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9B21N010

Emaan Modaraba: ISLAMIC FINANCE and the Real Economy[[1]](#footnote-1)

Fawad R. Baluch wrote this case under the supervision of Professor Diane-Laure Arjaliès solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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On August 11, 2020, Amina Ali, an investment manager at Emaan Modaraba in Karachi, Pakistan, (Emaan), received an email from Sadiqa Khan, the chief executive officer of Emaan. Khan requested that Ali “urgently review” the annual financial statements of Indus Motor Company Limited (Indus), which had been published the day before, and provide recommendations. Khan was worried that Indus was no longer Shariah-compliant, and she wondered whether Emaan should keep the company in its portfolio. Ali was a recent hire, and she was keen to make a good impression on company management. Her prior experience as an equity research analyst at an investment bank meant that she was well versed in evaluating stocks and analyzing companies’ financial statements. However, this was the first time she had worked at a fund where the investments and operations had to comply with the principles of Islamic finance. Ali knew that her recommendations had to include the Shariah-compliance status of Indus stock. Aware that it would be a long day, she began going through the annual report.

ISLAMIC FINANCE

An Equity-Based Rather than a Debt-Based Financial System

According to the International Monetary Fund, by 2019, global Islamic financial assets had grown to around US $2 trillion.[[2]](#footnote-2) Islamic financial institutions have been recognized by the Financial Stability Board as being “systemically important” in 13 jurisdictions, and they have a presence in over 60 countries.[[3]](#footnote-3) The term “Islamic finance” refers to financial and banking arrangements that do not contravene the religious prohibitions of the Shariah. These include a prohibition on financing and transacting in areas that are forbidden by Islam, such as the gambling and alcohol industries. One key prohibition under the Shariah is the prohibition against *riba* (interest). This prohibition attempts to ensure equity in a situation in which one party (the lender) has greater bargaining strength than the other (the borrower), since charging exorbitant interest could perpetuate a vicious cycle of poverty. There is disagreement among religious scholars as to whether riba refers to interest in all its forms, or if it is simply a prohibition against exploitation, which is considered characteristic of usury (lending at unreasonably high interest rates).[[4]](#footnote-4) Modern Islamic financial institutions consider all forms of interest to be prohibited.[[5]](#footnote-5) By catering to even the most conservative interpretations, they hope to protect themselves against any possible claim of Shariah non-compliance.

The challenge faced by Islamic financial institutions is that Islamic finance envisions an equity-based financial system, rather than a debt-based one.[[6]](#footnote-6) The common thread that unites the products offered by Islamic financial institutions is that they do not leverage debt by simply lending money or providing credit; instead, transactions are organized as sales, leases, or joint-venture projects. Transactions are structured in this manner to avoid charging interest, and they are intended to embed the transactions firmly within the “real economy.” In this context, the real economy is defined as that part of the economy that “. . . involves the production, transportation and selling of goods and services—as opposed to the exchange of paper assets, which is the concern of the ‘paper’ economy of the world of finance.”[[7]](#footnote-7)

Shariah-Compliant Arrangements

Shariah-compliant financial institutions employ several arrangements to create value and enter into transactions. The most important types of these arrangements are as follows:[[8]](#footnote-8)

*Modaraba*: A partnership arrangement that involves two parties, where one party is the *mudarib* (manager) or provides labor and the other is the *rabb al-mal* (investor), who provides the capital. Modarabas, such as Emaan, serve as the mudarib, as they manage investors’ funds. The certificate holders/shareholders of a modaraba are the investors. The modaraba makes investments and provides Islamic financial services to the public. The profits made by the modaraba (a combination of capital gains from investments and profits from financial services) are then distributed as dividends to the investors. The certificates of modarabas are often listed on stock exchanges, and a profitable modaraba’s certificates have a higher market value.

*Diminishing Musharaka*: A joint venture arrangement whereby a financing party (the financier) and a project sponsor (the sponsor) agree to enter into a project, and the total monetary value of the project is divided into units. The sponsor buys all the units in the project according to a payment schedule set by the financier. The financier (which is usually a bank) participates in the profits derived from the project or asset. Such an arrangement is often used by Islamic banks in place of a mortgage agreement for personal home finance. In these arrangements, the bank applies a “profit rate,” which is often calculated after taking into account interbank offering rates and other market factors.

