THE NEW BTU

Peabody

Peabody Energy NYSE: BTU

2007 Annual Report

MEET THE NEW BTU

Coal is the world's fastest-growing fuel, with coal use expected to grow 73% by 2030 and account for 45% of electricity.

Coal is also our most abundant energy resource, fueling the world's fastest-growing regions.

China, India and the United States are leading this growth, representing nearly 90% of coal demand.

New coal-fueled generation is being built all over the world, and emerging projects are converting coal into natural gas and transportation fuels.

Greater use of clean coal is vital for energy security, economic growth and environmental solutions.

Low-cost electricity from coal is also important for social development, enabling individuals to live longer and with a better quality of life.

And 21st century technologies combined with carbon capture and storage can transform coal to a near-zero emissions future.

Peabody is the world's largest private-sector coal company and the only global pure-play coal investment. The New BTU is:

- Sculpting a new business portfolio to serve the best global growth markets with number-one positions in key regions
- Expanding our international operating and trading platform with a growing emphasis on robust Pacific Rim markets
- Focusing on long-term operations in high-growth markets from China and Mongolia to Mozambique
- Advancing greater use of clean coal technologies for generation, coal-to-gas and carbon storage to fuel an energy-dependent world
- Leading global clean coal solutions, with flagship energy and environmental projects in the United States, China and Australia
- Delivering a five-year investment performance among the top 10 for S&P 500 companies

Financial Highlights

In Millions, Except Per-Share Data From Continuing Operations	2007	2006	Change
Tons Sold	237.8	223.3	6.5%
Revenues	$4,574.7	$4,108.4	11.3%
Operating Profit	$568.7	$590.9	(3.8%)
EBITDA[1]	$955.9	$901.0	6.1%
Income	$421.3	$552.6	(23.8%)
Earnings Per Share	$1.56	$2.05	(23.9%)
Stockholders' Equity	$2,519.7	$2,338.5	7.7%

[1] EBITDA or Adjusted EBITDA is defined as income from continuing operations before deducting net interest expense, income taxes, minority interests, asset retirement obligation expense, and depletion, depreciation and amortization.

Accomplishments

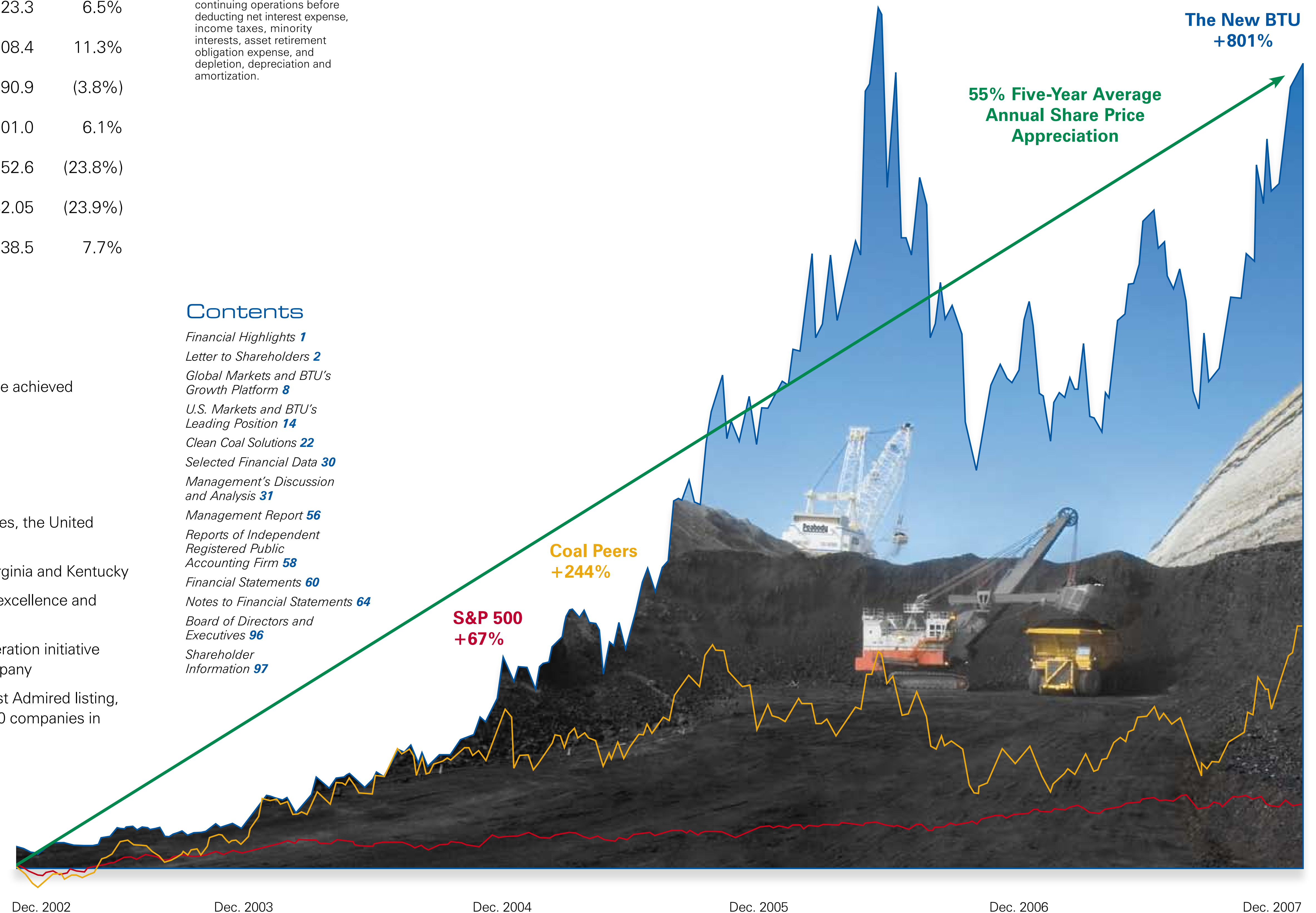
In 2007, The New BTU:

- Operated the safest large U.S. surface mine, a milestone achieved three of the past four years
- Set records for sales volume, revenues and EBITDA
- Delivered a 64% total shareholder return
- Completed three major new mines in Australia
- Expanded global trading, with offices in the United States, the United Kingdom, Australia and China
- Concluded the spin-off of certain operations in West Virginia and Kentucky
- Earned half of U.S. Interior's awards for environmental excellence and good neighbor practices
- Joined GreenGen, China's centerpiece coal-fueled generation initiative with near-zero emissions, as the only non-Chinese company
- Ranked first among mining companies in *Fortune's* Most Admired listing, named to the *Forbes* Platinum list and among the top 10 companies in *CFO Magazine's* "value creators" S&P 500 ranking

Contents

Financial Highlights **1**
Letter to Shareholders **2**
Global Markets and BTU's Growth Platform **8**
U.S. Markets and BTU's Leading Position **14**
Clean Coal Solutions **22**
Selected Financial Data **30**
Management's Discussion and Analysis **31**
Management Report **56**
Reports of Independent Registered Public Accounting Firm **58**
Financial Statements **60**
Notes to Financial Statements **64**
Board of Directors and Executives **96**
Shareholder Information **97**

BTU: Eight-Fold Return in Five Years



LETTER TO SHAREHOLDERS

Chairman and Chief Executive Officer Gregory H. Boyce

The entire Peabody team takes satisfaction in delivering an 840% total shareholder return in the past five years

Dear Shareholder:

Following a very successful year, we begin 2008 at a time of extraordinary opportunity in the history of Peabody, coal and the global energy industry.

2008 is the 125th anniversary of Peabody, and it is an exceptional time to be the world's largest coal company. The world is short of energy, and coal has been the fastest-growing fuel in the world for each of the past five years.

New coal technologies are being developed to turn coal into transportation fuels and natural gas, and clean coal initiatives are advancing our goal of environmental improvement as we move toward near-zero emissions technologies.

Peabody is completing a global transformation of our business portfolio and operating platform. We are a world leader in clean coal solutions, and we intend to continue to build on our achievements from this past year. So let's look at The New BTU… and the strong base that we continue to build upon.

2007 was a year of significant accomplishment for Peabody. Your company:

- Was recognized with the highest U.S. honor for the safest large surface mine, and has posted our three safest years in Peabody's history.
- Delivered a 64 percent total shareholder return, beating the S&P 500 return by nearly 12-fold in 2007.
- Was the world's largest private-sector coal company for the 37th consecutive year, with the industry's largest sales volumes and reserves.
- Set new company marks for sales volume, revenues and EBITDA (earnings before interest, taxes, depreciation, depletion and amortization).
- Completed three major new mines in Australia, expanded global coal trading with offices in the United States, the United Kingdom, Australia and China, and evaluated business opportunities through our offices in China and Mongolia.
- Concluded the spin-off of operations in West Virginia and Kentucky.
- Joined GreenGen, China's centerpiece coal-fueled climate initiative, as the only non-Chinese company.
- Broke ground on the Prairie State Energy Campus, a clean coal generating plant in Southern Illinois that is the largest new coal plant to be developed in the United States in the past several decades.
- Ranked first among mining companies in Fortune's Most Admired listing. We were also named to the Forbes Platinum List of Best Big Companies.

I am now in my fifth year at Peabody, and am proud to join the entire Peabody team in taking satisfaction in our shareholder performance during that time. We have delivered an 840 percent total shareholder return since 2002.

CFO Magazine recognized Peabody as one of the top 10 performers in total shareholder return in the S&P 500 over five years, outperforming all coal peers. We also have far outperformed the S&P 500 for each of the one-, three- and five-year periods, which is reflected in the chart at right.

Some would call our performance in 2007, along with our 125 years of leadership, a good run. I view it as a good start. Let's take a look at the source of our optimism for continued strong performance.

We have long expected the global coal markets to be extremely strong, and they are. We also expected that oil prices would continue to increase, U.S. natural gas supplies would decline, and liquefied natural gas would not come into the United States in sufficient quantities or prices to help alleviate our natural gas crisis.

We were also accurate in expecting that new nuclear plants would still be at least a decade off… no new U.S. hydro plants would be added… renewables would grow but from a small base. Still, no one, including us, expected the level of energy demand and prices that have created a global pull on coal supplies everywhere.

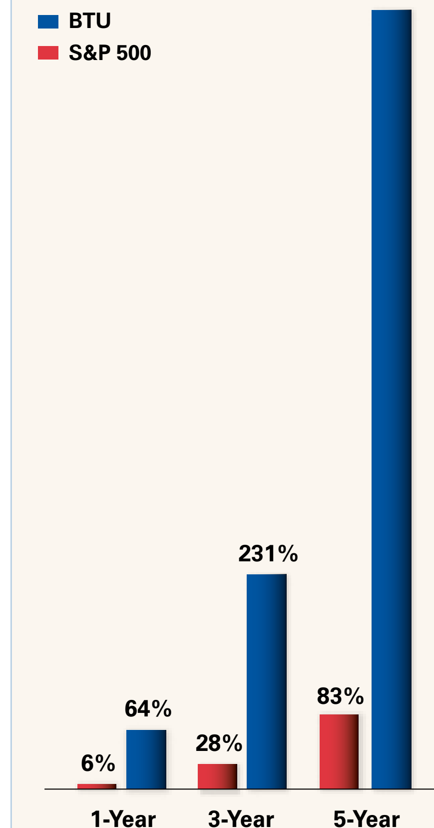
I believe we are entering a new era of convergence between energy and coal. This is driven by a number of factors: global energy demand as billions of people in the world awaken to the benefits of modern energy; depletion of large oil and gas reserves; limitations of alternative fuels coming from volatile regions; high prices or niche scale; and coal's ability to fuel large-scale electricity generation, steel production and, increasingly, coal-to-gas and coal-to-liquids projects.

While port and rail expansions are under way, rising demand often renders these additions insufficient. As I write this, global benchmark coal pricing is continuing to set new marks. Global coal stockpiles are at very low levels with generators increasingly concerned about supply in major hubs such as China, India, South Africa and Australia. Any minor supply disruptions are quickly reverberating around the globe. And more nations are keeping their coal at home to serve growing generation needs.

China last year added the equivalent of the entire United Kingdom power grid just in coal-fueled generation, while India plans to add 75,000 megawatts of coal-fueled generation over the next five years. Coal demand for steel production also continues to grow rapidly.

BTU Strongly Outperforms S&P 500

Total Shareholder Return



BTU is dramatically outperforming the S&P 500 for near- and long-term periods, with total shareholder return increasing more than eight-fold over the past five years. Peabody is among the top 10 companies in CFO Magazine's "value creators" list for S&P 500 companies.

These same factors have been felt in the United States both directly and indirectly. Coal is being used to satisfy growing generation in the United States, while other nations are turning to U.S. coal to satisfy world needs. We believe net U.S. exports should more than triple just between 2006 and 2008.

Unprecedented coal demand, greater convergence of pricing between coal, oil and natural gas, and structural long-term increases in coal plants create a very favorable future. This is not some perfect storm or rare event. Instead, I believe we have a bright future based upon a long period of sustained growth in worldwide coal use.

In the context of these global coal fundamentals, we are pursuing several core priority areas in 2008 to capitalize on these strong markets. Our primary focus comes in the area of execution, to ensure we are getting as much coal into these tight markets as possible.

- We plan to improve productivity and costs. We're increasing our focus on efficiency improvements and debottlenecking activities at all operations, while aggressively managing commodity cost pressures.
- We will expand our access to high-growth, high-margin markets. Peabody has the most global exports of any U.S.-based company, and that position will grow further in 2008 from our Australian, U.S., and trading platforms.
- We plan to increase our capital efficiency, as we benefit from our strong investment program of recent years.
- We are pursuing international development opportunities and evaluating projects in several countries to feed our growth pipeline.
- And we will advance multiple clean coal projects.

Let me expand on this, as I believe that clean coal is essential to solving the world's energy security concerns and advancing climate solutions.

Coal is the world's most abundant fuel… and black, if you will, is the new green. Peabody advanced multiple clean coal projects in recent months, ranging from coal-to-gas plants with ConocoPhillips and GreatPoint Energy to near-zero emissions projects such as GreenGen.

Peabody is a global leader in clean coal solutions, and we believe it is essential to aggressively develop efficient new coal-fueled generation, coal-to-gas and coal-to-liquids plants, even as we commercialize breakthrough initiatives such as carbon capture and storage.

Leading this 125-year-young company and its unique growth platform are our experienced board of directors and the industry's best management team, who rely on an enduring mission and principles at every level.

I was honored to add the position of Chairman to my Chief Executive Officer responsibilities in October 2007, and I intend to lead the board in continued best practices for corporate governance.

Along those lines, at this year's annual meeting, directors will ask shareholders to determine whether all directors will be elected on an annual basis through a phased declassified board proposal. We have seen growing shareholder interest in the declassified board structure and believe it appropriate that our shareholders decide on this matter. We also adopted a majority voting standard for election of directors, further enhancing our governance.

Peabody's leadership is also strengthened this year by the appointment of Rick Navarre to the position of President and Chief Commercial Officer.

In his new role, Rick is primarily responsible for Peabody's global sales and trading, business development and planning activities.

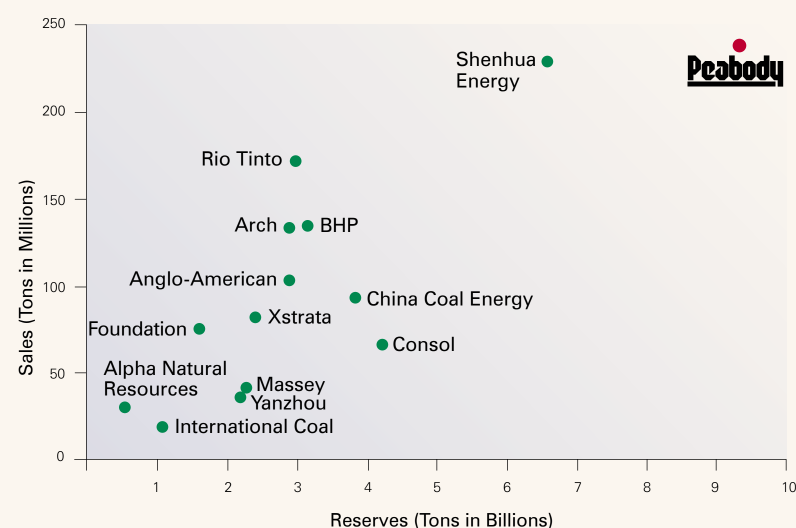
In closing, I'd like to thank Peabody's team of employees around the world for a safe and successful 2007. We look forward to beginning to benefit from growing volumes and pricing in 2008 even as we build from a larger base to satisfy a growing world with the primary sustainable fuel… clean coal.

That is our intention… that is our mission… and that is The New BTU.

Greg Boyce

Gregory H. Boyce
Chairman and Chief Executive Officer
March 15, 2008

BTU Has Industry-Best Sales and Reserves

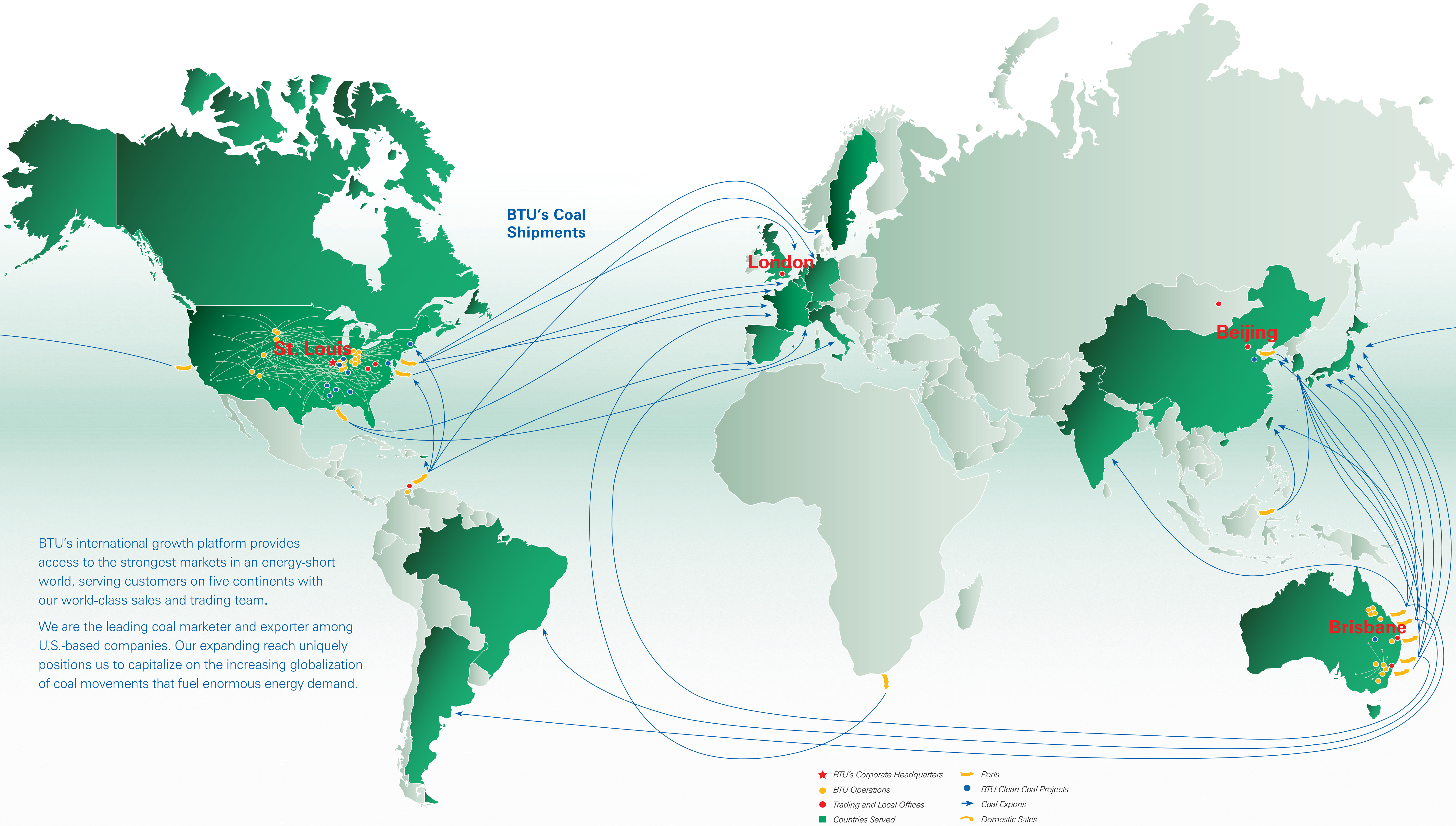


Source: Most recent company reports and websites, SEC filings and Peabody analysis. Values are on a short-ton basis. Peabody sales and reserves based on 2007 data.

Peabody is the world's largest private-sector coal company, with world record sales of 238 million tons and a 9.3 billion-ton reserve base. The energy value of our reserves exceeds the oil or gas reserves in the Continental United States.

Peabody's Executive Team (from left) includes Richard A. Navarre, Gregory H. Boyce, Eric Ford; (standing from left) Sharon D. Fiehler, Fredrick D. Palmer, Alexander C. Schoch and Roger B. Walcott, Jr.

THE NEW BTU: THE ONLY GLOBAL PURE-PLAY COAL INVESTMENT



BTU's international growth platform provides access to the strongest markets in an energy-short world, serving customers on five continents with our world-class sales and trading team.

We are the leading coal marketer and exporter among U.S.-based companies. Our expanding reach uniquely positions us to capitalize on the increasing globalization of coal movements that fuel enormous energy demand.

The port of Newcastle is the hub for Australia's thermal exports and among five ports BTU accesses in Australia. Our Australia sales nearly doubled in 2007 over the prior year, and we are expanding access to dedicated through-put capacity via participation in rail and port expansion projects.

ROBUST GLOBAL MARKETS AND BTU'S GROWTH PLATFORM

Global coal markets are outstanding. More clean coal is being used around the world to drive enormous economic development in the largest population centers at a time when oil is hitting record prices, reserves are depleting and costly natural gas supplies are increasingly strained.

Coal's low cost, abundance and security of supply make it the perfect solution to fuel an energy-dependent world. Global coal demand continues to rise for both thermal and metallurgical coal products, world coal inventories are low, U.S. exports are accelerating, and new coal-fueled generation rapidly is being built.

Against this backdrop, it is a great time to be The New BTU. We are the world's largest private-sector coal company, based on our leading reserve position and sales, making us well positioned to leverage global markets.

Our international business platform offers significant long-term growth opportunities through expanded operations, coal trading and global business partnerships.

Coal has been the world's fastest-growing fuel for each of the past five years, and global coal use is expected to increase nearly 75 percent over the next 25 years as new coal plants and coal-based projects are built.

World electricity demand will nearly double in the next quarter century, with coal-fueled generation accounting for 45 percent of all generation, according to the International Energy Agency's 2007 World Energy Outlook.

All told, more than 156,000 megawatts of coal-fueled generation is under construction around the world, representing more than 500 million tons of annual coal use.

Increasing Global Energy Demand Driven by China and India

Today, China and India account for almost a quarter of the world's primary energy use. These nations are setting the pace for global energy markets, with populations that reach billions and sustained annual double-digit economic growth.

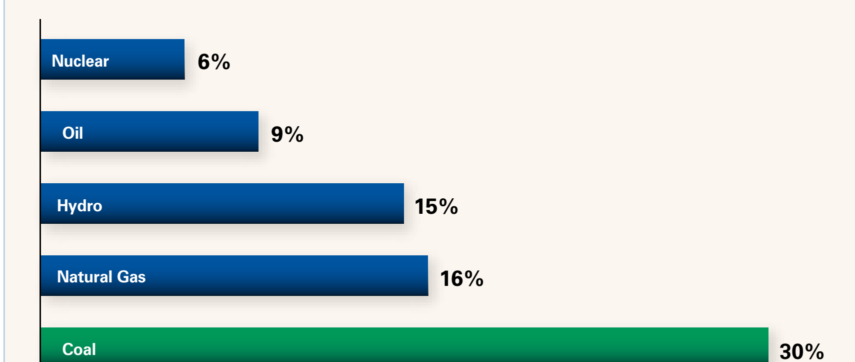
China and India also are driving global energy demand, accounting for more than 80 percent of new coal consumption in the coming decades, due to rapid economic development, industrialization, urbanization and improved quality of life.

In the next 25 years, China is expected to invest $3.7 trillion to build out its energy supply structure and add 1,300 gigawatts of electricity… more capacity than is currently installed in the United States.

Global coal demand is unprecedented, creating an exceptional long-term outlook

Global Coal Use Grows 30% in Five Years

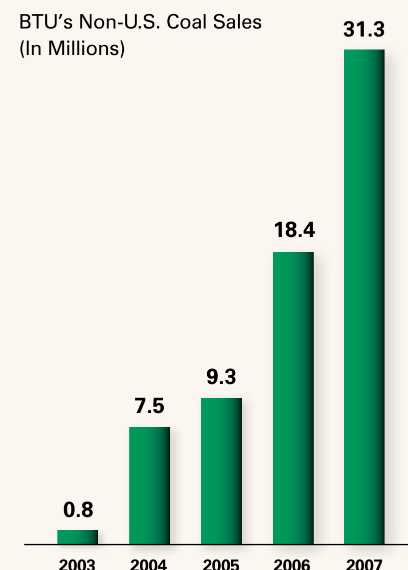
Change from 2001 to 2006



Source: BP Statistical Review of World Energy, June 2007.

Coal has been the fastest-growing fuel each of the past five years, with global demand soaring 30 percent, or 1.4 billion tons in just five years. During that time, nuclear, oil and natural gas have grown at just a fraction of coal's pace.

Expanding to Fuel High-Growth Markets



BTU continues fueling high-growth global markets, dramatically increasing our international sales in the past four years.

Primary energy demand in India is expected to more than double by 2030 and India's coal use could triple.

The use of wood and other biomass for heating and cooking remains high in India, making greater use of clean coal crucial for electrification.

Expanding Markets for Coal Through Btu Conversion

Proven technology that converts the energy stored in coal into other high-demand energy forms – what we call Btu Conversion – is expanding markets for clean coal to natural gas, diesel and aircraft fuels.

There are nearly 150 commercial gasification plants operating in 27 nations. The U.S. Department of Energy notes that this capacity is set to climb 30 percent in the next two years as new plants, primarily fed by coal, become operational.

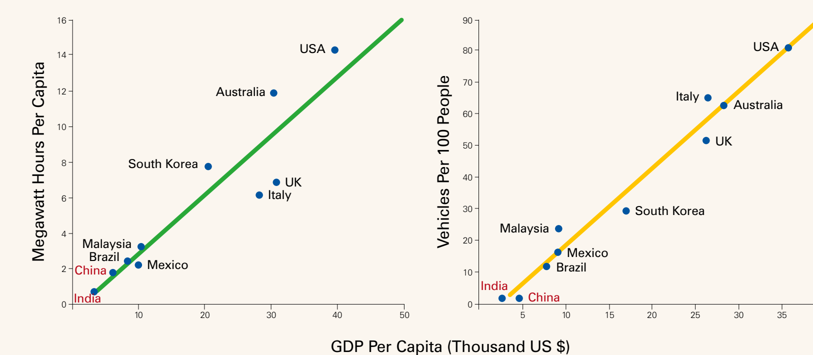
As more nations turn to coal for energy security, global coal-to-liquids production is expected to annually top more than 800 million barrels of synthetic fuels by 2030, according to the U.S. Energy Information Administration.

China seeks to replace more than 10 percent of its petroleum consumption with coal-to-liquids and is developing about 20 projects that would annually produce more than 100 million barrels of oil by 2030, based on estimates by the International Energy Agency's World Energy Outlook. Other reports call for even more robust development of facilities in China.

Peabody is pursuing several coal-to-liquids and coal-to-gas projects to capitalize on these new markets.

3 Billion People Awaken to Modern Energy

Electricity Usage per Capita | *Passenger Vehicles per Capita*



Source: United Nations Human Development Report; Dargay, Gately and Sommer, 2007.

China and India will continue to feed enormous energy needs as their economies mature and they increase their per capita energy use. China uses approximately one-eighth the electricity per capita as the United States and has just 2 percent of our per capita passenger vehicle ownership.

The Millennium Mine in Queensland expands BTU's metallurgical coal portfolio and is growing to produce 3 million tons annually for export primarily to India, Korea and Japan.

Peabody is working closely with a number of major partners to pursue coal-related projects and commercial opportunities in Asia. BTU has business offices in China and Mongolia.

We also are investing in companies that are advancing emerging technologies for coal gasification. More information on these initiatives is illustrated on page 21.

Serving Robust Markets Through Our Growing International Platform

Peabody successfully implemented key global growth and productivity initiatives this past year. We completed our Australian operations platform – set to triple our presence in the world's largest exporting nation between 2006 and 2010 – and we are among Australia's fastest-growing coal companies.

Our Australia sales increased to more than 21 million tons in 2007, up from 11 million tons the prior year. An additional 10 to 12 million tons of dedicated throughput also is being pursued through two major port infrastructure projects at Newcastle and Dalrymple Bay.

Three new greenfield mines were developed, capable of producing nearly 15 million tons of coal. We also acquired an additional 35 million tons of high-quality metallurgical coal reserves that contribute to our already strong reserve position.

The North Wambo Mine in New South Wales uses state-of-the-art longwall technology and will annually produce 3 million tons of thermal coal primarily for export to Asian electricity generators through the Port of Newcastle. North Wambo is among three Australian mines completed this past year.

With 11 surface and underground mines in Queensland and New South Wales, Peabody has a broad portfolio of metallurgical and thermal coal products for domestic and export customers, accessing five ports and multiple rails in Australia.

BTU also significantly expanded its coal trading, increasing activities in the United States and Australia with a global reach that spans North and South America to Europe, South Africa, Asia and Australia.

The company's EBITDA contribution from international trading and brokerage activities has grown more than 150 percent over the past two years.

Peabody has positioned itself to participate in tremendous Pacific Basin growth through our office in Beijing and partnerships with China's largest coal, energy and steel companies.

We are working closely with a number of major companies to pursue coal-related projects and commercial opportunities in China and the Pacific Rim.

And we became the only non-Chinese equity partner in GreenGen, China's premier large-scale carbon initiative. GreenGen is a planned commercial near-zero emissions coal-fueled power plant with carbon capture and storage.

We opened a representative office in Mongolia, and we're continuing to evaluate numerous investment opportunities in China, Mongolia and Mozambique.

China is the largest and fastest-growing coal market in the world. Mongolia has abundant, high-quality metallurgical and thermal coal reserves to supply China and other global markets.

And Mozambique's undeveloped coalfields hold high potential to serve India's rapidly growing demand.

THE NEW BTU

Expanding Our Global Trading Activities

Peabody's new London office further serves our European customer base in the largest and most liquid of the global coal trading markets.

Peabody has expanded its trading platform, offering customers a one-stop sales, trading and transportation network around the clock, around the world. With lively coal markets that are becoming more globally interconnected, our transformation is well-timed.

BTU tripled its international activities this past year, trading more than 167 million tons of coal. We expanded our presence in the United States, Europe, Australia, China, Indonesia, South Africa and South America and opened offices in Beijing and London.

We enjoy a growing reach, yet remain nimble, uniquely positioned to capture value: In just the first few weeks of 2008, Peabody committed to deliver coal from the Powder River Basin… Rocky Mountain area… Illinois Basin… and Appalachia to Europe. We shipped Australian coal to Japan and Taiwan… and Indonesian and Chinese coal to Korea.

These shipments are among thousands of trains and hundreds of cargos simultaneously moved around the world each year to fuel enormous demand.

Global reach, superior service, minute-by-minute… It's The New BTU.

RISING U.S. MARKETS AND BTU'S LEADING POSITION

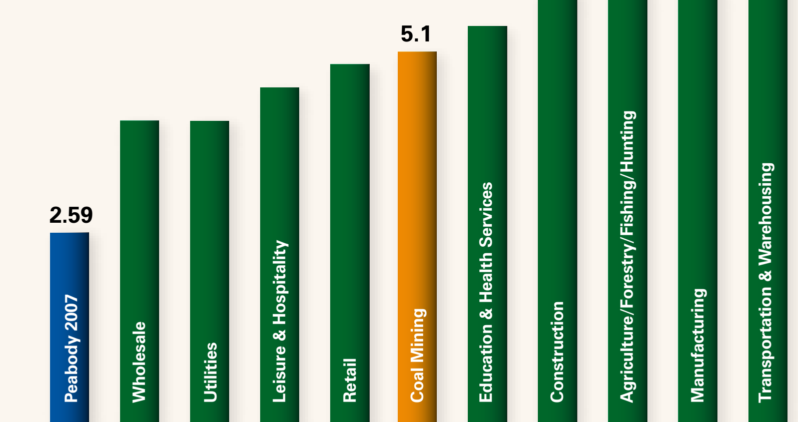
Coal's role in clean electricity generation is crucial for energy security. U.S. generation capacity reserve margins are declining and reliability is weakening, with demand for electricity expected to grow more than twice as fast as new generation over the next 10 years, according to the North American Electric Reliability Corporation.

Coal is the only fuel equipped to close the gap of rising needs versus scarce and expensive alternatives. Coal is expected to account for 55 percent of U.S. generation by 2030.

Soaring global coal demand and tight supplies also have created a strong pull for U.S. coal exports. Net coal exports are expected to more than triple between 2006 and 2008, as European utilities compete for U.S. coal.

BTU's Safety Results Better Than Major Industries

U.S. Accidents Per 200,000 Worker Hours



Source: Peabody 2007 data; U.S. Department of Labor Occupational Safety and Health Administration, 2006 data; Mine Safety and Health Administration, 2006 data.

Peabody operated the safest U.S. surface mine and earned nearly 20 awards for emergency preparedness and best practices in 2007. Our safety results are far better than our peer average and other major industries, and we maintain an intense focus to continually improve performance.

Peabody is increasing exports from the Illinois Basin, Powder River Basin and Colorado, and is also selling this coal increasingly to Eastern U.S. customers. Peabody also has access to Appalachian coal through brokerage arrangements and its leading trading operations.

Turning to Abundant Coal as Other Fuels Lag

Coal fuels approximately 50 percent of U.S. electricity, equaling all other sources combined. It is also America's most abundant energy resource, representing 85 percent of our energy reserves.

In the United States, oil production has been depleting for several decades and the U.S. petroleum industry states that the global supply of oil and natural gas from conventional sources is unlikely to meet the projected 50 to 60 percent growth in demand over the next 25 years. The effects on customers are harsh: The price of oil rising from $80 to $100 a barrel is akin to adding $150 billion in taxes.

Natural gas tells a similar story, as the United States increases its reliance on expensive imports from unstable regions of the world. Higher natural gas prices have cost America nearly $500 billion more than expected since the beginning of the decade.

Coal averages less than half the delivered cost of natural gas, and the 10 states that use the most electricity from coal enjoy power costs that average 40 percent lower than the states relying on other fuels. Affordable energy also fuels business growth: Over the past decade, the states with the lowest business energy costs grew 25 percent faster and created 60 percent more new jobs than the states with higher energy costs.

Our North Antelope Rochelle Mine in the Powder River Basin achieved world record sales and was honored by both the governor and the state as the safest mine in Wyoming in 2007.

The past three years have been the safest in Peabody's 125-year history

Coal is fueling the largest build-out of baseload power in a generation. A new fleet of state-of-the-art coal plants is being developed across the country as existing plants run at higher utilization.

There are 40 coal units in 19 states that are new, under construction or in late-stage development, accounting for 20 gigawatts of electricity and 85 million tons of annual coal use. Btu Conversion technologies also are being put into place as coal-to-gas and coal-to-liquids facilities are pursued.

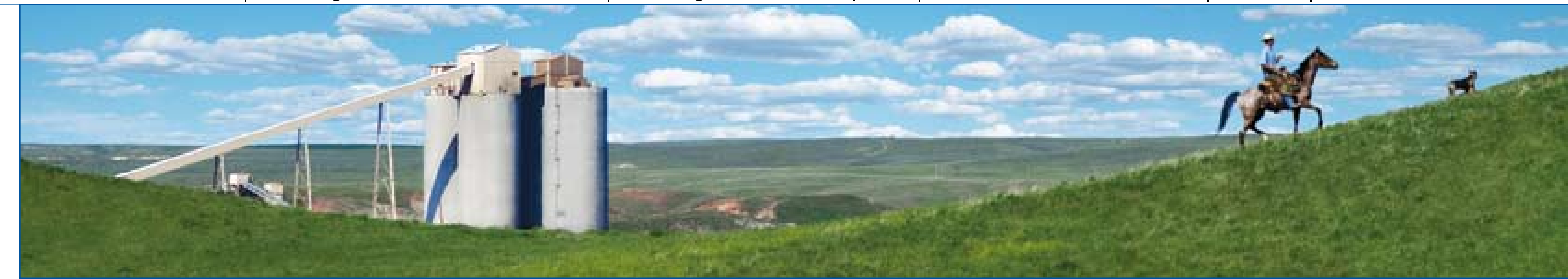
These projects are important in an environment where U.S. natural gas demand continues to increase while most growth can only be met through imports.

New uses for coal could more than double long-term U.S. coal demand, with coal used for electricity generation, natural gas, liquids, steel, ethanol and hydrogen growing to 2 billion tons or more by 2025, according to a National Coal Council study.

Interest in Btu Conversion continues to strengthen, creating ready-made opportunities for long-term contracts: The U.S. Department of Defense has a goal of procuring half of its fuel from domestic synthetic sources by 2016.

Against this backdrop, BTU is well positioned to fuel rapidly expanding energy needs, as the leading producer in the Powder River Basin, Colorado and the Midwest, and among the top two producers in the Southwest.

Farmersburg Mine employees in Indiana celebrate U.S. Labor's Sentinels of Safety honors, America's most prestigious award in coal mining safety. It's the third time in four years that Peabody has received the award.



The U.S. government presented a Silver Good Neighbor Award to Peabody's Caballo Mine in the Powder River Basin for working with ranchers to improve range productivity and assist with conservation projects.

