

## **A CASE STUDY OF AN APPRAISAL PROJECT TURNING SOUR**

Trevor R. Ellis, Vice President, AIMA

In the spring of last year, I received one of those rare, unexpected phone calls in my Denver home office. It was the owner of a little investment business located out near the east coast of the USA. He was essentially requesting that I drop everything to jump on a plane to a western state to begin an appraisal project. Although I wasn't starving for work, times as usual were lean in the mining industry, so I was willing to jump.

The little investment business, we will call it Rising Sun Investments, had partnered with a little mineral property development company, Apex Exploration, which was based in the southwest U.S. The owner of Rising Sun told me that Apex had pulled a coup in securing the purchase rights to a proven reserve of many hundreds of thousands of tons of a valuable industrial mineral sitting out in the middle of the western desert. He told me that the processed product was selling throughout the USA and internationally at about \$6/lb and they had three written expressions of interest to purchase the product at that price. The feasibility study of Apex's consulting metallurgist had shown that the cost to extract a product of adequate purity would be around \$2/lb. Rising Sun had a lender lined up to provide the many millions of dollars for the plant and equipment. They needed my appraisal in short order to secure the loan.

Things didn't smell right. The investor had only found my name on the Internet and didn't even have a reference on me. Yet he was immediately telling me that my rough estimated cost for doing the job was acceptable and he would wire a deposit tomorrow to my bank. Just fax him the contract and he both he and the President of Apex would sign on it so that both companies would be on the hook for my fee. The lender must have my report within 20 days.

I was still suspicious. My suspicions increased when the owner of Rising Sun told me that I could talk to anyone I liked, except for the President of Apex. Apparently he and Apex's President were having a falling out over how to do business together. It didn't sound good.

But, then Mr. Rising Sun dropped a few names which quickly got me back on board. By whatever quirk of circumstance, it turned out that I already knew the geologist and geochemist who were working on the project. In fact, they worked for a consulting company a few miles from my office, owned by my best friend of the past 20 years.

I immediately phoned them, and found everybody in. I drove over. They had thoroughly sampled, tested and investigated the reserves. The reserves were definitely there. It **did** seem like a coup for Apex. In their report they had indicated that the contained minerals had a potentially astronomical value.

Their words of advice indicated that I shouldn't worry about doing the job. They had done work for Mr. Apex a number of times over the years. He wasn't good at paying. Still owed them a few thousand from the last job. But, Mr. Rising Sun would take care of everything. He was the type

who paid immediately, and was taking care of their bills. The credit history of him and his company sparkled.

I received the contract signed by the Presidents of both companies the next day, and my bank told me that their deposit was in my account. I was to write two appraisal reports. The first was to value the reserves as is. The second was under strict terms provided in written instructions from the lending institution, to determine what they termed “the net processed value” of the small portion of the reserves that would be run through the plant in the first couple of years. That is, the lender wanted to know the net value of the selling price minus direct operating cost for the resulting processed product. No problem. The consulting metallurgist had the operating costs worked out and Apex had three letters of interest to purchase the product at \$6/lb.

The following day I was out in the desert picking up samples with the consulting metallurgist and my friend, the geologist. I asked the metallurgist to show me his design and costing for the processing plant. He pulled out a couple of worn sheets of writing paper with a hand sketched flow chart and some rough calculations. I had no intention of relying on those. I asked him lots of probing questions. He was working for a piece of the action and hadn’t been paid anything yet. He had no direct experience with this particular mineral, but could talk a good story and could quote metallurgical text references about the mineral.

The metallurgist showed me the three letters expressing interest in purchasing the product at about \$6/lb. They wanted everything that Apex could possibly produce. One was a trading company based in Europe buying for the European market, and another a minerals trading company based in New Zealand, buying for the Asian market.

I phoned Mr. Rising Sun and to tell him that I couldn’t rely on the metallurgist’s work. I headed for the capital city to do some historical research. The next day I found out that a very well respected metallurgy professor that I had known peripherally for many years, was on his way down to take some bulk samples back to a major minerals research lab for bench testing. I knew that I could rely on his report.

A week later, the professor’s tests weren’t working out well. Mr. Rising Sun was getting worried. He told me that he was now in a severe legal fight with Mr. Apex. He was fighting to get control of the project and the reserves.

