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Sickness And Health

Michael Cartwright, AIMA Past President, recently had quadruple heart by-pass surgery following a severe heart attack. He is reportedly doing well and is now recuperating at home. Get well **Mike** and back to work soon from all of us. His E-Mail address is michael@minval.com for those who desire to send him an electronic get-well card.

Australasian JORC Recommendations On Minerals Industry Reporting

The Australasian Joint Ore Reserves Committee (JORC) has recently submitted its recommendations to the International Accounting Standards Board (IASB) concerning their Issues Paper on Extractive Industries. *Editors note: Australasian is correctly spelled. In an economic and political context, it encompasses, Australia, New Zealand, New Guinea, and nearly all islands of the South Pacific Ocean.*

The JORC Code of 1999 has been used as a model for the reserves reporting standards of the mining institutes of South Africa, UK, Canada and USA. A European Code, based on JORC, should be in operation later in year 2001. Further, an International Reporting Code is underdevelopment by the Council of Mining and Metallurgical Institutions (CMMI). Trevor Ellis, AIMA President, is the invited U.S. speaker on the Code session panel at the CMMI Congress 2002, in Australia in May. The JORC Code is viewed to be a minimum

standard for Public Reporting. The aims of JORC and Accounting Standards are therefore closely aligned.

The main recommendations of JORC to the IASB are as follows;

- ❑ Information about reserves and resource quantities (but not financial values) and changes in them is a key indicator of the performance of an extractive industries enterprise.
- ❑ The financial statements should be based on historical cost, not on estimated reserve values. Historical costs indicate where the enterprise is now or has been, whereas reserves/resources can be used to assess the enterprise's future potential.
- ❑ Information about reserve quantities (but excluding financial values) should be disclosed as supplemental information.
- ❑ Proved and probable reserves should be disclosed separately.
- ❑ In the interest of full disclosure, measured, indicated and inferred resources, should also be reported in the supplemental information.
- ❑ Changes in reserve (and resource) quantities should be reconciled with quantities for the previous corresponding period.
- ❑ Recognizing actual operating practice (expected life of mine), some resource may need to be taken into account when estimating the effective "divisor" number for depreciation write-off purposes.

IVSC Recommendations On Extractive Industries Reporting

The International Valuation Standards Committee (IVSC) has submitted its recommendations regarding the International Accounting Standards Board's (IASB) proposed Extractive Industries International Accounting Standard for financial reporting of public companies. The IVSC functions as a sister body to the IASB. The submission was developed in response to the IASB's *Issues Paper* released in November 2000 regarding the proposed Extractive Industries Standard. The *Issues Paper* is discussed in articles by Trevor Ellis in previous editions of the Newsletter, these being, *IASC Reviews Extractive Industry Valuation*, February 2001, and *Potential Increase in U.S. Appraisals from Extractive industries International Accounting Standard*, June 2001.

An AIMA President, Trevor R. Ellis, was instrumental in forming the IVSC Task Force, and led it in developing the IVSC submission. Trevor has provided a copy of the submission to our Web Master for posting on the AIMA Web Site. Discussion of the Australasian JORC submission is in this edition in a separate article. If you would like to obtain a copy of the *Issues Paper* or the JORC submission, contact Trevor Ellis by e-mail to ellis@minevaluatin.com.

The IVSC major recommendations are as follows;