*Ijarah*: An arrangement in which a *mu’jir* (lessor) leases an asset to a *musta’jir* (lessee) in exchange for *ujra* (rent). The arrangement is commonly applied as an asset lease, and it is often used by Islamic banks for automobile financing. The lessor applies a “profit rate,” which is incorporated into the rent payments. See Exhibit 1 for an explanation of Shariah-compliant arrangements.

EMAAN

Emaan was founded in Pakistan as a modaraba after a process known as flotation. Flotation began with the incorporation of two legal entities, namely, a modaraba management company (which acted as an investment manager) and a modaraba (the fund itself). The management company was incorporated as a conventional company, while the modaraba was incorporated under a special law governing modarabas.[[9]](#footnote-9) Under Pakistani law, the modaraba management company was required to hold 10 per cent of the shares or certificates of the modaraba fund, and the modaraba itself had to be publicly listed on a stock exchange.[[10]](#footnote-10) During the flotation process, Emaan issued its prospectus, carried out an initial public offering, and was subsequently listed on the Pakistan Stock Exchange (PSX).

Emaan had two principal lines of business: making investments and offering its own financial services to the public. The company’s investment activities ranged from purchasing plots of industrial land to making investments in capital markets. Emaan created value by offering Islamic financial services to the public through diminishing musharaka arrangements for personal home financing and ijarah arrangements for automobile financing. It also provided project financing for industrial undertakings using Shariah-compliant arrangements. While Emaan’s Islamic financing services were based on commonly accepted Islamic financing arrangements, it still had to exercise caution when making investments to ensure that its holdings were Shariah-compliant. This was particularly relevant in relation to investments in the stock market, since both Shariah-compliant and non-compliant stocks were listed on the Pakistan Stock Exchange.

Emaan’s Portfolio

Some 52 per cent of Emaan’s assets were short- and long-term investments in stocks of listed companies, while 10 per cent of its assets comprised cash and receivables from its consumer and commercial financing services. The remainder was invested in real estate investments and fixed assets. Indus was a vital stock in Emaan’s portfolio. In fact, shares of Indus accounted for over 20 per cent of Emaan’s stock portfolio.

Emaan’s Investment Decision: Indus

Indus (PSX symbol: INDU) was one of the leading companies listed on the PSX, with a market capitalization of approximately CA$727 million. It was a joint venture between Toyota Motor Corporation and the House of Habib, a diversified business group located in Pakistan. It employed approximately 3,000 people in Pakistan. To provide affordable vehicles to the local market, the company assembled vehicles from completely knocked-down units imported from Toyota’s Japan-based manufacturing facilities. The company also facilitated the importation of fully assembled Toyota vehicles, although this accounted for only a small portion of its business, as customs duties on imported vehicles were relatively high in Pakistan. Indeed, imported vehicles accounted for less than two per cent of Indus’ sales in 2019–2020.[[11]](#footnote-11)

SHARIAH COMPLIANce MECHANISMS WITHIN THE PAKISTAN STOCK EXCHANGE

Capital Markets in Pakistan

The PSX can trace its roots back to the establishment of the Karachi Stock Exchange, which was incorporated in 1949. The PSX was formally incorporated in 2016 after three of the country’s major stock exchanges (the Karachi, Lahore, and Islamabad Stock Exchanges) were integrated to form a single market through legislation.[[12]](#footnote-12) In January 2021, the market capitalization of the PSX was approximately CA$67 billion.[[13]](#footnote-13) The PSX lists both conventional and Shariah-compliant companies. The listed companies vary widely, from Shariah-compliant modaraba funds to Pakistan’s largest brewery. The story is similar in relation to the debt market, where the offerings includes conventional interest-bearing bonds (such as Pakistan Investment Bonds and Term Finance Certificates) and Shariah-compliant offerings, such as *sukuk* (asset-backed Shariah-compliant bonds). The diversity of the companies included in the capital and finance markets in Pakistan means that there is interplay between companies that are Shariah-compliant and those that are not. This poses a challenge for modaraba funds such as Emaan, which are under an obligation to make Shariah-compliant investments. The process by which modaraba funds ensure that an investment is Shariah-compliant is termed “screening.”