But, then another miraculous breakthrough came. Mr. Rising Sun had been talking with the management of an operating toll processing facility. It sounded like it had everything going for it. The trucking distance for the raw mineral was long, but not too long. I talked on the phone to the operator and his process chemist. They sure sounded like they knew this specific reserve and its product well. The chemist had driven out to the property and taken a bulk sample. His initial tests were looking good. He would give me the results of more comprehensive testing in a couple of days.

In the meantime I was investigating the product market, even though Mr. Rising Sun was telling me that I must rely on the market data he provided. He told me that he didn't want me running up the bill for unnecessary research. He was worried about the fast mounting legal costs of fighting Mr. Apex. I was banned from talking to Mr. Apex, but Mr. Apex phoned me to bad mouth Mr. Rising Sun. Through my research I determined that the two international trading companies that had provided letters of expressions of interest, did indeed exist. However, my suspicions about them were fast mounting. I could not locate the third potential buyer. Mr. Rising Sun sent a stream of faxes with price quotes and specifications from magazines and market literature to support his theory that the selling price should be much higher than \$6/lb.

I suggested to the professor that we should cut our losses and bail out of the project. He phoned Mr. Rising Sun. The professor was convinced that all of the problems were coming from a sleazy Mr. Apex, and that Mr. Rising Sun wasn't trying to do anything underhand. Also the bench test by the toll processing facility had proved positive. Mr. Rising Sun needed us to leave immediately together to the property to take a larger, secure bulk sample, drive it to the processing facility, and supervise a larger test.

My payment for my first invoice immediately arrived by wire in my bank account. Also I still had the initial deposit, so I was breaking even. A fax from Mr. Rising Sun doubled the value of my contract. We caught the plane out west the next day.

The professor and I sure had a wonderful time driving across the desert, exchanging tales, while I tried to patch together a report on a laptop computer to still meet the lender's only slightly extended deadline. The professor supervised the testing while I continued my research from the motel.

By the time we had a sample of the product from bench testing ready for us to take back to Denver, I was convinced that the three letters expressing interest in purchasing the product were part of a scam job. But, Mr. Rising Sun insisted that I base my net process value calculations on quotes he had found for small lots of the material. I told him that he did not have the marketing ability to sell his product off in small lots. He would be a producer, not even a wholesaler, let alone a retailer. He sounded desperate. I began wondering what he planned to do with the cash from the loan even if he got it. I began doubting that much of it would be going into processing the "reserves."

The lab analysis found that the purity of the sample product was borderline; but the professor assured me that it could be improved sufficiently. I received the professor's moderately positive report on the process. His cost estimates based on the toll processing did not kill the project.

In the meantime, I had been continuing my unauthorized market research. I had taken some of the product sample to a specialist to determine its crystallography. The result was that the product could not meet high end market specifications.

I concluded my two reports very negatively, giving zero value to both appraisals. By this time, Mr. Rising Sun had a pretty good idea of what he would be receiving. He was irate, severely bad mouthing me with foul language. I asked for my payment before sending the report. He refused.

He knew the negative report would be useless to him. The reports, packaged, ready for shipping, are still in my office.

Mr. Rising Sun eventually won his battle against Mr. Apex, getting title to the minerals. But, he had to sell off his family investment business in the process. Mr. Apex spends a lot of time in the Bahamas these days, living on Mr. Rising Sun's initial investment, while he plans his next minerals scam. The two payments I had received, covered the cost of my education on the project, but nothing more. The professor came out a little better. A debt collector is attempting to squeeze some more money out of Mr. Rising Sun for my unpaid work. I don't expect to see any. Mr. Rising Sun frequently phones the geologist and geochemist at my friend's office to pick their brains about how he can peddle the mineral title he now holds, and is seeking a specialist to produce the type of report he needs.

I haven't developed any conclusions as to how to prevent this type of disaster from happening to us in the appraisal business. Attempting to collect even 50% of our fee up front will scare off many potential clients. An escrow arrangement may be possible, but adds complexity and an air of distrust, and I am not sure it could have been made to work in this fast paced case. I am somewhat resigned to expectation that even when we go into projects with our eyes open, we will occasionally end up unpaid. If any readers have any suggestions based on similar negative experiences, I would like to hear them.