- ❑ There should be a single reporting Standard for the extractive industries with differences between the mining and petroleum industries covered by individual rules.
- ❑ The *fair value* of Proved and Probable Mineral Reserves and Proved Petroleum Reserves should be in the primary financial accounts, with *historic cost* reporting an option.
- ❑ For mining industry enterprises, quantitative and qualitative information should be included in the supplemental statements for all Mineral Reserve and Mineral Resource categories.
- ❑ For petroleum enterprises, quantitative information should be included in the supplemental statements for all Proved and Probable reserves. No reporting for possible petroleum reserves should be allowed, nor should such for any petroleum category.
- ❑ For mining industry enterprises, reporting of the *fair value* of Measured and Indicated Resources should be encouraged in the supplemental notes, with mandatory *historic cost* reporting required as the alternative. *Fair value* reporting for Inferred Mineral Resources and exploration properties lacking defined Mineral Resource should also be allowed, subject to careful review for reasonableness, and only if such value does not compose a large portion of the value of the company, with *historic cost* basis being the alternative.
- ❑ *Fair Value* disclosure for Probable Petroleum Reserves should be allowed in the supplementary notes. Such disclosure should also be allowed for exploration properties lacking proved or probable reserves, subject to reasonableness, and only if such value does not compose a large portion of the value of the company. In both cases, *historic cost* basis disclosures should be the alternative.
- ❑ The IASB standard should specify that reports of Mineral Resources and Mineral Reserve estimates must be developed and reported in compliance with one of the CMMI-based standards. A Competent Person similar to that specified in the CMMI-based standard must take responsibility for the report. Reports of petroleum reserve estimates should comply with the SPE/WPC definitions. IASB should encourage the petroleum industry to develop a petroleum reserve reporting standard containing a competent person provision similar to that in the JORC Code.
- ❑ *Fair Value* valuations of all mineral and petroleum properties should be performed by defined Competent Persons and the name and qualifications of such persons should be disclosed by notation in the supplemental statements. Guidance by a comprehensive internationally respected mineral and petroleum valuation standard should be specified.
- ❑ The proposed IASB Standard must allow changes in the value of mineral and petroleum assets to be made in the financial statements without being reflected in the profit and loss statements.
- ❑ *Fair Value* revaluation of mineral and petroleum properties should only be expected at four or five yearly intervals for inclusion in the primary accounts and supplemental disclosures or when major quantitative changes in reserves or resources occur that are not due to production.
- ❑ Any enhancements to the petroleum industry's resource and reserve reporting definitions which IASB determines are needed, or possible future development of a reserve reporting standard, should be coordinated through SPE/WPC or a successor international body representative of the petroleum industry as may exist at the time.
- ❑ Any enhancements to the mining industry Mineral Resource and Mineral Reserve reporting Standards which IASB determines to be needed must be made through the CMMI or its successor.
- ❑ The proposed Standard should clearly differentiate the current valuation requirements for *fair value* and *value in use*, the former being entirely market related and the latter being entity specific. *Value in use* should conform to existing IASB definitions to take account of account trading connections, contractual arrangements and management attributes and be related to identifiable cash flow units. *Value in use* calculations should not include internally generated goodwill in the cash flows.

AIMA 2002 Annual Meeting

Trevor Ellis, AIMA President

The 2002 Annual Meeting will be held Monday, February 25th, in Phoenix, Arizona, beginning about 4:00 PM. It is in conjunction with the Annual Meeting and convention of the Society of Mining, Metallurgy and Exploration (SME). This has proved to be a successful, informal affiliation for our last three Annual Meetings. The SME convention will run Monday, February 25th, to Wednesday, February 27th. Its main meeting and exhibit location is the Phoenix Civic Plaza Convention Center. Stuart Limb and his Secretary, Alexandra, have selected a location for our Annual Meeting that is convenient to the Convention Center. It is **Kincades** which is located at **TWO South 3rd Street, Phoenix, AZ**. Kincades is a Fish, Chop and Steak House. They have reserved a room for us from 4:00 P.M. to 9:00 P.M. Our business meeting will be held first, then we will probably begin dinner about 6:30 P.M. as a guess, and depart about 8:30 P.M. or 9:00 P.M.

We have found that the informal affiliation with SME has worked well in allowing our members to attend business meeting on the Monday afternoon, followed by free flowing conversation and debate over dinner and free flowing drinks. Then on Tuesday, we have taken advantage of the SME Valuation sessions which have effectively become our technical program forum for our mining and quarry industry members to present their papers and otherwise participate. Some of our members have already committed to participating in this next SME Valuation session. Sam Pickering and Stuart Limb are co-chairing the session. Consider their call for papers published in our June Newsletter. Then post the dates on the wall of your office where they will be readily visible to you.

Nominations For AIMA Officers

Election time for Year 2002 AIMA Officers is nearing. The offices of President, Vice President, Secretary and Treasurer are open for nomination. If you wish to nominate someone, including yourself, please contact Sam Pickering (e-mail; indmin@aol.com or tel. 912-743-9323).