Regulatory Framework for Screening

Modarabas are subject to a plethora of regulatory requirements. They use International Financial Reporting Standards principles to prepare their financial statements, and they are subject to the Code of Corporate Governance issued by the Securities and Exchange Commission of Pakistan (SECP). This includes equity and diversity inclusion requirements, such as the requirement to have at least one woman on boards of directors.[[14]](#footnote-14) Modarabas, as listed companies, are also required to adhere to the PSX’s listing regulations. In other words, modarabas are subject to the same laws (including financial audits) as any public company, in addition to being subject to modaraba-specific laws.

The SECP has issued several regulations governing Shariah-compliant institutions. In issuing these regulations, the biggest challenge for the SECP has been to provide the public with confidence that modarabas and other Shariah-compliant institutions are adhering to the principles of Islamic finance. After a period of consultation, the SECP formulated the Shariah Compliance and Shariah Audit Mechanism (SCSAM) in 2012 to standardize compliance with Shariah principles.[[15]](#footnote-15)

Screening and the Shariah Compliance and Shariah Audit Mechanism

The SCSAM regulations state that a modaraba must only conduct the business activities specified in its prospectus. Further, the regulations require each modaraba company to appoint a qualified Shariah advisor and Shariah internal auditor. The Shariah advisor has to provide a Shariah-compliance report in the annual report of the modaraba after conducting a thorough review of its operations and investment portfolio. The Shariah-compliance report considers whether the operations and investment of the modaraba are compliant with the principles of Shariah and the prevailing Shariah regulations issued by the SECP. If any investment is deemed not to be Shariah-compliant, the Shariah advisor has to note this in the Shariah-compliance report and state that they had issued directions that the non-compliant investment be divested. The Shariah internal auditor is responsible for implementing risk management and internal controls, which are intended to ensure that the modaraba’s operations remain Shariah-compliant. Most importantly, the SCSAM regulations establish six Shariah screening criteria for investment in shares and a process for “dividend purification.” The six criteria are as follows[[16]](#footnote-16):

1. Principal business of a company: The principal business was required not to contravene any Shariah principles. A company’s business model had to not rely heavily on interest, as in the case of conventional banks. A company was also forbidden from involvement in activities expressly prohibited under religious edicts, such as gambling, the manufacture or consumption of alcohol, and the manufacture of pork products.
2. Ratio of interest-bearing debt-to-total assets had to be less than 37 per cent: This criterion ensured that the business model did not rely heavily on interest. Interest-bearing debt instruments were defined to include commercial paper, conventional bank loans, issuance of preference shares, bonds, and term finance certificates.[[17]](#footnote-17)
3. Ratio of non-compliant investments to total assets had to be less than 33 per cent: Non-compliant investments included both interest-bearing investments and instruments, as well as investments in companies that were not Shariah-compliant. Examples included commercial paper, investments in conventional mutual funds, market treasury bills, term deposit bills, and Pakistan Investment Bonds.
4. Ratio of non-compliant income to total revenue had to be less than 5 per cent: This ratio tracked how much of a company’s revenue was derived from non-compliant investments.
5. Ratio of illiquid assets to total assets had to be at least 25 per cent: The regulations stated that an “illiquid asset means any asset that Shariah permits to be traded at value other than the par.”[[18]](#footnote-18) Examples of illiquid assets included inventory of raw materials; work-in-process; and all fixed assets, such as property, plant, and equipment. The rationale behind this rule was that Shariah demanded that a company created value from the real economy using its illiquid assets.
6. Market price per share had to be equal to or greater than net liquid assets per share: To ensure that this criterion held, the net liquid assets per share was calculated using the formula below. The rationale behind this rule was to prevent liquid assets from being traded below their value, since Shariah requires that money be traded at its par value.[[19]](#footnote-19)

The screening criteria allowed companies to earn up to 5 per cent from non-compliant investments if those non-compliant investments accounted for no more than 33 per cent of a company’s total assets. To ensure that profit earnings were not tainted by non-compliant income, modarabas applied what was known as a “dividend purification” formula:

The purified dividend retained by a modaraba could be reinvested, kept in its reserves, or distributed to shareholders. The remainder of the dividend had to be transferred to the charity account maintained by the modaraba and then distributed as a donation to a recognized charity within three months.

In 2018, following another round of consultation, the SECP issued the Shariah Governance Regulations, which regulated all companies that claimed to issue Shariah-compliant securities or to be Shariah-compliant more broadly.[[20]](#footnote-20) Regulation 12 of the Shariah Governance Regulations required that Shariah screening be carried out by stock exchanges to create a Shariah index and, further, that the composition of the index be reviewed biannually by the stock exchange. This biannual review meant that analysts regularly scrutinized the financial statements of their portfolio companies to ensure their compliance with the Shariah screening criteria. If an investment were determined to have become non-compliant, the gains had to be transferred to that modaraba’s charity account and could not form part of its profits.

