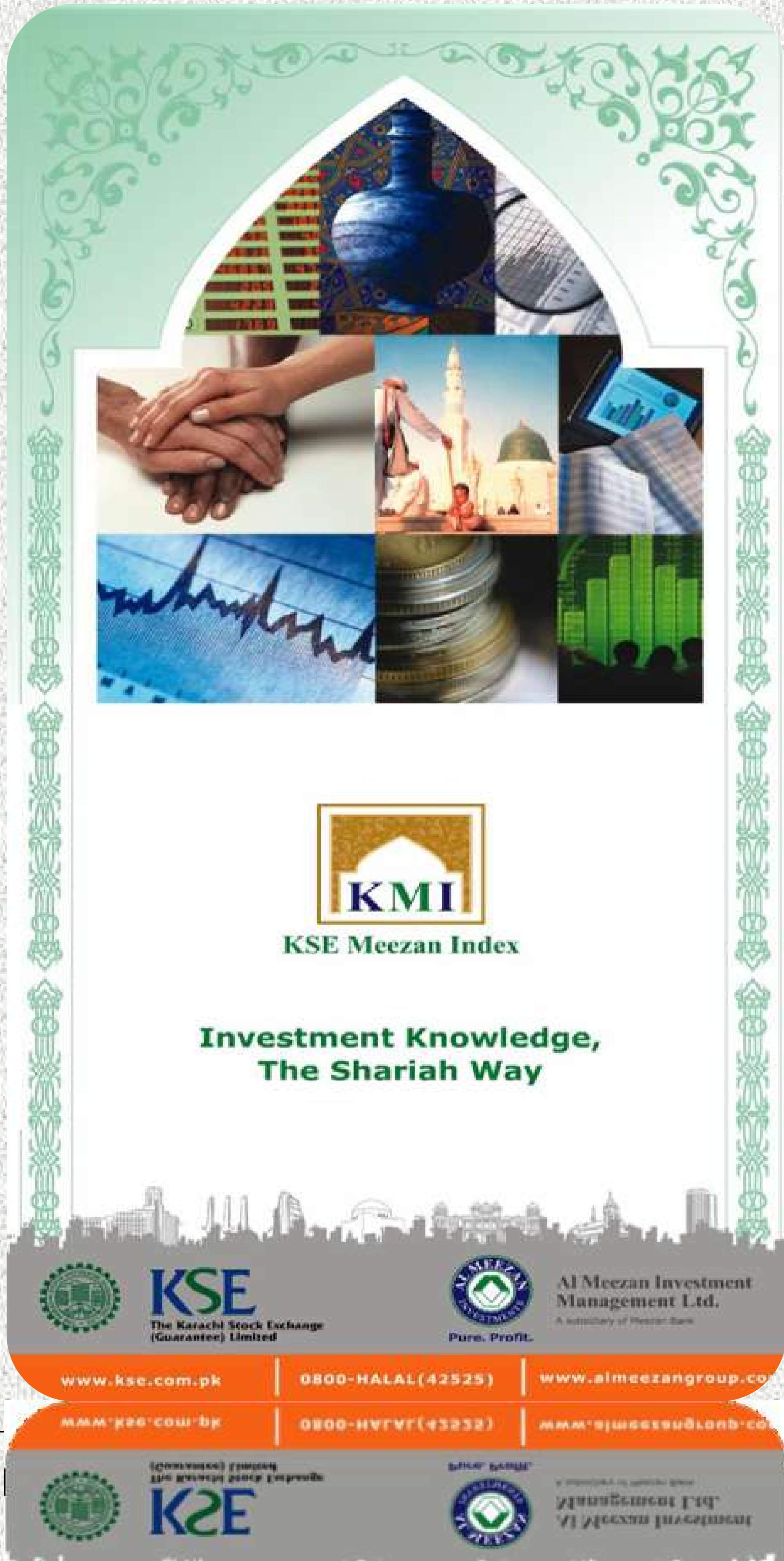
KMI
KSE Meezan Index
Investment Knowledge,
The Shariah Way
KSE
The Karachi Stock Exchange
(Guarantee) Limited
Al Meezan Investment
Management Ltd.
Pure. Profit.
www.kse.com.pk
0800-HALAL(42525)
www.almeezangroup.co

KMI INDEX

The objective of KSE-Meezan Index (KMI) is to serve as a gauge for measuring the performance of Shariah compliant equity investments. It may also act as a research tool for strategic asset allocation process. Besides tracking performance of Shariah compliant equities, its construction will increase investor trust and enhance their participation.

