companies due, in part, to our modern coal-loading facilities and the experience of our transportation coordinators.

Suppliers

The main types of goods we purchase are mining equipment and replacement parts, explosives, fuel, tires, steel-related (including roof control) products and lubricants. Although we have many well-established, strategic relationships with our key suppliers, we do not believe that we are dependent on any of our individual suppliers, except as noted below. The supplier base providing mining materials has been relatively consistent in recent years, although there continues to be some consolidation. Consolidation of suppliers of explosives has limited the number of sources for these materials. Although our current U.S. supply of explosives is concentrated with one supplier, some alternative sources are available to us in the regions where we operate. Further consolidation of underground equipment suppliers has resulted in a situation where purchases of certain underground mining equipment are concentrated with one principal supplier; however, supplier competition continues to develop. In recent years, demand for certain surface and underground mining equipment and off-the-road tires has increased. As a result, lead times for certain items have generally increased, although no material impact is currently expected to our financial condition, results of operations or cash flows.

Technical Innovation

To support the continued growth and globalization of our businesses, we have completed the U.S. implementation of a project to convert our existing information systems across the major business processes to an integrated Enterprise Resource Planning (ERP) information technology system provided by SAP AG. The project establishes a single global information platform for us and will enable standard processes and real-time capabilities in Finance, Materials, Maintenance, Human Resources, Sales, Production, Transportation and Quality across all of our U.S. operations. A future conversion of all of our Australian systems onto the same single global platform is planned for 2009.

We continue to place great emphasis on the application of technical innovation to improve new and existing equipment performance. This research and development effort is typically undertaken and funded by equipment manufacturers using our input and expertise. Our engineering, maintenance and purchasing personnel work together with manufacturers to design and produce equipment that we believe will add value to the business.

During 2007, we continued to make progress toward the improvement to the performance of our dragline systems. The dragline improvement effort includes more efficient bucket design, faster cycle times, improved swing motion controls to increase component life and better monitors to enable increased payloads. Draglines were refurbished and upgraded in Wyoming and Arizona with many new design features. All draglines are equipped with stress and performance monitoring equipment.

Technology to quickly capture, analyze and transfer information regarding safety, performance and maintenance conditions at our operations is a priority. A wireless data acquisition system has been installed at the North Antelope Rochelle Mine to more efficiently dispatch mobile equipment and monitor performance and condition of all major mining equipment on a real-time basis. Plans are underway to rollout the system to other mining operations. Proprietary software for hand-held Personal Digital Assistant (PDA) devices was developed in-house, and is being used for safety observations and safety audits and underground front-line supervisor reports in the U.S.

World-class maintenance standards based on reliability centered maintenance practices are being implemented at all operations. Use of these techniques is expected to allow us to increase equipment utilization and reduce maintenance and capital spending by extending the equipment life, while minimizing the risk of premature failures. Optimized equipment strategies are being developed to define the appropriate preventative and predictive maintenance activities emphasizing work being scheduled on condition rather than time. Benefits from sophisticated analysis derived from lubrication, vibration and infrared technologies typically include lower lubrication consumption, optimum equipment perform