Selected Financial Data

(Dollars in thousands, except share and per share data)	Year Ended December 31, 2005	Year Ended December 31, 2004	Year Ended December 31, 2003	Year Ended December 31, 2002	Nine Months Ended December 31, 2001
Results of Operations Data					
Revenues					
Sales	$4,545,323	$3,545,027	$2,729,323	$2,630,371	$1,869,321
Other revenues	99,130	86,555	85,973	89,267	57,029
Total revenues	4,644,453	3,631,582	2,815,296	2,719,638	1,926,350
Costs and expenses					
Operating costs and expenses	3,715,836	2,965,541	2,332,137	2,225,344	1,588,596
Depreciation, depletion and amortization	316,114	270,159	234,336	232,413	171,020
Asset retirement obligation expense	35,901	42,387	31,156	–	–
Selling and administrative expenses	189,802	143,025	108,525	101,416	73,553
Other operating income:					
Net gain on disposal of assets	(101,487)	(23,829)	(32,772)	(15,763)	(22,160)
(Income) loss from equity affiliates	(30,096)	(12,399)	(2,872)	2,540	(190)
Operating profit	518,383	246,698	144,786	173,688	115,531
Interest expense	102,939	96,793	98,540	102,458	88,686
Early debt extinguishment costs	–	1,751	53,513	–	38,628
Interest income	(10,641)	(4,917)	(4,086)	(7,574)	(2,155)
Income (loss) before income taxes and minority interests	426,085	153,071	(3,181)	78,804	(9,628)
Income tax provision (benefit)	960	(26,437)	(47,708)	(40,007)	(7,193)
Minority interests	2,472	1,282	3,035	13,292	7,248
Income (loss) from continuing operations	422,653	178,226	41,492	105,519	(9,683)
Loss from discontinued operations	–	(2,839)	–	–	–
Income (loss) before accounting changes	422,653	175,387	41,492	105,519	(9,683)
Cumulative effect of accounting changes	–	–	(10,144)	–	–
Net income (loss)	$ 422,653	$ 175,387	$ 31,348	$ 105,519	$ (9,683)
Basic earnings (loss) per share from continuing operations	$ 1.62	$ 0.72	$ 0.19	$ 0.51	$ (0.05)
Diluted earnings (loss) per share from continuing operations	$ 1.58	$ 0.70	$ 0.19	$ 0.49	$ (0.05)
Weighted average shares used in calculating basic earnings (loss) per share	261,519,424	248,732,744	213,638,084	208,662,940	194,985,776
Weighted average shares used in calculating diluted earnings (loss) per share	268,013,476	254,812,632	219,342,512	215,287,040	194,985,776
Dividends declared per share	$ 0.17	$ 0.13	$ 0.11	$ 0.10	$ 0.05
Other Data					
Tons sold (in millions)	239.9	227.2	203.2	197.9	146.5
Net cash provided by (used in):					
Operating activities	$ 702,759	$ 283,760	$ 188,861	$ 234,804	$ 99,492
Investing activities	(584,202)	(705,030)	(192,280)	(144,078)	(172,989)
Financing activities	(4,915)	693,404	48,598	(58,398)	49,396
Adjusted EBITDA[(1)]	870,398	559,244	410,278	406,101	286,551
Additions to property, plant, equipment and mine development	384,304	151,944	156,443	208,562	194,246
Federal coal lease expenditures	118,364	114,653	–	–	–
Purchase of mining and related assets	141,195	–	–	–	–
Balance Sheet Data (at period end)					
Total assets	$6,852,006	$6,178,592	$5,280,265	$5,125,949	$5,150,902
Total debt	1,405,506	1,424,965	1,196,539	1,029,211	1,031,067
Total stockholders' equity	2,178,467	1,724,592	1,132,057	1,081,138	1,035,472

(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):

	2005	2004	2003	2002	2001
Income (loss) from continuing operations	$ 422,653	$ 178,226	$ 41,492	$ 105,519	$ (9,683)
Income tax provision (benefit)	960	(26,437)	(47,708)	(40,007)	(7,193)
Depreciation, depletion and amortization	316,114	270,159	234,336	232,413	171,020
Asset retirement obligation expense	35,901	42,387	31,156	–	–
Interest expense	102,939	96,793	98,540	102,458	88,686
Early debt extinguishment costs	–	1,751	53,513	–	38,628
Interest income	(10,641)	(4,917)	(4,086)	(7,574)	(2,155)
Minority interests	2,472	1,282	3,035	13,292	7,248
Adjusted EBITDA	$ 870,398	$ 559,244	$ 410,278	$ 406,101	$ 286,551

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 34 active coal operations located throughout all major U.S. coal producing regions and internationally in Australia. In 2005, we sold 239.9 million tons of coal that accounted for an estimated 21.5% of all U.S. coal sales, and were more than 69% greater than the sales of our closest domestic competitor and 49% more than our closest international competitor. Based on Energy Information Administration ("EIA") estimates, demand for coal in the United States was more than 1.1 billion tons in 2005. Domestic consumption of coal is expected to grow at a rate of 1.7% per year through 2030 when U.S. coal demand is forecasted to be 1.8 billion tons. The EIA expects demand for coal use at coal-to-liquids ("CTL") plants to grow to 190 million tons by 2030. Coal-fueled generation is used in most cases to meet baseload electricity requirements, and coal use generally grows at the approximate rate of electricity growth, which is expected to average 1.6% annually through 2025. Coal production from west of the Mississippi River is projected to provide most of the incremental growth as Western production increases to a 63% share of total production in 2030. In 2004, coal's share of electricity generation was approximately 51%, a share that the EIA projects will grow to 57% by 2030.

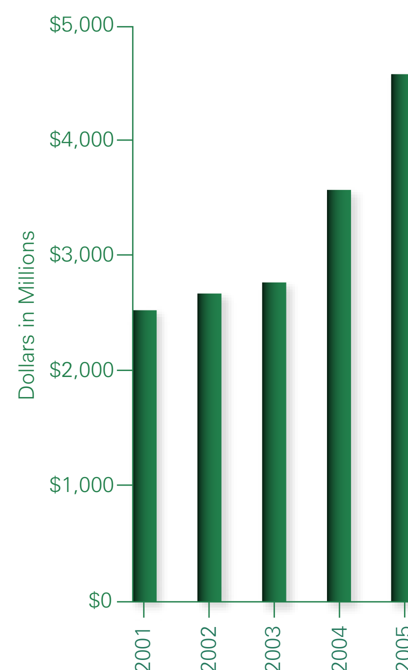
Our primary customers are U.S. utilities, which accounted for 87% of our sales in 2005. We typically sell coal to utility customers under long-term contracts (those with terms longer than one year). During 2005, approximately 90% of our sales were under long-term contracts. As of December 31, 2005, our unpriced volumes for 2006 were 15 to 25 million tons on expected production of 230 to 240 million tons and total sales of 255 to 265 million tons. 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.

We conduct business through four principal operating segments: Eastern U.S. Mining, Western U.S. Mining, Australian Mining, and Trading and Brokerage. Our Eastern U.S. Mining operations consist of our Appalachia and Midwest operations, and our Western U.S. Mining operations consist of our Powder River Basin, Southwest and Colorado operations. The principal business of the Western U.S. Mining segment is the mining, preparation and sale of steam coal, sold primarily to electric utilities. The principal business of the Eastern U.S. Mining segment is the mining, preparation and sale of steam coal, sold primarily to electric utilities, as well as the mining of some metallurgical coal, sold to steel and coke producers.

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

Our Australian Mining operations consist of our North Goonyella underground mine and our Wilkie Creek, Burton and Eaglefield surface mines. Eaglefield is a surface operation adjacent to, and fulfilling contract tonnages in conjunction with, the North Goonyella underground mine. In the first quarter of 2006, we will begin production at the 0.6 million ton per year Baralaba Mine, of which we own a 62.5% interest. The Baralaba Mine will produce PCI, a substitute for metallurgical coal, and steam coal. Australian Mining operations are

Revenues



Periods presented on a calendar year basis.

2001 excludes the revenues from Peabody Resources Limited, which was sold in 2001.

characterized by both surface and underground extraction processes, mining low-sulfur, high Btu coal sold to an international customer base. Primarily, metallurgical coal is produced from our Australian mines. Metallurgical coal is approximately 5% of our total sales volume and approximately 2% of U.S. sales volume.

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.

In addition to our mining operations, which comprised 85% of revenues in 2005, we also generate revenues from brokering and trading coal (15% of revenues), and by creating value from our vast natural resource position by selling non-core land holdings and mineral interests to generate additional cash flows as well as other ventures described below.

We continue to pursue the development of coal-fueled generating projects in areas of the United States 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 lessor. The projects we are currently pursuing are as follows: the 1,500-megawatt Prairie State Energy Campus in Washington County, Illinois; the 1,500-megawatt Thoroughbred Energy Campus in Muhlenberg County, Kentucky; and the 300-megawatt Mustang Energy Project near Grants, New Mexico. 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 first of these plants would not be operational earlier than mid-2010.

In February 2005, a group of Midwest rural electric cooperatives and municipal joint action agencies entered into definitive agreements to acquire 47% of the Prairie State Energy Campus project. After an initial appeal, the Illinois Environmental Protection Agency reissued the air permit on April 28, 2005. The same parties who filed the earlier permit challenge filed a new appeal on June 8, 2005. We believe the permit was appropriately issued and expect to prevail in the appeal process. Various other required permits are in process and may also be subject to challenge. If successfully completed, the Prairie State Energy Campus project would utilize approximately six million tons of coal each year.

During 2005, we engaged in several Btu Conversion projects which are designed to expand the uses of coal through various technologies. We are a founding member of the FutureGen Industrial Alliance, a non-profit company that is partnering with the U.S. Department of Energy to facilitate the design, construction and operation of the world's first zero-emission coal-fueled power plant. FutureGen will demonstrate advanced coal-based technologies to generate electricity and also produce hydrogen to power fuel cells for transportation and other energy needs. The technology also will integrate the capture of carbon emissions with carbon sequestration, helping to address the issue of climate change as energy demand continues to grow worldwide. We also entered into an agreement to acquire a 30% interest in Econo-Power International Corporation ("EPIC™"), which owns and markets modular coal gasifiers for industrial applications. The EPIC Clean Coal Gasification System™ uses air-blown gasifiers to convert coal into a synthetic gas that is ideal for industrial applications. In late 2005, we entered into a memorandum of understanding with ArcLight Capital Partners, LLC to advance project development of a commercial-scale coal gasification project in Illinois that would transform coal into pipeline-quality synthetic natural gas. The initial project would be designed with ConocoPhillips' "E-Gas™" Technology. When completed, the plant would be one of the largest coal-to-natural-gas plants in the United States and would require at least three million tons of Illinois Basin coal per year to fuel two gasifier trains that could produce more than 35 billion cubic feet of synthetic natural gas.

Effective January 1, 2006, Gregory H. Boyce became our President and Chief Executive Officer after we completed an orderly succession planning process. Irl F. Engelhardt, our former Chief Executive Officer, remains employed as Chairman of the Board. Effective March 1, 2005, Mr. Boyce was also elected to the Board of Directors and Chairman of the Executive Committee of the Board.

Effective March 30, 2005, we implemented a two-for-one stock split on all shares of our common stock. Subsequently, on February 22, 2006, we implemented another two-for-one stock split on all shares of our then outstanding common stock. All share and per share amounts in this annual report reflect both stock splits. During July 2005, we increased our quarterly dividend 27% to $0.0475 per share and 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. On January 23, 2006, our Board of Directors authorized a 26% increase in our dividend, to $0.06 per share, to shareholders of record on February 7, 2006.

In July 2005, the Board of Directors elected John F. Turner as an independent director who serves on the Board's Nominating and Corporate Governance Committee. Turner is former U.S. Assistant Secretary of State for Oceans and International Environmental and Scientific Affairs ("OES") within the State Department and is the past President and Chief Executive Officer of the Conservation Fund, a national nonprofit organization dedicated to public-private partnerships to protect land and water resources. He has also served as the Director of the U.S. Fish and Wildlife Service, with responsibility for increasing wetland protection and establishing 55 National Wildlife Refuges, the most of any administration in the nation's history.

RESULTS OF OPERATIONS

Adjusted EBITDA

The discussion of our results of operations in 2005 and 2004 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 primarily as a measure of our segments' operating performance. 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 27 to our consolidated financial statements included in this report.

YEAR ENDED DECEMBER 31, 2005 COMPARED TO YEAR ENDED DECEMBER 31, 2004

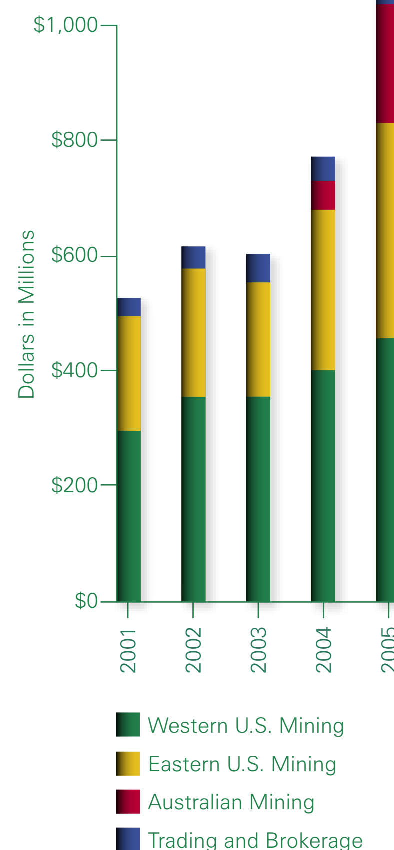
Summary

Our 2005 revenues of $4.64 billion increased 27.9% over the prior year. Revenues were driven higher by improved pricing in all of our mining operations and another year of industry-record sales volume with 239.9 million tons sold compared to 227.2 million tons in 2004.

For the year, segment Adjusted EBITDA of $1.08 billion was a 39.5% increase over the prior year. Segment Adjusted EBITDA was higher in the current year due to increases in sales volumes and prices at our U.S. and Australian Mining Operations. Results in our Western U.S. Mining Operations segment include amounts for our April 15, 2004, acquisition of the Twentymile Mine in Colorado. Results in our Australian Mining Operations segment include amounts for our April 15, 2004, acquisition of the Burton and North Goonyella Mines as well as the opening of the Eaglefield Mine adjacent to the North Goonyella Mine in the fourth quarter of 2004. Our Corporate and Other segment includes results from our December 2004 acquisition of a 25.5% interest in Carbones del Guasare, which owns and operates the Paso Diablo Mine in Venezuela. In addition, higher gains on property transactions contributed to higher year over year results.

Net income was $422.7 million in 2005, or $1.58 per share, an increase of 141.0% over 2004 net income of $175.4 million, or $0.69 per share. The increase in net income was primarily due to improved segment Adjusted EBITDA discussed above.

Segment Adjusted EBITDA



Periods presented on a calendar year basis.

Segment Adjusted EBITDA is Adjusted EBITDA less Corporate and Other.

2001 excludes results from and the gain associated with the sale of Peabody Resources Limited.

Tons Sold

The following table presents tons sold by operating segment for the years ended December 31, 2005 and 2004:

(Tons in millions)	Year Ended December 31, 2005	Year Ended December 31, 2004	Increase (Decrease)	
			Tons	%
Western U.S. Mining Operations	154.3	142.2	12.1	8.5 %
Eastern U.S. Mining Operations	52.5	51.7	0.8	1.5 %
Australian Mining Operations	8.3	6.1	2.2	36.1 %
Trading and Brokerage Operations	24.8	27.2	(2.4)	(8.8)%
Total	239.9	227.2	12.7	5.6 %

Revenues

The table below presents revenues for the years ended December 31, 2005 and 2004:

(Dollars in thousands)	Year Ended December 31, 2005	Year Ended December 31, 2004	Increase to Revenues	
			$	%
Sales	$4,545,323	$3,545,027	$1,000,296	28.2%
Other revenues	99,130	86,555	12,575	14.5%
Total revenues	$4,644,453	$3,631,582	$1,012,871	27.9%

Our revenues increased by $1.01 billion, or 27.9%, to $4.64 billion compared to prior year. The three mines we acquired in the second quarter of 2004 contributed $365.2 million of revenue growth due to the additional 105 days of operations in 2005 compared to the prior year. The remaining $647.7 million of revenue growth was driven by higher sales prices and volumes across all mining segments and improved volumes in our brokerage operations.

Sales increased 28.2% to $4.55 billion in 2005, reflecting increases in every operating segment. Western U.S. Mining sales increased $222.2 million, Eastern U.S. Mining sales were $224.0 million higher, sales in Australian Mining improved $328.0 million and sales from our brokerage operations increased $226.0 million. Sales in every segment increased on improved pricing, and volumes were higher in every segment other than Trading and Brokerage. Our average sales price per ton increased 17.4% during 2005 due to increased demand for all of our coal products, which drove pricing higher, particularly in the regions where we produce metallurgical coal. Prices for metallurgical coal and our ultra-low sulfur Powder River Basin coal have been the subject of increasing demand. We sell metallurgical coal from our Eastern U.S. and Australian Mining operations. We sell ultra-low sulfur Powder River Basin coal from our Western U.S. Mining operations. The sales mix also improved due to an increase in sales from our Australian Mining segment, where per ton prices are higher than in domestic markets due primarily to a higher proportion of metallurgical coal production in the Australian segment sales mix.

The increase in Eastern U.S. Mining operations sales was primarily due to improved pricing for both steam and metallurgical coal from the region. Sales in Appalachia increased $118.6 million, or 17.1%, and sales in the Midwest increased $105.4 million, or 13.6%. On average, prices in our Eastern U.S. Mining operations increased 14.1% to $33.10 per ton. Production increases in the Midwest were partially offset by lower production in Appalachia compared to the prior year. Most of the decrease in production in Appalachia occurred during the fourth quarter as our largest metallurgical coal mine worked to develop a new section and relocate its longwall. Sales increased in our Western U.S. Mining operations due to higher demand-driven volumes and prices. Overall, prices in our Western U.S. Mining operations increased 6.6% to $10.45 per ton. In the West, sales increased the most in the Powder River Basin, which improved $149.8 million due to increased sales prices and volumes. Powder River Basin production and sales volumes were up as a result of increasingly strong demand for the mines' low-sulfur product, which continues to expand its market area geographically. Powder River Basin operations were able to ship record volumes during 2005 by overcoming train derailments and weather and track maintenance disruptions

on the main shipping line out of the basin. Our Twentymile Mine, acquired in April of 2004, helped our Colorado operations contribute an additional $67.3 million to sales compared to prior year due to an additional four months of ownership, higher prices and increased mine productivity. Sales from our Southwestern operations, where the Black Mesa Mine closed at the end of 2005, were comparable to prior year. Sales from our Australian Mining operations were $328.0 million, or 122.1%, higher than in 2004. The increase in Australian sales was due primarily to a 63.3% increase in per ton sales prices largely due to higher international metallurgical coal prices, an increase in volumes which included the opening of our Eaglefield surface mine at the end of 2004, and $197.6 million of incremental sales from the two mines we acquired in April 2004 due to 105 additional days of operations in 2005 compared to 2004. Our Trading and Brokerage operations' sales increased $226.0 million in 2005 compared to prior year due to an increase in average per ton prices and higher Eastern U.S. and international brokerage volumes.

Other revenues increased $12.6 million, or 14.5%, compared to prior year primarily due to proceeds from a purchase contract restructuring and higher synthetic fuel revenues in the Midwest.

Segment Adjusted EBITDA

Our total segment Adjusted EBITDA of $1.08 billion for 2005 was $305.5 million higher than 2004 segment Adjusted EBITDA of $773.8 million, and was composed of the following:

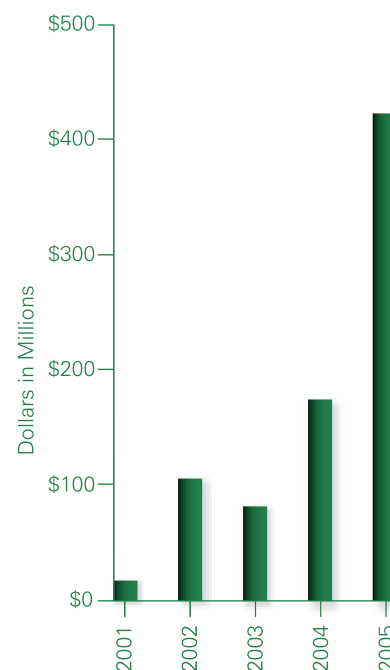
(Dollars in thousands)	*Year Ended December 31, 2005*	*Year Ended December 31, 2004*	*Increase to Segment Adjusted EBITDA*	
			$	*%*
Western U.S. Mining	$ 459,039	$402,052	$ 56,987	14.2%
Eastern U.S. Mining	374,628	280,357	94,271	33.6%
Australian Mining	202,582	50,372	152,210	302.2%
Trading and Brokerage	43,058	41,039	2,019	4.9%
Total Segment Adjusted EBITDA	$1,079,307	$773,820	$305,487	39.5%

Adjusted EBITDA from our Western U.S. Mining operations increased $57.0 million during 2005 due to a margin per ton increase of $0.15, or 5.3%, and a sales volume increase of 12.1 million tons. The Twentymile Mine, acquired in April of 2004, contributed $25.4 million more to Adjusted EBITDA in 2005 than in 2004, due to four months of incremental ownership and a 22.2% increase in per ton margin. The remaining increase in Adjusted EBITDA was driven by our Powder River Basin operations, which improved by $53.5 million and earned 12.3% higher per ton margins while increasing volumes 8.5% in response to greater demand for our low-sulfur products. Improved revenues overcame increased unit costs that resulted from higher fuel costs, lower than anticipated volume due to rail difficulties and an increase in revenue-based royalties and production taxes. Improvements in the Powder River Basin and Colorado overcame a decrease in Adjusted EBITDA of $13.5 million for our Southwest operations primarily due to lower volume and higher fuel costs. Pricing improvements in the Powder River Basin generally offset higher costs for fuel and explosives.

