KMI 30 Index Methodology

KSE Meezan Index

Contents

KMI 30 Index

The objective of KSE-Meezan Index (KMI 30 Index) 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.

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. Free - Float Methodology

Free-Float means proportion of total shares issued by a company that are readily available for trading at the Stock Exchange. 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. Objective and Description

- Free-Float calculation can be used to construct stock indices for better market representation than those constructed on the basis of total market capitalization of companies.
- It gives weight for constituent companies as per their actual liquidity in the market and is not unduly influenced by tightly held large-cap companies.
- Free-Float can be used by the Exchange for regulatory purposes such as risk management and market surveillance.

Free-Float Calculation Methodology			
Total Outstanding Shares			**xxx**
Less	Government Holdings	xxx	
	Shares held by Directors / Sponsors / Senior Management Officers and their Associates	xxx	
	Shares in Physical Form	xxx	
	Shares held by Associate Companies / Group Companies (Cross Holdings)	xxx	
	Shares issued under Employees Stock Option Scheme that cannot be sold in the Open market in normal course	xxx	
	Treasury Shares	xxx	
	Any other category that are barred from selling at the review date	xxx	
Free Float			**xxx**

Notwithstanding to the above calculations, under no circumstances, free-float of a scrip shall exceed its book entry shares, available in the Central Depository System.

Sponsor" has the same meaning as defined in The Companies (Issue of Capital) Rules, 1996

"Senior Management Officer" and "Associate" have the same meaning as defined in the Securities Act, 2015

2. Eligibility Criteria

2.1 Shariah Screening Filters

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

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 shareholder 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.

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.

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

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.

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.

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 =

(Total Assets – Illiquid Assets – Long Term Liabilities – Current Liabilities)/ No. of Shares Outstanding

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

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.

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.

5. Maintenance of KMI 30 Index

The day-to-day maintenance of the Index will be carried out within the Broad Index Policy Framework set by the Exchange. The Management will ensure that KMI 30 Index and all the other PSX indices maintain their benchmark properties by striking a balance between frequent replacements in indices and maintaining their historical continuity.

6. Review Period and Re-composition

The index will be re-composed on semi-annual basis as follows on receipt of sharia complaint list received from AL Meezan :

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

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 basis.

7. Online Computation of the Index

During market hours, prices of the Index scrips at which trades are executed, are automatically used by the trading computer to calculate the KMI 30 Index and continuously make updations on all trading workstations connected to the PSX trading computers on real time basis.

8. Adjustment in the KMI 30 Index for corporate actions

KMI 30 Index shall be calculated on total return basis and corporate actions (Cash dividend, Bonus and Right issue) adjustments shall be made in order to maintain the index continuity. If no adjustments were made, a discontinuity would arise between the current value of the index and its previous value despite the non-occurrence of any economic activity of substance. At the Exchange, the base value will be adjusted, which is used to alter market capitalization of the component stocks to arrive at the KMI 30 Index value.

The determination of Ex price of a security is mentioned in Rule 10.6 of PSX Rule Book that: “If the Books of a Security are closed for determining any entitlement for its shareholders by the Company, the Exchange shall determine the ex-price based on the mechanism prescribed by the Exchange, as an opening price for the Trading Day falling on two Settlement Day before its Books Closure starting date”.

New Divisor shall be calculated due to corporate action at the end of T-3 days of its Book Closure starting date. E.g. Starting day of Book Closure = Friday, new divisor shall be calculated at day end of Tuesday.

The adjustment for corporate actions will be made as given under:

8.1 Adjustment for Cash Dividend

KMI 30 Index is a total return index; therefore, adjustment of cash dividend shall be made.

If company declared a 10% cash dividend:

KMI 30 Index = 1,120 points

KMI 30 Index market capitalization = Rs. 13,950,000,000

Divisor = 12,455,357

Constituents	Share Price	Free Float Shares	Free Float Market Capitalization (RS)
Stock A	22.50	50,000,000	1,125,000,000
Stock B	41.00	150,000,000	6,150,000,000
Stock C	44.50	150,000,000	6,675,000,000
Total Free Float Market Capitalization			**13,950,000,000**

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

<u>Stock A</u>

Par value: Rs.10 per share

Closing Price: Rs. 22.50 per share

Cash Dividend 10 % of par value

i) Cash dividend amount per share = par value x dividend% = Rs 10 x 10% = Rs.1

ii) Ex-dividend price = closing price – cash dividend amount = Rs.22.50 – Rs.1 = Rs.21.50

Step-2

Illustration, Revision in the Market Capitalization and Divisor

Share price of stock A shall be adjusted after the close of day to calculate the New Divisor for the next day

Constituents	Share Price	Free Float Shares	Free Float Market Capitalization (Rs)
Stock A	21.50	50,000,000	1,075,000,000
Stock B	41.00	150,000,000	6,150,000,000
Stock C	44.50	150,000,000	6,675,000,000
Revised Free Float Market Capitalization			**13,900,000,000**

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New Divisor = Revised Market Cap. / Index points

13,900,000,000 / 1,120 = 12,410,714

8.2 Adjustment for Bonus Shares

Declaration of Bonus requires adjustment in the free float capitalization and within the Index Divisor itself. The following process illustrates the process for a situation whereby a stock 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 Stock A to calculate the revised free-float market capitalizations and new divisor for the next day.

