

THE CABINET OF MINISTERS OF UKRAINE

ORDINANCE

#1655 dated November 29, 2006

Kyiv

On Approval of National Standard #3

“Integral Property Complex Appraisal”

In accordance with Article 9 of the Law of Ukraine On Appraisal of Property, Property Rights and Professional Appraisal Activities in Ukraine” the Cabinet of Ministers of Ukraine **hereby resolves:**

To approve National Standard #3 “Integral Property Complex Appraisal” (attached).

Prime Minister of Ukraine

V. YANUKOVYCH

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APPROVED

by the Cabinet of Ministers of Ukraine

Ordinance #1655 dated November 29, 2006

NATIONAL STANDARD # 3

"Integral Property Complex Appraisal"

General Provisions

1. National Standard #3 (hereinafter referred to as the Standard) is mandatory in the process of appraising an integral property complex of a business entity (hereinafter referred to as integral property complex) by appraisors and the entities authorized by law to review integral property complex appraisal reports.

2. For the purposes of this Standard, the below definitions shall be used in the following meanings:

Invested capital is own equity and borrowed capital (long-term debt) of the integral property complex;

Capital investment is investment into construction, production, reconstruction, upgrading, purchase, and creation of non-current assets including non-current tangible assets aimed to replace the ones currently in use, and installation equipment, as well as advance payments to fund capital construction;

Corporate stake is a stake (interest, shares) in a business entity established on the basis of an integral property complex;

Multiplicator is a ratio calculated by dividing the bid (ask) price of a similar integral property complex or market capitalization of a joint stock company whose integral property complex is viewed as similar to the valued integral property complex by the relevant financial and economic or another indicator characterizing its activities;

Nominal cash flow is cash flow in projected prices of deferred periods including projected inflation rate;

Nominal discount rate is the discount rate applied to determine current value of nominal cash flow;

Working capital is the value of current assets of an integral property complex less its short term (current) liabilities;

Real cash flow is cash flow in prices fixed as of the appraisal date without projected inflation rate;

Real discount rate is the discount rate applied to determine current value of real cash flow.

Other definitions are used in the meanings specified in the National Property Appraisal Standards (hereinafter referred to as the Standards) and in other legal acts concerning appraisal.

3. Integral property complex appraisal framework shall be selected in accordance with the requirements of National Standard 1.

4. The legal acts on property appraisal may determine the cases of application thereof and the procedure for computing estimated value an integral property complex.

5. The methodologies are used and the report of an integral property complex is justified in accordance with the requirements of National Standard 1 and this Standard.

6. The procedure for integral property complex appraisal includes the following components:

analysis of organizational and legal forms of companies whose integral property complex is appraised;

study and analysis of the market of products (goods, works and services) of an integral property complex in the amount necessary to understand the volume and segmentation of the market, the current market share of the product (goods, works and services) of an integral property complex, prospects of the company, whose integral property complex is appraised, on the respective market in order to make correct assumptions in forecasting the performance of the appraised integral property complex;

study and analysis of the market for raw and basic materials used by the company whose integral property complex is appraised in cases where assumptions of the raw and basic materials market development prospects are one of the components of the property complex operations;

analysis of the legal framework regulating commercial activities of the company whose integral property complex is appraised, in particular licensing, quoting, application of price formation mechanisms on the market for the respective products (goods, works and services), eligibility to the State support or restrictions, antimonopoly or ecological requirements, and tax system;

analysis of its financial and commercial activities, its property and financial condition as of the appraisal date and for the period preceding the appraisal date;

preparation of justified projections for the company's operations whose integral property complex is appraised by key indicators of production and product sale, projections of the financial and property status, and projections of the company's need for investment including determination of funding sources.

The analysis based results shall serve as a basis for the assumptions used in the process of appraisal.

7. The following methodologies are used in appraising an integral property complex:

property based;

income based;

comparative.

Property Based Methodology

8. Property based methodology is used to determine market value of an integral property complex in cases where this methodology reflects typical logics of potential buyers which is based on a firmly established practice – in particular, in the process of integral property complex appraisal whose market value is determined on the basis of the current value of the expected outcome of the given integral property complex liquidation.

9. The key approach used in the property based methodology for integral property complex appraisal is assets accumulation approach. Appraisers may use the approach of current value of the expected outcome of the integral property complex liquidation, as well as other approaches of the property based methodology whose application in a given situation must be justified.

10. Assets accumulation approach is based on computing NAV of an integral property complex.

Integral property complex NAV is assets minus liabilities whose values are computed as of the appraisal date in accordance with item 11 of this Standard.