Eastern U.S. Mining operations' Adjusted EBITDA increased $94.3 million, or 33.6%, compared to prior year primarily due to an increase in margin per ton of $1.71, or 31.5%. Our Appalachia operations' Adjusted EBITDA increased $44.2 million, or 29.8%, as a result of sales price increases, partially offset by lower production at two of our mines and higher costs related to geologic issues, contract mining and roof support. Results in our Midwest operations were improved $50.1 million, or 37.9%, compared to prior year as benefits of higher volumes and prices were partially offset by higher costs due to higher fuel, repair and maintenance costs and the impact of heavy rainfall on surface operations early in the year.

Our Australian Mining operations' Adjusted EBITDA increased $152.2 million in the current year, a 302.2% increase compared to prior year due to an increase of $16.23, or 197.4%, in margin per ton and 2.2 million additional tons shipped. Our Australian operations produce mostly (75% to 85%) high margin metallurgical coal. The two mines we acquired in April 2004 added $87.4 million to Adjusted EBITDA compared to eight months of ownership in 2004. The remaining increase of $64.8 million was primarily due to an increase in volume, including tonnage from our surface operation opened at the end of the prior year, and an increase of 63.3% in average per ton sale price. While current year margins benefited from

Income



Periods presented on a calendar year basis.

2001 excludes the results from and the gain associated with the sale of Peabody Resources Limited and discontinued operations.

2001 and 2003 exclude debt extinguishment charges and 2003 excludes cumulative effects of accounting changes.

strong sales prices, margin growth was limited by the impact of port congestion, related demurrage costs and higher costs due to geological problems at the underground mine.

Trading and Brokerage operations' Adjusted EBITDA increased $2.0 million from the prior year primarily due to higher brokerage results. Results in 2005 included a net charge of $4.0 million, primarily related to the breach of a coal supply contract by a producer (see Note 3).

Reconciliation of Segment Adjusted EBITDA to Income Before Income Taxes and Minority Interests

(Dollars in thousands)	*Year Ended December 31, 2005*	*Year Ended December 31, 2004*	*Increase (Decrease) to Income*	
			$	*%*
Total Segment Adjusted EBITDA	$1,079,307	$ 773,820	$305,487	39.5 %
Corporate and Other Adjusted EBITDA	(208,909)	(214,576)	5,667	2.6 %
Depreciation, depletion and amortization	(316,114)	(270,159)	(45,955)	(17.0)%
Asset retirement obligation expense	(35,901)	(42,387)	6,486	15.3 %
Early debt extinguishment costs	–	(1,751)	1,751	n/a
Interest expense	(102,939)	(96,793)	(6,146)	(6.3)%
Interest income	10,641	4,917	5,724	116.4 %
Income before income taxes and minority interests	$ 426,085	$ 153,071	$273,014	178.4 %

Income before income taxes and minority interests of $426.1 million for the current year is $273.0 million, or 178.4%, higher than prior year primarily due to improved segment Adjusted EBITDA as discussed above. Increases in depreciation, depletion and amortization expense and interest expense offset improvements in Corporate and Other Adjusted EBITDA, asset retirement obligation expense, early debt extinguishment costs and interest income.

Corporate and Other Adjusted EBITDA results include selling and administrative expenses, equity income from our Venezuelan 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 and resource management. The $5.7 million improvement in Corporate and Other Adjusted EBITDA (net expense) in 2005 compared to 2004 included:

- net gains on asset sales that were $77.7 million higher than prior year primarily due to a $37.4 million gain from a property exchange related to settlement of a contract dispute with a third-party coal supplier (see Note 3), sales of Penn Virginia Resource Partners, L.P. ("PVR") units ($31.1 million) (see Note 11), resource sales involving non-strategic coal assets and properties ($12.5 million), and an asset exchange in which we acquired Illinois Basin coal reserves ($6.2 million). The gain from PVR unit sales in 2005 was from the sale of all of our remaining 0.838 million units compared to a gain of $15.8 million on the sale of 0.775 million units in two separate transactions during 2004. All other gains on asset disposals in 2005 and 2004 were $14.3 million and $8.0 million, respectively;
- higher equity income of $18.7 million from our 25.5% interest in Carbones del Guasare (acquired in December 2004), which owns and operates the Paso Diablo Mine in Venezuela, and;
- lower net expenses related to generation development of $5.1 million, primarily due to reimbursements from the Prairie State Energy Campus partnership group.

These improvements were partially offset by:

- a $36.0 million increase in past mining obligations expense, primarily related to higher retiree health care costs. The increase in retiree health care costs was actuarially driven by higher trend rates, and lower interest discount assumptions and higher amortization of actuarial losses in 2005, and;
- an increase of $46.8 million in selling and administrative expenses primarily related to accruals for higher short-term and long-term performance-based incentive

plans ($32.2 million). These incentives are principally long-term plans that are driven by total shareholder returns. Our share price increased 104% during 2005, significantly outperforming industrial benchmarks and our coal peer group average. The remaining increase in selling and administrative expenses was due to higher personnel and outside services costs needed to advance our growth initiatives in areas such as China and Btu Conversion, acquisitions and regulatory costs (e.g. Sarbanes-Oxley), and an increase in advertising costs related to an industry awareness campaign launched in late 2005.

Depreciation, depletion and amortization increased $46.0 million during 2005. Approximately 56% of the increase was due to acquisitions completed during 2004 and the remainder was from increased volumes at existing mines and operations opened during 2005. Asset retirement obligation expense decreased $6.5 million in 2005 due to additional expenses incurred in 2004 to accelerate the planned reclamation of certain closed mine sites. Interest expense increased $6.1 million primarily related to a full year of interest in 2005 on $250 million of 5.875% Senior Notes issued in late March of 2004 and increases in the cost of floating rate debt due to higher interest rates. Interest income improved $5.7 million due to higher yields on short-term interest rates and an increase in invested balances due to improved cash flows during 2005.

Net Income

(Dollars in thousands)	Year Ended December 31, 2005	Year Ended December 31, 2004	Increase (Decrease) to Income $	%
Income before income taxes and minority interests	$426,085	$153,071	$273,014	178.4 %
Income tax benefit (provision)	(960)	26,437	(27,397)	(103.6)%
Minority interests	(2,472)	(1,282)	(1,190)	(92.8)%
Income from continuing operations	422,653	178,226	244,427	137.1 %
Loss from discontinued operations	—	(2,839)	2,839	n/a
Net income	$422,653	$175,387	$247,266	141.0 %

Net income increased $247.3 million, or 141.0%, compared to the prior year due to the increase in income before income taxes and minority interests discussed above, partially offset by increases in our income tax provision. The income tax benefit in 2004 included a $25.9 million reduction in the valuation allowance on net operating loss carry-forwards (“NOLs”) and alternative minimum tax credits. The income tax provision in 2005 was higher based on the increase in pretax income which was partially offset by the higher permanent benefit of percentage depletion and the partial benefit of tax loss from a deemed liquidation of a subsidiary arising as an indirect consequence of a comprehensive and strategic internal restructuring we completed during 2005. This restructuring resulted from efforts to better align corporate ownership of subsidiaries on a geographic and functional basis.

YEAR ENDED DECEMBER 31, 2004 COMPARED TO YEAR ENDED DECEMBER 31, 2003

Summary

In 2004, our revenues increased to $3.63 billion, 29.0% higher than 2003, led by improved pricing and an industry-record sales volume of 227.2 million tons. Mines acquired in April 2004 contributed $335.0 million of sales and 11.0 million tons to our 2004 results.

Segment Adjusted EBITDA for 2004 totaled $773.8 million, a 28.1% increase over $603.9 million in the prior year. Segment Adjusted EBITDA was higher in 2004 due to increased sales volumes and prices.

Net income in 2004 was $175.4 million, or $0.69 per share, an increase of 459.5% over 2003 net income of $31.3 million, or $0.14 per share. The increase in net income was primarily due to improved operating results and acquisitions in 2004, and the impact in 2003 of $53.5 million in pretax early debt extinguishment charges and a $10.1 million after tax charge for the cumulative effect of accounting changes.

Tons Sold

The following table presents tons sold by operating segment for the years ended December 31, 2004 and 2003:

(Tons in millions)	*Year Ended December 31, 2004*	*Year Ended December 31, 2003*	*Increase*	
			Tons	*%*
Western U.S. Mining Operations	142.2	129.6	12.6	9.7%
Eastern U.S. Mining Operations	51.7	46.3	5.4	11.7%
Australian Mining Operations	6.1	1.3	4.8	369.2%
Trading and Brokerage Operations	27.2	26.0	1.2	4.6%
Total	227.2	203.2	24.0	11.8%

Revenues

The table below presents revenues for the years ended December 31, 2004 and 2003:

(Dollars in thousands)	*Year Ended December 31, 2004*	*Year Ended December 31, 2003*	*Increase to Revenues*	
			$	*%*
Sales	$3,545,027	$2,729,323	$815,704	29.9%
Other revenues	86,555	85,973	582	0.7%
Total revenues	$3,631,582	$2,815,296	$816,286	29.0%

Revenues increased by 29.0%, or $816.3 million, over 2003. The acquisition of three mines in April 2004 contributed $335.0 million of total revenue and 11.0 million tons during the year. Excluding revenues from acquisitions during 2004, U.S. Mining revenues increased $375.4 million, and revenues from our brokerage operations increased $110.9 million on higher pricing and volume worldwide. Our average sales price per ton increased 14.6% during 2004 due to increased overall demand, which has driven pricing higher, most notably in Appalachia, and a change in sales mix. The sales mix has benefited from the increase in sales from the Australian segment, where per ton prices are higher than in domestic markets. In addition to geographic mix changes, our 2004 revenues included a greater proportion of higher priced metallurgical coal sales. Pricing of metallurgical coal responded to increased international demand for the product. We sell metallurgical coal from our Eastern U.S. and Australian Mining operations. Other revenues were relatively unchanged from 2003.

In our Eastern U.S. Mining operations, revenues increased $302.8 million, or 25.3%, as a result of higher pricing and volumes from strong steam and metallurgical coal demand. Production increases at most eastern mines more than offset lower than expected production at certain of our mines and from contract sources as a result of geologic difficulties and from congestion-related shipping delays and hurricane-related production disruptions and delays to rail and export shipments. Appalachian revenues led the Eastern U.S. increase, benefiting the most from price increases while also increasing production and sales volumes. Revenues in Appalachia increased $188.1 million, or 37.0%, while in the Midwest, revenues increased by $114.7 million, or 16.6%. Revenues in our Western U.S. Mining operations increased $171.6 million, or 14.0%, on both increased volumes and prices. However, the primary driver of increased revenues in the West was a 12.6 million ton increase in sales volume. Growth in volumes were primarily in the Powder River Basin operations, where revenues were up $58.6 million, or 7.5%, and from the addition of the Twentymile Mine in April 2004, which added $99.0 million to sales. Powder River Basin production and sales volumes were up as a result of stronger demand for the mines' low-sulfur product, which overcame difficulties with rail service, downtime at the North Antelope Rochelle Mine to upgrade the loading facility and poor weather, which impaired production early in the year. Revenues in our Australian Mining operations increased $241.5 million compared to 2003 due primarily to the acquisition of two operating mines during 2004 and benefiting from higher overall pricing for our products there.

Segment Adjusted EBITDA

Our total segment Adjusted EBITDA of $773.8 million for 2004 was $169.9 million higher than 2003 segment Adjusted EBITDA of $603.9 million, and was composed of the following:

(Dollars in thousands)	Year Ended December 31, 2004	Year Ended December 31, 2003	Increase (Decrease) to Segment Adjusted EBITDA	
			$	%
Western U.S. Mining	$402,052	$356,898	$ 45,154	12.7 %
Eastern U.S. Mining	280,357	198,964	81,393	40.9 %
Australian Mining	50,372	2,225	48,147	2163.9 %
Trading and Brokerage	41,039	45,828	(4,789)	(10.4)%
Total Segment Adjusted EBITDA	$773,820	$603,915	$169,905	28.1 %

Western U.S. Mining operations Adjusted EBITDA increased $45.2 million during 2004, margin per ton increased $0.07, or 2.5%, while sales volume increased 12.6 million tons. The April 2004 acquisition of the Twentymile Mine contributed to $31.2 million of Adjusted EBITDA increase and sales volume, adding 6.2 million tons of the volume increase in 2004. An increase of $20.0 million in Adjusted EBITDA in the Powder River Basin, due primarily to increases in sales volume, contributed most of the remaining improvement in the West. Our Powder River Basin operations continued to benefit from strong demand, leading to record shipping levels which overcame the effects of a planned outage earlier in the year to increase throughput at our North Antelope Rochelle Mine, rail service problems throughout the year and the shutdown of our Big Sky Mine at the end of 2003. Results in the Southwest approximated 2003 levels. Pricing improvements generally offset higher costs for fuel and explosives.

Adjusted EBITDA from our Eastern U.S. Mining operations increased $81.4 million, or 40.9%, compared to 2003 due to an increase in margin per ton of $1.11, or 25.8%, and an increase in volume by 5.4 million, or 11.7%. Improved pricing led to increased margins in our Eastern operations, despite higher processing costs incurred to upgrade from steam to metallurgical quality, the cost of substitute coal purchases to enable production to be sold in higher-value metallurgical coal markets, hurricane-related transportation and production interruption and increased fuel and steel costs. Appalachia operations drove the improvement in the East with a $101.5 million increase in Adjusted EBITDA. The Appalachia region benefited from strong demand driven pricing and volume and increased higher-priced metallurgical coal sales. Our operations in Appalachia also benefited during the current year from $21.0 million in insurance recoveries, more than offsetting higher costs due to equipment and geologic difficulties at a mine in Kentucky and a $9.6 million increase in earnings from our equity interest in a joint venture. Adjusted EBITDA in the Midwest was $20.1 million less than 2003 as increased production and sales, as well as higher overall sales prices, did not overcome poor geologic conditions at certain mines, higher equipment repair costs and higher fuel and steel costs.

Our Australian Mining operations Adjusted EBITDA increased $48.1 million in 2004. Our acquisition of two mines in April 2004 added 4.8 million tons and increased overall sales volume to 6.1 million tons. Most of the increase in sales tonnage was in higher margin metallurgical coal sales, driving a margin per ton increase of $6.55, or nearly 400%. The acquisitions in 2004 contributed $43.1 million of Adjusted EBITDA to results for the year.

Trading and Brokerage Adjusted EBITDA decreased $4.8 million from 2003 primarily due to higher brokerage results in 2003. Adjusted EBITDA from trading activities increased over 2003 due to improved pricing on our long position, and pure brokerage results improved on higher pricing and volumes, particularly in international brokerage.

Reconciliation of Segment Adjusted EBITDA to Income (Loss) Before Income Taxes and Minority Interests

(Dollars in thousands)	Year Ended December 31, 2004	Year Ended December 31, 2003	Increase (Decrease) to Income $	Increase (Decrease) to Income %
Total Segment Adjusted EBITDA	$ 773,820	$ 603,915	$169,905	28.1 %
Corporate and Other Adjusted EBITDA	(214,576)	(193,637)	(20,939)	(10.8)%
Depreciation, depletion and amortization	(270,159)	(234,336)	(35,823)	(15.3)%
Asset retirement obligation expense	(42,387)	(31,156)	(11,231)	(36.0)%
Early debt extinguishment costs	(1,751)	(53,513)	51,762	96.7 %
Interest expense	(96,793)	(98,540)	1,747	1.8 %
Interest income	4,917	4,086	831	20.3 %
Income (loss) before income taxes and minority interests	$ 153,071	$ (3,181)	$156,252	n/a

Total segment Adjusted EBITDA of $773.8 million for 2004 is compared with $603.9 million from 2003 in the discussion above. Corporate and Other Adjusted EBITDA results include selling and administrative expenses, net gains on asset disposals, costs associated with past mining obligations and revenues and expenses related to our other commercial activities such as coalbed methane, generation development, resource management and our Venezuelan mining operations. The increase in Corporate and Other Adjusted EBITDA (net expense) in 2004 compared to 2003 was primarily due to:

- net gains on asset sales were $8.8 million higher in 2003, which included gains of $18.8 million on the sale of land, coal reserves and oil and gas rights, $6.4 million of other asset disposals, and $7.6 million from the sale of 1.15 million units of PVR, while 2004 included gains of only $8.0 million from other asset disposals and a $15.8 million gain from the sale of a total of 0.775 million units of PVR in two separate transactions;
- increased costs in 2004 for generation development ($5.3 million) related to the further development of the Prairie State and Thoroughbred Energy campuses;
- higher selling and administrative expenses of $34.5 million, primarily associated with higher long-term incentive costs ($17.8 million), pensions, an increase in outside services costs (including costs related to compliance with the Sarbanes-Oxley Act) and the impact of acquisitions during 2004; and
- a $2.9 million increase in our accrual for future environmental obligations.

These increased costs compared to 2003 were partially offset by the gain on sale of PVR units discussed above and:

- lower costs ($29.0 million) in 2004 associated with past mining obligations, primarily lower retiree health care costs from the passage of the Medicare Prescription Drug, Improvement and Modernization Act of 2003 and lower closed and suspended mine spending;
- contributions ($1.2 million) to Adjusted EBITDA from the December 2004 acquisition of a 25.5% interest in the Paso Diablo Mine in Venezuela.

Depreciation, depletion and amortization increased $35.8 million during 2004 due to higher volume and acquisitions. Asset retirement obligation expense increased $11.2 million during 2004 due to increased or accelerated reclamation work at certain closed mine sites and the acquisition of additional mining operations.

Debt extinguishment costs were $51.8 million higher in 2003 due to the significant prepayment premiums associated with the March 2003 refinancing, discussed in Note 14 to our consolidated financial statements.

Net Income

(Dollars in thousands)	Year Ended December 31, 2004	Year Ended December 31, 2003	Increase (Decrease) to Income $	%
Income (loss) before income taxes and minority interests	$153,071	$ (3,181)	$ 156,252	n/a
Income tax benefit	26,437	47,708	(21,271)	(44.6)%
Minority interests	(1,282)	(3,035)	1,753	57.8 %
Income from continuing operations	178,226	41,492	136,734	329.5 %
Loss from discontinued operations	(2,839)	–	(2,839)	n/a
Income before accounting changes	175,387	41,492	133,895	322.7 %
Cumulative effect of accounting changes	–	(10,144)	10,144	n/a
Net income	$175,387	$ 31,348	$144,039	459.5 %

The increase of $144.0 million in net income from 2003 to 2004 was due to the increase in income (loss) before income taxes and minority interests ($156.3 million) discussed above and the impacts of the following:

- a $21.3 million lower tax benefit in 2004. The tax benefit recorded in 2004 differs from the benefit in 2003 primarily as a result of significantly higher pre-tax income, partially offset by the higher permanent benefit of percentage depletion. The 2004 tax benefit also included a net $25.9 million reduction in the valuation allowance on those NOLs and alternative minimum tax credits. We evaluated and assessed the expected near-term utilization of NOLs, book and taxable income trends, available tax strategies and the overall deferred tax position to determine the amount and timing of valuation allowance adjustments;
- a $2.8 million loss, net of tax, from discontinued operations in 2004 due to costs to resolve a contract indemnification claim related to our former Citizens Power subsidiary;
- lower minority interests during 2004 due to the acquisition in April 2003 of the remaining 18.3% of Black Beauty Coal Company; and
- a charge in 2003 for the cumulative effect of accounting changes, net of income taxes, of $10.1 million, relating to the adoption of Statement of Financial Accounting Standard ("SFAS") No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"), the change in method of amortization of actuarial gains and losses related to net periodic postretirement benefit costs and the effect of the recession of Emerging Issues Task Force ("EITF") No. 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities," as discussed in Note 7 to the consolidated financial statements.

OUTLOOK

Events Impacting Near-Term Operations

Despite setting new industry records, shipments from our Powder River mines were lower than expected during 2005 due to a remedial maintenance program undertaken by the two railroad companies serving the Powder River Basin. The maintenance and repairs are expected to continue into 2006. We expect these repairs may restrict shipments from our Powder River operations during 2006, but continue to anticipate higher shipment levels than 2005.

Metallurgical coal production from our Appalachia operations is expected to be lower than prior year periods through the first quarter of 2006 as a metallurgical coal mine in our Appalachia segment continues development work and moves to new reserves. The longwall at the existing mine has depleted the final panel of available reserves in its current location and is relocating to a reserve extension in the first half of 2006. Following the longwall move, production of domestic metallurgical coal is expected to improve and finish the year with production equal to, or greater than, that of 2005.

Our North Goonyella Mine in Australia has experienced difficult geologic conditions in 2005 and experienced a roof fall that interrupted production for portions of the third and fourth quarters. In the first quarter of 2006, we plan to install new longwall equipment to maximize operating performance under these adverse geologic conditions. We plan to meet our shipping commitments from this mine by supplementing its output with production from our newly-opened, adjacent surface operation. In May 2005, we were notified of a reduced port allocation that is aimed at improving the loading of vessels and reducing demurrage at the main port for our Australian coal operations. Although port congestion has been reduced, high demurrage costs and unpredictable timing of vessel loading could continue to impact future results.

