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PEABODY ENERGY CORP
Form 10-K405/A
July 03, 2001

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-K/A
(Amendment No. 1)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934 For the Fiscal Year Ended March 31, 2001

or

[] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934 For the transition period from _____ to _____

Commission File Number 1-16463

PEABODY ENERGY CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE

13-4004153

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer
Identification No.)

701 MARKET STREET, ST. LOUIS, MISSOURI

63101

(Address of principal executive offices)

(Zip Code)

(314) 342-3400

Registrant's telephone number, including area code

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

Title of Each Class

Name of Each Exchange on Which Registered

Common Stock, par value \$0.01 per share

New York Stock Exchange

Securities Registered Pursuant to Section 12(g) of the Act: NONE

Indicate by check mark whether the registrant (1) has filed all reports
required to be filed by Section 13 or 15(d) of the Securities Exchange Act of
1934 during the preceding 12 months (or for such shorter period that the

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registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in any amendment to this Form 10-K. [X]

Aggregate market value of the voting stock held by non-affiliates of the Registrant as of May 31, 2001: Common Stock, par value \$0.01 per share, \$739.9 million.

Number of shares outstanding of each of the Registrant's classes of Common Stock, as of May 31, 2001: Common Stock, par value \$0.01 per share, 51.9 million shares outstanding.

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This Form 10-K/A is hereby filed with respect to the Annual Report on Form 10-K for the year ended March 31, 2001 of Peabody Energy Corporation filed with the Securities and Exchange Commission on June 28, 2001 to correct a typographical error related to the years referenced in the columnar headings of the consolidated balance sheet on page 44.

CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

This document includes statements of our expectations, intentions, plans and beliefs that constitute "forward-looking statements." These statements can be found in "Management's Discussion and Analysis of Financial Condition and Results of Operations," and "Business" and can often be identified by forward-looking words such as "expect," "anticipate," "believe," "goal," "plan," "intend," "estimate," "may" and "will" or similar words. You should be aware that these statements are subject to known and unknown risks, uncertainties and other factors, that could cause actual results to differ materially from those suggested by the forward-looking statements. You should read the following in conjunction with "Selected Financial Data" and the financial statements and related notes to those financial statements contained in "Financial Statements and Supplementary Data."

PART I

ITEM 1. BUSINESS.

OVERVIEW

We are the largest private-sector coal company in the world. Excluding our Australian operations that were sold in January 2001, we sold 181.6 million tons of coal in the year ended March 31, 2001, or more than 16% of all U.S. coal sales. During this period, we sold coal to more than 290 electric generating and industrial plants, fueling the generation of more than 9% of all electricity in the United States and 2.5% of all electricity in the world. At March 1, 2001, we had 9.3 billion tons of proven and probable coal reserves.

We own majority interests in 34 coal operations located throughout all major U.S. coal producing regions, with 66% of our fiscal year 2001 coal sales shipped from the western United States and the remaining 34% from the eastern United States. Most of our production in the western United States is low sulfur coal from the Powder River Basin. Our overall western U.S. coal production

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increased from 37.0 million tons in fiscal year 1990 to 119.7 million tons in fiscal year 2001, representing a compounded annual growth rate of 11%. In the west, we own and operate mines in Arizona, Colorado, Montana, New Mexico and Wyoming. In the east, we own and operate mines in Illinois, Indiana, Kentucky and West Virginia. We produced 77% of our fiscal year 2001 sales volume from non-union mines.

For the year ended March 31, 2001, 93% of our sales were to U.S. electricity generators, 3% were to the U.S. industrial sector and 4% were to customers outside the United States. Approximately 85% of our fiscal year 2001 coal sales were under long-term contracts. As of March 31, 2001, nearly one billion tons of our future coal production were committed under long-term contracts, with remaining terms ranging from one to 16 years and an average volume-weighted remaining term of four years. As a result of recent significant improvements in coal prices, we have added long-term contracts to our portfolio at favorable prices. Additionally, our uncommitted future production positions us well to continue to enter into favorably priced contracts. As of March 31, 2001, we had approximately 50 million tons, 101 million tons and 129 million tons of expected production available for sale at market-based prices in calendar year 2002, 2003 and 2004, respectively.

We are also expanding in related energy businesses that include coal trading, coalbed methane production, transportation-related services, third-party coal contract restructuring and participation in the development of coal-based generating plants.

HISTORY

Peabody, Daniels and Co. was founded in 1883 as a retail coal supplier, entering the mining business in 1888 as Peabody & Co. with our first mine in Illinois. In 1926, Peabody Coal Company was listed on the Chicago Stock Exchange and, beginning in 1949, on the New York Stock Exchange. In 1955, Peabody Coal Company, primarily an underground mine operator, merged with Sinclair Coal Company, a major surface mining company. In 1968, Peabody Coal Company was acquired by Kennecott Copper Company. In 1977, it was sold to Peabody Holding Company, which was formed by a consortium of companies.

In July 1990, Hanson, PLC acquired Peabody Holding Company. In February 1997, Hanson spun off its energy-related businesses, including Eastern Group and Peabody Holding Company, into The Energy Group, plc. The Energy Group was a publicly traded company in the United Kingdom and its American Depository Receipts (ADR's) were publicly traded on the New York Stock Exchange. On May 19, 1997, The Energy Group, through Peabody, purchased Citizens Power LLC, a leading power marketer.

On May 19, 1998, Lehman Brothers Merchant Banking Partners II L.P., an affiliate of Lehman Brothers Inc. purchased Peabody Holding Company and its affiliates, Peabody Resources Limited (Peabody Resources) and Citizens Power LLC.

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During the 1980s, Peabody grew through expansion and acquisition, opening the North Antelope Mine in Wyoming's coal-rich Powder River Basin in 1983 and the Rochelle Mine in 1985. In 1984, we acquired the West Virginia coal properties of ARMCO Steel and the following year purchased Coal Properties Corp. and Eastern Associated Coal Corp., which included seven operating mines and substantial low sulfur coal reserves in West Virginia.

From 1993 to 2001, we made 16 major acquisitions. In 1993, interests in

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three mines in New South Wales, Australia, were acquired from Costain Group in anticipation of the growing Pacific Rim market for coal. The properties included 100% ownership of the Ravensworth Mine, a 50% interest in the Narama Mine and a 28.75% interest in the Warkworth Mine, subsequently increased to 43.75%. We also subsequently developed a fourth mine, Bengalla, which began shipments in early 1999. Our interest in the Bengalla joint venture was increased from 35% to 37% in 1998 and to 40% in 2000.

In 1993 we also acquired the Lee Ranch Mine in New Mexico. The following year, we purchased a one-third ownership in Black Beauty Coal Company (Black Beauty), Indiana's largest coal producer. We increased our interest in Black Beauty to 43.3% in February 1998 and to 81.7% in January 1999. Black Beauty acquired Catlin Coal Company in 1999 and acquired an additional 25% of Arclar Coal Company in 2000.

In 1994, we acquired the Caballo and Rawhide mines in Wyoming's Powder River Basin from Exxon Coal USA Inc. This acquisition, along with the expansion of the North Antelope and Rochelle Mines, positioned Peabody as the leading producer in the Powder River Basin, the nation's largest and fastest growing coal region. Our sales volume from the Powder River Basin increased from 31 million tons in 1993 to 101 million tons in fiscal year 2001.

