

## Peabody Energy Corp.

# 4Q15: Two Steps Forward, Three Steps Back – Reducing Target to \$1

**We saw Peabody's 4Q15 results as discouraging for the U.S. coal markets in general and for the prospects for the stock in particular:** The company generated roughly half the quarterly EBITDA we had expected as costs ticked up in the Illinois Basin, and the outlook for 2016 appears bleak even when compared to a FY2015 that left Alpha, Arch, Patriot, and Walter all bankrupt. We've seen the company hustle over this past year to make use of every available vehicle for cost and cash savings, but unfortunately management hasn't been able to outrun the declines in coal and gas prices.

**Expected 2016 coal sales reflect a substantial volume decline:** New guidance calls for BTU to produce 184-196mm tons this year (ex brokered tons) compared to 214mm tons in 2015. PRB shipments will absorb the brunt of the reduction. For the domestic coal market as a whole, Peabody's bleak forecast shows a 40-60mm ton reduction in lower utility demand and a 150-170mm ton decline in US coal shipments after accounting for electric generators' inventory destocking and lower exports. Hopes for a long, cold winter to eat into coal stockpiles and push up natural gas prices have faded.

**Without a quick and material recovery in coal prices, Peabody's financial position will become more precarious:** There's only so much that even aggressive cost cutting can contribute when PRB prices are flatlining at \$10 and spot coking coal remains under \$80. Our model indicates negative operating cash flow continuing through 2018 as contract sales reprice lower and offset the positive effect of fuel and FX hedges rolling off. We also believe that in current markets the likelihood of a major asset sale at a multiple sufficient to allow deleveraging also looks more and more remote.

**Our target price is lowered to \$1:** With losses mounting, liquidity dwindling, and the company actively seeking to restructure its heavy debt load, we see little intrinsic equity value remaining for the shares. What had been a \$1.81 billion cushion of cash and available credit at the end of 3Q15 now stands at \$903M as of February 9, with BTU having drawn down all remaining capacity under its revolver.

### BTU: Quarterly and Annual EPS (USD)

FY Dec	2015		2016		2017		Change y/y		2017
	Actual	Old	New	Cons	Old	New	Cons	2016	
Q1	-6.34A	-7.63E	-10.30E	-9.05E	N/A	-8.95E	-6.34E	-62%	13%
Q2	-8.21A	-6.92E	-9.40E	-8.48E	N/A	-8.49E	-6.34E	-14%	10%
Q3	-8.13A	-7.31E	-8.75E	-8.22E	N/A	-8.10E	-6.34E	-8%	7%
Q4	-8.13A	-7.33E	-8.54E	-7.76E	N/A	-8.18E	-6.34E	-5%	4%
Year	-32.82A	-29.19E	-36.98E	-34.12E	N/A	-33.72E	-28.55E	-13%	9%
P/E	N/A		N/A			N/A			

Source: Barclays Research.

Consensus numbers are from Thomson Reuters

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Stock Rating **UNDERWEIGHT**  
Unchanged

Industry View **NEUTRAL**  
Unchanged

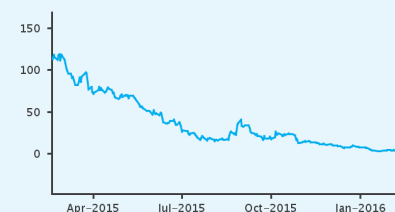
Price Target **USD 1.00**  
lowered -86% from USD 7.00

Price (16-Feb-2016) USD 2.32  
Potential Upside/Downside -56.9%  
Tickers BTU

Market Cap (USD mn) 43  
Shares Outstanding (mn) 18.50  
Free Float (%) 99.15  
52 Wk Avg Daily Volume (mn) 1.1  
52 Wk Avg Daily Value (USD mn) 35.14  
Dividend Yield (%) N/A  
Return on Equity TTM (%) -103.62  
Current BVPS (USD) 47.02

Source: Thomson Reuters

Price Performance Exchange-NYSE  
52 Week range USD 120.30-2.15



[Link to Barclays Live for interactive charting](#)

### U.S. Metals & Mining

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## U.S. Metals &amp; Mining Industry View: NEUTRAL