Outlook Overview

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. The U.S. economy grew at an annual rate of 4.1% in the third quarter of 2005 as reported by the U.S. Commerce Department, and China's economy grew 9.4% as published by the National Bureau of Statistics of China. Strong demand for coal and coal-based electricity generation in the U.S. is being driven by the growing economy, low customer stockpiles, favorable weather, capacity constraints of nuclear generation and high prices of natural gas and oil. The high price of natural gas is leading some coal-fueled generating plants to operate at increased levels. The Energy Information Administration ("EIA") projects that the high price of oil will lead to an increase in demand for unconventional sources of transportation fuel, including coal-to-liquids ("CTL"), and that coal will begin to displace natural gas-fired generation of electricity, including the addition of CTL plants. At year end, U.S. electricity generator coal inventories were at the lowest level in the past five years.

Demand for Powder River Basin coal is increasing, particularly for our ultra-low sulfur products. The Powder River Basin represents more than half of our production, and the published reference price for high-Btu, ultra-low sulfur Powder River Basin coal has increased substantially, tripling during 2005. We control approximately 3.5 billion tons of proven and probable reserves in the Southern Powder River Basin and sold 125.7 million tons of coal from this region during the year ended December 31, 2005. Customers have indicated that demand for Powder River Basin coal could increase by 15% or more during 2006, although the railroads expect that they will be able to accommodate only about half of the expected increase in demand. Metallurgical coal continues to sell at a significant premium to steam coal and metallurgical markets remain strong as global steel production grew 6% to 7% in 2005. We expect to capitalize on the strong global market for metallurgical coal primarily through production and sales of metallurgical coal from our Appalachia operations and our Australian operations.

We are targeting 2006 production of 230 million to 240 million tons and total sales volume of 255 million to 265 million tons, including 12 to 14 million tons of metallurgical coal. As of December 31, 2005, our unpriced volumes for produced tonnage for 2006 were 15 to 25 million tons.

Management expects strong market conditions and operating performance to overcome 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. 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.

CRITICAL ACCOUNTING POLICIES

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.

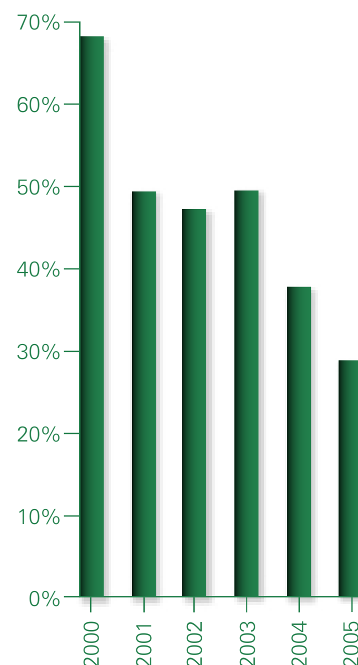
Employee-Related Liabilities

Our subsidiaries have significant long-term liabilities for our employees' postretirement benefit costs, workers' compensation obligations and defined benefit pension plans. Detailed information related to these liabilities is included in Notes 16, 17 and 18 to our consolidated financial statements. 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, 2005, for these liabilities totaled $193.8 million, while payments were $147.1 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.



Periods presented on a calendar year basis.

Defined as total balance sheet debt less cash divided by total balance sheet debt less cash plus equity.

(Dollars in thousands)	*One-Percentage-Point Increase*	*One-Percentage-Point Decrease*
Health care cost trend rate:		
Effect on total service and interest cost components[(1)]	$ 8,789	$ (6,961)
Effect on total postretirement benefit obligation[(1)]	$161,903	$(135,501)

(Dollars in thousands)	*One Half Percentage-Point Increase*	*One Half-Percentage-Point Decrease*
Discount rate:		
Effect on total service and interest cost components[(1)]	$ 1,183	$ (1,563)
Effect on total postretirement benefit obligation[(1)]	$(68,900)	$ 75,878

(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 8.99 years at December 31, 2005.

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, 2005, was $35.9 million, and payments totaled $33.6 million. See detailed information regarding our asset retirement obligations in Note 15 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, as considered appropriate by management. 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 13.

Revenue Recognition

In general, we recognize revenues when they are realizable and earned. We generated 98% of our revenue in 2005 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 supply agreements, most of which are long-term (greater than one year). Under the typical terms of these agreements, risk of loss transfers to the customers at the mine or port, where coal is loaded to the rail, barge, ocean-going vessels, 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 in over-the-counter markets. 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 and emission allowance positions. 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.

Ninety-nine percent of the contracts in our trading portfolio as of December 31, 2005 were valued utilizing prices from over-the-counter market sources, adjusted for coal quality and traded transportation differentials, and one percent of our contracts were valued based on similar market transactions. As of December 31, 2005, 76% of the estimated future value of our trading portfolio was scheduled to be realized by the end of 2006. See Note 4 to our consolidated financial statements for additional details regarding assets and liabilities from our coal trading activities.

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 the sale 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 6.875% Senior Notes, 5.875% Senior Notes and Senior Secured Credit Facility covenants. We typically fund all of our capital expenditure requirements with cash generated from operations, and during 2005 and 2004 we had no borrowings outstanding under our $900.0 million revolving line of credit, which we use primarily for standby letters of credit.

Net cash provided by operating activities was $702.8 million in 2005, an increase of $419.0 million, or 147.6%, from 2004. The increase was primarily driven by stronger operational performance in 2005, as net income increased $247.3 million from the prior year. Also contributing to the increase was lower funding of pension plans in 2005, as we voluntarily pre-funded $50.0 million in the prior year. The remainder of the increase was primarily due to higher working capital cash flows of $85.5 million.

Net cash used in investing activities was $584.2 million during 2005 compared to $705.0 million used in 2004. Total capital expenditures were $643.9 million in 2005, an increase of $377.3 million over prior year. In 2005, we purchased mining and related assets of $141.2 million, which included $56.5 million for the acquisition of coal reserves in Illinois and Indiana along with surface property and equipment and $84.7 million for the acquisition of mining and transportation infrastructure in the Powder River Basin. Our $118.4 million in federal coal lease expenditures in 2005 were similar to the 2004 expenditures. Other capital expenditures of $384.3 million were $232.4 million higher than the prior year. The 2005 other capital expenditures included the longwall equipment and mine development at our Australian mines, longwall replacement at our Twentymile mine, the opening of new mines and upgrading of existing mines in the Midwest and Appalachia, and expansion equipment. In 2005, we were able to make several acquisitions of strategic coal reserves and mining assets due to the strong operating results that we experienced in 2005. Proceeds from the disposal of assets increased $36.9 million primarily due to higher proceeds in 2005 from the sale of PVR units and non-strategic property, reserves and equipment. In 2004, we acquired the Twentymile mine in Colorado and two mines in Australia for $421.3 million and made a $5.0 million earn-out payment related to our April 2003 acquisition of the remaining minority interest in Black Beauty Coal Company. In December 2004, we acquired a 25.5% interest in Carbones del Guasare, which owns and manages the Paso Diablo mine in Venezuela, for a net purchase price of $32.5 million.

Net cash used in financing activities was $4.9 million in 2005 compared to cash provided by financing activities of $693.4 million in the prior year, with the decrease primarily related to the 2004 issuance of 35.3 million shares of common stock at $11.25 per share, netting proceeds of $383.1 million; issuance of $250 million of 5.875% Senior Notes due in 2016; and the payment of debt issuance costs of $12.9 million in connection with the acquisition of the three mines discussed above. During 2004, we also completed a repricing of our Senior Secured Credit Facility, consisting of an amended $450.0 million Term Loan and the $900 million Revolving Credit Facility. During 2005 and 2004, we made scheduled payments on our long-term debt of $20.2 and $36.3 million, respectively. Securitized interest in accounts receivable increased by $25.0 million in 2005 compared to an increase of $110.0 million in 2004. We paid dividends of $44.5 million and $32.6 million in 2005 and 2004, respectively. In 2005, we issued $11.5 million in notes payable as part of an asset exchange in which we acquired additional Illinois Basin coal reserves.

A detailed discussion of our debt instruments is included in Note 14 to our consolidated financial statements. Dividends are subject to limitations imposed by our 6.875% Senior Notes, 5.875% Senior Notes and Senior Secured Credit Facility covenants. As of December 31, 2005 and 2004, our total indebtedness consisted of the following:

(Dollars in thousands)	*December 31, 2005*	*December 31 2004*
Term Loan under Senior Secured Credit Facility	$ 442,500	$ 448,750
6.875% Senior Notes due 2013	650,000	650,000
5.875% Senior Notes due 2016	239,525	239,525
Fair value of interest rate swaps — 6.875% Senior Notes	(8,879)	5,189
5.0% Subordinated Note	66,693	73,621
Other	15,667	7,880
Total	$1,405,506	$1,424,965

On May 9, 2005, we filed a shelf registration statement on Form S-3 with the SEC, which was declared effective in June 2005. The universal shelf registration statement permits us to offer and sell from time to time up to an aggregate maximum of $3 billion of securities, including common stock, preferred stock, debt securities, warrants and units. Related proceeds could be used for general corporate purposes including repayment of other debt, capital expenditures, possible acquisitions and any other purposes that may be stated in any prospectus supplement. As of December 31, 2005, no securities had been issued under the universal shelf registration statement, which remains effective.

As of December 31, 2005, we had letters of credit outstanding under our Revolving Credit Facility of $406.7 million, leaving $493.3 million available for borrowing. This provides us with available borrowing capacity under the line of credit to fund strategic acquisitions or meet other financing needs. We were in compliance with all of the covenants of the Senior Secured Credit Facility, the 6.875% Senior Notes and the 5.875% Senior Notes as of December 31, 2005.

In May 2003, we entered into and designated four interest rate swaps with notional amounts totaling $100.0 million as a fair value hedge of our 6.875% Senior Notes. Under the swaps, we pay a floating rate that resets each March 15 and September 15, based upon the six-month LIBOR rate, for a period of ten years ending March 15, 2013, and receives a fixed rate of 6.875%. The average applicable floating rate of the four swaps was 7.09% as of December 31, 2005.

In September 2003, we entered into two $400.0 million interest rate swaps. One $400.0 million notional amount floating-to-fixed interest rate swap, expiring March 15, 2010, was designated as a hedge of changes in expected cash flows on the term loan under the Senior Secured Credit Facility. Under this swap we pay a fixed rate of 6.764% and receive a floating rate of LIBOR plus 2.5% (6.99% at December 31, 2005) that resets each March 15, June 15, September 15 and December 15 based upon the three-month LIBOR rate. Another $400.0 million notional amount fixed-to-floating interest rate swap, expiring March 15, 2013, was designated as a hedge of the changes in the fair value of the 6.875% Senior Notes due 2013. Under this swap, we pay a floating rate of LIBOR plus 1.97% (6.46% at December 31, 2005) that resets each March 15, June 15, September 15 and December 15 based upon the three-month LIBOR rate and receive a fixed rate of 6.875%. The swaps will lower our overall borrowing costs on $400.0 million of debt principal by 0.64% over the term of the floating-to-fixed swap. This results in annualized interest savings of $2.6 million over the term of the fixed-to-floating swap.

CONTRACTUAL OBLIGATIONS

The following is a summary of our significant contractual obligations as of December 31, 2005:

	Payments Due by Year			
(Dollars in thousands)	*Within 1 Year*	*2-3 Years*	*4-5 Years*	*After 5 Years*
Long-term debt obligations (principal and interest)	$108,189	$ 252,518	$ 538,730	$1,048,169
Capital lease obligations	790	763	–	–
Operating lease obligations	84,031	139,905	75,435	103,506
Unconditional purchase obligations[1]	129,522	8,993	–	–
Coal reserve lease and royalty obligations	203,840	398,423	149,996	44,094
Other long-term liabilities[2]	168,775	327,754	370,093	961,997
Total contractual cash obligations	$695,147	$1,128,356	$1,134,254	$2,157,766

(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.

We had $138.5 million of purchase obligations related to future capital expenditures at December 31, 2005. Commitments for coal reserve-related capital expenditures, including Federal Coal Leases, are included in “Coal reserve lease and royalty obligations” in the table above.

Total capital expenditures for 2006 are expected to range from $450 million to $525 million, excluding Federal Coal Lease payments. Approximately 60% of projected 2006 capital expenditures relates to replacement, improvement, or expansion of existing mines, particularly in Appalachia and the Midwest. The remainder of the expenditures relate to growth initiatives such as increasing capacity in the Powder River Basin. We anticipate funding these capital expenditures primarily through operating cash flow. In addition, cash requirements to fund employee related and reclamation liabilities included above are expected to be funded from operating cash flow, along with obligations related to long-term debt, capital and operating leases and coal reserves. We believe the risk of generating lower than anticipated operating cash flow in 2006 is reduced by our high level of sales commitments, improved pricing and ongoing efforts to improve our operating cost structure.

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, 2005:

(Dollars in millions)	*Reclamation Obligations*	*Lease Obligations*	*Workers' Compensation Obligations*	*Retiree Healthcare Obligations*	*Other(1)*	*Total*
Self bonding	$ 671.8	$ –	$ –	$ –	$ 2.9	$ 674.7
Surety bonds	335.6	258.8	19.2	–	28.4	642.0
Letters of credit	0.1	22.7	144.6	120.1	119.7	407.2
	$1,007.5	$281.5	$163.8	$120.1	$151.0	$1,723.9

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

We have guaranteed $9.8 million of debt of an affiliate in which we have a 49% equity investment. We have also provided guarantees to small coal mining companies in order to facilitate their efforts to obtain bonding or financing. These guarantees arose as part of exclusive sales representation agreements with the small coal mining companies and totaled $5.5 million as of December 31, 2005. See Note 23 to our consolidated financial statements for a more detailed description of guarantees and indemnifications.

In March 2000, we established an accounts receivable securitization program. Under the program, undivided interests in a pool of eligible trade receivables that have been 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 used proceeds from the sale of the accounts receivable to repay long term debt, effectively reducing our overall borrowing costs. The securitization program is scheduled to expire in September 2009, and the maximum amount of undivided interests in accounts receivable that may be sold to the Conduit is $225.0 million. The securitization transactions have been recorded as sales, with those accounts receivable sold to the Conduit removed from the consolidated balance sheet. The funding cost of the securitization program was $2.5 million and $1.7 million for the years ended December 31, 2005 and 2004, respectively. In the third quarter of 2005, we renegotiated certain terms of the program, including lowering the program pricing, removing a minimum balance requirement and adding the ability to issue letters of credit under the program. The amount of undivided interests in accounts receivable sold to the Conduit was $225.0 million and $200.0 million as of December 31, 2005 and 2004, respectively. A detailed description of our $225.0 million accounts receivable securitization is included in Note 5 to our consolidated financial statements.

The following is a summary of specified types of commercial commitments available to us as of December 31, 2005:

		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	$900,000	—	—	$900,000	—

ACCOUNTING PRONOUNCEMENTS NOT YET IMPLEMENTED

In March 2005, the EITF issued EITF Issue No. 04-6, "Accounting for Stripping Costs in the Mining Industry," which states "that stripping costs incurred during the production phase of a mine are variable production costs that should be included in the costs of the inventory produced during the period that the stripping costs are incurred." Advance stripping costs include those costs necessary to remove overburden above an unmined coal seam as part of the surface mining process, and are included as the "work-in-process" component of "Inventories" in the consolidated balance sheets ($245.5 million and $197.2 million as of December 31, 2005, and December 31, 2004, respectively - see Note 10). This is consistent

with the concepts embodied in Accounting Research Bulletin No. 43, "Restatement and Revision of Accounting Research Bulletins," which provides that "the term inventory embraces goods awaiting sale..., goods in the course of production (work-in-process), and goods to be consumed directly or indirectly in production..." At the June 15-16, 2005 EITF meeting, the Task Force clarified that the intended meaning of "inventory produced" is "inventory extracted." Based on this clarification, stripping costs incurred during a period will be attributed only to the inventory costs of the coal that is extracted during that same period. Due to physical loadout constraints and potential combustion issues, coal in most of our operations is not removed from the open pit until it is ready to ship; therefore, we will have little inventory on our balance sheet after implementing this interpretation. We expect this accounting treatment will introduce volatility in our earnings as costs associated with preparing coal for sale may be expensed before the coal is sold, and likewise, sales may be made with little to no cost matched to the sale.

EITF Issue No. 04-6 is effective for the first reporting period in fiscal years beginning after December 15, 2005 (January 1, 2006 for us). At the June 2005 EITF meeting, the Task Force modified the transition provisions of EITF Issue No. 04-6, indicating that companies that adopt in periods beginning after June 29, 2005 may utilize a cumulative effect adjustment approach where the cumulative effect adjustment is recorded directly to retained earnings in the year of adoption. If we had implemented the cumulative effect adjustment approach at December 31, 2005, the reduction to retained earnings, net of tax, would have been $150.6 million. We adopted EITF Issue No. 04-6 on January 1, 2006.

On December 16, 2004, the Financial Accounting Standards Board ("FASB") issued 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", 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 grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. Income tax benefits from stock options exercised will be included in financing activities in the statement of cash flows rather than operating activities.

In 2005, the Securities and Exchange Commission deferred the adoption date of SFAS No. 123(R) to fiscal years beginning after June 15, 2005. We adopted this standard 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 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. Based on stock option grants made in 2005 (and years prior) and currently anticipated for 2006, we estimate we will recognize stock option expense for the year ending December 31, 2006, of $5.6 million, net of tax*es. We began utilizing restricted stock as part of our equity-based compensation strategy in January 2005. Based on the restricted stock grants made in 2005 and years prior, we recognized expense related to restricted stock of $1.0 million, net of taxes, in 2005. Accounting for restricted stock awards is not affected by the adoption of SFAS 123(R).

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The potential for changes in the market value of our coal trading, interest rate and currency portfolios is referred to as "market risk." Market risk related to our coal trading portfolio is evaluated using a value at risk analysis (described below). Value at risk analysis is not used to evaluate our non-trading 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 and direct trading of coal. 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 at December 31, 2005, and included forwards and swaps at December 31, 2004. Our policy for accounting for coal trading activities is described in Note 1 to our consolidated financial statements.

We perform a value at risk analysis on our coal trading portfolio, which includes over-the-counter and brokerage trading of coal. 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 option and forward positions. Our value at risk model assumes a 15-day holding period 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. 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, 2005, the actual low, high and average values at risk for our coal trading portfolio were $1.2 million, $3.9 million and $2.3 million, respectively. During the year ended December 31, 2004, the actual low, high and average values at risk for our coal trading portfolio were $0.5 million, $6.1 million and $2.9 million, respectively. As of December 31, 2005, the timing of the estimated future realization of the value of our trading portfolio was as follows:

Year of Expiration	*Percentage of Portfolio*
2006	76%
2007	23%
2008	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. In the event that 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. 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 2006 involves hedging approximately 70% of our anticipated, non-capital Australian dollar-denominated expenditures. As of December 31, 2005, we had in place forward contracts designated as cash flow hedges with notional amounts outstanding totaling A$915.8 million of which A$434.8 million, A$300.0 million and A$181.0 million will expire in 2006, 2007 and 2008, respectively. The accounting for these derivatives is discussed in Note 2 to our consolidated financial statements. Our current expectation for 2006 non-capital, Australian dollar-denominated cash expenditures is approximately $633 million. A change in the Australian dollar/U.S. dollar exchange rate of US $0.01 (ignoring the effects of hedging) would result in an increase or decrease in our "Operating costs and expenses" of $6.3 million per year.

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 14 to our consolidated financial statements. As of December 31, 2005, after taking into consideration the effects of interest rate swaps, we had $860.7 million of fixed-rate borrowings and $544.8 million of variable-rate borrowings outstanding. A one percentage point increase in interest rates would result in an annualized increase to interest expense of $5.4 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 $52.1 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 90% of our sales volume under long-term coal supply agreements during 2005 and 2004. As of December 31, 2005, we had 15 to 25 million tons, 90 to 100 million tons and 155 to 165 million tons for 2006, 2007 and 2008, respectively, of expected production (including steam and metallurgical coal production) available for sale or repricing at market prices. We have an annual metallurgical coal production capacity of 12 to 14 million tons.

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. In addition, we utilize derivative contracts to hedge our commodity price exposure. As of December 31, 2005, we had derivative contracts outstanding that are designated as cash flow hedges of anticipated purchases of fuel. Notional amounts outstanding under these contracts, scheduled to expire through 2007, were 44.5 million gallons of heating oil and 24.4 million gallons of crude oil. Overall, we have fixed prices for approximately 50% of our anticipated diesel fuel requirements in 2006.

We expect to consume 95 to 100 million gallons of fuel per year. On a per gallon basis, based on this usage, a change in fuel prices of one cent per gallon (ignoring the effects of hedging) would result in an increase or decrease in our operating costs of approximately $1 million per year. Alternatively, 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 $2.3 million.

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, we carried out an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rules 13a-15(e) and 15d-15(e). Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that our disclosure controls and procedures were effective in timely alerting them to material information relating to our company and its consolidated subsidiaries required to be included in our periodic SEC filings.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

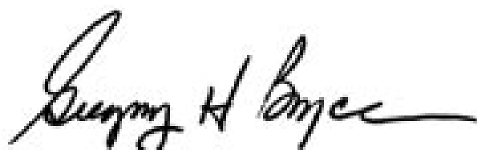
There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rules 13a-15 or 15d-15 that was conducted during the last fiscal quarter that have materially affected, or are reasonably likely to materially 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, 2005. Our Independent Registered Public Accounting Firm, Ernst & Young LLP, has audited this assessment of our internal control over financial reporting, as stated in their attestation report included herein.



Gregory H. Boyce
President and Chief Executive Officer

Richard A. Navarre
Executive Vice President and Chief Financial Officer

February 21, 2006

REPORTS OF

Independent Registered Public Accounting Firm

THE BOARD OF DIRECTORS AND STOCKHOLDERS PEABODY ENERGY CORPORATION

We have audited management's assessment, included in the accompanying Management's Report on Internal Controls, that Peabody Energy Corporation maintained effective internal control over financial reporting as of December 31, 2005, 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. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of 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, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, 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, management's assessment that Peabody Energy Corporation maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Peabody Energy Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We have also 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, 2005 and 2004, 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, 2005, and our report dated February 21, 2006, expressed an unqualified opinion thereon.

