

SECURITIES AND EXCHANGE COMMISSION OF PAKISTAN
(Monitoring & Enforcement Division)
State Life Building, 7-Blue Area,
Islamabad

NO. Co.265/79/EM/94

Islamabad, dated the 3rd June, 2000

**ORDER UNDER SECTION 265 OF THE COMPANIES ORDINANCE
1984 IN THE MATTER OF M/S. DIAMOND INDUSTRIES LIMITED**

M/s. Diamond Industries Limited (hereinafter referred to as the company) is listed on the Karachi, Lahore and Islamabad Stock Exchanges. The paid up capital of the company as on 30-6-1999 is Rs. 90.000 million. The principal activity of the company is to manufacture and sale foam, foam products and various industrial chemical/chemical binders used in textiles, leather and wood industries.

2. On examination of the annual accounts of the company for the year ended 30-06-1999 and earlier years, it was revealed that the company paid no return to its shareholders during the last four years. The company earned net profit of Rs. 31.509 million during the year ended 30-6-1995, paid dividend in 1995 has passed over the dividend continuously during the last four years i.e. 1996, 1997, 1998 and 1999. The position with regard to profit/loss during the proceeding four years is as follows:-

<u>YEAR ENDED</u>	<u>Rs. in million</u> <u>NET LOSS</u>
30-06-1996	78.753
30-06-1997	(20.560)
30-06-1998	(21.759)
30-06-1999	(5.788)

3. In view of the aforesaid state of affairs there was an apprehension that affairs of the company are not being managed in accordance with the sound business principles and prudent commercial practices, the members of the company have been deprived of a return on their investment. Accordingly, a show cause notice under section 265 of the Companies Ordinance, 1984 was served upon the Chief Executive of the company on 11-09- 1999 to show cause in writing by 06- 10-1999 as to why an Inspector should not be appointed to investigate into the affairs of the company.

4. In response to the said show cause notice, the Chief Executive of the company vide his letter No.DIL/CS/081, dated September 24, 1999 furnished the following explanations:

- (I) The loss of Rs. 2 1.760 million for the year ended June 30, 1998 as pointed out by you was due to the closure of our industry at Gadoon Amazai owing to withdrawal of facilities given by the Government. The production and sales figures under reference cover a period of only 3 months. This naturally increased our overhead expenses relating to dues of workers, such as gratuity, leave encashment and other benefits etc. This has also been mentioned in our Director's Report to the shareholders in the Annual General Meeting on December 30, 1998;
- (ii) As far as the non-payment of dividend for the last three years we may point out that the General Public contribution in the paid up capital is almost 25% while the sponsors contribution is 75% and as such it was more in the interest of the sponsors to pay the dividend;

- (iii) The company was engaged in litigation against the withdrawal of incentives to industries set up in Gadoon Amazai Industrial Estate in the Supreme Court of Pakistan. The Honourable Supreme Court of Pakistan dismissed our appeals.

5. The explanation furnished by the company was considered but was not found cogent. To provide to the company opportunity of being heard various hearings were held. On the last hearing held on 21-03-2000, Mr. Saleem Ahsan and the representative of the company appeared and intimated that company has declared 30% interim dividend and requested that proceedings be dropped. On this, he was asked to furnish following information for a decision in the matter:-

- (a) Detail of Trade Mark Registration;
- (b) Expenses paid by Diamond Industries Ltd. in last five years on developing trademark;
- (c) Estimated value of trademark;
- (d) Why no fee was charged from subsidiary company which is not a wholly owned subsidiary company for marketing its products under the said trademark;
- (e) The reasons of not setting up wholly owned subsidiary company and to provide break up of shareholding of subsidiary company.

The company has replied vide its letter dated April 26, 2000, rating shareholding as under:-

Diamond Industries Ltd.	800,000	53.33%
Citifoam Industries (Pvt) Ltd.	600,000	40.00%
Mr. Iftikhar A. Shaffi	40,000	2.67%
Mr. Waqar A. Shaffi	50,000	3.33%
Mr. Muhammad Saeed	10,000	0.67%
Total:-	1,500,000	100.00%

6. It has further been stated that the Diamond Industries Limited intended to invest above 50% of its subsidiary company's total capital due to the various incentives offered by the Government of Azad Jammu & Kashmir at Mirpur, in result of which the manufacturing cost of the product was low. The investment policy of Azad Jammu & Kashmir Government (AJK) was announced for setting up new industrial units at AJK. The board of directors decided only to invest in its subsidiary company at AJK with the intention of avoiding and securing their shareholders from the loss/risk as previously occurred due to the withdrawal of facilities from the industrial sector of Gadoon Amazai by the Government of Pakistan.

7. Regarding publicity expenses and trademark registration matter it has been explained by the company that the expenses incurred by Diamond Industries Limited for publicity and advertisement during the following periods were as follows:-

<u>Year</u>	<u>Amount</u>
1995	2,475,267
1996	6,019,018
1997	1,376,302
1998	31,856
1999	-
Total:-	9,902,443

The company informed that the trademark was initially got registered in 1986 in the name of one of group's sister concern i.e. Diamond Rubber Mills (DRM) located at Karachi. The said associated company charged no fee for the use of trademark from Diamond Industries Limited (DIL) during the above period, and due to the same reasons Diamond Industries Limited charged nothing from its

subsidiary company i.e. Diamond Polymers (Pvt) Limited (DPOL). It has further been stated that the Diamond Industries Limited has no authority to negotiate with its subsidiary Company for charging fee for the use of trademark.

8. The company further pleaded that it issued dividend to its shareholders during the under given period in the following manners:-

December - 1994.

