

Exhibit E

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Peabody Energy Q3 2007 Earnings Call Transcript

Executives

Vic Svec - IR

Rick Navarre - CFO and EVP of Corporate Development

Greg Boyce - Chairman and CEO

Analysts

Jim Rollyson - Raymond James

Sheneer Ghashuni - UBS

Paul Forward - Stifel Nicolaus

Brian Gamble - Simmons & Company

Jeremy Sussman - Natixis

David Connie - FBR

Lawrence Jawan - Lehman Brothers

Mark Liinamaa - Morgan Stanley

Michael Dudas - Bear Stearns

Justine Fisher - Goldman Sachs

Brett Levy - Jefferies & Company

Yuri Maslov - Nevsky Capital

Shneur Gershuni - UBS

Peabody Energy Corp ([BTU](#)) Q3 2007 Earnings Call November 6, 2007 11:00 AM ET

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Peabody Energy Quarterly Earnings Call. For the conference, all the participant lines are in a listen only mode, however, there will be an opportunity for your questions and instructions will be given at that time. (Operator Instructions). As a reminder, today's call is being recorded. I would now like to turn the conference over to Mr. Vic Svec. Please go ahead, sir.

Vic Svec

Okay, John and good morning everyone. Thanks for taking part in the conference call for the new BTU. Today CFO and Executive Vice President of Corporate Development, Rick Navarre, will review our results and our outlook. Chairman and CEO, Greg Boyce, will discuss the markets, as well as significant Peabody initiatives that we have underway.

As you know, we have completed the spin-off of Patriot Coal, which has been trading now for several weeks. Our actual results include Patriot's performance and we have offered information to help you determine our pro forma results, excluding Patriot. The same applies to our targets.

We can address questions regarding the effects of the spin-off on Peabody, but as Patriot is now independent, any questions regarding Patriot are more appropriately answered by their management, their filings, or their website.

Forward-looking statements should be considered along with the Risk Factors that we note at the end of our release as well as the MD&A section of our 10-K. We also refer you to peabodyenergy.com for additional information and I'll now turn the call over to Rick.

Rick Navarre

Thanks, Vic and good morning everyone. I'd like to also thank you for joining our earnings review today. This is an exciting time to be discussing Peabody's results and prospects.

Our U.S. mining operations delivered solid third quarter results with a 24% margin improvement over the prior year. In addition, the reshaping of our business portfolio is nearly complete with the recent spin-off of Patriot Coal, the major costs and productivity projects in the Powder River Basin and the new mines at Australia that are now in production.

These are achievements with both near-term and long-term benefits for Peabody and they happen at a time when global seaborne coal markets are setting new records and the U.S. market is steadily improving.

Most of the results I'll discuss today will include Patriot Coal. However, beginning next quarter and for the full year, Peabody's results will reflect the spin-off as a discontinued operation. You'll see our release also includes a pro forma presentation, i.e., without Patriot of our key financial statements on a year-to-date basis and our full year targets for Peabody's continuing operations. This should give you a sense for how the spin-off will affect Peabody's year-end results.

Now, let me begin with a high level review of the quarter's performance starting with the income statement. For the third quarter, Peabody achieved record revenues of \$1.49 billion, on record sales volume of 68.5 million tons. Our performance was driven by higher U.S. and Australia volumes and improved U.S. pricing. This more than offset lower realizations associated with met coal contracts that we signed last year and a significant change of product mix in Australia.

Our EBITDA for the quarter totaled \$211 million reflecting improved U.S. mining contributions, which was in turn offset by impacts of port congestion and currency in Australia that we advised you of in our last call.

Now, let me take you through the supplemental schedule for a more detailed review. For the quarter, our U.S. operations achieved higher prices throughout all areas, led by a 27% improvement in Powder River Basin realizations. And overall U.S. revenues grew 17% leading to a 24% expansion of U.S. margins over the prior year.

In the Midwest, we had price increases and stable costs, which drove third quarter Eastern margins more than 20% higher. In fact, 12 of 3 of our Midwestern operations that we are retaining realized improved prices.

In the West, this is the third quarter in a row of stable costs. Looking at the year-over-year results, you'll see that nearly one-third of the increase was from higher sales related taxes due to the price improvements that we discussed earlier. [Actually the] longwall move at Twenty Mile mine in Colorado and a higher than normal maintenance expense in the PRB, our third quarter costs in fact would have been lower than last quarter.

Additionally, our major investments in the Powder River Basin are beginning to pay off. For example, the productivity in our flagship North Antelope Rochelle mine improved 9% in the last quarter and we think there's a lot more to go. And we believe this is a start of a trend that is stable and improving western costs.

Turning now to the Australian operations, you'll see revenues were \$31 per ton lower due to both a change in mix toward

thermal coal products and an average \$22 per ton reduction of metpricing. We expect that we will fully regain the met margin in the upcoming market settlements, and Greg will talk more about the strength of the markets in a moment.

Also last quarter, we advised you that significant demurrage, transportation and currency effects were expected to heavily impact our third quarter results. In fact, combined, they reduced our EBITDA by \$57 million or more than \$9 per ton in the quarter. And it was largely because of the variability of these items that we didn't give you third quarter targets with our focus remaining on full year results and expectations for a stronger fourth quarter.

While Australia's coal chain has improved since June's peak congestion, the company is pursuing proactive ways to increase our export capabilities. Peabody has joined with other coal suppliers to evaluate a new terminal next to the Port of Newcastle. The NCIG project would initially add 30 million tons of throughput capacity with 5 million metric tons of dedicated throughput for Peabody in the near time frame of around 2010.

