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MARKET VISTA

PAKISTAN REFINERY

Brownfield policy reboot to enhance sector upgrade prospects

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- **PM's CCoE approved amendments to the Pakistan Oil Refining Policy 2023 (Brownfield Policy) on July 28th, directing its swift implementation.**
- **The latest amendments extend the fiscal incentive window from 6 to 7 years, increase escrow withdrawal caps and introduce enforcement clauses in order to unlock the US$6bn investment plan.**
- **With regards to beneficiaries, financing economics are expected to favor ATRL, however PRL offers the largest turnaround upside amid sovereign backing.**
- **We estimate US$600mn in annual FX savings once refineries complete their upgrades, as substitution of imports of finished MS/HSD for cheaper crude oil shipments take place, capturing the GRM currently lost to foreign refiners.**

CCoE clears path towards Brownfield Policy: CCoE has approved amendments to the 2023 Brownfield Policy on July 28th, covering PARCO, ATRL, NRL, PRL, CNERGY (20.5mn tpa combined). The changes have extended the incentive window from 6 to 7 years, increase escrow withdrawal caps to 24.5%/27.5%, and have added penalty/enforcement clauses to unlock the stalled US$6bn upgrade plan.

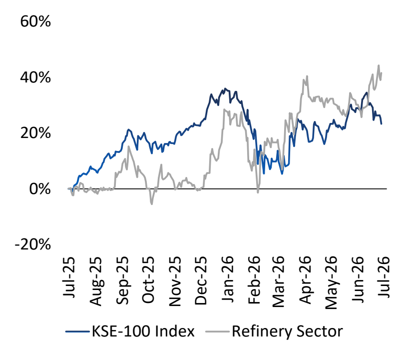
Capacity uplift to close gap between output and demand: Feasibility studies show MS output (+72%) to 18,400 TPD, HSD (+39%) to 29,500 TPD, RFO (-63%) to 5,700 TPD. As per our demand assumptions up till 2032 estimates domestic MS coverage from refineries to rise to 70% (from 33%) and HSD exceeds 100% (from 75%), opening potential for exports. Notably, the current output sits well below capacity due to utilization constraints amidst higher RFO production. Moreover, sector's crude processing is projected to rise to 22.5mn tons from 11.9mn tons in FY25 (MoE).

Funding plan remains ambiguous: PRL's US$2bn expansion (50k bpd to 100k bpd) assumes 60-70% debt, with talks in place with Saudi Arabia, China, and banks. Honeywell Technologies has proposed financing via US EXIM, DFC, and export credit agencies as local banks remain reluctant due to thin cash flows currently produced by the sector. Overall, we see probable scope for vendor equipment financing over 7-10 years. Notably, NRL has guided a capex plan of US$0.4-1.2bn (M/s Wood feasibility study) and CNERGY is estimated at US$1.0bn, while US$500mn was disclosed by ATRL.

Gulf partners may eye interest: GoP and KSA have reportedly shown interest in creating strategic reserves at Gwadar, driven by the US-Iran crisis, potentially lifting Pakistan's reserve cover toward global 60-90 day benchmarks. CEO of ATRL has separately urged joint reserve arrangements with KSA and Qatar to the authorities. For this reason, we view the brownfield policy push as linked to these developments.

Whats on the table for refiners? The 10% deemed duty on ex-refinery MS/HSD holds for 7 years, with incremental incentives escrowed and drawable up to 27.5%/24.5% of capex post-financial-close. More positively, HSD's 7.5% deemed duty now extends 20 years. Additionally, GST exemptions on upgrade machinery (backed by Finance bill 2027) and IFEM-backed GST reimbursement add further support, alongside the binding OMC-refinery offtake agreements mentioned in the policy. However, refiners in default on government petroleum/climate levy dues stay ineligible until settled with GoP. In essence, we estimate US$600mn in annual FX savings post-upgrade, as MS/HSD import substitution with cheaper crude captures the GRM which is currently lost to foreign refiners.

