STANDARD & POOR'S

Global Credit Portal®
RatingsDirect®

July 18, 2011

Research Update:

U.S. Coal Corp. Assigned Preliminary 'B' Rating On Expectations Of Increasing Production; Prelim Issue Ratings Assigned

Primary Credit Analyst:
Maurice Austin, New York (1) 212-438-2077;maurice_austin@standardandpoors.com

Secondary Contact:
Marie Shmaruk, New York (1) 212-438-7816;marie_shmaruk@standardandpoors.com

Table Of Contents

Research Update:

U.S. Coal Corp. Assigned Preliminary 'B' Rating On Expectations Of Increasing Production; Prelim Issue Ratings Assigned

Overview

- U.S.-based mining company U.S. Coal Corp. is refinancing substantially all of its outstanding debt.
- Standard & Poor's has assigned a preliminary 'B' corporate credit rating to the company.
- We also have assigned preliminary 'B+' issue-level and preliminary '2' recovery ratings to the company's proposed $105 million senior secured term loan due 2017.
- The stable rating outlook reflects our expectation that U.S. Coal Corp.'s production will improve over the next two years as the company obtains new mining permits.

Rating Action

On July 18, 2011, Standard & Poor's Ratings Services assigned its preliminary 'B' corporate credit rating to Lexington, Ky.-based U.S. Coal Corp. The rating outlook is stable.

At the same time, we assigned our preliminary 'B+' (one notch above the corporate credit rating) issue-level rating to the company's proposed $105 million senior secured term loan due 2017. The preliminary recovery rating is '2', indicating our expectation of substantial (70%-90%) recovery for lenders in the event of a payment default.

U.S. Coal Corp. plans to use proceeds from the proposed term loan to refinance substantially all existing debt and to expand its production capabilities, among other general corporate purposes.

Rationale

The preliminary 'B' corporate credit rating on U.S. Coal Corp. reflects the combination of what we consider to be its vulnerable business risk profile and aggressive financial risk profile. We also factor in its relatively small size, lack of geographic diversity, high customer concentration, and the challenges posed by the inherent risks of coal mining. Still, U.S. Coal has no legacy liabilities, which we typically include as debt, and we expect the company to maintain adequate liquidity.

The rating and outlook incorporate our expectation that EBITDA increases to about $45 million in 2011 and about $50 million in 2012, from about $35 million in 2010. The improvement in operations stems from higher coal production, which should increase in 2011 as a result of additional mining permits and contracted sale prices currently priced greater than market rates. In 2012, approximately 65% of U.S. Coal's production is committed at prices exceeding $85 per ton. We believe these prices are sustainable because of our expectation that utility inventories will continue to decline to more normalized levels. Standard & Poor's senior economist currently projects 2012 GDP growth of almost 3%, which likely would lead consumers to increase their electricity consumption.

We expect 2011 total adjusted debt, pro forma for the refinancing, to be about $155 million (adjusted for operating leases and other debt-like obligations). We do not adjust debt for other postretirement employee benefits--The company has no legacy liabilities given that it was formed in 2006 for the purpose of acquiring coal assets and began operations using contract miners. Given our assumptions, we expect 2011 adjusted debt to EBITDA of about 3.5x and funds from operations (FFO) to adjusted debt of about 20%. We expect 2012 adjusted debt to EBITDA of about 3x and FFO to adjusted debt of about 25%, levels we consider good for a preliminary 'B' corporate credit rating and our opinion of adequate liquidity, given our assessment of U.S Coal's vulnerable business risk profile and aggressive financial risk profile.

For the 12 months ended March 31, 2011, EBITDA was about $40 million, compared with about $20 million for the previous 12 months, because the expansion of production in Right Oakley mine led to higher volumes.

We consider U.S. Coal Corp. to be a small coal company, producing about 2 million tons annually (less than 1% of the U.S. coal market). U.S. Coal currently owns and operates six mines with approximately 65 million tons of reserves and a reserve life of about 35 years at the current rate of production. Its mines serve areas with the highest concentration of coal-fired generation. However, its operations, in Eastern Kentucky in the Central Appalachia (CAPP) region, provide limited geographic diversity. Operating in CAPP also offers supply challenges due to tougher permitting and safety regulations and, as the oldest mining region in the U.S., a degradation of its reserve base. Competition from the Powder River Basin has eroded its market share over the past decade, as well.