In August 1999, we purchased a 55% interest in the Moura Mine in Queensland, Australia. The Moura Mine supplies a range of steam and metallurgical coals to Asia-Pacific customers and operates a coalbed methane extraction operation.

In August 2000, we sold Citizens Power, our subsidiary that marketed and traded electric power and energy-related commodity risk management products, to Edison Mission Energy.

On January 29, 2001, we sold our Australian operations to a subsidiary of Rio Tinto Limited.

On April 10, 2001, we changed our name from P&L Coal Holdings Corporation to Peabody Energy Corporation.

On May 21, 2001, we completed an initial public offering of Common Stock and our shares began trading on the New York Stock Exchange under the symbol "BTU."

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MINING OPERATIONS

The following provides a description of the operating characteristics of the principal mines and reserves of each of our operating units and affiliates in the United States.

[MAP]

Within the United States, we conduct operations in four regions: Powder River Basin; Southwest; Appalachia; and Midwest.

POWDER RIVER BASIN OPERATIONS

We control approximately 3.0 billion tons of coal reserves in the Southern Powder River Basin, the largest and fastest growing major U.S. coal-producing region. We own and manage two active low sulfur, non-union surface mining complexes in Wyoming that sold approximately 99.2 million tons of coal during

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fiscal year 2001, or approximately 50% of our total coal sales. The North Antelope/Rochelle and Caballo mines are serviced by both major western railroads, the Burlington Northern & Santa Fe and the Union Pacific.

Our Wyoming Powder River Basin reserves are classified as surface mineable, subbituminous coal with seam thickness varying from 70 to 105 feet. The sulfur content of the coal in current production ranges from 0.2% to 0.4% and the heat value ranges from 8,500 to 8,900 Btu per pound.

We also operate the Big Sky Mine in Montana in the Northern Powder River Basin. Coal is shipped from this mine to customers in the upper Midwest by the Burlington Northern & Santa Fe railroad.

North Antelope/Rochelle

The North Antelope/Rochelle Mine is located 65 miles south of Gillette, Wyoming. This mine is the largest and most productive in the United States, selling 73.1 million tons during fiscal year 2001. The North Antelope/Rochelle Mine produces premium quality coal with a sulfur content averaging 0.2% and a heat value ranging from 8,500 to 8,900 Btu per pound. The

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North Antelope/Rochelle Mine produces the lowest sulfur coal in the United States, using a dragline along with six truck-and-shovel fleets. We are adding a second dragline in 2002 to improve productivity.

Caballo

The Caballo Mine is located 20 miles south of Gillette, Wyoming. During fiscal year 2001, it sold approximately 26.1 million tons of compliance coal. Caballo is a truck-and-shovel operation with a coal handling system that includes two 12,000-ton silos and two 11,000-ton silos.

Big Sky

The Big Sky Mine is located in the northern end of the Powder River Basin near Colstrip, Montana, and uses dragline mining equipment. The mine sold 1.7 million tons of medium sulfur coal during fiscal year 2001. Coal is shipped by rail to several major electric generating customers in the upper midwestern United States. This mine is near the exhaustion of its economically recoverable reserves, and we may close it in the next several years, depending upon market and mining conditions. Hourly workers at the Big Sky Mine are members of the United Mine Workers of America.

SOUTHWEST OPERATIONS

We own and manage four mines in the western bituminous coal region - two in Arizona, and one in each of Colorado and New Mexico. The Colorado and Arizona mines supply primarily compliance coal and the New Mexico mine supplies medium sulfur coal under long-term coal supply agreements to electricity generating stations in the region. Together, these mines sold 19.7 million tons of coal during fiscal year 2001.

Black Mesa

The Black Mesa Mine, which is located on the Navajo Nation and Hopi Tribe reservations in Arizona, uses two draglines and sold 4.8 million tons of coal during fiscal year 2001. The Black Mesa Mine coal is crushed, mixed with water and then transported 273 miles through the underground Black Mesa Pipeline

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(which is owned by a third party) to the Mohave Generating Station near Laughlin, Nevada, operated and partially owned by Southern California Edison. The mine and the pipeline were designed to deliver coal exclusively to the plant, which has no other source of coal. The Mohave Generating Station coal supply agreement extends until 2005, with the customer's option to extend the term up to an additional 15 years, subject to agreement on specified terms. Hourly workers at this mine are members of the United Mine Workers of America.

Kayenta

The Kayenta Mine is adjacent to the Black Mesa Mine and uses three draglines in three mining areas. It sold approximately 8.0 million tons of coal during fiscal year 2001. The Kayenta Mine coal is crushed, then carried 17 miles by conveyor belt to storage silos where it is loaded on to a private rail line and transported 83 miles to the Navajo Generating Station, operated by the Salt River Project near Page, Arizona. The mine and the railroad were designed to deliver coal exclusively to the power plant, which has no other source of coal. The Navajo coal supply agreement extends until 2011. Hourly workers at this mine are members of the United Mine Workers of America.

Seneca

The Seneca Mine near Hayden, Colorado shipped 1.6 million tons of compliance coal during fiscal year 2001, operating with two draglines in two separate mining areas. The mine's coal is hauled by truck to the nearby Hayden Generating Station, operated by the Public Service of Colorado, under a coal supply agreement that extends until 2011. Hourly workers at this mine are members of the United Mine Workers of America.

Lee Ranch Coal Company

The Lee Ranch Mine, located near Grants, New Mexico, sold approximately 5.3 million tons of medium sulfur coal during fiscal year 2001. Lee Ranch shipped the majority of its coal to two customers in Arizona and New Mexico under coal supply agreements extending until 2010 and 2014, respectively. Lee Ranch is a non-union surface mine that uses a combination of dragline and truck-and-shovel mining techniques. Lee Ranch is currently expanding its annual production capacity by approximately 2.0 million tons that we plan to sell under long-term agreements to two new customers.

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APPALACHIA OPERATIONS

We own and manage five operating units and related facilities in West Virginia. During fiscal year 2001, these operations sold approximately 18.5 million tons of compliance, medium sulfur and high sulfur steam and metallurgical coal to customers in the United States and abroad. Hourly workers at these operations are members of the United Mine Workers of America.

Big Mountain/White's Branch Operating Unit

The Big Mountain/White's Branch Operating Unit is based near Prenter, West Virginia. In August 2000, we closed the Robin Hood No. 9 Mine after depleting its mineable reserves and the White's Branch Mine began production. During fiscal year 2001, the Big Mountain No. 16, Robin Hood No. 9 and White's Branch mines sold approximately 2.4 million tons of steam coal. Big Mountain No. 16 and White's Branch are underground mines using continuous mining equipment. Processed coal is loaded on the CSX railroad.

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Harris Operating Unit

The Harris Operating Unit consists of the Harris No. 1 Mine near Bald Knob, West Virginia, which sold approximately 4.2 million tons of compliance coal during fiscal year 2001. This mine uses both longwall and continuous mining equipment.