Ernst & Young LLP

St. Louis, Missouri
February 21, 2006

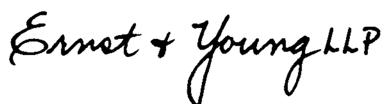
THE BOARD OF DIRECTORS AND STOCKHOLDERS
PEABODY ENERGY CORPORATION

We have audited the accompanying consolidated balance sheets of Peabody Energy Corporation as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in stockholders' equity, and cash flows of the Company for each of the three years in the period ended December 31, 2005. 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, 2005 and 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Peabody Energy Corporation's internal control over financial reporting as of December 31, 2005, 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 21, 2006, expressed an unqualified opinion thereon.



St. Louis, Missouri
February 21, 2006

CONSOLIDATED

Statements of Operations

(Dollars in thousands, except share and per share data)	*Year Ended December 31,* 2005	2004	2003
Revenues			
Sales	$4,545,323	$3,545,027	$2,729,323
Other revenues	99,130	86,555	85,973
Total revenues	4,644,453	3,631,582	2,815,296
Costs and Expenses			
Operating costs and expenses	3,715,836	2,965,541	2,332,137
Depreciation, depletion and amortization	316,114	270,159	234,336
Asset retirement obligation expense	35,901	42,387	31,156
Selling and administrative expenses	189,802	143,025	108,525
Other operating income:			
Net gain on disposal or exchange of assets	(101,487)	(23,829)	(32,772)
Income from equity affiliates	(30,096)	(12,399)	(2,872)
Operating Profit	518,383	246,698	144,786
Interest expense	102,939	96,793	98,540
Early debt extinguishment costs	–	1,751	53,513
Interest income	(10,641)	(4,917)	(4,086)
Income (Loss) From Continuing Operations Before Income Taxes and Minority Interests	426,085	153,071	(3,181)
Income tax provision (benefit)	960	(26,437)	(47,708)
Minority interests	2,472	1,282	3,035
Income From Continuing Operations	422,653	178,226	41,492
Loss from discontinued operations, net of income tax benefit of $1,893	–	(2,839)	–
Income Before Accounting Changes	422,653	175,387	41,492
Cumulative effect of accounting changes, net of income tax benefit of $6,762	–	–	(10,144)
Net Income	$ 422,653	$ 175,387	31,348
Basic Earnings Per Share			
Income from continuing operations	$ 1.62	$ 0.72	$ 0.19
Loss from discontinued operations	–	(0.01)	–
Cumulative effect of accounting changes	–	–	(0.04)
Net income	$ 1.62	$ 0.71	$ 0.15
Weighted Average Shares Outstanding – Basic	261,519,424	248,732,744	213,638,084
Diluted Earnings Per Share			
Income from continuing operations	$ 1.58	$ 0.70	$ 0.19
Loss from discontinued operations	–	(0.01)	–
Cumulative effect of accounting changes	–	–	(0.05)
Net income	$ 1.58	$ 0.69	$ 0.14
Weighted Average Shares Outstanding – Diluted	268,013,476	254,812,632	219,342,512
Dividends Declared Per Share	$ 0.17	$ 0.13	$ 0.11

See accompanying notes to consolidated financial statements

CONSOLIDATED

Balance Sheets

(Dollars in thousands, except share and per share data)	December 31, 2005	December 31, 2004
Assets		
Current assets		
Cash and cash equivalents	$ 503,278	$ 389,636
Accounts receivable, net of allowance for doubtful accounts of $10,853 and $1,361 at December 31, 2005 and 2004, respectively	221,541	193,784
Inventories	389,771	323,609
Assets from coal trading activities	146,596	89,165
Deferred income taxes	9,027	15,461
Other current assets	54,431	42,947
Total current assets	1,324,644	1,054,602
Property, plant, equipment and mine development		
Land and coal interests	4,775,126	4,512,893
Buildings and improvements	793,254	718,803
Machinery and equipment	1,237,184	883,380
Less accumulated depreciation, depletion and amortization	(1,627,856)	(1,333,645)
Property, plant, equipment and mine development, net	5,177,708	4,781,431
Investments and other assets	349,654	342,559
Total assets	$ 6,852,006	$ 6,178,592
Liabilities and Stockholders' Equity		
Current liabilities		
Current maturities of long-term debt	$ 22,585	$ 18,979
Liabilities from coal trading activities	132,373	63,565
Accounts payable and accrued expenses	867,965	691,600
Total current liabilities	1,022,923	774,144
Long-term debt, less current maturities	1,382,921	1,405,986
Deferred income taxes	338,488	393,266
Asset retirement obligations	399,203	396,022
Workers' compensation obligations	237,574	227,476
Accrued postretirement benefit costs	959,222	939,503
Other noncurrent liabilities	330,658	315,694
Total liabilities	4,670,989	4,452,091
Minority interests	2,550	1,909
Stockholders' equity		
Preferred Stock – $0.01 per share par value; 10,000,000 shares authorized, no shares issued or outstanding as of December 31, 2005 or 2004	–	–
Series Common Stock – $0.01 per share par value; 40,000,000 shares authorized, no shares issued or outstanding as of December 31, 2005 or 2004	–	–
Series A Junior Participating Preferred Stock – 1,500,000 shares authorized, no shares issued or outstanding as of December 31, 2005 or 2004	–	–
Common Stock – $0.01 per share par value; 400,000,000 shares authorized, 263,879,762 shares issued and 263,357,402 shares outstanding as of December 31, 2005 and 150,000,000 shares authorized, 259,658,268 shares issued and 259,135,908 shares outstanding as of December 31, 2004	2,638	2,596
Additional paid-in capital	1,503,397	1,436,021
Retained earnings	729,086	350,968
Unearned restricted stock awards	(5,943)	(459)
Accumulated other comprehensive loss	(46,795)	(60,618)
Treasury shares, at cost: 522,360 shares as of December 31, 2005 and 2004	(3,916)	(3,916)
Total stockholders' equity	2,178,467	1,724,592
Total liabilities and stockholders' equity	$ 6,852,006	$ 6,178,592

See accompanying notes to consolidated financial statements

CONSOLIDATED

Statements of Cash Flows

(Dollars in thousands)	2005	2004	2003
	Year Ended December 31,		
Cash Flows From Operating Activities			
Net income	$ 422,653	$ 175,387	$ 31,348
Loss from discontinued operations	–	2,839	–
Cumulative effect of accounting changes, net of taxes	–	–	10,144
Income from continuing operations	422,653	178,226	41,492
Adjustments to reconcile income from continuing operations to net cash provided by operating activities:			
Depreciation, depletion and amortization	316,114	270,159	234,336
Deferred income taxes	(24,962)	(31,925)	(48,259)
Early debt extinguishment costs	–	1,751	53,513
Amortization of debt discount and debt issuance costs	6,938	8,330	8,158
Net gain on disposal or exchange of assets	(101,487)	(23,829)	(32,772)
Income from equity affiliates	(30,096)	(12,399)	(2,872)
Dividends received from equity affiliates	7,552	13,614	4,781
Changes in current assets and liabilities, net of acquisitions:			
Accounts receivable, net of sale	(52,757)	(34,649)	(21,279)
Inventories	(67,125)	(57,781)	(16,805)
Net assets from coal trading activities	11,377	(3,583)	(22,771)
Other current assets	(10,769)	(1,438)	(3,621)
Accounts payable and accrued expenses	173,919	66,576	34,423
Asset retirement obligations	(981)	(6,571)	(9,563)
Workers' compensation obligations	11,390	10,479	156
Accrued postretirement benefit costs	19,719	(32,499)	3,705
Contributions to pension plans	(7,162)	(62,082)	(17,490)
Other, net	28,436	1,381	(16,271)
Net cash provided by operating activities	702,759	283,760	188,861
Cash Flows From Investing Activities			
Additions to property, plant, equipment and mine development	(384,304)	(151,944)	(156,443)
Federal coal lease expenditures	(118,364)	(114,653)	–
Purchase of mining and related assets	(141,195)	–	–
Additions to advance mining royalties	(14,566)	(16,239)	(14,010)
Acquisitions, net	–	(429,061)	(90,000)
Investments in joint ventures	(2,000)	(32,472)	(1,400)
Proceeds from disposal of assets	76,227	39,339	69,573
Net cash used in investing activities	(584,202)	(705,030)	(192,280)
Cash Flows From Financing Activities			
Net change in revolving lines of credit	–	–	(121,584)
Proceeds from long-term debt	11,734	700,013	1,102,735
Payments of long-term debt	(20,198)	(482,924)	(868,386)
Net proceeds from equity offering	–	383,125	–
Proceeds from stock options exercised	22,573	27,266	31,329
Proceeds from employee stock purchases	3,009	2,343	1,737
Increase (decrease) of securitized interests in accounts receivable	25,000	110,000	(46,400)
Payment of debt issuance costs	–	(12,875)	(23,700)
Distributions to minority interests	(2,498)	(1,007)	(4,186)
Dividends paid	(44,535)	(32,568)	(24,058)
Other	–	31	1,111
Net cash provided by (used in) financing activities	(4,915)	693,404	48,598
Effect of exchange rate changes on cash and cash equivalents	–	–	1,113
Net increase in cash and cash equivalents	113,642	272,134	46,292
Cash and cash equivalents at beginning of year	389,636	117,502	71,210
Cash and cash equivalents at end of year	$ 503,278	$ 389,636	$ 117,502

See accompanying notes to consolidated financial statements

CONSOLIDATED

Statements of Changes in Stockholders' Equity

(Dollars in thousands)	Common Stock	Additional Paid-in Capital	Unearned Restricted Stock Awards	Other Employee Stock Loans	Accumulated Other Comprehensive (Loss)	Retained Earnings	Treasury Stock	Total Stockholders' Equity
December 31, 2002	$2,096	$ 956,995	$ –	$(1,142)	$(77,627)	$200,859	$ (43)	$1,081,138
Comprehensive income:								
Net income	–	–	–	–	–	31,348	–	31,348
Foreign currency translation adjustment	–	–	–	–	3,138	–	–	3,138
Decrease in fair value of cash flows hedges (net of $4,694 tax benefit)	–	–	–	–	(7,041)	–	–	(7,041)
Minimum pension liability adjustment (net of $27 tax benefit)	–	–	–	–	(42)	–	–	(42)
Comprehensive income								27,403
Dividends paid	–	–	–	–	–	(24,058)	–	(24,058)
Loan repayments	–	–	–	1,111	–	–	–	1,111
Stock options exercised	90	35,245	–	–	–	–	–	35,335
Income tax benefits from stock options exercised	–	12,925	–	–	–	–	–	12,925
Employee stock purchases	4	1,733	–	–	–	–	–	1,737
Stock grants to non-employee directors	–	100	–	–	–	–	–	100
Employee stock grants	–	368	(368)	–	–	–	–	–
Deferred compensation earned	–	–	10	–	–	–	–	10
Shares repurchased	–	–	–	–	–	–	(3,644)	(3,644)
December 31, 2003	2,190	1,007,366	(358)	(31)	(81,572)	208,149	(3,687)	1,132,057
Comprehensive income:								
Net income	–	–	–	–	–	175,387	–	175,387
Increase in fair value of cash flow hedges (net of $9,945 tax provision)	–	–	–	–	14,915	–	–	14,915
Minimum pension liability adjustment (net of $4,026 tax provision)	–	–	–	–	6,039	–	–	6,039
Comprehensive income								196,341
Issuance of common stock in connection with equity offering, net of expenses	352	382,773	–	–	–	–	–	383,125
Dividends paid	–	–	–	–	–	(32,568)	–	(32,568)
Loan repayments	–	–	–	31	–	–	–	31
Stock options exercised	54	27,621	–	–	–	–	–	27,675
Income tax benefits from stock options exercised	–	15,718	–	–	–	–	–	15,718
Employee stock purchases	–	2,343	–	–	–	–	–	2,343
Employee stock grants	–	200	(200)	–	–	–	–	–
Deferred compensation earned	–	–	99	–	–	–	–	99
Shares repurchased	–	–	–	–	–	–	(229)	(229)
December 31, 2004	2,596	1,436,021	(459)	–	(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)
Increase in value of equity-based performance awards	–	4,305	–	–	–	–	–	4,305
Stock options exercised	36	22,627	–	–	–	–	–	22,663
Income tax benefits from stock options execised	–	30,437	–	–	–	–	–	30,437
Employee stock purchases	2	3,007	–	–	–	–	–	3,009
Employee stock grants	4	7,000	(7,004)	–	–	–	–	–
Deferred compensation earned	–	–	1,520	–	–	–	–	1,520
December 31, 2005	$2,638	$1,503,397	$(5,943)	$ –	$(46,795)	$729,086	$(3,916)	$2,178,467

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements include the accounts of the Company and its controlled affiliates. All intercompany transactions, profits, and balances have been eliminated in consolidation.

On January 23, 2006, the Company announced a two-for-one stock split on all shares of its common stock payable to shareholders of record at the close of business on February 7, 2006. The additional shares were distributed on February 22, 2006. 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 herein reflect the stock splits.

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 is also involved in related energy businesses that include participation in the development of coal-fueled generating plants, coalbed methane production and BTU conversion projects, which are designed to expand the uses of coal through technologies that convert coal to natural gas, liquid fuels, and hydrogen.

New Pronouncements

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"), which states "that stripping costs incurred during the production phase of a mine are variable production costs that should be included in the costs of the inventory produced during the period that the stripping costs are incurred." Advance stripping costs include those costs necessary to remove overburden above an unmined coal seam as part of the surface mining process, and are included as the "work-in-process" component of "Inventories" in the consolidated balance sheets ($245.5 million and $197.2 million as of December 31, 2005 and December 31, 2004, respectively - see Note 10). This is consistent with the concepts embodied in Accounting Research Bulletin No. 43, "Restatement and Revision of Accounting Research Bulletins," which provides that "the term inventory embraces goods awaiting sale..., goods in the course of production (work-in-process), and goods to be consumed directly or indirectly in production...." At the June 15-16, 2005 EITF meeting, the Task Force clarified that the intended meaning of "inventory produced" is "inventory extracted." Based on this clarification, stripping costs incurred during a period will be attributed only to the inventory costs of the coal that is extracted during that same period.

EITF Issue No. 04-6 is effective for the first reporting period in fiscal years beginning after December 15, 2005 (January 1, 2006 for the Company). At the June 2005 EITF meeting, the Task Force modified the transition provisions of EITF Issue No. 04-6, indicating that companies that adopt in periods beginning after June 29, 2005, may utilize a cumulative effect adjustment approach where the cumulative effect adjustment is recorded directly to retained earnings in the year of adoption. If the Company had implemented the cumulative effect adjustment approach at December 31, 2005, the reduction to retained earnings, net of tax, would have been $150.6 million. The Company adopted EITF Issue No. 04-6 on January 1, 2006.

In December 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 153, "Exchanges of Nonmonetary Assets - an Amendment of APB Opinion 29," which became effective for fiscal periods beginning after June 15, 2005. Accounting Principles Board ("APB") Opinion No. 29, "Accounting for Nonmonetary Transactions," is based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged with certain exceptions to that general principle. SFAS No. 153 eliminates the exception to fair value measurement for exchanges of similar productive assets that previously existed under APB Opinion No. 29 and replaces it with a general exception for exchanges that lack commercial substance. The Company early adopted SFAS No. 153 on July 1, 2005, and applied these provisions to subsequent coal reserve exchanges (see Note 3).

On December 16, 2004, the FASB issued 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 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. Pro forma disclosure is no longer an alternative. Income tax benefits from stock options exercised will be included in financing activities in the statements of cash flows rather than operating activities.

In 2005, the Securities and Exchange Commission deferred the adoption date of SFAS No. 123(R) to fiscal years beginning after June 15, 2005. The Company adopted this standard 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 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. Based on stock option grants made in 2005 (and years prior) and currently anticipated for 2006, the Company estimates it will recognize stock option expense for the year ending

December 31, 2006 of $5.6 million, net of taxes. The Company began utilizing restricted stock as part of its equity-based compensation strategy in January 2005. Based on the restricted stock grants made in 2005 and years prior, the Company recognized expense related to restricted stock of $1.0 million, net of taxes, in 2005. Accounting for restricted stock awards is not affected by the adoption of SFAS No. 123(R).

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.

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.

Stock Compensation

The Company applies APB Opinion No. 25 and related interpretations in accounting for its equity incentive plans. The Company recorded $1.6 million, $0.3 million and $0.4 million of compensation expense during the years ended December 31, 2005, 2004 and 2003, respectively, for stock options and restricted stock granted. The following table reflects 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:

	Year Ended December 31,		
(Dollars in thousands, except per share data)	*2005*	*2004*	*2003*
Net income:			
As reported	$422,653	$175,387	$31,348
Pro forma	418,704	168,628	22,617
Basic earnings per share:			
As reported	$ 1.62	$ 0.71	$ 0.15
Pro forma	1.60	0.68	0.11
Diluted earnings per share:			
As reported	$ 1.58	$ 0.69	$ 0.14
Pro forma	1.56	0.66	0.10

These pro forma amounts may not be representative of future expense amounts since the estimated fair value of stock options is amortized to expense over the vesting period, and additional options may be granted in future years.

Compensation expense for awards with graded vesting provisions is recognized on a straight-line basis.

Discontinued Operations

The Company classifies items within discontinued operations in the statement 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 for the year ended December 31, 2004, reflected a $2.8 million loss, net of taxes, related to the Company's former Citizens Power subsidiary.

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. 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. 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. Contracts entered into prior to October 25, 2002, were accounted for using the fair value method required by EITF Issue No. 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities" ("EITF Issue No. 98-10"), which was rescinded by 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" effective January 1, 2003. Accordingly, the effect of the rescission on non-derivative energy trading contracts entered into prior to October 25, 2002 was recorded as a cumulative effect of a change in accounting principle in the first quarter of 2003, as discussed in Note 7. This accounting change only affected the timing of the recognition of income or losses on contracts that do not meet the definition of a derivative, and did not change the underlying economics or cash flows of those transactions.

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, 2005 and 2004. 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 $0.1 million, $0.2 million and $1.2 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Expenditures which extend the useful lives of existing plant and equipment 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. 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, 2005 and 2004, the net book value of coal reserves totaled $3.7 billion and $3.6 billion, respectively. These amounts included $1.8 billion and $1.7 billion at December 31, 2005 and 2004, 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 and associated with advance royalties, and the net book value of these mineral rights was $2.1 billion at December 31, 2005 and 2004.

Depletion of coal reserves is computed using the units-of-production method utilizing only proven and probable reserves in the depletion base. Amortization of advance royalties is computed using the units-of-production method. 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 30
Machinery and equipment	3 to 30
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 33 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 currently has no investments accounted for under the 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 statement of operations in "Income from equity affiliates." The book value of the Company's equity method investments as of December 31, 2005 and 2004 was $97.2 million and $83.2 million, respectively, and is reported within "Investments and other assets" in the consolidated balance sheets.

Variable Interest Entities

The Company evaluates equity investments in joint ventures, notes issued, leases or other contractual relationships with third parties to determine whether the joint venture or third party is a variable interest entity, and if so, whether the Company's variable interest in the variable interest entity makes it the primary beneficiary of the entity, which would require the entity to be included in the Company's consolidated financial statements. The Company was not the primary beneficiary related to any variable interest entity and as a result did not consolidate any entity under the provisions of FASB Interpretation 46(R): "Consolidation of Variable Interest Entities, an interpretation of ARB No. 51," for any of the periods presented in these consolidated financial statements.

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 $22.4 million and $16.7 million were recorded as part of "Investments and other assets" in the consolidated balance sheets as of December 31, 2005 and 2004, respectively.

Asset Retirement Obligations

SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"), which was adopted by the Company on January 1, 2003 (see Note 7), 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 federal and state 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.

Postretirement Health Care and Life Insurance Benefits

The Company accounts for postretirement benefits other than pensions in accordance with SFAS No. 106 "Employers' Accounting for Postretirement Benefits Other Than Pensions" ("SFAS No. 106") which requires the cost to provide the benefits to be accrued over the employees' period of active service. These costs are determined on an actuarial basis.

Multi-Employer Benefit Plans

The Company has an obligation to contribute to two plans established by the Coal Industry Retiree Health Benefits Act of 1992 - the "Combined Fund" and the "1992 Plan". The Combined Fund obligations are accounted for in accordance with EITF Issue No. 92-13, "Accounting for Estimated Payments in Connection with the Coal Industry Retiree Health Benefit Act of 1992," as determined on an actuarial basis. The 1992 Plan qualifies as a multi-employer plan under SFAS No. 106 and expense is recognized as contributions are made.

A third fund, the 1993 Benefit Fund (the "1993 Plan"), was established through collective bargaining and provides benefits to qualifying retired former employees who retired after September 30, 1994, of certain signatory companies who have gone out of business and have defaulted in providing their former employees with retiree medical benefits. Beneficiaries continue to be added to this fund as employers go out of business; however, the Company's liability is limited to its contractual commitment of $0.50 per hour worked. The 1993 Plan qualifies as a multi-employer plan under SFAS No. 106 and expense is recognized as contributions are made.

Pension Plans

The Company sponsors non-contributory defined benefit pension plans which are accounted for in accordance with SFAS No. 87 "Employers' Accounting for Pensions" ("SFAS No. 87") which requires the cost to provide the benefits to be accrued over the employees' period of active service. These costs are determined on an actuarial basis.

The Company also participates in two multi-employer pension plans, the United Mine Workers of America 1950 Pension Plan (the "1950 Plan") and the United Mine Workers of America 1974 Pension Plan (the "1974 Plan"). These plans qualify as multi-employer plans under SFAS No. 87 and expense is recognized as contributions are made.