## Peabody Energy Corp. (BTU) Stock Rating: UNDERWEIGHT

Income statement (\$mn)	2015A	2016E	2017E	2018E	CAGR
Revenue	5,609	4,771	4,465	4,345	-8.2%
EBITDA (adj)	415	236	305	306	-9.6%
EBIT (adj)	-1,532	-285	-203	-194	N/A
Pre-tax income	-1,990	-834	-757	-752	N/A
Net income (adj)	-596	-675	-615	-612	N/A
EPS (adj) (\$)	-32.82	-36.98	-33.72	-33.53	N/A
Diluted shares (mn)	18	18	18	18	0.2%
DPS (\$)	0.04	0.00	0.00	0.00	-100.0%

Margin and return data	Average				
EBITDA (adj) margin (%)	7.4	5.0	6.8	7.1	6.6
EBIT (adj) margin (%)	-27.3	-6.0	-4.5	-4.5	-10.6
Pre-tax margin (%)	-35.5	-17.5	-16.9	-17.3	-21.8
Net (adj) margin (%)	-10.6	-14.1	-13.8	-14.1	-13.2
ROIC (%)	-16.5	-3.1	-2.3	-2.3	-6.1
ROA (%)	-5.4	-5.9	-5.7	-6.1	-5.8
ROE (%)	-68.5	-332.5	152.9	60.9	-46.8

Balance sheet and cash flow (\$mn)	CAGR				
Cash and equivalents	261	841	554	323	7.3%
Total assets	10,973	11,439	10,723	10,112	-2.7%
Short and long-term debt	6,316	7,516	7,516	7,516	6.0%
Other long-term liabilities	10,943	11,993	11,993	11,993	3.1%
Total liabilities	10,103	11,236	11,126	11,116	3.2%
Net debt/(funds)	6,054	6,675	6,961	7,193	5.9%
Shareholders' equity	870	203	-402	-1,004	N/A
Change in working capital	1,228	-95	-59	1	-92.3%
Cash flow from operations	-105	-241	-156	-101	N/A
Capital expenditure	-127	-130	-130	-130	N/A
Equity free cash flow	-330	-621	-286	-231	N/A

Valuation and leverage metrics	Average				
P/E (adj) (x)	N/A	N/A	N/A	N/A	N/A
EV/EBITDA (adj) (x)	14.7	28.4	23.0	23.6	22.4
Equity FCF yield (%)	-784.3	-1,465.8	-676.2	-546.4	-868.2
P/Sales (x)	0.0	0.0	0.0	0.0	0.0
P/BV (x)	0.0	0.2	-0.1	0.0	0.0
Dividend yield (%)	1.6	0.0	0.0	0.0	0.4
Total debt/capital (%)	87.9	97.4	105.7	115.4	101.6

Selected operating metrics	CAGR				
US coal sales (mm ton)	178	155	152	150	-5.5%
US realized price per ton (\$)	19.8	19.4	18.0	17.6	-3.9%
Australia coal sales (mm ton)	36	35	32	32	-3.9%
Australia realized price per ton (\$)	56.0	48.7	49.9	50.6	-3.3%

Price (16-Feb-2016) USD 2.32  
Price Target USD 1.00

**Why Underweight?** Weak demand, ample supply, and depressed prices remain the key trends of the global coal markets, and though Peabody offers investors production scale and diversification we don't believe the company's efforts at cost-cutting and asset-sales will be enough to maintain support for the stock at current levels.

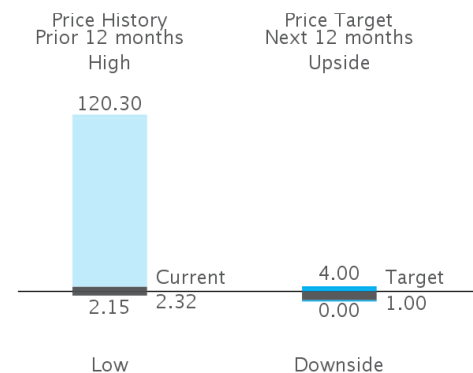
**Upside case** USD 4.00

Our upside case of \$4 assumes an 8.0x forward multiple applied to a projected 2017 EBITDA of \$755 million. This higher EBITDA value results from assuming higher prices for met coal, PRB coal and export seaborne thermal coal.