Achieving Best-in-Class Performance in Safety, Operations and Stewardship

BTU consistently achieves strong results in all market conditions and seeks best-in-class performance in safety, operations, marketing and stewardship. Peabody operated the nation's safest mine and the nation's most productive mine in 2007. We also achieved the industry's highest U.S. and global honors for environmental excellence and sustainable practices.

Safety is a core value and core to our mission. Our vision is to achieve zero incidents of any kind, and we continue to make progress toward this ultimate goal: The past three years have been our safest. Our U.S. mines achieved a 2.59 safety rate in 2007, reflecting a 29 percent improvement in the past three years.

Our Australia operations improved their lost-time accident rate by more than half, which includes the contribution of new mines that became part of Peabody through the Excel acquisition.

The Farmersburg Mine in Indiana was honored by the U.S. Department of Labor with the prestigious Sentinels of Safety Award as the safest U.S. mine. Peabody operations have achieved this milestone three of the past four years.

Peabody operated the nation's safest mine and the world's largest mine in 2007

The El Segundo Mine is the first greenfield mine developed in more than two decades in New Mexico, and is expected to be among the most productive mines in the Southwest when it is in full production.

Employees earned nearly 20 awards for emergency preparedness and best practices in safety in 2007, including four Sentinels of Safety certificates from U.S. Labor for low incidence rates.

Teams from every region were recognized with first-place honors in major national or regional safety competitions, including U.S. Labor's National Mine Rescue event.

With strong safety results, Peabody mines also are highly efficient: Our talented team delivered industry-leading sales of 237.8 million tons, and our North Antelope Rochelle Mine was the nation's most productive, based on the latest industry data.

Driving Down Costs and Increasing Efficiencies

Driving down costs and increasing efficiencies is part of Peabody's culture of continuous improvement. Peabody Peak Performance – P3 – is aimed at increasing productivity and results in every aspect of the business.

Centers of Excellence (COE) for Operations, Commercial, Engineering, Capital and Sourcing use a team-based approach to refine best practices and are resulting in greater efficiencies, improved capital spending and lower costs.

Streamlined practices implemented at the North Antelope Rochelle Mine, for instance, provide a barometer of the success being achieved: Strengthened COE processes combined with capital projects resulted in a significant production rate increase.

Overburden productivity improved 15 percent and truck hauling capacity increased 24 percent. Even shift changes and vehicle refueling processes were streamlined.

Dozens of productivity initiatives are being implemented at North Antelope Rochelle, expected to result in considerable cost savings each year. This standard of excellence is being implemented at each operation in the United States and Australia.

Improving Capital Efficiency and Managing Growth

Peabody uses a disciplined model for organic growth, putting capital to work to achieve greater efficiencies and drive down costs. Major organic growth and capital projects in 2007 include a new 6 million ton-per-year greenfield mine being developed in New Mexico.

El Segundo, "The Second," is under construction near the Lee Ranch Mine and will begin production in the second half of 2008. It will serve a 19-year contract with a major Southwest utility and is expected to generate $1 billion in revenue over the life of the agreement. El Segundo will have a low overburden ratio and is expected to improve our cost structure in New Mexico by some 35 percent.

Investments in a world-class dragline, conveyor and blending system at the North Antelope Rochelle Mine in the Powder River Basin are driving improved productivity and record performance while eliminating long uphill hauls and wear on trucks and tires. Operating costs are also significantly reduced.

At the Twentymile Mine in Northwest Colorado, a new, state-of-the-art preparation facility that began operating in late 2007 processes and blends coal at a 2,200 ton-per-hour rate, creating blending flexibility and improving coal quality. Twentymile's longwall has achieved a new performance benchmark of 1 million tons per month, which is key as the mine continues serving growing U.S. and export demand.

Peabody also completed the spin-off of certain operations in West Virginia and Kentucky into Patriot Coal Corp.

THE NEW BTU

Driving Down Costs in the Powder River Basin

A new state-of-the-art dragline is increasing productivity and improving costs at Peabody's North Antelope Rochelle Mine, the nation's premier ultra-low sulfur mine.

Innovation, technology and infrastructure enable Peabody to build productivity and drive down costs at our flagship Powder River Basin operations, which include the most productive mine in the nation.

At our North Antelope Rochelle Mine, a new dragline, conveyor and blending system improves efficiency and capacity while lowering annual costs by as much as 75 percent over the fleet it replaces. The system is also environmentally sound, saving nearly 3 million gallons of fuel per year and resulting in significant carbon reductions.

It's the third dragline added to the mine's fleet and is expected to be the world's most productive in its class, contributing to North Antelope Rochelle's industry-leading sales of 91.5 million tons of coal in 2007, more than any mine in the world.

Safe, smart and productive… It's The New BTU.

BTU's environmental and community practices on Arizona's Black Mesa were recognized as a world model for sustainability at the Energy Globe Awards in Brussels, Belgium, this year. Before and after views at Black Mesa show reclaimed lands that are up to 20 times more productive for livestock grazing than native range.

The transaction enhances our focus on large, long-lived surface operations and significantly lowers liabilities.

BTU continues to enhance its focus on business opportunities in strong economies as we sculpt our portfolio to target the very best growth markets.

Earning the Industry's Highest Honors for Sustainability

Stewardship is core to Peabody's mission. BTU is the most recognized company among its peers for sustainability and corporate responsibility, according to a study by Ceres and the Investor Responsibility Research Center.

One of Peabody's great legacies is its ability to innovate, creating environmental solutions that return lands for higher community benefit through best practices and stakeholder collaboration.

Within the spirit of sustainability in Peabody's mission, mined lands are returned to a condition that is "equal to or better than we found it."

Reclaimed lands are typically returned to prime farmland, productive rangeland, sturdy forests, pristine wetlands and robust recreation areas.

In 2007, employees reclaimed more than 5,600 acres of land in the United States and planted more than 525,000 trees. The company also recycled more than 10,000 tons of metals, oil, fuel and other materials. Peabody is intensifying its sustainable development initiatives and expanding community outreach.

BTU earned international recognition at the Energy Globe Awards in Brussels, Belgium, for community and environmental practices on tribal lands in Arizona. Mining on Black Mesa creates hundreds of local jobs, tens of millions of dollars in annual tribal revenue and a legacy of stewardship that preserves cultural and traditional values.

Peabody operations also garnered a dozen awards for stewardship, notably earning half of the U.S. Department of the Interior's 2007 awards for good neighbor practices and reclamation excellence in Colorado, Kentucky, Indiana and Wyoming.

And demonstrating the caliber of Peabody's environmental team, two Peabody managers were honored by peers for their leadership: Peabody's Vern Pfannenstiel and Ken Rogers join a growing group of Peabody environmental experts recognized in recent years.

Expanding Coal Markets for Clean Coal Technologies and Btu Conversion

As an early-mover to develop alternative energy solutions with new generation and Btu Conversion, Peabody is advancing multiple projects using its vast reserve base to create clean baseload electricity, aircraft and diesel fuel, and pipeline-quality natural gas.

The Prairie State Energy Campus that is under construction in Southern Illinois is leading the build-out of new generation in the United States. A model for clean electricity, Prairie State will have a superior environmental profile, including carbon dioxide emission rates that are 15 percent lower than conventional plants.

Peabody and eight equity partners completed Prairie State's financial close and broke ground on the plant this past year. BTU retains a 5 percent equity position.

Peabody also is advancing clean coal solutions through Btu Conversion as a partner with ConocoPhillips (NYSE: COP) in a coal-to-gas project and as a minority equity partner in GreatPoint Energy.

The ConocoPhillips project would be a large carbon-capture-ready coal-to-gas project in Western Kentucky, producing 1.6 trillion cubic feet of gas over its first 30 years, annually fueled by approximately 2.5 million tons of coal.

Peabody is moving through a feasibility study with ConocoPhillips for selection of a final site and working with the Kentucky Geological Survey to examine the best carbon capture and storage options.

GreatPoint, a Massachusetts-based start-up company, has proprietary bluegas™ technology that converts coal into clean substitute natural gas while enabling carbon storage. GreatPoint has successfully tested a pilot and is engineering its first commercial project. Peabody and GreatPoint also are evaluating the potential for development of joint coal gasification projects using Peabody reserves.

Peabody has multiple large contiguous blocks of coal that can be devoted to generation or conversion projects, leading to greater value creation.

BTU is advancing clean energy solutions with state-of-the-art generation and Btu Conversion initiatives

The Peabody team celebrates groundbreaking for Prairie State in Southern Illinois, a next generation clean coal plant with emission rates that will be one-fifth the U.S. average. Even its carbon dioxide emissions will be significantly lower than existing plants.

BTU: A LEADER IN CLEAN COAL SOLUTIONS

Energy and the environment are two of the top issues facing society, and clean coal is the answer to both

As the world's largest coal company, Peabody is uniquely positioned to create solutions for solving some of our toughest energy and environmental challenges. Greater use of clean coal is the answer to improving energy security, fueling the world's strongest economies and ensuring continuous emissions improvement: what we call the "3Es."

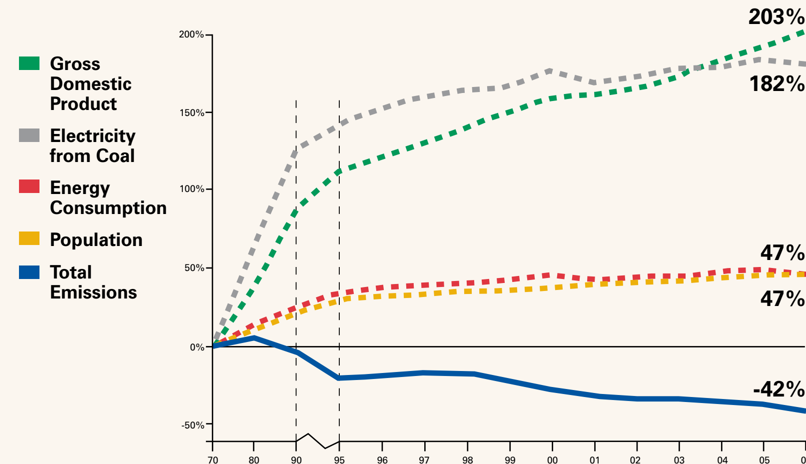
In the next quarter century, the global population will soar 25 percent to more than 8 billion people. World Gross Domestic Product (GDP), the primary driver of energy demand, will more than double. Global energy consumption will increase by more than half, and world electricity generation will nearly double, based on forecasts by the International Energy Agency's World Energy Outlook.

China, India and other developing Asian nations are driving this growth. China, in particular, offers a striking example of the progress made with coal: China's annual double-digit economic growth the past two decades – the fastest rate of any nation – is being fueled by coal, and China is developing the equivalent of a power plant a week. In the next two years, China is forecast to overtake the United States in energy consumption, and is expected to account for fully 20 percent of the world's energy demand by 2030.

Coal is the world's most abundant and fastest-growing fuel, supplying 40 percent of global electricity. Coal is increasingly important for energy security in an era when oil and natural gas resources are strained and concentrated in volatile regions, and a number of countries are nationalizing their energy resources and exerting greater control over supply and price for political gain.

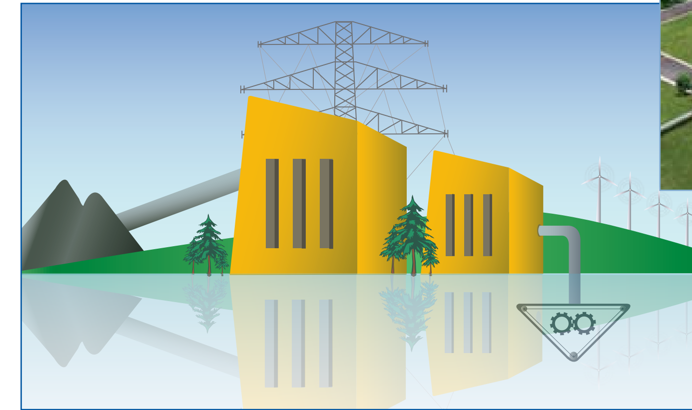
Good progress has been made bringing electricity to developing nations over the past two decades, with more than a billion people gaining access to the benefits of electricity. But there is still work ahead to alleviate energy poverty: About 25 percent of the world's population is unable to turn on a light or warm their home with electricity, according to the International Energy Agency.

In the coming decades, coal will continue to shoulder the load, bringing electricity – one of life's necessities – to more than 2 billion people in developing nations for the first time. Global coal use is expected to rise 73 percent in the next quarter century, according to the International Energy Agency, a dramatic increase over the forecast just last year.



Source: Energy Information Administration, Annual Energy Review, June 2007; U.S. EPA Air Emissions Trends Data, July 2007.

U.S. coal-based electricity generation has tripled since 1970 while emissions have been reduced by more than 40 percent. New emission standards are leading to continued environmental improvement, toward the ultimate goal of near-zero emissions.



GREENGEN 绿色煤电

Peabody is leading global initiatives toward near-zero emissions through GreenGen in China, the COAL21 Fund in Australia, and as a long-standing supporter of the Vision 21 and FutureGen clean coal projects in the United States.

Clean Coal Technology is the Key to Addressing Climate Concerns

Fueling the world's energy needs using clean coal is central to Peabody's mission and creates greater shareholder value.

Peabody's vision is to achieve near-zero emissions from coal, and we are advancing voluntary initiatives to commercialize clean coal technologies and address concerns about climate.

Coal has a strong and improving environmental track record thanks to tens of billions of dollars of investments in technologies that have enabled U.S. coal-fueled electricity to more than triple since 1970 while key emissions have been reduced by 42 percent.

Ultra-efficient projects, like the Prairie State Energy Campus being developed in Southern Illinois, represent a new generation of clean coal plants.

Prairie State will have one-fifth the average regulated emissions of the existing U.S. fleet, and even its carbon dioxide emission rates would be approximately 15 percent lower.

Technology advancements also are being made to scrub and store carbon dioxide in oil fields, saline aquifers and beneath the ocean floor in geology that offers both ample space and permanence.

Carbon dioxide for enhanced oil recovery, for instance, is a process that has been used by the petroleum industry for 30 years. This could lead to production of another 2 to 3 million barrels of oil per day in the United States alone, according to a major study by the National Coal Council.

The United States has more than 1,500 years of space for permanent carbon storage

Peabody is pursuing development of projects that would use carbon dioxide for enhanced oil recovery or under ground sequestration in former oil fields, saline aquifers and other geology.

Research is even under way with carbon-consuming algae that readily absorb carbon dioxide and other power plant emissions, oxygenating the air during photosynthesis.

Other promising carbon technology paths include coal gasification processes that can create separate hydrogen and carbon streams, reducing carbon dioxide in an oxygen-rich environment during combustion or using scrubbing agents for removal.

BTU is a Leader in Development of Near-Zero Emissions Initiatives

Peabody is a leader developing clean coal solutions. We are advancing global initiatives to commercialize clean coal technologies through GreenGen in China, the COAL21 Fund in Australia and our longstanding support of FutureGen in the United States. We also are participating in partnerships to advance the science of carbon storage.

Chief among these initiatives is GreenGen, where Peabody is the only non-Chinese equity partner in a commercial prototype for near-zero emissions being constructed southeast of Beijing.

The first phase of GreenGen is expected to be on line as early as next year. The project will ultimately include clean generation with hydrogen production, carbon storage and polygeneration.

Peabody is a founding member of the COAL21 Fund, Australia's near-zero emissions technology initiative funded by leading coal companies pursuing commercialization of advanced coal technologies such as oxygen-based coal-fueled generation.

The program is evaluating multiple demonstration projects and is funding a 30 megawatt oxyfuel project with carbon storage in Central Queensland that will start up next year.

The technology feeds pure oxygen into the boiler, creating a concentrated carbon dioxide stream for capture.

Other major Peabody clean coal partnerships include:

- Participation in the Midwest Geological Sequestration Consortium, a regional partnership that advances the science for the best geologic locations for carbon dioxide storage.
- The Power Systems Development Facility in Wilsonville, Ala., the nation's premier laboratory for testing coal gasification technology in partnership with the U.S. Department of Energy and Southern Company. Peabody is a major sponsor of the facility's research.
- The PowerTree Carbon Company, LLC, an initiative with 25 major U.S. power companies funding six major reforestation projects in the Lower Mississippi River Valley that create natural, carbon-consuming sinks.
- The Asia-Pacific Partnership for Clean Development and Climate. Driven by the United States, the partnership brings together companies in Australia, Canada, India, Japan, China and South Korea to develop and transfer technology to address energy security, emissions reductions and concerns about climate. Coal initiatives include oxyfuel demonstration and a mobile post-combustion pilot to capture carbon dioxide.

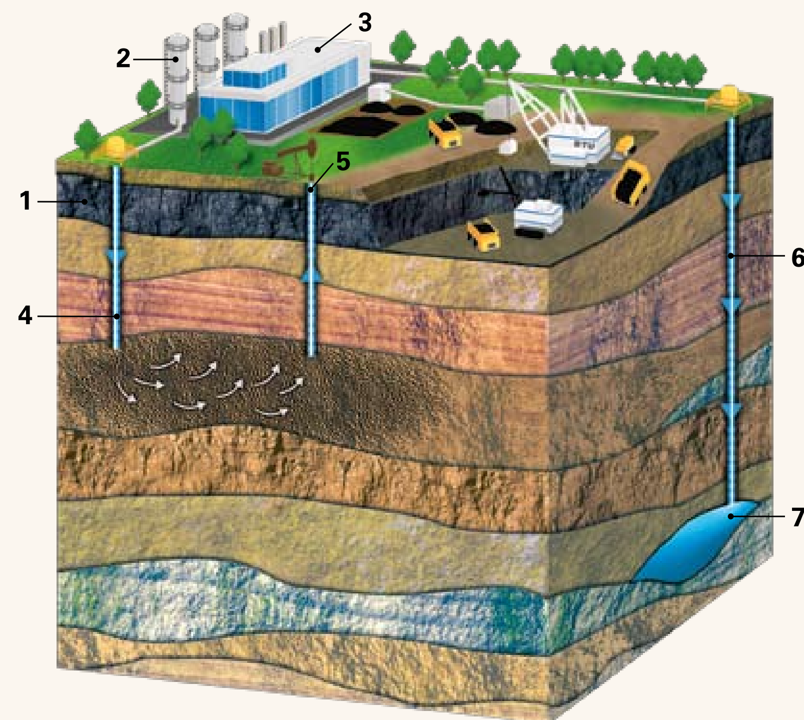
Beyond these core initiatives, BTU is developing a strategic technology program to advance emerging clean coal technologies through venture capital and equity partnerships.

Peabody continues progress with its own carbon management initiatives, reducing its greenhouse gas intensity by 31 percent since 1990. BTU also voluntarily contributes to the U.S. Department of Energy's reporting system.

In Australia, Peabody is part of Greenhouse Challenge Plus, a public and private partnership to improve energy efficiency and reduce greenhouse gas emissions.

All of these efforts are important for driving continuous environmental improvement and carbon management as the world increases its use of coal for energy security, economic growth and environmental solutions that help people live longer, healthier and with a better quality of life.

Peabody is Advancing Clean Coal Projects with Carbon Capture and Storage



1. Clean Coal Fuel Supply
2. Carbon Capture
3. Electricity Production
4. Carbon Dioxide Injection
5. Enhanced Oil Recovery
6. Carbon Dioxide Injection
7. Saline Aquifer Storage

THE NEW BTU

Joining China's Most Important Carbon Initiative

Chairman and Chief Executive Officer Greg Boyce (seated left) and President and Chief Commercial Officer Rick Navarre (standing left) formalize Peabody's participation in GreenGen. (Above) Peabody's Beijing office is located in the business district.

GreenGen Partners

- **Peabody Energy**
- **China Huaneng Group**
- **China Datang Corp.**
- **China Huadian Corp.**
- **China Guodian Corp.**
- **China Power Investment Corp.**
- **Shenhua Group**
- **China National Coal Group**
- **State Development and Investment Corp.**

China is an emerging giant of the world economy that prizes clean coal for energy security, economic growth and environmental solutions. As the world's fastest-growing coal-consuming nation, China added more coal generation this past year than the entire capacity of the United Kingdom's electric grid.

China is advancing near-zero emissions electricity with carbon storage through its centerpiece GreenGen initiative. Eight of China's top energy companies including China Huaneng Group – one of the world's top ten power companies – are partnering with BTU in project development.

GreenGen is a multi-phase 650 megawatt integrated gasification combined cycle power plant (IGCC) that will create hydrogen and marketable byproducts while using carbon dioxide for enhanced oil recovery.

Set for construction this year, the first 250 megawatt unit is planned to begin generating electricity for China's national grid as early as 2009.

GreenGen is just one example of Peabody's leadership advancing near-zero emissions through clean coal projects around the world.

Global, growing and green… leading real energy solutions. It's The New BTU.

CELEBRATING 125 YEARS

As the world settles into the 21st century, coal's contribution to society is even more valuable today than when Peabody was founded in 1883. What started as a small Chicago-based retail coal brokerage with $100 of capital has transformed into the world's largest private-sector coal company.

Here we celebrate our success, which is a tribute to our 7,000 employees around the world who work hard every day to live the values in our mission, creating "sustainable energy solutions, which power economic prosperity and result in a better quality of life." Peabody is 125 years strong, yet starting anew… We're The New BTU.

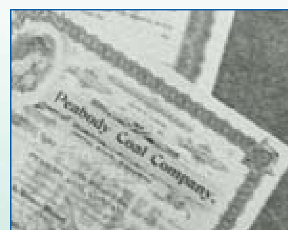
1880s

Francis Stuyvesant Peabody creates Peabody and Co. to serve Chicago's coal needs in 1883.

Peabody is the largest coal broker in Chicago.

Sourcing requirements quickly lead to development of Peabody's first mine in Williamson County, Ill.

1900s



During World War I, Peabody is producing 12 million tons of coal per year from seven states.

Peabody signs its first long-term coal supply agreement with a major Chicago utility.

Peabody becomes the largest producer in Illinois, with reserves totaling 1 billion tons.

Stock for Peabody is listed on the Chicago Stock Exchange.

1930s

Peabody is among the few companies that realizes steady profit and growth during the Great Depression.

An ambitious modernization program begins for Peabody's Southern Illinois properties.

Peabody supplies 200 tons of Great Heart Coal for Admiral Byrd's famed expedition to the South Pole.

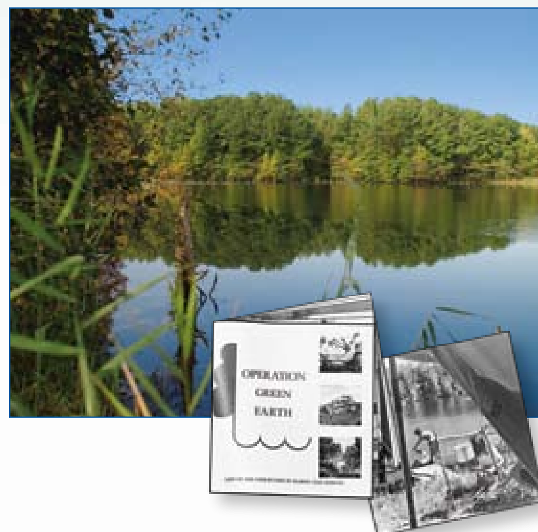
1940s

Peabody recapitalizes and begins construction of new mines to improve safety and increase productivity.

Peabody mines are brought under government control three times during and after World War II.

Peabody Coal Company is listed on the New York Stock Exchange.

1950s



Demonstrating early innovation in reclamation, Operation Green Earth is launched to plant trees on mined lands, even before the law requires it.

Peabody merges with St. Louis-based Sinclair Coal Company

Peabody's new identity campaign "Power for Progress" debuts

1960s

An ambitious exploration program in the Southwest begins at a time when electricity demand is doubling there each decade.

Peabody develops Moura Mine, Australia's first major export mine.

Production more than doubles in nine years to 62.4 million tons, and reserves swell to 4 billion tons.

Kennecott Copper purchases Peabody, an acquisition ultimately blocked by the Federal Trade Commission.

1970s

Peabody becomes the largest private-sector coal producer in 1971, a leadership position we have maintained ever since.

Peabody begins mining operations on native lands in Arizona through a partnership with the Navajo and Hopi.

Kennecott sells Peabody for $1.1 billion.

Peabody intensifies its environmental activities following passage of the Surface Mining Control and Reclamation Act.

A strategic plan for growing through expansion and diversification into low sulfur and metallurgical export markets is developed.

1980s

The North Antelope and Rochelle mines are developed in the Powder River Basin that later merge to become the largest mine in the world.

Peabody acquires the ARMCO mines in Appalachia, a region rich in high-quality steam and metallurgical coals.

Peabody acquires properties held by Eastern Gas and Fuel Associates, forming subsidiary Eastern Associated Coal.

1990s

Peabody transforms itself into the leading supplier of the world's low sulfur coal, with sales more than doubling from 1990 to 2000.

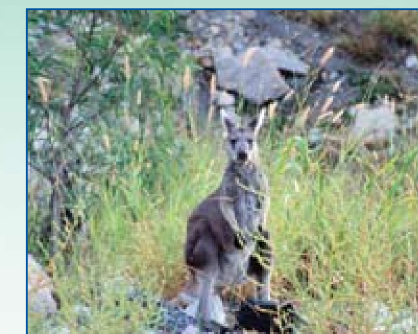
Hanson PLC acquires Peabody and later demerges The Energy Group, uniting Peabody with a United Kingdom electricity company.

Peabody is acquired by Lehman Merchant Banking Partners.

Peabody staff consolidates into St. Louis headquarters.

Peabody acquires a controlling interest in Black Beauty.

2000s



Peabody changes its name to Peabody Energy and executes one of the most successful IPOs of 2001.

Peabody purchases the Twentymile Mine, Australia operations and a Venezuela mine interest.

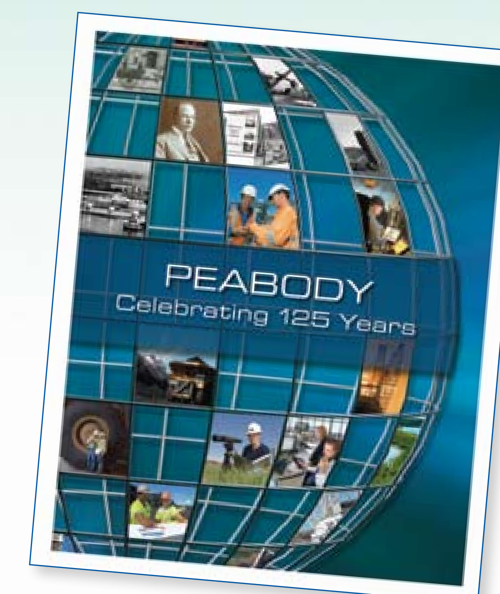
BTU turns in the safest and most productive years in its history.

Btu Conversion projects are announced and a Beijing office is opened; Peabody reorganizes for growth and acquires Excel Coal Ltd.

Peabody expands its global reach and transforms into The New BTU, serving the world's fastest-growing markets and leading clean coal solutions.

TODAY…

The New BTU celebrates its 125th anniversary and sets a course for its next 125 years of success.



THE NEW BTU: GLOBAL OPERATIONS AND RESERVES

Peabody has a growing global presence and 31 operations in the United States and Australia

Geographic Region/Operation	2007 Sales	Mine Type	Type of Coal	Proven & Probable Reserves
United States				
Powder River Basin				
Caballo	31.2	S	S	
North Antelope Rochelle	91.5	S	S	
Rawhide	17.1	S	S	
Total	139.8			3,341
Southwest/Colorado				
Kayenta	7.9	S	S	
Lee Ranch	5.8	S	S	
Twentymile	7.9	U	S	
Total	21.6			1,196
Midwest				
Air Quality	2.0	U	S	
Farmersburg	3.5	S	S	
Francisco Surface	2.1	S	S	
Francisco Underground	0.9	U	S	
Gateway	2.7	U	S	
Miller Creek	1.6	S	S	
Somerville Central	3.5	S	S	
Somerville North	2.5	S	S	
Somerville South	2.5	S	S	
Vermilion Grove	1.4	U	S	
Viking	1.7	S	S	
Wildcat Hills Surface	2.0	S	S	
Wildcat Hills Underground	0.9	U	S	
Willow Lake	3.6	U	S	
Total	30.9			3,691
Australia				
Queensland				
Baralaba	0.4	S	S/P	
Burton	3.2	S	S/M	
Millennium	1.0	S	M	
North Goonyella and Eaglefield	2.5	U/S	M	
Wilkie Creek	2.3	S	S	
Total	9.4			589
New South Wales				
Chain Valley	0.6	U	S	
Metropolitan	1.6	U	M	
North Wambo	0.3	U	S/P	
Wambo	4.4	S	S	
Wilpinjong	5.1	S	S	
Total	12.0			484
Total U.S. and Australia Mining Sales	**213.7**			**9,301**
Trading and Brokerage	24.1			
Total Coal Sales	**237.8**			

(Short tons in millions)

This table reflects wholly owned or majority owned operations.

Mine Type
U: Underground
S: Surface/Open Cut

Type of Coal
S: Steam/Thermal
M: Metallurgical Coal
P: Pulverized Coal Injection

Peabody is widely recognized for corporate and social responsibility, earning 40 major awards for safety, environmental excellence and financial performance in 2007.

2007 Awards and Recognition

CORPORATE MILESTONES

America's Most Admired Company
Fortune Magazine

Top 10 Value Creators Among S&P 500 Companies
CFO Magazine

Platinum 400 List of America's Best Big Companies
Forbes Magazine

Top 100 Global Ranking for Sustainable Practices
Ceres & Investor Responsibility Research Center

Top 50 Award
St. Louis Regional Chamber & Growth Association

Ferring Award for Philanthropy
Center of Creative Arts

Best Adoption-Friendly Workplace
Dave Thomas Foundation for Adoption

Lina Young
Most Influential Business Women
St. Louis Business Journal

Walter Hawkins
Most Influential Minority Business Leader
St. Louis Business Journal

Michael Creech
Excellence in Coal Geology Award
New South Wales Coalfield Geology Council

SAFETY MILESTONES

Farmersburg Mine
Sentinels of Safety Award
U.S. Department of Labor

Francisco Mine
Sentinels of Safety Certificate
U.S. Department of Labor

Lee Ranch Mine
Operator of the Year & Safe Operator Awards
New Mexico Mine Inspector

Lee Ranch Mine
Sentinels of Safety Certificate
U.S. Department of Labor

North Antelope Rochelle Mine
"Safe Sam" Award
State Mine Inspector & Wyoming Mining Association

North Antelope Rochelle Mine
Wyoming Governor's Safety Award
Governor's Office

Somerville Central Mine
Sentinels of Safety Certificate
U.S. Department of Labor

Viking Mine
Sentinels of Safety Certificate
U.S. Department of Labor

SAFETY COMPETITION MILESTONES

Caballo Mine
1st & 2nd Place
11th Annual Red Desert Trauma Conference

Caballo Mine
1st Place "B" Flight
21st Annual Safety Olympiad

North Antelope Rochelle Mine
1st Place Overall
1st Place in Advanced "A" Flight
21st Annual Safety Olympiad

North Wambo Mine
1st Place
Hunter Valley Mine Rescue Competition

Willow Lake Mine
1st Place
Illinois Department of Natural Resources Mine Rescue Competition

Twentymile Mine
1st Place: Chuck Harvey, Benchman
National Mine Rescue Competition
U.S. Department of Labor

Lee Ranch Mine
1st Place Five-Person Event
69th Annual Tri-State Firemen's Association Training & Competition

RECLAMATION MILESTONES

Caballo Mine
Bronze Good Neighbor Award
U.S. Department of the Interior

Caballo Mine
Wyoming Department of Environmental Quality "Good Neighbor" Award

Caballo Mine
Wyoming Engineering Society Project of the Year Award

Gibraltar Mine
Excellence in Reclamation Award
U.S. Department of the Interior

Miller Creek Mine
Excellence in Reclamation Award
Indiana Department of Natural Resources

Ken Rogers
Reclamation Innovation Award
Indiana Society of Mining & Reclamation

Vern Pfannenstiel
Reclamationist of the Year
American Society of Mining & Reclamation

Somerville Central Mine
Silver Good Neighbor Award
U.S. Department of the Interior

Somerville Central Mine
Excellence in Reclamation Award
U.S. Department of the Interior

Somerville Central Mine
Excellence in Reclamation Award
Indiana Department of Natural Resources

Seneca Coal Company
Excellence in Reclamation Award
Colorado Division of Reclamation, Mining & Safety; Colorado Mining Association

Twentymile Mine & Seneca Mine
Excellence in Reclamation Award
U.S. Department of the Interior

Selected Financial Data

All prior years adjusted to reflect continuing operations

Years Ended December 31 (Dollars in thousands, except share and per share data and tons sold)	2007	2006	2005	2004	2003
Results of Operations Data					
Revenues					
Sales	$4,364,708	$4,002,403	$3,584,422	$2,732,972	$2,142,767
Other revenues	210,004	105,993	81,754	82,186	82,783
Total revenues	4,574,712	4,108,396	3,666,176	2,815,158	2,225,550
Costs and expenses					
Operating costs and expenses	3,574,818	3,155,732	2,885,320	2,252,949	1,745,616
Depreciation, depletion and amortization	361,559	294,270	253,788	211,630	180,262
Asset retirement obligation expense	25,610	15,830	20,329	15,125	13,226
Selling and administrative expenses	147,146	128,031	132,679	84,534	66,688
Other operating income:					
Net gain on disposal or exchange of assets	(88,684)	(53,532)	(44,445)	(18,065)	(9,382)
(Income) loss from equity affiliates	(14,461)	(22,791)	(15,227)	(64)	538
Operating profit	568,724	590,856	433,732	269,049	228,602
Interest expense	235,236	137,668	98,066	89,052	90,754
Early debt extinguishment costs	(253)	1,396	–	1,751	53,513
Interest income	(7,094)	(11,309)	(9,088)	(3,999)	(2,126)
Income from continuing operations before income taxes and minority interests	340,835	463,101	344,754	182,245	86,461
Income tax provision (benefit)	(78,112)	(90,084)	63,779	281	(8,017)
Minority interests	(2,316)	611	2,472	1,007	3,035
Income from continuing operations	421,263	552,574	278,503	180,957	91,443
Income (loss) from discontinued operations	(156,978)	48,123	144,150	(5,570)	(49,951)
Income before accounting changes	264,285	600,697	422,653	175,387	41,492
Cumulative effect of accounting changes	–	–	–	–	(10,144)
Net income	$ 264,285	$ 600,697	$ 422,653	$ 175,387	$ 31,348
Basic earnings per share from continuing operations	$ 1.60	$ 2.10	$ 1.06	$ 0.73	$ 0.43
Diluted earnings per share from continuing operations	$ 1.56	$ 2.05	$ 1.04	$ 0.71	$ 0.42
Weighted average shares used in calculating basic earnings per share	264,068,180	263,419,344	261,519,424	248,732,744	213,638,084
Weighted average shares used in calculating diluted earnings per share	269,166,290	269,166,005	268,013,476	254,812,632	219,342,512
Dividends declared per share	$ 0.24	$ 0.24	$ 0.17	$ 0.13	$ 0.11
Other Data					
Tons sold (in millions)	237.8	223.3	216.1	202.6	182.2
Net cash provided by (used in) continuing operations:					
Operating activities	$ 447,181	$ 591,412	$ 683,804	$ 454,958	$ 314,819
Investing activities	(541,730)	(2,061,159)	(516,453)	(760,880)	(308,792)
Financing activities	44,768	1,407,581	(38,876)	577,426	39,184
Adjusted EBITDA [(1)]	955,893	900,956	707,849	495,804	422,090
Additions to property, plant, equipment and mine development	470,434	397,497	450,348	115,164	81,893
Federal coal lease expenditures	178,193	178,193	118,364	114,653	–
Acquisitions, net	–	1,507,775	–	426,571	90,000
Balance Sheet Data (at period end)					
Total assets	$9,668,307	$9,514,056	$6,852,006	$6,178,592	$5,280,265
Total debt	3,273,100	3,277,032	1,332,047	1,362,738	1,134,161
Total stockholders' equity	2,519,617	2,338,526	2,178,467	1,724,592	1,132,057

[(1)] Adjusted EBITDA is defined as income from continuing operations before deducting early debt extinguishment costs, net interest expense, income taxes, minority interests, asset retirement obligation expense and depreciation, depletion and amortization. Adjusted EBITDA is used by management to measure operating performance, and management also believes it is a useful indicator of our ability to meet debt service and capital expenditure requirements. Because Adjusted EBITDA is not calculated identically by all companies, our calculation may not be comparable to similarly titled measures of other companies.

Adjusted EBITDA is calculated as follows, in thousands (unaudited):	2007	2006	2005	2004	2003
Income from continuing operations	$ 421,263	$ 552,574	$ 278,503	$ 180,957	$ 91,443
Income tax provision (benefit)	(78,112)	(90,084)	63,779	281	(8,017)
Depreciation, depletion and amortization	361,559	294,270	253,788	211,630	180,262
Asset retirement obligation expense	25,610	15,830	20,329	15,125	13,226
Interest expense	235,236	137,668	98,066	89,052	90,754
Early debt extinguishment costs	(253)	1,396	–	1,751	53,513
Interest income	(7,094)	(11,309)	(9,088)	(3,999)	(2,126)
Minority interests	(2,316)	611	2,472	1,007	3,035
Adjusted EBITDA	$ 955,893	$ 900,956	$ 707,849	$ 495,804	$ 422,090

MANAGEMENT'S DISCUSSION AND ANALYSIS OF

Financial Condition and Results of Operations

OVERVIEW

We are the largest private sector coal company in the world, with majority interests in 31 coal operations located throughout all major U.S. coal producing regions, except Appalachia, and international interests in Australia and Venezuela. In 2007, we sold 237.8 million tons of coal. Our U.S. sales represented 19% of all U.S. coal sales and were approximately 80% greater than the sales of our closest U.S. competitor.