This capacity will supplement the existing allocation from the current PWCS Newcastle Port and should enable us to fully utilize our installed production capacity. In addition, we recently put in our nomination for volumes through Abbot Point as part of the Northern Missing Link development project in Queensland.

Now, let me focus your attention on the pro forma results excluding Patriot. I would note that the pro forma information is not intended to track our 10-Q filing that is due later this month or to be representative of Patriot's future results.

Let me first focus on the balance sheet and draw your attention to the pro forma income statement, where the year-to-date revenues and EBITDA from continuing operations were a full 12% and 8% higher compared to the prior year period.

And looking at the pro forma balance sheet, you'll see significantly lower legacy liabilities as a result of the spin-off. Our retiree, healthcare liability and related expense will be reduced by about 40%. Workers compensation liability will be cut nearly 90% and asset retirement obligations will be one-third lower and the combined fund and multi-employer co-act obligations will now fully reside with Patriot. In total, our legacy liabilities, expenses and cash flows will be nearly cut in half.

The spin-off marks the completion of a major strategic initiative for Peabody. Our portfolio was now comprised of assets with longer average lives, we have reduced our operating risk and cost profile, we've lowered our per ton capital costs, we've cut our legacy liabilities and related uncertainties, and we've given the company a greater focus on high growth, high margin opportunities. And Peabody is extremely well positioned now to benefit in the robust international markets as well as the strong U.S. dynamics.

Let me wrap up with Peabody's 2007 expectations. Here we continue to maintain our full year 2007 targets excluding the discontinued operations associated with Patriot Coal and expected one-time charge that's related to the spin-off.

Our full year EBITDA from continuing operations is targeted in the range of \$900 million to \$1 billion, with earnings per share of \$1.50 to 1.75. You'll note we are also tightening the range as we approach year-end.

So, in conclusion, the results for the quarter were as expected. We are closely monitoring the Australian coal chain and taking action to improve our long-term position. Our new Australian mines that were in development are now online. The benefits of significant cost and productivity projects completed over the last 12 months are beginning to deliver very promising results. And we are excited that the pieces of our plan are coming together just as the coal markets around the globe gain momentum, positioning Peabody very well as we move into 2008.

And I'll now turn the call over to our Chairman and Chief Executive Officer, Greg Boyce. Greg?

Greg Boyce

Good morning, everyone and thanks, Rick. As Rick has reviewed our quarter's solid performance and expectations for the remainder of 2007, I'd like to focus on the factors that are driving greater coal demand and increasing prices, as well as the steps we've taken to convert favorable markets into shareholder value.

Let's start with the international picture. Three sustained trends are leading the world to use more coal. First, massive economic development by the world's largest population centers; second, persistently high and rising oil prices, and most importantly, coal's low costs and security of supply.

Now regarding the C1 thermal coal market specifically, China's net importer status has sent Asian utilities to sources as far away as South Africa. India now imports 25 million tons of thermal coal per year, yet a third of its plants have stockpiles of one week or less. Therefore, India plans to at least triple its thermal coal imports again over the next five years. Japan is raising its coal use as it struggles with nuclear safety issues and the high cost of LNG.

The traditional exporters, Indonesia, Russia and South Africa are keeping more coal at home to serve their domestic needs. So, Europe must now look to the West for supplies and we believe South American coals will increasingly be diverted to Europe from the East Coast, at the same time that U.S. exports are rising.

The metallurgical coal is equally as tight. Steel demand continues to grow from new infrastructure and developing countries and to rebuild legacy infrastructure in the developed world. Russia's limiting its metallurgical coal exports and planned new capacity for Mozambique and Mongolia is longer term in nature.

Australia is the world's largest coal exporting nation, and the port and rail system continues to struggle limiting throughput of both thermal and coking coal, it's at the same time the prices for both products are setting records around the world. Newcastle thermal coal, for example, that was selling for \$46 per metric ton a year ago has moved past \$80. Metallurgical coal that was settled for \$98 per ton this year has been sold recently on a spot basis for \$140.

Such a level or higher for the new contracting season would have precedent. In fact, taking the \$125 per ton metallurgical coal prices of two years ago would come in at more than \$150 per ton today, simply adjusting for the stronger Australian dollar. It's in these robust markets Peabody is pleased to begin contract discussions for 2008 thermal and coking coal deliveries.

You'll recall Peabody has 11 to 13 million tons of Australian coal available for pricing for calendar 2008, which would benefit results in the second through fourth quarters of next year.

This market strength is very timely given Peabody's decision to expand Australian capacity. We produced just 6 million tons from Australia several years ago and now we're moving to 30 million tons or more over the next several years and as Rick said, securing more port capacity for the future. Now, this global strength is one of several factors that leads to U.S. market improvements.

European generators are beginning to compete with U.S. plants for coal from the Midwest and Appalachia. We believe the strong global coal demand and weak dollar are increasing U.S. exports by some 35% in the second half over the first half of this year. You factor in the reduced imports and we could see a near tripling in U.S. net coal exports over a two-year period, drawing from around 13 million tons in 2006 to 35 to 40 million tons in 2008.

In fact, we've secured more than a million tons of Illinois basin coal sales into the Gulf export market over the past year, and as the U.S. net export advantage builds, we expect a greater pull on PRB and Colorado coal fields as has occurred in the past. Already we're seeing forward published prices for PRB coal as much as two-thirds higher for 2009 than spot sales for immediate deliveries were at the beginning of this year.