Currently, the three indices being maintained at the Karachi Stock Exchange are KSE-100 Index, KSE All-Share Index, and KSE-30 Index. The KSE-100 and KSE All Share Indices are market capitalization indices while KSE-30 Index is based on free-float capitalization.

The free-float methodology of index construction is considered as the best practice by all major index providers including MSCI, FTSE, S&P, STOXX, and SENSEX, because it results in a performance measurement of stocks that are readily accessible and well traded.

KSE-Meezan Index is also calculated using the "Free-Float Market Capitalization", wherein, the level of index at any point in time reflects the free-float market value of the selected Shariah compliant shares in relation to the base period. The free-float methodology refers to an index construction methodology that takes into account only the market capitalization of free-float shares of a company for the purposes of index calculation. The free-float capitalization of the Islamic index constituents shall be capped in relation to the overall capitalization of Islamic index at 12% on the first day of composition. At all subsequent re-compositions dates, any constituent breaching this limit will thus be brought in line with this requirement. Any surplus free-float capitalization will be distributed to the remaining companies according to their relative capitalization in the index.

1.1 FREE FLOAT METHODOLOGY

Free-Float of a security is defined as the proportion of total shares outstanding that are deemed available for purchase in the Stock Exchange. Therefore, it generally excludes the shares held by controlling directors / sponsors / promoters, government and other locked-in shares not available for trading in the normal course.

Free-Float methodology reflect the true image of liquidity present in the market, hence the index movement is unbiased towards the closely held companies, High net-worth individuals, speculators, and hedgers, may use the free float number for framing trading strategies, while regulatory bodies may use these numbers for effective risk management and market surveillance to minimize market manipulation incidences.

Total Outstanding Shares				
				XXX
Less:	Shares held by Directors/sponsors		XXX	
	Government Holdings as promoter/acquirer/controller		XXX	
	Shares held by Associated Companies (Cross holdings)		XXX	
	Shares held with public in Physical Form	XXX	XXX	
		Free-Float:		**XXX**

Notwithstanding to the above calculations, under no circumstances whatsoever, free-float of a scrip shall exceed its book entry shares, available in the Central Depository System. Share held by investors that would not, under usual circumstances, be available in the market for trading shall be treated as "Controlling / Strategic Holdings" and shall *under no circumstances whatsoever*, be included in the Free-Float. Shares held by promoters, directors, acquirers for the purpose of maintaining control, whether or not related to Government, or held by associated groups in terms of cross-holding or any shares which precisely cannot be sold in the open market shall preclude such numbers while determining the free-float.

1.1.2 Determining the Free Float

Listed companies shall submit their pattern of shareholding in the prescribed manner to help the Exchange determine a Free-Float Factor. Free-Float Factor is a multiple with which the total market capitalization of a company is adjusted to arrive at its Free-Float market capitalization. The screened list of Shariah compliant securities will be provided by Al Meezan Investment Management Limited to provide its Shariah screening services. Once the equity is approved by Shariah Board and is included in the horizon for Islamic Index, its free-float is rounded-off to the higher multiple of five and each company is categorized into one of the 20 bands given below.

% Fr ee	Fre e Flo
>0-5%	0.05
>5-10%	.010
>10-15%	0.15
>15-20%	0.20
>20-25%	0.25
>25-30%	0.30
>30-35%	0.35
>35-40%	0.40
>40-45%	0.45
>45-50%	0.50
>50-55%	0.55
>55-60%	0.60
>60-65%	0.65
>65-70%	0.70
>70-75%	0.75
>75-80%	0.80
>80-85%	0.85
>85-90%	0.90
>90-95%	0.95
>95-100%	1.00

1.2 ELIGIBILITY CRITERIA

1.2.1 Shariah Screening Filters

For any stock to be Shar'iah compliant, it must meet <u>ALL six criteria</u> given below:

1.2.1.1 Screening Criteria # 1: Business of the Investee Company

The core business of the company should not violate any principle of Shar'iah. Therefore, it is not permissible to acquire the shares of the companies providing financial services on interest like conventional banks, insurance companies, leasing companies or the companies involved in some other business not approved by the Shar'iah e.g. Companies making or selling liquor, pork, haram meat, or involved in gambling, or any other impermissible activities.