The Shariah Indices

Al Meezan Investment Management Limited (Al Meezan) was one of Pakistan’s largest Shariah-compliant asset management companies, with approximately CA$1.3 billion in assets under management as of March 2021.[[21]](#footnote-21) Al Meezan had partnered with the erstwhile Karachi Stock Exchange to introduce the KSE Meezan Index (KMI 30). The KMI 30 was a capitalization-weighted index that only included shares deemed to meet the Shariah screening criteria set out in the SCSAM and the Shariah Governance Regulations. Upon the establishment of the PSX, the KMI 30 was retained, and another index, the PSX-KMI All Share Islamic Index, was also established as a comprehensive index of all Shariah-compliant companies listed on the PSX. The existence of a Shariah index allowed investors to make investments without needing to screen companies’ Shariah-compliance status.

DECISION

On July 10, 2020, the PSX issued the latest composition of the PSX-KMI All Share Islamic Index[[22]](#footnote-22) (see Exhibit 2), and Indus was designated Shariah-compliant based on the financial performance data available at the time. Indus’ share price on July 10 was Rs1,141[[23]](#footnote-23)—it had been trending upward after plummeting in March 2020 in response to the economic shock caused by the COVID-19 pandemic (see Exhibit 3). In July 2020, shortly after the PSX reported the composition of the PSX-KMI All Share Islamic Index, Emaan invested in Indus shares, hoping that its stock would continue to increase in value due to its apparent resilience against the consequences of the pandemic. In August 2020, Indus issued its annual report for the financial year ended June 30, 2020 (see Exhibit 4).

Based on what she knew about Shariah screening, Ali began reviewing Indus’ financial statements for the year ended June 30, 2020. She wondered what considerations she needed to take into account while preparing her recommendations. Was the company Shariah-compliant? Should it continue to be included in the fund? What should her rationale be for making the decision?

Exhibit 1: Diagrams of Common Islamic Finance Arrangements

**Modaraba Model**

**Modaraba**

**Fund**

*Investors/Shareholders*

Modaraba

Management Company

Management

Capital

Dividend

Dividend

Capital

Profit

Profit

Capital

Islamic Finance Services

Investments

Capital Markets

Public

Real Estate

Exhibit 1(continued)

Diminishing Musharaka Arrangement

**Musharaka Agreement**

**Project Assets**

**and Capital**

(100 Units)

Profits Based on

Units Owned

Profits Based on

Units Owned

Payment

**Financier**

(Financial Institution)

**Sponsor**

(Client)

Units

Source: Adapted by the case author from David M. Eisenberg, “Sources and Principles of Islamic Law,” in *Islamic Finance: Law and Practice*, ed. Craig R. Nethercott and David M. Eisenberg (Oxford: Oxford University Press, 2012), 172–191, 240–249.

Exhibit 2: Excerpt from July 10, 2020 KMI Composition

**PSX/N-805**

Dated: **July, 10 2020**

NOTICE FOR ALL MARKET PARTICIPANTS

SUBJECT: RE-COMPOSITION OF PSX-KMI ALL SHARE ISLAMIC

INDEX OF PAKISTAN

It is hereby informed that the Pakistan Stock Exchange Limited has carried-out [sic] the exercise of re-composition of PSX-KMI ALL SHARE ISLAMIC INDEX for the review period July 01, 2019 to December 31, 2019. The re-composition has been carried out on the basis of the criteria of selection of companies as detailed in the Brochure of PSX-KMI All Share Islamic Index of Pakistan, which can be downloaded from the website of the Exchange: www.psx.com.pk.

The recomposed PSX-KMI All Share Islamic Index of Pakistan will comprise of [sic] 217 companies, in aggregate, out of which 16 new companies have entered the Index, whereas, 22 companies have been removed from the Index. Enclosed herewith [is] the list with complete details of inclusion and exclusion of the recomposed Index.

The recomposed Index will be implemented w.e.f. July 20, 2020.