United States coal demand was approximately 1.1 billion tons in 2007, based on Energy Information Administration (EIA) estimates. Coal's predominate use is for baseload electricity requirements. For the 12 months ended November 2007, coal's share of electricity generation was approximately 50%, a share that the EIA projects will grow to 55% by 2030. EIA projects an additional 130 gigawatts of new U.S. coal-fueled generation by 2030, including 9 gigawatts at coal-to-liquids plants and 45 gigawatts at integrated gasification combined-cycle plants, which represents more than 500 million tons of additional coal demand. Domestic coal consumption is expected to grow at an average annual rate of 1.8% from 2007 through 2030 when U.S. coal demand is forecasted to reach 1.7 billion tons. Coal production located west of the Mississippi River is projected to provide most of the incremental growth as Western production increases to an estimated 65% share of total production in 2030 versus 58% in 2007.

Globally, we believe that coal demand is driven by electricity generation (65%) and industrial use (31%), including steel making. The International Energy Agency (IEA) estimates coal's share of total world energy consumption is projected to increase from 25% in 2005 to 28% through 2030, and in the electric power sector, its share is estimated to rise from 43% in 2004 to 45% in 2030. More than 80% of the growth in global coal demand is expected to come from China and India. These two countries comprise approximately 45% of global coal use, which is projected by IEA to grow to 80% by 2030. China alone added an estimated 96 gigawatts of new coal-fueled generation in 2007, representing more than 300 million tons of annual coal use. Coal demand in India is forecasted to nearly triple by 2030. In total, global coal consumption is expected to grow 73%, or more than 4 billion tons by 2030.

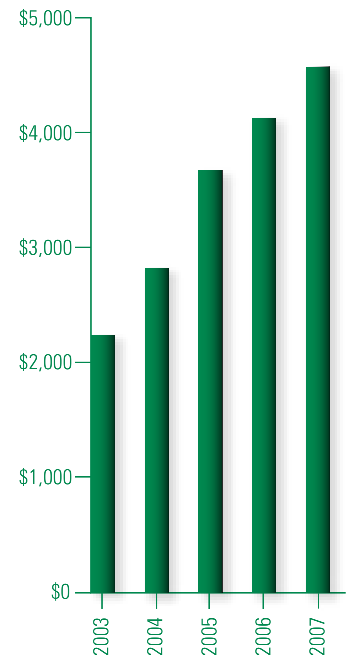
Our primary U.S. customers are utilities, which accounted for 85% of our sales in 2007. Our international production is sold primarily into export markets. Our international activities accounted for 13% of our sales by volume in 2007. We typically sell coal to utility customers under long-term contracts (those with terms longer than one year). During 2007, approximately 94% of our sales were under long-term contracts. As of December 31, 2007, production totaled 214.1 million tons and sales totaled 237.8 million tons. As discussed more fully in Item 1A. Risk Factors, our results of operations in the near-term could be negatively impacted by poor weather conditions, unforeseen geologic conditions or equipment problems at mining locations, and by the availability of transportation for coal shipments. On a long-term basis, our results of operations could be impacted by our ability to secure or acquire high-quality coal reserves, find replacement buyers for coal under contracts with comparable terms to existing contracts, or the passage of new or expanded regulations that could limit our ability to mine, increase our mining costs, or limit our customers' ability to utilize coal as fuel for electricity generation. In the past, we have achieved production levels that are relatively consistent with our projections. However, we expect to adjust our production levels in response to changes in market demand.

We conduct business through four principal operating segments: Western U.S. Mining, Eastern U.S. Mining, Australian Mining, and Trading and Brokerage. 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 Illinois and Indiana operations. The principal business of the Western and Eastern U.S. Mining segments is the mining, preparation and sale of steam coal, sold primarily to electric utilities.

Geologically, Western operations mine bituminous and subbituminous coal deposits and Eastern operations mine bituminous coal deposits. Our Western U.S. Mining operations are characterized by predominantly surface extraction processes, lower sulfur content and Btu of coal, and higher customer transportation costs (due to longer shipping distances). Our Eastern U.S.

Revenues

(Dollars in millions)



Revenues are adjusted to reflect continuing operations.

Mining operations are characterized by a mix of surface and underground extraction processes, higher sulfur content and Btu of coal, and lower customer transportation costs (due to shorter shipping distances).

Australian Mining operations are characterized by both surface and underground extraction processes, mining various qualities of low-sulfur, high Btu coal (metallurgical coal) as well as steam coal primarily sold to an international customer base with a small portion sold to Australian steel producers and power generators. In the second half of 2006, through two separate transactions, we acquired Excel Coal Limited (Excel), an independent coal company in Australia for a total acquisition price of US$1.51 billion, net of cash received, plus approximately $293.0 million in assumed debt. See Liquidity and Capital Resources for information on the financing of the Excel transaction. Assets acquired include three operating mines and three development-stage mines, along with up to 500 million tons of proven and probable coal reserves.

We own a 25.5% interest in Carbones del Guasare, which owns and operates the Paso Diablo Mine in Venezuela. The Paso Diablo Mine produces approximately 6 to 8 million tons of steam coal annually for export to the United States and Europe. During 2007, the Paso Diablo Mine contributed $21.2 million to segment Adjusted EBITDA in "Corporate and Other Adjusted EBITDA" and paid a dividend of $12.9 million. At December 31, 2007, our investment in Paso Diablo was $68.4 million.

Metallurgical coal is produced primarily from four of our Australian mines. Metallurgical coal is approximately 4% of our total sales volume, but represents a larger share of our revenue, approximately 15% in 2007.

In addition to our mining operations, which comprised 92% of revenues in 2007, we generate revenues and additional cash flows from our Trading and Brokerage operations (7% of revenues), and other activities, including transactions utilizing our vast natural resource position (selling non-core land holdings and mineral interests).

We continue to pursue the development of coal-fueled generating projects in areas of the U.S. where electricity demand is strong and where there is access to land, water, transmission lines and low-cost coal. The projects involve mine-mouth generating plants using our surface lands and coal reserves. Our ultimate role in these projects could take numerous forms, including, but not limited to, equity partner, contract miner or coal sales. We own 5.06% of the 1,600-megawatt Prairie State Energy Campus that is under construction in Washington County, Illinois. We are pursuing development of the 1,500-megawatt Thoroughbred Energy Campus in Muhlenberg County, Kentucky. The plants, assuming all necessary permits and financing are obtained and following selection of partners and sale of a majority of the output of each plant, could be operational following a four-year construction phase.

The EIA projects that the high price of oil will lead to an increase in demand for unconventional sources of transportation fuel, including Btu Conversion technologies, and that coal will increase its share as a fuel for electricity generation. We are exploring several Btu Conversion projects, which are designed to expand the uses of coal through various technologies, and we are continuing to explore options particularly as they relate to Btu Conversion technologies such as coal-to-liquids and coal gasification.

In July 2005, our Board of Directors authorized a share repurchase program of up to 5% of the outstanding shares of our common stock. The repurchases may be made from time to time based on an evaluation of our outlook and general business conditions, as well as alternative investment and debt repayment options. In 2006, we repurchased 2.2 million of our common shares for $99.8 million under this repurchase program.

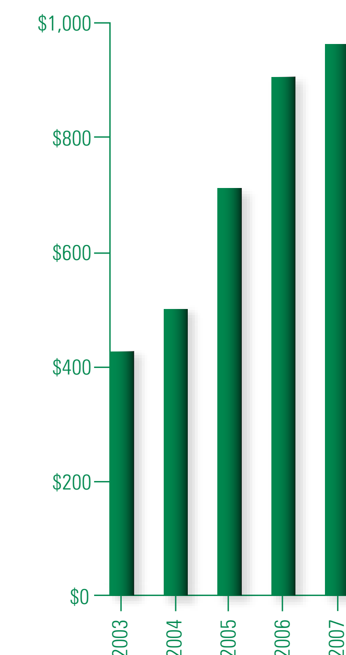
On October 31, 2007, we spun-off portions of our Eastern U.S. Mining operations business segment to form Patriot. We distributed Patriot stock to our stockholders at a ratio of one share of Patriot stock for every 10 shares of Peabody stock held on the record date of October 22, 2007. Our results for 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.

RESULTS OF OPERATIONS

The portions of the Eastern U.S. Mining operations business segment that were included in the spin-off of Patriot have been classified as discontinued operations and are excluded from the operating results for all periods presented. See the description of the spin-off in Part I, Item 1 "Discontinued Operations."

Adjusted EBITDA

The discussion of our results of operations below includes references to and analysis of our segments' Adjusted EBITDA results. Adjusted EBITDA is defined as income from continuing operations before deducting early debt extinguishment costs, net interest expense, income taxes, minority interests, asset retirement obligation expense and depreciation, depletion and amortization. Adjusted EBITDA is used by management to measure our segments' operating performance, and management also believes it is a useful indicator of our ability to meet debt service and capital expenditure requirements. Because Adjusted EBITDA is not calculated identically by all companies, our calculation may not be comparable to similarly titled measures of other companies. Adjusted EBITDA is reconciled to its most comparable measure, under generally accepted accounting principles, in Note 24 to our consolidated financial statements.



EBITDA is adjusted to reflect continuing operations.

YEAR ENDED DECEMBER 31, 2007 COMPARED TO YEAR ENDED DECEMBER 31, 2006

Summary

Higher average sales prices across all U.S. regions and increased volumes, primarily from Australian Mining operations, contributed to an 11.4% increase in revenues to $4.57 billion compared to 2006. Segment Adjusted EBITDA increased 3.4% to $1.06 billion primarily on higher prices in the Western U.S. and increased results from Trading and Brokerage operations. Increases in sales volumes and prices in our U.S. mining operations were partially offset by challenges experienced during the period such as ongoing shipping constraints from port congestion in Australia; geologic and equipment issues, higher commodity costs, as well as a weaker U.S. dollar against the Australian Dollar. Also, negatively impacting Australian Mining results was lower metallurgical coal prices associated with annual contracts that began in April 2007. Income from continuing operations was $421.3 million in 2007, or $1.56 per diluted share, a decrease of 23.8% from 2006 income from continuing operations of $552.6 million, or $2.05 per diluted share.

Tons Sold

The following table presents tons sold by operating segment for the years ended December 31, 2007 and 2006:

			Increase	
(Tons in millions)	*2007*	*2006*	*Tons*	*%*
Western U.S. Mining Operations	161.4	160.5	0.9	0.6%
Eastern U.S. Mining Operations	30.9	30.4	0.5	1.6%
Australian Mining Operations	21.4	11.0	10.4	94.5%
Trading and Brokerage Operations	24.1	21.4	2.7	12.6%
Total tons sold	237.8	223.3	14.5	6.5%

Revenues

The following table presents revenues for the years ended December 31, 2007 and 2006:

(Dollars in Thousands)	2007	2006	Increase (Decrease) to Revenues $	%
Western U.S. Mining Operations	$2,061,265	$1,703,445	$ 357,820	21.0%
Eastern U.S. Mining Operations	984,841	905,743	79,098	8.7%
Australian Mining Operations	1,161,093	843,194	317,899	37.7%
Trading and Brokerage Operations	320,692	652,029	(331,337)	(50.8%)
Other	46,821	3,985	42,836	1074.9%
Total revenues	$4,574,712	$4,108,396	$ 466,316	11.4%

In 2007, our total revenues were $4.57 billion, an increase of $466.3 million, or 11.4%, compared to the prior year, which resulted from sales price increases in all U.S. regions, most notably in our Powder River Basin operations and increased volumes from Australia. Volumes related to operations acquired in the October 2006 Excel acquisition accounted for 10.9 million tons of the increase to tons sold. Partially offsetting sales price and volume increases was the continued shift towards trading contracts versus brokerage contracts in our Trading and Brokerage operations. Trading and Brokerage operations' sales decreased during the year as the amount of brokerage business was reduced and replacement business was in the form of traded contracts. Contracts for trading activity are recorded at net margin in other revenues, whereas contracts for brokerage activity are recorded at gross sales price to revenues and operating costs. While the shift to trading contracts reduced total sales, there was no impact to Adjusted EBITDA.

Overall, prices in our Western U.S. Mining operations increased due to a sales realization increase of approximately 29% for our premium Powder River Basin product and an average increase across all U.S. regions of 16%. In addition, Eastern U.S. Mining revenues increased due to higher revenues from coal sold to synthetic fuel plants as those plants were idled for part of 2006. Offsetting this increase was lower average sales prices in our Australian Mining operations related to lower metallurgical contract pricing and a significant change in sales mix resulting in higher thermal export and domestic product sales. Volumes were unfavorably impacted at some of our Australian Mining operations as a result of damaged rails and further amplified port and rail congestion throughout the year, in addition to adverse weather events in the second quarter that affected production.

Segment Adjusted EBITDA

Our total segment Adjusted EBITDA was $1.06 billion for the year ended 2007, compared with $1.03 billion in the prior year. Details were as follows:

(Dollars in thousands)	2007	2006	Increase (Decrease) to Segment Adjusted EBITDA $	%
Western U.S. Mining Operations	$ 597,333	$ 473,074	$ 124,259	26.3%
Eastern U.S. Mining Operations	196,595	184,549	12,046	6.5%
Australian Mining Operations	159,473	278,411	(118,938)	(42.7%)
Trading and Brokerage Operations	110,169	92,604	17,565	19.0%
Total Segment Adjusted EBITDA	$1,063,570	$1,028,638	$ 34,932	3.4%

Adjusted EBITDA from our Western U.S. Mining operations increased $124.3 million, or 26.3%, during the year primarily related to the overall increase in average sales prices from our Powder River Basin operations. Partially offsetting higher average sales prices were higher costs associated with equipment repairs and maintenance and higher add-on taxes and royalties driven by higher sales prices compared to the prior year, mine shutdown for maintenance in our Colorado region in December, higher fuel costs and adverse weather conditions in the Powder River Basin and capital project delays in the first half of the year.

Eastern U.S. Mining operations' Adjusted EBITDA increased $12.0 million, or 6.5%, compared to prior year as both volumes and prices per ton saw moderate increases. Results improved compared to prior year as benefits of higher volumes and sales prices were offset by higher costs for commodities, including fuel. The 2007 results were also positively impacted by higher revenues from coal sold to synthetic fuel facilities of $12.5 million as customers idled their synthetic fuel plants for a portion of 2006.

Our Australian Mining operations' Adjusted EBITDA decreased $118.9 million, or 42.7%, compared to prior year primarily due to approximately $31 million of higher costs resulting from the weakening U.S. dollar (higher costs of approximately $112 million were offset by hedging gains of $81 million); higher congestion-related demurrage costs (approximately $50 million); lower pricing on annually repriced metallurgical coal contracts; and, rail and port congestion at Dalrymple Bay Coal Terminal and the Port of Newcastle. Dalrymple Bay Coal Terminal has been experiencing queues of over 41 vessels (approximately a 24-day load time) down from 50 vessels in the second quarter (approximately a 34-day delay). Partially offsetting these decreases were the full year contributions from our mines acquired in the Excel acquisition and a $6.3 million insurance recovery on a business interruption claim in the first half of 2007. Our Australian mines acquired in 2006 experienced shipping difficulties and damaged rail lines resulting from a storm late in the second quarter. The Port of Newcastle was closed for several days in June due to a storm, with up to 79 vessels in the queue (a 35 - 40 day wait). Queues at Newcastle have recently been reduced to 31 vessels (11-day wait).

Trading and Brokerage operations' Adjusted EBITDA increased $17.6 million from the prior year, as 2007 results reflected higher international trading gains, resulting from higher volumes and pricing due to expanded global trading activities, strong supply/demand fundamentals and tightened seaborne market conditions

Income From Continuing Operations Before Income Taxes and Minority Interests

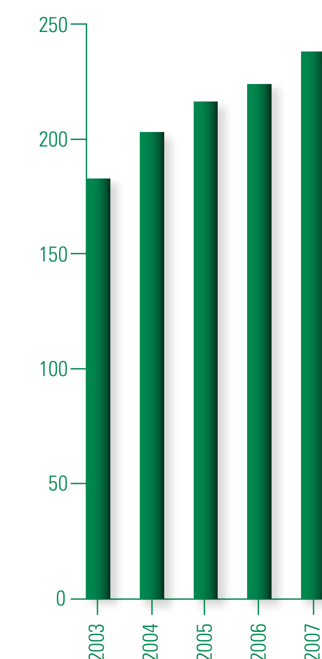
The following table presents income before income taxes and minority interests for the years ended December 31, 2007 and 2006:

(Dollars in thousands)	2007	2006	Increase (Decrease) to Income $	%
Total Segment Adjusted EBITDA	$1,063,570	$1,028,638	$ 34,932	3.4%
Corporate and Other Adjusted EBITDA	(107,677)	(127,682)	20,005	15.7%
Depreciation, depletion and amortization	(361,559)	(294,270)	(67,289)	(22.9%)
Asset retirement obligation expense	(25,610)	(15,830)	(9,780)	(61.8%)
Interest expense and early debt extinguishment costs	(234,983)	(139,064)	(95,919)	(69.0%)
Interest income	7,094	11,309	(4,215)	(37.3%)
Income from continuing operations before income taxes and minority interests	$ 340,835	$ 463,101	$(122,266)	(26.4%)

Income from continuing operations before income taxes and minority interests of $340.8 million for 2007 is $122.3 million, or 26.4%, lower than 2006 primarily due to higher interest expense and higher depreciation, depletion and amortization related to the acquisition of Excel in late 2006.

Tons Sold

(Tons in millions)



Tons sold are adjusted to reflect continuing operations.

Corporate and Other Adjusted EBITDA results include selling and administrative expenses, equity income from our joint venture, net gains on asset disposals or exchanges, costs associated with past mining obligations and revenues and expenses related to our other commercial activities such as coalbed methane, generation development, Btu Conversion and resource management. The $20.0 million improvement in Corporate and Other Adjusted EBITDA (net expense) in 2007 compared to 2006 includes the following:

- Higher gains on asset disposals and exchanges of $35.2 million. The 2007 activity included a gain of $26.4 million on the sale of approximately 172 million tons of coal reserves to the Prairie State equity partners. Our 2007 activity also included a gain of $50.5 million on the exchange of our coalbed methane and oil and gas rights in the Illinois Basin, West Virginia, New Mexico and the Powder River Basin for high-Btu coal reserves located in West Virginia and Kentucky and cash proceeds. In comparison, the 2006 activity included a $39.2 million gain on an exchange with the Bureau of Land Management of approximately 63 million tons of leased coal reserves at our Caballo mining operation for approximately 46 million tons of coal reserves contiguous with our North Antelope Rochelle mining operation and other gains on asset disposals totaling $14.3 million;
- Higher past mining obligation expenses of $15.5 million resulting from increased retiree healthcare costs due to higher than anticipated healthcare utilization by retirees, particularly related to prescription drugs;
- Higher selling and administrative expenses of $19.1 million during the year primarily resulting from the implementation of a new enterprise resource planning system and other corporate development initiatives; and
- Lower equity income of $6.8 million from our 25.5% interest in Carbones del Guasare (owner and operator of the Paso Diablo Mine in Venezuela), which primarily resulted from trucking issues experienced earlier in the year, a temporary shortage of explosives, and delays in receiving equipment, which impacted operations.

Depreciation, depletion and amortization increased $67.3 million primarily related to the addition of the Australian operations acquired in late 2006.

Interest expense and early debt extinguishment costs increased $95.9 million primarily due to approximately $1.8 billion in new debt issued or assumed as part of the Excel acquisition in the second half of 2006.

Net Income

			Increase (Decrease) to Income	
(Dollars in thousands)	2007	2006	$	%
Income from continuing operations before income taxes and minority interests	$ 340,835	$463,101	$(122,266)	(26.4%)
Income tax benefit	78,112	90,084	(11,972)	(13.3%)
Minority interests	2,316	(611)	2,927	479.1%
Income from continuing operations	421,263	552,574	(131,311)	(23.8%)
Income (loss) from discontinued operations	(156,978)	48,123	(205,101)	(426.2%)
Net income	$ 264,285	$600,697	$(336,412)	(56.0%)

Income from continuing operations decreased $131.3 million in 2007 compared to prior year due to the decrease in income from continuing operations before income taxes and minority interests discussed above and a lower income tax benefit compared to 2006. The decrease in the income tax benefit for the year ended 2007 related primarily to a $56.0 million foreign currency impact on deferred taxes as a result of increases in Australian dollar/U.S. dollar exchange rates and $33.2 million lower tax reserves than in the prior year, partially offset by lower pre-tax income, a $10.3 million increase in released valuation allowances, and $24.3 million of additional tax credits. Minority interests increased primarily from the absorption of losses in excess of the minority interest capital contribution at one of our mines, partially offset by lower earnings allocable to partners.

YEAR ENDED DECEMBER 31, 2006 COMPARED TO YEAR ENDED DECEMBER 31, 2005

Summary

Higher average sales prices and increased volumes in the Eastern U.S., Powder River Basin and Australian Mining operations, including the October 2006 acquisition of three mines in Australia, contributed to a 12.1% increase in revenues to $4.11 billion compared to 2005. Segment Adjusted EBITDA increased 17.8% to $1.03 billion primarily on growth in international volumes and higher sales prices from our Australian Mining operations and increased contributions from Trading and Brokerage operations. Increases in sales volumes and prices in our U.S. mining operations were partially offset by operational challenges experienced during the period such as ongoing shipping constraints from rail performance in the Powder River Basin and port congestion in Australia; geologic and equipment issues as well as mine closures in our Western U.S. Mining operations in late 2005. Net income was $600.7 million in 2006, or $2.23 per diluted share, an increase of 42.1% over 2005 net income of $422.7 million, or $1.58 per diluted share.

Tons Sold

The following table presents tons sold by operating segment for the years ended December 31, 2006 and 2005:

			Increase (Decrease)	
(Tons in millions)	2006	2005	Tons	%
Western U.S. Mining Operations	160.5	154.3	6.2	4.0%
Eastern U.S. Mining Operations	30.4	28.7	1.7	5.9%
Australian Mining Operations	11.0	8.3	2.7	32.5%
Trading and Brokerage Operations	21.4	24.8	(3.4)	(13.7%)
Total tons sold	223.3	216.1	7.2	3.3%

Revenues

The table below presents revenues for the years ended December 31, 2006 and 2005:

			Increase (Decrease) to Revenues	
(Dollars in thousands)	2006	2005	$	%
Western U.S. Mining Operations	$1,703,445	$1,611,587	$ 91,858	5.7%
Eastern U.S. Mining Operations	905,743	760,404	145,339	19.1%
Australian Mining Operations	843,194	598,085	245,109	41.0%
Trading and Brokerage Operations	652,029	679,176	(27,147)	(4.0%)
Other	3,985	16,924	(12,939)	(76.5%)
Total revenues	$4,108,396	$3,666,176	$442,220	12.1%

In 2006, our total revenues were $4.11 billion, an increase of $442.2 million, or 12.1%, compared to prior year, which resulted from sales price increases in all regions, particularly in our Eastern and Australian operations and demand-driven sales volume increases in the Powder River Basin, Midwest and Australian operations. Volumes related to the October 2006 Excel acquisition accounted for 2.1 million tons of the increase to tons sold and approximately 43% of the increase to sales in Australia. Partially offsetting sales price increases were lower western regional sales due to the late 2005 mine closures in the Western U.S. Mining operations and lower brokerage volumes.

Overall, prices and volumes in our Western U.S. Mining operations increased, mainly reflecting increases to sales prices of over $0.70 per ton and volumes of 12.7 million tons in the Powder River Basin. These increases at our Powder River Basin operations resulted from strong demand for the mines' low-sulfur products and improved rail conditions compared to 2005, when the

region was dealing with major railroad maintenance. Despite rail performance improvements relative to 2005, constrained rail capacity continued to limit growth in the region in 2006.

Also, affecting Western U.S. Mining revenues was lower production due to the cessation of mining operations at our Seneca and Black Mesa mines in late 2005 and unfavorable geologic conditions and equipment issues at our Twentymile Mine.

Per ton sales prices in our Eastern U.S. Mining operations increased and sales volumes increased due primarily to our Gateway mine, which began operation in late 2005. Partially offset by the overall increase in 2006 total revenues was the customer idling of synfuel plants during 2006.

Revenues from our Australian Mining operations were $245.1 million, or 41.0%, higher than in 2005, primarily due to higher international metallurgical coal prices, higher production at our underground mine following installation of a new longwall in the second quarter of 2006 and additional volumes from our newly acquired mines ($105.1 million). A higher per ton sales price reflected higher contract prices in 2006 for metallurgical coal as well as the slower realization of metallurgical coal price increases in 2005 when we operated under some lower priced carry-over contracts from 2004 through most of the first nine months of 2005.

Brokerage operations' revenues decreased $27.1 million in 2006 compared to 2005 due to lower sales volumes, partially offset by higher sales prices and proceeds of $28.2 million from settlement of commitments by a third-party coal producer following a brokerage contract restructuring.

Segment Adjusted EBITDA

Our total segment Adjusted EBITDA was $1.03 billion for the year ended 2006 compared with $873.5 million in 2005. Details were as follows:

			Increase to Segment Adjusted EBITDA	
(Dollars in thousands)	2006	2005	$	%
Western U.S. Mining Operations	$ 473,074	$459,039	$ 14,035	3.1%
Eastern U.S. Mining Operations	184,549	168,793	15,756	9.3%
Australian Mining Operations	278,411	202,582	75,829	37.4%
Trading and Brokerage Operations	92,604	43,058	49,546	115.1%
Total Segment Adjusted EBITDA	$1,028,638	$873,472	$155,166	17.8%

Adjusted EBITDA from our Western U.S. Mining operations increased $14.0 million, or 3.1%, during 2006 primarily reflecting an increase in sales volumes of 12.7 million tons at our Powder River Basin operations, which resulted from continued strong demand and improved rail performance relative to 2005. Western U.S. Mining operations sales price per ton increased moderately due to mix changes resulting from ceasing operations at our Black Mesa and Seneca mines. Western U.S. Mining operations cost increases were driven by higher fuel costs, an increase in revenue-based royalties and production taxes, and the timing of major repairs. In addition, we experienced unfavorable geologic conditions and equipment issues related to the new longwall system at our Twentymile Mine; however, a recovery of certain costs associated with the equipment difficulties lessened the impact of these issues on our 2006 results. The Western U.S. Mining operations were also negatively impacted in 2006 by the cessation of operations at the Black Mesa mine in late 2005.

Eastern U.S. Mining operations' Adjusted EBITDA increased $15.8 million, or 9.3%, compared to 2005 primarily due to higher volumes and sales prices, partially offset by higher costs per ton due to fuel costs, revenue-based royalties and production taxes as well as higher costs associated with equipment and geologic issues. The 2006 results were also negatively impacted by lower revenues from synthetic fuel facilities of $10.1 million as customers idled their synthetic fuel plants.

Our Australian Mining operations' Adjusted EBITDA increased $75.8 million, or 37.4%, compared to 2005 primarily due to increased sales volumes following increased production from the second quarter installation of a new longwall system at our underground mine, higher metallurgical coal sales prices, and a $19.7 million contribution from our newly acquired mines.

Trading and Brokerage operations' Adjusted EBITDA increased $49.5 million from 2005, as 2006 results included proceeds from restructuring the brokerage contract mentioned above, improved brokerage margins and contributions from the newly established international trading operation, partially offset by lower U.S. trading results.

Income From Continuing Operations Before Income Taxes and Minority Interests

			Increase (Decrease) to Income	
(Dollars in thousands)	2006	2005	$	%
Total Segment Adjusted EBITDA	$1,028,638	$ 873,472	$155,166	17.8%
Corporate and Other Adjusted EBITDA	(127,682)	(165,623)	37,941	22.9%
Depreciation, depletion and amortization	(294,270)	(253,788)	(40,482)	(16.0%)
Asset retirement obligation expense	(15,830)	(20,329)	4,499	22.1%
Interest expense and early debt extinguishment costs	(139,064)	(98,066)	(40,998)	(41.8%)
Interest income	11,309	9,088	2,221	24.4%
Income from continuing operations before income taxes and minority interests	$ 463,101	$ 344,754	$118,347	34.3%

Income from continuing operations before income taxes and minority interests of $463.1 million for 2006 is $118.3 million, or 34.3%, higher than 2005 primarily due to improved segment Adjusted EBITDA as discussed above.

Corporate and Other Adjusted EBITDA results include selling and administrative expenses, equity income from our joint ventures, net gains on asset disposals or exchanges, costs associated with past mining obligations and revenues and expenses related to our other commercial activities such as coalbed methane, generation development, Btu Conversion and resource management. The $37.9 million improvement in Corporate and Other Adjusted EBITDA (net expense) in 2006 compared to 2005 includes the following:

- Higher gains on asset disposals and exchanges of $9.1 million. The 2006 activity included a $39.2 million gain on an exchange with the Bureau of Land Management of approximately 63 million tons of leased coal reserves at our Caballo mining operation for approximately 46 million tons of coal reserves contiguous with our North Antelope Rochelle mining operation and other gains on asset disposals totaling $14.3 million. In comparison, activity in 2005 included a $31.1 million gain from the sale of our remaining 0.838 million units of Penn Virginia Resource Partners, L.P., a $12.5 million gain from the sale of non-strategic coal reserves and properties, and other gains on asset disposals of $0.8 million;
- Higher equity income of $8.0 million from our 25.5% interest in Carbones del Guasare, which owns and operates the Paso Diablo Mine in Venezuela;
- Lower selling and administrative expenses of $4.6 million primarily associated with lower performance-based incentive costs, partially offset by increases to share-based compensation expense as a result of the new requirement to expense stock options, costs to support corporate and international growth initiatives and costs for the development and installation of a new enterprise resource planning system. The lower costs associated with the performance-based incentive plan related to a long-term, executive incentive plan that is driven by shareholder return and reflected lower stock price appreciation in 2006 than in 2005; and
- Lower net expenses of $4.7 million related to the development of the Prairie State Energy Campus due to a higher rate of cost reimbursement from the partners in 2006.

Depreciation, depletion and amortization increased $40.5 million in 2006 due to higher production volume, acquisitions and the impact of escalating capital costs and new capital, including two new longwall installations and new mine development. Also, 2005 depreciation, depletion and amortization was net of amortization of acquired contract liabilities.

Interest expense and early debt extinguishment costs increased $41.0 million primarily due to approximately $1.8 billion of debt issued or assumed in the second half of 2006 as part of the Excel acquisition. See Liquidity and Capital Resources for more details of the debt issued.

Net Income

			Increase (Decrease) to Income	
(Dollars in thousands)	2006	2005	$	%
Income from continuing operations before income taxes and minority interests	$463,101	$344,754	$118,347	34.3%
Income tax benefit (provision)	90,084	(63,779)	153,863	241.2%
Minority interests	(611)	(2,472)	1,861	75.3%
Income from continuing operations	$552,574	$278,503	$274,071	98.4%
Income from discontinued operations	48,123	144,150	(96,027)	(66.6%)
Net income	$600,697	$422,653	$178,044	42.1%

Income from continuing operations increased $274.1 million in 2006 compared to 2005 due to the increase in income from continuing operations before income taxes and minority interests discussed above and an income tax benefit compared to an income tax provision in 2005. The income tax benefit for the year ended 2006 related primarily to a reduction in tax reserves no longer required due to the finalization of various federal and state returns and expiration of applicable statute of limitations, and a reduction in a portion of the valuation allowance related to net operating loss (NOL) carry-forwards. The reduction to the valuation allowance resulted from an increase to estimated future taxable income primarily resulting from long-term contracts signed in late 2006 which increased our ability to realize these benefits in the future. Minority interests increased primarily as a result of acquiring an additional interest in a joint venture near the end of the first quarter of 2006.

OUTLOOK

Events Impacting Near-Term Operations

Global coal markets continued to grow, driven by increased demand from growing and developing economies. The U.S. economy grew 2.2% for 2007 as reported by the U.S. Commerce Department, while China's economy grew 11.4% in 2007 as published by the National Bureau of Statistics of China.

Growing constraints of global coal supplies ignited U.S. coal export interests beginning in the third quarter of 2007. By the start of 2008, global supply challenges became even greater. Flooding in Queensland, Australia in early 2008 is estimated to reduce seaborne coal supplies by more than 10 million metric tons; China issued a temporary moratorium on 2008 coal exports to secure supply for domestic needs, and South Africa temporarily shutdown coal production destined for export markets to conserve energy while reestablishing sufficient domestic coal supply. As a result, U.S. coal products are realizing expanded market reach resulting in higher published prices for all products. We expect to capitalize on the strong global markets primarily through production and sales of metallurgical and thermal coal from our Australian operations as well as through our U.S. and international coal trading activities.

In Australia, we anticipate selling 23 to 25 million tons in 2008, as much as 17% higher than 2007's level. Of our anticipated shipments, we have nine to 10 million tons of coal production available to be priced in 2008, approximately two-thirds of which is metallurgical coal. Our 2008 results will be affected by the final Australian coal price settlements. Our two primary shipping points, Dalrymple Bay Coal Terminal and Port of Newcastle, continue to experience lengthy vessel queues, extreme weather conditions impacting operations and the coal logistics chain, and transportation challenges, which could result in delayed shipments and demurrage charges.

In the U.S., we anticipate higher volumes in 2008 versus 2007 from all the coal basins where we operate. Approximately 97% of our higher 2008 volumes are committed to existing customer contracts. In addition, the higher 2008 volume includes the mid-year startup of a new mine in the Southwestern U.S. Our 2008 results will be impacted to the extent we complete ramp-up activities on time and at expected capacity. Although we currently expect to increase our shipment levels, our ability to reach targeted volumes is dependent upon the performance of the rail carriers.

We expect strong improvements in U.S. and Australia operating results from higher prices and increased volumes, partly offset by some of the factors discussed above and escalation of key supply costs including approximately $150 million in higher energy-related expenses and the effects of exchange rates.

Long-term Outlook

Our outlook for the coal markets remains positive. We believe strong coal markets will continue worldwide, as long as growth continues in the U.S., Asia and other industrialized economies that are increasing coal demand for electricity generation and steelmaking. More than 100 gigawatts of new coal-fueled electricity generating capacity is scheduled to come on line around the world between 2008 and 2010, and the EIA projects an additional 130 gigawatts of new U.S. coal-fueled generation by 2030, including 9 gigawatts at coal-to-liquids plants and 45 gigawatts at integrated gasification combined-cycle plants, which represents more than 500 million tons of additional coal demand.

Coal-to-gas (CTG) and coal-to-liquids (CTL) plants represent a significant avenue for long-term industry growth. The EIA continues to project an increase in demand for unconventional sources of transportation fuel, including CTL, and in the U.S. CTL technologies are receiving U.S. support from both political parties. China and India are developing CTG and CTL facilities.

Demand for Powder River Basin coal remains strong, particularly for our ultra-low sulfur products. The Powder River Basin represents more than half of our production. We control approximately 3.3 billion tons of proven and probable reserves in the Southern Powder River Basin, and we sold 139.8 million tons of coal from this region during 2007.

We are targeting 2008 production of 220 to 240 million tons and total sales volume of 240 to 260 million tons, both of which include 23 to 25 million tons from Australia. As of December 31, 2007, our unpriced volumes for 2008 planned production included nine to 10 million Australian tons, two-thirds of which is metallurgical coal, and five to seven million U.S. tons. Unpriced volumes for 2009 include 17 to 20 million Australian tons, approximately half of which is metallurgical coal, and 80 to 90 million U.S. tons.

Management plans to aggressively control costs and operating performance to mitigate external cost pressures, geologic conditions and potentially adverse port and rail performance. We are experiencing increases in operating costs related to fuel, explosives, steel, tires, contract mining and healthcare, and have taken measures to mitigate the increases in these costs, including a company-wide initiative to instill best practices at all operations. In addition, historically low long-term interest rates also have a negative impact on expenses related to our actuarially determined, employee-related liabilities. We may also encounter poor geologic conditions, lower third-party contract miner or brokerage source performance or unforeseen equipment problems that limit our ability to produce at forecasted levels. To the extent upward pressure on costs exceeds our ability to realize sales increases, or if we experience unanticipated operating or transportation difficulties, our operating margins would be negatively impacted. See "Cautionary Notice Regarding Forward-Looking Statements" and Item 1A. Risk Factors for additional considerations regarding our outlook.

Global climate change continues to attract considerable public and scientific attention. Enactment of laws and passage of regulations regarding greenhouse gas emissions by the United States or some of its states or by other countries, or other actions to limit carbon dioxide emissions, could result in electric generators switching from coal to other fuel sources. We continue to support clean coal technology development and voluntary initiatives addressing global climate change through our participation as a founding member of the FutureGen Alliance, through our commitment to the Australian COAL21 Fund, and through our participation in the Power Systems Development Facility, the PowerTree Carbon Company LLC, and the Asia-Pacific Partnership for Clean Development and Climate. In addition, we are the only non-Chinese equity partner in GreenGen, the first near-zero emissions coal-fueled power plant with carbon capture and storage (CCS) which is under development in China.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

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

Employee-Related Liabilities

We have significant long-term liabilities for our employees' postretirement benefit costs and defined benefit pension plans. Detailed information related to these liabilities is included in Notes 15 and 16 to our consolidated financial statements. The adoption of SFAS No. 158 on December 31, 2006 resulted in each of these liabilities recorded on the consolidated balance sheet as of December 31, 2006 being equal to the actuarially-determined funded status of the plans. Liabilities for postretirement benefit costs and workers' compensation obligations are not funded. Our pension obligations are funded in accordance with the provisions of federal law. Expense for the year ended December 31, 2007 for the pension and postretirement liabilities totaled $102.2 million, while payments were $71.6 million.

Each of these liabilities are actuarially determined and we use various actuarial assumptions, including the discount rate and future cost trends, to estimate the costs and obligations for these items. Our discount rate is determined by utilizing a hypothetical bond portfolio model which approximates the future cash flows necessary to service our liabilities.