If the main business of the investee companies is Halal, like automobiles, textiles, manufacturing concerns etc but they deposit their surplus amounts in an interest bearing account or borrow money on interest, the share holder must express his/her disapproval against such dealings, preferably by raising his/her voice against such activities in the annual general meeting of the company and/or by sending a letter to the management in this regard.

1.2.1.2 Screening Criteria # 2: Interest Bearing Debt to Total Assets, <37%

The Interest Bearing Debt to Assets ratio should be less than 37%. To understand the rationale behind this condition, it should be kept in mind that such companies are mostly based on interest. Here again, the aforementioned principle applies i.e. if the shareholder is not personally agreeable to such borrowings, but has been overruled by the majority, these borrowing transactions cannot be attributed to him/her. Debt, in this case, is classified as any interest bearing debt including Bonds, TFCs, Commercial Paper, Conventional Bank Loans, Finance Lease, Hire Purchase, issuing preference shares etc.

1.2.1.3 Screening Criteria # 3: Non-Compliant Investments to Total Assets, <33%

The ratio of Non Compliant Investments to Total Assets should be less than 33%. Non-Shar'iah Compliant Investments include investments in conventional mutual funds, conventional money market instruments, Commercial Paper, interest bearing bank deposits, Bonds, PIBs, FIB, T-Bills, CoIs, CoDs, TFCs, DSCs, NSS, derivatives etc. Non-Compliant investments also include investments in companies which are declared Shar'iah non-Compliant due to non-compliance to any of the mentioned criteria for Shar'iah Compliance.

1.2.1.4 Screening Criteria # 4: Non-complaint Income to Total revenue, <5%

The ratio of Non Compliant Income to Total Revenue should be less than 5%. Total Revenue includes Gross Revenue plus any other income earned by the company. Non Compliant Income includes income from gambling, income from interest based transactions, income from Gharar based transactions i.e. derivatives, insurance claim reimbursement from a conventional insurance company, any penalty charged on late payment in credit sale, income from casinos, addictive drugs, alcohol, dividend income from above mentioned businesses or companies which have been declared Shar'iah Non-Compliant due to non-compliance to any of the mentioned criteria for Shar'iah Compliance etc.

1.2.1.5 Screening Criteria # 5: Illiquid Assets to Total Assets, >25%

The ratio of Illiquid Assets to Total Assets should be at least 25%. The Sum of all those assets whose trade price can deviate from par value, according to the rules of Shar'iah, is considered the aggregate value of illiquid assets. Illiquid Assets include inventory of raw materials, work-in-process, all fixed assets such as property, plant & equipment, stores and spares, stock in trade etc.

1.2.1.6 Screening Criteria # 6: Net Liquid Assets/Share Vs Market Price/Share

Market Price per share should be at least equal to or greater than net liquid assets per share. Net liquid assets per share are calculated by using the following formula:

Net Liquid Assets Per share =

$$\frac{\text{Total Assets} - \text{Illiquid Assets} - \text{Long Term Liabilities} - \text{Current Liablities}}{\text{No. of Shares Outstanding}}$$

1.2.2 Technical Screening Filters

1.2.2.1 Screening Criteria # 1:

The Company which is on the Defaulters' Counter and/or its trading is suspended, declared Non-Tradable (i.e. NT) in preceding 6 months from the date of re-composition shall NOT be considered for inclusion in KMI-30 Index;

1.2.2.2 Screening Criteria # 2:

The Company will be eligible for KMI-30 Index if its securities are available in the Central Depository System;

1.2.2.3 Screening Criteria # 3

The Company should have a formal listing history of at least two months on KSE;

1.2.2.4 Screening Criteria # 4

The company must have an operational track record of at least one financial year;

1.2.2.5 Screening Criteria # 5

The Company should have minimum free-float shares of 5% of total outstanding shares;

1.2.2.6 Screening Criteria # 6

The Company will be eligible for KMI-30 Index if its securities are traded for 75% of the total trading days;

1.2.2.7 Screening Criteria # 7

Mutual Funds (both Open-Ended and Closed-Ended) are ineligible for inclusion in the KMI-30 Index;

1.3 SELECTION CRITERIA

All the eligible companies for the Islamic Index can be included up to a maximum of thirty (30) companies. During the selection process, each company's financial reports are thoroughly reviewed by research analysts of Al Meezan to ensure that the company meets benchmarks or thresholds for Shariah compliance screening. Those that are found to be non-compliant are screened out. The industries that are considered non-compliant (as defined in the eligibility criteria) are not considered for inclusion in the Islamic, as these would not be appropriate for investment from Shariah perspective. From the list of Shariah compliant companies, securities are selected on the basis of Free Float and Impact Cost. While ranking the companies 50% weight is assigned to Free Float capitalization and the remaining 50% is allocated to Impact Cost, such that the companies with the highest Free Float and the lowest Impact Cost get the highest rank in the selection process. Top 30 ranked companies as per above criteria are included in Islamic Index.