Minerals Valuation Sessions SME 2000 Annual Meeting Appeal for Papers

The next SME (Society for Mining, Metallurgy & Exploration) meeting will be in Phoenix, Arizona on February 25 – 27th, 2002. We are scheduled to have a single session of up to 6 papers on mineral appraisal Tuesday afternoon, 26 February, followed perhaps by a lively debate on Discount Rate selection.

Stuart Limb (e-mail; cmc@doitnow.com, tel. 602-443-3978), and Sam Pickering (e-mail indmin@aol.com, tel. 912-743-9323) have agreed to chair the session. Please contact either of them as quickly as possible if you would like to present a paper. SME deadlines are looming.

AIMA Membership Listing

In the May 2001 Newsletter, our members were requested to furnish a short summary of contact information, background, areas of expertise and specialization, types of minerals typically appraised, etc. The purpose of this request was to supplement information now appearing in our Web Site. The thinking was, the additional information would be helpful to potential clients in their selection of an appraiser. Again you are requested to furnish a short qualification summary to Donald Warnken (tel. 918-663-3074, fax 918-665-8343 or e-mail; Dongene32@aol.com).

Name _____
Company _____
Address _____
E-mail address _____
AIMA Certification No. _____
Background (geologist, engineer, etc.) _____

Specialization _____
Comments _____

Responses To Uniform Appraisal Standards For Federal Acquisitions Question

In the May 2001 Newsletter, AIMA members were invited to comment on the following position presented in Section D-11 of the “standards”.

“In developing an estimate of value by the income capitalization approach for a mineral property, it is generally recognized that the most appropriate method of capitalization is yield capitalization, most notably discounted cash flow (DFC) analysis. The income that may be capitalized is the royalty income, and not the income or profit generated by the business of mining and selling the mineral. For this reason, the income capitalization approach, when applied to mineral properties, is sometimes referred to as the royalty income approach.”

Only one response was submitted. The Editor was hopeful that a member would have tackled the position that the income or profit generated by the business can not be capitalized. Maybe next time.

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Response To Uniform Appraisal Standards Question, con't from page 3

Response – From Louis Posgate, ASA, P.E.

The author commented on the Department of Justice's recently revised Uniform Appraisal Standards For Federal Land Acquisitions, Section D-11. These regulations suggest a single-period, income capitalization approach to valuing mineral royalties. This is an edited version of comments provided to and solicited by the editor of the American Institute of Mineral Appraisers Newsletter, vol. 5, no. 3, regarding the regulations, Louis R. Posgate on June 13, 2001. Lou is an accredited senior appraiser, designated in both business valuation and oil and gas valuation, by the American Society of Appraisers. He is a licensed engineer and is an independent valuation consultant in San Antonio.

I focused my attention on the Department of Justice's section D-11 standard for valuing a mineral royalty, and its opinion that the valuation method most appropriate is the yield capitalization method, without regard to the profit generated by the business of mining and selling the mineral. This is actually one of two capitalization methods available to real estate appraisers, the other one being the direct capitalization approach, where market rates are extracted from sales of properties having a net operating income stream (see *The Appraisal of Real Estate, 10th Edition, chapter 20, the Appraisal Institute*). These comments are relevant to oil and gas mineral rights valuation, centered on a right to receive a specified mineral royalty from produced minerals. While the DOJ suggests discounted cash flow analysis and yield capitalization as a generally recognized most appropriate method to estimate values of royalty streams, it is noted that direct capitalization discount rate extraction from oil property sales are considered in calculating discount rates, by the Property Tax Division of the Texas Comptroller of Public Accounts in its 1994 Property Value Study. Other studies suggest similar methods.