We make assumptions related to future trends for medical care costs in the estimates of retiree health care and work-related injuries and illnesses obligations. Our medical trend assumption is developed by annually examining the historical trend of our cost per claim data. In addition, we make assumptions related to future compensation increases and rates of return on plan assets in the estimates of pension obligations.

If our assumptions do not materialize as expected, actual cash expenditures and costs that we incur could differ materially from our current estimates. Moreover, regulatory changes could increase our obligation to satisfy these or additional obligations. Our most significant employee liability is postretirement health care, and assumed discount rates and health care cost trend rates have a significant effect on the expense and liability amounts reported for health care plans. Below we have provided two separate sensitivity analyses to demonstrate the significance of these assumptions in relation to reported amounts.

(Dollars in thousands)	One Percentage-Point Increase	One Percentage-Point Decrease
Healthcare cost trend rate:		
Effect on total service and interest cost components [1]	$ 11,202	$ (9,580)
Effect on total postretirement benefit obligation [1]	$ 81,535	$(70,842)

(Dollars in thousands)	One-Half Percentage-Point Increase	One-Half Percentage-Point Decrease
Discount rate:		
Effect on total service and interest cost components [1]	$ 1,076	$ (1,913)
Effect on total postretirement benefit obligation [1]	$(35,166)	$ 41,399

[1] *In addition to the effect on total service and interest cost components of expense, changes in trend and discount rates would also increase or decrease the actuarial gain or loss amortization expense component. The gain or loss amortization would approximate the increase or decrease in the obligation divided by 8.92 years at December 31, 2007.*

Asset Retirement Obligations

Our asset retirement obligations primarily consist of spending estimates for surface land reclamation and support facilities at both surface and underground mines in accordance with federal and state reclamation laws as defined by each mining permit. Asset retirement obligations are determined for each mine using various estimates and assumptions including, among other items, estimates of disturbed acreage as determined from engineering data, estimates of future costs to reclaim the disturbed acreage, the timing of these cash flows, and a credit-adjusted, risk-free rate. As changes in estimates occur (such as mine plan revisions, changes in estimated costs, or changes in timing of the reclamation activities), the obligation and asset are revised to reflect the new estimate after applying the appropriate credit-adjusted, risk-free rate. If our assumptions do not materialize as expected, actual cash expenditures and costs that we incur could be materially different than currently estimated. Moreover, regulatory changes could increase our obligation to perform reclamation and mine closing activities. Asset retirement obligation expense for the year ended December 31, 2007, was $25.6 million, and payments totaled $10.2 million. See detailed information regarding our asset retirement obligations in Note 14 to our consolidated financial statements.

Income Taxes

We account for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes" (SFAS No. 109), which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. SFAS No. 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized. In our annual evaluation of the need for a valuation allowance, we take into account various factors, including the expected level of future taxable income and available tax planning strategies. If actual results differ from the assumptions made in our annual evaluation of our valuation allowance, we may record a change in valuation allowance through income tax expense in the period such determination is made.

We establish reserves for tax contingencies when, despite the belief that our tax return positions are fully supported, certain positions are likely to be challenged and may not be fully sustained. The tax contingency reserves are analyzed on a quarterly basis and adjusted based upon changes in facts and circumstances, such as the progress of federal and state audits, case law and emerging legislation. Our effective tax rate includes the impact of tax contingency reserves and changes to the reserves, including related interest. We establish the reserves based upon management's assessment of exposure associated with permanent tax differences (i.e. tax depletion expense, etc.) and certain tax sharing agreements. We are subject to federal audits for several open years due to our previous inclusion in multiple consolidated groups and the various parties involved in finalizing those years. Additional details regarding the effect of income taxes on our consolidated financial statements is available in Note 12.

Interpretation No. 48 "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" (FIN No. 48) prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. We adopted this interpretation effective January 1, 2007.

Revenue Recognition

In general, we recognize revenues when they are realizable and earned. We generated 95% of our revenue in 2007 from the sale of coal to our customers. Revenue from coal sales is realized and earned when risk of loss passes to the customer. Coal sales are made to our customers under the terms of coal supply agreements, most of which are long-term (greater than one year). Under the typical terms of these coal supply agreements, title and risk of loss transfer to the customer at the mine or port, where coal is loaded to the rail, barge, ocean-going vessel, truck or other transportation source(s) that delivers coal to its destination.

With respect to other revenues, other operating income, or gains on asset sales recognized in situations unrelated to the shipment of coal, we carefully review the facts and circumstances of each transaction and apply the relevant accounting literature as appropriate, and do not recognize revenue until the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred or services have been rendered; the seller's price to the buyer is fixed or determinable; and collectibility is reasonably assured.

Trading Activities

We engage in the buying and selling of coal, freight and emissions allowances, both in over-the-counter markets and on exchanges. Our coal trading contracts are accounted for on a fair value basis under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." To establish fair values for our trading contracts, we use bid/ask price quotations obtained from multiple, independent third-party brokers to value coal, freight and emission allowance positions from the over-the-counter market. Prices from these sources are then averaged to obtain trading position values. We could experience difficulty in valuing our market positions if the number of third-party brokers should decrease or market liquidity is reduced. Published settlement prices are used to value our exchange-based positions.

As of December 31, 2007, 97% of the contracts in our trading portfolio were valued utilizing prices from over-the-counter market sources, adjusted for coal quality and traded transportation differentials. As of December 31, 2007, 58% of the estimated future value of our trading portfolio was scheduled to be realized by the end of 2008 and 99% within 24 months. See Note 6 to our consolidated financial statements for additional details regarding assets and liabilities from our coal trading activities.

Exploration and Drilling Costs

Exploration expenditures are charged to operating costs as incurred, including costs related to drilling and study costs incurred to convert or upgrade mineral resources to reserves.

Advance Stripping Costs

Pre-production: At existing surface operations, additional pits may be added to increase production capacity in order to meet customer requirements. These expansions may require significant capital to purchase additional equipment, expand the workforce, build or improve existing haul roads and create the initial pre-production box cut to remove overburden (i.e., advance stripping costs) for new pits at existing operations. If these pits operate in a separate and distinct area of the mine, the costs associated with initially uncovering coal (i.e., advance stripping costs incurred for the initial box cuts) for production are capitalized and amortized over the life of the developed pit consistent with coal industry practices.

Post-production: Advance stripping costs related to post-production are expensed as incurred. Where new pits are routinely developed as part of a contiguous mining sequence, we expense such costs as incurred. The development of a contiguous pit typically reflects the planned progression of an existing pit, thus maintaining production levels from the same mining area utilizing the same employee group and equipment.

Business Combinations

We account for our business acquisitions under the purchase method of accounting consistent with the requirements of SFAS No. 141, "Business Combinations." The total cost of acquisitions is allocated to the underlying identifiable net assets, based on their respective estimated fair values. Determining the fair value of assets acquired and liabilities assumed requires management's judgment, and the utilization of independent valuation experts, and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, asset lives, and market multiples, among other items.

Share-Based Compensation

We account for share-based compensation in accordance with the fair value recognition provisions of SFAS No. 123 (Revised 2004), "Share-Based Payment" (SFAS 123(R)), which we adopted using the modified prospective option on January 1, 2006. Under SFAS No. 123(R), share-based compensation expense is generally measured at the grant date and recognized as expense over the vesting period of the award. We utilize restricted stock, nonqualified stock options, performance units, and an employee stock purchase plan as part of our share-based compensation program. Determining fair value requires us to make a number of assumptions, including items such as expected term, risk-free rate and expected volatility. The assumptions used in calculating the fair value of share-based awards represent our best estimates, but these estimates involve inherent uncertainties and the application of management judgment. Although we believe the assumptions and estimates we have made are reasonable and appropriate, changes in assumptions could materially impact our reported financial results.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of cash include sales of our coal production to customers, cash generated from our trading and brokerage activities, sales of non-core assets and financing transactions, including sales of our accounts receivable through our securitization program. Our primary uses of cash include our cash costs of coal production, capital expenditures, interest costs and costs related to past mining obligations as well as planned acquisitions. Our ability to pay dividends, service our debt (interest and principal) and acquire new productive assets or businesses is dependent upon our ability to continue to generate cash from the primary sources noted above in excess of the primary uses. Future dividends, among other things, are subject to limitations imposed by our Senior Notes and Debenture covenants. We expect to fund all of our capital expenditure requirements with cash generated from operations.

Net cash provided by operating activities from continuing operations was $447.2 million for the year ended December 31, 2007, a decrease of $144.2 million compared to $591.4 million provided by operating activities from continuing operations in the prior year. The decrease was primarily related to lower profitability from our operations. Net cash used in operating activities of discontinued operations of $130.8 million was primarily used to fund the region's net operating loss and for cash costs of the spin-off.

Net cash used in investing activities from continuing operations was $541.7 million for the year ended December 31, 2007 compared to $2.06 billion used in the prior year. The decrease was primarily related to the acquisition of Excel of $1.51 billion, net of cash acquired, in 2006 and higher proceeds of $90.2 million from disposals of assets in 2007. Partially offsetting these items was higher capital spending of $72.9 million. Capital expenditures in 2007 included mine development at our recently acquired Australian mines, the completion of an in–pit conveyor system, and coal blending and loadout facility at one of our Western U.S. mines and the purchase of coal reserves and surface lands in the Illinois Basin. Net cash used in investing activities of discontinued operations was $33.6 million and was used for pre-spin capital costs for Patriot.

Net cash provided by financing activities from continuing operations was $44.8 million during the year ended December 31, 2007, compared to $1.41 billion provided in 2006. During 2007, we repaid $37.9 million of our Term Loan and purchased in the open market $13.8 million face value of our 5.875% Senior Notes due 2016. We also made the final principal payment of $59.5 million on our 5% Subordinated Note. Our Revolving Credit Facility balance increased to $97.7 million as it was utilized to fund cash contributions to Patriot at the spin-off. In 2006, we issued net borrowings of $1.74 billion, which we utilized to fund the $1.51 billion Excel acquisition, the repayment of Excel's bank facility and a portion of its outstanding bonds, and other corporate purposes. The net issuance of debt related to the Excel acquisition was partially offset in 2006 by repurchases of $7.7 million of our 5.875% Senior Notes in the open market, scheduled debt repayments of $11.1 million on our 5% Subordinated Note and other notes payable, and $99.8 million for the repurchase of common stock. Net cash used in financing activities of discontinued operations of $67.0 million was primarily cash provided to Patriot at spin-off to fund their working capital needs.

Our total indebtedness as of December 31, 2007 and 2006 consisted of the following:

(Dollars in thousands)	2007	2006
Term Loan under Senior Unsecured Credit Facility	$ 509,084	$ 547,000
Revolving Credit Facility	97,700	–
Convertible Junior Subordinated Debentures due 2066	732,500	732,500
7.375% Senior Notes due 2016	650,000	650,000
6.875% Senior Notes due 2013	650,000	650,000
7.875% Senior Notes due 2026	246,965	246,897
5.875% Senior Notes due 2016	218,090	231,845
5.0% Subordinated Note	–	59,504
6.84% Series C Bonds due 2016	43,000	43,000
6.34% Series B Bonds due 2014	21,000	21,000
6.84% Series A Bonds due 2014	10,000	10,000
Capital lease obligations	92,186	96,869
Fair value of interest rate swaps	1,604	(13,784)
Other	971	2,201
Total	$3,273,100	$3,277,032

Senior Unsecured Credit Facility

In September 2006, we entered into a Third Amended and Restated Credit Agreement, which established a $2.75 billion Senior Unsecured Credit Facility and which amended and restated in full our then existing $1.35 billion Senior Secured Credit Facility. The Senior Unsecured Credit Facility provides a $1.8 billion Revolving Credit Facility and a $950.0 million Term Loan Facility. The Revolving Credit Facility is intended to accommodate working capital needs, letters of credit, the funding of capital expenditures and other general corporate purposes. The Revolving Credit Facility also includes a $50.0 million sub-facility available for same-day swingline loan borrowings.

The Term Loan Facility, which was fully drawn in October 2006 in connection with the Excel acquisition was paid down in December 2006 ($403.0 million), from a portion of the net proceeds from the Debentures. In conjunction with the establishment of the Senior Unsecured Credit Facility, we incurred $8.6 million in financing costs, of which $5.6 million related to the Revolving Credit Facility and $3.0 million related to the Term Loan Facility. These debt issuance costs will be amortized to interest expense over five years, the term of the Senior Unsecured Credit Facility.

Loans under the facility are available in U.S. dollars, with a sub-facility under the Revolving Credit Facility available in Australian dollars, pounds sterling and Euros. Letters of credit under the Revolving Credit Facility are available to us in U.S. dollars with a sub-facility available in Australian dollars, pounds sterling and Euros. The interest rate payable on the Revolving Credit Facility and the Term Loan Facility under the Senior Unsecured Credit Facility is based on a pricing grid tied to our leverage ratio, as defined in the Third Amended and Restated Credit Agreement. Currently, the interest rate payable on the Revolving Credit Facility and the Term Loan Facility is LIBOR plus 0.75%, which at December 31, 2007 was 5.4%.

Under the Senior Unsecured Credit Facility, we must comply with certain financial covenants on a quarterly basis including a minimum interest coverage ratio and a maximum leverage ratio, as defined in the Third Amended and Restated Credit Agreement. The financial covenants also place limitations on our investments in joint ventures, unrestricted subsidiaries, indebtedness of non-loan parties, and the imposition of liens on our assets. The new facility is less restrictive with respect to limitations on our dividend payments, capital expenditures, asset sales or stock repurchases. The Senior Unsecured Credit Facility matures on September 15, 2011.

As of December 31, 2007, we had $97.7 million borrowings and $413.5 million letters of credit outstanding under our Revolving Credit Facility. Our Revolving Credit Facility is primarily used for standby letters of credit and short-term working capital needs. The remaining available borrowing capacity ($1.29 billion as of December 31, 2007) can be used to fund strategic acquisitions or meet other financing needs, including additional standby letters of credit. We were in compliance with all of the covenants of the Senior Unsecured Credit Facility, the 6.875% Senior Notes, the 5.875% Senior Notes, the 7.375% Senior Notes, the 7.875% Senior Notes and the Convertible Junior Subordinated Debentures as of December 31, 2007.

Convertible Junior Subordinated Debentures

On December 20, 2006, we issued $732.5 million aggregate principal amount of 4.75% Convertible Junior Subordinated Debentures due 2066 (the Debentures). Net proceeds from the offering, after deducting underwriting discounts and offering expenses, were $715.0 million and were used to repay indebtedness under our Senior Unsecured Credit Facility. The Debentures pay interest semiannually at a rate of 4.75% per year. We may elect to, and if and to the extent that a mandatory trigger event (as defined in the indenture governing the Debentures) has occurred and is continuing will be required to, defer interest payments on the Debentures. After five years of deferral at our option, or upon the occurrence of a mandatory trigger event, we generally must sell warrants or preferred stock with specified characteristics and use the funds from that sale to pay deferred interest, subject to certain limitations. In no event may we defer payments of interest on the Debentures for more than 10 years.

The Debentures are convertible at any time on or prior to December 15, 2036 if any of the following conditions occur: (i) our closing common stock price exceeds 140% of the then applicable conversion price for the Debentures (currently $81.83 per share) for at least 20 of the final 30 trading days in any quarter; (ii) a notice of redemption is issued with respect to the Debentures; (iii) a change of control, as defined in the indenture governing the Debentures; (iv) satisfaction of certain trading price conditions; and (v) other specified corporate transactions described in the indenture governing the Debentures. In addition, the Debentures are convertible at any time after December 15, 2036 to December 15, 2041, the scheduled maturity date. In the case of conversion following a notice of redemption or upon a non-stock change of control, as defined in the indenture governing the Debentures, holders may convert their Debentures into cash in the amount of the principal amount of their Debentures and shares of our common stock for any conversion value in excess of the principal amount. In all other conversion circumstances, holders will receive perpetual preferred stock (see Note 17 to our consolidated financial statements) with a liquidation preference equal to the principal amount of their Debentures, and any conversion value in excess of the principal amount will be settled with our common stock. As a result of the Patriot spin-off, the conversion rate was adjusted to 17.1078 shares of common stock per $1,000 principal amount of Debentures effective November 23, 2007. This adjusted conversion rate represents a conversion price of approximately $58.45.

The Debentures are unsecured obligations, ranking junior to all existing and future senior and subordinated debt (excluding trade accounts payable or accrued liabilities arising in the ordinary course of business) except for any future debt that ranks equal to or junior to the Debentures. The Debentures will rank equal in right of payment with our obligations to trade creditors. Substantially, all of our existing indebtedness is senior to the Debentures. In addition, the Debentures will be effectively subordinated to all indebtedness of our subsidiaries. The indenture governing the Debentures places no limitation on the amount of additional indebtedness that we or any of our subsidiaries may incur (see Note 13 to our consolidated financial statements for additional information on the Debentures).

7.375% Senior Notes Due November 2016 and 7.875% Senior Notes Due November 2026

On October 12, 2006, we completed a $650.0 million offering of 7.375% 10-year Senior Notes due 2016 and $250 million of 7.875% 20-year Senior Notes due 2026. The notes are general unsecured obligations and rank senior in right of payment to any subordinated indebtedness; equally in right of payment with any senior indebtedness; effectively junior in right of payment to our existing and future secured indebtedness, to the extent of the value of the collateral securing that indebtedness; and effectively junior to all the indebtedness and other liabilities of our subsidiaries that do not guarantee the notes. Interest payments are scheduled to occur on May 1 and November 1 of each year, and commenced on May 1, 2007.

The notes are guaranteed by our Subsidiary Guarantors, as defined in the note indenture. The note indenture contains covenants that, among other things, limit our ability to create liens and enter into sale and lease-back transactions. The notes are redeemable at a redemption price equal to 100% of the principal amount of the notes being redeemed plus a make-whole premium, if applicable, and any accrued unpaid interest to the redemption date. Net proceeds from the offering, after deducting underwriting discounts and expenses, were $886.1 million.

6.875% Senior Notes Due March 2013

On March 21, 2003, we issued $650.0 million of 6.875% Senior Notes due March 2013. The notes are senior unsecured obligations and rank equally with all of our other senior unsecured indebtedness. Interest payments are scheduled to occur on March 15 and September 15 of each year. The notes are guaranteed by our Subsidiary Guarantors as defined in the note indenture. The note indenture contains covenants which, among other things, limit our ability to incur additional indebtedness and issue preferred stock, pay dividends or make other distributions, make other restricted payments and investments, create liens, sell assets and merge or consolidate with other entities. The notes are redeemable prior to March 15, 2008, at a redemption price equal to 100% of the principal amount plus a make-whole premium (as defined in the indenture) and on or after March 15, 2008, at fixed redemption prices as set forth in the indenture.

5.875% Senior Notes Due March 2016

On March 23, 2004, we completed an offering of $250.0 million of 5.875% Senior Notes due March 2016. The notes are senior unsecured obligations and rank equally with all of our other senior unsecured indebtedness. Interest payments are scheduled to occur on April 15 and October 15 of each year, and commenced on April 15, 2004. The notes are guaranteed by our Subsidiary Guarantors as defined in the note indenture. The note indenture contains covenants which, among other things, limit our ability to incur additional indebtedness and issue preferred stock, pay dividends or make other distributions, make other restricted payments and investments, create liens, sell assets and merge or consolidate with other entities. The notes are redeemable prior to April 15, 2009, at a redemption price equal to 100% of the principal amount plus a make-whole premium (as defined in the indenture) and on or after April 15, 2009, at fixed redemption prices as set forth in the indenture. Net proceeds from the offering, after deducting underwriting discounts and expenses, were $244.7 million.

Series Bonds

As of December 31, 2007, we had $74.0 million in Series Bonds outstanding, which were assumed as part of the Excel acquisition. The 6.84% Series A Bonds have a balloon maturity in December 2014. The 6.34% Series B Bonds mature in December 2014 and are payable in installments beginning December 2008. The 6.84% Series C Bonds mature in December 2016 and are payable in installments beginning December 2012. Interest payments are scheduled to occur in June and December of each year.

Interest Rate Swaps

As of December 31, 2007, we had entered into a series of fixed-to-floating interest rate swaps with a notional principal amount of $120.0 million. Under the terms of these swaps we receive a fixed rate of 6.875% and pay a weighted average floating rate of LIBOR plus 2.0%, which resets each March 15, June 15, September 15 and December 15. The swaps have been designated as a hedge of the changes in the fair value of the 6.875% Senior Notes due 2013.

We have also entered into another series of fixed-to-floating interest rate swaps with a notional principal amount of $100.0 million. Under the terms of these swaps we receive a fixed rate of 5.875% and pay a weighted average floating rate of LIBOR plus 0.25%, which resets each April 15 and October 15. This series of swaps has been designated as a hedge of the changes in the fair value of the 5.875% Senior Notes due 2016.

In conjunction with the Term Loan Facility, we have a floating-to-fixed interest rate swap in place for a notional principal amount of $120.0 million. Under the terms of this swap we receive a floating rate of LIBOR plus 1.0% and pay a fixed rate of 6.25%. This interest rate swap was designated as a hedge of the variable interest payments on the Term Loan under the Senior Unsecured Credit Facility.

Because the critical terms of the swaps and the respective debt instruments they hedge coincide, there was no hedge ineffectiveness recognized in the consolidated statements of operations during the years ended December 31, 2007 and 2006. At December 31, 2007 and 2006 there was an unrealized loss related to the cash flow hedge of $6.8 million and $2.5 million, respectively. At December 31, 2007, there was a net unrealized gain on the fair value hedges of $1.6 million. At December 31, 2006, the net unrealized loss on the fair value hedges was $13.8 million. The fair value hedge is reflected as an adjustment to the carrying value of the Senior Notes (see table above).

Third-party Security Ratings

The ratings for our Senior Unsecured Credit Facility and our Senior Unsecured Notes are as follows: Moody's has issued a Ba1 rating, Standard & Poor's a BB rating and Fitch has issued a BB+ rating. The ratings on our Convertible Junior Subordinated Debentures are as follows: Moody's has issued a Ba3 rating, Standard & Poor's a B rating and Fitch has issued a BB- rating. These security ratings reflected the views of the rating agency only. An explanation of the significance of these ratings may be obtained from the rating agency. Such ratings are not a recommendation to buy, sell or hold securities, but rather an indication of creditworthiness. Any rating can be revised upward or downward or withdrawn at any time by a rating agency if it decides that the circumstances warrant the change. Each rating should be evaluated independently of any other rating.

Shelf Registration Statement

On July 28, 2006, we filed an automatic shelf registration statement on Form S-3 as a well-known seasoned issuer with the SEC. The registration was for an indeterminate number of securities and is effective for three years, at which time we can file an automatic shelf registration statement that would become immediately effective for another three-year term. Under this universal shelf registration statement, we have the capacity to offer and sell from time to time securities, including common stock, preferred stock, debt securities, warrants and units. The Debentures, 7.375% Senior Notes due 2016 and 7.875% Senior Notes due 2026 were issued pursuant to the shelf registration statement.

Excel Transaction

In October 2006, we acquired Excel Coal Limited (Excel) for US$1.54 billion in cash plus assumed debt of US$293.0 million, less US$30.0 million of cash acquired in the transaction. This acquisition was financed with borrowings under our Senior Unsecured Credit Facility and Senior Notes due 2016 and 2026 (see Note 13 of our consolidated financial statements for additional information on the financing of the Excel acquisition). The Excel acquisition included three operating mines and three development-stage mines (all of which are operating as of December 31, 2007), with up to 500 million tons of proven and probable coal reserves. The results of operations of Excel are included in our Australian Mining Operations segment from October 2006. The acquisition was accounted for as a purchase in accordance with SFAS No. 141, "Business Combinations" (see Note 5 of our consolidated financial statements for additional information on the Excel acquisition).

CONTRACTUAL OBLIGATIONS

The following is a summary of our contractual obligations as of December 31, 2007:

		Payments Due By Year			
(Dollars in thousands)	Total	Less Than 1 Year	2 - 3 Years	4 - 5 Years	More Than 5 Years
Long-term debt obligations (principal and interest)	$5,781,312	$344,324	$471,852	$ 825,632	$4,139,504
Capital lease obligations (principal and interest)	116,861	17,349	34,258	30,234	35,020
Operating lease obligations	359,045	85,356	120,218	71,759	81,712
Unconditional purchase obligations [(1)]	168,923	168,923	–	–	–
Coal reserve lease and royalty obligations	383,416	187,946	139,564	12,777	43,129
Other long-term liabilities [(2)]	1,302,039	112,418	215,443	210,275	763,903
Total contractual cash obligations	$8,111,596	$916,316	$981,335	$1,150,677	$5,063,268

(1) We have purchase agreements with approved vendors for most types of operating expenses. However, our specific open purchase orders (which have not been recognized as a liability) under these purchase agreements, combined with any other open purchase orders, are not material. The commitments in the table above relate to significant capital purchases.

(2) Represents long-term liabilities relating to our postretirement benefit plans, work-related injuries and illnesses, defined benefit pension plans and mine reclamation and end of mine closure costs.

As of December 31, 2007, we had $67.8 million of purchase obligations for capital expenditures and $301.6 million of obligations related to federal coal reserve lease payments due over the next three years. Total capital expenditures for 2008 are expected to range from $350 million to $400 million, excluding federal coal reserve lease payments, and relate to replacement, improvement, or expansion of existing mines, particularly in Australia, the El Segundo mine development in New Mexico, and growth initiatives such as increasing capacity in the Powder River Basin. Capital expenditures were funded primarily through operating cash flow.

Our subsidiary, Peabody Pacific, has committed to pay up to a maximum of A$0.20/tonne (approximately US$0.15/tonne) of coal sales for a period of five years to the Australian COAL21 Fund. The COAL21 Fund is a voluntary coal industry fund to support clean coal technology demonstration projects and research in Australia. All major coal companies in Australia have committed to this fund. The commitment to pay started on April 1, 2007 with a levy of A$0.10/tonne of coal sales. This levy rose to A$0.20/tonne on July 1, 2007.

We do not expect any of the $152.6 million of gross unrecognized tax benefits reported in our consolidated financial statements to require cash settlement within the next year. Beyond that, we are unable to make reasonably reliable estimates of periodic cash settlements with respect to such unrecognized tax benefits.

OFF-BALANCE SHEET ARRANGEMENTS

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

We use a combination of surety bonds, corporate guarantees (i.e. self bonds) and letters of credit to secure our financial obligations for reclamation, workers' compensation, postretirement benefits and coal lease obligations as follows as of December 31, 2007:

(Dollars in millions)	Reclamation Obligations	Lease Obligations	Workers' Compensation Obligations	Retiree Healthcare Obligations	Other [(1)]	Total
Self Bonding	$ 640.6	$ –	$ –	$ –	$ –	$ 640.6
Surety Bonds	418.3	73.0	31.2	–	16.7	539.2
Letters of Credit	1.6	–	102.7	41.4	267.9	413.6
	$1,060.5	$73.0	$133.9	$41.4	$284.6	$1,593.4

(1) Includes financial guarantees primarily related to joint venture debt, the Pension Benefit Guarantee Corporation and collateral for surety companies.

As part of arrangements through which we obtain exclusive sales representation agreements with small coal mining companies (the Counterparties), we issued financial guarantees on behalf of the Counterparties. These guarantees facilitate the Counterparties' efforts to obtain bonding or financing. In 2007, we purchased approximately 345 million tons of coal reserves and surface lands in the Illinois Basin. In conjunction with this purchase, we agreed to provide up to $64.8 million of reclamation and bonding commitments to a third-party coal company. We have recognized the full amount of these commitments as a liability as of December 31, 2007. The non-cash portion of this transaction was excluded from the investing section of the statement of cash flows.

In the event of default, the terms of our guarantees provide for multiple recourse options, including the ability to assume the loans and procure title and use of the equipment purchased through the loans. If default occurs, we have the ability and intent to exercise our recourse options, so the liability associated with the guarantee has been valued at zero. The aggregate amount guaranteed for all such Counterparties was $8.8 million at December 31, 2007. See Note 20 to our consolidated financial statements included in this report for a discussion of our guarantees.

As part of the Patriot spin-off, we agreed to maintain in force several letters of credit that secured Patriot obligations for certain employee benefits and workers' compensation obligations. These letters of credit are to be released upon Patriot satisfying the beneficiaries with alternate letters of credit or insurance, which is expected to occur in 2008. If Patriot is unable to satisfy the primary beneficiaries by June 30, 2011, they are then required to provide directly to us a letter of credit in the amount of the remaining obligation. As of December 31, 2007, the amount of letters of credit securing Patriot obligations was $136.8 million.

Under our accounts receivable securitization program, undivided interests in a pool of eligible trade receivables contributed to our wholly-owned, bankruptcy-remote subsidiary are sold, without recourse, to a multi seller, asset backed commercial paper conduit (Conduit). Purchases by the Conduit are financed with the sale of highly rated commercial paper. We utilize proceeds from the sale of our accounts receivable as an alternative to other forms of debt, effectively reducing our overall borrowing costs. The funding cost of the securitization program was $11.2 million and $1.9 million for the years ended December 31, 2007 and 2006, respectively. The securitization program is scheduled to expire in September 2009. The securitization transactions have been recorded as sales, with those accounts receivable sold to the Conduit removed from the consolidated balance sheets. The amount of undivided interests in accounts receivable sold to the Conduit was $275.0 million and $219.2 million as of December 31, 2007 and 2006, respectively (see Note 7 to our consolidated financial statements for additional information on accounts receivable securitization).

The following is a summary of specified types of commercial commitments available to us as of December 31, 2007:

		Expiration Per Year			
(Dollars in thousands)	Total Amounts Committed	Within 1 Year	2 - 3 Years	4 - 5 Years	Over 5 Years
Lines of credit and / or standby letters of credit	$1,800,000	$ –	$ –	$1,800,000	$ –

NEWLY ADOPTED ACCOUNTING PRONOUNCEMENTS

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

We adopted the provisions of FIN No. 48 on January 1, 2007, and as a result, reported $135.0 million of net unrecognized tax benefits ($144.0 million gross) in our consolidated financial statements. Due to the valuation allowance recorded against our deferred tax asset for NOL carryforwards as of January 1, 2007, none of the $135.0 million required an adjustment to retained earnings upon adoption.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS No. 158). For fiscal years ending after December 15, 2006, SFAS No. 158 required recognition of the funded status of pension and other postretirement benefit plans (an asset for overfunded status or a liability for underfunded status) in a company's balance sheet. In addition, the standard required recognition of actuarial gains and losses, prior service cost, and any remaining transition amounts from the initial application of SFAS No. 87, "Employers' Accounting for Pensions" (SFAS No. 87) and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (SFAS No. 106) when determining a plan's funded status, with a corresponding charge to accumulated other comprehensive income (loss).

We adopted SFAS No. 158 on December 31, 2006, and as a result, recorded a noncurrent liability of $376.1 million, which reflected the total underfunded status of the pension, retiree healthcare and workers' compensation plans. The funded status of each plan was measured as the difference between the fair value of the assets and the projected benefit obligation (the funded status). SFAS No. 158 did not impact net income.

ACCOUNTING PRONOUNCEMENTS NOT YET IMPLEMENTED

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, and therefore does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 (January 1, 2008 for the Company). In February 2008, the FASB amended SFAS No. 157 to exclude leasing transactions and to delay the effective date by one year for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. We are in the process of determining the effect, if any, the adoption of SFAS No. 157 will have on our financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115" (SFAS No. 159). SFAS No. 159 provides all entities with an option to report selected financial assets and liabilities at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 (January 1, 2008 for the Company). We are in the process of determining the effect, if any, the adoption of SFAS No. 159 will have on our financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51" (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for (1) noncontrolling interests in partially owned consolidated subsidiaries and (2) the loss of control of subsidiaries. SFAS No. 160 requires noncontrolling interests (minority interests) to be reported as a separate component of equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS No. 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 (January 1, 2009 for the Company). Early adoption is not allowed. We are in the process of determining the effect the adoption of SFAS No. 160 will have on our financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations," which replaces SFAS No. 141. SFAS No. 141(R) significantly changes the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. This statement also provides guidance for the recognition and measurement of goodwill acquired in a business combination and for determination of required disclosures that will enable users of the financial statements to evaluate the nature and financial effects of the business combination. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (January 1, 2009 for the Company). We are in the process of determining the effect, if any, the adoption of SFAS No. 141(R) will have on our financial statements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The potential for changes in the market value of our coal, freight and emissions allowance trading, fuel, explosives, interest rate and currency portfolios is referred to as "market risk." Market risk related to our coal, freight and emissions allowance trading portfolio is evaluated using a value at risk analysis (described below). Value at risk analysis is not used to evaluate our non-trading fuel, explosives, interest rate and currency portfolios. A description of each market risk category is set forth below. We attempt to manage market risks through diversification, controlling position sizes and executing hedging strategies. Due to lack of quoted market prices and the long-term, illiquid nature of the positions, we have not quantified market risk related to our non-trading, long-term coal supply agreement portfolio.

Coal Trading Activities and Related Commodity Price Risk

We engage in over-the-counter, exchange-based and direct trading of coal, freight and emission allowances (collectively coal trading). These activities give rise to commodity price risk, which represents the potential loss that can be caused by an adverse change in the market value of a particular commitment. We actively measure, monitor and adjust traded position levels to remain within risk limits prescribed by management. For example, we have policies in place that limit the amount of total exposure, in value at risk terms, that we may assume at any point in time.

We account for coal trading using the fair value method, which requires us to reflect financial instruments with third parties, such as forwards, options and swaps, at market value in our consolidated financial statements. Our trading portfolio included forwards and swaps as of December 31, 2007 and 2006.

We perform a value at risk analysis on our coal trading portfolio. The use of value at risk allows us to quantify in dollars, on a daily basis, the price risk inherent in our trading portfolio. Value at risk represents the potential loss in value of our mark-to-market portfolio due to adverse market movements over a defined time horizon (liquidation period) within a specified confidence level. Our value at risk model is based on the industry standard variance/co-variance approach. This captures our exposure related to both swaps and forward positions. Our value at risk model assumes 5 and 15 day holding periods as applicable and a 95% one-tailed confidence interval. This means that there is a one in 20 statistical chance that the portfolio would lose more than the value at risk estimates during the liquidation period.

The use of value at risk allows management to aggregate pricing risks across products in the portfolio, compare risk on a consistent basis and identify the drivers of risk. Due to the subjectivity in the choice of the liquidation period, reliance on historical data to calibrate the models and the inherent limitations in the value at risk methodology, we perform regular stress and scenario analysis to estimate the impacts of market changes on the value of the portfolio. Additionally, back-testing is regularly performed to monitor the effectiveness of our value at risk measure. The results of these analyses are used to supplement the value at risk methodology and identify additional market-related risks.

We use historical data to estimate our value at risk and to better reflect current asset and liability volatilities. Given our reliance on historical data, value at risk is effective in estimating risk exposures in markets in which there are not sudden fundamental changes or shifts in market conditions. An inherent limitation of value at risk is that past changes in market risk factors may not produce accurate predictions of future market risk. Value at risk should be evaluated in light of this limitation.

During the year ended December 31, 2007, the combined actual low, high, and average values at risk for our coal trading portfolio were $1.2 million, $13.7 million, and $6.8 million, respectively. Our value at risk increased over the prior year due to greater price volatility in the coal markets, particularly in the international markets into which we have recently expanded. As of December 31, 2007, the timing of the estimated future realization of the value of our trading portfolio was as follows:

Year of Expiration	Percentage of Portfolio
2008	58%
2009	41%
2010	0%
2011	1%
	100%

We also monitor other types of risk associated with our coal trading activities, including credit, market liquidity and counterparty nonperformance.

Credit Risk

Our concentration of credit risk is substantially with energy producers and marketers and electric utilities. Our policy is to independently evaluate each customer's creditworthiness prior to entering into transactions and to constantly monitor the credit extended. If we engage in a transaction with a counterparty that does not meet our credit standards, we will protect our position by requiring the counterparty to provide appropriate credit enhancement. In general, increases in coal price volatility and our own trading activity resulted in greater exposure to our coal-trading counterparties during the year. When appropriate (as determined by our credit management function), we have taken steps to reduce our credit exposure to customers or counterparties whose credit has deteriorated and who may pose a higher risk of failure to perform under their contractual obligations. These steps include obtaining letters of credit or cash collateral, requiring prepayments for shipments or the creation of customer trust accounts held for our benefit to serve as collateral in the event of a failure to pay. To reduce our credit exposure related to trading and brokerage activities, we seek to enter into netting agreements with counterparties that permit us to offset receivables and payables with such counterparties. Counterparty risk with respect to interest rate swap and foreign currency forwards and options transactions is not considered to be significant based upon the creditworthiness of the participating financial institutions.

Foreign Currency Risk

We utilize currency forwards to hedge currency risk associated with anticipated Australian dollar expenditures. Our currency hedging program for 2008 targets hedging at least approximately 70% of our anticipated, non-capital Australian dollar-denominated expenditures. As of December 31, 2007, we had in place forward contracts designated as cash flow hedges with notional amounts outstanding totaling A$2.03 billion of which A$1.08 billion, A$556.7 million, and A$388.8 million will expire in 2008, 2009, and 2010, respectively. The accounting for these derivatives is discussed in Note 3 to our consolidated financial statements. Assuming we had no hedges in place, our exposure in "Operating costs and expenses" due to a $0.01 change in the Australian dollar/U.S. dollar exchange rate is approximately $12 million for 2008. However, taking into consideration hedges currently in place, our net exposure to the same rate change is approximately $1.6 million in 2008.

Interest Rate Risk

Our objectives in managing exposure to interest rate changes are to limit the impact of interest rate changes on earnings and cash flows and to lower overall borrowing costs. To achieve these objectives, we manage fixed-rate debt as a percent of net debt through the use of various hedging instruments, which are discussed in detail in Note 13 to our consolidated financial statements. As of December 31, 2007, after taking into consideration the effects of interest rate swaps, we had $2.57 billion of fixed-rate borrowings and $707.2 million of variable-rate borrowings outstanding. A one percentage point increase in interest rates would result in an annualized increase to interest expense of $7.1 million on our variable-rate borrowings. With respect to our fixed-rate borrowings, a one percentage point increase in interest rates would result in a $0.3 million decrease in the estimated fair value of these borrowings.

