

**10th Annual ASA
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VIRTUAL!



**Incorporating Demonstratives into
Your Appraisal Report**

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Learning Objectives

1. Define the terms:
 1. Demonstrative;
 2. Demonstrative Evidence;
 3. Probative Value; and
 4. Proof
2. Have participants observe the author's use of demonstratives throughout his career.
3. Through these illustrations, show how the use of demonstratives will aid the participant in any appraisal review process including litigation.

The Fine Print

- This presentation contains general information only and is based on the experience of Mr. Svoboda. The material is based on and represents his personal opinion.
- The speaker is not rendering accounting, auditing, business, financial, investment, legal or other professional advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.
- Illustrations and examples are just that – illustrations and examples. They are presented as **instructional material**. The reader is advised to use caution if extrapolating general comments to issues with specific facts & circumstances.

Define Terms for Today's Topic

Demonstrative (adjective/ pronoun)

- Serving as conclusive evidence of something; giving proof. (www.lexico.com)
- Serving to prove the truth of anything; indubitably conclusive. (www.dictionary.com)

Define Terms for Today's Topic (cont.)

Demonstrative Evidence (noun)

- Actual objects, pictures, models and other devices which are supposedly intended to clarify the facts for the judge and jury.
[\(<https://dictionary.law.com>\)](https://dictionary.law.com)
- Objects, pictures, models, and other devices used in a trial or hearing to demonstrate or explain facts that the party is trying to prove.
[\(\[https://www.law.cornell.edu/wex/demonstrative_evidence\]\(https://www.law.cornell.edu/wex/demonstrative_evidence\)\)](https://www.law.cornell.edu/wex/demonstrative_evidence)

Define Terms for Today's Topic (cont.)

Probative Value (noun)

- Evidence which is sufficiently useful to prove something important in a trial. (<https://dictionary.law.com>)

Proof (noun)

- Evidence which tends to prove something which is relative to the issues in a lawsuit or criminal prosecution. (<https://dictionary.law.com>)

In short, Demonstratives are factual, persuasive evidence supporting your appraisal.

Introduction

Why do you need demonstratives?

1. To support your opinion; and/or
2. to prove a point

When do you need demonstratives?

1. When challenged
 - a. Litigation
 - b. Financial Statement Audit Reviews
 - c. Clients who question your conclusions

Introductory Comments

- The following examples are extracted from actual appraisals, litigation cases and audit reviews involving the author
- Some of the examples have been used in prior presentations and are presented here to illustrate the specific use of demonstratives
- **A key point throughout this discussion is that demonstratives should be:**
 - In your workpapers; and
 - In your appraisal report, especially if you anticipate a challenge.

Let's Begin with the Basics

Appraisal of:

- Erie 50,000-Lb. Steam Operated Drop Forging Hammer
- Clearing Hydraulic Trim Press
- Purpose: Liquidation Value

Appraisal of a 50,000# Forging Hammer

Appraiser No. 1

- Erie 50,000-Lb. Steam Operated Drop Forging Hammer, S/N xxxx, with Spare Components (included a trim press)
- Disassembled and in Storage at Time of Inspection.
- Condition: Good
- Concluded OLV - \$150,000
- *Note: narrative report contains 3 paragraphs discussing market conditions at time of appraisal and covers many other types of assets.*

Appraisal of Forging Hammer

Appraiser No. 2 (\approx 4 years later)

Sets forth **Facts** in narrative report:

- Hammer (incl trim press) purchased by owner 10 yrs prior for \$800,000
- Intent of Owner: Remove unit from market and possibly install in future.
- Hammer & trim press components disassembled & stored in yard
- Est. Yr Built: (mid 1950's)
- Condition: Poor

Appraisal of Forging Hammer

Additional Hammer Narrative description in Report:

- Replacement Cost (installed): \approx \$5mm
- **Auction sales:** No hammers of this size have sold within the last 5 years
- **Dealer #1:** This particular hammer has a small bed and is not desirable. Difficult to sell at any price.
- **Dealer #2:** No buyers; Scrap
- Conclusion: OLV = Scrap

Appraisal of Forging Hammer



Appraisal of Forging Hammer Comments

For the purpose of this illustration, the demonstrative is the narrative discussion describing the basis for the opinion.