This comes at a time when the strong fall generation has added to good growth in coal consumption in 2007. So in short, we see the potential for substantial continued reductions in coal inventories through 2008.

Now, against this backdrop of U.S. market strength, we're pleased to have increased our premium PRB product contract prices, 45% for forward years over realized 2006 pricing. We've signed Illinois basin contracts at levels 21% above 2006 average realized pricing.

Peabody still has 15 to 20 million tons of U.S. coal available for pricing for 2008 and 80 to 90 million tons for 2009. We've finished two of three major projects in the Powder River Basin to secure our role there as the low-cost producer. And we'll start our El Segundo mine in New Mexico in the second half of 2008.

Now, you'll hear some other producers talk of having 4 or 5 million tons of seaborne coal sales exposure, but no U.S. based company comes close to our position. Adjusting for the spin, Peabody expects to ship nearly 30 million tons of seaborne coal this year from Australia, Venezuela, the U.S. and through our global trading platform. And we expect these sales will be re-priced at higher levels beginning next April.

Now, the near-term markets are strong and improving, and longer term we continue to see the largest new coal build-out in both the global and U.S. markets in several decades. The U.S. now has 45 coal units in 21 states that are new, under construction or in late stage development.

One such plant is the Prairie State Energy Campus, and I'm pleased to say that in the recent months Peabody has completed its financial close, we gave notice to Bechtel to proceed with construction and have broken ground on the plan. I'm also pleased to report that we continue to advance our coal-to-gas project with ConocoPhillips.

So let me summarize. We've discussed for some time the major actions that we are under way to transform our portfolio. We're now positioned to deliver improved results from these activities. If you consider that in little more than a year, we've made a major acquisition in Australia and completed three new mines there. We've moved to the final stages of three major projects in the Powder River Basin aimed at lowering cost and boosting productivity. We concluded the spinoff of our operations in West Virginia and Kentucky. We expanded our coal trading activities in the US, London, Australia and Beijing. We've advanced Business Development activities in China, Mongolia, and other high growth regions, broken ground on Prairie State and advanced the development of the coal-to-gas project.

Simply put, we have dramatically reshaped our portfolio to tire at the highest growth Markets at a time of record coal demand and prices.

As always, I want to thank Peabody employees around the globe for their hard work and accomplishments and we also appreciate your support and we would be happy to take your questions at this time.

Question-and-Answer Session

Operator

(Operator Instructions) And we will go to Jim Rollyson with Raymond James. Please go ahead.

Jim Rollyson -Raymond James

Good morning, everyone. Sorry about that.

Greg Boyce

Good morning, Jim.

Jim Rollyson -Raymond James

Greg, you mentioned the Australian pricing really for both markets, but specifically let's talk about thermal coal being north of 80 bucks a metric ton at Newcastle. You guys have 11 million to 13 million tons still open for next year in total. When do you suspect you might start locking some of that up?

Greg Boyce

Well, that's obviously a good question, Jim, and discussions are starting on both thermal and met-coal. But as you can imagine, that process may take a little longer than normal, only because of the price increases that are anticipated. Realistically, if history is any guide, we'll take through the end of the year, likely we'll see some settlements before the end of the year, although some will also carry over into the first quarter of next year.

Jim Rollyson -Raymond James

And you think those discussions will be just for '08 or anything on '09 as well?

Greg Boyce

The vast majority of it would be for '08. I mean, it would be for the fiscal year, Japan fiscal year which is the last three quarters of '08 and the first quarter of '09 would be the vast majority of what would be contracted for over the course of the next three or four months.

Jim Rollyson -Raymond James

Understood, and then just for a follow-up, staying with Australia; you kind of detailed some of the issues that hit

profitability or cost with the merge, and currency translations, etcetera. Can you maybe detail how you see your cost curve kind of heading out into next year as you start bringing on production from your mine portfolio changes?

Greg Boyce

Well, sure. I mean, in general, at the high level our cost structure in Australia is coming down. If you'll go back a number of years ago, we had the North Goonyella operation and the surface operations at Burton and Eagle Field. With our recent acquisition and new mines, we now have a large surface operation at Millennium, Wilpinjong. We've expanded Wambo and also installed and started up a lower cost longwall mine at North Wambo. So, the entire mix of our productive capacity in Australia has been increases in lower cost production.

Jim Rollyson - Raymond James

Thanks.

Operator

And next, we'll go to the line of [Sheneer Ghashuni] with UBS. Please go ahead.

Sheneer Ghashuni - UBS

Hi, good morning.

Rick Navarre

Good morning.

Sheneer Ghashuni - UBS

Just a couple quick questions; one, I was wondering if you can reconcile with your guidance a little bit with respect to the income tax benefit that you expect to achieve on a full year basis. Are we talking about over \$100 million benefit just in the fourth quarter alone and kind of how that comes about?

Greg Boyce

Sure. We talked about this in the past. I think if you followed us, you'll know that we usually have a benefit in the fourth quarter and to try to just give you kind of an abbreviated discussion of what happened. Essentially during the year we book taxes on an interim basis, based upon a normalized tax rate and then when we get to our budget cycle in the fourth quarter and look at our forward-looking earnings, based upon our projections, we would expect to fully utilize our net operating losses which are tax assets.

Some time ago when these tax assets were established back in the '90s on our balance sheet, there was a full valuation allowance established against them and these tax assets were on our books for zero. So, as we look a bit forward at our five year plan and see profitability and taxability, we have clarity enough to then release the valuation allowance and we kind of said at the very beginning of the year that we thought this tax benefit would occur for the full year. We thought, it's been in our guidance in the very beginning and so this should be the last year of this type of transaction as it relates to the tax and then we should go to more of a 15% standard tax rate going forward into '08 and then ramping up into the 20% to 25% range over the next five years.