Other Non-trading Activities

We manage our commodity price risk for our non-trading, long-term coal contract portfolio through the use of long-term coal supply agreements, rather than through the use of derivative instruments. We sold 94% and 90% of our sales volume under long-term coal supply agreements during 2007 and 2006, respectively. As of December 31, 2007, we had 5 to 10 million tons of expected U.S. production unpriced for 2008. We had 9 to 10 million tons remaining to be priced for 2008 in Australia at December 31, 2007. We have approximately 80 to 90 million tons of expected U.S. production unpriced for 2009, with an additional 17 to 20 million tons of expected Australia coal production unpriced for 2009.

Some of the products used in our mining activities, such as diesel fuel and explosives, are subject to commodity price risk. To manage this risk, we use a combination of forward contracts with our suppliers and financial derivative contracts, primarily swap contracts with financial institutions. As of December 31, 2007, we had derivative contracts outstanding that are designated as cash flow hedges of anticipated purchases of fuel and explosives.

Notional amounts outstanding under fuel-related, derivative swap contracts were 114.8 million gallons of crude oil scheduled to expire through 2010. We expect to consume 125 to 130 million gallons of fuel next year. A one dollar per barrel change in the price of crude oil would increase or decrease our annual fuel costs (ignoring the effects of hedging) by approximately $2.4 million.

Notional amounts outstanding under explosives-related swap contracts, scheduled to expire through 2010, were 5.7 mmbtu of natural gas. We expect to consume 315,000 to 325,000 tons of explosives per year. Through our natural gas hedge contracts, we have fixed prices for approximately 49% of our anticipated explosives requirements for 2008. Based on our expected usage, a change in natural gas prices of ten cents per mmbtu (ignoring the effects of hedging) would result in an increase or decrease in our operating costs of approximately $0.6 million per year.

Management Report

OVERVIEW

Management of Peabody Energy Corporation is responsible for the preparation and presentation of the financial statements included in this annual report. Management is also responsible for the reasonableness of estimates and judgments inherent in the preparation of the financial statements. These statements have been prepared in conformity with U.S. generally accepted accounting principles and include amounts based on management's best estimates and judgments.

The financial statements have been audited by Ernst & Young LLP, an independent registered public accounting firm. Their audit was conducted in accordance with generally accepted auditing standards. Ernst & Young also audited our assessment of the effectiveness of our internal control over financial reporting.

Management maintains a strong awareness of the importance of full and open presentation of our financial position and results of operations and utilizes a system of disclosure controls and procedures to ensure such presentation. To facilitate this, the Company maintains a Disclosure Committee, which includes senior executives who possess in-depth knowledge of the Company's business.

The Audit Committee of the Board of Directors, composed of independent directors, meets periodically with the independent registered public accountants, our internal auditors and management to review accounting, auditing, internal accounting controls and financial reporting matters. The independent certified public accountants and our internal auditors have access to and separately meet on a periodic basis with the Audit Committee.

EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES

As of the end of the period covered by this Annual Report on Form 10-K, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures, as defined in Rule 13a-15 under the Securities Act of 1934, were effective.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

We periodically review our internal control over financial reporting as part of our efforts to ensure compliance with the requirements of Section 404 of the Sarbanes-Oxley Act of 2002. In addition, we routinely review our system of internal control over financial reporting to identify potential changes to our processes and systems that may improve controls and increase efficiency, while ensuring that we maintain an effective internal control environment. Changes may include such activities as implementing new systems, consolidating the activities of acquired business units, migrating certain processes to our shared services organizations, formalizing and refining policies and procedures, improving segregation of duties, and adding additional monitoring controls. In addition, when we acquire new businesses, we incorporate our controls and procedures into the acquired business as part of our integration activities. There have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2007 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Management is responsible for maintaining and establishing adequate internal control over financial reporting. Our internal control framework and processes were designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of our consolidated financial statements for external purposes in accordance with U.S. generally accepted accounting principles.

Because of inherent limitations, any system of internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management conducted an assessment of the effectiveness of our internal control over financial reporting using the criteria set by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework. Based on this assessment, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2007.

Our Independent Registered Public Accounting Firm, Ernst & Young LLP, has audited our internal control over financial reporting, as stated in their unqualified opinion report included herein.

Gregory H. Boyce
Chairman and Chief Executive Officer

Richard A. Navarre
President, Chief Commercial Officer and Chief Financial Officer

February 27, 2008

REPORTS OF
Independent Registered Public Accounting Firm

THE BOARD OF DIRECTORS AND STOCKHOLDERS
PEABODY ENERGY CORPORATION

We have audited Peabody Energy Corporation's (the Company's) internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Peabody Energy Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the Company's internal control over financial reporting based on our audit.

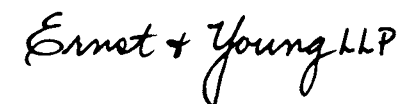
We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Peabody Energy Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007 based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Peabody Energy Corporation as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007, and our report dated February 27, 2008, expressed an unqualified opinion thereon.



St. Louis, Missouri
February 27, 2008

THE BOARD OF DIRECTORS AND STOCKHOLDERS
PEABODY ENERGY CORPORATION

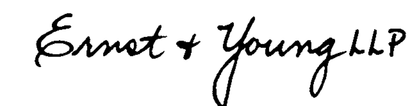
We have audited the accompanying consolidated balance sheets of Peabody Energy Corporation (the Company) as of December 31, 2007 and 2006, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2007. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Peabody Energy Corporation at December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 1 to the consolidated financial statements, on January 1, 2007, the Company changed its method of accounting for uncertain tax positions, on January 1, 2006, the Company changed its method of accounting for stripping costs and share-based payments, and on December 31, 2006, the Company changed its method of accounting for defined pension benefit and other postretirement plans.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Peabody Energy Corporation's internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated February 27, 2008, expressed an unqualified opinion thereon.



St. Louis, Missouri
February 27, 2008

CONSOLIDATED
Statements of Operations

Years Ended December 31 (Dollars in thousands, except share and per share data)	2007	2006	2005
Revenues			
Sales	$4,364,708	$4,002,403	$3,584,422
Other revenues	210,004	105,993	81,754
Total revenues	4,574,712	4,108,396	3,666,176
Costs and Expenses			
Operating costs and expenses	3,574,818	3,155,732	2,885,320
Depreciation, depletion and amortization	361,559	294,270	253,788
Asset retirement obligation expense	25,610	15,830	20,329
Selling and administrative expenses	147,146	128,031	132,679
Other operating income:			
Net gain on disposal or exchange of assets	(88,684)	(53,532)	(44,445)
Income from equity affiliates	(14,461)	(22,791)	(15,227)
Operating Profit	568,724	590,856	433,732
Interest expense	235,236	137,668	98,066
Early debt extinguishment costs	(253)	1,396	–
Interest income	(7,094)	(11,309)	(9,088)
Income From Continuing Operations Before Income Taxes and Minority Interests	340,835	463,101	344,754
Income tax provision (benefit)	(78,112)	(90,084)	63,779
Minority interests	(2,316)	611	2,472
Income From Continuing Operations	421,263	552,574	278,503
Income (loss) from discontinued operations	(156,978)	48,123	144,150
Net Income	$ 264,285	$ 600,697	$ 422,653
Basic Earnings Per Share			
Income from continuing operations	$ 1.60	$ 2.10	$ 1.06
Income (loss) from discontinued operations	(0.60)	0.18	0.55
Net income	$ 1.00	$ 2.28	$ 1.61
Weighted Average Shares Outstanding - Basic	264,068,180	263,419,344	261,519,424
Diluted Earnings Per Share			
Income from continuing operations	$ 1.56	$ 2.05	$ 1.04
Income (loss) from discontinued operations	(0.58)	0.18	0.54
Net income	$ 0.98	$ 2.23	$ 1.58
Weighted Average Shares Outstanding - Diluted	269,166,290	269,166,005	268,013,476
Dividends Declared Per Share	$ 0.24	$ 0.24	$ 0.17

See accompanying notes to consolidated financial statements

CONSOLIDATED
Balance Sheets

December 31 (Dollars in thousands, except share and per share data)	2007	2006
Assets		
Current assets		
Cash and cash equivalents	$ 45,279	$ 326,511
Accounts receivable, net of allowance for doubtful accounts of $11,888 and $10,893 at December 31, 2007 and 2006, respectively	257,950	320,822
Inventories	268,862	202,909
Assets from coal trading activities	966,548	150,373
Deferred income taxes	98,633	77,562
Other current assets	215,928	109,859
Current assets of discontinued operations	74,093	108,522
Total current assets	1,927,293	1,296,558
Property, plant, equipment and mine development		
Land and coal interests	7,198,090	6,498,816
Buildings and improvements	700,509	622,059
Machinery and equipment	1,267,328	1,139,072
Less accumulated depreciation, depletion and amortization	(1,833,527)	(1,551,117)
Property, plant, equipment and mine development, net	7,332,400	6,708,830
Goodwill	–	240,667
Investments and other assets	408,614	304,518
Noncurrent assets of discontinued operations	–	963,483
Total assets	$9,668,307	$9,514,056
Liabilities and Stockholders' Equity		
Current liabilities		
Current maturities of long-term debt	$ 134,373	$ 95,757
Liabilities from coal trading activities	918,596	126,731
Accounts payable and accrued expenses	953,661	944,151
Current liabilities of discontinued operations	180,356	160,730
Total current liabilities	2,186,986	1,327,369
Long-term debt, less current maturities	3,138,727	3,181,275
Deferred income taxes	315,604	412,886
Asset retirement obligations	369,547	283,328
Accrued postretirement benefit costs	785,708	809,013
Other noncurrent liabilities	318,127	351,166
Noncurrent liabilities of discontinued operations	33,236	777,156
Total liabilities	7,147,935	7,142,193
Minority interests, including $16,153 of discontinued operations at December 31, 2006	701	33,337
Stockholders' equity		
Preferred Stock – $0.01 per share par value; 10,000,000 shares authorized, no shares issued or outstanding as of December 31, 2007 or 2006	–	–
Series A Junior Participating Preferred Stock – 1,500,000 shares authorized, no shares issued or outstanding as of December 31, 2007 or 2006	–	–
Perpetual Preferred Stock – 750,000 shares authorized, no shares issued or outstanding as of December 31, 2007 or 2006	–	–
Series Common Stock – $0.01 per share par value; 40,000,000 shares authorized, no shares issued or outstanding as of December 31, 2007 or 2006	–	–
Common Stock – $0.01 per share par value; 800,000,000 shares authorized, 272,911,564 shares issued and 270,066,621 shares outstanding as of December 31, 2007 and 800,000,000 shares authorized, 266,554,157 shares issued and 263,846,839 shares outstanding as of December 31, 2006	2,729	2,666
Additional paid-in capital	1,750,627	1,572,614
Retained earnings	941,424	1,115,994
Accumulated other comprehensive loss	(67,066)	(249,058)
Treasury shares, at cost: 2,844,943 shares as of December 31, 2007 and 2,707,318 shares as of December 31, 2006	(108,043)	(103,690)
Total stockholders' equity	2,519,671	2,338,526
Total liabilities and stockholders' equity	$9,668,307	$9,514,056

See accompanying notes to consolidated financial statements

CONSOLIDATED

Statements of Cash Flows

Years Ended December 31 (Dollars in thousands)	2007	2006	2005
Cash Flows From Operating Activities			
Net income	$ 264,285	$ 600,697	$ 422,653
(Income) loss from discontinued operations	156,978	(48,123)	(144,150)
Income from continuing operations	421,263	552,574	278,503
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:			
Depreciation, depletion and amortization	361,559	294,270	253,788
Deferred income taxes	(201,444)	(195,546)	10,436
Amortization of debt discount and debt issuance costs	7,185	7,410	6,938
Net gain on disposal or exchange of assets	(88,684)	(53,532)	(44,445)
Income from equity affiliates	(14,461)	(22,791)	(15,227)
Dividends received from equity affiliates	12,927	18,128	–
Changes in current assets and liabilities, net of acquisitions:			
Accounts receivable, including securitization	64,871	(111,242)	(32,601)
Inventories	(63,440)	(30,210)	(62,628)
Net assets from coal trading activities	(77,631)	(9,419)	11,377
Other current assets	(56,459)	(20,339)	(12,016)
Accounts payable and accrued expenses	56,872	104,192	182,877
Asset retirement obligations	15,143	(3,058)	12,484
Workers' compensation obligations	2,742	(86)	6,345
Accrued postretirement benefit costs	13,122	59,062	57,814
Distributions to minority interests	(2,975)	(4,545)	(2,498)
Contributions to pension plans	(5,322)	(6,146)	(7,162)
Other, net	1,913	12,690	39,819
Net cash provided by continuing operations	447,181	591,412	683,804
Net cash provided by (used in) discontinued operations	(130,816)	(8,150)	41,457
Net cash provided by operating activities	316,365	583,262	725,261
Cash Flows From Investing Activities			
Acquisition of Excel Coal, net of cash acquired	–	(1,507,775)	–
Additions to property, plant, equipment and mine development	(470,434)	(397,497)	(450,348)
Federal coal lease expenditures	(178,193)	(178,193)	(118,364)
Proceeds from disposal of assets, net of notes receivable	119,586	29,411	62,731
Additions to advance mining royalties	(8,123)	(4,956)	(8,472)
Investments in joint ventures	(4,566)	(2,149)	(2,000)
Net cash used in continuing operations	(541,730)	(2,061,159)	(516,453)
Net cash used in discontinued operations	(33,602)	(82,659)	(67,749)
Net cash used in investing activities	(575,332)	(2,143,818)	(584,202)
Cash Flows From Financing Activities			
Change in revolving line of credit	97,700	–	–
Proceeds from long-term debt	–	2,604,087	11,734
Payments of long-term debt	(117,817)	(1,045,973)	(20,198)
Common stock repurchase	–	(99,774)	–
Dividends paid	(63,658)	(63,456)	(44,535)
Payment of debt issuance costs	(774)	(40,611)	–
Excess tax benefit related to stock options exercised	96,743	33,173	–
Proceeds from stock options exercised	26,197	15,617	22,573
Issuance of notes payable	–	–	(11,459)
Proceeds from employee stock purchases	6,377	4,518	3,009
Net cash provided by (used in) continuing operations	44,768	1,407,581	(38,876)
Net cash provided by (used in) discontinued operations	(67,033)	(23,792)	11,459
Net cash provided by (used in) financing activities	(22,265)	1,383,789	(27,417)
Net increase (decrease) in cash and cash equivalents	(281,232)	(176,767)	113,642
Cash and cash equivalents at beginning of year	326,511	503,278	389,636
Cash and cash equivalents at end of year	$ 45,279	$ 326,511	$ 503,278

See accompanying notes to consolidated financial statements

CONSOLIDATED

Statements of Changes in Stockholders' Equity

(Dollars in thousands)	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Earnings	Treasury Stock	Total Stockholders' Equity
December 31, 2004	$2,596	$1,435,562	$ (60,618)	$ 350,968	$ (3,916)	$1,724,592
Comprehensive income:						
Net income	–	–	–	422,653	–	422,653
Increase in fair value of cash flow hedges (net of $7,613 tax provision)	–	–	11,421	–	–	11,421
Minimum pension liability adjustment (net of $1,601 tax provision)	–	–	2,402	–	–	2,402
Comprehensive income						436,476
Dividends paid	–	–	–	(44,535)	–	(44,535)
Stock options exercised	36	22,627	–	–	–	22,663
Income tax benefits from stock options exercised	–	30,437	–	–	–	30,437
Employee stock purchases	2	3,007	–	–	–	3,009
Employee stock grants	4	(4)	–	–	–	–
Share-based compensation	–	5,825	–	–	–	5,825
December 31, 2005	$2,638	$1,497,454	$ (46,795)	$ 729,086	$ (3,916)	$2,178,467
Comprehensive income:						
Net income	–	–	–	600,697	–	600,697
Increase in fair value of cash flow hedges (net of $16,230 tax provision)	–	–	24,347	–	–	24,347
Minimum pension liability adjustment (net of $16,842 tax provision)	–	–	22,377	–	–	22,377
Comprehensive income						647,421
Postretirement plans and workers' compensation obligations (net of $149,499 tax benefit):	–	–	(241,954)	–	–	
Accumulated actuarial loss, net of tax	–	–	(7,033)	–	–	
Prior service cost, net of tax			(248,987)			(248,987)
Dividends paid	–	–	–	(63,456)	–	(63,456)
Stock options exercised	20	15,600	–	–	–	15,620
Share-based compensation	–	21,877	–	–	–	21,877
Income tax benefits from stock options exercised	–	33,173	–	–	–	33,173
Employee stock purchases	2	4,516	–	–	–	4,518
Employee stock grants	6	(6)	–	–	–	–
Advance stripping adjustment (net of $95,189 tax benefit)	–	–	–	(150,333)	–	(150,333)
Shares repurchased	–	–	–	–	(99,774)	(99,774)
December 31, 2006	$2,666	$1,572,614	$(249,058)	$1,115,994	$(103,690)	$2,338,526
Comprehensive income:						
Net income	–	–	–	264,285	–	264,285
Increase in fair value of cash flow hedges (net of $14,530 tax provision)	–	–	21,796	–	–	21,796
Postretirement plans and workers' compensation obligations (net of $50,232 tax provision):	–	–	87,211	–	–	87,211
Comprehensive income						373,292
Dividends paid	–	–	–	(63,658)	–	(63,658)
Patriot Coal Corp. spin-off	–	–	72,985	(375,197)	–	(302,212)
Stock options exercised	54	26,143	–	–	–	26,197
Income tax benefits from stock options exercised	–	96,743	–	–	–	96,743
Employee stock purchases	2	6,375	–	–	–	6,377
Employee stock grants	7	(7)	–	–	–	–
Share-based compensation	–	48,759	–	–	–	48,759
Shares relinquished	–	–	–	–	(4,353)	(4,353)
December 31, 2007	$2,729	$1,750,627	$ (67,066)	$ 941,424	$(108,043)	$2,519,671

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements

Years Ended December 31

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The 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.

Description of Business

The Company is engaged in the mining of steam coal for sale primarily to electric utilities and metallurgical coal for sale to industrial customers. The Company's mining operations are located in the United States and Australia, and include an equity interest in mining operations in Venezuela. In addition to the Company's mining operations, the Company markets, brokers and trades coal. The Company's other energy related commercial activities include the development of mine-mouth coal-fueled generating plants, the management of its vast coal reserve and real estate holdings, coalbed methane production and Btu conversion technologies. The Company's Btu conversion projects are designed to expand the uses of coal through various technologies such as coal-to-liquids and coal gasification.

New Accounting Pronouncements

In December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standard (SFAS) No. 123 (revised 2004), "Share-Based Payment" (SFAS No. 123(R)), which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation" (SFAS No. 123). SFAS No. 123(R) supersedes Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees" (APB Opinion No. 25") and amends FASB Statement No. 95, "Statement of Cash Flows." Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including employee stock options, to be recognized in the income statement based on their fair values at the grant date.

The Company adopted SFAS No. 123(R) on January 1, 2006 and used the modified prospective method, in which compensation cost is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted or modified after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123(R) that remain unvested on the effective date. Prior to January 1, 2006, the Company had elected to apply APB Opinion No. 25 and related interpretations in accounting for its stock option plans, as permitted under SFAS No. 123 and SFAS No. 148 "Accounting for Stock-Based Compensation-Transition and Disclosure." Beginning in 2006, SFAS No. 123(R) also requires that excess income tax benefits from stock options exercised be recorded as financing cash inflow on the statements of cash flows. The excess income tax benefit from stock option exercises during 2005 is included in operating cash flows, netted in deferred tax activity.

In March 2005, the Emerging Issues Task Force (EITF) issued EITF Issue No. 04-6, "Accounting for Stripping Costs in the Mining Industry" (EITF Issue No. 04-6). EITF Issue No. 04-6 and its interpretations require stripping costs incurred during a period to be attributed only to the inventory costs of the coal that is extracted during that same period. The Company adopted EITF Issue No. 04-6 on January 1, 2006 and utilized the cumulative effect adjustment approach whereby the cumulative effect adjustment reduced retained earnings by $150.3 million, net of tax. This non-cash item is excluded from the consolidated statements of cash flows. Advance stripping costs are primarily expensed as incurred.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS No. 158). For fiscal years ending after December 15, 2006, SFAS No. 158 requires recognition of the funded status of pension and other postretirement benefit plans (an asset for overfunded status or a liability for underfunded status) in a company's balance sheet. In addition, the standard requires recognition of actuarial gains and losses, prior service cost, and any remaining transition amounts from the initial application of SFAS No. 87, "Employers' Accounting for Pensions" (SFAS No. 87) and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" (SFAS No. 106) when determining a plan's funded status, with a corresponding charge to accumulated other comprehensive income (loss).

The Company adopted SFAS No. 158 on December 31, 2006, and as a result, recorded a noncurrent liability of $376.1 million, which reflected the net underfunded status of the pension, retiree healthcare and workers' compensation plans. The funded status of each plan was measured as the difference between the fair value of the assets and the projected benefit obligation (the funded status). SFAS No. 158 did not impact net income.

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

The Company adopted the provisions of FIN No. 48 on January 1, 2007, and as a result, reported $135.0 million of net unrecognized tax benefits ($144.0 million gross) in its consolidated financial statements. Due to the valuation allowance recorded against the Company's deferred tax asset for net operating loss (NOL) carryforwards as of January 1, 2007, none of the $135.0 million required an adjustment to retained earnings upon adoption.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements," (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, and therefore does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 (January 1, 2008 for the Company). In February 2008, the FASB amended SFAS No. 157 to exclude leasing transactions and to delay the effective date by one year for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The Company is in the process of determining the effect, if any, the adoption of SFAS No. 157 will have on its financial statements.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115" (SFAS No. 159). SFAS No. 159 provides all entities with an option to report selected financial assets and liabilities at fair value. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007 (January 1, 2008 for the Company). The Company is in the process of determining the effect, if any, the adoption of SFAS No. 159 will have on its financial statements.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51" (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for (1) noncontrolling interests in partially owned consolidated subsidiaries and (2) the loss of control of subsidiaries. SFAS No. 160 requires noncontrolling interests (minority interests) to be reported as a separate component of equity. The amount of net income attributable to the noncontrolling interest will be included in consolidated net income on the face of the income statement. In addition, this statement requires that a parent recognize a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss will be measured using the fair value of the noncontrolling equity investment on the deconsolidation date. SFAS 160 also includes expanded disclosure requirements regarding the interests of the parent and its noncontrolling interest. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008 (January 1, 2009 for the Company). Early adoption is not allowed. The Company is in the process of determining the effect the adoption of SFAS No. 160 will have on its financial statements.

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations," which replaces SFAS No. 141. SFAS No. 141(R) significantly changes the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree. This statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (January 1, 2009 for the Company). The Company is in the process of determining the effect, if any, the adoption of SFAS No. 141(R) will have on its financial statements.

Sales

The Company's revenue from coal sales is realized and earned when risk of loss passes to the customer. Coal sales are made to the Company's customers under the terms of coal supply agreements, most of which are long-term (greater than one year). Under the typical terms of these coal supply agreements, title and risk of loss transfer to the customer at the mine or port, where coal is loaded to the rail, barge, ocean-going vessel, truck or other transportation source(s) that serves each of the Company's mines. The Company incurs certain "add-on" taxes and fees on coal sales. Coal sales are reported including taxes and fees charged by various federal and state governmental bodies. Coal sales includes the freight charges on destination customer contracts.

Other Revenues

Other revenues include royalties related to coal lease agreements, sales agency commissions, farm income, coalbed methane revenues, property and facility rentals, generation development activities, net revenues from coal trading activities accounted for under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133), as amended, and contract termination or restructuring payments. Royalty income generally results from the lease or sublease of mineral rights to third parties, with payments based upon a percentage of the selling price or an amount per ton of coal produced. Certain agreements require minimum annual lease payments regardless of the extent to which minerals are produced from the leasehold. The terms of these agreements generally range from specified periods of five to 15 years, or can be for an unspecified period until all reserves are depleted.

Discontinued Operations

The Company classifies items within discontinued operations in the consolidated statements of operations when the operations and cash flows of a particular component (defined as operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity) of the Company have been (or will be) eliminated from the ongoing operations of the Company as a result of a disposal transaction, and the Company will no longer have any significant continuing involvement in the operations of that component. Discontinued operations, net of taxes, for the years ended December 31, 2007, 2006, and 2005, reflected a $157.0 million loss, $48.1 million income, and $144.2 million income, respectively, related to the spin-off of Patriot Coal Corporation (Patriot) respectively. See Note 2 for additional details related to discontinued operations.

Cash and Cash Equivalents

Cash and cash equivalents are stated at cost, which approximates fair value. Cash equivalents consist of highly liquid investments with original maturities of three months or less.

Inventories

Materials and supplies and coal inventory are valued at the lower of average cost or market. Raw coal represents coal stockpiles that may be sold in current condition or may be further processed prior to shipment to a customer. Coal inventory costs include labor, supplies, equipment, operating overhead and other related costs.

Assets and Liabilities from Coal Trading Activities

The Company's coal trading activities are evaluated under SFAS No. 133, as amended. Trading contracts that meet the SFAS No. 133 definition of a derivative are accounted for at fair value, while contracts that do not qualify as derivatives are accounted for under the accrual method. All trading contracts are recorded subject to the requirements of EITF Issue No. 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities" (EITF Issue No. 02-3).

The Company's trading contracts are reflected at fair value and are included in "Assets and liabilities from coal trading activities" in the consolidated balance sheets as of December 31, 2007 and 2006. Under EITF Issue No. 02-3, all mark-to-market gains and losses on energy trading contracts (including derivatives and hedged contracts) are presented on a net basis in the statement of operations, even if settled physically. The Company's consolidated statements of operations reflect revenues related to all mark-to-market trading contracts on a net basis in "Other revenues."

Property, Plant, Equipment and Mine Development

Property, plant, equipment and mine development are recorded at cost. Interest costs applicable to major asset additions are capitalized during the construction period, including $2.0 million, $3.0 million and $0.1 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Expenditures which extend the useful lives of existing plant and equipment assets are capitalized. Maintenance and repairs are charged to operating costs as incurred. Costs incurred to develop coal mines or to expand the capacity of operating mines are capitalized. Costs incurred to maintain current production capacity at a mine and exploration expenditures are charged to operating costs as incurred, including costs related to drilling and study costs incurred to convert or upgrade mineral resources to reserves. Costs to acquire computer hardware and the development and/or purchase of software for internal use are capitalized and depreciated over the estimated useful lives.

Coal reserves are recorded at cost, or at fair value in the case of acquired businesses. As of December 31, 2007 and 2006, the net book value of coal reserves totaled $5.6 billion and $4.6 billion, respectively. These amounts included $2.1 billion and $1.7 billion at December 31, 2007 and 2006, respectively, attributable to properties where the Company was not currently engaged in mining operations or leasing to third parties and, therefore, the coal reserves were not currently being depleted. Included in the book value of coal reserves are mineral rights for leased coal interests including advance royalties and the net book value of these mineral rights was $2.2 billion and $3.2 billion at December 31, 2007 and 2006, respectively. The remaining net book value of the Company's coal reserves of $3.4 billion and $1.4 billion, at December 31, 2007 and 2006, respectively, relates to coal reserves held by fee ownership.

Depletion of coal reserves and amortization of advance royalties is computed using the units-of-production method utilizing only proven and probable reserves (as adjusted for recoverability factors) in the depletion base. Mine development costs are principally amortized over the estimated lives of the mines using the straight-line method. Depreciation of plant and equipment (excluding life of mine assets) is computed using the straight-line method over the estimated useful lives as follows:

	Years
Building and improvements	10 to 20
Machinery and equipment	3 to 29
Leasehold improvements	Life of Lease

In addition, certain plant and equipment assets associated with mining are depreciated using the straight-line method over the estimated life of the mine, which varies from one to 29 years.

Investments in Joint Ventures

The Company accounts for its investments in less than majority owned corporate joint ventures under either the equity or cost method. The Company applies the equity method to investments in joint ventures when it has the ability to exercise significant influence over the operating and financial policies of the joint venture. Investments accounted for under the equity method are initially recorded at cost, and any difference between the cost of the Company's investment and the underlying equity in the net assets of the joint venture at the investment date is amortized over the lives of the related assets that gave rise to the difference. The Company's pro rata share of earnings from joint ventures and basis difference amortization is reported in the consolidated statements of operations in "Income from equity affiliates." The book value of the Company's equity method investments as of December 31, 2007 and 2006 was $76.7 million and $65.1 million, respectively, and is reported in "Investments and other assets" in the consolidated balance sheets. Included in the Company's equity method investments was its 25.5% interest in Carbones del Guasare, which owns and operates the Paso Diablo Mine in Venezuela. The Company's investment in Paso Diablo was $68.4 million and $60.1 million as of December 31, 2007 and 2006, respectively. The Company recorded income from this equity affiliate of $21.2 million, $28.0 million and $20.0 million for the years ended December 31, 2007, 2006 and 2005, respectively, which is reported in "Income from equity affiliates" in the consolidated statements of operations. The Company received dividends from this equity affiliate of $12.9 million and $18.1 million for the years ended December 31, 2007 and 2006, respectively, while no dividends were received for the year ended December 31, 2005.

Generation Development Costs

Development costs related to coal-based electricity generation, including expenditures for permitting and licensing, are capitalized at cost under the guidelines in SFAS No. 142, "Goodwill and Other Intangible Assets." Start-up costs, as defined in Statement of Position (SOP) No. 98-5, "Reporting on the Costs of Start-up Activities," are expensed as incurred. Development costs of $36.9 million and $21.4 million were recorded as part of "Investments and other assets" in the consolidated balance sheets as of December 31, 2007 and 2006, respectively.

Asset Retirement Obligations

SFAS No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143) addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The Company's asset retirement obligation (ARO) liabilities primarily consist of spending estimates related to reclaiming surface land and support facilities at both surface and underground mines in accordance with applicable reclamation laws as defined by each mining permit.

The Company estimates its ARO liabilities for final reclamation and mine closure based upon detailed engineering calculations of the amount and timing of the future cash spending for a third-party to perform the required work. Spending estimates are escalated for inflation and then discounted at the credit-adjusted, risk-free rate. The Company records an ARO asset associated with the discounted liability for final reclamation and mine closure. The obligation and corresponding asset are recognized in the period in which the liability is incurred. The ARO asset is amortized on the units-of-production method over its expected life and the ARO liability is accreted to the projected spending date. As changes in estimates occur (such as mine plan revisions, changes in estimated costs or changes in timing of the performance of reclamation activities), the revisions to the obligation and asset are recognized at the appropriate credit-adjusted, risk-free rate. The Company also recognizes an obligation for contemporaneous reclamation liabilities incurred as a result of surface mining. Contemporaneous reclamation consists primarily of grading, topsoil replacement and revegetation of backfilled pit areas.

Environmental Liabilities

Included in "Other noncurrent liabilities" are accruals for other environmental matters that are recorded in operating expenses when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. Accrued liabilities are exclusive of claims against third parties and are not discounted. In general, costs related to environmental remediation are charged to expense.

Income Taxes

Income taxes are accounted for using a balance sheet approach in accordance with SFAS No. 109, "Accounting for Income Taxes." The Company accounts for deferred income taxes by applying statutory tax rates in effect at the date of the balance sheet to differences between the book and tax basis of assets and liabilities. A valuation allowance is established if it is "more likely than not" that the related tax benefits will not be realized. In determining the appropriate valuation allowance, the Company considers projected realization of tax benefits based on expected levels of future taxable income, available tax planning strategies, and the overall deferred tax position.

FIN No. 48 "Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109" prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company adopted this interpretation effective January 1, 2007.

Postretirement Health Care and Life Insurance Benefits

The Company accounts for postretirement benefits other than pensions in accordance with SFAS No. 106, which requires the costs of benefits to be provided to be accrued over the employees' period of active service. These costs are determined on an actuarial basis. As a result of the adoption of SFAS No. 158 on December 31, 2006, the Company's consolidated balance sheet reflects the funded status of postretirement benefits.

Pension Plans

The Company sponsors non-contributory defined benefit pension plans accounted for in accordance with SFAS No. 87, which requires that the cost to provide the benefits be accrued over the employees' period of active service. These costs are determined on an actuarial basis. SFAS No. 158 amended SFAS No. 87 and as a result of the adoption of SFAS No. 158 on December 31, 2006, the Company's consolidated balance sheet reflects the funded status of the defined benefit pension plans.

Postemployment Benefits

The Company provides postemployment benefits to qualifying employees, former employees and dependents and accounts for these benefits on the accrual basis in accordance with SFAS No. 112 "Employers' Accounting for Postemployment Benefits." Postemployment benefits include workers' compensation occupational disease, which is accounted for on the actuarial basis over the employees' period of active service; workers' compensation traumatic injury claims, which are accounted for based on estimated loss rates applied to payroll and claim reserves determined by independent actuaries and claims administrators; disability income benefits, which are accrued when a claim occurs; and continuation of medical benefits, which are recognized when the obligation occurs. As a result of the adoption of SFAS No. 158 on December 31, 2006, the Company's consolidated balance sheet reflects the funded status of postemployment benefits.

Derivatives

SFAS No. 133, as amended, requires the recognition at fair value of all derivatives as assets or liabilities on the consolidated balance sheets. Gains or losses from derivative financial instruments designated as fair value hedges are recognized immediately in the consolidated statements of operations, along with the offsetting gain or loss related to the underlying hedged item.

Gains or losses on derivative financial instruments designated as cash flow hedges are recorded as a separate component of stockholders' equity until settlement (or until hedge ineffectiveness is determined), whereby gains or losses are reclassified to the consolidated statements of operations in conjunction with the recognition of the underlying hedged item. To the extent that the periodic changes in the fair value of the derivatives are not effective, or if the hedge ceases to qualify for hedge accounting, the ineffective portion of the periodic non-cash changes are recorded in "Operating costs and expenses" in the consolidated statement of operations in the period of the change. The potential for hedge ineffectiveness is only present in the design of the hedge relationship in the Company's cash flow hedges of anticipated fuel purchases (see Note 3 for additional details).

Use of Estimates in the Preparation of the Consolidated Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

In particular, the Company has significant long-term liabilities relating to retiree health care, work-related injuries and illnesses and defined benefit pension plans. Each of these liabilities is actuarially determined and the Company uses various actuarial assumptions, including the discount rate and future cost trends, to estimate the costs and obligations for these items. In addition, the Company has significant asset retirement obligations that involve estimations of costs to remediate mining lands and the timing of cash outlays for such costs. If these assumptions do not materialize as expected, actual cash expenditures and costs incurred could differ materially from current estimates. Moreover, regulatory changes could increase the obligation to satisfy these or additional obligations.

Finally, in evaluating the valuation allowance related to the Company's deferred tax assets, the Company takes into account various factors, including the expected level of future taxable income and available tax planning strategies. If actual results differ from the assumptions made in the evaluation of the valuation allowance, the Company may record a change in valuation allowance through income tax expense in the period such determination is made.

Impairment of Long-Lived Assets

The Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that assets might be impaired and the undiscounted cash flows estimated to be generated by those assets under various assumptions are less than the carrying amounts of the assets. Impairment losses are measured by comparing the estimated fair value of the impaired asset to its carrying amount. There were no impairment losses recorded during the periods covered by the consolidated financial statements.

Fair Value of Financial Instruments

SFAS No. 107, "Disclosures About Fair Value of Financial Instruments," defines the fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. See Note 21 for additional information.

Foreign Currency Translation

The Company's foreign subsidiaries utilize the U.S. dollar as their functional currency. As such, monetary assets and liabilities are translated at year-end exchange rates while non-monetary items are translated at historical rates. Income and expense accounts are translated at the average rates in effect during the year, except for those expenses related to balance sheet amounts that are remeasured at historical exchange rates. Gains and losses from foreign currency remeasurement are included in the consolidated statements of operations with amounts related to the remeasurement of deferred tax balances included as a component of the income tax provision. The foreign currency remeasurement loss for the years ended December 31, 2007 and 2006 was $60.4 million and $12.8 million, respectively. Gains and losses from foreign currency remeasurement did not have a material impact on the Company's consolidated results of operations for the year ended December 31, 2005.

Business Combinations

The Company accounts for its business acquisitions under the purchase method of accounting consistent with the requirements of SFAS No. 141, "Business Combinations." The total cost of acquisitions is allocated to the underlying identifiable net assets, based on their respective estimated fair values. Determining the fair value of assets acquired and liabilities assumed requires management's judgment, and the utilization of independent valuation experts, and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, asset lives, and market multiples, among other items.

Share-Based Compensation

The Company accounts for share-based compensation in accordance with the fair value recognition provisions of SFAS No. 123 (Revised 2004), "Share-Based Payment" (SFAS 123(R)), which the Company adopted using the modified prospective option on January 1, 2006. Under SFAS No. 123(R), share-based compensation expense is generally measured at the grant date and recognized as expense over the vesting period of the award.

Reclassifications

Certain amounts in prior periods have been reclassified to conform with the presentation of 2007, with no effect on previously reported net income or stockholders' equity.

(2) DISCONTINUED OPERATIONS

On October 10, 2007, the Company's Board of Directors approved a spin-off of portions of its Eastern U.S. Mining operations business segment. The spin-off was accomplished on October 31, 2007 through a dividend of all outstanding shares of Patriot, which is now an independent public company traded on the New York Stock Exchange (symbol PCX). Prior to the spin-off, the Company received necessary regulatory approvals including a private letter ruling on the tax-free nature of the transaction from the Internal Revenue Service, and a declaration of effectiveness for Patriot's registration statement on Form 10 with the Securities and Exchange Commission (SEC). Distribution of the Patriot stock to the Company's stockholders occurred on October 31, 2007, 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.