1.4 BASE PERIOD

The Governing Policy committee of KMI shall ultimately determine and direct the Management regarding the base period and base index value. However, for the simulation purposes, The Index Technical Committee has used 15,000 as the base value, whereas June 30, 08 serve as the base period for the index. The value of Islamic Index shall be arrived at by dividing the free-float market capitalization of all eligible Islamic Securities in the Index by a number called the Index Divisor. The Divisor is the only link to the original base period value of the KMI Index. It will keep the Index comparable over a period and will be the adjustment point for all future corporate actions, replacement of scrips etc.

1.5 MAINTENANCE OF ISLAMIC INDEX

The day-to-day maintenance of the Index will be carried out within the Broad Index Policy Framework set by the Exchange and Al Meezan Investments. The Management will ensure that Islamic Index and KSE Index family maintain their benchmark properties by striking a balance between frequent replacements in indices and maintaining their historical continuity.

1.6 REVIEWPERIOD AND RECOMPOSITIONS

The index will be re-composed on semi-annual basis as follows:

Basis		**Revision**	
December	31	May	15
June	30	November	15

To minimize the impact of corporate actions implemented between the revision date and review period, the 31st March and 30th September prices and free-float shall be used for the May 15th and November 15th revsions respectively.

1.7 COMPUTATION AND REAL TIME DISSEMINATION

Islamic Index shall be calculated and disseminated to market participants, regulators and trading screens on real-time basis. The Index shall be computed on the executed orders only.

1.8 ADJUSTMENTS IN THE ISLAMIC INDEX AGAINST CORPORATE ACTIONS

Maintaining the Islamic Index will include monitoring and completing the adjustments to the securities of individual companies for e.g. cash dividends, additions and deletions, share changes, stock splits, stock dividends, and stock price adjustments due to restructurings or spin-offs.

To maintain the index's continuity, adjustments to the base date value free float capitalization are performed as often as necessary. Corporate actions and capital changes such as mergers acquisitions, spin-offs, and right offerings, repurchases of shares, public offerings and special cash of stock distributions of other than the same stock may also call for adjustments to be made. Such adjustments are necessary to prevent the value of the index from changing due to such events. Hence, this helps in keeping the value of the index an accurate and unbiased gauge of performance, and ensures that the movement of the index is not affected by corporate actions of constituent companies. Divisor adjustments are made after the close of trading and after the calculation of the closing value of the index.

Given the circumstances, the revised market capitalization is divided by closing index value (prior to adjustment) to get the new divisor which takes care of the impact arising out of cash dividend, bonus, right issues or other such corporate actions affecting the market price or number of outstanding shares.. The calculation will be carried out one day prior to the commencement of closure of share transfer register on t+2 settlement basis and the prices shall be opened on ex entitlement basis one day prior to the commencement of book closure of share transfer register.

1.8.1 Adjustment for Cash Dividend

If company declared a 10% cash dividend:

KMI -30 index	=	1120
KMI -30 index market capitalization	=	13,950,000,000
Divisor	=	12,454,545,455

Step-1

Determine the ex-dividend price of the stock a to calculate the revised market capitalization and a new divisor for the next day

Stock A

Par value: Rs.10 per share

Market value on day 3: Rs 22.50 per share

Cash Dividend : 10 %

i) Cash dividend amount per share = par value x dividend%	=	Rs 10 x 10%	= Rs.1
ii) Ex-dividend price = market price – cash dividend amount	=	22.50 - 1	
	=	21.50	

1.8.2 Adjustment for Bonus Shares

Declaration of Bonus requires adjustments in the free float capitalization and within the Index Divisor itself. The following process illustrates the process for a situation whereby an equity called “A” has declared 10% bonus in terms of shares. Following steps are recommended to be followed in order to determine the price of Ex-Bonus of Company "A" to calculate the revised free-float market capitalizations and new divisor for the next day.