Refinery Sector Vs. KSE100 Index



Source: PSX & AKD Research

Refinery sector production slates

FY25	MS	HSD	FO	Others	Util. (%)
ATRL	33%	34%	22%	12%	66%
CNEGRY	15%	39%	42%	4%	21%
NRL	15%	52%	20%	13%	44%
PRL	18%	48%	25%	9%	78%
PARCO	24%	47%	17%	13%	88%

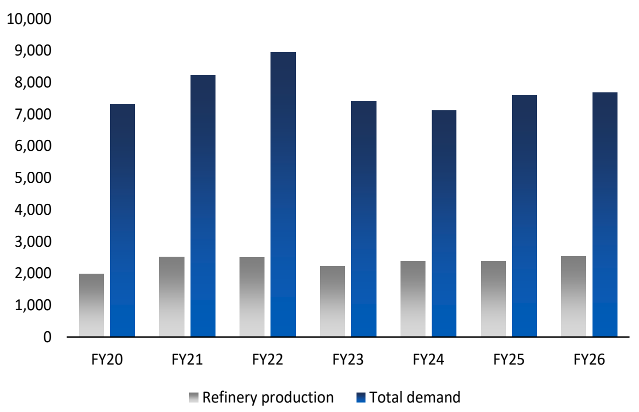
FY24	MS	HSD	FO	Others	Util. (%)
ATRL	33%	33%	21%	13%	73%
CNEGRY	14%	31%	53%	3%	15%
NRL	17%	54%	19%	10%	38%
PRL	19%	45%	28%	8%	71%
PARCO	24%	45%	18%	13%	91%

Source: MoE & AKD Research

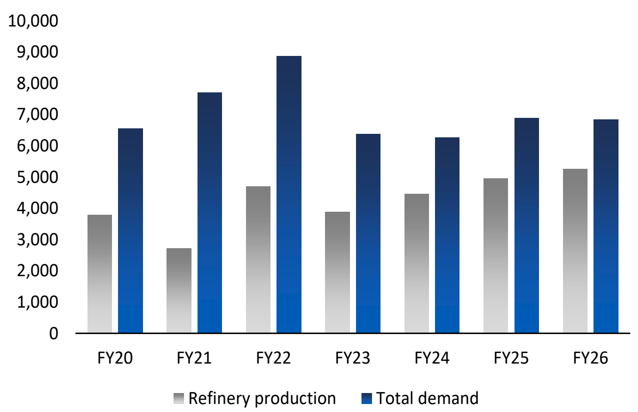
AKD Securities Limited

Brownfield refinery policy finally gets second wind: Prime Minister's Cabinet Committee on Energy approved amendments to the Pakistan Oil Refining Policy 2023 (Brownfield Policy) on July 28, directing swift implementation. The policy, originally notified in Aug'23, covers five refiners i.e. PARCO, ATRL, NRL, PRL and CNERGY, with a combined 450,000 bpd (20.5 mtpa) installed capacity. The latest amendments extend the fiscal incentive window from 6 to 7 years (from Upgrade Agreement signing), raise escrow withdrawal caps to 24.5%/27.5% (used/new equipment), and introduce protection and enforcement clauses in order to unlock the US$6bn in aggregate upgrade investment which have remained stalled since original notification.

Motor Spirit: Refinery production vs. total demand (k tons)



HSD: Refinery production vs. total demand (k tons)



Source: MoE & AKD Research

Post-upgrade output to rise sharply: As per the latest feasibility studies, total MS output is set to rise 72% to 18,400 tpd, HSD 39% to 29,500 tpd, while RFO output will decline by 63% to 5,700 tpd. Based on our OMC demand growth assumptions by 2032, domestic MS production would cover 70% of total demand (up from 33% currently) once upgradations are achieved, while HSD production would exceed 100% of domestic demand (up from 75% currently), opening possibility of HSD exports once refinery output surpasses local consumption. Notably, current production runs below capacity potential due to depressed refinery utilization amid RFO ullage constraints. Post-upgrade, sector's crude oil processing is estimated to rise to 22.5mn tons from 11.9mn tons in FY25, as per the MoE data.

Capacities of existing refineries pre and post upgrades

	Current Capacity (TPD)				Post Upgrade Capacity (TPD)		
	MS	HSD	FO	Post Upgrade (TPD)	MS	HSD	FO
PARCO	3,678	5,600	3,290	PARCO	4,023	7,734	1,806
ATRL	1,923	2,071	1,024	ATRL	2,379	2,008	908
PRL	783	1,793	1,350	PRL	4,500	5,000	250
NRL	818	3,273	2,253	NRL	1,000	3,775	1,750
CNEGRY	3,500	8,500	7,500	CNEGRY	6,500	11,000	1,000
Total	**10,702**	**21,237**	**15,417**	**Total**	**18,402**	**29,517**	**5,714**
Utilization	65%	68%	40%	Utilization	100%	100%	100%
Share of local demand	33%	77%	376%	Share of local demand	69%	136%	348%

