Focus Stock Report

May 16, 2011

Peabody Energy Corp (BTU)

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Company Description

Founded in 1983 by Francis S. Peabody with start up capital of only $100, Peabody Energy is today the largest private sector coal producer in the United States. The company owns majority interests in 28 coal mining operations in the U.S. and Australia.

Thermal coal is the world's most abundant fossil fuel and used by power producers and industrial facilities to produce heat. Thermal coal fuelled 41% of world electricity generation in 2008 according to the International Energy Association.

Peabody Energy provides coal primarily to electricity generators, industrial facilities, and some steel manufacturers. Peabody coal fuels about 10% of U.S. electricity generation and satisfies 2% of worldwide requirements.

Most of the Company's sales are made under long-term coal supply agreements and represent about 90% of Company sales. Contracts in backlog have remaining terms ranging from one to 16 years, collectively representing over four years of production. In 2010, about 25% of revenues were derived from the Company's five largest customers.

Peabody Energy Corp.
(BTU-NYSE)

Rating: Outperform **Risk: Medium**

Summary Data (U$)

Price (May 9/2011)	$60.86	**Fiscal Year-End:**	December
12-Month Target:	$80.00	**Dividend:**	$0.34
Total Return:	32%	**Yield:**	0.6%
52-Week High:	$73.95	**52-Week Low:**	$34.89
ROE LTM	18.4%	**Market Value ($mil)**	$16,487

Earnings Per Share (U$)

Annual	**2010A**	**2011E**	**2012E**	**2013E**
EPS:	$2.93	$4.64	$6.59	$6.44
P/E Multiple:	21.8x	13.1x	9.2x	9.5x

Source: Bloomberg; Credit Suisse

Peabody has roughly 10 billion tons of proven and probable coal reserves, or roughly 40 years of supply based on 2010 coal sales of 245.9 million tons.

Peabody's principal U.S. competitors are Alpha Natural Resource Inc., Arch Coal Inc., Cloud Peak Energy Inc., CONSOL Energy Inc., and Massey Energy Company. Major foreign competitors include Anglo American PLC, BHP Billiton, China Coal, Rio Tinto, Shenhua Group, and Xstrata Plc.

Key elements supporting our investment thesis

Still the Cheapest Source of Electricity: Although coal is viewed as a "dirty" fuel, it is the most abundant and cheapest fossil fuel in the world. Coal's abundance, low cost and technological advancements should ensure coal is the dominant source of fuel for electricity generation for years to come.

In January, 2010, the delivered cost of coal was less than a fourth of the cost of natural gas and substantially less than nuclear power. While alternative/renewable energy sources are a growing part of social and political consciousness, in most cases they are expensive and in some instances prohibitively so in the absence of high oil prices and government subsidies.

Technological advancements should improve environmentalists' and public perception of coal powered generating capacity. The latest equipment reduces plant emissions by 80% compared with plants built only 20 years ago. Carbon capture (storing CO_2 emissions underground) is another technology that could be employed to reduce emissions. The U.S. government has committed U$2 billion over the next 20 years to aid technological progress.