Postemployment Benefits

The Company provides postemployment benefits to qualifying employees, former employees and dependents and accounts for these items 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.

Derivatives

SFAS No. 133 (as amended) requires the recognition of all derivatives as assets or liabilities within the consolidated balance sheets at fair value. Gains or losses on 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 income statement in the period of the change. The potential of hedge ineffectiveness is only present in the design of the hedge relationship in the Company's cash flow hedges of anticipated fuel purchases as discussed in more detail in Note 2. During the year ended December 31, 2005, the Company recognized approximately $0.1 million of lower operating costs and expenses related to the ineffectiveness of its fuel hedges. Hedge ineffectiveness had no effect on results of operations for the years ended December 31, 2004 or 2003.

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 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 the 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 those 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.

Foreign Currency Translation

For the Company's foreign subsidiaries where the functional currency is the U.S. dollar, 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. The Company has foreign subsidiaries whose functional currency is the U.S. dollar during the years ended December 31, 2005 and 2004. Gains and losses from foreign currency remeasurement are included in the consolidated statements of operations. Gains and losses from foreign currency remeasurement did not have a material impact on the Company's consolidated financial position or results of operations for the years ended December 31, 2005 or 2004.

The Company had foreign subsidiaries whose functional currency was the local currency during the year ended December 31, 2003. For the Company's foreign subsidiaries whose functional currency is the local currency, all assets and liabilities are translated at current exchange rates. Consolidated statements of operations accounts are translated at an average rate for each period. Resulting translation adjustments are reported as a component of comprehensive income.

Reclassifications

Certain amounts in prior periods have been reclassified to conform with the report classifications of the year ended December 31, 2005, with no effect on previously reported net income or stockholders' equity.

(2) 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 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 14.

Trading Activities

The Company performs a value at risk analysis of its trading portfolio, which includes over-the-counter and brokerage trading of coal. The use of value at risk allows management to quantify, in dollars, on a daily basis, the price risk inherent in its trading portfolio. The Company's value at risk model is based on the industry standard variance/co-variance approach. This captures exposure related to both option and

forward positions. During the year ended December 31, 2005, the low, high, and average values at risk for the Company's coal trading portfolio were $1.2 million, $3.9 million and $2.3 million, respectively. Further discussion of the Company's coal trading assets and liabilities is included in Note 4.

The Company also monitors other types of risk associated with its coal trading activities, including credit, market liquidity and counterparty nonperformance.

Commodity Price Risk

In addition to the derivatives related to trading activities, the Company enters contracts to manage its exposure to price volatility of diesel fuel. As of December 31, 2005, the Company had derivative contracts designated as cash flow hedges with notional amounts outstanding totaling 68.9 million gallons, with maturities extending through 2007. The consolidated balance sheet as of December 31, 2005, reflects unrealized gains on the cash flow hedges of $33.9 million, which is recorded net of a $13.5 million tax provision, in other comprehensive income (see Note 21). During 2005, the Company recognized approximately $0.1 million of lower operating costs and expenses related to the ineffectiveness of its diesel fuel hedges. Hedge ineffectiveness had no effect on results of operations for the years ended December 31, 2004 and 2003.

Ineffectiveness is inherent in hedging diesel fuel with derivative positions based on other crude oil related commodities. Due to the volatility in markets for crude oil, and crude oil related products, and the current refining spreads that have widened the price spread between crude oil and other petroleum distillates (such as diesel fuel), the Company is unable to predict the amount of ineffectiveness 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 results.

The notional amounts outstanding of 68.9 million gallons included derivative swap contracts for 44.5 million gallons of heating oil and 24.4 million gallons of crude oil that were designated as cash flow hedges of future anticipated diesel fuel purchases as of December 31, 2005. The heating oil contracts are used to hedge fuel purchases in the Company's Eastern mining operations and the crude oil derivatives are used to hedge fuel purchases in the Company's Western mining operations. Hedge ineffectiveness is present in the design of both of these hedge relationships since diesel fuel prices are not perfectly correlated with either heating oil or crude oil prices.

Despite the ineffectiveness present in the hedge relationships, very little ineffectiveness is recognized in the Company's statements of operations, due to two factors. First, the Company's contract for physical fuel purchases hedged with heating oil derivatives are priced based on the derivative contract (adjusted for a fixed transportation differential), resulting in little ineffectiveness. Second, the crude oil hedges, which have more ineffectiveness present, are nearly all in an "underhedge" position, where change in the fair value of the derivative is less than the change in the fair value of the hedged item. Under SFAS No. 133, ineffectiveness in cash flow hedges is only recognized in the income statement in cases where the derivative has changed in value more than the hedged item.

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 engages in 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 the 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, 2005, the Company had forward contracts designated as cash flow hedges with notional amounts outstanding totaling A$915.8 million, with maturities extending through 2008. The consolidated balance sheet as of December 31, 2005, reflects unrealized losses on the cash flow hedges of $3.8 million, which is recorded net of a $1.5 million tax benefit, in other comprehensive income (see Note 21).

Employees

As of December 31, 2005, the Company and its subsidiaries had approximately 8,300 employees. As of December 31, 2005, approximately 39% of the Company's hourly employees were represented by organized labor unions and generated 19% of the 2005 coal production. Relations with its employees and, where applicable, organized labor are important to the Company's success.

In 2005, the Company opened training centers in the eastern and western regions of the United States under its "Workforce of the Future" initiative. Due to the current employee demographics, a significant portion of the Company's current hourly employees will retire over the next decade. The training centers are educating the Company's workforce, particularly the most recent hires, in rigorous safety standards and the latest in mining techniques and equipment, and the centers serve as centers for dissemination of mining best practices across all of the Company's operations. The training efforts exceed minimum government standards for safety and technical expertise with the intent of developing and retaining a world-class workforce.

United States

The United Mine Workers of America represented approximately 30% of the Company's subsidiaries' hourly employees, who generated 14% of the Company's domestic production during the year ended December 31, 2005. An additional 6% of the hourly employees are represented by labor unions other than the United Mine Workers of America ("UMWA"). These employees generated 2% of the Company's production during the year ended December 31, 2005. Hourly workers at the Company's mines in Arizona and one of its mines in Colorado are represented by the UMWA under the Western Surface Agreement of 2000, which is effective through September 1, 2007. Union labor east of the Mississippi River is primarily represented by the UMWA and the majority of union mines are subject to the National Bituminous Coal Wage Agreement. The current five-year labor agreement was ratified in December 2001 and is effective through December 31, 2006.

Australia

The Australian coal mining industry is highly unionized and the majority of workers employed at the Company's Australian mining operations are members of trade unions. The Construction Forestry Mining and Energy Union ("CFMEU") represents the Australian mining operation's hourly production employees. The Australian hourly employees are approximately 4% of the Company's hourly workforce and generated 4% of the total production in the year ended December 31, 2005. Negotiations are underway to renew the labor agreement at the Wilkie Creek Mine, which expires in June 2006. The Eaglefield Mine operates under a labor agreement that expires in May 2007. The Burton and North Goonyella Mines operate under agreements due to expire in 2008.

(3) SIGNIFICANT PROPERTY TRANSACTIONS

In the first quarter of 2005, the Company purchased mining assets from Lexington Coal Company for $61.0 million. The purchased assets included $2.5 million of materials and supplies that were recorded in "Inventories" in the consolidated balance sheet. The remaining purchased assets consisted of approximately 70 million tons of reserves, preparation plants, facilities and mining equipment that were recorded in "Property, plant, equipment and mine development" in the consolidated balance sheet. The Company is using the acquired assets to open a new mine that is expected to produce 2 to 3 million tons per year, after it reaches full capacity, and to provide other synergies to existing properties. The new mine, which began production early in the third quarter, will supply coal under a new agreement with terms that can be extended through 2015 (and a minimum term through the end of 2008). The Company also recorded $21.6 million for the estimated asset retirement obligations associated with the acquired assets.

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, a non-cash addition which is not included in "Additions to property, plant, equipment and mine development" in the consolidated statement of cash flows.

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 will utilize these reserves and infrastructure to accelerate the development of a new mine, which will include adjoining Company-leased reserves.

(4) ASSETS AND LIABILITIES FROM COAL TRADING ACTIVITIES

The Company's coal trading portfolio included forward contracts as of December 31, 2005, and included forward, futures, and options contracts as of December 31, 2004. The fair value of coal trading derivatives and related hedge contracts as of December 31, 2005 and 2004 is set forth below:

	December 31, 2005		*December 31, 2004*	
(Dollars in thousands)	*Assets*	*Liabilities*	*Assets*	*Liabilities*
Forward contracts	$146,596	$131,988	$89,042	$60,914
Other	–	385	123	2,651
Total	$146,596	$132,373	$89,165	$63,565

Ninety-nine percent of the contracts in the Company's trading portfolio as of December 31, 2005, were valued utilizing prices from over-the-counter market sources, adjusted for coal quality and traded transportation differentials, and one percent of the Company's contracts were valued based on similar market transactions. As of December 31, 2005, the timing of the estimated future realization of the value of the Company's trading portfolio was as follows:

Year of Expiration	*Percentage of Portfolio*
2006	76%
2007	23%
2008	1%
	100%

At December 31, 2005, 42% of the Company's credit exposure related to coal trading activities was with investment grade counterparties and 58% was with non-investment grade counterparties, which were primarily other coal producers. The Company's coal trading operations traded 36.2 million tons, 33.4 million tons and 40.0 million tons for the years ended December 31, 2005, 2004, and 2003, respectively.

(5) 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 $2.5 million, $1.7 million and $2.3 million for the years ended December 31, 2005, 2004 and 2003, 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 $225.0 million and $200.0 million as of December 31, 2005 and 2004, 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 domestic 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 $69.7 million of receivables as of December 31, 2005, 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.

(6) BUSINESS COMBINATIONS

The results of operations for each of the acquired entities (discussed below) are included in the Company's consolidated results of operations from the effective date of each acquisition. Except for the RAG Coal International AG acquisitions, had the acquired entities' results of operations been included in the Company's results of operations since January 1, 2003, there would have been no material effect on the Company's consolidated statements of operations, financial condition or cash flows.

RAG Coal International AG

On April 15, 2004, the Company purchased, through two separate agreements, all of the equity interests in three coal operations from RAG Coal International AG. The combined purchase price, including related costs and fees, of $442.2 million was funded from the Company's equity and debt offerings as discussed in Notes 14 and 19. The purchases included two mines in Queensland, Australia that collectively produce 6 to 7 million tons per year of metallurgical coal and the Twentymile Mine in Colorado, which produces 8 to 9 million tons per year of steam coal with a planned production expansion up to 12 million tons per year by 2008. The results of operations of the two mines in Queensland, Australia are included in the Company's Australian Mining Operations segment and the results of operations of the Twentymile Mine are included in the Company's Western U.S. Mining Operations segment from the April 15, 2004, purchase date. The acquisition was accounted for as a purchase.

The purchase accounting allocations related to the acquisition have been finalized and recorded in the accompanying consolidated financial statements as of, and for periods subsequent to, April 15, 2004. The following table summarizes the fair values of the assets acquired and the liabilities assumed at the date of acquisition:

(Dollars in thousands)	
Accounts receivable	$ 46,639
Materials and supplies	5,669
Coal inventory	11,543
Other current assets	6,234
Property, plant, equipment and mine development, net	463,567
Accounts payable and accrued expenses	(48,688)
Other noncurrent assets and liabilities, net	(63,699)
Total purchase price, net of cash received of $20,914	$421,265

In connection with the acquisition of the assets of the Australian mines and the Twentymile Mine, the Company acquired contract based intangibles consisting solely of coal supply agreement obligations (customer contracts) that were unfavorable based upon current market prices for similar coal as of April 15, 2004. As required by SFAS No. 141, "Business Combinations," these below market obligations were fair valued as part of the purchase price allocation and recorded as liabilities. The liabilities were amortized as the coal was shipped as follows:

Contractual Obligation (Dollars in thousands)	*Opening Balance at April 15, 2004*	*Amortization for the Year Ended Dec. 31, 2004*	*Amortization for the Year Ended Dec. 31, 2005*	*Net Book Value at Dec. 31, 2005*
US	$35,285	$ (9,472)	$(10,560)	$15,253
Foreign	11,483	(10,840)	(643)	–
Total	$46,768	$(20,312)	$(11,203)	$15,253

Estimated amortization (to income) for the next five years is as follows:

(Dollars in thousands)	Year Ended December 31,
2006	$ 7,111
2007	6,504
2008	1,020
2009	618
2010	–
Total	$15,253

The following unaudited pro forma financial information presents the combined results of operations of the Company and the operations acquired from RAG Coal International AG, 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 the operations acquired from RAG Coal International AG constituted a single entity during those periods:

	Year Ended December 31,	
(Dollars in thousands, except per share data)	2004*	2003
Revenues:		
As reported	$3,631,582	$2,815,296
Pro forma	3,756,944	3,206,002
Income before accounting changes:		
As reported	$ 175,387	$ 41,492
Pro forma	172,746	89,328
Net income:		
As reported	$ 175,387	$ 31,348
Pro forma	172,746	79,184
Basic earnings per share – net income:		
As reported	$ 0.71	$ 0.15
Pro forma	0.67	0.32
Diluted earnings per share – net income:		
As reported	$ 0.69	$ 0.14
Pro forma	0.66	0.31

* *During the first quarter of 2004, prior to the Company's acquisition, the Australian underground mine acquired by the Company in April 2004 experienced a roof collapse on a portion of the active mine face, resulting in the temporary suspension of mining activities. Due to the inability to ship during a portion of this downtime, costs to return the mine to operations and shipping limits imposed as the result of unrelated restrictions of capacity at a third party loading facility, the Australian operation experienced a pro forma net loss in the quarter immediately prior to acquisition.*

Dodge Hill Holding JV, LLC

On December 29, 2004, the Company purchased the remaining 55% interest in Dodge Hill Holding JV, LLC for $7.0 million of assumed debt that was repaid immediately upon closing, $2.8 million of cash and contingent earn-out payments based on annual and cumulative EBIT (as defined in the purchase agreement) through 2007. Dodge Hill Holding JV, LLC operates an underground operation located in Kentucky which mined 1.2 million tons during each of the years ended December 31, 2005 and 2004. The acquisition was accounted for as a purchase.

Carbones del Guasare

On December 2, 2004, the Company completed the acquisition of a 25.5% equity interest in Carbones del Guasare, S.A., from RAG Coal International AG for a net purchase price of $32.5 million. Carbones del Guasare, a joint venture that includes Anglo American plc and a Venezuelan governmental partner, operates the Paso Diablo surface mine in northwestern Venezuela, which produces approximately 7 million tons per year of steam coal for electricity generators and steel producers primarily in North America and Europe. The Company accounted for the purchase under the equity method of accounting.

(7) CUMULATIVE EFFECT OF ACCOUNTING CHANGES

On January 1, 2003, the Company adopted SFAS No. 143, which addresses accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs.

Pursuant to the January 1, 2003 adoption of SFAS No. 143, the Company:

- recognized a credit to income during the first quarter of 2003 of $9.1 million, net of taxes, for the cumulative effect of the accounting change;
- increased total liabilities by $0.5 million to record the asset retirement obligations;
- increased property, plant and equipment by $12.1 million to add incremental asset retirement costs to the carrying amount of the Company's mine properties and investments and other assets by $6.5 million to reflect the incremental amount of reclamation obligations recoverable from third parties; and
- increased accumulated depreciation, depletion and amortization by $2.9 million for the amount of expense that would have been recognized in prior periods.

Adopting SFAS No. 143 had no impact on the Company's reported cash flows. The Company's reclamation liabilities are unfunded.

On October 25, 2002, the EITF rescinded EITF Issue No. 98-10, and as a result, trading contracts entered into prior to October 25, 2002, that did not meet the definition of a derivative under SFAS No. 133 were no longer accounted for on a fair value basis, effective January 1, 2003. In the first quarter of 2003, the Company recorded a cumulative effect charge in the statement of operations of $20.2 million, net of income taxes, to reverse the unrealized gains and losses on non-derivative energy trading contracts recorded prior to December 31, 2002.

Effective January 1, 2003, the Company changed its method of amortizing actuarial gains and losses related to net periodic postretirement benefit costs. The Company previously amortized actuarial gains and losses using a 5% corridor with an amortization period of three years. Under the new method, the corridor has been eliminated and all actuarial gains and losses are now amortized over the average remaining service period of active plan participants, which was estimated at 9.26 years. The Company considers this method preferable in that the elimination of the corridor allows a closer approximation of the fair value of the liability for postretirement benefit costs, and the amortization of actuarial gains and losses over the average remaining service period provides a better matching of the cost of the associated liability over the working life of the active plan participants. As a result of this change, the Company recognized a $0.9 million, net of taxes, cumulative effect gain in the first quarter of 2003.

The effect of the accounting changes noted above for the year ended December 31, 2003, was to increase income before accounting changes by $20.4 million, or $0.09 per diluted share, net of income taxes. The cumulative effect charge of $10.1 million (net of income tax benefit of $6.8 million) to apply retroactively the new methods described above was included in results of operations for the year ended December 31, 2003. Below are pro forma net income and earnings per share results for the Company assuming the new methods had been retroactively applied:

(Dollars in thousands, except per share data)	*Year Ended December 31, 2003*
Net income:	
As reported	$31,348
Pro forma	41,492
Basic earnings per share:	
As reported	$ 0.15
Pro forma	0.19
Diluted earnings per share:	
As reported	$ 0.14
Pro forma	0.19

(8) SHELF REGISTRATION STATEMENT

On May 9, 2005, the Company filed a shelf registration statement on Form S-3 with the SEC, which was declared effective in June 2005. Under this universal shelf registration statement, the Company has the capacity to offer and sell from time to time up to an aggregate maximum of $3 billion of securities, including common stock, preferred stock, debt securities, warrants and units. As of December 31, 2005, no securities had been issued under the universal shelf registration statement, which remains effective.

(9) EARNINGS PER SHARE

A reconciliation of weighted-average shares outstanding follows:

	Year Ended December 31,		
	2005	*2004*	*2003*
Weighted-average shares outstanding – basic	261,519,424	248,732,744	213,638,084
Dilutive impact of stock options, restricted stock units and performance units	6,494,052	6,079,888	5,704,428
Weighted-average shares outstanding – diluted	268,013,476	254,812,632	219,342,512

For the years ended December 31, 2004 and 2003, respectively, options for three thousand and 0.2 million shares were excluded from the diluted earnings per share calculations for the Company's common stock because they were anti-dilutive. In addition, the Company granted options to purchase 0.5 million shares of common stock, 0.5 million shares of restricted stock and 0.1 million performance units (that will ultimately be settled in Company common stock) in January 2006.

(10) INVENTORIES

Inventories consisted of the following:

	December 31,	
(Dollars in thousands)	*2005*	*2004*
Materials and supplies	$ 65,942	$ 57,467
Raw coal	14,033	17,590
Advance stripping	245,522	197,225
Saleable coal	64,274	51,327
Total	$389,771	$323,609

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. Advance stripping consists of the costs to remove overburden above an unmined coal seam as part of the surface mining process. These costs include labor, supplies, equipment costs and operating overhead, and are charged to operations as coal from the seam is sold. Effective January 1, 2006, and as discussed in Note 1, advance stripping costs included in inventories at December 31, 2005, will no longer be included as a separate component of inventory.

(11) 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 $108.6 million, $108.1 million and $106.8 million for the years ended December 31, 2005, 2004 and 2003, respectively. The net book value of property, plant, equipment and mine development assets under capital leases was $1.5 million and $1.4 million as of December 31, 2005 and 2004, 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 $288.1 million, $233.9 million and $183.5 million for the years ended December 31, 2005, 2004 and 2003, 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. The terms of 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 the coal reserves at its Arizona mines 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, 2005, are as follows:

Year Ended December 31 (Dollars in thousands)	*Capital Leases*	*Operating Leases*	*Coal Reserves*
2006	$ 790	$ 84,031	$203,840
2007	716	77,176	201,354
2008	47	62,729	197,069
2009	–	42,869	138,812
2010	–	32,566	11,184
2011 and thereafter	–	103,506	44,094
Total minimum lease payments	$1,553	$402,877	$796,353
Less interest	24		
Present value of minimum capital lease payments	$1,529		

On December 19, 2002, the Company entered into a transaction with Penn Virginia Resource Partners, L.P. ("PVR") whereby the Company sold 120 million tons of coal reserves in exchange for $72.5 million in cash and 2.76 million units, or 15%, of the PVR master limited partnership. The Company's subsidiaries leased back the coal and pay royalties as the coal is mined. No gain or loss was recorded at the inception of this transaction.

In 2005, 2004 and 2003, the Company sold 0.838 million, 0.775 million and 1.15 million, respectively, of the PVR units received in the December 2002 transaction. As of December 31, 2005, the Company had no remaining ownership in PVR. The sales were accounted for under SFAS No. 66, "Sales of Real Estate," and gains of $31.1 million, $15.8 million and $7.6 million were recognized in the years ended December 31, 2005, 2004 and 2003, respectively. The remaining deferred gain from the sales of the reserves and units of $16.6 million is intended to provide for the Company's potential exposure to loss resulting from its continuing involvement in the properties and will be amortized over the minimum term of the leases. The Company accounted for its investment in PVR under the equity method of accounting, under the provisions of SOP No. 78-9, "Accounting for Investments in Real Estate Ventures."

As of December 31, 2005, certain of the Company's lease obligations were secured by outstanding surety bonds and letters of credit totaling $281.4 million. As of December 31, 2005, the covenants under certain lease agreements of one of the Company's subsidiaries required a minimum consolidated tangible net worth (as defined in the agreement) of not less than $500.0 million.