- Both appraisers may be correct given the facts & circumstances at each appraisal date;
- Appraiser No 1 may have the same information in his workpapers (condition notes, dealer discussions, etc.); but....
- Appraiser No. 2 provided much more information in the narrative to support his opinion. He ***“demonstrated”*** his basis for concluding scrap value.

Steel Mill Appraisal

Valuation of Rouge Steel in Dearborn, MI

- Property: [Integrated Steel Mill](#)
- Purpose: [Property Tax Litigation](#)
- Valuation Dates: [Multiple in late 1980's & early 1990's](#)

Key Points:

- Plant was purchased 2 weeks before first valuation date (stock acquisition)
- Acquisition included all assets of the steel mill + minority interests in an electro galvanizing line, iron ore mine and the Rouge power plant
- Buyer booked **negative goodwill** - Acquired Working capital exceeded purchase price
 - Purchase price of fixed assets was recorded on the balance sheet at \$0 (zero)
- *Of concern to counsel, buyer retained a well-known ASA appraiser before the acquisition who said the mill assets were worth over \$600mm.*

Steel Mill Appraisal

• Taxing Authority

Market Value:

- > \$1 billion
- **Strategy:**
 - Cost Approach only
 - No Income Approach (can't rent a steel mill)
 - No Sales Comparison (no comps)

Taxpayer

Market Value:

- ≈ \$200mm

Strategy:

- Three Approaches
- Force judge to consider comparable sales and income approach and **not rely exclusively on a cost approach**

Steel Mill Appraisal Key Points in Case

Taxpayer provided testimony as follows:

- Detailed Cost approach with significant obsolescence
- Income Approach supporting minimal value for taxable assets
- Sales Comparison Approach
 - Analysis of purchase
 - Sales of steel mills
- Steel Industry Engineer re Replacement Cost
- Steel Industry Economist citing a bleak future for the industry

Steel Industry Valuation Key Points in Case (cont.)

Taxing Authority presented testimony as follows:

- Direct: Detailed Cost approach using Reproduction Cost with minimal obsolescence
- Rebuttal Testimony:
 - Actual purchase was a bargain purchase because Seller retained certain financial, labor & environmental liabilities thereby invalidating the PPA
 - Can't use an income approach
 - Can't use Sales Comparison

Steel Mill Appraisal Litigation Issues

- Competing Cost Approaches - judge favored taxpayer's analysis
- Income Approach – judge deemed financial projections too speculative
- Actual Purchase – much “noise” around transaction – judge deemed transaction as not representing “Market Value” per Michigan definition
- “Market Sales Method” was turning point

Steel Mill Appraisal

Sales Comparison Approach priorities:

