

**Rating Action: Moody's assigns B2 CFR to US Coal Corp, rates proposed term loan**

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Global Credit Research - 19 Jul 2011

**Approximately \$105 million of rated obligations affected**

New York, July 19, 2011 -- Moody's Investors Service assigned ratings to U.S. Coal Corporation (US Coal) -- Corporate Family Rating (CFR) at B2, and Probability of Default Rating at B3. In a related action, Moody's assigned a B2 rating to US Coal's new senior secured term loan. The new senior secured term loan will be used to refinance the company's existing debt, and increase balance sheet cash which could be used for expansion activities. The rating outlook is stable.

The following ratings were assigned:

Corporate Family Rating, B2;

Probability of Default, B3;

B2 (LGD3, 34%), for the \$105 million senior secured term loan

**RATINGS RATIONALE**

US Coal's B2 CFR incorporates the company's modest leverage pro forma for the transaction, favorable contract positions in thermal coal, and high predictability of cash flows over the intermediate term. The company's CFR is, however, constrained by the company's small size relative to its peers, short history as a combined company with fully operational Licking River and JAD divisions, regional concentration in Central Appalachia where we remain concerned about declining production and regulatory issues, reliance on Right Oakley and high wall miners for majority of its margins, and, to a lesser extent, the need for further permits at the Foresters Creek assets beyond the intermediate horizon.

Pro forma for the refinancing transaction, US Coal's 2011 Debt/EBITDA is expected to be below 3 times (including Moody's standard adjustments and partial treatment of preferred stock as debt). The company has operations in eastern Kentucky with roughly 67 million tons of coal reserves and 2 million tons of annual thermal coal sales volumes. It operates 6 mines and two high wall miners. Roughly 90% and two-thirds of 2011 and 2012 production, respectively, is already contracted.

The stable fundamental rating outlook assumes that US Coal would continue to generate reasonable cash margins, satisfactorily complete the refinancing transaction, and meet its increased production targets over the next couple years. The outlook also anticipates that the company will maintain balance sheet cash above \$20 million, and make progress in gaining favorable thermal coal commitments for 2012 and 2013.

US Coal is expected to have an adequate liquidity profile over the next twelve months supported by positive free cash flow generation and cash on hand. Pro forma for the close of the transaction, US Coal is expected to have about \$30 million of balance sheet cash. The company currently maintains a \$8.5 million revolver (which is expected to be repaid fully in the refinancing transaction) maturing in November 2011. The term loan credit agreement provides for a carve-out of a new \$10 million revolver which we would consider as modest for the company's size once put in place. Alternate liquidity will be limited as all of the company's assets will secure the bank credit facilities.

The ratings are not likely to be upgraded over the next 12-18 months. Upward rating momentum is currently limited by US Coal's modest revenue base, concentrated regional footprint, and short operating history. However, Moody's could consider a negative action if the thermal coal outlook diminishes dramatically over the next 2-3 years; if leverage stays above 3.5 times or FCF to Debt below 10% on a sustained basis; or if the company experiences significant margin compression, production delays or deterioration in liquidity position.

The principal methodology used in rating U.S. Coal Corporation was the Global Mining Industry Methodology published in May 2009. Other methodologies used include Loss Given Default for Speculative-Grade Non-Financial Companies in the U.S., Canada and EMEA published in June 2009.

Headquartered in Lexington, Kentucky, U.S. Coal Corporation is engaged in the mining and marketing of steam and industrial coal. The company currently operates six mines and two high wall miners in Central Appalachia. Revenues were approximately \$194 million for the LTM period ended June 30, 2011.

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