In the valuation of depleting oil and gas properties, there have been some property tax discount rate studies performed over the past 18 years. An eminent one is *Fair Market Value Transactions, Cost of Capital, and Risk, California Oil and Gas Property Transactions 1983-2000*, by Richard J. Miller & Associates, Inc. February 2, which compares the equity return rates and weighted average cost of capital for public oil companies to calculate internal rate of return ("IRR") projected by the buyers of such properties. (The IRR is also referred to as the yield rate in *The Appraisal of Real Estate*.) Richard's annual California study contains a good analysis of market surveys of ranges of IRRs expected by anonymous buyers in specific oil and gas reserves transactions (proved producing, proved undeveloped, etc.). It provides a comparison of the calculated IRR for private transactions to the average cost of capital of companies having listed stock, by using Ibbotson Associates' total equity returns data (after adjusting to pre-tax) and debt calculated from Moody's. One conclusion provided in this study is the market-derived oil and

gas property yield, or IRR of 23.3%, averaged 7.2% higher from 1990 to 1999, than the calculated BFIT weighted-average cost of capital, the latter of which explicitly reflects the company's financial leverage, rather than the growth (or decline) rate of underlying specific property cash flow. Perhaps the IRR or yield rate extracted from the market is such studies better reflects a decline rate, buyers' estimates of business, geologic, and technical risks, reserve life, and operating cost exposure, than calculated real estate rates applied to single-period capitalization methods suggested by the DOJ.

Lets turn back to yield capitalization applied solely to the royalty stream without any reference to mineral price appreciation, decline rate of the production or grade quality, cost of extracting the mineral, or risk. To ignore these considerations would be placing the cart before the horse by not considering the economics of producing the properties. Capitalizing the royalty received in year one, prospectively, by an approximated yield rate as preferred in D-11, assumes a perpetual stream, unless a decline factor is included.

As I understand in *The Appraisal of Real Estate, Chapter 21*, the following applies. A yield rate analysis can assume an Inwood premise or a Hoskold premise of level annuity with factors found in discounting tables. These tabled factors contain a return **on** (yield) as well as return **of** capital, by using a sinking fund factor. It should require a prudent examination of the royalty and production decline history, crucial to a meaningful result, for this method. Which is advocated by the DOJ standards. An estimate of what the real estate texts refer to, as a reversion value change component is included, a function of whether the property is sold at the end of the holding period, or abandoned when no economic value remains. For minerals, in the absence of a factual sale at the end of some holding period to back-calculate, this amounts to projecting a life assuming 100% economic depletion, to derive the capital sinking fund factor ΔS_n , which increases the capitalization rate to be applied to the royalty stream. For minerals, in the absence of a factual sale at the end of some holding period to back-calculate, this amounts to projecting a life assuming 100% economic depletion, to derive the capital sinking factor ΔS_n , which increases the capitalization rate to be applied to the royalty stream. The Inwood premise assumes the capital replacement sinking fund grows at the risky yield rate. A more conservative Hoskold premise assumes that the benefit stream contains an annual component of revenue dedicated to replacement of capital, growing at a slower sae sinking fund rate. The return *on* capital employs a speculative rate, like Inwood. The overall discount or yield rate is thus increased to factor in risk/life, approaching the higher market-extracted rates. The accuracy of Value=Income/Rate using a Hoskold premise depends on hitting these factors accurately, by reasonably estimating property or portfolio decline rates, comparable to the capitalization process for other types of valuation, such as business enterprise valuation. Its application to a royalty income stream, assumes the royalty percentage of (profitable) gross production times unit oil or gas price, at the end of the property or portfolio life, is 0. The

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Proposed Merger of Appraisal Societies

Editors Note: Below is a communication addressed to ASFMRA Members that was furnished by our President, Trevor Ellis. It has been published in its entirety for your edification and comment.

“Our Board of Directors approved sending a delegation of our members to a joint meeting with representatives of other organizations to discuss how our organizations might work together to more effectively meet the changing environment that you, our members, face. That meeting was held in Denver the past weekend, as I wanted to inform you of the nature of the discussions at that meeting.”

“This meeting grew from independent work done by the SWOT (Strength, Weakness, Opportunities and Threats) team, regarding the issues facing property and valuation professions. The team is made up of members, all of whom have served on Boards or as officers of the various organizations. A presentation on their preliminary work was made to our Board earlier this year.”