Sheneer Ghashuni - UBS

Okay, and if we can continue on, you know, looking at your guidance and subtracting out Patriot and so fourth, it kind of looks like you're looking for a reversal of what occurred in Australia this quarter. Can you sort of give us a little bit of color on what the items are going to change that's going to fix the cost structure and the price realizations in the fourth quarter with respect to the Australian operation?

Greg Boyce

Well, in Australia obviously we're still going to continue to incur higher demerger charges, and obviously we said we signaled that early on when we had our last call, we expected about which \$80 million in demerger cost and we said 50 of it was going to occur in the second half. Some of that got pushed out of the third into the fourth quarter, so it still has an impact on us. But we're starting to ramp up the operations at Waambo, the new longwall just started so we're going to see higher volumes come out of that particular property. You are going to see an increase in volumes coming out of Wilpinjongas those properties begin to ramp up as well as Millennium too. So, we're seeing higher volumes and that's going to help as we move forward.

Sheneer Ghashuni -UBS

And then one last final question. You talked about the port congestion issues and what you're doing to mitigate the issues. Can you talk a little bit about rail congestion in Australia as well too and will that beat the next bottleneck that we have to deal with on a go forward basis?

Greg Boyce

Yes, just to cover the rail for a second you're absolutely right. There's a combination of coal chain capacity in Australia, whether it's Newcastle through Dalrymple Bay in Queensland. So, it is a combined effect of what the port side capacity is along with the rail capacity. In the case of Dalrymple Bay, the Queensland rail is adding rolling stock coal wagons. They've added some in the fourth quarter of this year and they've got plans to -- as they take deliveries, continue to add through three quarters of next year to significantly increase their capabilities of turning around coal to the port. That's all-time to be in place when the port completes some of its expansions during the course of next year.

So, we expect Dalrymple Bay capacities and the coal chain capacities in Newcastle to continue to increase through '08 into '09 and then ultimately, as we look to the northern missing link in 2010 and beyond to add additional capacity for met-coal.

Out of Newcastle, again, the port has been running reasonably well. It's been rail issues. Again, there's a significant program for track upgrading, additional horsepower, additional people, similar to the types of programs that we went through several years ago out in the western part of the US, when we were building rail capacity there. So, again, during the course of next year, we expect to see some improvement and then into '09 and then ultimately as Rick talked about, by the time you get to 2010, potentially see the impacts over the Newport of Newcastle Coal Infrastructure Group, which we're a part of.

Sheneer Ghashuni -UBS

Great. Thank you very much.

Operator

Our next question is from the line of Paul Forward with Stifel Nicolaus. Please go ahead.

Paul Forward - Stifel Nicolaus

Thanks. Just a couple questions here. What's your latest thinking on both timing and cost and maybe size of the School Creek project?

Greg Boyce

Well, Paul, in terms of School Creek, we continue to look at what's the best size, timing and cost relative to the market. We've actually been very successful in our productivity improvements at North Antelope Rochelle and that Caballo in Rawhide; frankly beyond our original expectations. This has given us an option for some additional tons there in the near term that's allowed us to, if you will, rethink the timing of School Creek. We don't have a specific timing that we've put out to the market at this point, suffice it to say, it will not be starting up in a major way in 2008 or 2009.

Now, having said that, we do have a [load-out] facility at School Creek that we are looking at potentially sending some of our coal from the North Antelope Rochelle complex through that facility as that capacity becomes as available to us under our agreement with Arch.

Paul Forward - StifelNicolaus

Okay, and I guess just as maybe as far as the size of that project, is that still 30 million to 40 million tons or can you ramp it up when you eventually do start it up, do you start it up at a smaller pace?

Greg Boyce

We would start up at a smaller pace and ramp it up overtime. The existing infrastructure there is capable of 25 plus million tons. So, we've got the ability to bring on and add mining equipment at a lower rate, use that facility that's already in place, add mining equipment until we get up to that capacity and it would only be until we needed to get above that upper 20 number where we would have to begin to add capital for additional infrastructure.

Paul Forward - StifelNicolaus

Okay, thanks and on this coal-to-gas project with ConocoPhillips, just wondering if you had -- is there a number you keep in mind as far as dollars per MCF of natural gas production that you think that cost would be all in?

Greg Boyce

Well, obviously, we would like to continue to look at that plant and hope that those numbers are around that \$6 range. We're also continuing to do engineering to see what the cost of the carbon capture and sequestration that would also need to go into that factor. But suffice to say, our view currently is that we'll be able to bring that plant online with significant margin above and beyond gas forecast prices going forward, certainly when you look at the five year strip as it exists today.

Paul Forward - StifelNicolaus

Great. Thanks a lot.

Operator

Next we'll go to the line of [Brian Gamble] with Simmons & Company. Please go ahead.

Brian Gamble - Simmons & Company

Yes, good morning, guys.

Greg Boyce

Good morning.

Rick Navarre

Good morning.

Brian Gamble - Simmons & Company

You mentioned your exposure to the seaborne market, you talked about a 30 million ton number. I was wondering if you could break that out by market and then possibly talk about incremental opportunities that you have and the capacity for getting that coal out via the various markets that you currently export from?

Greg Boyce

I think you really have to focus first, Brian, on what's happening in Australia, and that's where the lion's share of that volume is going to come from initially. As you look at it, obviously we're still trying to decide and working with both of the ports to figure out what the allocation is next year for total capacity. So, we don't really have firm handle on exactly what that number is going to be but we certainly think it's in the 20 plus million range around that number, around 20 million

tons.