(12) ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses consisted of the following:

	December 31,	
(Dollars in thousands)	*2005*	*2004*
Trade accounts payable	$348,320	$273,274
Accrued taxes other than income	111,997	98,208
Accrued payroll and related benefits	110,675	74,907
Accrued health care	78,523	84,286
Workers' compensation obligations	34,312	41,436
Other accrued benefits	21,939	17,025
Accrued royalties	50,344	23,517
Accrued environmental	23,619	15,095
Income taxes payable – Australia	23,409	1,658
Accrued interest	21,260	21,304
Other accrued expenses	43,567	40,890
Total accounts payable and accrued expenses	$867,965	$691,600

(13) INCOME TAXES

Income (loss) before income taxes, minority interests and discontinued operations consisted of the following:

	Year Ended December 31,		
(Dollars in thousands)	*2005*	*2004*	*2003*
U.S.	$253,329	$118,076	$ 1,734
Non U.S.	172,756	34,995	(4,915)
Total	$426,085	$153,071	$(3,181)

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

	Year Ended December 31,		
(Dollars in thousands)	*2005*	*2004*	*2003*
Current:			
U.S. federal	$ –	$ 655	$ –
Non U.S.	25,622	4,533	251
State	300	300	300
Total current	25,922	5,488	551
Deferred:			
U.S. federal	(18,475)	(33,275)	(46,231)
Non U.S.	22,997	(328)	–
State	(29,484)	1,678	(2,028)
Total deferred	(24,962)	(31,925)	(48,259)
Total provision (benefit)	$ 960	$(26,437)	$(47,708)

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

	Year Ended December 31,		
(Dollars in thousands)	*2005*	*2004*	*2003*
Federal statutory rate	$ 149,130	$ 53,575	$ (1,113)
Depletion	(59,412)	(43,488)	(34,436)
Foreign earnings rate differential	(12,279)	(8,043)	(965)
State income taxes, net of U.S. federal tax benefit	(29,288)	1,872	(1,834)
Deemed liquidation of subsidiary	(314,071)	–	–
Changes in valuation allowance	216,908	(25,863)	(230)
Changes in tax reserves	44,968	–	(10,000)
Other, net	5,004	(4,490)	870
Total	$ 960	$(26,437)	$(47,708)

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)	December 31, 2005	December 31, 2004
Deferred tax assets:		
Tax credits and loss carryforwards	$ 742,368	$ 377,183
Postretirement benefit obligations	410,905	391,410
Accrued long-term workers' compensation liabilities	101,346	100,157
Additional minimum pension liability	46,931	48,188
Accrued reclamation and mine closing liabilities	46,139	46,776
Intangible tax asset and purchased contract rights	35,405	45,001
Obligation to industry fund	12,112	13,365
Others	71,311	82,844
Total gross deferred tax assets	1,466,517	1,104,924
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	1,356,692	1,271,758
Inventory	77,824	64,973
Others	1,021	2,465
Total gross deferred tax liabilities	1,435,537	1,339,196
Valuation allowance	(360,441)	(143,533)
Net deferred tax liability	$ (329,461)	$ (377,805)
Deferred taxes consisted of the following:		
Current deferred income taxes	$ 9,027	$ 15,461
Noncurrent deferred income taxes	(338,488)	(393,266)
Net deferred tax liability	$ (329,461)	$ (377,805)

The Company's deferred tax assets included alternative minimum tax ("AMT") credits of $26.2 million and $54.0 million as of December 31, 2005 and 2004, respectively, and net operating loss ("NOL") carryforwards of $716.2 million and $322.7 million as of December 31, 2005 and 2004, respectively. The AMT credits have no expiration date and the NOL carryforwards begin to expire in the year 2019. Utilization of these AMT credits and NOL carryforwards is subject to various limitations because of previous changes in ownership (as defined in the Internal Revenue Code) of the Company, and ultimate realization could be negatively impacted by market conditions and other variables not known or anticipated at this time. The AMT credits and NOL carryforwards are offset by a valuation allowance of $360.4 million. The valuation allowance was increased by $216.9 million for the year ended December 31, 2005, to correspond with an increase in available NOLs and reduced by $25.9 million and $0.2 million for the years ended December 31, 2004 and 2003, respectively. The Company evaluated and assessed the expected near-term utilization of NOLs, book and taxable income trends, available tax strategies and the overall deferred tax position to determine the amount and timing of valuation allowance adjustments.

During 2005, the Company completed a comprehensive and strategic internal corporate restructuring project. This restructuring focused on realigning the Company's subsidiary ownership on a geographic and functional basis and facilitated the consolidation of assets in a tax-efficient manner, better positioning the Company to execute future strategic transactions. One of the indirect consequences of the internal corporate restructuring was a deduction for a deemed liquidation of a subsidiary for tax purposes, which, as a result, increased the Company's net operating losses by $1.0 billion.

The Company establishes reserves for tax contingencies when, despite the belief that the Company's 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. The Company's effective tax rate includes the impact of tax contingency reserves and changes to the reserves, including related interest, as considered appropriate by management. The Company establishes the reserves based upon management's assessment of exposure associated with permanent tax differences (e.g., tax depletion expense) and certain tax sharing agreements. The Company is subject to federal audits for several open years due to its previous inclusion in multiple consolidated groups and the various parties involved in finalizing those years. The tax contingency reserve was increased by $45.0 million for the tax year ended December 31, 2005. The tax contingency reserve was decreased for the year ended December 31, 2003, by $10.0 million reflecting the reduction in exposure due to the completion of a federal audit.

The total amount of undistributed earnings of foreign subsidiaries for income tax purposes was approximately $156.0 million and $28.2 million at December 31, 2005 and 2004, respectively. On October 22, 2004, the American Jobs Creation Act of 2004 (the "Act") was signed into law. The Act created a temporary incentive for U.S. multinationals to repatriate accumulated income earned outside the U.S. at an effective tax rate of 5.25%. The Company did not repatriate foreign income through December 31, 2005, and the Company has not provided deferred taxes on foreign earnings because such earnings were intended to be indefinitely reinvested outside the U.S. 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 $53 million could occur.

The Company made no U.S. Federal tax payments for the years ended December 31, 2005 and 2003. The Company made U.S. Federal tax payments totaling $1.4 million for the

year ended December 31, 2004. The Company paid state and local income taxes totaling $0.3 million, $0.3 million and $0.4 million for the years ended December 31, 2005, 2004 and 2003, respectively. The Company made non-U.S. tax payments totaling $2.8 million, $6.3 million and $3.2 million for the years ended December 31, 2005, 2004 and 2003, respectively.

(14) LONG-TERM DEBT

The Company's total indebtedness consisted of the following at:

	December 31,	
(Dollars in thousands)	*2005*	*2004*
Term Loan under Senior Secured Credit Facility	$ 442,500	$ 448,750
6.875% Senior Notes due 2013	650,000	650,000
5.875% Senior Notes due 2016	239,525	239,525
Fair value of interest rate swaps – 6.875% Senior Notes	(8,879)	5,189
5.0% Subordinated Note	66,693	73,621
Other	15,667	7,880
Total	$1,405,506	$1,424,965

Senior Secured Credit Facility

On March 21, 2003, the Company entered into a Senior Secured Credit Facility (the "Facility") that consisted of a $600.0 million revolving credit facility and a $450.0 million term loan. On March 8, 2004, the Company entered into an amendment to refinance the Facility, which expanded the maximum borrowings under the revolving credit facility from $600.0 million to $900.0 million and reduced the interest rate payable on the existing term loan under the Facility from LIBOR plus 2.5% to LIBOR plus 1.75%. On October 27, 2004, the Company refinanced the Facility, which reduced the applicable margin on the loans and the revolving credit agreement fee rate and extended the revolving credit facility termination date to March 2010. The refinancing reduced the interest rate payable on the existing term loan under the Facility from LIBOR plus 1.75% to LIBOR plus 1.25%. The applicable rate was 3.74% as of December 31, 2004.

For the year ending December 31, 2005, based on the attainment of certain leverage ratios, as defined in the agreement, there was a reduction in the interest rate payable on the existing term loan under the Facility from LIBOR plus 1.25% to LIBOR plus 0.75%. The same reduction in the margin applies to fees under the revolving credit facility. The applicable rate for the term loan was 5.24% as of December 31, 2005. The Company had letters of credit outstanding under the revolving credit facility of $406.7 million at December 31, 2005, leaving $493.3 million available for borrowing.

Under the term loan, total principal of $42.5 million will be paid in quarterly installments through March 31, 2009. The remaining principal of $400.0 million is due in quarterly installments of $100.0 million to be paid from June 30, 2009, through March 21, 2010. The Facility is secured by the capital stock and certain assets of the Company's "restricted subsidiaries" (as defined in the Facility). These restricted subsidiaries are also guarantors of the Facility. Under the Facility, the Company must comply with certain financial covenants on a quarterly basis. These covenants include a minimum EBITDA (as defined in the Facility) interest coverage ratio, a maximum "total obligations" (as defined in the Facility) to EBITDA ratio and a maximum senior secured debt to EBITDA ratio. The Company was in compliance with these covenants as of December 31, 2005.

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, and commenced on September 15, 2003. The notes are guaranteed by the Company's "restricted subsidiaries" 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 "restricted subsidiaries" 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.

Interest Rate Swaps

In May 2003, the Company entered into and designated four interest rate swaps with combined notional amounts totaling $100.0 million as a fair value hedge of the Company's 6.875% Senior Notes. Under the swaps, the Company pays a floating rate that resets each March 15 and September 15, based upon the six-month LIBOR rate, for a period of 10 years ending March 15, 2013 and receives a fixed rate of 6.875%. The average applicable floating rate for the four swaps was 7.09% as of December 31, 2005.

In September 2003, the Company entered into two $400.0 million interest rate swaps. One $400.0 million notional amount floating-to-fixed interest rate swap, expiring March 15, 2010, was designated as a hedge of changes in expected cash flows on the term loan under the Senior Secured Credit Facility. The term loan was refinanced in October 2004, and the swap was re-designated as a hedge of the refinanced term loan. Under this swap, the Company pays a fixed rate of 6.764% and receives a floating rate of LIBOR plus 2.5% (6.99% at December 31, 2005) that resets each March 15, June 15, September 15 and December 15 based upon the three-month LIBOR rate. Another $400.0 million notional amount fixed-to-floating interest rate swap, expiring March 15, 2013, was designated as a hedge of the changes in the fair value of the 6.875% Senior Notes due 2013. Under this swap, the Company pays a floating rate of LIBOR plus 1.97% (6.46% at December 31, 2005) that resets each March 15, June 15, September 15 and December 15 based upon the three-month LIBOR rate and receives a fixed rate of 6.875%. The swaps will lower the Company's overall borrowing costs on $400.0 million of debt principal by 0.64% over the term of the floating-to-fixed swap.

Because the critical terms of the swaps and the respective debt instruments they hedge coincide, there was no hedge ineffectiveness recognized in the statement of operations during the year ended December 31, 2005. Related to the cash flow hedge, the balance sheet at December 31, 2005 and 2004, respectively, reflected an unrealized gain of $2.3 million and an unrealized loss of $10.9 million, which is recognized net of a $0.9 million tax provision and a $4.4 million tax benefit, in other comprehensive loss (see Note 21). As of December 31, 2005 and 2004, the balance sheet reflected a net unrealized loss of $8.9 million and a net unrealized gain of $5.2 million, respectively, on the fair value hedges discussed above, which is reflected as an adjustment to the carrying value of the Senior Notes (see table above).

5.0% Subordinated Note

The 5.0% Subordinated Note is recorded net of discount at an effective annual interest rate of 12.0%. Interest and principal are payable each March 1, and a scheduled principal payment of $10.0 million is due in 2006, with the remaining $60.0 million due March 1, 2007. The 5.0% Subordinated Note is expressly subordinated in right of payment to all prior indebtedness (as defined), including borrowings under the Senior Secured Credit Facility, the 6.875% Senior Notes due March 2013 and the 5.875% Senior Notes due March 2016.

Other

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 5.54% as of December 31, 2005.

The aggregate amounts of long-term debt maturities subsequent to December 31, 2005 are as follows:

Year of Maturity (Dollars in thousands)	
2006	$ 22,585
2007	72,268
2008	16,435
2009	304,797
2010	101,112
2011 and thereafter	888,309
Total	$1,405,506

Interest paid on long-term debt was $94.2 million, $87.4 million and $89.0 million for the years ended December 31, 2005, 2004 and 2003, respectively. No interest was paid on the revolving credit facility in 2005 or 2004. Interest paid on the revolving credit facility was $0.1 million for the year ended December 31, 2003.

Early Debt Extinguishment Costs

In 2004, the Company recorded a net charge for early debt extinguishment of $1.8 million. In connection with the refinancing of the Senior Secured Credit Facility on October 27, 2004, the Company incurred a non-cash charge of $2.4 million to write-off unamortized debt issuance costs related to the term loan. In connection with the July 2004 repurchase of $10.5 million of 5.875% Senior Notes due March 2016, the Company realized a gain of $0.6 million, which included a gain from the excess of carrying value of the notes over the cash cost to retire the notes of $0.8 million partially offset by charges to write-off debt issuance costs associated with the debt extinguished of $0.2 million.

In 2003, the Company recorded total early debt extinguishment costs of $53.5 million in connection with a series of transactions to refinance a substantial portion of its outstanding indebtedness. The early debt extinguishment costs included prepayment premiums paid on the debt retired of $41.8 million, non-cash charges to write-off the associated debt issuance costs of $17.5 million, and a gain from the termination and monetization of interest rate swaps associated with the debt extinguished of $5.8 million.

(15) 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 federal and state reclamation laws as defined by each mine permit. The obligation and corresponding asset are recognized in the period in which the liability is incurred.

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, then discounted at the credit-adjusted risk-free rate (5.81% at January 1, 2005). The Company records an ARO asset associated with the liability. The ARO asset is amortized based on the units of production method over its expected life, and the ARO liability is accreted to the projected spending date. Changes in estimates could occur due to mine plan revisions, changes in estimated costs, and changes in timing of the performance of reclamation activities. The Company also recognizes an obligation for contemporaneous reclamation liabilities incurred as a result of surface mining.

A reconciliation of the Company's liability for asset retirement obligations for the year ended December 31, 2005, is as follows:

(Dollars in thousands)	
Balance at December 31, 2004	$396,022
Liabilities incurred	24,101
Liabilities settled or disposed	(40,341)
Accretion expense	24,095
Revisions to estimate	(4,674)
Balance at December 31, 2005	$399,203

Total asset retirement obligations as of December 31, 2005, of $399.2 million consisted of $340.7 million related to locations with active mining operations and $58.5 million related to locations that are closed or inactive. In 2005, the Company recorded a $9.2 million reduction in its asset retirement obligations associated with the disposal of non-strategic properties and the assumption of the related reclamation liabilities by the purchaser.

As of December 31, 2005 and 2004, the Company had $323.6 million and $294.5 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 $671.8 million and $653.3 million as of December 31, 2005 and 2004, respectively. Additionally, the Company had $0.1 million and $0.4 million of letters of credit in support of reclamation obligations or activities as of December 31, 2005 and 2004, respectively.

(16) WORKERS' COMPENSATION OBLIGATIONS

Certain subsidiaries of the Company are subject to the Federal Coal Mine Health and Safety Act of 1969 and the related workers' compensation laws in the states in which they operate. These laws require the subsidiaries to pay benefits for occupational disease resulting from coal workers' pneumoconiosis ("occupational disease"). Changes to the federal regulations became effective in August 2001, and the revised regulations could ultimately result in higher costs, although experience to date has not resulted in higher claims costs. Provisions for occupational disease costs are based on determinations by independent actuaries or claims administrators.

The Company provides income replacement and medical treatment for work related traumatic injury claims as required by applicable state law. Provisions for estimated claims incurred are recorded based on estimated loss rates applied to payroll and claim reserves determined by independent actuaries or claims administrators.

Certain subsidiaries of the Company are required to contribute to state workers' compensation funds for second injury and other costs incurred by the state fund based on a payroll-based assessment by the applicable state. Provisions are recorded based on the payroll-based assessment criteria.

As of December 31, 2005, the Company had $163.8 million in surety bonds and letters of credit outstanding to secure workers' compensation obligations.

Workers' compensation provision consists of the following components:

	Year Ended December 31,		
(Dollars in thousands)	*2005*	*2004*	*2003*
Occupational disease:			
Service cost	$ 4,491	$ 4,346	$ 3,807
Interest cost	10,425	11,568	11,760
Net amortization	(1,213)	742	339
Total occupational disease	13,703	16,656	15,906
Traumatic injury claims	25,610	27,141	19,691
State assessment taxes	16,820	15,365	15,016
Total provision	$56,133	$59,162	$50,613

The weighted-average assumptions used to determine the workers' compensation provision were as follows:

	Year Ended December 31,		
	2005	*2004*	*2003*
Discount rate	6.10%	6.40%	7.00%
Inflation rate	3.50%	3.50%	3.50%

Workers' compensation obligations consist of amounts accrued for loss sensitive insurance premiums, uninsured claims and related taxes and assessments under black lung and traumatic injury workers compensation programs.

The workers' compensation obligations consisted of the following:

	December 31,	
(Dollars in thousands)	2005	2004
Occupational disease costs	$190,347	$186,647
Traumatic injury claims	81,034	81,713
State assessment taxes	505	552
Total obligations	271,886	268,912
Less current portion	(34,312)	(41,436)
Noncurrent obligations	$237,574	$227,476

The reconciliation of changes in the benefit obligation of the occupational disease liability is as follows:

	December 31,	
(Dollars in thousands)	2005	2004
Beginning of year obligation	$199,346	$191,993
Service cost	4,491	4,346
Interest cost	10,425	11,568
Actuarial gain	(16,071)	(601)
Acquisitions	–	2,514
Benefit and administrative payments	(10,284)	(10,474)
Net obligation at end of year	187,907	199,346
Unamortized gain (loss) and prior service cost	2,440	(12,699)
Accrued cost	$190,347	$186,647

The liability for occupational disease claims represents the actuarially-determined present value of known claims and an estimate of future claims that will be awarded to current and former employees. The liability for occupational disease claims was based on a discount rate of 5.9% and 6.1% at December 31, 2005 and 2004, respectively. Traumatic injury workers' compensation obligations are estimated from both case reserves and actuarial determinations of historical trends, discounted at 6.1% and 6.4% for the years ended December 31, 2005 and 2004, respectively.

Federal Black Lung Excise Tax Refund Claims

In addition to the obligations discussed above, 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 of $19.4 million as of December 31, 2005 and 2004.

(17) PENSION AND SAVINGS PLANS

One of the Company's subsidiaries, Peabody Investments Corp., sponsors a defined benefit pension plan covering substantially all salaried U.S. 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 of 2000 (the "Western Plan"). Twentymile Coal Company ("Twentymile"), a subsidiary of the Company, sponsors two defined benefit pension plans, one which covers substantially all Twentymile hourly employees (the "Twentymile Hourly Plan") and one which covers substantially all Twentymile salaried employees (the "Twentymile Salaried 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 and increased benefits to reflect a service adjustment factor.

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 which requires the Company to maintain certain minimum funding requirements. 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:

	Year Ended December 31,		
(Dollars in thousands)	2005	2004	2003
Service cost for benefits earned	$ 11,853	$ 12,275	$ 10,184
Interest cost on projected benefit obligation	45,499	43,658	41,794
Expected return on plan assets	(52,812)	(49,813)	(44,462)
Other amortizations and deferrals	24,588	22,366	13,179
Net periodic pension costs	29,128	28,486	20,695
Curtailment charges	9,527	–	–
Total pension costs	$ 38,655	$ 28,486	$ 20,695

The Company amortizes actuarial gains and losses using a 5% corridor with a five-year amortization period.

The curtailment charges resulted from the planned closure during 2005 of two of the Company's three operating mines that participate in the Western Plan. 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 closures.

During the period ended March 31, 1999, the Company made an amendment to phase out the Peabody Plan beginning January 1, 2000. Effective January 1, 2001, certain employees no longer accrue future service under the plan while other employees accrue reduced service under the plan based on their age and years of service as of December 31, 2000. For plan benefit calculation purposes, employee earnings are also

frozen as of December 31, 2000. The Company has adopted an enhanced savings plan contribution structure in lieu of benefits formerly accrued under the defined benefit pension plan.

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

	December 31,	
(Dollars in thousands)	2005	2004
Change in benefit obligation:		
Benefit obligation at beginning of period	$ 759,283	$ 681,300
Service cost	11,853	12,275
Interest cost	45,499	43,658
Acquisitions	–	27,328
Plan amendments	(225)	–
Curtailments	(1,309)	–
Special termination benefits	7,896	–
Benefits paid	(38,315)	(35,095)
Actuarial loss	17,136	29,817
Benefit obligation at end of period	801,818	759,283
Change in plan assets:		
Fair value of plan assets at beginning of period	642,400	527,914
Actual return on plan assets	42,707	68,819
Acquisitions	–	18,680
Employer contributions	7,231	62,082
Benefits paid	(38,315)	(35,095)
Fair value of plan assets at end of period	654,023	642,400
Funded status	(147,795)	(116,883)
Unrecognized actuarial loss	141,517	140,175
Unrecognized prior service cost	346	2,201
Accrued pension asset (liability)	$ (5,932)	$ 25,493
Amounts recognized in the consolidated balance sheets:		
Accrued benefit liability	$(125,622)	$ (99,905)
Intangible asset	2,362	4,067
Additional minimum pension liability, included in other comprehensive income	117,328	121,331
Net amount recognized	$ (5,932)	$ 25,493

The accumulated benefit obligation for all pension plans was $779.6 million and $740.9 million as of December 31, 2005, and 2004, respectively. The projected benefit obligation and the accumulated benefit obligation exceeded plan assets for all plans as of December 31, 2005 and 2004. The following presents information applicable to pension plans with accumulated benefit obligations in excess of plan assets:

	December 31,	
(Dollars in thousands)	2005	2004
Projected benefit obligation	$801,818	$759,283
Accumulated benefit obligation	779,646	740,931
Fair value of plan assets	654,023	642,400

The provisions of SFAS No. 87 require the recognition of an additional minimum liability and related intangible asset to the extent that accumulated benefits exceed plan assets. As of December 31, 2005 and 2004, the Company has recorded $117.3 million and $121.3 million, respectively, to reflect the Company's minimum liability. The current portion of the Company's pension liability as reflected within "Accounts payable and accrued expenses" at December 31, 2005 and 2004 was $7.9 million and $5.8 million, respectively. The noncurrent portion of the Company's pension liability as reflected within "Other noncurrent liabilities" at December 31, 2005 and 2004 was $115.4 million and $90.0 million, respectively.