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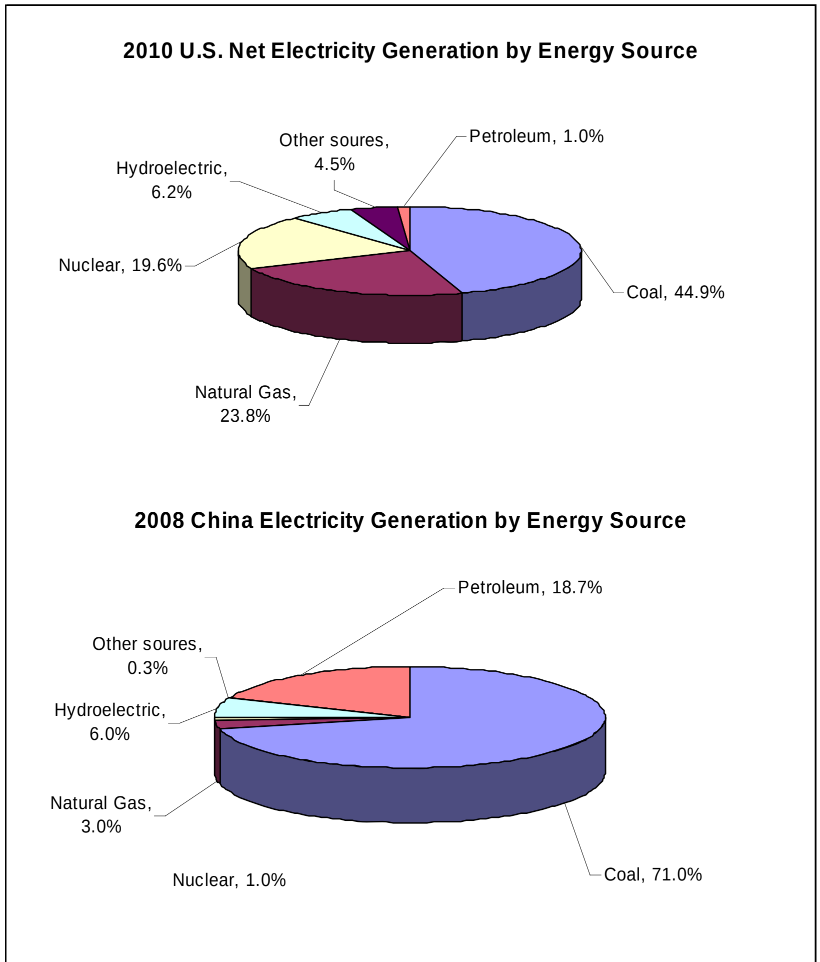
A Secure Source of Energy: In an era where the security of supply is of growing importance, coal is likely to remain a primary source of fuel for U.S. utilities for years to come. To enhance energy security, the U.S. government is investing heavily in coal-fired power plants with significant new capacity in longer-term planning stages.

According to recent statistics from the International Energy Association, approximately 44.9% of U.S. electricity production is fuelled by coal, compared with nuclear and natural gas, accounting for about 20% and 24%, respectively.

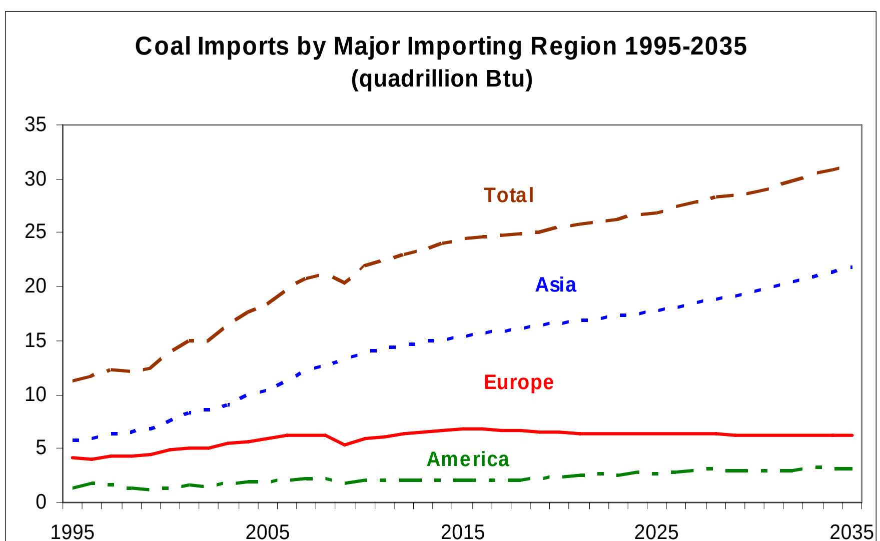


Source: International Energy Association

Asian demand is a Driving Force: Coal is an important fossil fuel in meeting rising developing market energy demand. According to a report from the IEA, China and India should account for roughly 85% of global incremental demand over the next two decades (see chart). It is unlikely that an increase in domestic production will fully satisfy their demand for coal leading both countries to be net importers. China accounts for nearly half of global thermal coal consumption.

Coal Powers China's Economic Growth: China's insatiable demand for all things energy (including coal) is a positive for Peabody. Chinese electricity use was up 13.4% Y/Y in the first quarter of 2011, according to China's National Energy Association. The country's overall electricity consumption is expected to grow 12% in 2011. Coal remains the primary fuel for power plants accounting for 71% of consumption in 2008. While China sits on vast recoverable coal reserves, production has failed to keep pace with demand over the past two years. China became a net importer of coal in 2009 and net coal imports rose to 146 million tons in 2010 according to customs data. China's rapid urbanization and rising middle class has led to an exponential number of new refrigerators, air conditioners and other appliances in homes. China's energy consumption per capita remains relatively low. The U.S. consumes roughly four times more electricity per capita than China. While the Chinese government would like to reduce its reliance on coal; that will likely prove to be a difficult task.