As far as incremental opportunities there, obviously we'll have to be pretty smart about how we allocate our shipments and our production to try to get the highest margin product out of a constrained situation over the next 18 to 24 months as they continue to fix that situation. And obviously we do trading as well out of those regions that we ship coal out, and then in Venezuela we continue to have an ownership there. I think of about 7 million ton coal mine and that will move on into the export market and most of that product will probably go into Europe.

Brian Gamble - Simmons & Company

Were you trying to imply you could financially do any coal out of the western US towards China or that direction or was that not part of what you would --

Greg Boyce

No, I think what we're saying is that we've seen exports, obviously significant export capacity out of the [cap and nap] regions. We've also personally shipped coal from Colorado in the Illinois basin on an export basis which is really starting to put a big pull on the market and we think that coupled with what's happening in the east, you're going to see a significant net increase in the export market in the US, which is going to pull in all of the other regions tighter.

Brian Gamble - Simmons & Company

Then looking at the potential to add port capacity in Australia and your talking around a 5 million ton number coming online in 2010. Is that the only option you have on that particular port or if you wanted to secure another 5 million on top of that, could you potentially layer that into contracting and/or negotiations that are ongoing?

Rick Navarre

Well, there's a couple of opportunities there. There's the turn used expansion of PWCS which is the Newcastle port, as it comes online it will provide additional tonnage capabilities as that expansion gets built. The NCIG is a new project, that is dedicated user facility, demerger neutral, stockpiles on hand and should be at much lower cost which relates to demerger that Peabody is the second largest owner, shareholder. So that's where we would get that 5 million tons of capacity, and the plans today are to start that facility up at about 30 million tons of capacity but there are certainly other plans to take it to 60 if need be, over time. So, there are other opportunities for us.

Brian Gamble - Simmons & Company

How quickly could it go to 60? Would that be 2012?

Greg Boyce

I think it would be dependent upon demand how quickly people want to bring that on, I think you'd see that's probably some time, I'd have to guess now three to four years after the 2010 time frame if the demand was there. It's all going to depend on how quickly PWCS is able to achieve their expansion which is the current existing facility.

Brian Gamble - Simmons & Company

Fair enough. Thank you very much.

Operator

And next we'll go to the line of Jeremy Sussman with Natixis. Please go ahead.

Jeremy Sussman - Natixis

Hi, good morning.

Greg Boyce

Good morning Jeremy.

Jeremy Sussman - Natixis

Good morning. Just regarding the Illinois Basin, you mentioned that you had exported a million tons so far year-to-date. Given the rise in API to pricing in Europe, any plans to increase that number in '08 or 2009?

Greg Boyce

Part of our trading platform expansion was opening our trading office in London earlier in the year. They've got a significant charge right now of continuing to look at ways to expand our Illinois export business into Europe as well as coupling our Colorado operations and tonnage into that export market as well. So, our view is the Markets will stay strong, continue to strengthen, Europe will be looking for coal and so we see that expanding through the course of the next several years.

Jeremy Sussman - Natixis

Great. And then when I'm taking a look at your pro forma costs, basically getting to a cross-decrease on a per ton basis, somewhere between \$2.50 and \$3 with spinning off some of your higher cost production; how much of an effect does something like the reduced legacy liabilities have on a number like that?

Rick Navarre

Well, it certainly has an impact on it. I guess in total, I think we probably have given these numbers out before, we're reducing our overall legacy liabilities roughly \$1 billion, and reducing our expense and cash spending in the neighborhood of \$100 million as well.

Jeremy Sussman - Natixis

Okay. Great. Thank you very much.

Operator

Our next question is from [David Connie] with FBR. Please go ahead.

David Connie - FBR

Jeremy took one of my questions here, but how much is the hundred million that's cash on the legacy liabilities pro forma '07 is that the accruals as well?

Rick Navarre

Yeah. They're pretty closely match, expense and casual match pretty closely.

David Connie - FBR

How much steam coal is expected to stay within Australia for next year '08, '09, '10?

Rick Navarre

Out of our operations, we would be just a little bit over 5 million tons.

David Connie - FBR

Okay, a little over 5 million tons per year?

Rick Navarre

Yeah. It's under our long term contract we have with the domestic Power Plant.

David Connie - FBR

And then I'm going to break the rule here, but how much coal did you actually export out of Colorado, because that's a pretty interesting data point.

Rick Navarre

Well, right now we've put together -- we're talking about tens of thousands of tons of export coal that we've coupled into our exports with the Midwest that we have shipped to date. That number is starting to increase in terms of additional shipments going forward.

Greg Boyce

We think there's more opportunities there because of its low sulfur characteristics and it gets a premium into the European market.

David Connie - FBR

Are you saying you're blending it with some of your Midwest stuff to ship it abroad?

Greg Boyce

Yes.

Rick Navarre

Exactly.

Greg Boyce

That's typically what we would do. We would put together several sources for these cargos.

David Connie - FBR

Do you think you could do a substantial amount? Is there enough rail capacity to do that?

Rick Navarre

Well, they're performing quite well right now. So, we haven't found with what we've done to date that the rails have been a limiting factor, so and out of Colorado, we don't expect the rails would be a limiting factor given our -- we could achieve our productive capacity at 20 mile through both domestic and export.

Greg Boyce

And the export business for the rails is all incremental business. So they're pretty keen to try to take that business if they can get it.