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

	Year Ended December 31,	
	2005	2004
Discount rate	5.90%	6.10%
Rate of compensation increase	3.50%	3.50%
Measurement date	December 31, 2005	December 31, 2004

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

	Year Ended December 31,		
	2005	2004	2003
Discount rate	6.10%	6.40%	7.00%
Expected long-term return on plan assets	8.75%	8.75%	8.75%
Rate of compensation increase	3.50%	3.75%	3.75%
Measurement date	Dec. 31, 2004	Dec. 31, 2003	Dec. 31, 2002

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 historic ranges, inflation assumptions and the expected net value from active management of the assets based on actual results.

Plan Assets

Assets of the Peabody Plan, the Western Plan, the Twentymile Hourly Plan and the Twentymile Salaried 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, 2005, Master Trust assets totaled $654.0 million and were invested in the following major asset categories:

(Dollars in thousands)	*Balance as of December 31, 2005*	*Percentage Allocation of Total Assets*	*Target Allocation*
Equity securities	$360,133	55.1%	50.0%
Fixed income	247,747	37.9%	40.0%
Real estate	45,328	6.9%	10.0%
Cash fund	815	0.1%	0.0%
Total	$654,023	100.0%	100.0%

As of the year ended December 31, 2004, Master Trust assets totaled $642.4 million and were invested in the following major asset categories:

(Dollars in thousands)	*Balance as of December 31, 2004*	*Percentage Allocation of Total Assets*	*Target Allocation*
Equity securities	$339,287	52.8%	50.0%
Fixed income	250,749	39.0%	40.0%
Real estate	49,647	7.8%	10.0%
Cash fund	2,717	0.4%	0.0%
Total	$642,400	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 $6.6 million to its funded pension plans and make $1.3 million in expected benefit payments attributable to its unfunded pension plans during 2006.

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*
2006	$ 40,804
2007	42,162
2008	44,227
2009	45,839
2010	47,695
Years 2011-2015	282,423

Multi-Employer Pension Plans

Certain subsidiaries 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 other than those covered by the Western Plan. Benefits under the UMWA plans are computed based on service with the subsidiaries or other signatory employers. There were no contributions to the multi-employer pension plans during the years ended December 31, 2005, 2004 or 2003, and the Company does not anticipate any contributions in 2006.

Defined Contribution Plans

The Company sponsors employee retirement accounts under seven 401(k) plans for eligible salaried U.S. employees. The Company matches voluntary contributions to each plan up to specified levels. The expense for these plans was $10.7 million, $10.2 million and $9.4 million for the years ended December 31, 2005, 2004 and 2003, 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 $9.3 million, $6.7 million and $3.7 million for the years ended December 31, 2005, 2004 and 2003, respectively.

(18) 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 the health and life insurance benefits is provided to future hourly retirees in accordance with the applicable labor agreement. The Company accounts for postretirement benefits in accordance with SFAS No. 106,

which requires the cost to provide the benefits to be accrued over the employees' period of active service. These costs are determined on an actuarial basis.

Net periodic postretirement benefit costs included the following components:

	Year Ended December 31,		
(Dollars in thousands)	*2005*	*2004*	*2003*
Service cost for benefits earned	$ 5,343	$ 4,430	$ 4,670
Interest cost on accumulated postretirement benefit obligation	72,673	63,635	77,984
Amortization of prior service cost	(5,339)	(13,230)	(15,787)
Amortization of actuarial losses	26,304	3,575	16,802
Net periodic postretirement benefit costs	$98,981	$ 58,410	$ 83,669

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 (8.99 years and 8.43 years at January 1, 2005 and 2004, respectively).

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

	December 31,	
(Dollars in thousands)	*2005*	*2004*
Change in benefit obligation:		
Benefit obligation at beginning of period	$ 1,234,185	$ 1,023,453
Service cost	5,343	4,430
Interest cost	72,673	63,635
Participant contributions	1,716	1,360
Plan amendments	–	4,492
Acquisitions	–	10,191
Benefits paid	(87,250)	(83,451)
Actuarial loss	62,288	210,075
Benefit obligation at end of period	1,288,955	1,234,185
Change in plan assets:		
Fair value of plan assets at beginning of period	–	–
Employer contributions	85,534	82,091
Participant contributions	1,716	1,360
Benefits paid	(87,250)	(83,451)
Fair value of plan assets at end of period	–	–
Funded status	(1,288,955)	(1,234,185)
Unrecognized actuarial loss	272,617	236,634
Unrecognized prior service cost	(17,932)	(23,270)
Accrued postretirement benefit obligation	(1,034,270)	(1,020,821)
Less current portion	75,048	81,318
Noncurrent obligation	$ (959,222)	$ (939,503)

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

	Year Ended December 31,	
	2005	*2004*
Discount rate	5.90%	6.10%
Rate of compensation increase	3.50%	3.50%
Measurement date	December 31, 2005	December 31, 2004

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

	Year Ended December 31,		
	2005	*2004*	*2003*
Discount rate	6.10%	6.40%	7.00%
Expected long-term return on plan assets	not applicable	not applicable	not applicable
Rate of compensation increase	3.50%	3.75%	3.75%
Measurement date	Dec. 31, 2004	Dec. 31, 2003	Dec. 31, 2002

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

	Year Ended December 31,	
	2005	*2004*
Health care cost trend rate assumed for next year	7.00%	8.00%
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	2011	2010

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	$ 8,789	$ (6,961)
Effect on total postretirement benefit obligation	$161,903	$(135,501)

Plan Assets

The Company's postretirement benefit plans are unfunded.

Cash Flows

The Company expects to pay $75.0 million in benefits attributable to its postretirement benefit plans during 2006.

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)	
2006	$ 75,048
2007	78,823
2008	81,618
2009	84,381
2010	87,331
Years 2011-2015	$493,716

Medicare and Other Plan Changes

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 July 2001, the Company adopted changes to the prescription drug program. Effective January 1, 2002, an incentive mail order and comprehensive utilization management program was added to the prescription drug program. The effect at the time of adoption of the change on the retiree health care liability was $38.4 million. The Company began recognizing the effect of the plan amendment over three years beginning July 1, 2001. Net periodic postretirement benefit costs were reduced by $6.4 million for the year ended December 31, 2004, and $12.8 million for the year ended December 31, 2003, for this change.

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 current medical plan is 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 year ended December 31, 2005, and $2.5 million for each of the years ended December 31, 2004 and 2003.

Multi-Employer Benefit Plans

Retirees formerly employed by certain subsidiaries and their predecessors, who were members of the UMWA, last worked before January 1, 1976 and were receiving health benefits on July 20, 1992, receive health benefits provided by the Combined Fund, a fund created by the Coal Industry Retiree Health Benefit Act of 1992 (the "Coal Act"). The Coal Act requires former employers (including certain subsidiaries of the Company) and their affiliates to contribute to the Combined Fund according to a formula. In addition, certain Federal Abandoned Mine Lands funds will be transferred to the Combined Fund to fund certain benefits.

The Company has recorded an actuarially determined liability representing the amounts anticipated to be due to the Combined Fund. The noncurrent portion related to this obligation as reflected within "Other noncurrent liabilities" in the consolidated balance sheets as of December 31, 2005 and 2004, was $27.9 million and $33.4 million, respectively. The current portion related to this obligation reflected in "Accounts payable and accrued expenses" in the consolidated balance sheets as of December 31, 2005 and 2004, was $8.8 million and $6.4 million, respectively.

Expense of $0.9 million was recognized related to the Combined Fund for the year ended December 31, 2005, and consisted of interest discount of $1.0 million and amortization of actuarial gain of $0.1 million. Expense of $4.9 million was recognized related to the Combined Fund for the year ended December 31, 2004, and consisted of interest discount of $3.8 million and amortization of actuarial loss of $1.1 million. Expense of $1.2 million was recognized related to the Combined Fund for the year ended December 31, 2003, and consisted of interest discount of $3.4 million and amortization of actuarial gain of $2.2 million. The Company made contributions of $4.0 million, $16.6 million and $16.2 million to the Combined Fund for the years ended December 31, 2005, 2004 and 2003, respectively.

The Coal Act also established a multi-employer benefit plan ("1992 Plan") which will provide medical and death benefits to persons who are not eligible for the Combined Fund, who retired prior to October 1, 1994, and whose employer and any affiliates are no longer in business. A prior labor agreement established the 1993 United Mine Workers of America Benefit Trust ("1993 Plan") to provide health benefits for retired miners not covered by the Coal Act. The 1992 Plan and the 1993 Plan qualify under SFAS No. 106 as multi-employer benefit plans, which allows the Company to recognize expense as contributions are made. The expense related to these funds was $4.0 million, $4.4 million and $5.3 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Pursuant to the provisions of the Coal Act and the 1992 Plan, the Company is required to provide security in an amount equal to three times the annual cost of providing health care benefits for all individuals receiving benefits from the 1992 Plan who are attributable to the Company, plus all individuals receiving benefits from an individual employer plan maintained by the Company who are entitled to receive such benefits. In accordance with the Coal Act and the 1992 Plan, the Company has outstanding letters of credit as of December 31, 2005, of $120.1 million to secure the Company's obligation.

(19) STOCKHOLDERS' EQUITY

Common Stock

The Company has 400.0 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 ratably receive dividends if, as and when dividends are declared from time to time by the Board of Directors. 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.

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, 2005.

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

In July 2002, the Board of Directors of the Company adopted a preferred share purchase rights plan (the "Rights Plan"). In connection with the Rights Plan, the Board of Directors of the Company declared a dividend of one preferred share purchase right (a "Right") for each outstanding share of common stock, par value $0.01 per share, of the Company. The Rights Plan 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 and 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, 2005.

Treasury Stock

During the year ended December 31, 2004, the Company received 20,136 shares of common stock as consideration for employees' exercise of stock options. The value of the common stock tendered by employees to exercise stock options 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.

Equity Offering

On March 23, 2004, the Company completed an offering of 35,300,000 shares of the Company's common stock, priced at $11.25 per share. Net proceeds from the offering, after deducting underwriting discounts and commissions and other expenses, were $383.1 million, and were primarily used, as discussed in Note 6, to fund the acquisition of three coal operations from RAG Coal International AG.

The following table summarizes common share activity from December 31, 2002 to December 31, 2005:

	Shares Outstanding
December 31, 2002	209,601,112
Stock options exercised	9,055,080
Employee stock purchases	304,268
Stock grants to non-employee directors	19,960
Stock grant to executive	40,000
Shares repurchased	(433,404)
December 31, 2003	218,587,016
Stock options exercised	4,953,868
Employee stock purchases	297,648
Stock grants to non-employee directors	17,512
Equity offering	35,300,000
Shares repurchased	(20,136)
December 31, 2004	259,135,908
Stock options exercised	3,633,750
Employee stock purchases	210,750
Stock grants to non-employee directors	1,594
Stock grants to employees	375,400
December 31, 2005	263,357,402

(20) EQUITY COMPENSATION PLANS

Long-Term Equity Incentive Plans

Effective May 6, 2004, shareholders approved and the Company adopted the "2004 Long-Term Equity Incentive Plan," making 14.0 million shares of the Company's common stock available for grant. The Board of Directors may provide such grants in the form of stock appreciation rights, restricted stock, performance awards, incentive stock options, nonqualified stock options and stock units. The Company granted 0.4 million stock options and 0.4 million shares of restricted stock grants under this plan for the year ended December 31, 2005.

In connection with the initial public offering, the Company adopted the "Long-Term Equity Incentive Plan," making 10.0 million shares of the Company's common stock available for grant. The Board of Directors may provide such grants in the form of stock appreciation rights, restricted stock, performance awards, incentive stock options, nonqualified stock options and stock units. The Company granted 3.9 million and 2.7 million non-qualified options to purchase common stock during the years ended December 31, 2003 and 2002, respectively. These options generally vest over three years and expire 10 years after date of grant. The Company granted 0.2 million performance units under this plan for the year ended December 31, 2005.

Performance units granted by the Company vest over a three year measurement period, subject to the achievement of performance goals at the conclusion of the three years. Three performance unit grants were outstanding during 2005. The payout related to the 2003 grant (which will be settled in cash) is based on the Company's stock price performance compared to both an industry peer group and an S&P Index. The payout related to the 2004 grant (which will be settled in cash) and 2005 grant (which will be settled in common stock) is based 50% on stock price performance compared to both an industry peer group and an S&P Index and 50% on a return on capital target. During the years ended December 31, 2005, 2004 and 2003, the Company granted 0.2 million, 0.5 million and 0.4 million performance units in each period, respectively. As a result of the Company's performance under the terms of these grants, the Company recognized compensation expense of $41.2 million, $21.1 million and $3.3 million in 2005, 2004 and 2003, respectively.

Stock Purchase and Option Plan

Effective May 19, 1998, the Company adopted the "1998 Stock Purchase and Option Plan for Key Employees of P&L Coal Holdings Corporation," making 22.4 million shares of the Company's common stock available for grant. The Board of Directors provided such grants in the form of stock, non-qualified options and incentive stock options. No grants were made under this plan in 2005.

Non-Employee Director Equity Incentive Plan

During the nine months ended December 31, 2001, the Company also adopted the "Equity Incentive Plan for Non-Employee Directors." Under that plan, members of the Company's Board of Directors who are not employees of the Company or one of its affiliates will be eligible to receive grants of restricted stock and stock options. All options granted under the plan vest ratably over three years and will expire after 10 years from the date of the grant, subject to earlier termination in connection with a director's termination of service. Members of the Company's Board of Directors are eligible for stock option and restricted stock grants (made either from the Equity Incentive Plan for Non-Employee Directors or the Long-Term Equity Incentive Plan) at the date of their election and annually in January.

The Company recognized compensation cost related to grants of common stock and options to management, employees and non-employee directors of $1.6 million, $0.3 million and $0.4 million during the years ended December 31, 2005, 2004, and 2003, respectively.

A summary of outstanding option activity is as follows:

	Year Ended December 31, 2005	Weighted-Average Exercise Price	Year Ended December 31, 2004	Weighted-Average Exercise Price	Year Ended December 31, 2003	Weighted-Average Exercise Price
Beginning balance	14,468,336	$ 5.90	17,547,372	$ 5.22	23,095,316	$4.26
Granted	418,606	20.54	2,157,484	10.63	3,929,148	7.72
Exercised	(3,633,750)	6.22	(4,953,868)	5.55	(9,055,080)	3.87
Forfeited	(469,406)	5.75	(282,652)	6.03	(422,012)	4.83
Outstanding	10,783,786	$ 6.37	14,468,336	$5.90	17,547,372	$5.22
Exercisable	2,825,334	$ 7.35	4,126,956	$5.93	6,652,256	$5.25

A summary of options outstanding and exercisable as of December 31, 2005 is as follows:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number	Weighted-Average Exercise Price
$3.58	5,900,708	3.1	$ 3.58	504,500	$ 3.58
$5.85 to $6.82	469,682	6.0	6.70	460,806	6.71
$6.83 to $7.80	1,605,136	6.6	7.23	832,060	7.16
$7.81 to $8.77	367,566	7.8	8.40	321,710	8.46
$8.78 to $9.75	404,000	7.8	9.74	402,666	9.75
$9.76 to $10.72	1,482,656	8.0	10.49	263,098	10.49
$10.73 to $17.24	137,432	8.4	12.20	40,494	12.24
$17.25 to $25.86	406,654	9.1	20.24		
$25.87 to $30.66	9,952	9.6	30.51		
	10,783,786			2,825,334	

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, 2005, 2004 and 2003) were as follows:

	December 31,		
	2005	2004	2003
Weighted-average fair value	$8.03	$4.46	$3.38
Risk-free interest rate	3.6%	3.9%	3.6%
Expected option life	5.7 years	5.9 years	6.6 years
Expected volatility	40%	40%	42%
Dividend yield	1.0%	1.0%	1.4%

Employee Stock Purchase Plan

During 2001, the Company adopted an employee stock purchase plan. Total shares of common stock available for purchase under the plan were 6.0 million. 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 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 and ending dates of each offering period. Shares purchased under the plan were 0.2 million, 0.3 million and 0.3 million for the years ended December 31, 2005, 2004 and 2003, respectively.

(21) ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The after-tax components of accumulated other comprehensive income (loss) are as follows:

(Dollars in thousands)	Foreign Currency Translation Adjustment	Minimum Pension Liability Adjustment	Cash Flow Hedges	Total Accumulated Other Comprehensive Loss
December 31, 2002	$ 15	$(77,642)	$ –	$(77,627)
Net decrease in value of cash flow hedges	–	–	(4,955)	(4,955)
Reclassification from other comprehensive income to earnings	–	–	(2,086)	(2,086)
Current period change	3,138	(42)	–	3,096
December 31, 2003	3,153	(77,684)	(7,041)	(81,572)
Net increase in value of cash flow hedges	–	–	17,329	17,329
Reclassification from other comprehensive income to earnings	–	–	(2,414)	(2,414)
Current period change	–	6,039	–	6,039
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)

(22) RELATED PARTY TRANSACTIONS

On March 23, 2004, August 4, 2003, and May 7, 2003, Lehman Brothers Merchant Banking Partners II L.P. and affiliates ("Merchant Banking Fund"), the Company's largest stockholder as of those dates, sold 41.1 million, 21.6 million and 22.5 million shares, respectively, of the Company's common stock. The Company did not receive any proceeds from the sales of shares by Merchant Banking Fund. The March 2004 offering completed Merchant Banking Fund's planned exit strategy and eliminated the remaining portion of their beneficial ownership of the Company.

Lehman Brothers Inc. ("Lehman Brothers") is an affiliate of the Merchant Banking Fund. In March 2004, Morgan Stanley and Lehman Brothers served as joint managers in connection with the secondary equity offering discussed above. Lehman Brothers received from third parties customary underwriting discounts and commissions from the offering. The Company paid no fees to Lehman Brothers related to the secondary equity offerings. In May 2003 and August 2003, Lehman Brothers served as the lead underwriter in connection with the secondary offerings discussed above and fees for their services were paid by the selling shareholders and not by the Company. The Company paid incidental expenses customarily incurred by a registering company in connection with the secondary offerings.

Lehman Brothers served as lead underwriter in connection with the Company's sale of limited partner interests in PVR in March 2004 and December 2003, as discussed in Note 11 above. Lehman Brothers received customary fees, plus reimbursement of certain expenses, for those services.

As discussed in Note 14 above, in March 2003, the Company refinanced a substantial portion of its indebtedness by entering into a new Senior Secured Credit Facility and issuing new Senior Notes. Based upon a competitive bidding process conducted by members of management and reviewed by members of the Company's Board of Directors not affiliated with Lehman Brothers, the Company appointed Wachovia Securities, Inc., Fleet Securities, Inc. and Lehman Brothers as lead arrangers for the Senior Secured Credit Facility, and Lehman Brothers and Morgan Stanley as joint book running managers for the Senior Notes. Lehman Brothers received total fees of $7.4 million for their services in connection with the refinancing; such fees were consistent with the fees paid to other parties to the transaction for their respective services.

As discussed in Note 14 above, in May 2003, the Company entered into four $25.0 million fixed-to-floating interest rate swaps as a hedge of the changes in fair value of the 6.875% Senior Notes due 2013. Lehman Brothers was chosen as one of the swap counterparties as part of a competitive bidding process among eight financial institutions.

(23) 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 performance being required. 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, 2005:

(Dollars in thousands)	*Reclamation Obligations*	*Lease Obligations*	*Workers' Compensation Obligations*	*Retiree Healthcare Obligations*	*Other(1)*	*Total*
Self Bonding	$ 671,815	$ –	$ –	$ –	$ 2,917	$ 674,732
Surety Bonds	335,644	258,769	19,193	–	28,411	642,017
Letters of Credit	105	22,652	144,591	120,089	119,745	407,182
	$1,007,564	$281,421	$163,784	$120,089	$151,073	$1,723,931

(1) Other includes the two letters of credit obligations described below and an additional $71.3 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. The Company's maximum reimbursement obligation to the commercial bank is in turn supported by a letter of credit totaling $42.8 million.

The Company is party to an agreement with the Pension Benefit Guarantee Corporation, or 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, 2005. 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.

Other Guarantees

The Company owns a 49.0% interest in a joint venture that operates an underground mine and preparation plant facility in West Virginia. The partners have severally agreed to guarantee the debt of the joint venture, which consists of a $19.9 million loan facility. Monthly principal payments on the loan facility of approximately $0.4 million are due through September 2010. Interest payments on the loan facility are due monthly and accrue at prime, or 7.25%, as of December 31, 2005. The total amount of the joint venture's debt guaranteed by the Company was $9.8 million as of December 31, 2005.