-Sd-

MOHAMMAD HUSSAIN

Senior Manager

Product Management & Research

List of Incoming / Outgoing Companies

Re-composition of PSX-KMI All Share[s] Islamic Index of Pakistan for the

Review period July 01, 2019 to December 31, 2019

|  |  |  |
| --- | --- | --- |
| **S NO.** | **Symbol** | **Incoming Companies** |
| 9 | INDU | Indus Motors [sic] Company Limited |

Exhibit 2 (Continued)

FINAL RE-COMPOSITION LIST – ALL SHARE ISLAMIC INDEX FOR THE PERIOD

ENDED DECEMBER 2019 (COMPLETE RATIOS)

| No. | Ticker | Company Name | Objective | Debt Ratio (D/A <  37%) | Investment Ratio  (NCInv/TA < 33%) | Income Ratio  (NCInc/TR < 5%) | Illiquid Assets Ratio  (IA/TA => 25%) | Net Liquid Assets  Ratio (NLA < P) | Share Price as of  December 31, 2019 | Final Shariah Status |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 114 | INDU | Indus Motor Company | Compliant | 0.33% | 29.15% | 2.10% | 54% | 102.00 | 1161 | Compliant |

Source: “Re-Composition of PSX-KMI All Share Islamic Index of Pakistan,” Pakistan Stock Exchange Limited, July 10, 2020, accessed February 13, 2021, www.psx.com.pk/psx/themes/psx/uploads/Notice-with-List-incoming-outgoing-KMI-ALL-Shares-July-01-2019-Dec-31-2019.pdf.

Exhibit 3: Indus Motor Company Stock Price in 2020

Source: Created by the case author based on historical data from “Indus Motor Company Ltd (INDM),” Investing.com, accessed February 14, 2021, www.investing.com/equities/indus-motor-historical-data.

Exhibit 4: Indus Motor Company Annual Report

Statement of Financial Position as at June 30, 2020

|  | **Note** | **2020** | **2019** |
| --- | --- | --- | --- |
| **ASSETS** |  | (Pakistani Rupees in ’000) | |
| **Non-Current Assets** |  |  |  |
| Property, plant, and equipment | 4 | 16,501,642 | 13,804,509 |
| Intangible assets | 4 | 72,550 | 93,524 |
| Long-term loans and advances | 5 | 12,639 | 15,906 |
| Long-term deposits | 6 | 10,020 | 11,129 |
| Deferred taxation - net | 7 | 64,491 | - |
| **Current Assets** |  | 16,661,342 | 13,925,068 |
| Stores and spares | 8 | 478,455 | 544,005 |
| Stock-in-trade | 9 | 15,932,791 | 13,560,393 |
| Trade debts - unsecured | 10 | 1,141,711 | 2,547,915 |
| Loans and advances | 11 | 2,990,543 | 3,728,026 |
| Short-term prepayments | 12 | 27,272 | 31,946 |
| Accrued return | 13 | 111,128 | 34,846 |
| Other receivables | 14 | 438,655 | 3,109,549 |
| Taxation - net | 16 | 130,725 | 617,068 |
| Short-term investments | 15 | 41,194,878 | 23,402,464 |
| Cash and bank balances | 17 | 1,171,064 | 3,281,782 |
|  |  | 63,617,222 | 50,857,994 |
| **TOTAL ASSETS** |  | 80,278,564 | 64,783,062 |
| **EQUITY** |  |  |  |
|  |  |  |  |
| **Share Capital** |  |  |  |
| Authorized capital |  |  |  |
| 500,000,000 (2019: 500,000,000) ordinary shares of Rs 10   each |  | 5,000,000 | 5,000,000 |
|  |  |  |  |
| Issued, subscribed, and paid-up capital | 18 | 786,000 | 786,000 |
| Reserves | 19 | 40,383,391 | 39,259,309 |
|  |  | **41,169,391** | **40,045,309** |

Exhibit 4 Report (Continued)

| **LIABILITIES** |  |  |  |
| --- | --- | --- | --- |
| **Non-Current Liabilities** |  |  |  |
| Long-term loan | 20 | 479,326 | 80,540 |
| Deferred revenue |  | 3,799 | 53,690 |
| Deferred taxation - net | 7 | - | 424,690 |
|  |  | 483,125 | 558,920 |
| **Current Liabilities** |  |  |  |
| Current portion of deferred revenue | 20 | 28,420 | 3,300 |
| Current portion of long-term loan |  | 113,425 | - |
| Unclaimed dividends |  | 357,066 | 295,597 |
| Trade payables, other payables, and provisions | 21 | 13,593,480 | 15,950,203 |
| Advances from customers and dealers | 22 | 24,533,657 | 7,929,733 |
|  |  | 38,626,048 | 24,178,833 |
| **TOTAL EQUITY AND LIABILITIES** |  | 80,278,564 | 64,783,062 |