“In Denver, the SWOT team made a presentation recommending the formation of a single domestic valuation/management/consulting organization to our task force representatives (along with representatives of five other organizations) that served as a basis for further discussion and analysis. The organizations represented at the meeting included the American Society of Appraisers, The American Society of Farm Managers and Rural Appraisers, Appraisal Institute, The Appraisal Institute of Canada, The International Association of Assessing Officers, and the National Association of Independent Fee Appraisers.”

“After two days of discussion and exploration of the issues, the combined task force agreed unanimously that the concept of a single organization has merit. Given the changing market place, increased competitive forces upon our members and our organization, declining membership in our organizations and unnecessary duplication of programs and activities (thereby stretching scarce financial, members and staff resources even further), the task force members in Denver believes that it is in the best interest of our professions, and the members we serve, to explore the idea of a single umbrella organization within which each of our disciplines can operate independently.”

“The group committed to going to the Boards of Directors of each organization to seek authorization to continue exploring this idea. There are a great many issues that could stand in the way of this concept and substantial work has yet to be done. However, the representatives unanimously agreed that it is worthwhile effort to continue exploring this and other means of bring the presently fragmented valuator/property professions together in a much closer, more organized manner.”

“As the task force continues its work, and subject to approval by our Board of Directors there will be more information available so that you can consider this idea for yourself. Those participating in the exploration of the idea will be looking to you to also analyze the concept and provide input for their discussions.”

Response To The Appraisal Foundations' Appraiser Qualification Board Request

Trevor Ellis, AIMA President

Editors Comment: Our President, Trevor Ellis, has submitted his responses to a request for written comments on the Discussion Draft for revising the Real Property Appraiser Qualification Criteria. He has submitted it from the perspective of an individual licensed appraiser rather than as President of AIMA. He has taken that approach since AIMA does not fund The Appraiser Foundation (as I recall it would cost about \$25,000 to become a member), therefore he thought it best to avoid that complexity. He has addressed the State Licensing issue that concerns many AIMA members. His letter has been reprinted below in its entirety. The AIMA Newsletter is your forum for addressing issues that affect our profession. Trevor has presented his views on State Licensing. What is your view?

Dear Sir/Madam:

My recommendation is that your review must be widened to include the whole basis of having the licensing of appraisers on a state level. Many of us work nationally. I am a Certified General Appraiser (Colorado) who only appraises mineral properties (including mines and quarries). In this niche, we often work internationally. The mineral property cannot come to us, so we must go to where the property is located. State level barriers to us plying our trade nationally can be more difficult for us to overcome than national barriers to us working internationally. Once we have the appropriate qualifications in hand, we should be able to work freely nationally without having to apply for licensing or a Temporary Practice Permit for each state to which our work takes us. Our appraisal report may be needed before the temporary permit can be issued.

I strongly recommend that licensing must be moved to a national level. The Australian model for Chartered Professionals is an excellent model to follow. Australia removed State level licensing in recent years. If not moved to the national level, state boundaries must be made completely transparent. Maybe an identification card reader system could be installed at airports and border crossings on highways. Our current system of state licensing forms a restriction on interstate free trade in professional services.

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Response To The Appraisal Foundations' Appraiser Qualification Board Request

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Response To Uniform Appraisal Standard Question cont'd from page 4

Hoskold premise rate is:

Overall rate, or $R_o = Y_o + \Delta_o x1/S_n$,

Where the first term represents the calculated risked yield rate constructed from a build-up or Capital Asset Pricing Model (CAPM) equity or discount rate, and the second term represents the sinking fund rate calculated from tables assuming a safer rate, like long-term government bonds, assuming a reversion or decline in property value of 100%.

In business valuation the cash flow capitalization rate can be derived by using 1) a modified CAPM method, by considering returns on diversified *equity* portfolios, modified by size considerations and specific non-diversifiable risk, and 2) the annual rate of growth of the cash flow stream computed over a long-term holding period. The growth factor is subtracted (unless the stream is declining, in which case the factor could be added to the discount rate). Therefore the effect of growth or decline of the benefit stream on the capitalization rate is similarly critical. The depreciation of assets and the capital replacement expenditures are included in the cash flow stream to the enterprise, on an after tax basis, and this also effects the growth (decline) rate assumed and subtracted (added) to compute a cash flow capitalization rate. In the mineral property case, it increases the required rate of yield rate, to provide for capital replacement of a single declining asset value.