The Company has guaranteed the performance of Asset Management Group ("AMG") under their coal purchase contract with a third party, which has terms extending through December 31, 2006. Default occurs if AMG does not deliver specified monthly tonnage amounts to the third party. In the event of a default, the Company would assume AMG's obligation to ship coal at agreed prices for the remaining term of the contract. As of December 31, 2005, the maximum potential future payments under this guarantee are approximately $4.0 million, based on recent spot coal prices. As a matter of recourse in the event of a default, the Company has access to cash held in escrow and the ability to trigger an assignment of AMG's assets to the Company. Based on these recourse options and the remote probability of non-performance by AMG due to their proven operating history, the Company has valued the liability associated with the guarantee at zero.

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. The Company also guaranteed bonding for a partnership in which it formerly held an interest as part of an exchange in which the Company obtained strategic Illinois Basin coal reserves. The total amount guaranteed by the Company was $5.5 million, and the fair value of the guarantees recognized as a liability was $0.4 million as of December 31, 2005. The Company's obligations under the guarantees extend to September 2015.

The Company is the lessee under numerous equipment and property leases, as described in Note 11. 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 11 and the Company assumes that no amounts could be recovered from third parties.

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. Descriptions of the Company's (and its subsidiaries') debt are included in Note 14. The maximum amounts payable under the Company's debt agreements are presented in Note 14 and assume that no amounts could be recovered from third parties.

In connection with the sale of Citizens Power LLC ("Citizens Power"), the Company has indemnified the buyer from certain losses resulting from specified power contracts and guarantees. The indemnity is described in detail in Note 25. A discussion of the Company's accounts receivable securitization is included in Note 5 to the consolidated financial statements.

(24) 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.

The following methods and assumptions were used by the Company in estimating its fair value disclosures for financial instruments as of December 31, 2005 and 2004:

- 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 4.
- Long-term debt fair value estimates are based on estimated borrowing rates to discount the cash flows to their present value. The 5.0% Subordinated Note carrying amount is net of unamortized note discount.
- The fair values of interest rate swap contracts, currency forward 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, 2005, the Company would have paid $6.7 million and $3.8 million, respectively, upon liquidation of its interest rate swaps and currency forwards and would have received $33.9 million upon liquidation of its fuel hedges.
- Other noncurrent liabilities include a deferred purchase obligation related to the prior purchase of a mine facility. The fair value estimate is based on the same assumption as long-term debt.

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

	December 31, 2005		December 31, 2004	
(Dollars in thousands)	*Carrying Amount*	*Estimated Fair Value*	*Carrying Amount*	*Estimated Fair Value*
Long-term debt	$1,405,506	$1,389,666	$1,424,965	$1,447,235
Deferred purchase obligation	1,397	1,402	6,717	6,807

See Note 2 for a discussion of the Company's derivative financial instruments.

(25) COMMITMENTS AND CONTINGENCIES

Oklahoma Lead Litigation

Gold Fields Mining, LLC ("Gold Fields"), one of the Company's subsidiaries, is a dormant, non-coal producing entity that was previously managed and owned by Hanson PLC, a predecessor owner of the Company. In the February 1997 spin-off of its energy businesses, 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. The Company has agreed to indemnify a former affiliate of Gold Fields for certain claims.

Gold Fields and two other companies are defendants in two class action lawsuits filed in the U.S. District Court for the Northern District of Oklahoma (Betty Jean Cole, et al. v. Asarco Inc., et al. and Darlene Evans, et al. v. Asarco Inc., et al.). The plaintiffs have asserted claims predicated on allegations of intentional lead exposure by the defendants and are seeking compensatory damages for diminution of property value, punitive damages and the implementation of medical monitoring and relocation programs for the affected individuals. 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 1.5% of the total amount of the ore mined in the county.

Gold Fields is also a defendant, along with other companies, in several personal injury lawsuits involving over 50 children, pending in the U.S. District Court for the Northern District of Oklahoma, arising out of the same lead mill operations. Plaintiffs in these actions are seeking compensatory and punitive damages for alleged personal injuries from lead exposure. Previously scheduled trials for some of these plaintiffs have been postponed.

In December 2003, the Quapaw Indian tribe and certain Quapaw land owners filed a class action lawsuit against Gold Fields and five other companies in the U.S. District Court for the Northern District of Oklahoma. The plaintiffs are seeking compensatory and punitive damages based on a variety of theories. 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.

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 potential loss cannot be estimated. However, the Company believes this matter is likely to be resolved without a material adverse effect on the Company's financial condition, results of operations or cash flows.

Navajo Nation

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. On March 4, 2003, the U.S. Supreme Court issued a ruling in a companion lawsuit involving the Navajo Nation and the United States rejecting the Navajo Nation's allegation that the United States breached its trust responsibilities to the Tribe in approving the coal lease amendments.

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 customers purchasing coal from the Black Mesa and Kayenta mines are in mediation with respect to this litigation and other business issues.

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

The Future of the Mohave Generating Station and Black Mesa Mine

The Company had been supplying coal to the Mohave Generating Station pursuant to a long-term coal supply agreement through its Black Mesa Mine. The mine suspended its operations on December 31, 2005, and the coal supply agreement expired on that date. As a part of the alternate dispute resolution referenced in the Navajo Nation litigation, Peabody Western has been participating in mediation with the owners of the Mohave Generating Station and the Navajo Generating Station and the two tribes to resolve the complex issues surrounding groundwater and other disputes involving the two generating stations. Resolution of these issues is critical to the operation of the Mohave Generating Station after December 31, 2005. There is no assurance that these issues will be resolved. The Mohave plant was the sole customer of the Black Mesa Mine, which sold 4.6 million tons of coal in 2005. During 2005, the mine generated $29.8 million of Adjusted EBITDA (reconciled to its most comparable measure under generally accepted accounting principles in Note 27), which represented 3.4% of the Company's total Adjusted EBITDA of $870.4 million.

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 $74.2 million and $68.6 million included in "Investments and other assets" in the consolidated balance sheets at December 31, 2005, and December 31, 2004, respectively.

The outcome of litigation is subject to numerous uncertainties. Based on the Company's evaluation of the issues and their potential impact, the amount of any potential loss cannot be estimated. However, 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.

West Virginia Flooding Litigation

Three of the Company's subsidiaries have been named in six separate complaints filed in Boone, Kanawha, Wyoming, and McDowell Counties, West Virginia seeking compensation for property damage and personal injury arising out of flooding that occurred in southern West Virginia during heavy rainstorms in July of 2001. These cases, along with approximately 50 similar cases not involving the Company's subsidiaries, include approximately 3,500 plaintiffs and 77 defendants engaged in the extraction of natural resources. Plaintiffs have alleged that timbering, mining and disturbances of surface land by the defendants in the extraction of natural resources caused natural surface waters to be diverted in unnatural ways, thereby resulting in flooding which would not have occurred absent the defendants' use and disturbance of surface lands.

These cases have been consolidated pursuant to the Court's Mass Litigation Rules. The Mass Litigation Panel has ordered that the cases be tried based upon the six geographic watersheds in which the flooding occurred. The first such trial is scheduled for early March 2006; however, the Company's subsidiaries held no active mining permits in the geographic area which is the focus of the first trial. Trials involving two additional watersheds are scheduled for the second half of 2006. No trials are scheduled for the remaining three watersheds. Certain of the Company's defendant subsidiaries did hold multiple active permits in the five remaining geographic watersheds. The Company's insurance carrier has acknowledged the Company's tender of these claims and is currently providing a defense under applicable policies of insurance.

While the outcome of litigation is subject to uncertainties, based on the Company's preliminary evaluation of the issues and the potential impact on it, the Company believes this matter ultimately will be resolved without a material adverse effect on its financial condition, results of operations or cash flows.

Citizens Power

In connection with the August 2000 sale of the Company's former subsidiary, Citizens Power, the Company has indemnified the buyer, Edison Mission Energy, from certain losses resulting from specified power contracts and guarantees. During the period that the Company owned Citizens Power, Citizens Power guaranteed the obligations of two affiliates to make payments to third parties for power delivered under fixed-priced power sales agreements with terms that extend through 2008. Edison Mission Energy has stated and the Company believes there will be sufficient cash flow to pay the power suppliers, assuming timely payment by the power purchasers. In 2004, the Company incurred costs related to restructuring one of the indemnified power purchase agreements of $2.8 million, net of a tax benefit of $1.9 million. These amounts are classified within discontinued operations in the statement of operations.

Environmental

The Company is subject to federal, state and local environmental laws and regulations, including the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended ("CERCLA" or "Superfund"), the Superfund Amendments and Reauthorization Act of 1986, the Clean Air Act, the Clean Water Act and the Conservation and Recovery Act. Superfund and similar state laws create liability for investigation and remediation in response to releases of hazardous substances in the environment and for damages to natural resources. Under that legislation and many state Superfund statutes, joint and several liability may be imposed on waste generators, site owners and operators and others regardless of fault. These regulations could require the Company to do some or all of the following:

- remove or mitigate the effects on the environment at various sites from the disposal or release of certain substances;
- perform remediation work at such sites; and
- pay damages for loss of use and non-use values.

Environmental claims have been asserted against Gold Fields related to activities of Gold Fields or its former affiliates. Gold Fields is a dormant, non-coal producing entity that was previously managed and owned by Hanson PLC, a predecessor owner of the Company. The Company has been named a potentially responsible party ("PRP") based on CERCLA at five sites, and claims have been asserted at 17 other sites. 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 Company's estimated share of responsibility.

The Company's policy is to accrue environmental cleanup-related costs of a non-capital nature when those costs are believed to be probable and can be reasonably estimated. The quantification of environmental exposures requires an assessment of many factors, including the nature and extent of contamination, the timing, extent and method of the remedial action, changing laws and regulations, advancements in environmental technologies, the quality of information available related to specific sites, the assessment stage of each site investigation, preliminary findings and the length of time involved in remediation or settlement. The Company also assesses the financial capability and proportional share of costs of other PRPs and, where allegations are based on tentative findings, the reasonableness of the Company's apportionment. The Company has not anticipated any recoveries from insurance carriers in the estimation of liabilities recorded in its consolidated balance sheets. Undiscounted liabilities for environmental cleanup-related costs for all of the sites noted above totaled $42.5 million at December 31, 2005, and $40.5 million at December 31, 2004, $23.6 million and $15.1 million of which was 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 historic mining sites. Gold Fields has participated in the ongoing settlement discussions. 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 1.5% of the total amount of the ore mined in the county. Gold Fields believes it has meritorious defenses to these claims. Gold Fields is involved in other litigation in the Picher area, and the Company has agreed to indemnify one of the defendants in this litigation as 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.

Although waste substances generated by coal mining and processing are generally not regarded as hazardous substances for the purposes of Superfund and similar legislation, some products used by coal companies in operations, such as chemicals, and the disposal of these products are governed by the statute. Thus, coal mines currently or previously owned or operated by the Company, and sites to which the Company has sent waste materials, may be subject to liability under Superfund and similar state laws.

Other

In addition, the Company at times becomes a party to other claims, lawsuits, arbitration proceedings and administrative procedures in the ordinary course of business. Management believes that the ultimate resolution of pending or threatened proceedings will not have a material effect on the financial position, results of operations or liquidity of the Company.

Accounts receivable in the consolidated balance sheets as of December 31, 2005, and December 31, 2004, included $9.9 million and $18.1 million, respectively, of receivables billed between 2001 and 2005 related to legal fees incurred in the Company's defense of the Navajo lawsuit discussed above. The billings have been disputed by two customers, who withheld payment. The Company believes these billings were made properly under the coal supply agreements. The billings were consistent with past practice, when litigation costs related to legal or regulatory issues were billed under the contract and paid by the customer. One customer and the Company settled all claims for legal fees incurred to date as of December 31, 2005. The settlement did not have a material impact on the Company's results of operations for the year ended December 31, 2005. The Company is in litigation with a similar claim against the other customer to resolve this issue. In the second quarter of 2005, the trial court dismissed the Company's claim, and the Company has appealed that decision. Although the Company believes it has meritorious grounds for appeal, the Company recognized an allowance against the disputed receivable, which resulted in a charge of $9.9 million in 2005. The net receivable balance related to these claims, net of the allowance, was zero and $18.1 million at December 31, 2005, and December 31, 2004, respectively.

At December 31, 2005, purchase commitments for capital expenditures were approximately $138.5 million. Commitments for expenditures to be made under coal leases are reflected in Note 11.

(26) SUMMARY QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

A summary of the unaudited quarterly results of operations for the years ended December 31, 2005 and 2004, is presented below. Peabody Energy common stock is listed on the New York Stock Exchange under the symbol "BTU."

	Year Ended December 31, 2005			
(Dollars in thousands except per share and stock price data)	*First Quarter*	*Second Quarter*	*Third Quarter*	*Fourth Quarter*
Revenues	$1,077,480	$1,108,786	$1,223,510	$1,234,677
Operating profit	80,803	129,309	150,885	157,386
Net income	51,890	95,254	113,340	162,169
Basic earnings per share	$0.20	$0.36	$0.43	$0.62
Diluted earnings per share	$0.19	$0.36	$0.42	$0.60
Weighted-average shares used in calculating basic earnings per share	260,693,518	261,630,146	262,432,394	263,076,194
Weighted-average shares used in calculating diluted earnings per share	266,801,306	267,620,416	268,521,976	268,975,324
Stock price – high and low prices	$ 25.47-$18.38	$ 28.23-$19.68	$ 43.03-$26.01	$ 43.48-$35.22
Dividends per share	$0.0375	$0.0375	$0.0475	$0.0475

Operating profit for the first quarter of 2005 included the $31.1 million gain on the sale of PVR common units as discussed in Note 11 offset by $34.0 million of contract losses primarily related to a breach of a coal supply contract by a producer. Second quarter operating profit included $12.5 million of gains from property sales and a $12.5 million reduction of estimated contract losses recorded in the first quarter of 2005. Operating profit in the third quarter of 2005 included $43.6 million of gains resulting from exchanges of assets and an additional $6.7 million recovery of the contract losses recorded in the first quarter. Operating profit for the third quarter and fourth quarter of 2005 included charges related to long-term compensation plans of $18.6 million and $11.6 million, respectively. Net income for the fourth quarter of 2005 included the tax benefit realized from the deemed liquidation of a subsidiary as discussed in Note 13 partially offset by an increase in the valuation allowance on NOL carryforwards.

(Dollars in thousands except per share and stock price data)	Year Ended December 31, 2004 First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Revenues	$772,293	$916,771	$918,989	$1,023,529
Operating profit	38,723	51,827	73,905	82,243
Net income	22,580	41,481	43,437	67,889
Basic earnings per share	$0.10	$0.16	$0.17	$0.26
Diluted earnings per share	$0.10	$0.16	$0.17	$0.26
Weighted-average shares used in calculating basic earnings per share	223,152,504	255,855,800	257,114,348	258,607,704
Weighted-average shares used in calculating diluted earnings per share	228,619,396	261,753,044	263,116,128	264,903,612
Stock price – high and low prices	$ 12.65-$9.11	$ 14.01-$10.44	$ 15.11-$12.69	$ 21.70-$13.51
Dividends per share	$0.0313	$0.0313	$0.0313	$0.0375

Operating profit for the first quarter and fourth quarter of 2004 included the $9.9 million and $5.9 million, respectively, gains on the sale of PVR common units as discussed in Note 11. Operating profit for the third quarter and fourth quarter of 2004 included $9.5 million and $11.5 million, respectively, in business interruption insurance recoveries. Operating profit for the second quarter and fourth quarter of 2004 included charges related to long-term compensation plans of $6.6 million and $10.5 million, respectively. Net income for the second quarter and the fourth quarter of 2004 included a reduction in the valuation allowance on NOL carryforwards of $10.0 million and $18.0 million, respectively. The results of operations from the RAG Coal International AG acquisitions were included in the Company's consolidated results of operations from the effective date of the acquisitions, April 15, 2004.

(27) 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 reflect the aggregation of the Appalachia and 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, 2005, 87% of the Company's sales were to U.S. electricity generators, 4% were to the U.S. industrial sector, and 9% 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 majority of 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 primarily subbituminous and Eastern operations mine bituminous coal deposits. Australian Mining operations are characterized by surface and underground extraction processes, mining primarily low sulfur, metallurgical coal sold to an international customer base. 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, 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	$1,738,681	$598,085	$679,176	$16,924	$4,644,453
Adjusted EBITDA	459,039	374,628	202,582	43,058	(208,909)	870,398
Total assets	2,566,034	1,136,738	426,810	212,550	2,509,874	6,852,006
Additions to property, plant, equipment and mine development	113,047	88,320	85,335	–	97,602	384,304
Federal coal lease expenditures	118,364	–	–	–	–	118,364
Purchase of mining and related assets	84,695	34,988	–	–	21,512	141,195
Income from equity affiliates	14	9,718	–	–	20,364	30,096

Operating segment results for the year ended December 31, 2004 were as follows:

(Dollars in thousands)	Western U.S. Mining	Eastern U.S. Mining	Australian Mining	Trading and Brokerage	Corporate and Other	Consolidated
Revenues	$1,393,622	$1,501,352	$270,926	$454,537	$11,145	$3,631,582
Adjusted EBITDA	402,052	280,357	50,372	41,039	(214,576)	559,244
Total assets	2,435,152	1,170,570	343,155	121,306	2,108,409	6,178,592
Additions to property, plant, equipment and mine development	52,541	66,418	19,665	23	13,297	151,944
Federal coal lease expenditures	114,653	–	–	–	–	114,653
Income from equity affiliates	21	8,666	–	–	3,712	12,399

Operating segment results for the year ended December 31, 2003 were as follows:

(Dollars in thousands)	Western U.S. Mining	Eastern U.S. Mining	Australian Mining	Trading and Brokerage	Corporate and Other	Consolidated
Revenues	$1,221,994	$1,198,531	$29,435	$351,929	$13,407	$2,815,296
Adjusted EBITDA	356,898	198,964	2,225	45,828	(193,637)	410,278
Additions to property, plant, equipment and mine development	31,667	111,815	1,393	1,943	9,625	156,443
Income (loss) from equity affiliates	36	(1,678)	–	–	4,514	2,872

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

(Dollars in thousands)	Year Ended December 31, 2005	Year Ended December 31, 2004	Year Ended December 31, 2003
Total adjusted EBITDA	$870,398	$559,244	$410,278
Depreciation, depletion and amortization	316,114	270,159	234,336
Asset retirement obligation expense	35,901	42,387	31,156
Interest expense	102,939	96,793	98,540
Early debt extinguishment costs	–	1,751	53,513
Interest income	(10,641)	(4,917)	(4,086)
Income tax provision (benefit)	960	(26,437)	(47,708)
Minority interests	2,472	1,282	3,035
Income from continuing operations	$422,653	$178,226	$ 41,492

(28) SUPPLEMENTAL GUARANTOR/NON-GUARANTOR FINANCIAL INFORMATION

Supplemental guarantor/non-guarantor financial information can be located in Note 28 of the Company's consolidated financial statements filed as part of the 2005 Annual Report on Form 10-K with the U.S. Securities and Exchange Commission.

Board of Directors and Executives

DIRECTORS

Gregory H. Boyce (51) [3]
President and
Chief Executive Officer
Peabody Energy

B.R. "Bobby" Brown (73) [2]
Independent Director
Former Chairman, President
and Chief Executive Officer
CONSOL Energy Inc.

William A. Coley (62) [3]
Independent Director
President and Chief Executive
Officer British Energy Group plc

Irl F. Engelhardt (59) [3]
Chairman
Peabody Energy

Dr. Henry Givens, Jr. (72) [4]
Independent Director
President
Harris-Stowe State University

William E. James (60) [2]
Independent Director
Founding Partner
RockPort Capital Partners LLC

Robert B. Karn III (64) [1, 2]
Independent Director
Former Managing
Partner, Arthur Andersen
Financial & Consulting,
St. Louis

Henry E. Lentz (60) [3]
Independent Director
Advisory Director
Lehman Brothers Inc.

William C. Rusnack (61) [1, 3]
Independent Director
Former President and
Chief Executive Officer
Premcor Inc.

Dr. James R. Schlesinger (77) [4]
Independent Director
Former U.S. Secretary
of Energy, U.S. Secretary
of Defense & CIA Director

Dr. Blanche M. Touhill (74) [4]
Independent Director
Chancellor Emeritus
University of Missouri-
St. Louis

John F. Turner (63) [4]
Independent Director
Former U.S. Assistant Secretary
of State for Oceans and
International Environmental
and Scientific Affairs

Sandra A. Van Trease (45) [1]
Independent Director
Group President
BJC Healthcare

Alan H. Washkowitz (65) [4]
Independent Director
Former Managing Director
Lehman Brothers Inc.

[1] **Audit Committee**
William C. Rusnack, Chair
Robert B. Karn III
Sandra A. Van Trease

[2] **Compensation Committee**
Robert B. Karn III, Chair
B.R. Brown
William E. James

[3] **Executive Committee**
Gregory H. Boyce, Chair
William A. Coley
Irl F. Engelhardt
Henry E. Lentz
William C. Rusnack

[4] **Nominating & Corporate Governance Committee**
Dr. Blanche M. Touhill, Chair
Dr. Henry Givens, Jr.
Dr. James R. Schlesinger
John F. Turner
Alan H. Washkowitz

EXECUTIVES

Gregory H. Boyce (51)
President and
Chief Executive Officer

Charles A. Burggraf (51)
Group Vice President
Technical Services

Ian S. Craig (52)
Managing Director
Australian Operations

Sharon D. Fiehler (49)
Executive Vice President
Human Resources and
Administration

Richard A. Navarre (45)
Executive Vice President
and Chief Financial Officer

Jiri Nemec (49)
Group Vice President
U.S. Eastern Operations

Fredrick D. Palmer (61)
Senior Vice President
Government Relations

Roger B. Walcott, Jr. (49)
Executive Vice President
Resource Management and
Strategic Planning

Richard M. Whiting (51)
Executive Vice President
Sales, Marketing & Trading

Kemal Williamson (46)
Group Vice President
U.S. Western Operations