Cash Dividend	20%
In Specie Dividend	30% (Shares of Shaffi Chemical Industries Ltd).

June - 1995

Bonus Shares	50%
Cash Dividend	20%

It was argued that in addition to the above given payouts by the company to its shareholders, the shareholders have also enjoyed the dividend on their respective shareholdings in respect of Specie Dividend announced by its sister concern Shaffi Chemical Industries Limited (SCIL) @ 15% during the year 1999 and will also be entitled from the present interim dividend announced by the parent company as well as sister concern (SCIL) during the year 2000.

9. For the reasons given in following, I fear that it is a clear case of managing affairs of the company against the interest of the shareholders. The company's reply to the question that why fully owned subsidiary company was not formed is that "the board of directors decided only to invest in its subsidiary company at AJK with the intention of avoiding and securing their shareholders from the loss/risk as previously accrued due to withdrawal of facility from the industrial sector of Gadoon". So as per statement of the company, decision to

setup the partially owned subsidiary company was taken to avoid risk and 40% shares of subsidiary company were given to some other party so that risk is spread. In the circumstances an *inquiry* with regard to ownership of Citifoam Industries (Pvt) Ltd. was considered necessary and the information provided by the CR0, Lahore indicates that Citifoam Industries (Pvt) Ltd., is owned by none others but Mr. Iftikhar A. Shaffi and Mr. Waqar A. Shaffi and their family members. In view of this I do not tend to accept this plea that shares in subsidiary company were allotted to others only to avoid risk. In fact *in* the subsidiary company, directors retained with them-selves a big portion of equity and accordingly rights as to dividend and control of Shareholder stand diluted to that extent. In its reply the management has further tried to be very innocent regarding spending heavy amounts on advertising a trade name, which was not registered in the name of the company. In my view the expenditure incurred on publicizing a trade name not owned by the company is not even an expense incurred for the purpose of the business of the company. I have further noted that company which carried raw material stock of only Rs.4.725 million on 30th June, 1997 (when sales of the Company were of Rs 16.901 million), built these stock to Rs.10.683 million on 30.6.1998, although it had stopped production in September, 1997 and its total sale during this year were of only Rs. 8.356 million. Not only that, the company further built *its* raw material stocks to Rs.61.745 million on 30.6.1998. On the other hand the subsidiary company has achieved the sales of Rs. 250 million in 1998 and 275 million in 1999 with a raw material inventories of Rs. 29 million on 30.6.98 and Rs. 38 million on 30.6.99. The published accounts are silent about company's transactions with associated companies and it also appears that there is no adherence to provisions of section 203 of the Companies Ordinance, 1984 in case of this group. In this situation I think that a fact finding exercise should be carried out to determine the facts of the case.

10. Therefore, I, in the public interest and in exercise of powers

conferred by section 265 of the Companies ordinance, 1984 (XLVII of 1984) hereby appoint M/ s. Hussain Chaudhary & Co., Chartered Accountants, 25-E, Main Market, Gulberg-2, Lahore to act as an Inspector to investigate into the affairs of M/s. Diamond Industries Ltd. on remuneration Rs. 100,000/- to be paid by the company.

11. Without in any way limiting to the scope of investigation, the Inspector shall conduct investigation on all aspects of the operations of the company and shall after scrutiny of the entire record and books of accounts furnish reports, inter alia, on the following:-

- i) Reasons of heavy losses after 1997 and impact of concession withdrawn by the Government in regard to Gadoon Amzai Industrial Estate, NWFP.
- ii) The matter of heavy expenditure on advertising a trade name not registered in name of the company may be examined. Expenditure incurred by other company to build this trademark be ascertained giving an opinion that what may be the value of trademark and to what extent it should be owned by the respective companies.
- iii) The reason of not setting up a wholly owned subsidiary company to be examined, to what extent facilities and assets belonging to this company have been used for setting up project of subsidiary company. The Inspector will have to analyze the whole situation to determine that to what extent this decision has been in interest of share-holders of the companies.

- iv) Inspector will examine transactions with associated companies and the 'true relationship' between this company and other associated companies so as to report whether or not the transactions have been at arm's length/relationship has not been contrary to the investment of the shareholders of this company. The Inspector will also inspect the position with regard to compliance of section 203 of the Companies Ordinance, 1984 by the companies of this group.

- v) Whether or not proper records have been kept by the company as required by section 230 and section 234 of the Companies Ordinance, 1984.

- vi) Whether or not an adequate system of internal controls has been existing so as to prevent misappropriation and misapplication of Company's assets.

- vii) Whether or not some effective budgetary and cost control system existed. Whether or not proper inventory system was maintained and stocks, stores raw material and finished goods quantitatively reconciled and have been correctly valued, provision against dead stocks, slow moving spare and stores have been made and the production and wastage rates are comparable with other units. The purpose of building huge raw-material, stocks to be examined and reported

- viii) Whether or not expenses, have been properly incurred, sanctioned, vouched and allocated.

- ix) Ascertain the frequency of meeting of board of directors, role of non-executive and executive directors, the overall comprehension of board of directors, their experiences/ability to run the business in which company is engaged.
- x) Compliance with statutory requirements in the operations of the company indicating that the business was conducted and expenditure were incurred in accordance with the objects and for purposes of the company.
- xi) Lapse or other delinquency detected during the course of investigation.

The Inspector shall submit a detailed report alongwith supporting documents/evidences to the Commission (in quadruplicate) within 60 from the date of this order.

(M. Zafar – ul – Haq Hijazi)
Commissioner (Enforcement)