

RAB

Special Situations
Company Limited

Key Facts

AIM quoted
Ticker: RSS.L

Company Information

Shares in issue: 63,987,761*
Denomination: GBP
Admission date: 31 May 2005
Year end: 31 December

*Voting shares in issue as at 31/03/15,
excludes shares held in treasury

Share Price (as at 31/03/15)

9.00 p

Manager

RAB Capital

Administrator & Company Secretary

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Investment Commentary

The RAB Special Situations Company (the "Company") returned -3.3% (Mar) and +11.1% (Q1). RAB Special Situations (Master) Fund Limited (the "Fund") returned +9.4% during the first quarter of 2015. Notably, this compares favourably with the performance of the Bloomberg World Mining and FTSE AIM Oil and Gas Indices (-2.3% and -16.0% respectively). Among the Fund's top contributing positions in the first quarter were Falkland Oil and Gas Limited, Oxus Gold plc and Victoria Gold Corp.

The first quarter of the year proved to be very strong for the Falkland Oil and Gas Limited share price as excitement built in relation to its upcoming drilling campaign. The successful result of their first well at Zebedee was announced on 2 April with 25million of net oil pay while another 17.5million of net gas pay were observed in the Hector horizon. Oil was also encountered in a number of other sands and their partner, Rockhopper, speculated that pressure data indicated there may be an oil rim to the Hector discovery. Management have highlighted that they will now interpret these results and release an updated resource size as well as seeking a third party assessment. After this solid start to the exploration programme the rig has now moved and the next prospect, Isobel, was spudded on 8 April and is expected to take 30 days to drill. Subsequent to these events, the company has also announced that it has reached an agreement with its partners in the southern acreage that they will not drill the second well in that area. Instead the rig slot will be used to drill the Rhea prospect in a licence area Noble and Edison recently acquired to the north of the Islands. (Continued overleaf)

Portfolio Breakdown

Top 5 Holdings		Gross Assets (%)
1	Falkland Oil & Gas	37.6
2	Royal Nickel	12.4
3	Trevali Mining	10.0
4	Brasol do Brasil	4.5
5	E-Therapeutics	2.8

Top 5 holdings represent **67.3**

Sector Split

	Sector	(%)
1	Oil & Gas	53.9
2	Ind. Base Metals	25.4
3	Gold & P. Metal	5.9
4	Biotech	3.2
5	Coal/Uranium	2.8
6	Real Estate	1.3
7	Agriculture	0.8
8	Clean Tech/Energy	0.7
9	Consumer	0.6
10	Other	0.5

95.1

Country Split

	Sector	(%)
1	UK	52.7
2	Canada	30.0
3	Australia/Far East	5.5
4	USA	5.1
5	Europe	1.8

95.1

Listing Split

	Sector	(%)
1	Listed	80.8
2	Unlisted	14.3

95.1

While there is clearly some disappointment that we will not see the drilling of a second prospect in the south, this is counterbalanced by the strengthened financial position of the company. We believe that a concern had built within the market that FOGL would potentially have been stretched by the financing of the full five well programme and as such would have needed to seek additional funding to complete it. This concern has been alleviated while the high risk, high impact drilling of the Humpback prospect offers exposure to a potential mid case net unrisks prospective resource of 268million barrels.

Both Oxus Gold plc and Victoria Gold Corp had a strong quarter, reflecting in their quarterly share price performance the relative strength in their underlying commodity.

On the negative side, Goviex Uranium Inc and Madagascar Oil SA were amongst our poorest performing holdings in Q1 2015.

This year has so far seen very poor performance from the Goviex Uranium Inc share price. We believe this reflects concerns over whether the company will be able to obtain the financing necessary to move forward with its plans to develop its uranium resource in Niger. Despite this, the process continues to move forward with the announcement in March that: "the Environmental and Social Impact Assessment (ESIA) for the company's Madaouela Uranium Project has been completed and filed with the Nigerien Minister in charge of the Environment."

Madagascar Oil found itself in a similar situation with the market concerned about its ability to develop its heavy oil project, especially when set against the oil price turbulence. On the ground the steam flood pilot project is progressing and the company are currently awaiting a decision by the government in relation to the Tsimiroro development plan.

Q1 commodity price volatility clouds the picture

Market fundamentals at the start of 2015 gave us reason to believe that natural resource equities would outperform the wider market, especially given an unprecedented four years of underperformance for the sector globally. Unfortunately as the quarter unfolded, the continued oversupply of materials accompanied by ongoing slowdown in China and the relief from producer currencies have all caused us to question this view. Initial 2015 outperformance has now largely been eroded by evidence of structural issues in both, the supply and demand pictures.

Price volatility was a major feature of the quarter, which clouded the overall picture for commodities. Gold, for instance, rose 9.5% in January, then fell by 11.7% by mid-March before recovering to end the quarter almost flat (-0.3%). Price changes reflected positive momentum from the removal of the Swiss currency peg and Greek elections, but also selling pressure related to a significantly stronger US Dollar and mixed perceptions of Federal Reserve interest rate commentary.