Rocklick Operating Unit and Contract Mines

The Rocklick preparation plant, located near Wharton, West Virginia, processes coal produced by the Harris Mine and contract mining companies from coal reserves that we control. This preparation plant shipped approximately 7.7 million tons of steam and metallurgical coal during fiscal year 2001, including 4.2 million tons related to the Harris Operating Unit. Processed coal is loaded at the plant site on the CSX railroad or transferred via conveyor to our Kopperston loadout facility and loaded on the Norfolk Southern railroad.

Wells Operating Unit

The Wells Operating Unit, in Boone County, West Virginia, sold approximately 3.7 million tons of metallurgical and steam coal during fiscal year 2001. The unit consists of the Lightfoot No. 2 Mine, contract mines and the Wells Preparation Plant, located near Wharton, West Virginia. The mine uses continuous mining equipment to produce coal from reserves we own. Processed coal is loaded on the CSX railroad.

Federal No. 2 Mine

The Federal No. 2 Mine, near Fairview, West Virginia, uses longwall mining equipment and shipped approximately 4.8 million tons of steam coal during fiscal year 2001. Coal shipped from the Federal No. 2 Mine has a sulfur content only slightly above that of medium sulfur coal and has an above average heating content. As a result, it is more marketable than some other medium sulfur coals. The CSX and Norfolk Southern railroads jointly serve the mine.

Kanawha Eagle Coal Joint Venture

We have a minority interest in Kanawha Eagle Coal, LLC, which owns a deep mine, a preparation plant and barge-and-rail loading facilities near Marmet, West Virginia. The union-free mine uses continuous mining equipment and shipped 1.1 million tons during fiscal year 2001.

MIDWEST OPERATIONS

We own and operate five mines in the midwestern United States, which collectively sold 8.8 million tons of coal during fiscal year 2001. Our midwest operations include three underground and two surface mines, along with five preparation plants and four barge loading facilities, located in western Kentucky, southern Illinois and southwestern Indiana. We ship coal from these mines primarily to electricity generators in the midwestern United States, and we sell some coal to industrial customers that generate their own power. Some of our hourly workers in this region are members of the United Mine Workers of America; however, some of our mines in this region operate union-free.

We control 16 additional mines in the midwestern United States through our 81.7% joint venture interest in Black Beauty, as discussed below.

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We own 81.7% of Black Beauty, the largest coal company in the Midwest region, which operates ten mines in Indiana and also has interests in one mine in east-central Illinois, four mines in southern Illinois and one mine in western Kentucky. Together these operations sold 22.9 million tons of compliance, medium sulfur and high sulfur steam coal during fiscal year 2001. We purchased a one-third interest in Black Beauty in 1994, and increased our interest to 43.3% in 1998 and 81.7% in 1999. Black Beauty Resources, Inc., owned by certain members of Black Beauty's management team, owns the remaining interest.

Black Beauty's principal mines include Air Quality No. 1, Farmersburg, Francisco and two mines in Somerville, Indiana. Air Quality No. 1 is an underground coal mine located near Monroe City, Indiana that shipped 1.7 million tons of compliance coal during fiscal year 2001. Farmersburg is a surface mine in Vigo and Sullivan counties in Indiana that sold 4.1 million tons of medium sulfur coal during fiscal year 2001. Francisco, located in Gibson county, Indiana, sold 2.2 million tons during fiscal year 2001 and the two Somerville mines, also located in Gibson county, shipped a total of 4.8 million tons in fiscal year 2001. All of Black Beauty's mines operate union-free.

Black Beauty owns a 75%-equity interest in Sugar Camp Coal, LLC, a 5.0 million-ton per year complex comprised of two surface mines, Wildcat Hills and Cottage Grove, and one underground mine, Eagle Valley, located in southern Illinois. Sugar Camp also owns Arclar Coal Company, which operates one underground mine, Big Ridge, in southern Illinois that currently sells 1.8 million tons per year. The contract work forces at Eagle Valley and Big Ridge are both represented under non-UMWA labor agreements.

Camp Operating Unit

The Camp Operating Unit, located near Morganfield, Kentucky, currently operates the Camp No. 11 Mine, an underground mine, and a large preparation and barge loading facility. The Camp No. 1 Mine exhausted its economically recoverable reserves and ceased operations in October 2000. Together, these operations sold 5.4 million tons of coal during fiscal year 2001. The Camp No. 11 Mine uses both longwall and continuous mining equipment. We sell most of the production under contract to the Tennessee Valley Authority.

Midwest Operating Unit

The Midwest Operating Unit near Graham, Kentucky sold 1.3 million tons of coal during fiscal year 2001. The unit currently includes the Gibraltar surface mining operation, which uses truck-and-shovel equipment, and the Gibraltar Highwall Mine, which uses continuous mining equipment. The unit used to include the Martwick mine; however in November 2000, the Martwick Mine exhausted its economically recoverable reserves and ceased operations, and the Gibraltar Highwall mine began operations to replace the production. We sell coal from these mines under contract to the Tennessee Valley Authority.

Patriot Coal Company

Patriot Coal Company operates Patriot, a surface mine, and Freedom, an underground mine, in Henderson County, Kentucky, and sold approximately 2.1 million tons of coal during fiscal year 2001. The underground mine uses continuous mining equipment, and the surface mine uses truck-and-shovel equipment. Patriot Coal Company also operates a preparation plant and a dock. These mines operate union-free.

LONG-TERM COAL SUPPLY AGREEMENTS

We currently have coal supply agreements to sell nearly one billion tons of

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coal, with remaining terms ranging from one to 16 years and an average volume-weighted remaining term of four years. For fiscal year 2001, we sold 85% of our sales volume under coal supply agreements. During fiscal year 2001, we sold coal to more than 290 electric generators and industrial plants in 12 countries.

We expect to continue selling a significant portion of our coal under long-term supply agreements. Our strategy is to selectively renew, or enter into new, long-term supply contracts when we can do so at favorable prices. Long-term contracts may be particularly attractive in regions where market prices are expected to remain stable, with respect to high sulfur coal that would otherwise not be in great demand or for sales under cost-plus arrangements serving captive power plants. Prices for coal have recently risen, particularly in the Powder River Basin and in Appalachia, primarily due to increased prices for competing fuels and increased demand for electricity.

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

Each contract sets a base price. Base prices are often adjusted at quarterly or annual intervals for changes due to inflation and/or changes in actual costs such as taxes, fees and royalties. The inflation adjustments are measured by public indices, the most common of which is the implicit price deflator for the gross domestic product as published by the Department of Commerce. In addition, most of the contracts contain price adjustments for changes in the laws regulating the mining, production, sale or use of coal. In the majority of these contracts, the purchaser has the right to terminate the contract if the price increases beyond certain limits, although we can usually decrease the price in order to maintain the contract.

Price adjustment provisions are present in most of our long-term coal contracts greater than three years in duration. These provisions allow either party to commence a renegotiation of the contract price at various intervals. If the parties do not agree on a new price, the purchaser or seller often has an option to terminate the contract. Some agreements provide that if the parties fail to agree on a price adjustment caused by cost increases due to changes in applicable law and regulations, the purchaser may terminate the agreement, subject to the payment of liquidated damages. Under some contracts, we have the right to match lower prices offered to our customers by other suppliers.