1.8.3 Board Lot Adjustment

KMI – 30 Index	= 1,120	**Company A**	
Free-float market capitalization	= 13,950,000,000	Market value of share	22.50/
Divisor	= 12,455,357	Bonus:	10 %
		Board-lot	100 Shares

Given below example, calculates the Ex-bonus price on the basis of a board-lot of 100 shares by observing following steps.

- Total free-float shares after the Bonus issue: 100 + (100 X 10 %) = 110 shares
- Cost of a Board-lot: 100 shares x market price of Company "A"

  100 x 22.50 is Rupees 2,250/=

  Divide unadjusted board lot value by adjusted lot-size in order to get Ex-Bonus Price:

  2250/110 = RS 20.45

1.8.4 Illustration, Revision in the free-float of the equity

The free-float of the equity "A" is to be revised thereby increasing the free-float size by the percentage declared as Bonus.

- Total number of free-float shares + (Bonus % x total number of free-float)
- Revised Free Float Size = 50,000,000 + (10% x 50,000,000)

  = 55,000,000 shares

Share price and the total number of free-float shares of "A "is adjusted in the following manner to calculate the New Divisor for the next day.

- Free Float Value as per unadjusted prices: 50,000,000 X 22.50 = 1,125,000,000/=
- Ex-Price is calculated by dividing unadjusted value of whole free of the equity the revised free float size in the following manner:

  1,125,000,000 / 55,000,000 = 20.45

1.8.5 Illustration, Revision in the Market Capitalzation and Divisor

Following table present a scenario thereby the Islamic Index horizon has three symbols:

S#	Equity	Share Price	Free Float Shares	Market Cap
01	A	20.45	55,000,000	1,125,000,000
02	B	41.00	150,000,000	6,150,000,000
03	C	44.50	150,000,000	6,675,000,000
Revised free-float Market				13,950,000,000

New Divisor = Revised Market Cap. / Index point

13,950,000,000 / 1120 = 12,455,357

1.8.6 Adjustment for Right Shares

The Right issues of the companies, which constitute the Islamic Index, are adjusted in two stages. At first stage, the Ex-Right price is adjusted and at the second stage the capital (free-float shares) are adjusted. A brief detail about the right issues is mentioned below:

- The company, which declares Right shares, has to close its books (shareholders register) to determine entitlement within 45 days of the declaration.
- At the date of book closure, the Ex–Right price is ascertained and if the company belongs to the Islamic index then the Divisor is adjusted due to the Ex-Right price of the company.
- When the company informs the Exchange that it has dispatched Letter of Rights Offer to the shareholders, the trading in the Letter of Rights Offer (Un- paid) is commenced. A separate block of capital, Un-Paid-Right, is formed equal to amount of right issue and the trading continues till next 45 days or till the last date of payment.

After the last date of payment, the trading in Un-Paid-Right (Letter of Rights Offer) is discontinued. By the end of 30th day of the last date of payment or earlier, the company informs that shares certificates are ready for exchange with Right Allotment Letter (RAL) or credited in the CDS, the capital of the RAL is merged with the company. At this stage, the Divisor of the Islamic Index is adjusted for the increase in the number of shares of the company.

1.8.6.1 Right issue without premium

Following illustration, explain the case of Right Issue without premium. Let us assume that the Company "A" issues 10 % right in terms of shares thereby starting the Book Closure Process from the fourth day. Adjustments are deemed to be made in two stages; first being one day prior to the commencement of closure of share transfer register and 2nd being on the 15th day when RAL shares are merged with the company and divisor is adjusted.

1.8.6.1.1 First Stage of RAL Adjustment

Following actions are to be taken-in order to determine the Ex-Right price of the Company "A" to calculate the revised free-float market capitalization and a new divisor

Islamic Index on Day-3 = 1120

Market Capitalization———— = 13,950,000,000

Divisor = 12,455,357

- Market value of the Equity = 22.50
- Percentage of Right Declared : = 10 %

Ex-Right Price Calculation on the Board Lot of 100 shares.