Peabody should benefit from its strong export position: Peabody's acquisition of Excel Coal in Australia provides the company with a better strategic position in which to serve growing Asian markets. The company's quality reserves (40 year reserve life), geographic diversification, and strong management team are competitive advantages.



Source: IEA International Energy Outlook 2010

Improving Profitability: A combination of strong thermal coal pricing this year and next, coupled with volume growth should drive earnings and cash flow over the two year period. The table below shows Credit Suisse's volume, pricing, and cost assumptions for Peabody's operations over the next three years. The average margin per ton is forecast to rise from a recession low of U$6.69 per ton in 2009 to U$13.50 per ton in 2012.

Operating Highlights

	2009A	2010A	2011E	2012E	2013E
Tons sold (in millions)					
Midwestern	31.8	29.7	33.0	40.0	40.0
West	160.1	163.8	167.8	200.0	200.0
Australia	22.5	27.0	28.0	30.0	31.0
Trading	29.4	25.4	22.2	24.0	24.0
Total tons sold	243.8	245.9	251.0	294.0	295.0
Revenues per ton					
Midwestern	$41.04	$44.49	$48.31	$49.33	$49.50
West	$16.31	$16.52	$16.20	$19.78	$21.40
Australia	$75.05	$93.36	$134.35	$130.94	$124.60
Weighted Avg. total revenues/ton	$26.14	$29.70	$35.29	$36.50	$37.35
Operating costs per ton					
Midwestern	$32.17	$33.65	$33.87	$34.02	$34.73
West	$11.80	$11.54	$12.88	$13.98	$14.47
Australia	$55.94	$57.98	$70.24	$68.46	$17.85
Average cost per ton	$19.46	$20.20	$22.93	$23.00	$71.07
Average margin per ton	**$6.69**	**$9.50**	**$12.36**	**$13.50**	**$13.42**

Source: Credit Suisse

Valuation: The shares are trading at 13.4 times forecast 2011 earnings and 6.9 times EV/EBITDA based on Credit Suisse's 2011 estimates, a reasonable entry point based on projections for earnings, EBITDA, and historical average multiples.

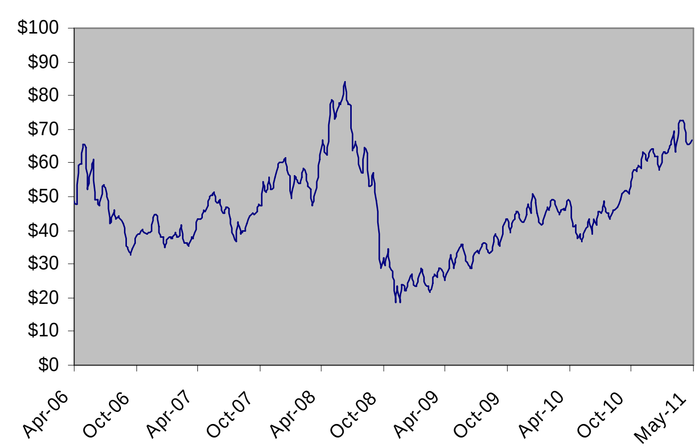
Risks

Mining is an inherently risky business affected by regulatory and safety issues, adverse weather conditions and natural disasters, maintenance problems and equipment failures, as well as variations in coal deposits and geologic conditions. It is estimated the industry lost 25 million tonnes of production in Australia in late 2010 due to heavy rains and flooding.

Peabody's profitability is subject to the strength of the U.S. and global economy, worldwide power generation, and the resultant demand and pricing for thermal coal.

Transportation costs represent a significant portion of the total cost of coal, and thus play a critical role in customers' purchasing decisions. The surge in diesel prices this year will lead to fuel surcharges that could impact demand.

Peabody Energy : 5-Year Price Chart (U$)



Bloomberg: Source

The author(s) of the report own(s) securities of the following companies.
None.

The supervisors of the Portfolio Advisory Group own securities of the following companies.
None.

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