Quality and volumes for the coal are stipulated in coal supply agreements, and in some instances buyers have the option to vary annual or monthly volumes if necessary. Variations to the quality and volumes of coal may lead to adjustments in the contract price. Coal supply agreements typically stipulate procedures for quality control, sampling and weighing. Most coal supply agreements contain provisions requiring us to deliver coal within certain ranges for specific coal characteristics such as heat content (Btu), sulfur, ash, grindability and ash fusion temperature. Failure to meet these specifications can result in economic penalties, suspension or cancellation of shipments or termination of the contracts.

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Contract provisions in some cases set out mechanisms for temporary reductions or delays in coal volumes in the event of a force majeure, including events such as strikes, adverse mining conditions or serious transportation problems that affect the seller or unanticipated plant outages that may affect the buyer. More recent contracts stipulate that this tonnage can be made up by mutual agreement or at the discretion of the buyer. Buyers often negotiate similar clauses covering changes in environmental laws. We often negotiate the right to supply coal that complies with a new environmental requirement to avoid contract termination. Coal supply agreements typically contain termination clauses if either party fails to comply with the terms and conditions of the contract, although most termination provisions provide the opportunity to cure defaults.

In some of our contracts, we have a right of substitution, allowing us to provide coal from different mines as long as the replacement coal meets quality specifications and will be sold at the same delivered cost. Contracts usually contain specified sampling locations: in the eastern United States, approximately 50% of customers require that the coal is sampled and weighed at the destination, whereas in the western United States, samples are usually taken at the shipping source.

SALES AND MARKETING

Our sales and marketing operations include Peabody COALSALES and Peabody COALTRADE. Through these entities, we sell coal produced by our diverse portfolio of operations, broker coal sales of other coal producers, both as principal and agent, trade coal and emissions allowances, and provide transportation-related services. We also restructure third-party coal supply agreements by acquiring a customer's right to receive coal from another coal company under a coal supply agreement, reselling that coal, and supplying that customer with coal from our own operations. As of March 31, 2001, we had 67 employees in our sales and marketing operations, including personnel dedicated to performing market research, contract administration and risk management activities.

TRANSPORTATION

Coal consumed domestically is usually sold at the mine, and transportation costs are normally borne by the purchaser. Export coal is usually sold at the loading port, with purchasers paying ocean freight. Producers usually pay shipping costs from the mine to the port.

The majority of our sales volume is shipped by rail, but a portion of our production is shipped by other modes of transportation. For example, coal from our Camp operating unit in Kentucky is shipped by barge to the Tennessee Valley Authority's Cumberland plant in Tennessee. Coal from our Black Mesa Mine in Arizona is transported by a 273-mile coal-water pipeline to the Mohave Generating Station in southern Nevada. Coal from the Seneca Mine in Colorado is transported by truck to a nearby electric generating plant. Other mines transport coal by rail and barge or by rail and lake carrier on the Great Lakes. All coal from our Powder River Basin mines is shipped by rail, and two competing railroads, the Burlington Northern & Santa Fe and the Union Pacific, serve our two Southern Powder River Basin mines. Approximately 8,000 unit trains are loaded each year to accommodate the coal shipped by these mines. A unit train generally consists of 100 to 140 cars, each of which can hold 100 to 120 tons of coal.

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Our transportation department manages the loading of trains and barges. We believe we enjoy good relationships with the rail carriers and barge companies due, in part, to our modern coal-loading facilities and the experience of our transportation coordinators.

SUPPLIERS

The main types of goods we purchase are mining equipment and replacement parts, explosives, fuel, tires and lubricants. We also purchase coal from third parties to satisfy some of our customer contracts. The supplier base providing these goods has been relatively consistent in recent years and we have many long established relationships with our key suppliers. We do not believe that we are dependent on any of our individual suppliers.

TECHNICAL INNOVATION

We place great emphasis on the application of technical innovation to improve the mining process. This research and development effort is typically undertaken and funded by equipment manufacturers using our input and expertise. Our engineering staff and purchasing departments work with manufacturers to design and produce equipment that we believe will add value to the business. For example, we worked with a manufacturer to design larger trucks to haul overburden and coal at various mines throughout our company. In Wyoming, we were the first coal company to use the current, state-of-the-art 400-ton haul trucks. We have worked with our underground equipment suppliers to develop higher horsepower continuous mining machines, which mine the coal more effectively, and at a lower cost per ton. We have also assisted them in the development of a continuous haulage machine, which can be operated by one person as opposed to the standard four-person requirement. We are the largest user of advanced coal quality analyzers among coal producers, according to the manufacturer of this sophisticated equipment. These analyzers allow continuous analysis of certain coal quality parameters such as sulfur content. Their use helps ensure consistent product quality and helps customers meet stringent air emission requirements. We also use global positioning satellite technology extensively in our larger surface mining operations to ensure proper mine layout. As a result of these efforts, many of our mines have become among the most productive in the industry. We also support the Power Systems Development Facility, a highly efficient electric generating plant using advanced emissions reduction technology funded primarily through the Department of Energy and operated by an affiliate of Southern Company.

COMPETITION

The markets in which we sell our coal are highly competitive. The top 10 coal producers in the United States produce approximately 64% of total domestic coal, although there are approximately 730 coal producers in the United States. Our principal competitors are other large coal producers, including Arch Coal, Inc., Kennecott Energy Co., a subsidiary of Rio Tinto, RAG AG, CONSOL Energy Inc., AEI Resources, Inc. and Massey Energy Company, which collectively accounted for approximately 41% of total U.S. coal production in 2000.

A number of factors beyond our control affect the markets in which we sell our coal. Continued demand for our coal and the prices obtained by us depend primarily on the coal consumption patterns of the electricity industries in the United States, the availability, location, cost of transportation and price of competing coal and other electricity generation and fuel supply sources such as natural gas, oil, nuclear and hydroelectric. Coal consumption patterns are affected primarily by the demand for electricity, environmental and other governmental regulations and technological developments. We compete on the basis of coal quality, delivered price, customer service and support and reliability.

CERTAIN LIABILITIES

We have significant long-term liabilities for reclamation, work-related injuries and illnesses, pensions and retiree health care. In addition, labor contracts with the United Mine Workers of America and voluntary arrangements with non-union employees include long-term benefits, notably health care coverage for retired and future retirees and their dependents. We provide reserves

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for a substantial portion of these obligations. The majority of our existing liabilities relate to our past operations, which had more mines and employees than we currently have.

Reclamation. Reclamation liabilities primarily represent the future costs to restore surface lands to productivity levels equal to or greater than pre-mining conditions, as required by the Surface Mining Control and Reclamation Act. We also record other related liabilities, such as water treatment and environmental costs. Our long-term reclamation costs, mine-closing and other related liabilities totaled approximately \$451.3 million as of March 31, 2001, \$3.6 million of which was a current liability. Expense for fiscal year 2001 was \$4.1 million.

Workers' Compensation. These liabilities represent the actuarial estimates for compensable, work-related injuries (traumatic claims) and occupational disease, primarily black lung disease (pneumoconiosis). The Federal Black Lung Benefits Act requires employers to pay black lung awards to former employees who filed claims after June 1973. These liabilities totaled approximately \$244.3 million as of March 31, 2001, \$33.6 million of which was a current liability. Expense for fiscal year 2001 was \$41.4 million.