11. Evaluation of assets and liabilities as of the appraisal date shall be carried out taking into account the following details:

non-current assets, such as fixed assets, intangible assets, non-finished construction and long-term financial investments, are valued on the basis of valuation that complies with market value or non-market types of the valuation selected and determined in accordance with the national standards;

non-current assets in the part of long-term accounts receivable and deferred tax assets shall be valued taking into account their repayment (redemption, reimbursement) deadline and the likeliness of such repayment (redemption, reimbursement);

current accounts receivable shall be evaluated taking into account its repayment (redemption, reimbursement) term and the likeliness of such repayment (redemption, reimbursement);

tangible current assets (supplies, goods) in cases where their current value is equivalent to the value reported in accounting statements is computed based on the value of such assets reported in accounting statements while in other cases it is based on their market value or liquidating value provided that their market value does not exceed their liquidating value;

long-term and current financial investment shall be evaluated based on their market value;

received promissory notes are evaluated based on their market value taking into account the deadline and the likeliness of redemption;

current value of long-term and current liabilities by their types is acknowledged as identical to the value reported in accounting statements or is computed by way of discounting the sums (principal debt, interest) to be covered in the relevant periods at a discount rate justified for each type of liability.

For the purposes of computing estimated value of an integral property complex, legal acts concerning appraisal may contain other requirements on appraisal of assets and liabilities.

12. Calculation of the current value of the likely outcome of an integral property complex liquidation may be a separate task or part of the process of computing market value of an integral property complex.

Current value of the likely outcome of an integral property complex liquidation equals current value of revenues expected from the sale of the integral property complex assets less the amount of expenses related to liquidation of such complex increased by the current value of cash flows expected from continued commercial activities of the company whose integral property complex is appraised, in the process of liquidation if such activities are projected, and decreased by the amount of current value of liabilities of this company.

In case a decision is taken on liquidation of the appraised integral property complex resulting in cutting the term for repayment of long-term debt of the company, the current value of liabilities of the company is calculated taking into account the likeliness of such cut of deadline.

The proceeds from the sale of assets of the appraised integral property complex are calculated with the following details taken into account:

if liquidation is performed in accordance with decision of the owner of the integral property complex or the court and does not provide for mandatory alienation of assets of the integral property complex within the term significantly shorter than the term for similar property display for sale purposes, the assets shall be evaluated in accordance with the requirements listed in item 11 and item 12.1-12.3 of this Standard;

if liquidation is performed in accordance of court decision and provides for mandatory disposal of assets of the integral property complex within the term significantly shorter than the term for similar property display for sale purposes, the assets shall be evaluated in accordance with the requirements established by the national standards for computing of liquidating value.

Income Based Methodology

13. Income based methodology for appraisal of an integral property complex is based on evaluation procedures whereby expected revenues (net cash flows or dividends) are transformed into the value of the integral property complex. An integral property complex shall be evaluated taking into account financial condition of the company whose integral property complex is evaluated and projected performance of such integral property complex.

14. The key approach of the income based methodology applied to appraisal of integral property complexes is discounted cash flows approach.

Discounted cash flows approach provides for the following appraisal procedures:

selection of the appropriate cash flows model;

determination of the projection period for cash flows income;

projection of net cash flows components and calculation thereof for each year (quarter, month) of the projection period;

justification of components of the discount rate and calculation of the discount rate;

calculation of reversion value and justification of the calculation;

calculation of the current value of net cash flows, reversion and property in excess if any in the integral property complex;

calculation of the integral property complex value as added up value of net cash flows, reversion and current value of the property in excess.

15. Based on the nature of the company business whose integral property complex is appraised and the purposes of appraisal, the following cash flows models are used:

net cash flows for equity capital;

net cash flows for invested capital.

16. Calculation of cash flows is based on the analysis of financial and business performance of the company whose integral property complex is appraised, for the period preceding the appraisal date, and for the projection period.

The projection period is determined based on the nature of business of the appraised integral property complex, in particular the following details: lifecycle of products (goods, works, services), the schedule for servicing long-term debt, investment plans and projections on the expected significant changes that will occur in the business of the company whose integral property complex is appraised.

Selected duration of the projection period shall comply with the methodology for computing the value of reversion. The duration of the projection period is considered sufficient if the selected reversion calculation methodology allows to take into account all facts known as of the calculation date and assumptions of performance of the company whose integral property complex is appraised in the period following the projection period.

17. Net cash flows for equity capital for each year (quarter, month) of the projection period equals the projected net profit plus the projected depreciation amount included in costs for the purpose of net profit calculation less the projected working capital gains (plus the amount of the decrease in the working capital) less the projected capital investment plus long-term liabilities growth (less the amount of decrease in long-term liabilities) for the relevant period.

