RAB Special Situations Company Limited

Key Facts
AIM quoted
Ticker: RSS.L

Company Information

Shares in issue:	64,665,000*
Denomination:	GBP
Admission date:	31 May 2005
Year end:	31 December

**Voting shares in issue, excludes shares held in treasury*

Share Price (as at 12/09/12)
25.00 p

Manager
RAB Capital

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Investment Commentary

The RAB Special Situations Company (the "Company") returned +12.0% (August), -8.2% (6 Months), +9.7% (YTD) and +10.0% (12 months). In August 2012, RAB Special Situations Fund ($ Class) returned +12.8%. This compares with the performance of the Bloomberg World Mining Index, which was up +1.7%. The Fund's performance compared favourably to both the major indices, such as the Dow Jones and the FTSE 100 (which returned +0.6% and +1.4% respectively) and the main mining indices, with the GDX and the GDX-J up +11.9% and +12.8% respectively, while the base metals indices of the SXPP and the FTSE All-Share Basic Resources Index trailed with returns of -1.5% and -1.4%.

During August the market's focus shifted from the economic woes of Europe to the economic climate in the US, and in particular the fast approaching Fiscal Cliff and the central bankers' symposium in Jackson Hole. Before the symposium, market commentators speculated as to the contents of Federal Reserve Chairman Ben Bernanke's speech, hoping that it would at least provide clues on the chances of the Fed embarking on a third round of quantitative easing. This was supported by minutes of the Fed's last meeting, released on August 22. The minutes stated: "Many members judged that additional monetary accommodation would likely be warranted fairly soon unless incoming information pointed to a substantial and sustainable strengthening in the pace of the economic recovery." Since then gold rose 2% in anticipation of the speech on August 31. Unfortunately, however, despite market excitement in the lead up to the speech, the content was fairly bland. Bernanke acknowledged that the previous bouts of quantitative easing worked, and although his speech was consistent with potentially more Fed easing, he was not definitive. In concluding he said: "Taking due account of the uncertainties and limits of its policy tools, the Federal Reserve will provide additional policy accommodation as needed to promote a stronger economic recovery and sustained improvement in labour market conditions in a context of price stability."

As far as trading in the Fund was concerned, during August there was little activity. The manager did take the opportunity to sell a couple of private positions, and also purchased some more shares in Royal Nickel.

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Portfolio - Top 5 Holdings

	Top 5 Holdings	**Gross Assets (%)**
1	Falkland Oil & Gas	36.9
2	Royal Nickel	7.0
3	Goviex Uranium	5.0
4	African Minerals	3.4
5	Madagascar Oil	3.2
	Top 5 holdings represent	**55.5**

Sector Split

	Sector	**(%)**
1	Oil & Gas	50.4
2	Ind. Base Metals	18.0
3	Coal/Uranium	8.7
4	Gold & P. Metal	10.4
5	Biotech	3.7
6	Agriculture	3.4
7	Technology	1.3
8	Consumer	1.4
9	Other	1.1
10	Clean Tech/Energy	1.3
11	Real Estate	0.9
		100.4

Investment Commentary *(Cont'd)*

A number of the Fund's largest positions performed strongly during August, contributing significantly to the Fund's overall performance. Borders & Southern rose as much as 94% for the month following the release of its Darwin fluid sample analysis. The initial condensate yield from the Darwin gas samples, varied from 123 to 140 stb/MMscf. Based on the condensate yield combined with ongoing reservoir modelling, the company estimates the recoverable volume of condensate to be 130 to 250 million barrels, with a mid case of 190 million barrels. This announcement had an impact on Falkland Oil and Gas' ("FOGL") share price in August as well, which rose as much as 10% on the back of the announcement. FOGL had already risen around 23% over August following the announcement that the company had started drilling Loligo. Another position that performed strongly during August was Royal Nickel. At one point the stock was up 91.8% for the month. This rise followed a $12m investment by the Quebec government's mining investment entity Ressources Quebec, in return for a 0.8% net smelter return and a 2% co-ownership interest. This should allow the company to complete a feasibility study on its Dumont project without having to issue equity in the near-term. The company also received a boost when company employees bought shares on market up to 66c/share.

On the negative side Victoria Gold and African Minerals have had a difficult month. Victoria Gold fell 25% following the publication of its Annual Information Form for the year ending February 29, 2012. Although all the information published in the document was public knowledge already, the possible reason for the subsequent sell off was that it reminded investors of the capex requirement and the company's current low cash position. African Minerals fell heavily on the back of an announcement revising 2012 production guidance down 50%, with the share price falling 16.5% on the day of the announcement. This has been compounded by falling iron ore spot prices, although low cost producers such as African Minerals should not be as materially affected as other producers.

Iron Ore: As mentioned earlier, iron ore prices came off hard during August, falling 23.5% during the month from US$117/t to US$89.4/t. Indeed this fall followed a weak July as well, where it started the month at US$134/t. This drop in pricing has been primarily driven by destocking in China, similar to the price drop off in September/October 2011. However a Macquarie report highlights one key difference. Whereas the 2011 drop was due to smaller mills simply buying less ore to reduce inventory, this price drop has been despite purchasing activity hardly deteriorating at all.

This implies that inventory volumes have run down instead by increasing the rate of consumption of iron ore –by keeping pig iron and crude steel production volumes at a high level. The risk with this is that if the smaller mills are yet to show sign of significant upstream production cuts, there is still more downside risk for iron ore, which could mean that the short-term cost support could be as low as US$80/t:

The question remains as to why iron ore prices have performed so badly if smaller mills have only reduced their purchasing activity by a relatively small amount of 7%. This is due to the behaviour of the larger steel mills, who are currently cutting production and inventory levels. In August Macquarie reported that iron ore demand by the larger mills fell by 13%. All in all, apparent Chinese mill iron ore demand fell 11%, or 104mtpa. What most market analysts seem to think, though, is that this dip is a short-term issue, although it is possible that this will continue for 1-3 months if China opts to defer any stimulus measures until the new government is announced. At US$100/t prices, 42% of China's mine supply will be out of the money, which will certainly shift the focus on to the iron ore seaborne traders. However the main takeaway is that although short-term prices can stay low (sub US$90/t), there will be a material supply response to get prices back to US$100/t.

Conclusion

At the time of writing all of our hopes/fears/prayers are focused on FOGL's drilling of Loligo. Retail investors have sold the shares down heavily, but we still await news in a week or so. We believe the management that logging of the well has not even started. Hopefully there will be positive news, but the Scotia well will follow on directly and then 3D seismic in 2013 and more drilling in 2014. At the current price (75p) there is not so much more downside to the estimated cash support level of 42p. So there is still much to play for.

Finally, we still believe the balance of roughly two thirds of our portfolio is deeply undervalued. The experience of Royal Nickel's share price nearly doubling on financing news supports this in so far as everything seems deeply oversold.

We thank our shareholders as we await the FOGL news together.

Philip Richards and Team