Statement of Profit or Loss for the Year Ended June 30, 2020

(Pakistani Rupees in ’000)

|  |  | **2020** | **2019** |
| --- | --- | --- | --- |
| Revenue from contracts with customers | 26 | 86,167,016 | 157,996,212 |
| Cost of sales | 27 | -78,716,157 | -138,804,538 |
| Gross profit |  | 7,450,859 | 19,191,674 |
| Distribution expenses | 28 | -1,468,862 | -1,403,611 |
| Administrative expenses | 29 | -1,385,099 | -1,410,033 |
| Other operating expenses | 30 | -196,740 | -234,977 |
|  |  | -3,050,701 | -3,048,621 |
|  |  | 4,400,158 | 16,143,053 |
| Workers’ Profit Participation Fund and Workers’ Welfare Fund | 31 | -231,934 | -1,406,379 |
|  |  | 4,168,224 | 14,736,674 |
| Other income | 32 | 3,204,872 | 4,306,662 |
|  |  | 7,373,096 | 19,043,336 |
| Finance cost | 33 | -85,737 | -67,407 |
| Profit before taxation |  | 7,287,359 | 18,975,929 |
| Taxation | 34 | -2,205,332 | -5,260,954 |
| Profit after taxation |  | 5,082,027 | 13,714,975 |
|  |  |  |  |
|  |  |  |  |
| (Pakistani Rupees) |  |  |  |
| Earnings per share - basic and diluted | 35 | 64.66 | 174.49 |

Exhibit 4 (Continued)

Statement of Comprehensive Income

Pakistani Rupees in ’000

|  | **Note** | **2020** |  | **2019** |
| --- | --- | --- | --- | --- |
| Profit after taxation |  | 5,082,027 |  | 13,714,975 |
|  |
| Other   comprehensive   income |
|  |
| *Items that will not be   reclassified to profit   or loss* |
| Remeasurement   gain on net defined   benefit obligation | 23.4 | 15,993 |  | 693 |
| Related deferred tax   charge thereon |  | -4,638 |  | -201 |
|  |  | 11,355 |  | 492 |
| Total comprehensive   income for the year |  | 5,093,382 |  | 13,715,467 |

Statement of Cash Flows for the Year Ended June 30, 2020

Pakistani Rupees in ’000

| CASH FLOWS FROM OPERATING ACTIVITIES | **Note** | **2020** | **2019** |
| --- | --- | --- | --- |
| Cash generated from (utilized in)   operations | 36 | 24,617,778 | -6,346,782 |
| Net decrease in long-term loans and   advances |  | 3,267 | 32,619 |
| Net decrease (increase) in long-term   deposits |  | 1,109 | -1,686 |
| Compensation paid on advances   received from customers |  | -13,526 | -403,646 |
| (Decrease) increase in deferred   revenue |  | -49,891 | 30,979 |
| Payment to Workers’ Profit Participation   Fund |  | -370,000 | -1,020,000 |
| Payment to Workers’ Welfare Fund |  | -330,495 | -450,978 |
| Interest paid on long term loan |  | -4,038 | - |
| Income tax paid |  | -2,212,807 | -7,129,771 |
| Net cash inflow from (outflow) on   operating activities |  | 21,641,397 | -15,289,265 |
|  |  |  |  |

Exhibit 4 (Continued)