The spin-off included eight company-operated mines, two 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. Revenues, pretax income (loss) and the income tax provision (benefit) reported in discontinued operations were as follows.

(Dollars in thousands)	2007	2006	2005
Revenues	$1,024,462	$1,147,919	$978,277
Income (loss) before income taxes and minority interests	(235,215)	67,861	81,331
Income tax provision (benefit)	(81,473)	8,569	(62,819)

The Company entered into agreements to pay for certain retiree healthcare liabilities of Patriot arising under the Coal Act and the 2007 National Bituminous Coal Wage Agreement (NBCWA), as well as retiree healthcare liabilities relating to certain Patriot salaried employees. These liabilities totaled $617 million at October 31, 2007 and are included in accrued postretirement benefit costs.

The 2007 loss before income taxes and minority interests totaling $235.2 million includes certain charges taken in connection with the spin-off including a $162.2 million loss related to firm purchase commitments that extend through 2010 for purchases from Patriot to supply pre-existing below market customer sales contracts that will be sourced from Patriot operations, $23.8 million of accelerated vesting of share-based compensation awarded to Patriot executives and $21.5 million of transaction related costs.

The Company has also entered into a transition services agreement to provide certain administrative and other services to Patriot for a period of six months. Patriot will have the option to extend this agreement for an additional term of three months and, under certain circumstances, for another term of three months. Under this agreement, the Company billed $0.9 million for transitional services in the last two months of 2007.

The assets, liabilities and minority interests of the discontinued operations as of December 31, 2007 and 2006 are shown below.

(Dollars in thousands)	2007	2006
Assets		
Current assets		
Accounts receivable, net	$ 74,093	$ 37,420
Inventories	–	34,693
Deferred income taxes	–	29,405
Other current assets	–	7,004
Total current assets	$ 74,093	$ 108,522
Property, plant, equipment and mine development, net	–	842,687
Investments and other assets	–	120,796
Total assets	$ 74,093	$1,072,005
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	$180,356	$ 160,730
Total current liabilities	180,356	160,730
Long-term debt, less current maturities	–	20,717
Deferred income taxes	–	(217,673)
Asset retirement obligations	–	139,703
Workers' compensation obligations	–	211,500
Accrued postretirement benefit costs	–	559,673
Other noncurrent liabilities	33,236	63,236
Total liabilities	$213,592	$ 937,886
Minority interests	$ –	$ 16,153

(3) RISK MANAGEMENT AND DERIVATIVE FINANCIAL INSTRUMENTS

The Company is exposed to various types of risk in the normal course of business, including fluctuations in commodity prices, interest rates and foreign currency exchange rates. These risks are actively monitored to ensure compliance with the risk management policies of the Company. In most cases, commodity price risk (excluding coal trading activities) related to the sale of coal is mitigated through the use of long-term, fixed-price contracts rather than financial instruments, while commodity price risk related to materials used in production is managed through the use of fixed price and cost plus contracts and derivatives. Interest rate and foreign currency exchange risk are managed through the use of forward contracts, swaps and options. The Company's usage of interest rate swaps is discussed in Note 13.

Commodity Price Risk

In addition to the derivatives related to coal trading activities, the Company manages its exposure to price volatility of materials used in production, including diesel fuel and explosives, through various contractual arrangements. As of December 31, 2007, the Company had designated derivative contracts as cash flow hedges for 114.8 million gallons of anticipated fuel usage with contract maturities extending through 2010. The consolidated balance sheet at December 31, 2007 reflects unrealized gains on these cash flow hedges of $48.4 million, which is recorded net of a $19.4 million tax provision in "Accumulated other comprehensive loss" (see Note 19).

A measure of ineffectiveness is inherent in hedging future diesel fuel purchases with derivative positions based on crude oil or other mid-distillate commodities. The amount of ineffectiveness in the Company's hedge of physical fuel purchases with heating oil derivatives has historically been insignificant and is expected to remain minimal because the hedged diesel fuel contracts are priced based on the underlying derivative, heating oil, adjusted for a fixed transportation differential. Due to the market volatility of crude oil prices and refining spreads, the measured ineffectiveness in the Company's hedges of physical diesel fuel purchases with crude oil derivatives has historically been greater than for hedging contracts based on heating oil. Due to the implicit market volatility of crude and heating oil prices and refining crack spreads, the Company is unable to predict the amount of ineffectiveness that may occur in future periods, including the loss of hedge accounting (which could be determined on a derivative by derivative basis or in the aggregate), which may result in increased volatility in the Company's future results.

Due to the inherent ineffectiveness that occurs when the price of a derivative contract does not perfectly mirror the value of the hedged instrument or transaction, SFAS No. 133 permits a degree of ineffectiveness within a narrowly defined corridor, provided that critical terms of the hedge contract and the hedged activity are sufficiently matched, including maturity and notional amount, and provided that historical and expected future prices are sufficiently correlated. During 2007 and 2006, the Company did not recognize any impact due to ineffectiveness of hedging contracts that exceeded the defined corridor stipulated in SFAS No. 133.

The notional amounts outstanding of 114.8 million gallons of derivative swap contracts for crude oil that were designated as cash flow hedges of future anticipated diesel fuel purchases as of December 31, 2007. The crude oil swaps are used to hedge incremental fuel purchases in the Company's Eastern mining operations with any excess over Eastern requirements allocated to Western operations.

In addition to the derivatives related to trading activities and diesel fuel, the Company enters contracts to manage its exposure to the price volatility of explosives. As of December 31, 2007, the Company had derivative contracts designated as cash flow hedges with notional amounts outstanding totaling 5.7 million MMBtu of natural gas, with maturities extending through August 2010. The consolidated balance sheet as of December 31, 2007, reflects unrealized losses on these cash flow hedges of $2.0 million, which is recorded net of a $0.8 million tax benefit in "Accumulated other comprehensive loss" (see Note 19). The Company's hedge of explosives with natural gas is perfectly effective by design since the contractual purchase of explosives is fixed to the previous month's closing price for natural gas, which occurs in a constant ratio of MMBtu per ton in the manufacture of explosives, plus a fixed surcharge.

Credit Risk

The Company's concentration of credit risk is substantially with energy producers and marketers and electric utilities, although it also has exposure to international steel producers, brokerage sources and trading counterparties. The Company's policy is to independently evaluate each customer's creditworthiness prior to entering into transactions and to constantly monitor the credit extended. In the event that the Company enters into a transaction with a counterparty that does not meet its credit standards, the Company may protect its position by requiring the counterparty to provide appropriate credit enhancement.

When appropriate, the Company has taken steps to reduce the Company's credit exposure to customers or counterparties whose credit has deteriorated and who may pose a higher risk, as determined by the Company's credit management function, of failure to perform under their contractual obligations. These steps include obtaining letters of credit or cash collateral, requiring prepayments for shipments or the creation of customer trust accounts held for the Company's benefit to fund payment for coal under existing coal supply agreements.

To reduce the Company's credit exposure related to its trading and brokerage activities, the Company seeks to enter into netting agreements with counterparties that permit the Company to offset receivables and payables with such counterparties. Counterparty risk with respect to interest rate swap and foreign currency forwards transactions is not considered to be significant based upon the creditworthiness of the participating financial institutions.

Foreign Currency Risk

The Company utilizes currency forwards to hedge currency risk associated with anticipated Australian dollar expenditures. As of December 31, 2007, the Company had forward contracts designated as cash flow hedges with notional amounts outstanding totaling approximately A$2.03 billion, with maturities extending through 2010. The consolidated balance sheet as of December 31, 2007, reflects unrealized gains on the cash flow hedges of $124.8 million, which is recorded net of a $49.9 million tax benefit in "Accumulated other comprehensive loss" (see Note 19).

Employees

As of December 31, 2007, the Company had approximately 7,000 employees. As of December 31, 2007, approximately 27% of the Company's hourly employees were represented by organized labor unions and generated 10% of the 2007 coal production. Relations with its employees and, where applicable, organized labor are important to the Company's success.

United States Labor Relations

The United Mine Workers of America (UMWA) represented approximately 6% of the Company's U.S. subsidiaries' hourly employees, who generated 4% of the Company's U.S. production during the year ended December 31, 2007. An additional 7% of the U.S. hourly employees are represented by labor unions other than the UMWA. These employees generated 2% of the Company's U.S. production during the year ended December 31, 2007. Hourly workers at the Company's mine in Arizona are represented by the UMWA under the Western Surface Agreement, which is effective through September 2, 2013. In April 2007, a new labor agreement was ratified for the Company's hourly workforce at the Willow Lake underground mine, which is represented by the International Brotherhood of Boilermakers. The new four-year labor agreement expires on April 15, 2011.

Australia Labor Relations

The Australian coal mining industry is unionized and all of the Company's hourly workers and those employed through contract mining relationships are members of trade unions. The Construction Forestry Mining and Energy Union represents the Company's Australian subsidiary's hourly production employees. As of December 31, 2007, the Company's Australian hourly employees were approximately 26% of its hourly workforce and generated 29% of the Company's total Australian production in the year then ended. The labor agreements at the Company's Metropolitan Mine were renewed in July and October 2007 and those agreements expire in 2010. The Wambo mine coal handling plant labor agreement is under negotiation and the North Goonyella Mine operates under an agreement due to expire in March 2008.

(4) RESOURCE MANAGEMENT AND OTHER COMMERCIAL EVENTS

During 2007, the Company purchased approximately 345 million tons of coal reserves and surface lands in the Illinois Basin. In conjunction with the purchase, the Company also agreed to provide up to $64.8 million of reclamation and bonding commitments to a third-party coal company. The Company has recognized the full amount of these commitments as a liability as of December 31, 2007. The non-cash portion of this transaction was excluded from the investing section of the statement of cash flows.

During 2007, the Company sold approximately 172 million tons of coal reserves and surface lands to the Prairie State Energy Campus (Prairie State) equity partners. The Company recognized a gain totaling $26.4 million and received $114.3 million in cash proceeds associated with this transaction. See Note 20 for additional information regarding Prairie State.

In 2007, the Company exchanged oil and gas rights and assets in more than 860,000 acres in the Illinois Basin, West Virginia, New Mexico and the Powder River Basin for approximately 40 million tons of high-Btu coal reserves in West Virginia and Kentucky and $15.0 million in cash proceeds. The Company's subsidiaries, including one subsidiary now owned by Patriot, received approximately 40 million tons of coal reserves. Based on the fair value of the coal reserves received, the Company recognized a $50.5 million gain on the exchange. The non-cash portion of this transaction was excluded from the investing section of the statement of cash flows.

In 2006, the Company exchanged approximately 63 million tons of coal reserves at its Caballo mining operation for approximately 46 million tons of coal reserves contiguous with the Company's North Antelope Rochelle mining operation. Based on the fair value of the coal reserves exchanged, the Company recognized a gain totaling $39.2 million. This non-cash transaction was excluded from the investing section of the statement of cash flows.

The Company recognized $35.8 million during the year ended December 31, 2006 in gains related to the settlement of commitments by a third-party coal producer following a brokerage contract restructuring. The gains are included in "Other revenues" in the consolidated statements of operations.

In the fourth quarter of 2005, the Company acquired rail, loadout and surface facilities as well as other mining assets from another major coal producer for $84.7 million and exchanged 60 million ton blocks of leased coal reserves in the Powder River Basin. The Company plans to utilize these reserves and infrastructure to accelerate the development of a new mine, which will include adjoining Company-leased reserves. In the first quarter of 2005, the Company purchased mining assets from Lexington Coal Company for $61.0 million, of which $56.5 million was recorded in "Property, plant, equipment and mine development" and the remainder recorded primarily to "Inventories" in the consolidated balance sheet. The Company used the acquired assets to open a new mine that produced 2.4 million tons of coal during 2006 and to provide other synergies to existing properties.

In the third quarter of 2005, the Company exchanged certain idle steam coal reserves for steam and metallurgical coal reserves as part of a contractual dispute settlement. Under the settlement, the Company received $10.0 million in cash, a new coal supply agreement that partially replaced the disputed coal supply agreement, and exchanged the idle steam coal reserves. As a result of the final settlement and based on the fair values of the items exchanged in the overall settlement transaction, the Company recorded net contract losses of $4.0 million and a gain on assets exchanged of $37.4 million. The fair value of assets exchanged exceeded the book value by $33.4 million and this non-cash addition is not included in "Additions to property, plant, equipment and mine development" in the consolidated statements of cash flows. The gain from this transaction is included in "Net gain on disposal or exchange of assets" in the consolidated statements of operations.

(5) BUSINESS COMBINATIONS

Excel Coal Limited

In October 2006, the Company acquired Excel Coal Limited (Excel), an independent coal company, by means of a scheme of arrangement transaction under Australian law (the Transaction). The total acquisition price was $1.54 billion in cash plus assumed debt of $293.0 million, less $30.0 million of cash acquired in the transaction, and was financed with borrowings under the Company's Senior Unsecured Credit Facility and Senior Notes due 2016 and 2026 as discussed in Note 13. The Excel acquisition expands the Company's presence in Australia and included three operating mines and three development-stage mines (all of which are operating as of December 31, 2007), with up to 500 million tons of proven and probable coal reserves and approximately 100 million tons of coal resources. The results of operations of Excel are included in the Company's Australian Mining Operations segment from October 2006. The acquisition was accounted for as a purchase in accordance with SFAS No. 141, "Business Combinations."

The purchase accounting allocations related to the acquisition have been completed and recorded in the accompanying consolidated financial statements as of, and for periods subsequent to, October 2006. Pursuant to a final valuation, the adjustments to the Company's preliminary allocation were recorded in 2007 and resulted in an increase in the value assigned to property, plant and equipment and related deferred income taxes, thus eliminating the preliminary goodwill allocation. The following table summarizes the fair values of the assets acquired and the liabilities assumed at the date of acquisition:

(Dollars in thousands)	*Preliminary Allocation*	*Adjustments*	*Final Allocation*
Accounts receivable, net	$ 18,700	$ 2,543	$ 21,243
Inventories	32,044	(1,325)	30,719
Other current assets	5,336	2,513	7,849
Property, plant, equipment and mine development, net	1,897,672	363,307	2,260,979
Goodwill	240,667	(240,667)	–
Accounts payable and accrued expenses	(135,474)	(14,929)	(150,403)
Debt	(293,024)	9,508	(283,516)
Deferred income taxes, net	(179,026)	(114,083)	(293,109)
Other noncurrent assets and liabilities, net	(60,857)	(13,852)	(74,709)
Minority interests	(18,263)	6,985	(11,278)
Total purchase price, net of cash received of $29,995	$1,507,775	$ –	$1,507,775

In connection with the acquisition, the Company acquired contract based intangibles consisting solely of coal supply agreement obligations (customer contracts) and recorded a net intangible liability of $32.8 million. The net intangible liability is being amortized based on market differential and tonnage delivered over the terms of the applicable agreements, which range from 1 to 20 years. As of December 31, 2007, the carrying value of the net intangible liability was $28.9 million and the amortization (reduction to "Depreciation, depletion and amortization" in the consolidated statement of operations) recorded through December 31, 2007 was $3.9 million.

Estimated amortization (reduction to "Depreciation, depletion and amortization" in the consolidated statement of operations) as of December 31, 2007 is as follows:

(Dollars in thousands)	
2008	$ 9,414
2009	5,015
2010	4,245
2011	7,648
2012	182
Thereafter	2,351
Total	$28,855

The following unaudited pro forma financial information presents the combined results of operations of the Company and Excel, on a pro forma basis, as though the companies had been combined as of the beginning of each period presented. The pro forma financial information does not necessarily reflect the results of operations that would have occurred had the Company and Excel constituted a single entity during those periods.

(Dollars in thousands, except per share data)	*2006*	*2005*
Revenues:		
As reported	$4,108,396	$3,666,176
Pro forma	4,403,428	3,994,514
Net income:		
As reported	$ 600,697	$ 422,653
Pro forma	569,956	364,258
Basic earnings per share - net income:		
As reported	$ 2.28	$ 1.61
Pro forma	2.16	1.39
Diluted earnings per share - net income:		
As reported	$ 2.23	$ 1.58
Pro forma	2.12	1.36

(6) ASSETS AND LIABILITIES FROM COAL TRADING ACTIVITIES

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

(Dollars in thousands)	*2007*	*2006*
Assets from coal trading activities	$966,548	$150,373
Liabilities from coal trading activities	918,596	126,731
Net assets from coal trading activities	$ 47,952	$ 23,642

The recent increase in coal price volatility and trading volumes, particularly in the Company's international markets, has significantly increased the relative value of the Company's trading asset and liability portfolio. Trading assets and liabilities are primarily forward contracts with financial swaps represeting most of the remaining balance. The net value of trading assets and liabilities represents the future realizable value of the trading portfolio.

Of the coal trading derivatives and related hedge contracts in the Company's trading portfolio as of December 31, 2007, 97% were valued utilizing prices from over-the-counter market sources, adjusted for coal quality and traded transportation differentials and 3% of the Company's contracts were valued based on similar market transactions.

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

Year of Expiration	*Percentage of Portfolio*
2008	58%
2009	41%
2010	0%
2011	1%
	100%

At December 31, 2007, 27% of the Company's credit exposure related to coal trading activities with investment grade counterparties and 73% with non-investment grade counterparties. The Company's coal trading operations traded 166.5 million tons, 79.1 million tons and 36.2 million tons for the years ended December 31, 2007, 2006 and 2005, respectively.

(7) ACCOUNTS RECEIVABLE SECURITIZATION

The Company has established an accounts receivable securitization program through its wholly-owned, bankruptcy-remote subsidiary (Seller). Under the program, the Company contributes undivided interests in a pool of eligible trade receivables to the Seller, which then sells, without recourse, to a multi-seller, asset-backed commercial paper conduit (Conduit). Purchases by the Conduit are financed with the sale of highly rated commercial paper. The Company utilizes proceeds from the sale of its accounts receivable as an alternative to other forms of debt, effectively reducing its overall borrowing costs. The funding cost of the securitization program was $11.2 million, $1.9 million and $2.5 million for the years ended December 31, 2007, 2006 and 2005, respectively. The securitization program is currently scheduled to expire in September 2009.

The securitization transactions have been recorded as sales, with those accounts receivable sold to the Conduit removed from the consolidated balance sheets. The amount of undivided interests in accounts receivable sold to the Conduit was $275.0 million and $219.2 million as of December 31, 2007 and 2006, respectively.

The Seller is a separate legal entity whose assets are available first and foremost to satisfy the claims of its creditors. Eligible receivables, as defined in the securitization agreement, consist of trade receivables from most of the Company's U.S. subsidiaries, and are reduced for certain items such as past due balances and concentration limits. Of the eligible pool of receivables contributed to the Seller, undivided interests in only a portion of the pool are sold to the Conduit. The Company (the Seller) continues to own $186.5 million of receivables as of December 31, 2007, that represents collateral supporting the securitization program. The Seller's interest in these receivables is subordinate to the Conduit's interest in the event of default under the securitization agreement. If the Company defaulted under the securitization agreement or if its pool of eligible trade receivables decreased significantly, the Company could be prohibited from selling any additional receivables in the future under the agreement.

(8) EARNINGS PER SHARE

A reconciliation of weighted-average shares outstanding follows:

	2007	*2006*	*2005*
Weighted-average shares outstanding – basic	264,068,180	263,419,344	261,519,424
Dilutive impact of stock options, restricted stock units and performance units	5,098,110	5,746,661	6,494,052
Weighted-average shares outstanding – diluted	269,166,290	269,166,005	268,013,476

(9) INVENTORIES

Inventories consisted of the following:

(Dollars in thousands)	*2007*	*2006*
Materials and supplies	$ 90,242	$ 71,899
Raw coal	55,524	37,996
Saleable coal	123,096	93,014
Total	$268,862	$202,909

(10) LEASES

The Company leases equipment and facilities under various noncancelable lease agreements. Certain lease agreements require the maintenance of specified ratios and contain restrictive covenants which limit indebtedness, subsidiary dividends, investments, asset sales and other Company actions. Rental expense under operating leases was $104.7 million, $78.5 million and $78.6 million for the years ended December 31, 2007, 2006 and 2005, respectively. The gross value of property, plant, equipment and mine development assets under capital leases was $116.9 million and $72.3 million as of December 31, 2007 and 2006, respectively, related primarily to the leasing of mining equipment. The gross accumulated amortization for these items was $24.7 million and $15.6 million at December 31, 2007 and 2006, respectively.

The Company also leases coal reserves under agreements that require royalties to be paid as the coal is mined. Certain agreements also require minimum annual royalties to be paid regardless of the amount of coal mined during the year. Total royalty expense was $343.1 million, $285.7 million and $255.2 million for the years ended December 31, 2007, 2006 and 2005, respectively.

A substantial amount of the coal mined by the Company is produced from mineral reserves leased from the owner. One of the major lessors is the U.S. government, from which the Company leases substantially all of the coal it mines in Wyoming and Colorado under terms set by Congress and administered by the U.S. Bureau of Land Management. These leases are generally for an initial term of ten years but may be extended by diligent development and mining of the reserve until all economically recoverable reserves are depleted. The Company has met the diligent development requirements for substantially all of these federal leases either directly through production or by including the lease as a part of a logical mining unit with other leases upon which development has occurred. Annual production on these federal leases must total at least 1.0% of the original amount of coal in the entire logical mining unit. In addition, royalties are payable monthly at a rate of 12.5% of the gross realization from the sale of the coal mined using surface mining methods and at a rate of 8.0% of the gross realization for coal produced using underground mining methods. The Company also leases coal reserves in Arizona from The Navajo Nation and the Hopi Tribe under leases that are administered by the U.S. Department of the Interior. These leases expire upon exhaustion of the leased reserves or upon the permanent ceasing of all mining activities on the related reserves as a whole. The royalty rates are also generally based upon a percentage of the gross realization from the sale of coal. These rates are subject to redetermination every ten years under the terms of the leases. The remainder of the leased coal is generally leased from state governments, land holding companies and various individuals. The duration of these leases varies greatly. Typically, the lease terms are automatically extended as long as active mining continues. Royalty payments are generally based upon a specified rate per ton or a percentage of the gross realization from the sale of the coal.

Future minimum lease and royalty payments as of December 31, 2007, are as follows:

(Dollars in thousands)	Capital Leases	Operating Leases	Coal Reserves
2008	$ 17,349	$ 85,356	$187,946
2009	19,141	66,037	132,060
2010	15,117	54,181	7,504
2011	15,117	44,661	6,638
2012	15,117	27,098	6,139
2013 and thereafter	35,020	81,712	43,129
Total minimum lease payments	$116,861	$359,045	$383,416
Less interest	24,675		
Present value of minimum capital lease payments	$ 92,186		

As of December 31, 2007, certain of the Company's lease obligations were secured by outstanding surety bonds and letters of credit totaling $89.9 million.

(11) ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following:

(Dollars in thousands)	2007	2006
Trade accounts payable	$398,186	$369,891
Accrued taxes other than income	152,195	113,416
Accrued payroll and related benefits	76,066	109,006
Accrued health care	83,501	70,705
Workers' compensation obligations	6,220	6,510
Other accrued benefits	3,103	3,148
Accrued royalties	35,367	48,879
Accrued environmental	7,093	14,390
Income taxes payable - Australia	27,623	94,692
Accrued interest	30,869	38,189
Other accrued expenses	133,438	75,325
Total accounts payable and accrued expenses	$953,661	$944,151

(12) INCOME TAXES

Income from continuing operations before income tax provision (benefit) and minority interests consisted of the following

(Dollars in thousands)	2007	2006	2005
U.S.	$283,501	$224,218	$171,998
Non U.S.	57,334	238,883	172,756
Total	$340,835	$463,101	$344,754

Total income tax provision (benefit) consisted of the following:

(Dollars in thousands)	2007	2006	2005
Current:			
U.S. federal	$ –	$ 4,319	$ –
Non U.S.	26,410	67,565	25,622
State	179	405	300
Total current	26,589	72,289	25,922
Deferred:			
U.S. federal	$(141,086)	$(164,768)	$ 36,491
Non U.S.	44,142	4,094	22,997
State	(7,757)	(1,699)	(21,631)
Total deferred	(104,701)	(162,373)	37,857
Total provision (benefit)	$ (78,112)	$ (90,084)	$ 63,779

The income tax rate differed from the U.S. federal statutory rate as follows:

(Dollars in thousands)	2007	2006	2005
Federal statutory rate	$ 119,292	$ 162,086	$120,664
Depletion	(55,279)	(52,317)	(44,228)
Foreign earnings rate differential	(13,613)	(16,649)	(12,279)
Remeasurement of foreign deferred taxes	56,029	–	–
State income taxes, net of U.S. federal tax benefit	329	5,089	(21,436)
Deemed liquidation of subsidiary	–	–	(245,674)
Tax credits	(24,296)	–	–
Changes in valuation allowance	(175,735)	(165,481)	216,908
Changes in tax reserves	3,256	(28,658)	44,968
Other, net	11,905	5,846	4,856
Total provision (benefit)	$ (78,112)	$ (90,084)	$ 63,779

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and liabilities consisted of the following:

(Dollars in thousands)	2007	2006
Deferred tax assets:		
Tax credits and loss carryforwards	$ 660,325	$ 607,717
Postretirement benefit obligations	324,660	323,058
Intangible tax asset and purchased contract rights	73,715	90,462
Accrual at spin-off for loss on firm purchase commitment	52,934	–
Accrued reclamation and mine closing liabilities	15,981	5,243
Accrued long-term workers' compensation liabilities	15,581	13,818
Others	85,462	83,604
Total gross deferred tax assets	$1,228,658	$1,123,902
Deferred tax liabilities:		
Property, plant, equipment and mine development, leased coal interests and advance royalties, principally due to differences in depreciation, depletion and asset writedowns	$1,355,162	$1,217,217
Others	19,054	20,256
Total gross deferred tax liabilities	1,374,216	1,237,473
Valuation allowance	(71,413)	(221,753)
Net deferred tax liability	$ (216,971)	$ (335,524)
Deferred taxes consisted of the following:		
Current deferred income taxes	$ 98,633	$ 77,562
Noncurrent deferred income taxes	(315,604)	(412,886)
Net deferred tax liability	$ (216,971)	$ (335,324)

The Company's tax credits and loss carryforwards included alternative minimum tax (AMT) and general business credits of $50.0 million and $32.2 million, U.S. net operating loss (NOL) carryforwards of $574.9 million and $535.9 million and foreign loss carryforwards of $35.4 million and $39.6 million as of December 31, 2007 and 2006, respectively. The AMT credits and foreign NOL and capital loss carryforwards have no expiration date and the U.S. NOL carryforwards begin to expire in the year 2020. The Company evaluated and assessed the expected near-term utilization of NOLs, future book and taxable income, available tax strategies and the overall deferred tax position to determine the appropriate amount and timing of valuation allowance adjustments. This assessment resulted in a significant reduction of valuation allowance during 2007 and 2006. During 2005, the Company completed a comprehensive and strategic internal corporate restructuring project resulting in a deduction

for a deemed liquidation of a subsidiary for tax purposes which significantly increased the Company's NOL's. The valuation allowance was increased during 2005 to correspond with the increase in available NOL's. The remaining valuation allowance at December 31, 2007 of $71.4 million represents a reserve for AMT credits, certain foreign deferred tax assets and state and foreign loss carryforwards, due to uncertainty of their ultimate realization.

The Company adopted the provisions of FIN No. 48 on January 1, 2007. As a result of the implementation of FIN No. 48, the Company decreased its balance of unrecognized tax benefits by $24.6 million, none of which was accounted for as a reduction to the Company's retained earnings balance due to a valuation allowance recorded against the Company's deferred tax asset for NOL carryforwards.

The total amount of the net unrecognized tax benefits at January 1, 2007 and December 31, 2007 was $135.0 million ($144.0 million gross) and $143.0 million ($152.6 million gross), respectively. The amount of the Company's gross unrecognized tax benefits has increased by $8.6 million since January 1, 2007. A reconciliation of the beginning and ending amount of gross unrecognized tax benefits is as follows (dollars in thousands):

Balance at January 1, 2007	$144,000
Additions based on tax positions related to current year	4,000
Additions for tax positions of prior years	4,600
Balance at December 31, 2007	$152,600

The amount of the net unrecognized tax benefits that, if recognized, would directly affect the effective tax rate is $143.0 million. However, $27.0 million would generate a deferred tax asset for state NOL carryforwards that would more likely than not be offset by a valuation allowance. The Company does not expect any significant increases or decreases to its unrecognized tax benefits within twelve months of this reporting date.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits in its income tax provision. The Company has recognized $2.3 million of interest for the year ended December 31, 2007. Due to NOL carryforwards, the Company had not accrued interest for any of its unrecognized tax benefits in prior years. The Company has considered the application of penalties on its unrecognized tax benefits and determined, based upon several factors, including the existence of NOL carryforwards, that no accrual of penalties is required.

The Company's Federal income tax returns for the tax years 1999 through 2001 and 2003 through 2007 remain subject to examination by the Internal Revenue Service. The Company's state income tax returns for the tax years 1991 and beyond remain subject to examination by various state taxing authorities. The Company's foreign income tax returns for the tax years 2003 and beyond remain subject to examination by various foreign taxing authorities.

The total amount of undistributed earnings of foreign subsidiaries for income tax purposes was approximately $303.6 million and $318.9 million at December 31, 2007 and 2006, respectively. The Company has not provided deferred taxes on $264.5 million and $314.0 million of foreign earnings for 2007 and 2006, respectively, because such earnings were intended to be indefinitely reinvested outside the United States. Should the Company repatriate all of these earnings, a one-time income tax charge to the Company's consolidated results of operations of up to $92.6 million could occur.

The Company made U.S. Federal tax payments totaling $3.0 million and $3.9 million for the years ended December 31, 2007 and 2006, respectively. The Company made no U.S. Federal tax payments for the year ended December 31, 2005. The Company paid state and local income taxes totaling $1.2 million, $0.5 million and $0.3 million for the years ended December 31, 2007, 2006 and 2005, respectively. The Company made non-U.S. tax payments totaling $80.0 million, $23.1 million and $2.8 million for the years ended December 31, 2007, 2006 and 2005, respectively.

(13) LONG-TERM DEBT

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

(Dollars in thousands)	*2007*	*2006*
Term Loan under Senior Unsecured Credit Facility	$ 509,084	$ 547,000
Revolving Credit Facility	97,700	–
Convertible Junior Subordinated Debentures due 2066	732,500	732,500
7.375% Senior Notes due 2016	650,000	650,000
6.875% Senior Notes due 2013	650,000	650,000
7.875% Senior Notes due 2026	246,965	246,897
5.875% Senior Notes due 2016	218,090	231,845
5.0% Subordinated Note	–	59,504
6.84% Series C Bonds due 2016	43,000	43,000
6.34% Series B Bonds due 2014	21,000	21,000
6.84% Series A Bonds due 2014	10,000	10,000
Capital lease obligations	92,186	96,869
Fair value of interest rate swaps	1,604	(13,784)
Other	971	2,201
Total	$3,273,100	$3,277,032

Senior Unsecured Credit Facility

On September 15, 2006, the Company entered into a Third Amended and Restated Credit Agreement (the Agreement), which established a $2.75 billion Senior Unsecured Credit Facility (the Senior Unsecured Credit Facility) and which amended and restated in full the Company's then existing $1.35 billion Senior Secured Credit Facility (the Senior Secured Credit Facility). The Senior Unsecured Credit Facility provides a $1.8 billion Revolving Credit Facility (the Revolver) and a $950.0 million Term Loan Facility (the Term Loan Facility).

The Revolver is intended to accommodate working capital needs, letters of credit, the funding of capital expenditures and other general corporate purposes. The Revolver also includes a $50.0 million sub-facility available for same-day swingline loan borrowings. As of December 31, 2007, the Company had $97.7 million borrowings and $413.5 million letters of credit outstanding under the Revolver, with a remaining available borrowing capacity of $1.29 billion.

The Term Loan Facility, which was fully drawn in October 2006 in connection with the Excel acquisition was paid down ($403.0 million) from a portion of the net proceeds from the Debentures. In conjunction with the establishment of the Senior Unsecured Credit Facility, the Company incurred $8.6 million in financing costs, of which $5.6 million related to the Revolver and $3.0 million related to the Term Loan. These debt issuance costs are being amortized to interest expense over five years, the term of the Senior Unsecured Credit Facility.

Loans under the facility are available to the Company in U.S. dollars, with a sub-facility under the Revolver available in Australian dollars, pounds sterling and Euros. Letters of credit under the Revolver are available to the Company in U.S. dollars with a sub-facility available in Australian dollars, pounds sterling and Euros. The interest rate payable on the Revolver and the Term Loan is based on a pricing grid tied to the Company's leverage ratio, as defined in the Agreement. The interest rate payable on the Revolver and the Term Loan is currently LIBOR plus 0.75%, which was 5.4% at December 31, 2007.

Under the Senior Unsecured Credit Facility, the Company must comply with certain financial covenants on a quarterly basis including a minimum interest coverage ratio and a maximum leverage ratio, as defined in the Agreement. The financial covenants also place limitations on the Company's investments in joint ventures, unrestricted subsidiaries, indebtedness of non-loan parties and the imposition of liens on Company assets. The new facility is less restrictive with respect to limitations on the Company's dividend payments, capital expenditures, asset sales and stock repurchases. The Senior Unsecured Credit Facility matures on September 15, 2011.

Convertible Junior Subordinated Debentures

On December 20, 2006, the Company issued $732.5 million aggregate principal amount of 4.75% Convertible Junior Subordinated Debentures due 2066 (the Debentures), including $57.5 million issued pursuant to the underwriters' exercise of their over-allotment option. Net proceeds from the offering, after deducting underwriting discounts and offering expenses, were $715.0 million and were used to repay indebtedness under the Company's Senior Unsecured Credit Facility.

The Debentures will pay interest semiannually at a rate of 4.75% per year. The Company may elect to, and if and to the extent that a mandatory trigger event (as defined in the indenture governing the Debentures) has occurred and is continuing will be required to, defer interest payments on the Debentures. After five years of deferral at the Company's option, or upon the occurrence of a mandatory trigger event, the Company generally must sell warrants or preferred stock with specified characteristics and use the funds from that sale to pay deferred interest, subject to certain limitations. In no event may the Company defer payments of interest on the Debentures for more than 10 years.

The Debentures are convertible at any time on or prior to December 15, 2036 if any of the following conditions occur: (i) the Company's closing common stock price exceeds 140% of the then applicable conversion price for the Debentures (currently $81.83 per share) for at least 20 of the final 30 trading days in any quarter; (ii) a notice of redemption is issued with respect to the Debentures; (iii) a change of control, as defined in the indenture governing the Debentures; (iv) satisfaction of certain trading price conditions; and (v) other specified corporate transactions described in the indenture governing the Debentures. In addition, the Debentures are convertible at any time after December 15, 2036 to December 15, 2041, the scheduled maturity date. In the case of conversion following a notice of redemption or upon a non-stock change of control, as defined in the indenture governing the Debentures, holders may convert their Debentures into cash in the amount of the principal amount of their Debentures and shares of the Company's common stock for any conversion value in excess of the principal amount. In all other conversion circumstances, holders will receive perpetual preferred stock (see Note 17) with a liquidation preference equal to the principal amount of their Debentures, and any conversion value in excess of the principal amount will be settled with the Company's common stock. As a result of the Patriot Coal Corporation spin-off, the conversion rate was adjusted to 17.1078 shares of common stock per $1,000 principal amount of Debentures effective November 23, 2007. This adjusted conversion rate represents a conversion price of approximately $58.45.

The Debentures are not subject to redemption prior to December 20, 2011. Between December 20, 2011 and December 19, 2036 the Company may redeem the Debentures, in whole or in part, if for at least 20 out of the 30 consecutive trading days immediately prior to the date on which notice of redemption is given, the Company's closing common stock price has exceeded 130% of the then applicable conversion price for the Debentures. On or after December 20, 2036, whether or not the redemption condition is satisfied, the Company may redeem the Debentures, in whole or in part. The Company may not redeem any Debentures unless (i) all accrued and unpaid interest on the Debentures has been paid in full on or prior to the redemption date and (ii) if any perpetual preferred stock is outstanding, the Company has first given notice to redeem the perpetual preferred stock in the same proportion as the redemption of the Debentures. Any redemption of the Debentures will be at a cash redemption price of 100% of the principal amount of the Debentures to be redeemed, plus accrued and unpaid interest to the date of redemption.

On December 15, 2041, the scheduled maturity date, the Company will use commercially reasonable efforts, subject to the occurrence of a market disruption event, as defined in the indenture governing the Debentures, to issue securities of equivalent equity content in an amount sufficient to pay the principal amount of the Debentures, together with accrued and unpaid interest. The final maturity date of the Debentures is December 15, 2066, on which date the entire principal amount of the Debentures will mature and become due and payable, together with accrued and unpaid interest.

In connection with the issuance of the Debentures, the Company entered into a Capital Replacement Covenant (the CRC). Pursuant to the CRC, the Company covenanted for the benefit of holders of covered debt, as defined in the CRC (currently the Company's 7.875% Senior Notes due 2026, issued in the aggregate principal amount of $250.0 million), that neither the Company nor any of its subsidiaries shall repay, redeem or repurchase all or any part of the Debentures on or after December 15, 2041 and prior to December 15, 2046, except to the extent that the total repayment, redemption or repurchase price does not exceed the sum of: (i) 400% of the Company's net cash proceeds from the sale of its common stock and rights to acquire its common stock (including common stock issued pursuant to the Company's dividend reinvestment plan or employee benefit plans); (ii) the Company's net cash proceeds from the sale of its mandatorily convertible preferred stock, as defined in the CRC, or debt exchangeable for equity, as defined in the CRC; and (iii) the Company's net cash proceeds from the sale of other replacement capital securities, as defined in the CRC, in each case, during the six months prior to the notice date for the relevant payment, redemption or repurchase.

