



KSE Meezan Index

**Investment Knowledge,
The Shariah Way**



KSE
The Karachi Stock Exchange
(Guarantee) Limited



**Al Meezan Investment
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A subsidiary of Meezan Bank

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Section 1

CONCEPT PAPER

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 a Impact Costiety of purposes in the 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.

1.1.1 Free Float Calculation

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	<u>XXX</u>	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.

% Free-Float	Free-Float Factor
>0 – 5%	0.05
>5 – 10%	0.10
>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 Technical Screening Filters

- 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;
- The Company will be eligible for KMI-30 Index if its securities are available in the Central Depository System;
- The Company should have a formal listing history of at least two months on KSE;
- The company must have an operational track record of at least one financial year and it should not be in default(s) of the Listing Regulations;
- The Company should have minimum free-float shares of 5% of total outstanding shares;
- The Company will be eligible for KMI-30 Index if its securities are traded for 75% of the total trading days;
- Mutual Funds (both Open-Ended and Closed-Ended) are ineligible for inclusion in the KMI-30 Index;

1.2.2 Shariah Screening Filters

Shariah compliance of stocks shall be done under the guidance of qualified and reputed Shariah experts. For stocks to be "Shariah compliant", it must meet ALL the six key tests given below.

- **Business of the Investee Company:** Core business of the company must be HALAL and in-line with the dictates of Shariah. Hence, investment in securities of any company dealing in conventional banking, conventional insurance, alcoholic drinks, tobacco, pork production, arms manufacturing, pornography or related un-Islamic activities is not permissible.
- **Debt to Total Assets:** Debt to Asset ratio should be less than 40%. Debt, in this case, is classified as any interest bearing debts. Zero coupon bonds and preference shares are, both, by definition, part of debt.
- **Non-compliant Investments to Total Assets:** The ratio of non compliant investments to total assets should be less than 33%. Investment in any non-compliant security shall be included for the calculation of this ratio.
- **Non-compliant Income to total revenue – Purification of Non-compliant:** income 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. This amount is to be cleansed out as charity on a pro rata ratio of dividends issued by the company.

- **Illiquid Assets to Total Assets:** The ratio of illiquid assets to total assets should be at least 20%. Illiquid asset, here, is defined as any asset that that Shariah permits to be traded at value other than the par.
- **Net Liquid Assets to Share Price:** The market price per share should be greater than the net liquid assets per share calculated as: $(\text{Total Assets} - \text{Illiquid Assets} - \text{Total Liabilities})$ divided by number of shares.

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 Review Period and Recompositions

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

<u>Basis</u>		<u>Revision</u>	
December	31	May	15
June	30	November	15

1.7 Computations and Realtime Disseminations

Islamic Index shall be calculated and disseminated to all 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

Section 2 DIVIDEND ADJUSTMENT

If company a has declared 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		

2.1.1 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.

2.1.2 Board Lot Adjustment

KMI – 30 Index	=	1,120
Free-float market capitalization	=	13,950,000,000
Divisor	=	12,455,357

Company A

Market value of share 22.50/

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: $100 + (100 \times 10\%) = 110$ shares
- Cost of a Board-lot: 100 shares x market price of Company "A"

$$100 \times 22.50 \text{ is Rupees } 2,250/=$$

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

$$2250/110 = \text{RS } 20.45$$

2.1.3 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 = $50,000,000 + (10\% \times 50,000,000)$

$$= 55,000,000 \text{ shares}$$

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: $50,000,000 \times 22.50 = 1,125,000,000/=$
- Ex-Price is calculated by dividing unadjusted value of whole free of the equity the revised free float size in the following manner:

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

2.1.4 Illustration, Revision in the Market Capitalization 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

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

2.1.5 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.

2.1.5.1 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.

2.1.5.1.1 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 : $100 + (100 \times 10 \% \text{ Right}) = 110 \text{ shares}$
- Revised Cost of single Board Lot: $100 \times \text{Market Price} + 10 (\text{right shares} \times \text{par value})$

$$= 100 \times 22.50 + (10 \times 10)$$

$$= 2350$$
- 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

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

2.1.5.1.2 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)

$$= 50,000,000 \times 10 \%$$

$$= 5,000,000 \text{ shares}$$

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

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

$$= 55,000,000 \text{ shares}$$

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

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

2.1.5.2 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 : $100 + (100 \times 10 \% \text{ Right}) = 110 \text{ shares}$
- Cost of a lot (100 shares) shall be revised : $100 \text{ shares} \times \text{market price of A} + \{10 \text{ right shares} \times (\text{par value} + \text{premium})\}$

$$= 100 \times 22.50 + 10 \times (10 + 10)$$

$$= \text{RS } 2450$$

- 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.

2.1.6 Bonus and Right Adjustments in Simultaneous

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

$$\text{Value of Islamic Index} = 1120$$

$$\text{Market Capitalization on } \text{—————} = 13,950,000,000$$

$$\text{Divisor } \text{—————} = 12,454,357$$

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 :

$$100 + (100 \text{ shares} \times 10 \% \text{ Right}) + (100 \text{ shares} \times 10 \% \text{ Bonus})$$

$$= 100 + 10 + 10$$

$$= 120 \text{ shares}$$

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

$$100 \text{ shares} \times \text{market price of A} + \{10 \text{ right shares} \times (\text{par value} + \text{premium})\}$$

$$= 100 \times 22.50 + 10 \times (10 + 10)$$

$$= \text{RS } 2450$$

- 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:

$$\text{Total number of shares} + \text{Total number of shares} \times \text{Bonus \%}$$

$$= 50,000,000 + 50,000,000 \times 10\% \text{ Bonus}$$

$$= 55,000,000 \text{ shares}$$

- 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
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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 Right issue without premium.