**Downside case** USD 0.00

Our downside case of \$0 assumes coal prices remain weak for an extended period, US demand for coal continues to decline, and BTU is not able to generate enough earnings and cash flows to support its business.

## Upside/Downside scenarios



Source: Company data, Barclays Research  
Note: FY End Dec

## Lowering Price Target to \$1

We use a probability adjusted scenario analysis to determine our new \$1 price target. Our upside case is one in which natural gas prices turn materially upward, coal production in the U.S. contracts substantially as mines close, global seaborne coal markets stabilize, and key coal prices move up by 25% or more. In such an environment our model suggests BTU could earn \$755M in EBITDA in 2017, roughly in line with what the company generated for FY2014. With a “normal” 8x EV/EBITDA multiple this would imply a \$4 share price.

Unfortunately the probability of this outcome appears to be small. We expect curtailed coal production and natural gas drilling activity to restart fairly quickly with any appreciation in energy prices which in turn would cap the upside. Additionally, potential for a structural rebound in domestic coal demand seems remote, even with new uncertainties regarding the Clean Power Plan. We therefore assign a 25% probability that BTU could realize this optimistic scenario.

What seems much more likely is that a low-price, declining demand environment remains in place for the next several years – our downside case. Under these conditions BTU’s liquidity would continue to decline rapidly as its EBITDA moves lower (our estimates are for \$236M in 2016 and \$305M in 2017) on reduced volumes and pricing. Without debt restructuring, the company’s interest payments – absorbing over \$400M in cash in 2015 – would then become increasingly onerous. In this downside scenario we believe a \$0 stock price is a reasonable potential outcome, especially given the recent history of other coal equities that also spent much of 2015 cutting costs, reducing capex, and trying to sell assets. We assign a 75% probability of a \$0 share price.

The weighted average of these scenarios is a \$1 price target, which in terms of an EBITDA multiple is 19.6x our new 2017 EBITDA estimate of \$305M.

Our prior \$7 price target was based on a 14.4x EV/EBITDA multiple on our previous 2017 estimated adjusted EBITDA of \$423M.