In addition, U.S. Coal's customer base is narrowly focused, with its largest customer accounting for more than 35% of 2010 sales and its two largest customers accounting for more than 50% of 2010 sales. Profitability could suffer if either of these customers have a prolonged unexpected outage.

Liquidity

Given our operating expectations, U.S. Coal Corp.'s liquidity is adequate under our criteria. Pro forma for the proposed transaction, the company will likely have total liquidity of about $25 million, consisting of cash on its balance sheet. The company does not currently have a revolving credit facility in its capital structure. However, we expect U.S. Coal to propose a $10 million revolver subsequent to the closing of the proposed term loan.

Key aspects of our liquidity assessment include the following:

- We expect liquidity sources (including cash and internally generated cash flow) will exceed uses by over 1.2x over the next 12 months to 18 months.
- We expect that liquidity sources will continue to exceed uses, even if EBITDA were to decline by up to 20%.
- EBITDA could decline by up to 20% without the company breaching covenants.

U.S. Coal's cash flow from operations for the 12 months ended March 31, 2011, was approximately $30 million, compared with about $12 million during the prior 12 months. We expect this amount to remain fairly stable through the end of 2011 because of increased volumes and higher pricing on contracted tonnage. In 2012, we expect cash flow from operations to increase to about $35 million because of increasing electricity consumption and, therefore, thermal coal production. We expect capital spending, primarily maintenance-related, to be about $15 million annually in 2011 and 2012. Consequently, we expect free operating cash flow of about $15 million in 2011 and about $20 million in 2012.

Financial covenants governing the company's senior secured term loan will likely include a maximum total leverage ratio and a minimum interest coverage ratio. We expect U.S. Coal to maintain a 30% cushion in the near term under both covenant requirements given our expectations.

U.S. Coal's debt maturities over the next several years are manageable. The proposed senior secured term loan doesn't mature until 2017.

Recovery analysis

Standard & Poor's assigned a preliminary issue-level rating of 'B+' (one notch above the corporate credit rating) to U.S. Coal's proposed $105 million senior secured term loan due 2017. The preliminary recovery rating is '2', indicating our expectation of substantial (70%-90%) recovery for lenders in the event of a payment default. (For the complete recovery analysis, see Standard & Poor's recovery report on U.S. Coal Corp., to be published shortly following this report on RatingsDirect on the Global Credit Portal.)

Outlook

The stable rating outlook reflects our expectation that operating performance improves in 2011, as a result of higher production and higher prices, resulting in an increase in 2011 EBITDA to about $45 million. Given our operating assumptions, we expect U.S. Coal's credit measures will remain at a level we would consider good for the preliminary rating, given our view of its vulnerable business risk profile. Specifically, we expect 2011 adjusted debt to EBITDA of about 3.5x and FFO to debt of about 20%.

We would consider a negative rating action if the company's credit measures weaken materially amid lower coal production during the next several quarters. Specifically, a decline in electricity consumption, resulting in lower coal prices and production, could cause a 30% or more decline in our projected 2011 EBITDA and adjusted debt to EBITDA to exceed 5x (with little chance of quick improvement).

A positive rating action is less likely in the near term given the company's limited size and lack of geographic diversity, which factor into our assessment of its vulnerable business risk profile. However, we could consider one if the company's business risk profile strengthens through increased size and materially improving geographic diversification without any significant increase in debt leverage.

Related Criteria And Research

- Key Credit Factors: Methodology And Assumptions On Risks In The Mining Industry, June 23, 2009
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009

Ratings List

New Rating

U.S. Coal Corp.	
Corporate Credit Rating	B(prelim)/Stable/--
Senior Secured	
$105 mil. term loan due 2017	B+(prelim)
Recovery rating	2(prelim)

Complete ratings information is available to subscribers of RatingsDirect on the Global Credit Portal at www.globalcreditportal.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column.