The error resulting from ignoring or superficially addressing the benefit stream decline rate in the mineral royalty yield capitalization valuation method, advocated by the DOJ, is similar to errors expected to occur is the growth issue is mishandled in the construction of a business valuation capitalization rate, when applied to a single-period estimate. It would be better to apply a Hoskold premise method to a portfolio on mineral properties wherein some diversification of volatile decline rates, costs and risks could be achieved. This would be more reliable when properties are stratified by area with typical decline rates and applying a rate to that stratum, or better when applying a rate to each property.

If one is not using some grouping method to stratify the application of cap rates considering decline history, these caveats point to the more reliable and traditional royalty valuation method. This requires engineering the property for economic life prior to valuing the royalty stream, estimated over that same life. Shortcuts taken will yield results due to differing factors affecting the production stream and assumptions implied in the single-period capitalization method.

My ability to ply my trade as a mineral property appraiser freely across state boundaries is additionally restricted by often being required to abide by geologist licensure rules, even though I am licensed as a Professional Geologist in two states. I find that I can work more freely in Canada and most countries than I can in the adjoining states to where I live. I am far from alone in this experience. These restrictions raise the cost of doing business for us and our clients, and often results in them failing to receive the professional services they seek. It can also cause transactions under consideration to be canceled.

You must also plan on how to implement free trade in appraisal services internationally, through U.S. recognition of international qualifications, and vice versa. As U.S. real property appraisers, we expect to be able to work around the world wherever our client sends us, and presently we have little problem doing so. However, our state level barriers to entry are such that it is essentially impossible for a foreign appraiser to come to the U.S. and legally appraise a real property holding for his client. We cannot expect to continue to practice in the backyards of other countries if we won't allow their professionals to practice in our backyard.

I am the U.S. representative on mineral property and industry valuation to a number of international standards and qualifications setting bodies. This includes being the leader of the Extractive Industries Task Force of the International Valuation Standards Committee, which in 2001 provided a comprehensive submission to the International Accounting Standards Board on minerals and petroleum industry valuation issues.

Our present system of state level licensing barriers (which functions as state regulated guild protection), is in violation, at least in spirit, of the North American Free Trade Agreement (NAFTA) Article 1210 and Annex 1210 which deal with trade in professional services.

It also is in violation of the spirit of the World Trade Organization's General Agreement on Trade in Services (GATS):

GATS Article VI (Domestic Regulation) Paragraph 4 states: *With a view to ensuring that measures relating to qualification requirements and procedures, technical standards and licensing requirements do not constitute unnecessary barriers to trade in services, the Council for Trade in Services shall, through appropriate bodies it may establish, develop any necessary disciplines. Such disciplines shall aim to ensure that such requirements are, inter alia: (a) based on objective and transparent criteria, such as competence and the ability to supply the service;*
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(b) not more burdensome than necessary to ensure the quality of the service;
(c) in the case of licensing procedures, not in themselves a restriction on the supply of the service.

Article VII (Recognition) Paragraphs 1 and 3 contain the following:

1. For the purposes of the fulfilment, in whole or in part, of its standards or criteria for the authorization, licensing or certification of services suppliers, and subject to the requirements of paragraph 3 below, a Member may recognize the education or experience obtained, requirements met, or licenses or certifications granted in a particular country.
3. A Member shall not accord recognition in a manner which would constitute a means of discrimination between countries in the application of its standards or criteria for the authorization, licensing or certification of services suppliers, or a disguised restriction on trade in services. (WTO, 1994).

NAFTA Article 1210 contains similar language on professional services to the above quotes from GATS. It also contains a comprehensive annex (Annex 1210) detailing implementation and expectations relating to professional services. It goes as far as suggesting an interview or oral examination as an alternative to a licensing examination, and encourages the development of temporary licensing (NAFTA, 1992).

I trust that you will give this submission your serious consideration. My contact information is listed below if you wish to discuss this matter further.

Sincerely,

Trevor Ellis, CPG-AIPG, CMA-AIMA, FAusIMM(CPGeo, CGA-CO

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