FIGURE 1

## BTU Income Statement

BTU Income Statement <i>Millions of dollars, except as noted</i>	Q4'14	Q3'15	Q4'15	% Chg vs.		2015	2016E	% chg.	2017E	% chg.	2018E	% chg.
				Q4'14	Q3'15							
<b>Total Revenue</b>	<b>1,685</b>	<b>1,419</b>	<b>1,313</b>	<b>-22.0%</b>	<b>-7.5%</b>	<b>5,609</b>	<b>4,771</b>	<b>-14.9%</b>	<b>4,465</b>	<b>-6.4%</b>	<b>4,345</b>	<b>-2.7%</b>
Costs and Expenses:												
Operating costs & expenses	1,401	1,254	1,233	-12.0%	-1.7%	5,008	4,296	-14.2%	3,945	-8.2%	3,829	-3.0%
DD&A	172	136	142	-17.6%	4.1%	572	522	-8.8%	508	-2.6%	500	-1.6%
SG&A	56	38	48	-14.2%	25.9%	176	150	-15.0%	148	-1.3%	148	0.0%
Operating Expense Subtotal	1,629	1,428	1,423	-12.6%	-0.4%	5,756	4,968	-13.7%	4,601	-7.4%	4,477	-2.7%
Impairment of long-lived assets	154	0	377	144.2%	n/a	1,278	0	n/a	0	n/a	0	n/a
Net Gain on ppty. Disp.+ ARO expense	19	4	(20)	n/a	n/a	1	72	14300.0%	72	0.0%	72	0.0%
(Gain) Loss from Equity Affiliates	64	5	4	-94.3%	-32.1%	16	16	0.6%	(5)	n/a	(10)	n/a
Other Operating Expense	26	2	1	-98.1%	-72.2%	24	0	n/a	0	n/a	0	n/a
Operating Profit	(207)	(20)	(471)	n/a	n/a	(1,465)	(285)	n/a	(203)	n/a	(194)	n/a
Interest Expense	104	119	121	17.1%	1.9%	466	568	21.9%	568	0.0%	568	0.0%
Interest Income	(4)	(1)	(1)	n/a	n/a	(8)	(20)	n/a	(14)	n/a	(9)	n/a
Net interest expense	100	118	120	20.3%	2.2%	458	548	19.7%	554	1.0%	559	0.9%
Other Non-operating expenses	2	(1)	0	-100.0%	n/a	67	0	n/a	0	n/a	0	n/a
<b>Earnings before taxes</b>	<b>(309)</b>	<b>(138)</b>	<b>(591)</b>	<b>n/a</b>	<b>n/a</b>	<b>(1,990)</b>	<b>(834)</b>	<b>n/a</b>	<b>(757)</b>	<b>n/a</b>	<b>(752)</b>	<b>n/a</b>
Income Tax provision (benefit)	170	7	(52)	n/a	n/a	(135)	(167)	n/a	(151)	n/a	(150)	n/a
<b>Income From Continuing Operations</b>	<b>(479)</b>	<b>(144)</b>	<b>(539)</b>	<b>n/a</b>	<b>n/a</b>	<b>(1,855)</b>	<b>(667)</b>	<b>n/a</b>	<b>(605)</b>	<b>n/a</b>	<b>(602)</b>	<b>n/a</b>
Less Net (Loss) Income from Non-controlling int.	2	3	(1)	n/a	n/a	7	8	12.7%	10	25.0%	10	0.0%
Loss (Gain) from Discontinued Ops	34	158	(21)	n/a	n/a	182	0	n/a	0	n/a	0	n/a
Net Income Available to BTU Shareholders	(515)	(305)	(518)	n/a	n/a	(2,045)	(675)	n/a	(615)	n/a	(612)	n/a
<b>Adjusted Net Income from Cont. Ops</b>	<b>12</b>	<b>(148)</b>	<b>(148)</b>	<b>n/a</b>	<b>n/a</b>	<b>(596)</b>	<b>(675)</b>	<b>n/a</b>	<b>(615)</b>	<b>n/a</b>	<b>(612)</b>	<b>n/a</b>
Reported EPS - Basic	(\$28.78)	(\$16.74)	(\$29.47)	n/a	n/a	(\$112.56)	(\$36.88)	n/a	(\$33.63)	n/a	(\$33.44)	n/a
Reported EPS - Fully Diluted	(\$28.78)	(\$16.74)	(\$29.55)	n/a	n/a	(\$112.63)	(\$36.98)	n/a	(\$33.72)	n/a	(\$33.53)	n/a
Adjusted EPS from Cont. Ops - Basic	(\$26.87)	(\$8.13)	(\$9.32)	n/a	n/a	(\$32.80)	(\$36.88)	n/a	(\$33.63)	n/a	(\$33.44)	n/a
<b>Adjusted EPS from Cont. Ops - Fully Diluted</b>	<b>\$0.69</b>	<b>(\$8.13)</b>	<b>(\$8.13)</b>	<b>n/a</b>	<b>n/a</b>	<b>(\$32.82)</b>	<b>(\$36.98)</b>	<b>n/a</b>	<b>(\$33.72)</b>	<b>n/a</b>	<b>(\$33.53)</b>	<b>n/a</b>
Diluted Shares Outstanding (mm)	18	18	18	2.1%	0.3%	18	18	0.5%	18	0.0%	18	0.0%
Income Tax Rate	-55%	-5%	9%	n/a	n/a	7%	20%	194.9%	20%	0.0%	20%	0.0%
EBIT	(209)	(20)	(471)	n/a	n/a	(1,532)	(285)	n/a	(203)	n/a	(194)	n/a
<b>Adjusted EBITDA</b>	<b>173</b>	<b>117</b>	<b>53</b>	<b>-69.4%</b>	<b>-54.6%</b>	<b>415</b>	<b>236</b>	<b>-43.0%</b>	<b>305</b>	<b>29.0%</b>	<b>306</b>	<b>0.4%</b>