Pension-Related Provisions. Pension-related costs represent the actuarially-estimated cost of pension benefits. Annual contributions to the pension plans are determined by consulting actuaries based on the Employee Retirement Income Security Act minimum funding standards and an agreement with the Pension Benefit Guaranty Corporation. Pension-related liabilities totaled approximately \$10.7 million as of March 31, 2001, \$8.1 million of which was a current liability.

Retiree Health Care. Consistent with Statement of Financial Accounting Standards No. 106, we record a liability representing the estimated cost of providing retiree health care benefits to current retirees and active employees who will retire in the future. Provisions for active employees represent the amount recognized to date, based on their service to date; additional amounts are provided periodically so that the total liability is accrued when the employee retires.

A second category of retiree health care obligations represents the liability for future contributions to the United Mine Workers of America Combined Fund created by federal law in 1992. This multiemployer fund provides health care benefits to a closed group of former employees who retired prior to 1976; no new retirees will be added to this group. The liability is subject to increases or decreases in per capita health care costs, offset by the mortality curve in this aging population of beneficiaries.

Our retiree health care liabilities totaled approximately \$1,036.1 million as of March 31, 2001, \$62.0 million of which was a current liability. Expense for fiscal year 2001 was \$70.7 million. Obligations to the United Mine Workers of America Combined Fund totaled \$57.8 million as of March 31, 2001, \$5.6 million of which was a current liability. Income for fiscal year 2001 was \$8.0

million.

DEREGULATION OF THE ELECTRICITY GENERATION INDUSTRY

In October 1992, Congress enacted the Energy Policy Act of 1992. To stimulate competition in the electricity market, that legislation gave wholesale suppliers access to the transmission lines of U.S. electricity generators. In April 1996, the Federal Energy Regulatory Commission issued the first of a series of orders establishing rules providing for open access to electricity transmission systems. The federal government is currently exploring a number of options concerning utility deregulation. Individual states are also proceeding with their own deregulation initiatives.

The pace of deregulation differs significantly from state to state. To date, 24 states and Washington, D.C. have enacted programs leading to the deregulation of the electricity market; 19 other states are considering similar programs. Due to the uncertainty around the timing and implementation of deregulation, it is difficult to predict the impact on individual electricity generators. This uncertainty has increased due to the recent energy crisis in California, where market inefficiencies and supply and demand imbalances have created electricity supply shortages. The crisis has slowed deregulation activity in other states and at the federal level.

If ultimately implemented, full-scale deregulation of the power industry is expected to enable both industrial and residential customers to shop for the lowest-cost supply of power and the best service available. This fundamental change in the power industry is expected to compel electricity generators to be more aggressive in developing and defending market share, to be more focused on their pricing and cost structures and to be more flexible in reacting to changes in the market.

A possible consequence of deregulation is downward pressure on fuel prices. However, because of coal's cost advantage and because some coal-based generating facilities are underutilized in the current regulated electricity market, we believe that additional coal demand would arise as electricity markets are deregulated if the most efficient coal-based power plants are operated at greater capacity.

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EMPLOYEES

As of March 31, 2001, we and our subsidiaries had approximately 6,100 employees. Approximately 37% of our employees are affiliated with organized labor unions, which accounted for approximately 23% of the tons we sold in the United States during fiscal year 2001. Relations with organized labor are important to our success and we believe our relations with employees are satisfactory. Hourly workers at our mines in Arizona, Colorado and Montana are represented by the United Mine Workers of America under the Western Surface Agreement, which was ratified in 2000 and is effective through September 1, 2005. Our union labor east of the Mississippi River is also represented by the United Mine Workers of America and is subject to the National Bituminous Coal Wage Agreement, which is effective through December 31, 2002.

REGULATORY MATTERS

Federal, state and local authorities regulate the U.S. coal mining industry with respect to matters such as employee health and safety, permitting and licensing requirements, air quality standards, water pollution, plant and wildlife protection, the reclamation and restoration of mining properties after

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mining has been completed, the discharge of materials into the environment, surface subsidence from underground mining and the effects of mining on groundwater quality and availability. In addition, the industry is affected by significant legislation mandating certain benefits for current and retired coal miners. Numerous federal, state and local governmental permits and approvals are required for mining operations. We believe that we have obtained all permits currently required to conduct our present mining operations. We may be required to prepare and present to federal, state or local authorities data pertaining to the effect or impact that a proposed exploration for or production of coal may have on the environment. These requirements could prove costly and time-consuming, and could delay commencing or continuing exploration or production operations. Future legislation and administrative regulations may emphasize the protection of the environment and, as a consequence, our activities may be more closely regulated. Such legislation and regulations, as well as future interpretations and more rigorous enforcement of existing laws, may require substantial increases in equipment and operating costs to us and delays, interruptions or a termination of operations, the extent of which we cannot predict.

We endeavor to conduct our mining operations in compliance with all applicable federal, state and local laws and regulations. However, because of extensive and comprehensive regulatory requirements, violations during mining operations occur from time to time in the industry. None of the violations to date or the monetary penalties assessed upon us has been material.

MINE SAFETY AND HEALTH

Stringent health and safety standards have been in effect since Congress enacted the Coal Mine Health and Safety Act of 1969. The Federal Mine Safety and Health Act of 1977 significantly expanded the enforcement of safety and health standards and imposed safety and health standards on all aspects of mining operations.

Most of the states in which we operate have state programs for mine safety and health regulation and enforcement. Collectively, federal and state safety and health regulation in the coal mining industry is perhaps the most comprehensive and pervasive system for protection of employee health and safety affecting any segment of U.S. industry. While regulation has a significant effect on our operating costs, our U.S. competitors are subject to the same degree of regulation.

Our goal is to achieve excellent safety and health performance. We measure our success in this area primarily through the use of accident frequency rates. We believe that a superior safety and health regime is inherently tied to achieving our productivity and financial goals. We seek to implement this goal by: training employees in safe work practices; openly communicating with employees; establishing, following and improving safety standards; involving employees in establishing safety standards; and recording, reporting and investigating all accidents, incidents and losses to avoid reoccurrence.

BLACK LUNG

Under the Black Lung Benefits Revenue Act of 1977 and the Black Lung Benefits Reform Act of 1977, as amended in 1981, each coal mine operator must secure payment of federal black lung benefits to claimants who are current and former employees and to a trust fund for the payment of benefits and medical expenses to claimants who last worked in the coal industry prior to July 1, 1973. Less than 7% of the miners currently seeking federal black lung benefits are awarded these benefits by the federal government. The trust fund is funded by an excise tax on production of up to \$1.10 per ton for deep-mined coal and up to \$0.55 per ton for surface-mined coal, neither amount to exceed 4.4% of the gross sales price. This tax is passed on to the purchaser under many of our coal

supply agreements.

In December 2000, the Department of Labor issued new amendments to the regulations implementing the federal black lung laws that, among other things, establish a presumption in favor of a claimant's treating physician and limit a coal operator's ability

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to introduce medical evidence regarding the claimant's medical condition. Industry reports anticipate that the number of claimants who are awarded benefits will increase significantly as will the amounts of those awards. The National Mining Association has filed a lawsuit challenging these regulations. The U.S. District Court of the District of Columbia issued a preliminary injunction staying the effectiveness of the new rules. A trial on the merits was held on June 5, 2001, and the Court has not issued its decision on the matter.