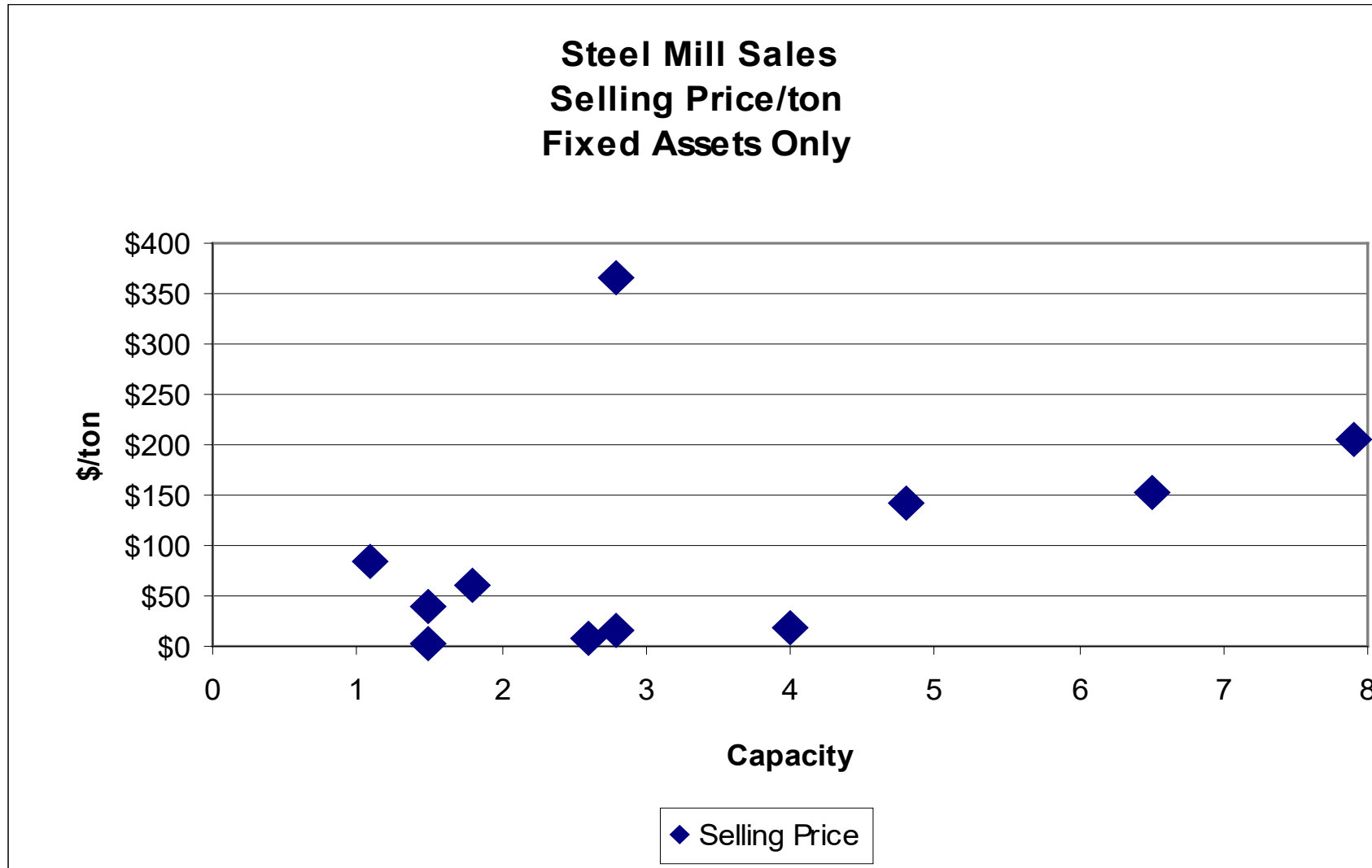
1. Investigate sales of flat rolled mills with the goal of reaching a “point estimate” of value for the mill;
2. Absent a point estimate: Define range of selling prices; and
3. Assist counsel:
 - a. Combat assessor’s appraiser if this approach was used; and
 - b. Demonstrate very low values of steel mill assets to counter the “bargain purchase”.

Note: the following information was included in the appraisal report

Flat Rolled Steel Mill Sales

1980's

Mill Sold	Capacity mm tons	Deal Price - \$/ton	Deal Type	Interest Acq'd - %	Fixed Assets - \$/ton
McLouth	2.8	\$ 291	AP	100	\$17
Weirton	4	\$ 97	AP	100	\$18
CA Steel	1.8	\$ 61	AP	100	\$61
LTV/Republic	7.9	\$ 269	M	100	\$204
National/NKK	6.5	\$ 50	S	50	\$152
Gulf States	1.5	\$ 27	AP	100	\$3
Acme	1.1	\$ 121	SS	100	\$84
Geneva	2.6	\$ 17	AP	100	\$8
Warren	1.5	\$ 86	AP	100	\$39
Dofasco/Algoma	2.8	\$ 469	S	100	\$367
Armco/Kawasaki	4.8	\$ 79	S	40	\$142
	AP - Asset Purchase			Average	\$100
	M - Merger				
	S - Stock			Median	\$61
	SP - Spin-off				