Source: Company Reports, Barclays Research Estimates

FIGURE 2  
BTU Balance Sheet

BTU Balance Sheet					
<i>Millions of dollars, except as noted</i>	2014	2015	2016E	2017E	2018E
Current Assets:					
Cash and cash equivalents	298	261	841	554	323
Accounts Receivable, Net	563	221	264	247	241
Coal Inventories	407	308	293	260	255
Assets from Allowance Trading Act.	0	0	0	0	0
Deferred taxes	80	54	54	54	54
Other Current Assets	363	402	402	402	402
<b>Total Current Assets</b>	<b>1,711</b>	<b>1,246</b>	<b>1,854</b>	<b>1,516</b>	<b>1,275</b>
Property, Plant, Equipment, & Mine Dev., Net	10,577	9,259	8,867	8,489	8,119
Other Noncurrent Assets	0	0	250	250	250
Investments & other assets	903	468	468	468	468
<b>TOTAL ASSETS</b>	<b>13,191</b>	<b>10,973</b>	<b>11,439</b>	<b>10,723</b>	<b>10,112</b>
Liabilities:					
Short term borrowings & current mat. of LTD	21	23	23	23	23
Liabilities from Allowance Trading Act.	33	16	16	16	16
Accounts payable & accrued expenses	1,768	1,446	1,455	1,344	1,335
<b>Total current liabilities</b>	<b>1,822</b>	<b>1,485</b>	<b>1,493</b>	<b>1,383</b>	<b>1,373</b>
Long-term debt, less current maturities	5,966	6,293	7,493	7,493	7,493
Deferred income taxes	89	69	69	69	69
Other	2,588	2,256	2,181	2,181	2,181
Total noncurrent liabilities	8,643	8,618	9,743	9,743	9,743
<b>TOTAL LIABILITIES</b>	<b>10,465</b>	<b>10,103</b>	<b>11,236</b>	<b>11,126</b>	<b>11,116</b>
Minority interest	0	0	0	0	0
<b>TOTAL EQUITY</b>	<b>2,727</b>	<b>870</b>	<b>203</b>	<b>(402)</b>	<b>(1,004)</b>
<b>Total liabilities and shareholders equity</b>	<b>13,191</b>	<b>10,973</b>	<b>11,439</b>	<b>10,723</b>	<b>10,112</b>

Source: Company Reports, Barclays Research Estimates

FIGURE 3

## BTU Cash Flow Statement

BTU Cash Flow	2014	2015	2016E	2017E	2018E
<i>Millions of dollars, except as noted</i>					
<b>CASH FLOW STATEMENT</b>					
<b>Net earnings</b>	<b>(777)</b>	<b>(2,038)</b>	<b>(667)</b>	<b>(605)</b>	<b>(602)</b>
(income) loss from discontinued operations	28	203	-	-	-
Adjustments					
DD&A	656	572	522	508	500
Other, net	534	1,186	(95)	(59)	1
Cash provided by continuing operations	441	(76)	(241)	(156)	(101)
Cash provided by discontinued operations	(104)	(29)	-	-	-
<b>Cash flow from operations</b>	<b>337</b>	<b>(105)</b>	<b>(241)</b>	<b>(156)</b>	<b>(101)</b>
Additions to PP&E	(488)	(127)	(130)	(130)	(130)
Additions to advance mining royalties	(34)	(99)	(250)	-	-
Acquisitions, net	-	-	-	-	-
Investment in JV	4	(10)	-	-	-
Proceeds from/investments in securities	(2)	11	-	-	-
Proceeds from property and equipment disposals	204	40	-	-	-
Other	0	(20)	-	-	-
Cash utilized by continuing operations	(315)	(205)	(380)	(130)	(130)
Cash utilized by discontinued operations	-	-	-	-	-
<b>Cash from investing activities</b>	<b>(315)</b>	<b>(205)</b>	<b>(380)</b>	<b>(130)</b>	<b>(130)</b>
Proceeds from borrowings	1	976	1,200	-	-
Payments of borrowings	(21)	(666)	-	-	-
Dividends paid	(92)	(1)	-	-	-
Proceeds from sale of treasury stock	-	-	-	-	-
Repurchase of treasury stock	-	-	-	-	-
Other	(56)	(35)	-	-	-
Cash utilized by continuing operations	(168)	273	1,200	-	-
Cash utilized by discontinued operations	-	-	-	-	-
<b>Cash from financing activities</b>	<b>(168)</b>	<b>273</b>	<b>1,200</b>	<b>-</b>	<b>-</b>
(Decrease) increase in cash and cash equivalents	(146)	(37)	579	(286)	(231)
Cash and cash equivalents at beginning of period	444	298	261	841	554
<b>Cash and cash equivalents at end of period</b>	<b>298</b>	<b>261</b>	<b>841</b>	<b>554</b>	<b>323</b>