The Debentures are unsecured obligations of the Company, ranking junior to all existing and future senior and subordinated debt (excluding trade accounts payable or accrued liabilities arising in the ordinary course of business) except for any future debt that ranks equal to or junior to the Debentures. The Debentures will rank equal in right of payment with the Company's obligations to trade creditors. Substantially, all of the Company's existing indebtedness is senior to the Debentures. In addition, the Debentures will be effectively subordinated to all indebtedness of the Company's subsidiaries. The indenture governing the Debentures places no limitation on the amount of additional indebtedness that the Company or any of the Company's subsidiaries may incur.

7.375% Senior Notes Due November 2016 and 7.875% Senior Notes Due November 2026

On October 12, 2006, the Company completed a $650.0 million offering of 7.375% 10-year Senior Notes due 2016 and $250.0 million of 7.875% 20-year Senior Notes due 2026. The notes are general unsecured obligations of the Company and rank senior in right of payment to any subordinated indebtedness of the Company; equally in right of payment with any senior indebtedness of the Company; effectively junior in right of payment to the Company's existing and future secured indebtedness, to the extent of the value of the collateral securing that indebtedness; and effectively junior to all the indebtedness and other liabilities of the Company's subsidiaries that do not guarantee the notes. Interest payments are scheduled to occur on May 1 and November 1 of each year. The first interest payment occurred on May 1, 2007.

The notes are guaranteed by the Company's Subsidiary Guarantors, as defined in the note indenture. The note indenture contains covenants that, among other things, limit the Company's ability to create liens and enter into sale and leaseback transactions. The notes are redeemable at a redemption price equal to 100% of the principal amount of the notes being redeemed plus a make-whole premium, if applicable, and any accrued unpaid interest to the redemption date. Net proceeds from the offering, after deducting underwriting discounts and expenses, were $886.1 million.

6.875% Senior Notes Due March 2013

On March 21, 2003, the Company issued $650.0 million of 6.875% Senior Notes due March 2013. The notes are senior unsecured obligations of the Company and rank equally with all of the Company's other senior unsecured indebtedness. Interest payments are scheduled to occur on March 15 and September 15 of each year. The notes are guaranteed by the Company's Subsidiary Guarantors as defined in the note indenture. The note indenture contains covenants which, among other things, limit the Company's ability to incur additional indebtedness and issue preferred stock, pay dividends or make other distributions, make other restricted payments and investments, create liens, sell assets and merge or consolidate with other entities. The notes are redeemable prior to March 15, 2008, at a redemption price equal to 100% of the principal amount plus a make-whole premium (as defined in the indenture) and on or after March 15, 2008, at fixed redemption prices as set forth in the indenture.

5.875% Senior Notes Due March 2016

On March 23, 2004, the Company completed an offering of $250.0 million of 5.875% Senior Notes due March 2016. The notes are senior unsecured obligations of the Company and rank equally with all of the Company's other senior unsecured indebtedness. Interest payments are scheduled to occur on April 15 and October 15 of each year, and commenced on April 15, 2004. The notes are guaranteed by the Company's Subsidiary Guarantors as defined in the note indenture. The note indenture contains covenants which, among other things, limit the Company's ability to incur additional indebtedness and issue preferred stock, pay dividends or make other distributions, make other restricted payments and investments, create liens, sell assets and merge or consolidate with other entities. The notes are redeemable prior to April 15, 2009, at a redemption price equal to 100% of the principal amount plus a make-whole premium (as defined in the indenture) and on or after April 15, 2009, at fixed redemption prices as set forth in the indenture. Net proceeds from the offering, after deducting underwriting discounts and expenses, were $244.7 million.

5.0% Subordinated Note

The 5.0% Subordinated Note was retired during the three months ended March 31, 2007.

Series Bonds

As of December 31, 2007, the Company had $74.0 million in Series Bonds outstanding, which were assumed as part of the Excel acquisition. The 6.84% Series A Bonds have a balloon maturity in December 2014. The 6.34% Series B Bonds mature in December 2014 and are payable in installments beginning December 2008. The 6.84% Series C Bonds mature in December 2016 and are payable in installments beginning December 2012. Interest payments are scheduled to occur in June and December of each year.

Interest Rate Swaps

As of December 31, 2007, the Company had a series of fixed-to-floating interest rate swaps with a notional principal amount of $120.0 million. Under the terms of these swaps the Company receives a fixed rate of 6.875% and pays a weighted average floating rate of LIBOR plus 2.0%, which resets each March 15, June 15, September 15 and December 15. The swaps have been designated as a hedge of the changes in the fair value of the 6.875% Senior Notes due 2013.

The Company also has another series of fixed-to-floating interest rate swaps with a notional principal amount of $100.0 million. Under the terms of these swaps the Company receives a fixed rate of 5.875% and pays a weighted average floating rate of LIBOR plus 0.25%, which resets each April 15 and October 15. This series of swaps has been designated as a hedge of the changes in the fair value of the 5.875% Senior Notes due 2016.

In conjunction with the Term Loan Facility, the Company has a floating-to-fixed interest rate swap in place for a notional principal amount of $120.0 million. Under the terms of this swap the Company receives a floating rate of LIBOR plus 1.0% and pays a fixed rate of 6.25%. This interest rate swap was designated as a hedge of the variable interest payments on the Term Loan under the Senior Unsecured Credit Facility.

Because the critical terms of the swaps and the respective debt instruments they hedge coincide, there was no hedge ineffectiveness recognized in the consolidated statements of operations during the years ended December 31, 2007 and 2006. At December 31, 2007 and 2006 there was an unrealized loss related to the cash flow hedge of $6.8 million and $2.5 million, respectively. At December 31, 2007 there was a net unrealized gain on the fair value hedges of $1.6 million. At December 31, 2006 there was a net unrealized loss on the fair value hedges of $13.8 million. The fair value hedge is reflected as an adjustment to the carrying value of the Senior Notes (see table above).

Capital Lease Obligations and Other

Capital lease obligations include obligations assumed from the Excel acquisition, primarily for mining equipment (see Note 10 for additional information on the Company's capital lease obligations).

Other long-term debt, which consists principally of notes payable, is due in installments through 2016. The weighted-average effective interest rate of this debt was 6.32% as of December 31, 2007.

As of December 31, 2006, "Capital lease obligations" reflected an additional $40.2 million that was previously classified as "Accounts payable and accrued expenses" on the Company's consolidated balance sheet in its Annual Report on Form 10-K for the year ended December 31, 2006. The reclassification relates to a capital lease transaction structure that was finalized during the three months ended March 31, 2007. The lease term is seven years with annual payments of approximately $7.2 million over the term of the lease, and a balloon payment at maturity of approximately $11.2 million.

The aggregate amounts of long-term debt maturities subsequent to December 31, 2007, including capital lease obligations, were as follows:

Year of Maturity (Dollars in thousands)	
2008	$ 36,673
2009	37,395
2010	33,217
2011	546,875
2012	20,862
2013 and thereafter	2,598,078
Total	$3,273,100

Interest paid on long-term debt was $191.9 million, $114.6 million and $94.2 million for the years ended December 31, 2007, 2006 and 2005, respectively. The Company paid interest expense of $1.5 million and $3.3 million on the Revolver in 2007 and 2006, respectively, and no interest was paid on the Revolver in 2005.

Early Debt Extinguishment Costs

For the year ended December 31, 2007, the Company recorded net early debt extinguishment costs of $0.3 million, primarily related to the repayment of borrowings under the Term Loan Facility. For the year ended December 31, 2006, the Company recorded net early debt extinguishment costs of $1.4 million, primarily related to the repayment of borrowings on the 5.875% Senior Notes.

Shelf Registration Statement

On July 28, 2006, the Company filed an automatic shelf registration statement on Form S-3 as a well-known seasoned issuer with the SEC. The registration was for an indeterminate number of securities and is effective for three years, at which time the Company can file an automatic shelf registration statement that would become immediately effective for another three-year term. Under this universal shelf registration statement, the Company has the capacity to offer and sell from time to time securities, including common stock, preferred stock, debt securities, warrants and units. The Debentures, 7.375% Senior Notes due 2016 and 7.875% Senior Notes due 2026 were issued pursuant to the shelf registration statement.

(14) ASSET RETIREMENT OBLIGATIONS

Reconciliations of the Company's liability for asset retirement obligations were as follows:

(Dollars in thousands)	2007	2006
Balance at beginning of year, including discontinued operations	$ 423,031	$ 399,203
Liabilities incurred or acquired	27,041	18,573
Liabilities settled or disposed	(16,563)	(40,621)
Accretion expense	27,813	29,480
Revisions to estimate	32,142	16,396
Consolidated asset retirement obligations	493,464	423,031
Liabilities related to the Patriot spin-off	(123,917)	(139,703)
Balance at end of year	$ 369,547	$ 283,328

As of December 31, 2007, asset retirement obligations of $369.5 million consisted of $337.0 million related to locations with active mining operations and $32.5 million related to locations that are closed or inactive. As of December 31, 2006, asset retirement obligations of $423.0 million consisted of $354.0 million related to locations with active mining operations and $69.0 million related to locations that are closed or inactive. The amount of asset retirement obligations related to discontinued operations was $139.7 million at December 31, 2006. This total consists of $96.3 million related to locations with active mining operations and $43.4 million related to locations that are closed or inactive. The credit-adjusted, risk-free interest rates were 7.85% at December 31, 2007 and 6.60% and 6.16% at January 1, 2007 and 2006, respectively.

As of December 31, 2007 and 2006, the Company had $418.3 million and $356.0 million, respectively, in surety bonds outstanding to secure reclamation obligations or activities. The amount of reclamation self-bonding in certain states in which the Company qualifies was $640.6 million and $636.5 million as of December 31, 2007 and 2006, respectively. Additionally, the Company had $1.6 million and $2.7 million of letters of credit in support of reclamation obligations or activities as of December 31, 2007 and 2006, respectively. These figures have all been adjusted to exclude financial guarantees related to Patriot Coal Corporation.

(15) PENSION AND SAVINGS PLANS

One of the Company's subsidiaries, Peabody Investments Corp., sponsors a defined benefit pension plan covering certain U.S. salaried employees and eligible hourly employees at certain Peabody Investments Corp. subsidiaries (the Peabody Plan). A Peabody Investments Corp. subsidiary also has a defined benefit pension plan covering eligible employees who are represented by the UMWA under the Western Surface Agreement (the Western Plan). Peabody Investments Corp. also sponsors an unfunded supplemental retirement plan to provide senior management with benefits in excess of limits under the federal tax law.

Annual contributions to the plans are made as determined by consulting actuaries based upon the Employee Retirement Income Security Act of 1974 minimum funding standard. In May 1998, the Company entered into an agreement with the Pension Benefit Guaranty Corporation (PBGC) which requires the Company to maintain certain minimum funding requirements. Beginning on January 1, 2008, new minimum funding standards will be required by the Pension Protection Act of 2006. Assets of the plans are primarily invested in various marketable securities, including U.S. government bonds, corporate obligations and listed stocks.

Net periodic pension costs included the following components:

(Dollars in thousands)	2007	2006	2005
Service cost for benefits earned	$12,719	$12,234	$11,853
Interest cost on projected benefit obligation	48,959	46,034	45,499
Expected return on plan assets	(57,370)	(54,587)	(52,812)
Amortization of prior service cost	349	(32)	–
Amortization of actuarial losses	15,329	22,685	24,588
Net periodic pension costs	19,986	26,334	29,128
Curtailment (gain) loss	(403)	–	9,527
Total net periodic pension costs	$19,583	$26,334	$38,655

During 2007, benefits were frozen for certain participants of the Company's Western U.S. Mining Operations and those participants impacted by the Patriot spin-off under the Peabody Plan resulting in a curtailment gain of $0.4 million. The 2005 curtailment loss resulted from the termination of operations at two of the three operating mines that participate in the Western Plan during 2005. The loss is actuarially determined and consists of an increase in the actuarial liability, the accelerated recognition of previously unamortized prior service cost and contractual termination benefits under the Western Plan resulting from the termination of operations.

The following includes amounts recognized in accumulated other comprehensive income:

(Dollars in thousands)	2007
Net actuarial gain arising during year	$(89,628)
Prior service cost arising during year	7,893
Amortizations:	
Actuarial loss	(15,329)
Prior service credit	54
Total recognized in other comprehensive income	(97,010)
Net periodic postretirement benefit costs	19,986
Total recognized in net periodic postretirement benefit costs and other comprehensive income	$(77,024)

The Company amortizes actuarial gains and losses using a 5% corridor with a five-year amortization period. The estimated net actuarial gain and prior service cost that will be amortized from accumulated other comprehensive income (loss) into net periodic pension costs during the year ended December 31, 2008 are $0.5 million and $1.2 million, respectively.

The following summarizes the change in benefit obligation, change in plan assets and funded status of the Company's plans:

(Dollars in thousands)	2007	2006
Change in benefit obligation:		
Projected benefit obligation at beginning of period	$832,800	$ 801,818
Service cost	12,719	12,234
Interest cost	48,959	46,034
Plan amendments	(7,893)	–
Curtailments	(20,516)	–
Benefits paid	(42,642)	(40,323)
Actuarial (gain) loss	(61,063)	13,037
Projected benefit obligation at end of period	778,150	832,800
Change in plan assets:		
Fair value of plan assets at beginning of period	704,172	654,023
Actual return on plan assets	65,417	84,326
Employer contributions	5,357	6,146
Benefits paid	(42,642)	(40,323)
Fair value of plan assets at end of period	732,304	704,172
Funded status at end of year	$ (45,846)	$(128,628)
Amounts recognized in the consolidated balance sheets:		
Intangible asset (included in Investments and other assets)	$ 208	$ –
Current obligation (included in Accounts payable and accrued expenses)	(1,315)	(1,312)
Noncurrent obligation (included in Other noncurrent liabilities)	(44,739)	(127,316)
Net amount recognized	$ (45,846)	$(128,628)

The weighted-average assumptions used to determine the benefit obligations as of the end of each year were as follows:

	2007	2006
Discount rate	6.75%	6.00%
Rate of compensation increase	N/A	3.50%
Measurement date	Dec. 31, 2007	Dec. 31, 2006

The weighted-average assumptions used to determine net periodic benefit cost were as follows:

	2007	2006	2005
Discount rate	6.00%	5.90%	6.10%
Expected long-term return on plan assets	8.75%	8.75%	8.75%
Rate of compensation increase	3.50%	3.50%	3.50%
Measurement date	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2004

The expected rate of return on plan assets is determined by taking into consideration expected long-term returns associated with each major asset class (net of inflation) based on long-term historical ranges, inflation assumptions and the expected net value from active management of the assets based on actual results.

The projected benefit obligation and the accumulated benefit obligation exceeded plan assets for all plans as of December 31, 2007 and 2006. The accumulated benefit obligation for all pension plans was $681.1 million and $808.4 million as of December 31, 2007, and 2006, respectively.

Plan Assets

Assets of the Peabody Plan and the Western Plan are commingled in the Peabody Investment Corporation Master Trust (the Master Trust) and are invested in accordance with investment guidelines that have been established by the Company's Retirement Committee (the Retirement Committee) after consultation with outside investment advisors and actuaries.

As of the year ended December 31, 2007, Master Trust assets totaled $732.3 million and were invested in the following major asset categories:

	Percentage Allocation of Total Assets	Target Allocation
Equity securities	38.5%	40.0%
Fixed income	36.6%	35.0%
International equity	15.5%	15.0%
Real estate	9.4%	10.0%
Total	100.0%	100.0%

As of the year ended December 31, 2006, Master Trust assets totaled $704.2 million and were invested in the following major asset categories:

	Percentage Allocation of Total Assets	Target Allocation
Equity securities	58.5%	55.0%
Fixed income	32.9%	35.0%
Real estate	7.6%	10.0%
Cash fund	1.0%	0.0%
Total	100.0%	100.0%

The asset allocation targets have been set with the expectation that the plan's assets will fund the plan's expected liabilities with an appropriate level of risk. To determine the appropriate target asset allocations, the Retirement Committee considers the demographics of the plan participants, the funding status of the plan, the business and financial profile of the Company and other associated risk preferences. These allocation targets are reviewed by the Retirement Committee on a regular basis and revised as necessary. Periodically, assets are rebalanced among major asset categories to maintain the allocations within a range of plus or minus 5% of the target allocation.

Plan assets are either under active management by third-party investment advisors or in index funds, all selected and monitored by the Retirement Committee. The Retirement Committee has established specific investment guidelines for each major asset class including performance benchmarks, allowable and prohibited investment types and concentration limits. In general, the plan investment guidelines do not permit leveraging the Master Trust's assets. Equity investment guidelines do not permit entering into put or call options (except as deemed appropriate to manage currency risk), and futures contracts are permitted only to the extent necessary to equitize cash holdings.

Contributions

The Company expects to contribute $19.7 million to its funded pension plans and make $1.3 million in expected benefit payments attributable to its unfunded pension plans during 2008.

Estimated Future Benefit Payments

The following benefit payments (net of retiree contributions), which reflect expected future service, as appropriate, are expected to be paid by the Master Trust:

(Dollars in thousands)	*Pension Benefits*
2008	$ 45,287
2009	46,575
2010	48,084
2011	50,211
2012	52,010
Years 2013-2017	321,112

Defined Contribution Plans

The Company sponsors employee retirement accounts under three 401(k) plans for eligible salaried U.S. employees. The Company matches voluntary contributions to each plan up to specified levels. Excluding the discontinued operations of Patriot, the expense for these plans was $21.7 million, $12.7 million and $9.5 million for the years ended December 31, 2007, 2006 and 2005, respectively. A performance contribution feature allows for additional contributions from the Company based upon meeting specified Company performance targets, and the performance contributions made by the Company were $4.9 million, $7.3 million and $8.7 million for the years ended December 31, 2007, 2006 and 2005, respectively, excluding the discontinued operations of Patriot.

Multi-Employer Pension Plan – Discontinued Operations

Certain subsidiaries that were part of the Patriot spin-off participate in multi-employer pension plans (the 1950 Plan and the 1974 Plan), which provide defined benefits to substantially all hourly coal production workers represented by the UMWA under the 2007 NBCWA. During 2007, contributions of $5.9 million made to the 1974 Plan were expensed as paid, and are reflected in "Discontinued operations." There were no contributions to the multi-employer pension plans during the years ended December 31, 2006 or 2005.

(16) POSTRETIREMENT HEALTH CARE AND LIFE INSURANCE BENEFITS

The Company currently provides health care and life insurance benefits to qualifying salaried and hourly retirees and their dependents from defined benefit plans established by the Company. Plan coverage for health and life insurance benefits is provided to future hourly retirees in accordance with the applicable labor agreement.

Net periodic postretirement benefit costs included the following components:

(Dollars in thousands)	*2007*	*2006*	*2005*
Service cost for benefits earned	$ 9,427	$ 7,575	$ 4,812
Interest cost on accumulated postretirement benefit obligation	50,542	43,497	45,108
Amortization of prior service cost	(158)	(2,232)	(2,667)
Amortization of actuarial losses	22,788	18,123	16,318
Net periodic postretirement benefit costs	$82,599	$66,963	$63,571

Net periodic postretirement benefit costs related to the spin-off of Patriot for the years ended December 31, 2007, 2006, and 2005, were $46.6 million, $41.4 million, and $35.4 million, respectively, and were included in "Discontinued operations." The Company amortizes actuarial gains and losses using a 0% corridor with an amortization period that covers the average remaining service period of active employees (8.92 years and 8.47 years at January 1, 2007 and 2006, respectively).

The following includes amounts recognized in accumulated other comprehensive income:

(Dollars in thousands)	*2007*
Net actuarial gain arising during year	$(24,474)
Prior service cost arising during year	13,835
Amortizations:	
Actuarial loss	(22,788)
Prior service credit	158
Total recognized in other comprehensive income	(33,269)
Net periodic postretirement benefit costs	82,599
Total recognized in net periodic postretirement benefit costs and other comprehensive income	$ 49,330

The estimated net actuarial loss and prior service cost that will be amortized from accumulated other comprehensive income (loss) into net periodic postretirement benefit costs during the year ended December 31, 2008 are $18.0 million and $0.4 million, respectively.

The following table sets forth the plans' combined funded status reconciled with the amounts shown in the consolidated balance sheets:

(Dollars in thousands)	*2007*	*2006*
Change in benefit obligation:		
Accumulated postretirement benefit obligation at beginning of period	$ 872,732	$ 765,928
Service cost	9,427	7,575
Interest cost	50,542	43,497
Participant contributions	883	1,082
Plan amendments	13,835	15,878
Benefits paid	(67,168)	(68,475)
Actuarial (gain) loss	(24,474)	107,247
Accumulated postretirement benefit obligation at end of period	855,777	872,732
Change in plan assets:		
Fair value of plan assets at beginning of period	–	–
Employer contributions	66,285	67,393
Participant contributions	883	1,082
Benefits paid and administrative fees (net of Medicare Part D reimbursements)	(67,168)	(68,475)
Fair value of plan assets at end of period	–	–
Funded status at end of year	(855,777)	(872,732)
Less current portion (included in Accounts payable and accrued expenses)	70,069	63,719
Noncurrent obligation (included in Accrued postretirement benefit costs)	$(785,708)	$(809,013)

The weighted-average assumptions used to determine the benefit obligations as of the end of each year were as follows:

	2007	*2006*
Discount rate	6.60%	6.00%
Rate of compensation increase	3.50%	3.50%
Measurement date	Dec. 31, 2007	Dec. 31, 2006

The weighted-average assumptions used to determine net periodic benefit cost were as follows:

	2007	*2006*	*2005*
Discount rate	6.00%	5.90%	6.10%
Rate of compensation increase	3.50%	3.50%	3.50%
Measurement date	Dec. 31, 2006	Dec. 31, 2005	Dec. 31, 2004

The following presents information about the assumed health care cost trend rate:

	2007	*2006*
Healthcare cost trend rate assumed for next year	7.50%	7.50%
Rate to which the cost trend is assumed to decline (the ultimate trend rate)	4.75%	4.75%
Year that the rate reaches the ultimate trend rate	2013	2012

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percentage-point change in the assumed health care cost trend would have the following effects:

(Dollars in thousands)	*One-Percentage-Point Increase*	*One-Percentage-Point Decrease*
Effect on total service and interest cost components	$11,202	$ (9,580)
Effect on total postretirement benefit obligation	$81,535	$(70,842)

Plan Assets

The Company's postretirement benefit plans are unfunded.

Estimated Future Benefit Payments

The following benefit payments (net of retiree contributions), which reflect expected future service, as appropriate, are expected to be paid by the Company:

(Dollars in thousands)	Postretirement Benefits
2008	$ 70,069
2009	71,115
2010	72,391
2011	73,755
2012	76,752
Years 2013-2017	378,227

Medicare and Other Plan Changes

Effective November 15, 2006, the medical premium reimbursement plan was changed for salaried employees who retired after December 31, 2004. The plan change did not apply to Powder River or Lee Ranch employees. The amendment resulted in a $20.6 million increase to the retiree health care liability. The Company began recognizing the effect of the plan amendment over 10.25 years beginning November 15, 2006. The effect was $2.0 million and $0.3 million for the years ended December 31, 2007 and 2006, respectively.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act) was signed into law. The Company elected not to defer the effects of the Act as discussed in FASB Staff Position 106-1, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003." Additionally, the Company did not elect the federal subsidy provisions of the Act; rather the Company coordinated benefits with available Medicare coverage considered the primary payer, whether or not the beneficiary enrolled and paid the required premiums.

The Company recognized a reduction in the benefit obligation on two distinct components. For plans that required amendment to incorporate the Act, the Company recognized a liability reduction of $19.1 million. This reduction was treated as a negative plan amendment and is being amortized to income over six years beginning December 15, 2003. For plans that did not require amendment, the Company recognized a liability reduction of $162.4 million. The reduction was treated as a change in the estimated cost to provide benefits to Medicare eligible beneficiaries constituting a component of the cumulative actuarial gain or loss subject to amortization in accordance with the Company's amortization method.

In January 1999, the Company adopted reductions to the salaried employee medical coverage levels for employees retiring before January 1, 2003, which was changed to January 1, 2005, in 2002. For employees retiring on or after January 1, 2005, the previous medical plan was replaced with a medical premium reimbursement plan. This plan change did not apply to Powder River or Lee Ranch salaried employees. The change in the retiree health care plan resulted in a $22.4 million reduction to the salaried retiree health care liability. The Company began recognizing the effect of the plan amendment over nine years beginning January 1, 1999. The effect was $1.0 million for the years ended December 31, 2007, 2006 and 2005, respectively.

Multi-Employer Benefit Plans – Discontinued Operations

Multi-employer benefit obligations related to the Combined Fund, the 1992 Benefit Plan and 1993 Benefit Plan became the responsibility of Patriot in conjunction with the spin-off. The Surface Mining Control and Reclamation Act Amendments of 2006 amended the federal laws establishing the Combined Fund and the 1992 Benefit Plan and include the 1993 Benefit Plan. To the extent that (i) the annual federal funding exceeds a specified amount, (ii) Congress does not allocate additional funds to cover the shortfall and (iii) Patriot's subsidiaries do not pay for their share of the shortfall, some of the Company's subsidiaries would be responsible for the additional costs.

As of December 31, 2006, the $25.6 million noncurrent obligation for the Combined Fund was in "Noncurrent liabilities of discontinued operations" and the current portion of $5.2 million was in "Current liabilities of discontinued operations" in the consolidated balance sheets. The total expense for the Combined Fund, the 1992 Benefit Plan and 1993 Benefit Plan was $14.5 million, $8.2 million and $4.9 million for the years ended December 31, 2007, 2006 and 2005, respectively, and was included in "Discontinued operations."

Pursuant to the provisions of the Coal Act and the 1992 Benefit Plan, the Company was required to provide a specified amount of security. In accordance with the 1992 Benefit Plan, the Company had outstanding letters of credit of $41.4 million as of October 31, 2007 and $119.4 million as of December 31, 2006, to secure the Company's obligation.

(17) STOCKHOLDERS' EQUITY

Common Stock

The Company has 800.0 million authorized shares of $0.01 par value common stock. Holders of common stock are entitled to one vote per share on all matters to be voted upon by the stockholders. The holders of common stock do not have cumulative voting rights in the election of directors. Holders of common stock are entitled to receive ratably dividends if, as and when dividends are declared from time to time by the Board of Directors out of funds legally available for that purpose, after payment of dividends required to be paid on outstanding preferred stock or series common stock. Upon liquidation, dissolution or winding up, any business combination or a sale or disposition of all or substantially all of the assets, the holders of common stock are entitled to receive ratably the assets available for distribution to the stockholders after payment of liabilities and accrued but unpaid dividends and liquidation preferences on any outstanding preferred stock or series common stock. The common stock has no preemptive or conversion rights and is not subject to further calls or assessment by the Company. There are no redemption or sinking fund provisions applicable to the common stock.

Effective February 22, 2006, the Company implemented a two-for-one stock split on all shares of its common stock. The Company had a similar two-for-one stock split on March 30, 2005. All share and per share amounts in these consolidated financial statements and related notes reflect the stock splits.

The following table summarizes common stock activity from December 31, 2004 to December 31, 2007:

	Shares Outstanding
December 31, 2004	259,135,908
Stock options exercised	3,633,750
Stock grants to employees	375,400
Employee stock purchases	210,750
Stock grants to non-employee directors	1,594
December 31, 2005	263,357,402
Stock options exercised	1,940,539
Stock grants to employees	566,631
Employee stock purchases	156,785
Stock grants to non-employee directors	10,440
Shares repurchased	(2,184,958)
December 31, 2006	263,846,839
Stock options exercised	5,222,074
Stock grants to employees	937,795
Employee stock purchases	185,646
Stock grants to non-employee directors	11,892
Shares relinquished	(137,625)
December 31, 2007	270,066,621

Preferred Stock and Series Common Stock

In addition to the common stock, the Board of Directors is authorized to issue up to 10.0 million shares of preferred stock and up to 40.0 million shares of series common stock. The Board of Directors is authorized to determine the terms and rights of each series, including the number of authorized shares, whether dividends (if any) will be cumulative or non-cumulative and the dividend rate of the series, redemption or sinking fund provisions, conversion terms, prices and rates, and amounts payable on shares of the series in the event of any voluntary or involuntary liquidation, dissolution or winding up of the affairs of the Company. The Board of Directors may also determine restrictions on the issuance of shares of the same series or of any other class or series, and the voting rights (if any) of the holders of the series. There were no outstanding shares of preferred stock or series common stock as of December 31, 2007.

Perpetual Preferred Stock

As discussed in Note 13, the Company issued $732.5 million aggregate principal amount of Debentures on December 20, 2006. Perpetual preferred stock issued upon a conversion of Debentures will be fully paid and non-assessable, and holders will have no preemptive or preferential right to purchase any of the Company's other securities. The perpetual preferred stock has a liquidation preference of $1,000 per share, is not convertible and is redeemable at the Company's option at any time at a cash redemption price per share equal to the liquidation preference plus any accumulated dividends. Holders are entitled to receive cumulative dividends at an annual rate of 3.0875% if and when declared by the Company's Board of Directors. After the Company has failed to pay dividends on the perpetual preferred stock for five years, or upon the occurrence of a mandatory trigger event, as defined in the certificate of designations governing the perpetual preferred stock, the Company generally must sell warrants or preferred stock with specified characteristics and use the funds from that sale to pay accumulated dividends after the payment in full of any deferred interest on the Debentures, subject to certain limitations. In the event of a mandatory trigger event, the Company may not declare dividends on the perpetual preferred stock other than those funded through the sale of warrants or preferred stock as described above. Any deferred interest on the Debentures at the time of notice of conversion will be reflected as accumulated dividends on the perpetual preferred stock at issuance. Additionally, holders of the perpetual preferred stock are entitled to elect two additional members to serve on the Company's Board of Directors if (i) prior to any remarketing of the perpetual preferred stock, the Company fails to declare and pay dividends with respect to the perpetual stock for 10 consecutive years or (ii) after any successful remarketing or any final failed remarketing of the perpetual preferred stock, the Company fails to declare and pay six dividends thereon, whether or not consecutive. The perpetual preferred stock may be remarketed at the holder's election after December 15, 2046 or earlier, upon the first occurrence of a change of control if the Company does not redeem the perpetual preferred stock. There were no outstanding shares of perpetual preferred stock as of December 31, 2007.

Preferred Share Purchase Rights Plan and Series A Junior Participating Preferred Stock

Each outstanding share of common stock, par value $0.01 per share, of the Company carries one preferred share purchase right (a Right). The Rights are governed by a plan that expires in August 2012.

The Rights have certain anti-takeover effects. The Rights will cause substantial dilution to a person or group that attempts to acquire the Company on terms not approved by the Company's Board of Directors, except pursuant to any offer conditioned on a substantial number of Rights being acquired. The Rights should not interfere with any merger or other business combination approved by the Board of Directors since the Rights may be redeemed by the Company at a redemption price of $0.001 per Right prior to the time that a person or group has acquired beneficial ownership of 15% or more of the common stock of the Company. In addition, the Board of Directors is authorized to reduce the 15% threshold to not less than 10%.

Each Right entitles the holder to purchase one quarter of one-hundredth of a share of series A junior participating preferred stock from the Company at an exercise price of $27.50, which in turn provides rights to receive the number of common stock shares having a market value of two times the exercise price

of the Right. The Right is exercisable only if a person or group acquires 15% or more of the Company's common stock. The Board of Directors is authorized to issue up to 1.5 million shares of series A junior participating preferred stock. There were no outstanding shares of series A junior participating preferred stock as of December 31, 2007.

Treasury Stock

In July 2005, the Company's Board of Directors authorized a share repurchase program of up to 5% of the then outstanding shares of its common stock, or approximately 13.1 million shares. The repurchases may be made from time to time based on an evaluation of the Company's outlook and general business conditions, as well as alternative investment and debt repayment options. During the year ended December 31, 2006, the Company repurchased 2,184,958 of its common shares at a cost of $99.8 million. There were no share repurchases under this program for the year ended December 31, 2007.

During the year ended December 31, 2007, the Company received 137,625 shares of common stock as consideration for employees' exercise of stock options and to pay estimated taxes at the vesting date of restricted stock. The value of the common stock tendered by employees to exercise stock options and to settle taxes on restricted stock was based upon the closing price on the dates of the respective transactions. The common stock tenders were in accordance with the provisions of the 1998 Stock Purchase and Option Plan, which was previously approved by the Company's Board of Directors.

(18) SHARE-BASED COMPENSATION

The Company recognizes share-based compensation expense in accordance with SFAS No. 123(R), which it adopted on January 1, 2006, and utilizes restricted stock, nonqualified stock options, performance units, and an employee stock purchase plan as part of its share-based compensation program. The Company has four equity incentive plans for employees and non-employee directors that in the aggregate allow for the issuance of share-based compensation in the form of stock appreciation rights, restricted stock, performance awards, incentive stock options, nonqualified stock options and stock units. Members of the Company's Board of Directors are eligible for stock option and restricted stock grants at the date of their election and annually in January. These plans made 47.4 million shares of the Company's common stock available for grant, with 13.6 million shares available for grant as of December 31, 2007. Additionally, in 2001, the Company established an employee stock purchase plan that provided for the purchase of up to 6.0 million shares of the Company's common stock.

For share-based payment instruments excluding restricted stock, the Company recognized $6.6 million (or $0.02 per diluted share), $17.7 million (or $0.07 per diluted share) and $24.8 million (or $0.09 per diluted share) of expense, net of taxes, for the years ended December 31, 2007, 2006 and 2005, respectively. Share-based compensation expense is recorded in "Selling and administrative expenses" in the consolidated statements of operations. As of December 31, 2007, the total unrecognized compensation cost related to nonvested awards was $26.9 million, net of taxes, which is expected to be recognized over 5.2 years with a weighted-average period of 1.1 years.

The Company used the Black-Scholes option pricing model to determine the fair value of stock options and employee stock purchase plan share-based payments made before and after the adoption of SFAS No. 123(R). The Company utilized U.S. Treasury yields as of the grant date for its risk-free interest rate assumption, matching the treasury yield terms to the expected life of the option or vesting period of the performance unit awards. The Company utilized historical company data to develop its dividend yield, expected volatility and expected option life assumptions.

Restricted Stock Awards

The Company began utilizing restricted stock as part of its equity-based compensation strategy in January 2005. Accounting for restricted stock awards was not changed by the adoption of SFAS No. 123(R). The Company recognized $10.6 million, $4.2 million and $0.9 million of expense, net of taxes, for the years ended December 31, 2007, 2006 and 2005, respectively, related to restricted stock.

A summary of restricted stock award activity is as follows:

	2007	Weighted Average Grant-Date Fair Value
Nonvested at January 1, 2007	1,011,577	$33.32
Granted	1,020,809	42.16
Vested	(38,607)	27.12
Acceleration at spin-off	(389,798)	47.55
Forfeited	(71,122)	32.79
Nonvested at December 31, 2007	1,532,859	36.01

Stock Options

Employee and director stock options granted since the Company's initial public offering (IPO) of common stock in May 2001 generally vest ratably over three years and expire after 10 years from the date of the grant, subject to earlier termination upon discontinuation of an employee's service. Options granted prior to the IPO generally cliff vest in 2010 and represented 1.2 million options of the 4.8 million options outstanding at December 31, 2007. Option grants are typically made in January of each year or following the inception of employment for employees hired during the year who are eligible to participate in the plan. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model. The Company recognized expense, net of taxes, of $3.7 million, $4.7 million and $0.1 million for the years ended December 31, 2007, 2006 and 2005, respectively, related to stock option grants to employees and non-employee directors.

A summary of outstanding option activity under the plans is as follows:

	2007	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life	Aggregate Intrinsic Value (in millions)
Beginning balance	9,320,718	$ 8.16		
Granted	427,298	35.05		
Spin-off adjustment	349,108			
Exercised	(5,222,074)	4.86		
Forfeited	(70,116)	3.86		
Outstanding	4,804,934	$12.46	4.8	$236.3
Vested and Exercisable	2,626,802	$ 8.95	4.5	$138.4

During the years ended December 31, 2007, 2006 and 2005, the total intrinsic value of options exercised, defined as the excess fair value of the underlying stock over the exercise price of the options, was $248.7 million, $84.2 million and $77.6 million, respectively. The weighted-average fair values of the Company's stock options and the assumptions used in applying the Black-Scholes option pricing model (for grants during the years ended December 31, 2007, 2006 and 2005) were as follows:

	2007	2006	2005
Weighted-average fair value	$37.93	$16.52	$8.03
Risk-free interest rate	4.6%	4.3%	3.6%
Expected option life	5.0 years	6.0 years	5.7 years
Expected volatility	43%	36%	40%
Dividend yield	0.6%	0.8%	1.0%

Prior to adopting SFAS No. 123(R), the Company applied APB Opinion No. 25 and related interpretations to account for its equity incentive plans. The following table reflects 2005 pro forma net income and basic and diluted earnings per share had compensation cost been determined for the Company's non-qualified and incentive stock options based on the fair value at the grant dates consistent with the methodology set forth under SFAS No. 123:

(Dollars in thousands except per share data)	2005
Net income:	
As reported	$422,653
Pro forma	418,704
Basic earnings per share:	
As reported	$ 1.62
Pro forma	1.60
Diluted earnings per share:	
As reported	$ 1.58
Pro forma	1.56

Performance Units

Performance units, which are typically granted annually in January, and vest over a three-year measurement period, subject to the achievement of performance goals and relative stock price performance at the conclusion of the vesting term. Three performance unit grants were outstanding during 2007 (the 2005, 2006 and 2007 grants), 2006 (the 2004, 2005 and 2006 grants) and 2005 (the 2003, 2004 and 2005 grants). The payouts related to all active grants will be settled in the Company's common stock. The payouts for the 2004 and 2003 grants were settled in cash. Payouts for the 2004 through 2007 grants are based 50% on stock price performance compared to both an industry peer group and a S&P index (a "market condition" under SFAS No. 123(R)) and 50% on a return on capital target (a "performance condition" under SFAS No. 123(R)). The payout related to the 2003 grant was based on the Company's stock price performance relative to both an industry peer group and an S&P index. The Company granted 0.2 million performance units in each of the years ended December 31, 2007, 2006, and 2005.