18. The model of net cash flows for invested capital reflects the value of an integral property complex taking into account equity and borrowed capital.

Net cash flows for invested capital per year (quarter, month) of the projection period equals the projected net profit computed under the assumption that there are no costs for the payment of interest under long-term debt, plus the projected depreciation amount included in costs for the purpose of computing net profit less the projected working capital gains (plus the amount of decrease in the working capital) less projected capital investment for the relevant period.

19. For each of the models specified in item 15 hereof, cash flows are projected in the prices of the relevant year (quarter, month) of the projection period taking into account the projected inflation rate (nominal cash flow) or in the prices effective as of the appraisal date without taking into account the projected inflation rate (actual cash flow).

In projecting nominal cash flow, the projected inflation rate is taken into account in computing the discount rate in accordance with item 23 hereof.

20. The most effective use principle is implemented in appraising integral property complexes by way of making assumptions on efficient disposal of the property that includes the appraised integral property complex in the process of projecting cash flows of the integral property complex. Disposal of the property of the integral property complex is considered efficient when it is aimed to maximize the current value of expected net cash flows of such integral property complex, i.e. to maximize its market value.

The projection of cash flows are based on logical interrelation and justification of its components.

In cases where an increase (decrease) of the volume of products (goods, works, services) production is projected at the company whose integral property complex is appraised, the relevant expectations of changes in the working capital are taken into account in projecting net cash flows.

Projections of capital investments, increase (decrease) of the working capital and the amounts of long-term liabilities, are made on the basis and in relation of/to performance of the company whose integral property complex is appraised. In the projecting process, it is necessary to take into account only the investment, the increase (decrease) of the working capital and the amounts of long-term liabilities which are economically reasonable, and the relevant costs are covered by the projected internal or external sources of funding (the possibility of borrowing the needed money).

21. In cases where the assumption about the possibility of starting or continuing (renewing) the projected business activity by the company whose integral property complex is appraised without initial capital investment or investment into current assets (coverage of current assets deficit) is incorrect, such investment is taken into account in the process of calculations:

without discounting if the expected term for investment inflow is close to the date of appraisal and may be reasonably treated as similar with it;

included in the projected cash flows for the relevant quarters or months that are subject to discounting. In the meantime, cash flows are projected and discounted within the framework of the projected period for quarters or months.

The deficit of current assets equals the amount of the working capital necessary for ordinary operations of the company whose integral property complex is appraised less the amount of its working capital available as of the appraisal date.

22. The value of reversion is computed based on the expected results of the most efficient use of assets of an integral property complex in the period that follows the projection period on the basis of cash flows of the integral property complex expected to be received after the projection period, taking into account the tendency of their steady growth (decrease), if any.

23. In order to calculate the discount rate, the methods are used that are in accordance with the cash flows model chosen for appraisal.

The key method for computing the discount rate for equity capital is the method of cumulative structure, which takes into account additional investment risks of the appraised integral property complex as compared to investing into alternative objects with minimum exposure.

The key method for computing the discount rate for invested capital is the method of average weighted capital value based on including the rate of return on equity and borrowed capital taking into account the shares of equity and borrowed capital in the invested capital.

The use of other methods for discount rate calculation and fulfillment of such calculation in the beginning, the middle or the end of each year (quarter, month) of the projection period shall be justified in the integral property complex appraisal report.

In order to discount the value of reversion, the ratios are used whose calculation takes into account the period in time for which the value of reversion is computed and the selection of which depends on the method of reversion value calculation. This is justified in the integral property complex appraisal report.

Discount rate for nominal cash flow is computed taking into account inflation rate, while computing of the discount rate for real cash flow does not take into account the rate of inflation.

24. Current value of the property in excess (non-current and/or current tangible assets) shall be computed using appraisal frameworks that comply with the principles of efficiency and the most effective use of the property in excess.

25. In cases where cash flows from the operation of an integral property complex are expected to be constant and similar in amount or to have a tendency of steady growth, and they may be received at any point in time, the method of direct income capitalization may be used. Moreover, the income is considered to be the net cash flow defined in accordance with this Standard. In cases where the integral property complex includes property in excess, its value is added up to the value computed by the method of direct income capitalization.

26. The method of direct income capitalization provides for computation of the following items:

the period of capitalization of net cash flow (year, quarter, month, operating cycle);

net cash flow over the period;

the relevant capitalization rate and justification thereof;

the value of property in excess if available in the integral property complex;

the value of the integral property complex by way of dividing net cash flow by the rate of capitalization and increasing the quotient by the value of the property in excess if there is any in the integral property complex.

Comparative Methodology

27. The key approaches to appraisal of integral property complexes under the comparative methodology include capital market approach and market contracts approach.