- Total free-float shares after the Right issue : 100 + (100 X 10 % Right) = 110 shares
- Revised Cost of single Board Lot: 100 X Market Price + 10 (right shares X par value)

  = 100 X 22.50+ (10 X 10)

  = 2350
- Ex- Right price per share is determined by dividing Revised Cost of Board Lot by Revised Board Lot

  = 2350/110

  = 21.36

Share price of A is adjusted in order to get a revised divisor for next business day

Following table present a scenario thereby the Islamic Index horizon has three symbols:

S#	Equity	Share Price	Free Float Shares	Market Cap
01	A	21.36	50,000,000	1,068,000,000
02	B	41.00	150,000,000	6,150,000,000
03	C	44.50	150,000,000	6,675,000,000
Revised free-float Market				13,893,000,000

New Divisor = Revised Market Cap. / Index point

13,893,000,000 / 1120 = 12,404,464

1.8.6.1.2 Second Stage of RAL Adjustment after 15th Day

After 15 days of the last date of payment the company confirms the subscription amount, accordingly, the capital of RAL is merged with the company and the Divisor is adjusted for the increase in number of free-float shares in the following manner.

1. Calculate the total number of free-float shares of after with respect to declared percentage of the RAL:

- Total number of free-float shares (5M) x Right issue percentage (10)

= 50,000,000 x 10 %
= 5,000,000 shares

2. Revise the total free float size after accreditation /merger RAL Capital thereby enhancing the overall Capital of the Equity

Total number of free-float shares + RAL Capital

= 50,000,000 + 5,000,000

= 55,000,000 shares

3. Increase the number of free-float shares of company A to calculate the New Divisor for the next day:

Following table present a scenario thereby the Islamic Index horizon has three symbols:

S#	Equity	Share Price	Free Float Shares	Market Cap
01	A	21.00	55,000,000	1,155,000,000
02	B	42.00	150,000,000	6,300,000,000
03	C	45.00	150,000,000	6,675,000,000
Revised free-float Market				14,205,000,000

New Divisor = Revised Market Cap. / Index point as on Day 14

14,205,000,000 / 1136 = 12,504,401

1.8.6.2 Right issue with premium

Following steps may be observed in case the listed equity announces Right and Premium in simultaneous. Let us assume that equity "A" declares a 10% Right with a premium of RS 10/= per share and determine the Ex-Right Price of the same stock for a single Board Lot:

- Market value of the equity - = 22.50
- The Company declares Right : = 10 %
- The Company declares premium : = RS 10 per right share

In order to calculate the Ex-Right price on the basis of a single board lot, following procedure may be adopted.

- Board Lot shall be revised : 100 + (100 X 10 % Right) = 110 shares
- Cost of a lot (100 shares) shall be revised : 100 shares X market price of A + {10 right shares X (par value + premium)} = 100 x 22.50+ 10 x (10+10) = RS 2450
- Ex- Right price per share shall be determined by dividing the value of new board lot by revised board lot size in the following manner:

  = 2450/110 = 22.27

  The rest of the working would be same as mentioned in the section 1.8.6.1, which explained the handling of Right issue without premium.

1.8.7 Bonus and Right Adjustments in Simultaenous

Let us assume that the same equity announces a Bonus of 10% and Right of 10% at a premium of RS 10 per share:

Value of Islamic Index = 1120

Market Capitalization on ———————— = 13,950,000,000

Divisor ———————— = 12,454,357

Following procedure illustrates the procedure and computations to calculate the Ex-Bonus and Ex-Right price of the equity on a single board lot.

- Revised Number of Shares shall be calculated after accommodating both the Right and Bonus Shares by using following equations :

  100 + (100 shares X 10 % Right) + (100 shares X 10% Bonus)

  = 100+ 10 +10 = 120 shares

- Revised Cost of Board Lot may be calculated in the following manner:

  100 shares x market price of A + {10 right shares x (par value+premium)}

  = 100 x 22.50+ 10 x (10+10) = RS 2450

- Ex-Bonus and Ex- Right price per share shall be determined by dividing the revised cost of the board lot by the revised board lot itself

  = 2450/120 = 20.42

- Calculate the total number of free-float shares after the Bonus issue using the following formula:

  Total number of shares + Total number of shares x Bonus %

  = 50,000,000 + 50,000,000 x 10% Bonus = 55,000,000 shares

- Share price and the total number of free-float shares of A shall be adjusted to calculate the New Divisor for the next day

Following table present a scenario thereby the Islamic Index horizon has three symbols:

S#	Equity	Share Price	Free Float Shares	Market Cap
01	A	20.42	55,000,000	1,123,100,000
02	B	41.00	150,000,000	6,150,000,000
03	C	44.50	150,000,000	6,675,000,000
Revised free-float Market				13,984,100,000

New Divisor = Revised Market Cap. / Index point

13,948,100,000 / 1120 = 12,453,661

The rest of the working would be same as mentioned in the section 1.8.6.1, which explained the handling of <u>Right issue without premium.</u>