| CASH FLOWS FROM INVESTING   ACTIVITIES |  |  |  |
| --- | --- | --- | --- |
| Purchase of property, plant, and   equipment & intangible assets |  | -5,566,967 | -8,749,118 |
| Proceeds from disposals of property,   plant, and equipment |  | 122,732 | 68,577 |
| Interest received on bank deposits and   Term Deposit Receipts |  | 937,582 | 1,583,036 |
| Gain on sale of Pakistan Investment   Bonds (PIBs) |  | 137,022 | 308,105 |
| Investment in PIBs |  | -499,962 | - |
| Investment in listed mutual fund units |  | -6,750,000 | -8,238,074 |
| Dividend income received from mutual  fund units |  | 173,648 | 494,074 |
| Proceeds from redemption of listed   mutual fund units |  | 6,756,809 | 17,242,007 |
| Interest received on Market Treasury  Bills (MTBs) |  | 9,196 | 399,787 |
| Investment in MTBs |  | -18,800,438 | - |
| Proceeds from sale of MTBs |  | 20,416,251 | 1,103,183 |
| Net cash (outflow) on inflow from  investing activities |  | -3,064,127 | 4,211,577 |
|  |  |  |  |
| CASH FLOWS FROM FINANCING   ACTIVITIES |  |  |  |
| Long-term loan received |  | 512,211 | 80,540 |
| Dividend paid |  | -3,907,831 | -10,361,785 |
| Net cash outflow on financing activities |  | -3,395,620 | -10,281,245 |
|  |  |  |  |
| Net increase (decrease) in cash and  cash equivalents during the year |  | 15,181,650 | -21,358,933 |
|  |  | 26,684,246 | 48,043,179 |
| Cash and cash equivalents at  beginning of the year |  |  |  |
| Cash and cash equivalents at end of  the year | 37 | 41,865,896 | 26,684,246 |

Exhibit 4 (Continued)

Relevant Notes to the Financial Statements

|  | **Note** | **2020** | **2019** |
| --- | --- | --- | --- |
| 4 PROPERTY, PLANT, AND EQUIPMENT & INTANGIBLE ASSETS |  |  |  |
| Property, plant, and equipment | 4.1 | 16,501,642 | 13,804,509 |
| Intangible assets | 4.2 | 72,550 | 93,524 |
|  |  | 16,574,192 | 13,898,033 |
| 4.1 Property, plant, and equipment |  |  |  |
| Tangible operating assets | 4.2 | 15,334,649 | 13,360,788 |
| Capital work-in-progress | 4.6 | 1,166,993 | 443,721 |
|  |  | 16,501,642 | 13,804,509 |

|  | **Note** | **2020** | **2019** |
| --- | --- | --- | --- |
| 8 STORES AND SPARES |  |  |  |
| Stores |  | 377,815 | 310,569 |
| Spares |  | 719,806 | 574,924 |
|  |  | 1,097,621 | 885,493 |
| Less: Provision for slow-moving   stores and spares |  | 619,166 | 341,488 |
|  |  | 478,455 | 544,005 |
| 9 STOCK-IN-TRADE |  |  |  |
| In hand |  |  |  |
| Manufacturing stock |  |  |  |
| Raw material and components |  | 12,643,074 | 6,307,657 |
| Less: Provision for slow-moving   stock-in-trade |  | 58,579 | 38,181 |
|  |  | 12,584,495 | 6,269,476 |
| Work-in-process |  | 970,298 | 683,469 |
| Finished goods (vehicles - own   manufactured) | 9.2 | 455,838 | 117,347 |
| Less: Provision for slow-moving   stock-in-trade |  | 17,328 | 1,162 |
|  |  | 13,993,303 | 7,069,130 |
| Trading stock |  |  |  |
| Vehicles | 9.2 | 461,505 | 924,741 |
| Less: Provision for slow-moving   stock-in-trade |  | 73,344 | 110,038 |
|  |  | 388,161 | 814,703 |
|  |  |  |  |
| Spare parts | 9.3 | 786,208 | 486,621 |
| Special service tools and publications |  | 7,432 | 8,036 |
| Less: Provision for slow-moving   stock-in-trade |  | 120,179 | 84,635 |
| In transit |  |  |  |
| Raw material - manufacturing stock |  | 641,895 | 4,903,060 |
| Trading stock |  | 235,971 | 363,478 |
|  |  | **15,932,791** | **13,560,393** |

Exhibit 4 (Continued)

|  |  |  |  |
| --- | --- | --- | --- |
| 15 SHORT-TERM INVESTMENTS |  |  |  |
| At amortised cost |  |  |  |
| - Term Deposit Receipts (TDRs) | 15.1 | 34,000,000 | 19,000,000 |
| At fair value through profit or loss |  |  |  |
| Government securities |  |  |  |
| - Market Treasury Bills (MTBs) | 15.2 | 6,694,832 | 4,402,464 |
| - Pakistan Investment Bonds (PIBs) | 15.3 | 500,046 | - |
|  |  | 7,194,878 | 4,402,464 |
|  |  | 41,194,878 | 23,402,464 |

15.1 = As at June 30, 2020, the Company holds TDRs carrying profit rates ranging between 7% and 9.40% per annum (2019: 13.50% and 15% per annum). The TDRs are due to mature maximum by July 16, 2020. Balances in TDRs include an amount of Rs10,000 million (2019: Rs8,500 million) held with Habib Metropolitan Bank Limited, a related party.