Both comparative methodology approaches share the stage of creating a list of similar integral property complexes to be used for comparison and the stage of collecting information about such complexes. In creating the list of similar integral property complexes, the following criteria are taken into account: the industry in which the integral property complex (of the company) is used, the size of it, the range of business (one or multi products), the market for products (goods, works, services), the structure of assets and invested capital, location, and other material criteria.

28. Capital market method is based on the assumption that the value of an integral property complex is equal to its market capitalization or possible market capitalization taking into account the value of control rights.

Market capitalization of an integral property complex is computed by multiplying market rate of one share of a joint stock company that exists or may be created on the basis of the appraised integral property complex by the total amount of shares of such company.

Market rate of a share is computed based on the data on sale (offering) of a joint stock company shares at stock exchanges and off-exchange trade and information systems.

Market rate per share based on the sales data is computed on the basis of information on the last contract executed as of the date of appraisal. If no contracts are executed on such date, information is used about the last contract executed prior to the date of appraisal for which the rate is computed. The appraisal report must contain justification of the use of such information.

Market rate per share based on the offering data (maximum price offered by the buyer or minimum price offered by the seller) is computed on the basis of offering prices effective as of the date for which the rate is computed. In cases where no offerings are available as of the appraisal date, market rate per share based on offering data is computed on the basis of offering prices effective as of the closest date preceding the appraisal date for which the rate is computed. The possibility of such data use is justified in the appraisal report.

In computing market rate per share the only information used is the information on the bid price in the last contract (contracts) or ask prices which are representational. Rejection of data on the bid and ask price must be justified in the report on integral property complex appraisal.

The value of control rights is taken into account by way of using control premium.

Possible market capitalization of an integral property complex equals financial and economic performance of the company whose integral property complex is appraised by the relevant multipliers determined in the basis of information about similar companies based on bid (ask) prices for their integral property complexes.

If an integral property complex is appraised on the basis of its possible capitalization, the market value of such property complex is computed by way of summing up the received results, calculation of its possible market capitalization, taking into account control rights, and introducing other amendments.

29. Market contracts method is based on the assumption that market value of an integral property complex is equivalent to the bid prices of similar integral property complexes. The basic indicators used for this method include bid and ask prices of similar integral property complexes or bid and ask prices for their corporate shares carrying certain control rights.

In cases where the basic indicator is the bid (ask) price of a similar integral property complex, market value of the appraised integral property complex is computed by way of multiplying financial and economic performance illustrating operations of the company whose integral property complex is appraised by the relevant multipliers specified on the basis of information about similar objects.

If the bid (ask) price of a corporate share of the similar integral property complex is the basic indicator, preliminarily it is adjusted to the amount of the control premium in order to take into account control rights under a 100% corporate share, then followed by calculation of multipliers.

Market value of an integral property complex is computed by way of multiplying financial and economic performance illustrating operations of the company whose integral property complex is appraised by the relevant multipliers determined on the basis of information about similar objects.

30. Financial and economic performance indicators that illustrate operations of the company whose integral property complex is appraised or of similar integral complexes include balance sheet value of equity capital, financial performance of the ordinary course of business, and other indicators justified in the integral property complex appraisal report.

31. In preparing a report about the value of the appraised integral property complex computed in accordance with the comparative methodology, information may be taken into account about changes in bid and ask prices for the appraised integral property complex and its corporate shares.

Requirements to Integral Property Complex Appraisal Report

32. Integral property complex appraisal report is compiled in full form in accordance with the requirements established by National Standard 1 and special requirements established by this Standard.

33. In addition to the requirements of items 54, 56-61 of National Standard 1, the report of integral property complex appraisal must contain information specified in item 8 of this Standard.

Other Issues

34. Liquidation value of an integral property complex is computed based on the market value of an integral property complex as adjusted to the extent of impact the terms of sale thereof within shorter term has.

35. In computing the value of an integral property complex appraised for the purpose of meeting liabilities of the company whose integral property complex is appraised by way of selling it, the liabilities subject to redemption at the expense of such sale are not taken into account in the computation.

36. Appraisal of items in material and non-material forms whose value is determined by the value of the integral property complex created on their basis (the items associated with the business) is carried out in accordance with this Standard and includes the relevant adjustment and justification in the report about how reasonable it is to apply provisions of this Standard to these items.

37. Appraisal of certain kinds of integral property complexes is carried out taking into account the details typical for operations of the companies operating on their basis.

38. Reports on appraisal of integral property complexes are inspected in accordance with the Law of Ukraine On Appraisal of Property, Ownership Rights, and Professional Appraisal Activities in Ukraine, National Standard 1, and this Standard.