Copper displayed similar volatility - falling 14.7% in January, only to claw most of this back, rising 14.0% to close to its price at the start of the year. While the question of Chinese demand strength continues to be posed, with supply side disruptions showing the highest annual rate for years. Following the Chilean floods, which led to numerous operational shutdowns, copper supply outages are now annualising at c.6%, the highest rate seen since 2009.

Likewise, despite signs of a recovery in February, bulk commodities such as iron ore and metallurgical coal suffered the biggest losses during March, falling 17.9% and 14.0% respectively. In fact, iron ore suffered its biggest quarterly price loss (-27.9%) since 2009, falling to a ten-year low of US\$51.4 per tonne during March with low cost supplies from Australia and Brazil flooding the market and Chinese demand remaining weak. Metallurgical coal had the same poor demand outlook as iron ore, coupled with China's interventions to help domestic suppliers.

Meanwhile, nickel dropped to its lowest levels in almost six years in Q1 (18.1% drop to US\$12,339 per tonne), amid investors worrying about excess supply against the backdrop of a weakening Chinese economy. Last year's ban on exports by Indonesia, which sent the metal price sharply higher in May, has not created a much-expected shortage of material in the market.

The first three months of the year were also marred by the WTI oil price tumbling a further 10.6%. Oil kicked off a several-week recovery rally in late January, thanks to hopes that production cartel OPEC would try to end a deep plunge in prices by cutting output. However, a rampant rise in the US dollar coupled with a deal on nuclear weapons with Iran, which could unleash a new supply of crude oil if sanctions are lifted, have both subsequently pressured the commodity.

Elevated levels of commodity price volatility have negatively impacted investors' sentiment, triggering a debate about whether conditions are likely to emerge to damp it again, and resulting in the erosion of share price gains enjoyed by some companies in the natural resources space at the beginning of the quarter. Consequently, the Bloomberg World Mining Index and the Market Vectors Gold Miners ETF (GDX) posted an intra-quarter draw up of +6.5% and +24.8% before ending the quarter down 2.3% and 0.8% respectively.

There is a significant difference of views across commodities as to whether volatility should fall as prices start to trade into commodity cost curves, as they have already for oil. The generalist view is that volatility will fall, based on historical precedent in other lower price environments. However, quite possibly the reverse will be true. Hitting the bottom might be a lot like hitting price peaks, where volatility increases as demand is rationed by high prices.

Will commodities reach a trough in Q2?

There are several reasons why commodities may be reaching a short-term trough. The oil market, which plays an important role in the pricing of other commodities, will likely see the lowest annual demand this quarter and a peaking of storage, while expected investor outflows from physically backed crude ETFs are likely to push markets further towards a pricing low in Q2.

Nevertheless, moderate global economic growth and continuing increases in output of most commodities, triggered by the investments that were themselves the result of high prices in the last decade, should keep the markets fairly soft, underperforming broader risk markets in the second quarter. At the same time, commodity demand may actually pick up in the developed economies, which are benefiting far more than emerging markets from lower prices. However, short-term headwinds to growth in emerging economies, especially China, may continue to keep most markets flat after a brief recovery.

Meanwhile geopolitical risks are yet to rise as commodity prices fall to levels below earlier expectations. This should particularly be the case for oil producing countries, with government revenues less than half of what they were only a year ago. There is no end in sight for fragmentation risk in Libya, with a high probability it could spread to other oil producing countries, especially Nigeria, and where lower commodity prices are affecting political dynamics in Latin America and Africa. The Middle East, however, remains the highest source of disruption risk, with military conflicts under way in Syria, Iraq and Yemen and a risk of spill over given the frailty of

the Iran-Saudi relationship.

Nonetheless, four key factors currently weighing on commodity performance should be potentially creating good entry points into this asset class and turn into drivers of future growth, perhaps as early as the end of this year, if not before. Vital to these developments is the perceived role of foreign exchange and divergent central bank policies.

First, while weak global economic growth, including China’s ongoing economic transition, drags on demand, looser monetary policies globally could provide the stimuli needed to restore macro growth. By Q3 the recent habit of revisiting expected global growth down might well be reversed with lower prices as a new stimulus.

Second, even as currency gyrations and broad-based currency depreciation against the US dollar weigh on emerging markets, creating potential political tensions along the way, the FOMC policymakers’ recognition of the US Dollar strength should slow the pace of the US rate hikes, thus moderating its appreciation. Looser monetary policy should promote growth and recent Federal Reserve statements allude to concerns about headwinds to US growth, also visible in macro ex-payrolls data.

Third, while currency depreciation has dampened the benefits of low oil prices, sub-US\$90 oil prices should remain structurally positive for most advanced economies and for emerging market countries like India and China that are both import dependent and whose consumers have generally open, i.e. non-subsidised exposure to oil.

Exhibit 1: Falling prices should generate net benefit to importers over time (million barrels/day)



Source: Bloomberg, RAB Capital Ltd, 31 March 2015.

Last but not least, commodity prices have remained quite weak, but we believe a supply response is coming, such as cuts in oil production, zinc and copper output, shortening the commodity cyclical trough now clearly so dominant.

Given the above, we remain positive on the structural prospects for natural resources in the medium to long term.

Philip Richards and Team

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