David Connie - FBR

Great. Thanks.

Operator

And our next question is from Lawrence Javan with Lehman Brothers.

Lawrence Jawan - Lehman Brothers

Good morning. Just moving back to Australia, can you talk a bit about your hedges in place regarding the Australian dollar? I'm just trying to get a sense for operating expenses next year.

Rick Navarre

Sure, sure. Obviously, the Australian dollar and the U.S. dollar have been at odds this year with an increase of over 20% probably since last year. For this year, we're pretty well hedged out at about probably 85% hedge for the rest of the year, so just not a lot of exposure for the rest of the year here, but roughly about 78 to 79% hedge into 2008 at a rate that's probably high 78, 79 range. So in today's rate it's 93.

Lawrence Jawan - Lehman Brothers

Now, if you quoted 57 million I believe of impacts in the quarter -- EBITDA impacts related to demurrage, transportation, and FX. If I strip that out, I get to roughly a \$40 per ton cost in Australia. Is that what you guys are striving for and should we see a sequential decline from the \$49 --

Rick Navarre

Yeah, that's what we think. Even our total cost, you should see a low \$40-ish number and you're exactly right. If you take out the \$9 of higher currency, you should see that number come down. But remember that the currency is going to be in next year as long as rates stay up where they are today, so we may have it hedged. We just, it's versus what we had forecasted at the beginning of the year when rates were in the high 70s. So, you got to be a little careful with the currency because it will still be there next year unless you know better than I do that currency is coming down, but I don't predict it's going to come down from much from where it's at right now.

Lawrence Jawan - Lehman Brothers

Okay, and then lastly just on your leverage levels, you're roughly three times levered as I calculated pro forma today, can you give us a sense for what peak leverage levels you're comfortable operating in? And how that potential acquisition might impact?

Rick Navarre

Well, I think we've always said with our long-term contract position and portfolio we're obviously comfortable with the levels that we're at now and we could go higher if we chose to do so, but we don't think it's the right thing to do right now. We're not looking to do that but we think that the optimum level from a cost of capital standpoint for the management of the business is somewhere around 40%, the low 40s, debt to total capital. So, that's what we're shooting for.

And we think next year, you'll find us with a lower capital profile than we had this year; one, we won't have Patriot; and two, as we talked earlier, a significant number of projects were completed this year including the Australian new mine developments, three big projects in the Powder River Basin, so we'll get back to a sustaining CapEx level with a few smaller projects and you should see our CapEx come down.

Lawrence Jawan - Lehman Brothers

Thanks very much.

Operator

And your next question is from Mark Liinamaa with Morgan Stanley. Please go ahead.

Mark Liinamaa - Morgan Stanley

Hi, guys.

Greg Boyce

Hi, Mark.

Mark Liinamaa -Morgan Stanley

I'd be interested in any update you could provide on PRB growth opportunities in the Eastern markets, as those markets are tightening up?

Greg Boyce

Well, I think history has shown us that the Powder River Basin coals have the ability to extend all the way into the Eastern Markets. It's not an issue of burnability anymore, and as we said in our comments, while the export market is as strong as it is today and then our view is it will continue, we're seeing exports from Columbia, Venezuela diverted out of the U.S. and we're seeing additional exports out of the U.S. And we're also seeing thermal coal that was available a year ago in the U.S. being washed and produced as a met coal, because of the strength of the met coal markets.

All of that says that the Powder River Basin is going to have to move further to the east to replace all of these coals that are no longer available for the Eastern utilities. So, what that volume is we haven't put a number on it yet, but suffice it to say, we don't believe there's a rail limitation and we don't believe that there's burnability limitations to the PRB coals getting pulled into the Eastern market.

Mark Liinamaa -Morgan Stanley

Great. Thanks, and with the issue of the mine permits, could you give any update, do you have any issues and are you seeing change with the fairly rapid price improvement in evolution of the export opportunities in production plans in the Eastern United States?

Greg Boyce

Well, of course, where we sit right now, with the new BTU, we don't have any Eastern permits that we're trying to obtain, and we're fully permitted everywhere else within our operating platform in the Midwest and in the West and Australia. There's been some talk about additional volumes over the course of 2008 and 2009 in the East. I guess, I would just say we'll count those chickens when they hatch, but we do not have any issues at this point within our portfolio on any permitting.

Mark Liinamaa -Morgan Stanley

And would you expect there to be some ratcheting back in Eastern production because of the various issues, even with the strengthening export opportunity?

Greg Boyce

Well, we've said all along, we think that the Appalachia Markets from a geologic perspective are in a long-term decline. Things are thinner, the geology is getting tougher. You've got safety regulations that are being very costly to implement. You've got the lack of synfuel credits that were supporting a significant piece of that business. You can go through that whole list which says while there are people that are going to try and potentially can add some additional capacity, the question we all have to ask ourselves is will it ever overcome the natural decline that we'll see in the East over a long period of time. Our view is not on a trend line -- and maybe on a quarter to quarter basis but not on a trend line.

Mark Liinamaa -Morgan Stanley

Great. Thanks very much.

Operator

And our next question is from Michael Dudas with Bear Stearns. Please go ahead.

Michael Dudas - Bear Stearns

Good morning, everyone.

Greg Boyce

Good morning.

Michael Dudas - BearStearns

A couple of things. One, can you talk about pace of acquisition or [lack thereof] in the U.S., now that you're out of the Appalachia region, do you sense that there could be some consolidation opportunities, especially maybe in the Illinois basin where there's been a little bit of overinvestment maybe in the last year or two? And internationally, would Peabody's strategy be a bit more on the greenfield basis or there are certain other parts of the world that you would look at cooperating companies? And is it a mix of -- rather it's a thermal or coking opportunity would suit Peabody better?