Source: Company Reports, Barclays Research Estimates

## ANALYST(S) CERTIFICATION(S):

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**Peabody Energy Corp.** (BTU, 16-Feb-2016, USD 2.32), Underweight/Neutral, CD/CE/F/J/K/M

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Our coverage analysts use a relative rating system in which they rate stocks as Overweight, Equal Weight or Underweight (see definitions below) relative to other companies covered by the analyst or a team of analysts that are deemed to be in the same industry (the "industry coverage universe").

In addition to the stock rating, we provide industry views which rate the outlook for the industry coverage universe as Positive, Neutral or Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

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**Overweight** - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

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**Positive** - industry coverage universe fundamentals/valuations are improving.

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Below is the list of companies that constitute the "industry coverage universe":

#### U.S. Metals & Mining

Agrium Inc. (AGU)	AK Steel Holding Corp. (AKS)	CF Industries Holdings (CF)
Cloud Peak Energy Inc. (CLD)	Consol Energy Inc. (CNX)	Freeport-McMoRan (FCX)
Israel Chemicals Ltd. (ICL)	Nucor Corp. (NUE)	Peabody Energy Corp. (BTU)
Potash Corporation of Saskatchewan (POT)	Southern Copper Corp. (SCCO)	Steel Dynamics, Inc. (STLD)
The Mosaic Company (MOS)	United States Steel Corp. (X)	

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### Top Picks:

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## IMPORTANT DISCLOSURES CONTINUED

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**Peabody Energy Corp. (BTU / BTU)**

**USD 2.32 (16-Feb-2016)**

Stock Rating

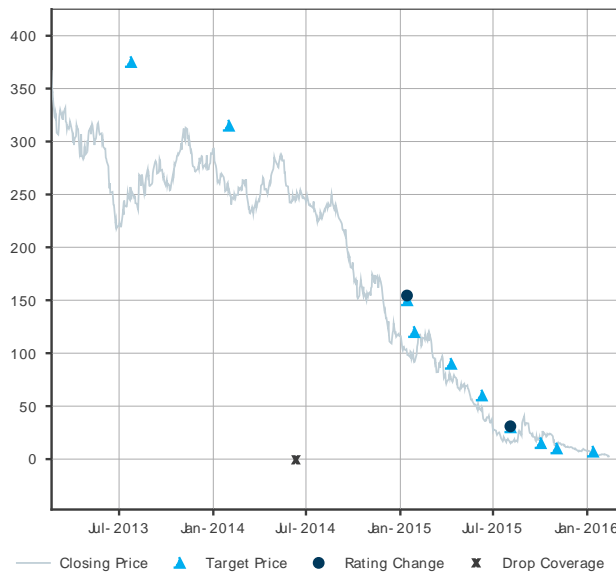
**UNDERWEIGHT**

Industry View

**NEUTRAL**

**Rating and Price Target Chart - USD (as of 16-Feb-2016)**

Currency=USD



Date	Closing Price	Rating	Adjusted Price Target
12-Jan-2016	4.48		7.00
02-Nov-2015	13.68		10.00
02-Oct-2015	18.14		15.00
04-Aug-2015	15.30	Underweight	30.00
09-Jun-2015	49.20		60.00
10-Apr-2015	76.35		90.00
28-Jan-2015	91.50		120.00
14-Jan-2015	100.65	Equal Weight	150.00
05-Jun-2014	248.70	Coverage Dropped	
31-Jan-2014	255.75		315.00
24-Jul-2013	245.70		375.00

Source: Thomson Reuters, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

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**Valuation Methodology:** Our \$1 price target is based on a 19.6x EV/EBITDA multiple on our 2017 estimated adjusted EBITDA of \$305M.

**Risks which May Impede the Achievement of the Barclays Research Valuation and Price Target:** Should global coal producers adjust production levels lower faster than we expect to bring the market into balance with reduced demand, prices could rise materially and lift Peabody's earnings power higher than is reflected in our estimates. This would lift the outlook for the company's cash flow power and balance sheet strength, which are the primary overhangs on the stock.

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