COAL INDUSTRY RETIREE HEALTH BENEFIT ACT OF 1992

The Coal Act provides for the funding of health benefits for certain United Mine Workers of America retirees. The Coal Act established the Combined Fund into which "signatory operators" and "related persons" are obligated to pay annual premiums for beneficiaries. The Coal Act also created a second benefit fund for miners who retired between July 21, 1992 and September 30, 1994 and whose former employers are no longer in business. Companies that are liable under the Coal Act must pay premiums to the Combined Fund. Annual payments made by certain of our subsidiaries under the Coal Act totaled \$5.1 million and \$4.1 million, respectively, during fiscal years 2000 and 2001.

In October 1998, the Combined Fund sent a premium notice to all assigned operators subject to the fund that included retroactive death benefit and health benefit premiums dating back to February 1, 1993. On November 13, 1998, 10 employers, including two of our subsidiaries, Peabody Coal Company and Eastern Associated Coal Corp., challenged the fund's retroactive rebilling in a lawsuit filed in the Northern District Court of Alabama. If we are successful in this litigation, we will be eligible for a \$1.0 million credit as a reduction to future premiums.

In 1996, the Combined Fund sued the Social Security Administration in the District of Columbia seeking a declaration that the Social Security Administration's original calculation of the per-beneficiary premium was proper. Certain coal companies, but not our subsidiaries, intervened in the lawsuit. On February 25, 2000, the federal District Court ruled in favor of the Combined Fund. The Combined Fund has obtained an amended order and the intervenor coal companies have appealed the court's decision. If this decision is upheld on appeal, our subsidiaries will be required to pay an additional premium to the Combined Fund of approximately \$2.4 million.

ENVIRONMENTAL LAWS

We are subject to various federal, state and foreign environmental laws. These laws require approval of many aspects of coal mining operations, and both federal and state inspectors regularly visit our mines and other facilities to ensure compliance.

Surface Mining Control and Reclamation Act

The Surface Mining Control and Reclamation Act, which is administered by the Office of Surface Mining Reclamation and Enforcement, establishes mining, environmental protection and reclamation standards for all aspects of surface

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mining as well as many aspects of deep mining. The Surface Mining Control and Reclamation Act and similar state statutes require, among other things, the restoration of mined property in accordance with specified standards and an approved reclamation plan. In addition, the Abandoned Mine Land Fund, which is part of the Surface Mining Control and Reclamation Act, imposes a fee on all current mining operations, the proceeds of which are used to restore mines closed before 1977. The maximum tax is \$0.35 per ton on surface-mined coal and \$0.15 per ton on deep-mined coal.

A mine operator must submit a bond or otherwise secure the performance of these reclamation obligations. Mine operators must receive permits and permit renewals for surface mining operations from the Office of Surface Mining Reclamation and Enforcement or, where state regulatory agencies have adopted federally approved state programs under the act, the appropriate state regulatory authority. We accrue for the liability associated with all end-of-mine reclamation on a ratable basis as the coal reserve is being mined.

All states in which we have active mining operations have achieved primary control of enforcement through approved state programs. Although we do not anticipate significant permit issuance or renewal problems, we cannot assure you that our permits will be renewed or granted in the future or that permit issues will not adversely affect operations. Under previous regulations of the act, responsibility for any coal operator currently in violation of the act could be imputed to other companies deemed, according to regulations, to "own or control" the coal operator. Sanctions included being blocked from receiving new permits and rescission or suspension of existing permits. Because of a recent federal court action invalidating these ownership and control regulations, the scope and potential impact of the "ownership and control" requirements on us are unclear. The Office of Surface Mining Reclamation and Enforcement has responded to the court action by promulgating interim regulations, which more narrowly apply the ownership and control standards to coal companies. Although the federal action could have, by analogy, a

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precedential effect on state regulations dealing with "ownership and control," which are in many instances similar to the invalidated federal regulations, it is not certain what impact the federal court decision will have on these state regulations.

West Virginia Mountaintop Mining

On October 20, 1999, the U.S. District Court for the Southern District of West Virginia issued a permanent injunction against the West Virginia Department of Environmental Protection in a mountaintop-mining lawsuit. As interpreted by the Director of the Department of Environmental Protection, the injunction prohibits the Department from approving any new permits that would authorize the placement of excess soil in intermittent and perennial streams for the primary purpose of waste (overburden) disposal. The Department also interpreted the injunction to affect certain existing coal refuse ponds, sediment ponds and mountaintop-mining operations.

The Department has filed an appeal of the decision with the U.S. Court of Appeals for the Fourth Circuit. On October 29, 1999, the District Court issued a stay of its decision pending a resolution of the appeal. In April 2001, the Fourth Circuit overturned the District Court decision regarding the intermittent and perennial stream issue.

The Clean Air Act

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The Clean Air Act, the Clean Air Act Amendments and the corresponding state laws that regulate the emissions of materials into the air, affect coal mining operations both directly and indirectly. Direct impacts on coal mining and processing operations may occur through Clean Air Act permitting requirements and/or emission control requirements relating to particulate matter, such as fugitive dust, including future regulation of fine particulate matter measuring ten micrometers in diameter or smaller. The Clean Air Act indirectly affects coal mining operations by extensively regulating the air emissions of sulfur dioxide and other compounds, including nitrogen oxides, emitted by coal-based electricity generating plants.

In July 1997, the EPA adopted new, more stringent National Ambient Air Quality Standards for very fine particulate matter and ozone. As a result, some states will be required to change their existing implementation plans to attain and maintain compliance with the new air quality standards. Our mining operations and electric generating customers are likely to be directly affected when the revisions to the air quality standards are implemented by the states. State and federal regulations relating to implementation of the new air quality standards may restrict our ability to develop new mines or could require us to modify our existing operations. The extent of the potential direct impact of the new air quality standards on the coal industry will depend on the policies and control strategies associated with the state implementation process under the Clean Air Act, but could have a material adverse effect on our financial condition and results of operations. The Court of Appeals for the District of Columbia issued an opinion in May 1999 limiting the manner in which the EPA can enforce these standards. After a request by the federal government for a rehearing by the Court of Appeals was denied, the Supreme Court agreed in January 2000 to review the case. On February 27, 2001, the Supreme Court found in favor of the EPA in material part and remanded the case to the Court of Appeals. Implementation of the fine particulate National Ambient Air Quality Standards will occur, if at all, after the Court of Appeals disposes of any preserved challenges to the standards and the EPA develops a new implementation policy. The effect of this decision on us and our customers is unknown at this time.

Title IV of the Clean Air Act Amendments places limits on sulfur dioxide emissions from electric power generation plants. The limits set baseline emission standards for these facilities. Reductions in emissions occurred in Phase I in 1995 and in Phase II in 2000 and apply to all coal-based power plants. The affected electricity generators have been able to meet these requirements by, among other ways, switching to lower sulfur fuels, installing pollution control devices, such as scrubbers, reducing electricity generating levels or purchasing sulfur dioxide emission allowances. Emission sources receive these sulfur dioxide emission allowances, which can be traded or sold to allow other units to emit higher levels of sulfur dioxide. We cannot ascertain the effect of these provisions of the Clean Air Act Amendments on us at this time. We believe that implementation of Phase II has resulted in a downward pressure on the price of higher sulfur coal, as additional coal-based electric generating plants have complied with the restrictions of Title IV.