Rick Navarre

Well, Michael, this is Rick and I think that we continue to look at all of the opportunities that come in front of us. Obviously we're not going to be inquisitive in the Appalachian coal fields at this point in time. We are going to leave that to the other folks that are out there now. And that was part of our strategy with putting together the Patriot team and the Patriots spin-off, but as you look at the Illinois basin and other opportunities in the U.S.

We'll continue to be inquisitive at the right time for the right price, if it makes sense. We are not going to overpay for assets we don't have a history of doing that and so we'll continue to look for those types of opportunities, hopefully if we have synergies or contract synergies that makes sense for us.

In the international market, I think we're going to continue to look at the high growth Asian Markets. We're seeing seaborne coal. The last two years, seaborne coal has grown 100 million tons in the total market and it's on a compounded annual growth rate of 7% to 8%, much higher growth than we're seeing in the U.S. So we're going to continue to be inquisitive in the international markets, like Australia. If the right properties come along for the right price we'll continue to look there.

As we look at the developing countries, China, India, and other places, we are looking hard into China as to how to play that, whether it be through a greenfield or partnering with someone in more developed mine, mine expansion. Mongolia obviously will be greenfield if we move forward with that, and then we're looking at some areas in Mozambique as well. So, those are all greenfield opportunities that are going to serve high growth metallurgical coal markets into Asia and India. So you'll see us continuing to look at that and more to come.

Michael Dudas - BearStearns

And Latin America?

Rick Navarre

We look at it, certain areas we're interested in and certain areas we're not interested in --.

Michael Dudas - BearStearns

I'm sure I could figure out which are which.

Rick Navarre

Tough place to do business at times.

Greg Boyce

Yeah, obviously, we spend a lot of time looking at all of the options that are out there, but I think what Rick said is I think our track record is first class in terms of the acquisitions that we've made whether they've been in the U.S. or they've been international. And we do have a high focus right now on the higher growth markets. International and then of

course what we believe are the higher growth markets within the U.S.

We talked about we did acquire additional reserves in the Illinois Basin this past quarter, about 350 million tons and that was to fill in and to put together some large additional blocks of reserves that could be used either for new mining complexes for the utility market or for conversion sites for coal to gas or coal to liquids.

So, we're still very opportunistic when it comes to our acquisition strategy, but again, as Rick said, the Patriot initiative was to restructure our portfolio and to enable another company to go out and pursue the kinds of consolidations that make sense for them in their region in the East.

Michael Dudas - Bear Stearns

Just one follow-up, Greg. Continuing on your thoughts on conversion, where would you anticipate we have this discussion a year from now that either Peabody or the market opportunities will be there for a conversion technology? And will the political noise kind of impact that in 2008 and push things out further?

Greg Boyce

Yeah, well, there's no question that there is a lot of "political noise" out there, but, as we said on this conference call, oil is what, \$96, \$97 a barrel and if we had the conversation three months ago it would have been lower. I think the cases are so compelling for the use of coal for either natural gas or for liquids that even through all of the public discussions about how we do that, as long as in the industry we stay focused on what are the cost points that we can build these plants and put them into the market for and what is a reduced carbon path that we can take on building these plants, I think we're going to be successful. My sense a year from now and my hope is a year from now, we'll have a plant or two that's in final engineering design, ultimately leading to permitting and construction.

Michael Dudas - Bear Stearns

Thank you, gentlemen.

Operator

Our next question is from Justine Fisher from Goldman Sachs. Please go ahead.

Justine Fisher - Goldman Sachs

Good morning.

Rick Navarre

Good morning, Justine.

Justine Fisher - Goldman Sachs

One other question on the Illinois Basin exports. On other conference calls when companies have talked about exports out of the Illinois Basin, they've highlighted a high mercury content as one reason why that coal might not be as advantageous for exporters to buy from the U.S. Can you tell us first of all how you might overcome that problem if that's been identified as a problem by your buyers and then maybe what types of buyers you're seeing by your Illinois Basin coal?

Greg Boyce

Justine, I have to admit the mercury issue is not one that we've had to deal with any of our exports. It would be more. There is a higher level of chlorine in some of the Illinois Basin coals, which can be a problem if it's shifted to higher levels. That's true both here in the U.S. as well as on an international basis, so if we're focusing on any kind of quality parameters, it would be blending for a sulfur need into a European utility as well as blending for chlorine level into a European.

But at this point in time, we've had access to enough variety, remember we've got more than a dozen operations in the Midwest, plus with our blending of Colorado coal, which is low in both sulfur and chlorine, we've not had any issues there and we expect we can continue to grow that business if the market is still available to us in 08 and 09.

Justine Fisher - Goldman Sachs

Okay. And then are the buyers who are looking to take your Illinois Basin and Colorado coal, are they doing so on a spot basis or are they actually looking to sign longer duration contracts with you guys?

Greg Boyce

Most of it right now has been on the spot basis, both through our trading activities as well as some direct sales. Most of it has been through our trading activities, time of sales through the API index is back over into Europe.

Operator

Our next question is from the line of Brett Levy with Jefferies & Company. Please go ahead.

Brett Levy - Jefferies & Company

Hi. It's Brett Levy here.

Rick Navarre

Good morning.