15.2 = These securities have varying maturities ranging from July 30, 2020 to November 5, 2020. The yield on these securities is 7.01% to 12.48% per annum (2019: 12.57% to 12.75% per annum).

15.3 = This security carries a markup at the rate [of] 8.92% per annum and will mature by April 18, 2029.

Source: Toyota, *Indus Motor Company Ltd. 2020 Annual Report*, accessed June 12, 2021, www.toyota-indus.com/financial-results/.

1. This case has been written on the basis of published sources only. Consequently, the interpretations and perspectives presented in the case are not necessarily those of Amina Ali, Emaan Modaraba, or any of its employees. [↑](#footnote-ref-1)
2. International Monetary Fund, *IMF Annual Report 2019: Our Connected World*, 2019, accessed February 14, 2021, www.imf.org/external/pubs/ft/ar/2019/eng/assets/pdf/imf-annual-report-2019.pdf. [↑](#footnote-ref-2)
3. Ibid. [↑](#footnote-ref-3)
4. David M. Eisenberg, “Sources and Principles of Islamic Law,” in *Islamic Finance: Law and Practice*, ed. Craig R. Nethercott and David M. Eisenberg (Oxford: Oxford University Press, 2012), 41–45. [↑](#footnote-ref-4)
5. Ibid. [↑](#footnote-ref-5)
6. Ibid. [↑](#footnote-ref-6)
7. Nicholas G. Pirounakis, “Aspects of the ‘Real’ Economy,” in *The Greek Economy: Past, Present and Future* (Basingstoke: Macmillan, 1997), 170. [↑](#footnote-ref-7)
8. David M. Eisenberg, op. cit., 172–191, 240–249. [↑](#footnote-ref-8)
9. “Modaraba,” JamaPunji, accessed February 14, 2021, https://jamapunji.pk/knowledge-center/modaraba. [↑](#footnote-ref-9)
10. Ibid. [↑](#footnote-ref-10)
11. Toyota, *Indus Motor Company Ltd. 2020 Annual Report*, accessed February 13, 2021, www.toyota-indus.com/financial-results/. [↑](#footnote-ref-11)
12. “About Us,” Pakistan Stock Exchange Limited, accessed February 14, 2021, www.psx.com.pk/psx/exchange/profile/about-us. [↑](#footnote-ref-12)
13. “Pakistan: Market Cap: PSX: All Shares,” CEIC, accessed February 14, 2021, www.ceicdata.com/en/pakistan/karachi-stock-exchange-market-capitalization-new-classification/market-cap-psx-all-shares. [↑](#footnote-ref-13)
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15. “Shari’ah Compliance and Shari’ah Audit Mechanism (SCSAM) for Modarabas,” Securities and Exchange Commission of Pakistan, February 3, 2012, accessed February 13, 2021, www.secp.gov.pk/document/shariah-compliance-and-shariah-audit-mechanism-scsam-for-modarabas/?wpdmdl=12796&amp;refresh=60288e0c30d131613270540. [↑](#footnote-ref-15)
16. Ibid. [↑](#footnote-ref-16)
17. “KMI 30 Index Methodology,” Pakistan Stock Exchange Limited, accessed February 13, 2021, www.psx.com.pk/psx/themes/psx/uploads/KMI\_30-Index-(New-Broucher).pdf. [↑](#footnote-ref-17)
18. “Shari’ah Compliance and Shari’ah Audit Mechanism (SCSAM) for Modarabas,” op. cit. [↑](#footnote-ref-18)
19. Ulrich Derigs and Shehab Marzban, “Review and Analysis of Current Shariah‐Compliant Equity Screening Practices,” *International Journal of Islamic and Middle Eastern Finance and Management* 1, no. 4 (2008): 285–303. https://doi.org/10.1108/17538390810919600. [↑](#footnote-ref-19)
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23. Rs= PKR = Pakistani rupee. [↑](#footnote-ref-23)