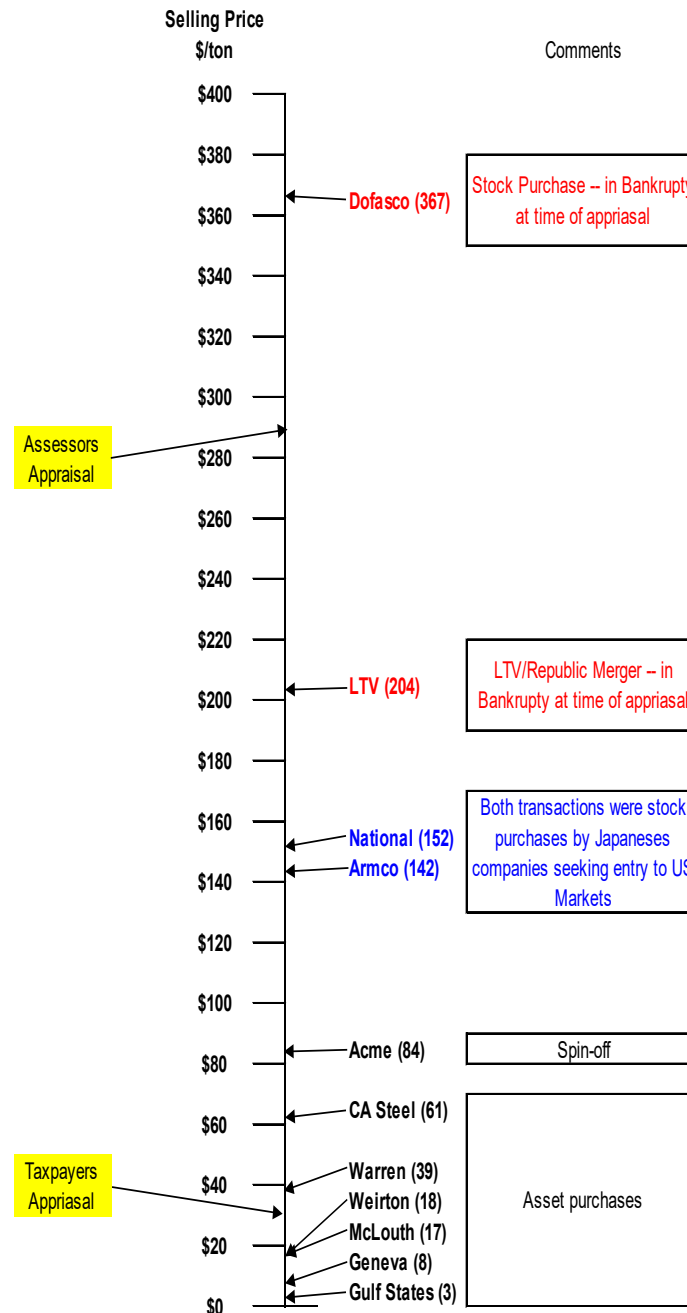
Steel Mill Sales

- Too many variables to draw a meaningful conclusion. But...
- Data does “bookend” the range of selling prices:
 - Low: \$3/ton
 - High: \$367/ton
- **Question:** What are we missing, if anything?

Steel Mill Thermometer

For reference,
RCN = \pm \$1000/ton

Excludes sale of
Subject



Steel Mill Commentary

Thermometer helped in many areas including:

1. Making some sense of the range of selling prices;
2. Demonstrated the economic difficulties of the industry
 - Bankruptcies
 - Low selling prices
3. Helped prepare counsel for defense of the transaction -
- stock purchase;

Steel Mill Commentary (cont.)

4. Demonstrated unreasonableness of assessor's approach & conclusion; and
5. Key exhibit for judge in that it summarized the case:
 - Identified all mill sales
 - Reasonableness of Taxpayer's appraisal; and
 - Unreasonableness of Assessor's appraisal

Backstory/Teachable Moment

- **Decision: Judge ultimately relied on one of the sales in formulating his opinion which was very favorable to the Taxpayer**

Alumina Plant Appraisal

Valuation of a US Alumina Facility located in Corpus Christi, TX

- Property: [Stand Alone Alumina Refinery](#)
- Purpose: [Property Tax Litigation](#)
- Valuation date: [Multiple dates in the early 2000's](#)
- Key Points:
 - Plant was purchased one day before first valuation date;
 - **No value assigned to the fixed assets**
 - The sale was a result of a court ordered divestiture; and
 - Counsel expected the assessor to exclude the Subject sale claiming the sale was “distressed”.