A summary of performance unit activity is as follows:

	2007	Weighted Average Grant-Date Fair Value	Weighted Average Remaining Contractual Life
Nonvested at January 1, 2007	421,421	$35.24	
Granted	180,462	42.33	
Spin-off adjustment	49,689		
Vested	(305,864)	38.32	
Nonvested at December 31, 2007	345,708	$41.53	1.5

As of December 31, 2007, there were 305,864 performance units vested that had an aggregate intrinsic value of $25.8 million and a conversion price per share of $59.31.

Under APB Opinion No. 25, all performance unit awards were accounted for as variable awards. Under SFAS No. 123(R), the awards settled in cash were accounted for as liability awards and adjusted to fair value at each period-end, and the awards settled in common stock are accounted for based on their grant date fair value. The performance condition awards were valued utilizing the grant date fair values of the Company's stock adjusted for dividends foregone during the vesting period. The market condition awards were valued utilizing a Monte Carlo simulation which incorporates the total shareholder return hurdles set for each grant. The Company recognized expense, net of taxes, of $1.6 million, $11.7 million, and $24.7 million for the years ended December 31, 2007, 2006, and 2005, respectively, related to performance units. The assumptions used in the valuations for grants during the years ended December 31, 2007 and 2006 were as follows:

	2007	2006
Risk-free interest rate	4.7%	4.3%
Expected volatility	43%	36%
Dividend yield	0.6%	0.8%

Employee Stock Purchase Plan

Based on the Company's employee stock purchase plan, eligible full-time and part-time employees are able to contribute up to 15% of their base compensation into this plan, subject to a limit of $25,000 per person per year. Employees are able to purchase Company common stock at a 15% discount to the lower of the fair market value of the Company's common stock on the initial or final trading dates of each six-month offering period. Offering periods begin on January 1 and July 1 of each year. The fair value of the six-month "look-back" option in the Company's employee stock purchase plan is estimated by adding the fair value of 0.15 of one share of stock to the fair value of 0.85 of an option on one share of stock. The Company recognized expense, net of taxes, of $1.2 million for the year ended December 31, 2007 related to its employee stock purchase plan. Shares purchased under the plan were 0.2 million for each of the years ended December 31, 2007, 2006 and 2005, respectively.

(19) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

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

(Dollars in thousands)	Foreign Currency Translation Adjustment	Minimum Pension Liability Adjustment	Net Actuarial Loss Associated with Postretirement Plans and Workers' Compensation Obligations	Prior Service Cost Associated with Postretirement Plans	Cash Flow Hedges	Total Accumulated Other Comprehensive Loss
December 31, 2004	$3,153	$(71,645)	$ –	$ –	$ 7,874	$ (60,618)
Net increase in value of cash flow hedges	–	–	–	–	36,154	36,154
Reclassification from other comprehensive income to earnings	–	–	–	–	(24,733)	(24,733)
Current period change	–	2,402	–	–	–	2,402
December 31, 2005	$3,153	$(69,243)	$ –	$ –	$ 19,295	$ (46,795)
Net increase in value of cash flow hedges	–	–	–	–	45,799	45,799
Reclassification from other comprehensive income to earnings	–	–	–	–	(21,452)	(21,452)
Current period change	–	22,377	–	–	–	22,377
Adjustment to initially apply SFAS No. 158	–	46,866	(288,820)	(7,033)	–	(248,987)
December 31, 2006	$3,153	$ –	$(288,820)	$ (7,033)	$ 43,642	$(249,058)
Net increase in value of cash flow hedges	–	–	–	–	83,606	83,606
Reclassification from other comprehensive income to earnings:						
Continuing operations	–	–	24,329	(127)	(61,810)	(37,608)
Discontinued operations	–	–	17,937	(6,074)	–	11,863
Current period change	–	–	64,183	(13,037)	–	51,146
Patriot spin-off	–	–	65,644	7,341	–	72,985
December 31, 2007	$3,153	$ –	$(116,727)	$(18,930)	$ 65,438	$ (67,066)

Comprehensive income differs from net income by the amount of unrealized gain or loss resulting from valuation changes of the Company's cash flow hedges (which include fuel and natural gas hedges, currency forwards and interest rate swaps) during the periods, and for the year ended December 31, 2007, the adjustment required by SFAS No. 158 to record the funded status of the Company's pension and other post-retirement benefit plans. The values of the Company's cash flow hedging instruments are affected by changes in interest rates, crude oil, heating oil and natural gas prices and the U.S. dollar/Australian dollar exchange rate.

(20) GUARANTEES AND FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK

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

Letters of Credit and Bonding

The Company has letters of credit, surety bonds and corporate guarantees (such as self bonds) in support of the Company's reclamation, lease, workers' compensation, retiree healthcare and other obligations as follows as of December 31, 2007:

(Dollars in thousands)	Reclamation Obligations	Lease Obligations	Workers' Compensation Obligations	Retiree Healthcare Obligations	Other[1]	Total
Self Bonding	$ 640,630	$ –	$ –	$ –	$ –	$ 640,630
Surety Bonds	418,303	72,985	31,210	–	16,747	539,245
Letters of Credit	1,625	–	102,687	41,361	267,947	413,620
	$1,060,558	$72,985	$133,897	$41,361	$284,694	$1,593,495

[1] *Other includes the three letter of credit obligations described below and an additional $78.3 million in self-bonding, letters of credit and surety bonds related to collateral for surety companies, road maintenance, performance guarantees and other operations.*

The Company owns a 30.0% interest in a partnership that leases a coal export terminal from the Peninsula Ports Authority of Virginia under a 30-year lease that permits the partnership to purchase the terminal at the end of the lease term for a nominal amount. The partners have severally (but not jointly) agreed to make payments under various agreements which in the aggregate provide the partnership with sufficient funds to pay rents and to cover the principal and interest payments on the floating-rate industrial revenue bonds issued by the Peninsula Ports Authority, and which are supported by letters of credit from a commercial bank. As of December 31, 2007, the Company's maximum reimbursement obligation to the commercial bank was in turn supported by a letter of credit totaling $42.8 million.

The Company is party to an agreement with the PBGC and TXU Europe Limited, an affiliate of the Company's former parent corporation, under which the Company is required to make special contributions to two of the Company's defined benefit pension plans and to maintain a $37.0 million letter of credit in favor of the PBGC. If the Company or the PBGC gives notice of an intent to terminate one or more of the covered pension plans in which liabilities are not fully funded, or if the Company fails to maintain the letter of credit, the PBGC may draw down on the letter of credit and use the proceeds to satisfy liabilities under the Employee Retirement Income Security Act of 1974, as amended. The PBGC, however, is required to first apply amounts received from a $110.0 million guarantee in place from TXU Europe Limited in favor of the PBGC before it draws on the Company's letter of credit. On November 19, 2002, TXU Europe Limited was placed under the administration process in the United Kingdom (a process similar to bankruptcy proceedings in the United States) and continues under this process as of December 31, 2007. As a result of these proceedings, TXU Europe Limited may be liquidated or otherwise reorganized in such a way as to relieve it of its obligations under its guarantee.

At December 31, 2007, the Company has a $126.6 million letter of credit for collateral for bank guarantees issued with respect to certain reclamation and performance obligations related to the mines acquired in the Excel acquisition.

Other Guarantees

As part of arrangements through which the Company obtains exclusive sales representation agreements with small coal mining companies (the Counterparties), the Company issued financial guarantees on behalf of the Counterparties. These guarantees facilitate the Counterparties' efforts to obtain bonding or financing. In 2007, the Company purchased approximately 345 million tons of coal reserves and surface lands in the Illinois Basin. In conjunction with this purchase, the Company agreed to provide up to $64.8 million of reclamation and bonding commitments to a third-party coal company. The Company has recognized the full amount of these commitments as a liability as of December 31, 2007. The non-cash portion of this transaction was excluded from the investing section of the statement of cash flows.

In the event of default, the Company has multiple recourse options, including the ability to assume the loans and procure title and use of the equipment purchased through the loans. If default occurs, the Company has the ability and intent to exercise its recourse options, so the liability associated with the guarantee has been valued at zero. The Company also guaranteed bonding for a partnership in which it formerly held an interest. The aggregate amount guaranteed by the Company for all such Counterparties was $8.8 million at December 31, 2007. The Company's obligations under the guarantees extend to September 2015.

The Company is the lessee under numerous equipment and property leases. It is common in such commercial lease transactions for the Company, as the lessee, to agree to indemnify the lessor for the value of the property or equipment leased, should the property be damaged or lost during the course of the Company's operations. The Company expects that losses with respect to leased property would be covered by insurance (subject to deductibles). The Company and certain of its subsidiaries have guaranteed other subsidiaries' performance under their various lease obligations. Aside from indemnification of the lessor for the value of the property leased, the Company's maximum potential obligations under its leases are equal to the respective future minimum lease payments as presented in Note 10, and the Company assumes that no amounts could be recovered from third parties.

The Company's former wholly-owned subsidiary, Prairie State Generating Company, LLC (PSGC), had previously entered into a cost reimbursable Target Price Engineering, Procurement and

Construction Agreement (the EPC Agreement) with Bechtel Power Corporation (Bechtel) related to the Prairie State mine mouth pulverized coal-fired generating facility. The Company provided an absolute and unconditional payment guarantee of all amounts due until financial closing by PSGC to Bechtel under the EPC Agreement (Initial Owner Guarantee). On September 28, 2007, PSGC gave Bechtel notice to proceed to full scale construction of the facility. On that date, the Company's ownership interest in PSGC was transferred to an Indiana non-profit corporation that is owned and controlled by a group of owners (Owners), including two of the Company's affiliates. Contemporaneously with the transfer of PSGC's membership interests, each Owner (including the Company's affiliates) issued a guarantee to Bechtel for its proportionate share of PSGC's obligations under the EPC Agreement and the Company issued a guarantee to Bechtel for the Company's two affiliates. The Initial Owner Guarantee was returned to the Company following the issuance of new guarantees by each Owner. After the sale of one of the Company's owner affiliates in December 2007, the Company's remaining affiliate owns 5.06% of PSGC.

The Company has provided financial guarantees under certain long-term debt agreements entered into by its subsidiaries, and substantially all of the Company's subsidiaries provide financial guarantees under long-term debt agreements entered into by the Company. The maximum amounts payable under the Company's debt agreements are equal to the respective principal and interest payments. See Note 13 for the descriptions of the Company's (and its subsidiaries') debt. Supplemental guarantor/non-guarantor financial information is provided in Note 25.

As part of the Patriot spin-off, the Company agreed to maintain in force several letters of credit that secured Patriot obligations for certain employee benefits and workers' compensation obligations. These letters of credit are to be released upon Patriot satisfying the beneficiaries with alternate letters of credit or insurance, which is expected to occur in 2008. If Patriot is unable to satisfy the primary beneficiaries by June 30, 2011, they are then required to provide directly to the Company a letter of credit in the amount of the remaining obligation. As of December 31, 2007, the amount of letters of credit securing Patriot obligations is $136.8 million.

A discussion of the Company's accounts receivable securitization is included in Note 7 to the consolidated financial statements.

(21) FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments as of December 31, 2007 and 2006:

- Cash and cash equivalents, accounts receivable and accounts payable and accrued expenses have carrying values which approximate fair value due to the short maturity or the financial nature of these instruments.
- The fair value of the Company's coal trading assets and liabilities was determined as described in Note 6.
- Long-term debt fair value estimates are based on observed prices for securities with an active trading market when available, and otherwise on estimated borrowing rates to discount the cash flows to their present value. The 7.875% Senior Notes due 2026 and the 5.0% Subordinated Note carrying amount are net of unamortized note discount.
- The fair values of interest rate swap contracts, currency forward contracts, explosives hedge contracts and fuel hedge contracts were provided by the respective contract counterparties, and were based on benchmark transactions entered into on terms substantially similar to those entered into by the Company and the contract counterparties. Based on these estimates as of December 31, 2007, the Company would have paid $1.1 million and $2.0 million, respectively, upon liquidation of its interest rate swaps and explosives hedges and would have received $124.8 million and $48.4 million, respectively, upon liquidation of its currency forwards and diesel fuel hedges.

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

	2007		2006	
(Dollars in thousands)	*Carrying Amount*	*Estimated Fair Value*	*Carrying Amount*	*Estimated Fair Value*
Long-term debt	$3,273,100	$3,471,561	$3,277,032	$3,310,590

See Note 3 for a discussion of the Company's derivative financial instruments.

(22) COMMITMENTS AND CONTINGENCIES

Commitments

As of December 31, 2007, purchase commitments for capital expenditures were $67.8 million. Commitments for expenditures to be made under coal leases are reflected in Note 10.

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

Litigation Relating to Continuing Operations

Navajo Nation Litigation

On June 18, 1999, the Navajo Nation served three of the Company's subsidiaries, including Peabody Western Coal Company (Peabody Western), with a complaint that had been filed in the U.S. District Court for the District of Columbia. The Navajo Nation has alleged 16 claims, including Civil Racketeer Influenced and Corrupt Organizations Act (RICO) violations and fraud. The complaint alleges that the defendants jointly participated in unlawful activity to obtain favorable coal lease amendments. The plaintiff is seeking various remedies including actual damages of at least $600 million, which could be trebled under the RICO counts, punitive damages of at least $1 billion, a determination that Peabody Western's two coal leases have terminated due to Peabody Western's breach of these leases and a reformation of these leases to adjust the royalty rate to 20%. Subsequently, the court allowed the Hopi Tribe to intervene in this lawsuit and the Hopi Tribe is also seeking unspecified actual damages, punitive damages and reformation of its coal lease. One of the Company's subsidiaries named as a defendant is now a subsidiary of Patriot. However, the Company is responsible for this litigation under the Separation Agreement entered into with Patriot in connection with the spin-off. On February 9, 2005, the U.S. District Court for the District of Columbia granted a consent motion to stay the litigation until further order of the court. Peabody Western, the Navajo Nation, the Hopi Tribe and the owners of the power plants served by the suspended Black Mesa mine and the Kayenta mine have terminated the mediation with respect to this litigation and other business issues, filed a status report with the Court and asked the Court to lift the stay. The Court has not lifted the stay.

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

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

Salt River Project and the other owners of the Navajo Generating Station filed a lawsuit on September 27, 1996, in the Superior Court of Maricopa County in Arizona seeking a declaratory judgment that certain costs relating to final reclamation, environmental monitoring work and mine decommissioning and costs primarily relating to retiree health care benefits are not recoverable by the Company's subsidiary, Peabody Western, under the terms of a coal supply agreement dated February 18, 1977. The contract expires in 2011. The trial court subsequently ruled that the mine decommissioning costs were subject to arbitration but that the retiree health care costs were not subject to arbitration. The Company has recorded a receivable for mine decommissioning costs of $87.7 million and $76.8 million included in "Investments and other assets" in the consolidated balance sheets as of December 31, 2007 and 2006, respectively. The parties negotiated a final comprehensive settlement and are in the process of obtaining all required approvals of the settlement documents.

Gulf Power Company Litigation

On June 22, 2006, Gulf Power Company filed a breach of contract lawsuit against a Company subsidiary in the U.S. District Court, Northern District of Florida, contesting the force majeure declaration by the Company subsidiary under a coal supply agreement with Gulf Power Company and seeking damages for alleged past and future tonnage shortfalls of nearly 5 million tons under the agreement, which expired on December 31, 2007. The Company has filed a motion to dismiss the Florida lawsuit or to transfer it to Illinois. The Court held an evidentiary hearing on the Company's motion to dismiss or transfer and has continued to stay discovery until the Court rules on the motion.

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

Claims and Litigation Relating to Indemnities or Historical Operations

Oklahoma Lead Litigation

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

Gold Fields and two other companies are defendants in two class action lawsuits allegedly involving past operations near Picher, Oklahoma. The plaintiffs have asserted claims predicated on allegations of intentional lead exposure by the defendants and are seeking compensatory damages, punitive damages and the implementation of medical monitoring and relocation programs for the affected individuals. Gold Fields was also a defendant, along with other companies, in personal injury lawsuits that at one time involved over 50 individuals, arising out of the same lead mill operations. Gold Fields, along with the former affiliate, has settled most of the claims in the personal injury lawsuits and the remaining lawsuits have been dismissed with prejudice. In December 2003, the Quapaw Indian tribe and certain Quapaw land owners filed a lawsuit against Gold Fields, five other companies and the United States. The plaintiffs are seeking compensatory and punitive damages based on a variety of theories. In December 2007, the court dismissed the tribe's medical monitoring claim. Gold Fields has filed a third-party complaint against the United States and other parties. In February 2005, the state of Oklahoma on behalf of itself and several other parties sent a notice to Gold Fields and other companies regarding a possible natural resources damage claim. All of the lawsuits are pending in the U.S. District Court for the Northern District of Oklahoma.

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

Environmental Claims and Litigation

Environmental claims have been asserted against Gold Fields related to activities of Gold Fields or a former affiliate. Gold Fields or the former affiliate has been named a potentially responsible party (PRP) at five national priority list sites based on the Superfund Amendments and Reauthorization Act of 1986. Claims were asserted at 12 additional sites, the total of which have since been reduced to 12 by completion of work, transfer or regulatory inactivity. The number of PRP sites in and of itself is not a relevant measure of liability, because the nature and extent of environmental concerns varies by site, as does the estimated share of responsibility for Gold Fields or the former affiliate. Undiscounted liabilities for environmental cleanup-related costs for all of the sites noted above were $42.4 million as of December 31, 2007 and $43.0 million as of December 31, 2006, $7.1 million and $14.4 million of which was reflected as a current liability, respectively. These amounts represent those costs that the Company believes are probable and reasonably estimable. In September 2005, Gold Fields and other PRPs received a letter from the U.S. Department of Justice alleging that the PRPs' mining operations caused the Environmental Protection Agency (EPA) to incur approximately $125 million in residential yard remediation costs at Picher, Oklahoma and will cause the EPA to incur additional remediation costs relating to historical mining sites. Gold Fields has participated in the settlement discussions. Gold Fields believes it has meritorious defenses to these claims. Gold Fields is involved in other litigation in the Picher area, and the Company indemnified TXU Group with respect to a defendant as is more fully discussed under the "Oklahoma Lead Litigation" caption above. Significant uncertainty exists as to whether claims will be pursued against Gold Fields in all cases, and where they are pursued, the amount of the eventual costs and liabilities, which could be greater or less than this provision. Based on the Company's evaluation of the issues and their potential impact, the amount of any future loss cannot be reasonably estimated. However, based on current information, the Company believes these claims and litigation are likely to be resolved without a material adverse effect on its financial condition, results of operations or cash flows.

Other

Certain subsidiaries of the Company are required to pay black lung excise taxes to the Federal Black Lung Trust Fund (the Trust Fund). The Trust Fund pays occupational disease benefits to entitled former miners who worked prior to July 1, 1973. Excise taxes are based on the selling price of coal, up to a maximum of $1.10 per ton for underground mines and $0.55 per ton for surface mines. The Company had a receivable for excise tax refunds paid on export shipments of $19.4 million as of December 31, 2007 and 2006. In a January 2007 decision, a federal appellate court ruled that coal companies are entitled to a refund of the Black Lung tax paid on export shipments for certain years and that they are also entitled to collect interest on the refund. This matter is now pending before the U.S. Supreme Court.

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

New York Office of the Attorney General Subpoena

The New York Office of the Attorney General sent a letter to the Company dated September 14, 2007. The letter referred to the Company's "plans to build new coal-fired electric generating units," and said that the "increase in CO_2 emissions from the operation of these units, in combination with Peabody Energy's other coal-fired power plants, will subject Peabody Energy to increased financial, regulatory, and litigation risks." The Company currently has no electrical generating capacity in place. The letter included a subpoena issued under New York state law, which seeks information and documents relating to the Company's analysis of the risks associated with climate change and possible climate change legislation or regulations, and its disclosure of such risks to investors. The Company believes that it has made full and proper disclosure of these potential risks.

(23) SUMMARY QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

A summary of the unaudited quarterly results of operations for the years ended December 31, 2007 and 2006, is presented below. The portions of the Eastern U.S. Mining operations business segment that were included in the spin-off of Patriot have been classified as discontinued operations and are excluded from the operating results for all periods presented. Peabody Energy common stock is listed on the New York Stock Exchange under the symbol "BTU."

	2007			
(Dollars in thousands except per share and stock price data)	*First Quarter*	*Second Quarter*	*Third Quarter*	*Fourth Quarter*
Revenues	$1,096,055	$1,065,835	$1,200,494	$1,212,328
Operating profit	147,384	174,891	112,896	133,553
Income from continuing operations	81,918	96,013	52,189	191,143
Net income	88,506	107,692	32,272	35,815
Basic earnings per share	$0.31	$0.37	$0.20	$0.72
Diluted earnings per share	$0.30	$0.36	$0.19	$0.71
Weighted average shares used in calculating basic earnings per share	263,031,869	263,479,042	263,871,330	265,861,546
Weighted average shares used in calculating diluted earnings per share	268,123,462	268,712,309	268,940,930	270,535,150
Stock price – high and low prices	$44.60-$36.20	$55.76-$39.96	$50.99-$38.42	$62.55-$47.52
Dividends per share	$0.06	$0.06	$0.06	$0.06

Second quarter operating profit included a $50.5 million gain resulting from an exchange of oil and gas rights for coal reserves (see Note 4 for information). Operating profit in the third and fourth quarters of 2007 included $17.8 million and $8.6 million, respectively, of gains from the sale of coal reserves and surface lands (see Note 4 for information). Operating profit for the third quarter of 2007 was negatively impacted by disruption in the coal-chain in Australia. Net income for the fourth quarter of 2007 included a tax benefit related to a reduction of $205.0 million in net operating loss valuation allowances, partially offset by ongoing tax expense and a $56.0 million impact on deferred taxes as a result of foreign exchange rates (see Note 12 for information).

	2006			
(Dollars in thousands except per share and stock price data)	*First Quarter*	*Second Quarter*	*Third Quarter*	*Fourth Quarter*
Revenues	$1,022,900	$1,004,091	$980,396	$1,101,009
Operating profit	133,078	159,628	152,450	145,700
Income from continuing operations	109,257	142,005	140,516	160,796
Net income	130,222	153,434	142,008	175,033
Basic earnings per share	$0.42	$0.54	$0.53	$0.61
Diluted earnings per share	$0.41	$0.52	$0.52	$0.60
Weighted average shares used in calculating basic earnings per share	263,491,072	263,958,590	263,444,254	262,790,879
Weighted average shares used in calculating diluted earnings per share	269,358,728	269,756,666	268,822,681	268,137,610
Stock price – high and low prices	$52.54-$41.24	$76.29-$46.81	$59.90-$32.94	$48.59-$34.05
Dividends per share	$0.06	$0.06	$0.06	$0.06

Second quarter operating profit included $39.2 million of gains resulting from exchanges of coal reserves (see Note 4 for information). Net income for the second quarter included the tax benefit related to a reduction in tax reserves due to the favorable finalization of former parent companies federal tax audits, partially offset by higher pretax earnings in 2006. Operating profit for the third quarter of 2006 benefited from lower performance-based compensation expense of $20.6 million. Net income for the fourth quarter of 2006 included a tax benefit related to the partial reduction in net operating loss valuation allowances (see Note 12 for information).

(24) SEGMENT INFORMATION

The Company reports its operations primarily through the following reportable operating segments: "Western U.S. Mining," "Eastern U.S. Mining," "Australian Mining" and "Trading and Brokerage." Western U.S. Mining operations reflect the aggregation of the Powder River Basin, Southwest and Colorado operating segments, and Eastern U.S. Mining operations reflects the Company's Midwest operating segments. The principal business of the Western U.S. Mining, Eastern U.S. Mining and Australian Mining segments is the mining, preparation and sale of steam coal, sold primarily to electric utilities, and metallurgical coal, sold to steel and coke producers. For the year ended December 31, 2007, 85% of the Company's sales were to U.S. electricity generators, 2% were to the U.S. industrial sector, and 13% were to customers outside the United States. Western U.S. Mining operations are characterized by predominantly surface mining extraction processes, lower sulfur content and Btu of coal and longer shipping distances from the mine to the customer. Conversely, Eastern U.S. Mining operations are characterized by a mix of surface and underground mining extraction processes, higher sulfur content and Btu of coal and shorter shipping distances from the mine to the customer. Geologically, Western operations mine bituminous and subbituminous coal deposits, and Eastern operations mine bituminous coal deposits. Australian Mining operations are characterized by both surface and underground extraction processes, mining low-sulfur, high Btu coal (metallurgical coal) as well as steam coal primarily sold to an international customer base with a small portion sold to Australian steel producers and power generators. The Trading and Brokerage segment's principal business is the marketing, brokerage and trading of coal. "Corporate and Other" includes selling and administrative expenses, net gains on property disposals, costs associated with past mining obligations, joint venture earnings related to the Company's 25.5% investment in a Venezuelan mine and revenues and expenses related to the Company's other commercial activities such as coalbed methane, generation development and resource management.

The Company's chief operating decision maker uses Adjusted EBITDA as the primary measure of segment profit and loss. Adjusted EBITDA is defined as income from continuing operations before deducting early debt extinguishment costs, net interest expense, income taxes, minority interests, asset retirement obligation expense and depreciation, depletion and amortization.

Operating segment results for the year ended December 31, 2007 were as follows:

(Dollars in thousands)	*Western U.S. Mining*	*Eastern U.S. Mining*	*Australian Mining*	*Trading and Brokerage*	*Corporate and Other*	*Consolidated*
Revenues	$2,061,265	$984,841	$1,161,093	$320,692	$46,821	$4,574,712
Adjusted EBITDA	597,333	196,595	159,473	110,169	(107,677)	955,893
Total assets	2,893,828	529,576	3,033,280	963,636	2,247,987	9,668,307
Additions to property, plant, equipment and mine development	175,423	35,763	168,258	–	90,990	470,434
Federal coal lease expenditures	178,193	–	–	–	–	178,193
Income (loss) from equity affiliates	10	(6,130)	–	–	20,581	14,461

Operating segment results for the year ended December 31, 2006 were as follows:

(Dollars in thousands)	Western U.S. Mining	Eastern U.S. Mining	Australian Mining	Trading and Brokerage	Corporate and Other	Consolidated
Revenues	$1,703,445	$905,743	$843,194	$652,029	$3,985	$4,108,396
Adjusted EBITDA	473,074	184,549	278,411	92,604	(127,682)	900,956
Total assets	2,628,070	348,790	2,784,922	240,329	2,439,940	8,442,051
Additions to property, plant, equipment and mine development	151,572	62,515	123,242	1,045	59,123	397,497
Federal coal lease expenditures	178,193	–	–	–	–	178,193
Income (loss) from equity affiliates	15	(4,968)	–	–	27,744	22,791

Operating segment results for the year ended December 31, 2005 were as follows:

(Dollars in thousands)	Western U.S. Mining	Eastern U.S. Mining	Australian Mining	Trading and Brokerage	Corporate and Other	Consolidated
Revenues	$1,611,587	$760,404	$598,085	$679,176	$16,924	$3,666,176
Adjusted EBITDA	459,039	168,793	202,582	43,058	(165,623)	707,849
Total assets	2,566,034	247,722	426,810	212,550	2,509,874	5,962,990
Additions to property, plant, equipment and mine development	113,047	13,169	85,335	–	97,602	309,153
Federal coal lease expenditures	118,364	–	–	–	–	118,364
Purchase of mining and related assets	84,695	34,988	–	–	21,512	141,195
Income (loss) from equity affiliates	14	(5,151)	–	–	20,364	15,227

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

(Dollars in thousands)	2007	2006	2005
Total adjusted EBITDA	$955,893	$900,956	$707,849
Depreciation, depletion and amortization	(361,559)	(294,270)	(253,788)
Asset retirement obligation expense	(25,610)	(15,830)	(20,329)
Interest expense	(235,236)	(137,668)	(98,066)
Early debt extinguishment costs	253	(1,396)	–
Interest income	7,094	11,309	9,088
Income tax (provision) benefit	78,112	90,084	(63,779)
Minority interests	2,316	(611)	(2,472)
Income from continuing operations	$421,263	$552,574	$278,503

(25) SUPPLEMENTAL GUARANTOR/NON-GUARANTOR FINANCIAL INFORMATION

Supplemental guarantor/non-guarantor financial information can be located in Note 25 of the Company's consolidated financial statements filed as part of the 2007 Annual Report on Form 10-K with the U.S. Securities and Exchange Commission.

Stock Price and Performance Information

MARKET INFORMATION

Our common stock is listed on the New York Stock Exchange, under the symbol "BTU." As of February 15, 2008, there were 1,074 holders of record of our common stock.

The table below sets forth the range of quarterly high and low sales prices for our common stock (after giving retroactive effect to the two-for-one stock split effective February 22, 2006) on the New York Stock Exchange during the calendar quarters indicated.

	High	Low
2006		
First Quarter	$52.54	$41.24
Second Quarter	76.29	46.81
Third Quarter	59.90	32.94
Fourth Quarter	48.59	34.05
2007		
First Quarter	$44.60	$36.20
Second Quarter	55.76	39.96
Third Quarter	50.99	38.42
Fourth Quarter	62.55	47.52

DIVIDEND POLICY

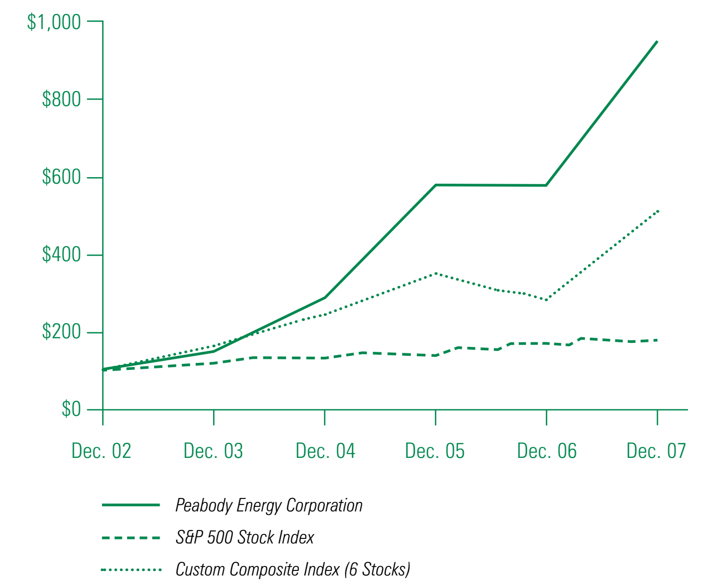
We paid quarterly dividends totaling $0.24 per share during the years ended December 31, 2007 and 2006. Most recently, our Board of Directors declared a dividend of $0.06 per share of Common Stock on January 29, 2008, payable on March 4, 2008, to stockholders of record on February 12, 2008. The declaration and payment of dividends and the amount of dividends will depend on our results of operations, financial condition, cash requirements, future prospects, any limitations imposed by our debt instruments and other factors deemed relevant by our Board of Directors; however, we presently expect that dividends will continue to be paid.

STOCK PERFORMANCE GRAPH

The following performance graph compares the cumulative total return on our common stock with the cumulative total return of the following indices: (i) the S&P 500 Stock Index and (ii) a peer group comprised of Arch Coal Inc., Massey Energy Company, CONSOL Energy, Inc., Foundation Coal Holdings Inc., Alpha Natural Resources, Inc. and International Coal Group, Inc. (Custom Composite Index). The graph assumes that the value of the investment in our common stock and each index was $100 at December 31, 2002. The graph also assumes that all dividends, including the spin-off of Patriot, were reinvested and that investments were held through December 31, 2007. These indices are included for comparative purposes only and do not necessarily reflect management's opinion that such indices are an appropriate measure of the relative performance of the stock involved, and are not intended to forecast or be indicative of possible future performance of the common stock.

Cumulative Total Return

(Based upon an initial investment of $100 on December 31, 2002 with dividends reinvested)



	Dec. 02	Dec. 03	Dec. 04	Dec. 05	Dec. 06	Dec. 07
Peabody Energy Corporation	$100	$145	$285	$584	$575	$942
S&P 500 Stock Index	$100	$129	$143	$150	$173	$183
Custom Composite Index (6 Stocks)	$100	$165	$247	$350	$281	$513

Board of Directors and Executives

Directors

Gregory H. Boyce (53)
Chairman and
Chief Executive Officer
Peabody Energy

William A. Coley (64)
Chief Executive Officer
British Energy Group plc

Dr. Henry Givens, Jr. (74)
President
Harris-Stowe State University

William E. James (62)
Founding Partner
RockPort Capital Partners LLC

Robert B. Karn III (66)
Former Managing Partner
Arthur Andersen Financial &
Consulting, St. Louis

Henry E. Lentz (62)
Advisory Director
Lehman Brothers Inc.

William C. Rusnack (63)
Former President and
Chief Executive Officer
Premcor Inc.

Dr. James R. Schlesinger (79)
Former U.S. Secretary
of Energy, U.S. Secretary
of Defense & CIA Director

Dr. Blanche M. Touhill (76)
Chancellor Emeritus
University of Missouri-
St. Louis

John F. Turner (65)
Former U.S. Assistant Secretary
of State for Oceans and
International Environmental
and Scientific Affairs

Sandra A. Van Trease (47)
Group President
BJC Healthcare

Alan H. Washkowitz (67)
Former Managing Director
Lehman Brothers Inc.

Audit Committee

William C. Rusnack, Chair
Robert B. Karn III
Sandra A. Van Trease
Alan H. Washkowitz

Compensation Committee

Robert B. Karn III, Chair
William A. Coley
Henry E. Lentz
John F. Turner

Executive Committee

Gregory H. Boyce, Chair
William A. Coley
Henry E. Lentz
William C. Rusnack

Nominating & Corporate Governance Committee

Dr. Blanche M. Touhill, Chair
Dr. Henry Givens, Jr.
William E. James
Dr. James R. Schlesinger
John F. Turner
Alan H. Washkowitz

Senior Executives

Gregory H. Boyce (53)
Chairman and
Chief Executive Officer

Sharon D. Fiehler (51)
Executive Vice President
and Chief Administrative Officer

Eric Ford (53)
Executive Vice President and
Chief Operating Officer

Richard A. Navarre (47)
President and
Chief Commercial Officer

Fredrick D. Palmer (63)
Senior Vice President
Government Relations

Alexander C. Schoch (53)
Executive Vice President Law
and Chief Legal Officer

Roger B. Walcott, Jr. (51)
Executive Vice President

All directors except Mr. Boyce are independent under New York Stock Exchange listing standards.

Ages as of February 15, 2008.

Shareholder Information

Stock Exchange Listing

Peabody Energy stock is traded on the New York Stock Exchange (NYSE) under the ticker symbol BTU.

Financial Information

Peabody Energy Corporation
701 Market Street, St. Louis, MO 63101-1826
Phone: (314) 342-7900 Fax: (314) 342-7799
E-mail: IR@PeabodyEnergy.com
Web: PeabodyEnergy.com

Annual Meeting

Peabody Energy will hold its annual shareholders meeting at The Ritz-Carlton Hotel, St. Louis, Missouri, at 10 a.m. on Thursday, May 8, 2008.

Independent Auditors

Ernst & Young LLP
190 Carondelet Plaza, Suite 1300, Clayton, MO 63105
Phone: (314) 290-1000 Fax: (314) 290-1882

Transfer Agent

If you have questions regarding your BTU account, please contact your broker, or our transfer agent, American Stock Transfer & Trust Company (AST), at (866) 621-2789 for residents of the U.S. or Canada, or (718) 921-8347 for residents outside the U.S. and Canada. AST may also be contacted at www.amstock.com. AST can help with dividend reinvestments, lost certificates, transfer of stock to another person and additional services.

Stock Splits

Shares of BTU split 2-for-1 on March 30, 2005, and 2-for-1 on February 22, 2006.

Dividends

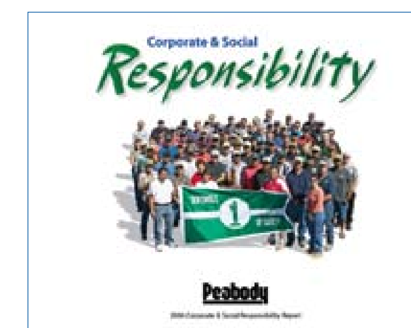
Peabody pays quarterly dividends on common stock, subject to the approval of the board of directors. On Oct. 31, 2007, Peabody completed the spin-off of Patriot Coal Corp. through a special dividend of all of Patriot's outstanding shares at a ratio of one Patriot share for every 10 Peabody shares.

Disclosure Certification

Peabody has included as exhibits to its 2007 Annual Report on Form 10-K, filed with the Securities and Exchange Commission (SEC), certificates of Peabody's Chairman and Chief Executive Officer and Peabody's President and Chief Commercial Officer (also the principal financial and accounting officer) certifying the quality of the company's public disclosure. Peabody's Chairman and Chief Executive Officer has also submitted a certificate to the NYSE confirming that he is not aware of any violations by Peabody of the NYSE's corporate governance listing standards.

Report on Corporate and Social Responsibility

Peabody's record of good corporate governance and sustainable practices spans our 125-year history. Our 2007 Corporate and Social Responsibility Report assesses progress against priorities and reviews Peabody's actions, positions and policies. The full report may be downloaded at PeabodyEnergy.com.



Peabody and Its Affiliates

The use of the words "Peabody," "the company," and "our" relate to Peabody, our subsidiaries and our majority-owned affiliates.

Forward-Looking Statements

Some of the information included in this report contains 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 is intended to come within the safe harbor protection provided by those sections. These statements relate to future events or our future financial performance. When considering these forward-looking statements, you should keep in mind the cautionary statements in our documents filed with the SEC.

Contains a minimum of 10% post-consumer fiber

© 2008 Peabody Energy Corporation

Peabody