Step-1

KMI 30 Index = 1,120 points

KMI 30 Index Free-float market capitalization = Rs. 13,950,000,000

Divisor= 12,455,357

Closing Price of Stock A: Rs. 22.50

Bonus: 10 %

Stock lot size= 100 Shares

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

- Total free-float shares after the Bonus issue: 100 + (100 X 10 %) = 110 shares
- Cost of stock-lot size 100 shares x closing price of stock A: 100 x 22.50= Rs. 2,250

  Ex-Bonus Price: 2,250/110 = RS 20.45

Step-2

Illustration, Revision in the Market Capitalization and Divisor

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

Stock A		
Free Float shares	**Bonus**	**Total free float shares**
50,000,000	10%	55,000,000

Constituents	Share Price	Free Float Shares	Free Float Market Capitalization
Stock A	20.45	55,000,000	1,124,750,000
Stock B	41.00	150,000,000	6,150,000,000
Stock C	44.50	150,000,000	6,675,000,000
Revised Free Float Market Capitalization			**13,949,750,000**

*New Divisor = Revised Market Cap. / Index points

13,949,750,000 / 1,120 = 12,455,134

**Divisor changed as stock prices are recorded in two decimal places*

8.3 Adjustment for Right Shares

The Right issues of the companies which constitute the KMI 30 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 30 days of its declaration.

At the date of book closure, the Ex–Right price is ascertained and if the company belongs to the KMI 30 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) are commenced. A separate block of capital, Un-Paid-Right, is formed equal to amount of right issue and the trading continues till next 30 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 KMI 30 Index is adjusted for the increase in the number of shares of the company.

A) Right issue without premium

If Company A has issued 10 % right shares

KMI 30 Index = 1,120

KMI 30 Index Free Float Market Capitalization = 13,950,000,000

Divisor = 12,455,357

First Stage

Step 1

Determine the Ex-Right price of the stock A to calculate the revised free-float market capitalization and a new divisor for the next day.

Stock A price Rs 22.50

Right: 10 %

For simplicity in working, we will calculate the Ex-Right price on the basis of a lot of 100 shares.

i. Total free-float shares after the Right issue

100 shares + (100 shares x 10 % Right) = 110 shares

ii. Cost of a lot (100 shares)

100 shares x market price of A + 10 right shares x par value

= 100 x 22.50+ 10 x 10

= Rs. 2350

iii. Ex- Right price per share = 2,350/110

= Rs. 21.36

Step 2

Share price of A is adjusted after the close of day to calculate the New Divisor for the next day.

Stock	Shares Price (Rs)	No of Free Float Shares	Market Value (Rs)
A	21.36	50,000,000	1,068,000,000
B	41	150,000,000	6,150,000,000
C	44.5	150,000,000	6,675,000,000
Revised Free Float Market Capitalization			**13,893,000,000**

New Divisor = Revised Free Float Market Capitalization/ Index points

=13,893,000,000/1,120 = 12,404,464

Second Stage

After 15 days of the last date of payment the company confirm 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.

Step 1

Free-float shares of Stock A shall be adjusted after the close of Day to calculate the New Divisor for the next day.

Stock A		
Free Float shares	**Right Issue**	**Total Free Float shares**
50,000,000	10%	55,000,000

Stock	Shares Price (Rs)	No of Free Float Shares	Market Value (Rs)
A	22	55,000,000	1,210,000,000
B	41	150,000,000	6,150,000,000
C	44.5	150,000,000	6,675,000,000
Revised Free Float Market Capitalization			**14,035,000,000**

New Divisor = Revised Free Float Market Capitalization/ Index Points

New Divisor = 14,035,000,000/1,120 =12,531,250

8.4 Bonus & Right Issue Adjustment (Simultaneously)

If Company A has announced;

Bonus: 10%

Right: 10% at a Premium of Rs 10 per share

KMI 30 Index = 1,120

KMI 30 Index Market Capitalization = 13,950,000,000

Divisor = 12,454,357

Step 1

Calculate the Ex-Bonus and Ex- Right price of the stock A:

For simplicity we will calculate its price on the basis of a lot of 100 shares.

i) Total shares after the Right issue and Bonus

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

100+ 10 +10

= 120 shares

ii) Cost of a lot (100 shares)

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

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

= Rs 2,450

iii) Ex-Bonus and Ex- Right price per share = 2,450/120

= Rs 20.42

Step 2

Calculate the total number of free-float shares after the Bonus issue.

Stock A		
Free Float shares	**Bonus Issue**	**Total Free Float shares**
50,000,000	10%	55,000,000

Step 3

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

Stock	Shares Price (Rs)	No of Free Float Shares	Market Value (Rs)
A	20.42	55,000,000	1,123,100,000
B	41	150,000,000	6,150,000,000
C	44.5	150,000,000	6,675,000,000
Revised Free Float Market Capitalization			**13,948,100,000**

New Divisor = Revised Free Float Market Capitalization/ Index points

New Divisor =13,948,100,000/1,120 = 12,453,661

9. Up-dation of Free Float

Listed companies submit quarterly free float to the Exchange, however KMI 30 Index update free float semiannually at the time of re-composition as it is cap adjusted Index.