Alumina Plant Appraisal

Similar Fact pattern as the steel mill example

- Competing Cost approaches
- Taxpayer considered income & sales comparison whereas Assessor did not.

Decided to do all three approaches -- including sales comparison -- so that a jury would understand that the actual sale was in line with the market of “arm’s-length” transactions of alumina plants

Alumina Plant Appraisal

Income Approach: Supported little to no value for taxable Assets

Cost Approach: Low Value - very old assets utilizing obsolete technology

Sales Comparison:

- Documented sales of Alumina Plants; and
- Developed evidence to support conclusions reached by cost and income approaches.

Once again, the following information was included in the appraisal report.

Alumina Plant Sales

Facility	Grantor	Grantee	Location	Start Up	MMT	Price USD/MT	Year	Operating Cost
Aughinish	Alcan	Glencore	Ireland	1983	1.40	\$136	1999	\$172
Alunorte	Aluvale	Norsk Hydro	Brazil	1995	0.38	\$527	2000	\$136
Worsley	Alcoa	BHP Billiton	Australia	1984, 1992, 2000	3.10	\$864	2001	\$85
Gove	CSR/AMP	Alcan	Australia		1.80	\$728	2001	\$137
QAL (Queensland)	Kaiser	Comalco	Australia	1967 1968 1971 1973 1984	3.65	\$624	2001	\$136
Gramercy	Kaiser	Century Aluminum/ Noranda	US	1950's, 2002	1.25	\$18	2004	\$204
Sources:								
Confidential sales excluded from exhibit								
Sales and capacity data from various public sources								
Operating cost data from Merrill Lynch Aluminum Review, 8/27/02								

- Alumina Plant Sales

Selling Prices ranged from:

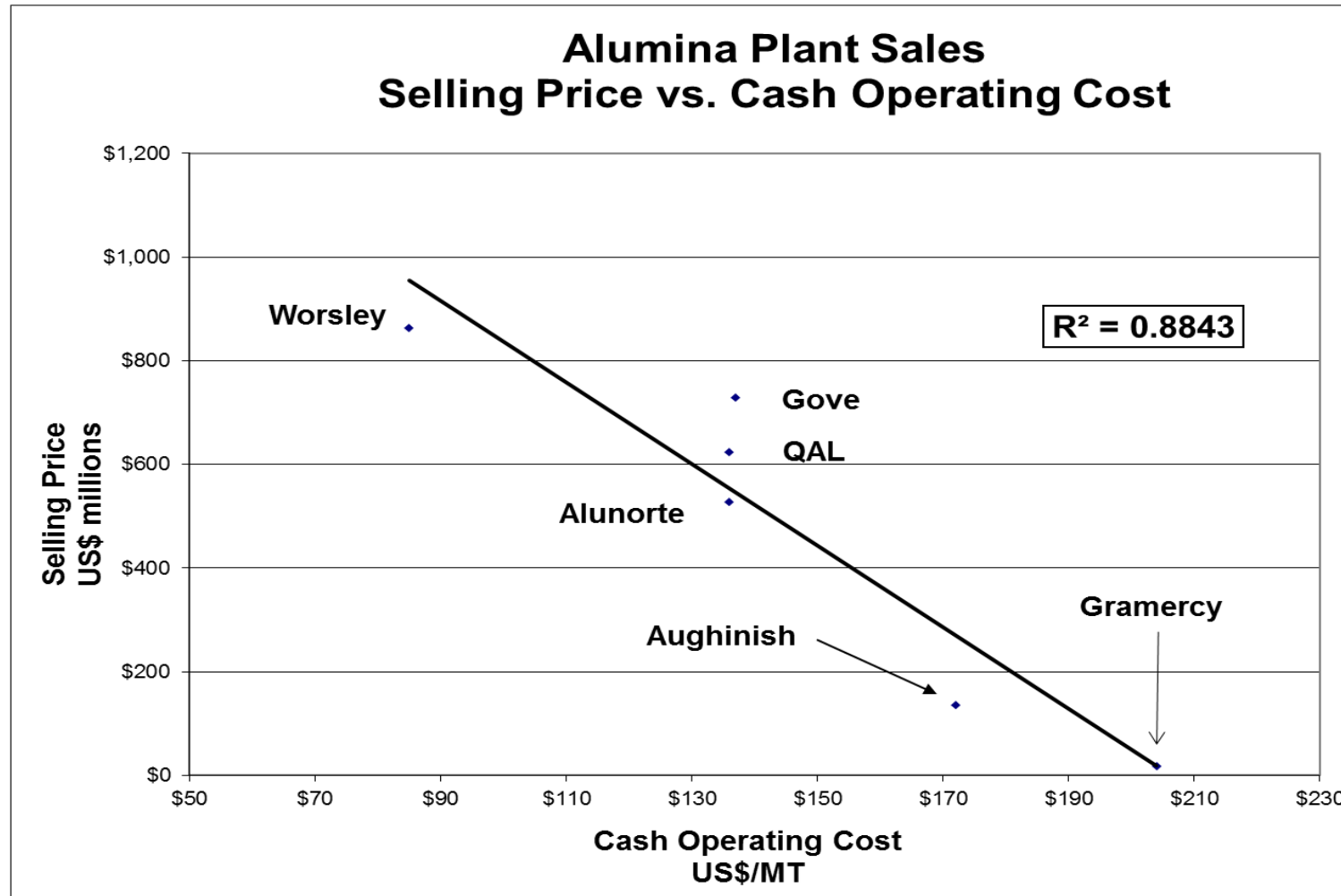
- Low: \$18/MT
- High: \$858/MT

Very difficult to sort out all elements of sale:

- Some included bauxite reserves, contracts, working capital, etc.
- Some were asset purchases, others were acquisition of minority interests, etc.

However,

- **There is a very strong relationship between selling price and cash operating cost that is instructive...**



Note: Three confidential sales excluded

Alumina Plant Sales Comments

1. Cash Operating Cost from a Wall Street Analyst;
2. Cash operating cost data was used to quantify functional obsolescence from excess operating cost;
3. Very strong correlation between selling price and cash operating cost;
 - 88% of selling price explained by operating cost
4. The Subject's cash operating cost was very high indicating a very low value;
5. **Our conclusion of value for the Subject was in the area of the chart where it was expected to be; and**