The Clean Air Act Amendments also require electricity generators that currently are major sources of nitrogen oxides in moderate or higher ozone non-attainment areas to install reasonably available control technology for nitrogen oxides, which are precursors of ozone. In addition, the EPA recently announced the final rules that would require 19 eastern states and Washington, D.C. to make substantial reductions in nitrogen oxide emissions. Installation of additional control measures required under the final rules will make it more costly to operate coal-based electric generating plants.

In accordance with Section 126 of the Clean Air Act, eight northeastern states filed petitions requesting the EPA to make findings and require decreases in nitrogen oxide emissions from certain sources in certain upwind states that

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might contribute to ozone nonattainment in the petitioning states. The EPA has granted four of the eight petitions finding that certain sources are

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contributing to ozone non-attainment in certain of the petitioning states and the EPA has proposed levels of nitrogen oxide control for the named sources. Our customers are among the named sources and, implementation of the requirement to install control equipment could impact the amount of coal supplied to those customers if they decide to switch to other sources of fuel, which would result in lower emission of nitrogen oxides. A coalition of 40 electricity generators and power companies petitioned the U.S. Court of Appeals for the District of Columbia to review the EPA's decision to grant the four petitions. On May 15, 2001, the Court of Appeals substantially upheld the EPA's ruling, but remanded for reconsideration the EPA's decision to regulate certain cogeneration facilities and the EPA's use of certain projections regarding future growth in setting the nitrogen oxide emission limitations.

The Clean Air Act Amendments provisions for new source review require electricity generators to install the best available control technology if they make a major modification to a facility that results in an increase in its potential to emit regulated pollutants. The Justice Department on behalf of the EPA filed a number of lawsuits since November 1999, alleging that ten electricity generators violated the new source review provisions of the Clean Air Act Amendments at power plants in the midwestern and southern United States. The EPA issued an administrative order alleging similar violations by the Tennessee Valley Authority, affecting seven plants and notices of violation for an additional eight plants owned by the affected electricity generators. Three electricity generators have reached settlements with the Justice Department requiring the installation of additional control equipment on selected generating units. If the remaining electricity generators are found to be in violation, they could be subject to civil penalties and be required to install the required control equipment or cease operations. Our customers are among the named electricity generators and if found not to be in compliance, the fines and requirements to install additional control equipment could adversely affect the amount of coal they would burn if the plant operating costs were to increase to the point that the plants were operated less frequently.

The Clean Air Act Amendments set a national goal for the prevention of any future, and the remedying of any existing, impairment of visibility in 156 national parks and wildlife areas across the country. Visibility in these areas is to be returned to natural conditions by 2064 through plans that must be developed by the states. The state plans may require the application of "Best Available Retrofit Technology" after 2010 on sources found to be contributing to visibility impairment of regional haze in these areas. The control technology requirements could cause our customers to install equipment to control sulfur dioxide and nitrogen oxide emissions. The requirement to install control equipment could affect the amount of coal supplied to those customers if they decide to switch to other sources of fuel to lower emission of sulfur oxides and nitrogen oxides.

In addition, the Clean Air Act Amendments require a study of electric generating plant emissions of certain toxic substances, including mercury, and direct the EPA to regulate these substances, if warranted. In December 2000, the EPA decided that mercury air emissions from power plants should be regulated. The EPA will propose regulations by December 2003 and will issue final regulations by December 2004. It is a possibility that future regulatory activity may seek to reduce mercury emissions and these requirements, if adopted, could result in reduced use of coal if electricity generators switch to other sources of fuel.

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Clean Water Act

The Clean Water Act of 1972 affects coal mining operations by imposing restrictions on effluent discharge into water. Regular monitoring, reporting requirements and performance standards are preconditions for the issuance and renewal of permits governing the discharge of pollutants into water.

Resource Conservation and Recovery Act

RCRA imposes requirements for the treatment, storage and disposal of hazardous wastes. Coal mining operations covered by the Surface Mining Control and Reclamation Act permits are exempted from regulation under RCRA by statute. We cannot, however, predict whether this exclusion will continue.

RCRA excludes certain large-volume wastes generated primarily from the combustion of coal from being regulated as a hazardous waste pending a report to Congress and a decision by the EPA either to regulate the coal combustion wastes as a hazardous waste under RCRA or deem the regulation as unwarranted. The EPA made its report to Congress in March 1999 and determined in May 2000 not to regulate coal waste as a hazardous substance under RCRA. Any requirement to regulate coal combustion waste as a hazardous waste could cause a switch to other lower ash fuels and reduce the amount of coal used by electric generators.

Federal and State Superfund Statutes

Superfund and similar state laws affect coal mining and hard rock operations by creating liability for investigation and remediation in response to releases of hazardous substances into the environment and for damages to natural resources. Under

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Superfund, joint and several liability may be imposed on waste generators, site owners and operators and others regardless of fault.

Global Climate Change

The United States, Australia and over 160 other nations are signatories to the 1992 Framework Convention on Climate Change, which is intended to limit emissions of greenhouse gases, such as carbon dioxide. In December 1997, in Kyoto, Japan, the signatories to the convention established a binding set of emission targets for developed nations. Although the specific emission targets vary from country to country, the United States would be required to reduce emissions to 93% of 1990 levels over a five-year budget period from 2008 through 2012. Although the United States has not ratified the emission targets and no comprehensive regulations focusing on greenhouse gas emissions are in place, these restrictions, whether through ratification of the emission targets or other efforts to stabilize or reduce greenhouse gas emissions, could adversely affect the price and demand for coal. According to the Energy Information Administration's Emissions of Greenhouse Gases in the United States 1999, coal accounts for 30% of greenhouse gas emissions in the United States, and efforts to control greenhouse gas emissions could result in reduced use of coal if electric generators switch to lower carbon sources of fuel. In March 2001, President Bush reiterated his opposition to the Kyoto Protocol and further stated that he did not believe that the government should impose mandatory carbon dioxide emission reductions on power plants.

PERMITTING

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Mining companies must obtain numerous permits that impose strict regulations on various environmental and safety matters in connection with coal mining. These provisions include requirements for coal prospecting; mine plan development; topsoil removal, storage and replacement; selective handling of overburden materials; mine pit backfilling and grading; protection of the hydrologic balance; subsidence control for underground mines; surface drainage control; mine drainage and mine discharge control and treatment; and revegetation.

We must obtain permits from applicable state regulatory authorities before we begin to mine reserves. The mining permit application process is initiated by collecting baseline data to adequately characterize the pre-mine environmental condition of the permit area. This work includes surveys of cultural resources, soils, vegetation, wildlife, assessment of surface and ground water hydrology, climatology and wetlands. In conducting this work, we collect geologic data to define and model the soil and rock structures and coal that we will mine. We develop mine and reclamation plans by utilizing this geologic data and incorporating elements of the environmental data. The mine and reclamation plan incorporates the provisions of the Surface Mining Control and Reclamation Act, the state programs and the complementary environmental programs that impact coal mining. Also included in the permit application are documents defining ownership and agreements pertaining to coal, minerals, oil and gas, water rights, rights of way, and surface land and documents required of the Office of Surface Mining's Applicant Violator System.