Brett Levy - Jefferies & Company

Good morning. Really most of my questions have been answered. As you look forward the next couple of years, whether it's equipment or tires or shipping capacity, what do you think is going to be the constraints to addressing the global growth in demand? Because I just, I can't imagine that this thing will happen without hiccups based on the history of the industry.

Greg Boyce

Well, I think you've mentioned a couple of the top ones. I guess export, port and rail capacity for the seaborne trade probably will continue to be the top of a list for the regulating valve in terms of how much coal makes it on to the seaborne trade. Right now, with all of the vessels parked off of Australia, it's hard to imagine that shipping capacity is a constraint, and as we see new shipping capacity come on line, we think that will absent a lot of (inaudible) around the world will probably stabilize.

So, it's really the capacity for building ports and rail systems to get the coal to the ports is number one. Behind that, there are some issues still with tires on a global basis, and for adding capacity in a very quick turnaround period, it's still the length or the lead time for major pieces of equipment, whether it's draglines, loading shovels, or long wall systems.

Brett Levy - Jefferies & Company

All right, thanks very much, guys.

Operator

And next we'll go to the line of Yuri Maslov with Nevsky Capital. Please go ahead.

Yuri Maslov - Nevsky Capital

Hello, thank you very much. I've got a follow-up question on your full year guidance because as you kept your full year guidance pretty much unchanged that implies that Q4 results should be very strong. So, specifically where do you see

the improvements coming from? You mentioned some growth in output in Australia but is there anything else beyond that? And specifically, how do you see EBITDA to turn in Australia in Q4 looking like? I mean it drops from \$8 in Q2 to less than \$2 in Q3, so how do you see that positioning in Q4? Thank you.

Rick Navarre

Let me just add, probably won't be able to give you the exact number on EBITDA on a region basis going forward for Q4 because that's kind of, little more specific guidance than what we've traditionally given but I can tell you that Australia is one of the areas we would hope to see a bit of improvement in the fourth quarter and we would also expect that according to previous comments that we've made, our PRB production volume is getting back up online where we were down in the first half of the year, and had met our full expectations and commitments. We're now ramping back up to make those commitments.

So, we should have a pretty strong quarter as our expectation out of the PRB, and if you look in the third quarter we also had a long wall move in Colorado which is obviously a large item and a significant expense, we won't have a long wall move in the fourth quarter. So, Colorado operations should be better than that were in the third quarter, so we should just see overall better quarter at most of the operations.

Yuri Maslov - Nevsky Capital

Okay, thanks.

Operator

We have a follow-up from Shneur Gershuni. Please go ahead.

Shneur Gershuni - UBS

Hi, actually just a question with respect to the previous caller's question. With respect to your guidance, is it fair to say that you've lowered the higher end of the range going into the fourth quarter relative to what it was for the second quarter once you adjust out PCX?

Rick Navarre

Well, what we've basically done if you look at the total is that the original guidance that we had was 1 billion to 1.2 billion and we've lowered the guidance down to essentially 100 on the low end and 200 on the top end, and you can draw whatever conclusion you like. But at the end of the day, Patriot for the nine months was \$100 million plus inside of the number, so you've got some additional earnings for Patriot for the last three months of the year that we had to pull out. So that kind of gets you maybe in the midpart of the range. And obviously when we gave you the guidance at the 1 to 1.2, we hadn't changed it from the previous quarter. We left it kind of flat knowing that if you go back to the second quarter we told you that we had about \$275 million of items that were going to hit us with currency and demurrage. So, along way of saying, yeah, we tightened the guidance a bit on the top end because we knew we weren't going to hit the top end of the guidance two quarters ago when we had the \$275 million we notified you of, but we still have maintained the range and we're still inside of the range.

Shneur Gershuni - UBS

Absolutely. Thank you for the clarification.

Operator

We have a follow-up from Justine Fisher. Please go ahead.

Justine Fisher - Goldman Sachs

Sorry, just one more question on School Creek. You guys were talking about how you expect PRB coal to fill some of the gaps that has been opened up by exports coming out of the East. So, how does that view affect the timing of School Creek and why would you not be bringing on School Creek tonnage sooner if that was the case

Greg Boyce

Well, first and foremost, we have always said with SchoolCreek as with any major new capacity, PowderRiver Basin or the Illinois Basin, is we would want to see a level of base load contracting complete prior to dedicating the capital to bring on a major new operation. So, at the point in time that takes place is when we'll really look at what the time frames are for School Creek.

To date, we have not gotten to the levels of long term contracting that we would like to be at and if that changes due to the kind of pull that we're talking about and we think that's a possibility, then of course we'll revise our plans accordingly but we would not intend to bring on an operation like School Creek predicated on spot sales into a future market.

Justine Fisher -Goldman Sachs

Okay, thanks.

Operator

And with no further questions, I'll turn it back to you, Mr. Boyce, for any closing comments.

Greg Boyce

Well, thank you all very much. It is exciting at this point in time in BTU and I think Vic said it appropriately when he said welcome to the new BTU. Now, as Rick described restructuring of the company, post the Patriot spin, we are a different company than we were a quarter ago and the prospects that we have for growth in our entire platform are significant as we go forward in time. So we appreciate all of your interest in BTU and we look forward to reporting our results next quarter. Thank you.

Operator

Ladies and gentlemen, this conference is available for replay. It starts today at 3:15 p.m. Central, will last for one month until December 6 at midnight. You may access the replay at any time by dialing 1-800-475-6701, international parties please dial 320-365-3844, the access code is 887228. Those numbers again, 1-800-475-6701 or 320-365-3844 with the access code 887228. That does conclude your conference for today. Thank you for your participation. You may now disconnect.

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