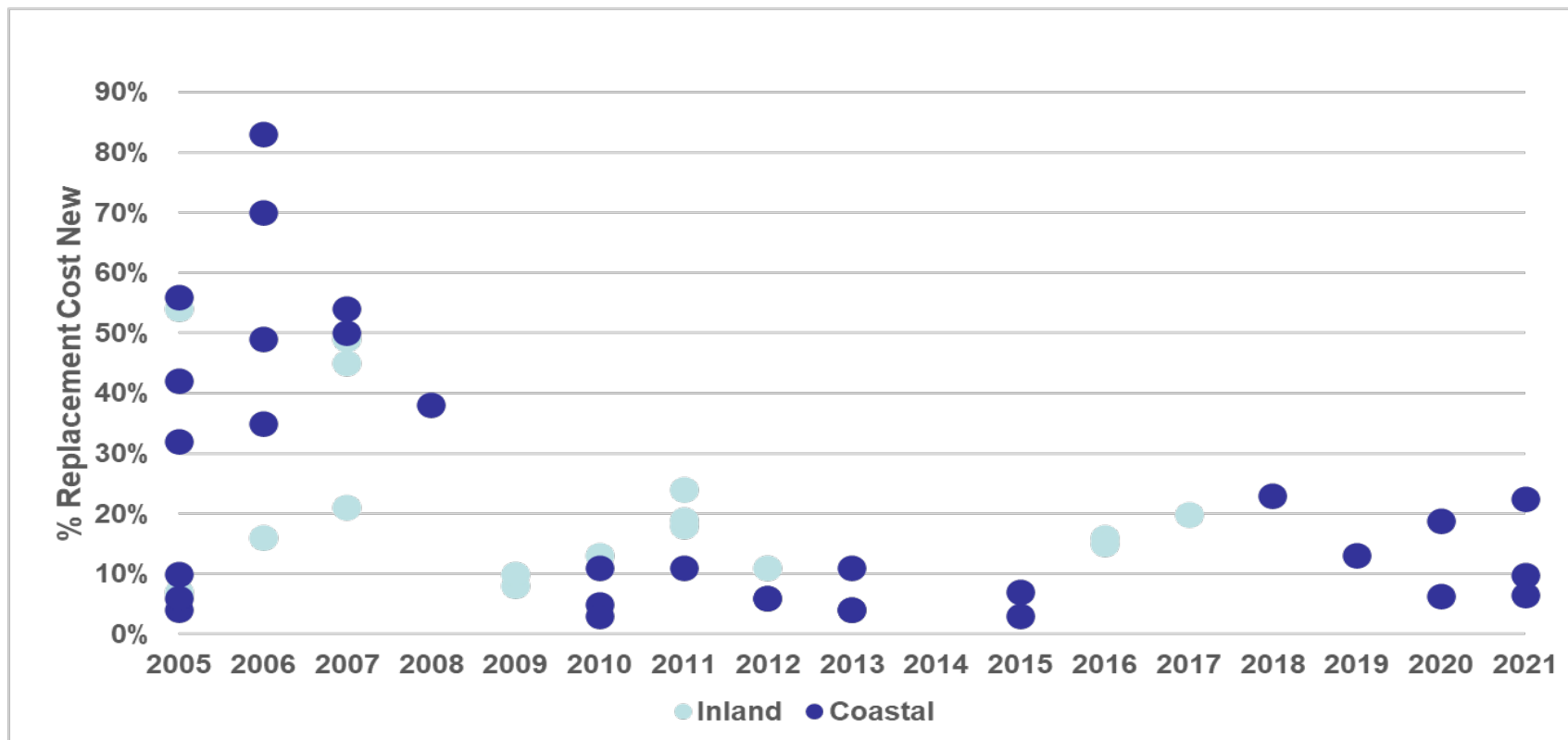
Alumina Plant Sales Comments

6. For the litigation, the analysis of comparable sales demonstrated our expertise compared to the assessor's appraiser;
- We had 9 sales vs. 5 for assessor;
 - Their analysis consisted of a simple average, whereas we correlated selling price and cash operating cost.

Backstory

After depositions, case settled at Taxpayer's initial settlement offer.

Refinery Sales



Slide courtesy of Karl Bartholomew extracted from ASA's 2021 Energy Valuation Conference

Refinery Sales

- Most consistent way to analyze refinery sales is % of RCN
- Preceding chart captures the market for refinery sales over time.
- If you are appraising a refinery and your conclusion falls outside the range set forth, you need to explain (i.e., demonstrate) why!
 - True for all examples

Appraisals Subject to Financial Statement Audits

Time permitting, here are some examples from audit reviews where **demonstratives were lacking**:

- **International Mining Company** – Experienced appraiser walked through some processing plants and wrote down a brief description of assets and his opinion of fair value. Provided no documentation supporting his opinion.
- **Specialty Paper Mill** – Buyer purchased business specifically for the customer list – fixed assets were very old and technologically obsolete. Appraiser did a “trend & bend” without consideration of obsolescence.
- **Iron Ore Mine** - Similar to the paper mill – strong customer base but operating old obsolete equipment. Appraiser did a “trend & bend” with no allowance for obsolescence.

Closing Comments

- Preparing Demonstratives – either as part of an appraisal report or as separate litigation exhibits - is time consuming and expensive; but....
- IMO, the benefits far outweigh the costs, especially when anticipating a challenge to your opinion.
- In reality, a thorough, well written appraisal report will typically yield demonstratives that may be used when and if challenged.

Closing Comments

Remember, Demonstratives are factual, persuasive evidence supporting your appraisal

1. Allows you to demonstrate your knowledge and expertise;
2. Often provides Industry Insight – particularly when analyzing market transactions;
3. Provides solid information to aid in any appraisal review
4. Help counsel prepare a litigation case;
5. Prepares you to testify; and
6. Helps the trier of fact (or any reviewer) to understand the valuation issues and why your opinion is correct.

Questions