Once a permit application is prepared and submitted to the regulatory agency, it goes through a completeness review, technical review and public notice and comment period before it can be approved. Some Surface Mining Control and Reclamation Act mine permits can take over a year to prepare, depending on the size and complexity of the mine and often take six months to sometimes two years to receive approval. Regulatory authorities have considerable discretion in the timing of the permit issuance and the public has rights to comment on and otherwise engage in the permitting process, including through intervention in the courts.

We do not believe there are any substantial matters that pose a risk to maintaining our existing mining permits or hinder our ability to acquire future mining permits. It is our policy to ensure that our operations are in full compliance with the requirements of the Surface Mining Control and Reclamation Act and the state laws and regulations governing mine reclamation.

ADDITIONAL INFORMATION

We file annual, quarterly and current reports and other information with the SEC. You may access and read our SEC filings through the SEC's Internet site at www.sec.gov. This site contains reports and other information that we file electronically with the SEC. You may also read and copy any document we file at the SEC's public reference room located at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room.

You may request copies of the filings, at no cost, by telephone at (314) 342-3400 or by mail at: Peabody Energy Corporation, 701 Market Street, Suite 700, St. Louis, Missouri 63101, attention: Public Relations.

ITEM 2. PROPERTIES.

Coal Reserves

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We had an estimated 9.3 billion tons of proven and probable coal reserves as of March 1, 2001, of which approximately 41% is compliance coal and 59% is non-compliance coal. We own approximately 45% of these reserves and lease the remaining 55%. Compliance coal is defined by Phase II of the Clean Air Act as coal having sulfur dioxide content of 1.2 pounds or less per million Btu. Electricity generators are able to use coal that exceeds these specifications by using emissions reduction technology, using emissions allowance credits or blending higher sulfur coal with lower sulfur coal.

Below is a table summarizing the locations and reserves of our major operating units.

| OPERATING REGIONS | LOCATIONS |
|--------------------|---------------------------------------|
| Powder River Basin | Wyoming and Montana..... |
| Southwest | Arizona, Colorado and New Mexico..... |
| Appalachia | West Virginia..... |
| Midwest | Illinois, Indiana and Kentucky..... |
| Total..... | |

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- (1) Reserves have been adjusted to take into account estimated losses involved in producing a saleable product.

Proven and probable coal reserves are classified as follows:

Proven Reserves--Reserve estimates in this category have the highest degree of geologic assurance. Proven coal lies within one-quarter mile of a valid point of measurement or point of observation (such as exploratory drill holes or previously mined areas) supporting such measurements. The sites for thickness measurement are so closely spaced, and the geologic character is so well defined, that the average thickness, areal extent, size, shape and depth of coalbeds are well established.

Probable Reserves--Reserve estimates in this category have a moderate degree of geologic assurance. There are no sample and measurement sites in areas of indicated coal. However, a single measurement can be used to classify coal lying beyond measured as probable. Probable coal lies more than one-quarter mile, but less than three quarters of a mile from a point of thickness measurement. Further exploration is necessary to place probable coal into the proven category.

In areas where geologic conditions indicate potential inconsistencies related to coal reserves, we perform additional drilling to ensure the continuity and mineability of the coal reserves. Consequently, sampling in those areas involves drill holes that are spaced closer together than those distances cited above.

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We prepare our reserve estimates based on geological data assembled and analyzed by our staff, which includes various geologists and engineers. We periodically update our reserve estimates to reflect production of coal from the reserves and new drilling or other data received. Accordingly, reserve estimates will change from time to time to reflect mining activities, analysis of new engineering and geological data, changes in reserve holdings, modification of mining methods and other factors. We maintain reserve information, including the quantity and quality (where available) of reserves as well as production rates, surface ownership, lease payments and other information relating to our coal reserve and land holdings, through a computerized land management system that we developed.

Our reserve estimates are predicated on information obtained from our extensive drilling program, which totals nearly 500,000 individual drill holes. We compile data from individual drill holes in a computerized drill-hole system from which the depth, thickness and, where core drilling is used, the quality of the coal are determined. The density of the drill pattern determines whether the reserves will be classified as proven or probable. The drill hole data are then input into our computerized land management system, which overlays the geological data with data on ownership or control of the mineral and surface interests to determine the extent of our reserves in a given area. In addition, we periodically engage independent mining and geological consultants to review estimates of our coal reserves. The most recent of these reviews, which was completed in March 2001, included a review of the procedures used by us to prepare our internal estimates, verification of the accuracy of selected property reserve estimates and retabulation of reserve groups according to standard classifications of reliability. This study confirmed that

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we controlled approximately 9.5 billion tons of proven and probable reserves as of April 1, 2000. After adjusting for production through March 1, 2001, proven and probable reserves totaled 9.3 billion tons.

We have numerous federal coal leases that are administered by the Department of the Interior under the Federal Coal Leasing Amendments Act of 1976. These leases cover our principal reserves in Wyoming and other reserves in Montana and Colorado. Each of these leases continues indefinitely, provided there is diligent development of the property and continued operation of the related mine or mines. The Bureau of Land Management has asserted the right to adjust the terms and conditions of these leases, including rent and royalties, after the first 20 years of their term and at 10-year intervals thereafter. Annual rents under our federal coal leases are now set at \$3.08 per acre. Production royalties on federal leases are set by statute at 12.5% of the gross proceeds of coal mined and sold for surface-mined coal and 8% for underground-mined coal. The federal government limits by statute the amount of federal land that may be leased by any company and its affiliates at any time to 75,000 acres in any one state and 150,000 acres nationwide. As of March 31, 2001, we leased or applied to lease 23,386 acres of federal land in Colorado, 11,252 acres in Montana, 30,167 acres in Wyoming for a total of 64,805 nationwide.

Similar provisions govern three coal leases with the Navajo and Hopi Indian tribes. These leases cover coal contained in 65,000 acres of land in northern Arizona lying within the boundaries of the Navajo Nation and Hopi Indian reservations. We also lease coal-mining properties from various state governments.

Private coal leases normally have terms of between ten and 20 years and

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usually give us the right to renew the lease for a stated period or to maintain the lease in force until the exhaustion of mineable and merchantable coal contained on the relevant site. These private leases provide for royalties to be paid to the lessor either as a fixed amount per ton or as a percentage of the sales price. Many leases also require payment of a lease bonus or minimum royalty, payable either at the time of execution of the lease or in periodic installments.

The terms of our private leases are normally extended by active production on or near the end of the lease term. Leases containing undeveloped reserves may expire or these leases may be renewed periodically. With a portfolio of approximately 9.3 billion tons, we believe that we have sufficient reserves to replace capacity from depleting mines for the foreseeable future and that our reserve base is one of our strengths. We believe that the current level of production at our major mines is sustainable.

Consistent with industry practice, we conduct only limited investigation of title to our coal properties prior to leasing. Title to lands and reserves of the lessors or grantors and the boundaries of our leased properties are not completely verified until we prepare to mine those reserves.

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The following chart provides a summary, by mining complex, of production for fiscal years 1999, 2000 and 2001, tonnage of coal reserves that is assigned to our operating mines, our property interest in those reserves and other characteristics of the facilities.

PRODUCTION AND ASSIGNED RESERVES(1)
(Tons in millions)

PRODUCTION

FISCAL FISCAL FISCAL