Source: MoE & AKD Research

Financing alternatives remain open: Financing remains the key bottleneck as PRL's US$1.5-2bn expansion (50k to 100k bpd) is assumed with 60-70% debt financing as per management, with talks ongoing across Saudi Arabia, China, and international banks. Separately, U.S firm Honeywell technologies has proposed a modernization package bundled with financing via US EXIM, DFC, and export credit agencies. Given reluctance of local banks due to thin refinery cash flows, we expect a portion of this may be in form of direct supplier/vendor equipment financing structured over a 7-10 year credit period, which may ease upfront capex strain. Guidance by other refineries include NRL disclosing capex requirements ranging between US$0.4-1.2bn (M/s Wood engineering study), while capex for CNERGY is expected at US$1.0bn.

Gulf countries may show interest amid geopolitical vulnerabilities: Saudi Arabia and and local authorities have reportedly showed interest to create strategic oil reserves in Gwadar, directly led by vulnerabilities exposed by the ongoing US-Iran crisis. This may possibly raise oil reserves to 60-90day, minimum benchmark for major energy importers. Moreover, ATRL's management has publicly urged authorities to pursue joint strategic-reserve arrangements with Saudi Arabia and Qatar, letting Gulf producers use Pakistan as a storage/export hub in exchange for emergency access during conflicts. We believe the current push to implement the brownfield refinery policy is linked to these sovereign-level developments.

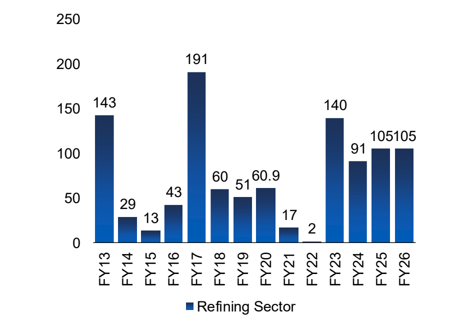
Refinery policy has a lot to offer: The latest amendments preserve the initial 10% deemed duty on ex-refinery MS/HSD pricing for 7 years, with eligible signers depositing 2.5% of the HSD incentive and 10% of the MS incentive into a jointly managed OGRA escrow account, which will be drawable up to 27.5%/24.5% of project capex once financial close and 25% physical progress milestones are reached. Furthermore, the policy amendments continue HSD's 7.5% deemed duty incentive for an additional 20 years after the 7-year incentive period expires (or until deregulation). The aforementioned benefits are separate to the FY27 Finance Act's GST exemption on upgrade machinery imports which has now resolved the input-tax-adjustment problem, while similarly allowing continued IFEM-backed reimbursement of GST mechanism incase any refunds are disallowed by FBR. Moreover, binding OMC-refinery offtake agreements through are also deemed to be positive for lenders to ensure project feasibility.

However, refiners in default on government petroleum/climate support levy dues are ineligible for the policy until a settlement is reached with GoP, with incentives redirected to IFEM until then.

Investment Perspective: With regards to beneficiaries financing economics will favor ATRL due to i) debt-free balance and a PkR98.3bn cash cushion, ii) smallest capex requirement with comfortable escrow cash generation, and iii) locally sourced crude and IFEM drawbacks to enhance incentives. Furthermore, PRL offers the largest turnaround led upside, however, carries higher financing burden but the only player which has formally executed the Amended Brownfield Policy 2023. Overall, we treat the latest amendments by CCoE as positive catalyst for the sector as a whole, as the 20-year HSD deemed duty is expected to materially enhance the long-run earnings case for the refinery which ultimately execute the agreement.

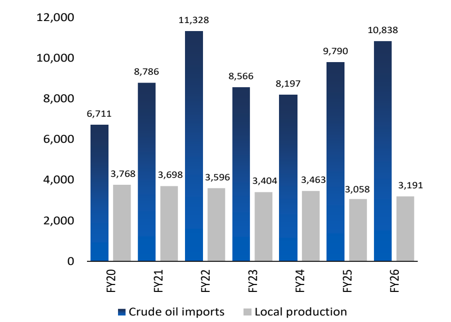
Moreover, we estimate US$600mn in annual FX savings once refineries complete their upgrades, as substitution of imports of finished MS/HSD for cheaper crude oil shipments take place, capturing the GRM currently lost to foreign refiners. This substitution effect, alongside higher storage/inventory build-up, strengthens domestic fuel security through enhanced storage and production.

FDI inflows in refinery sector over the years



Source: SBP & AKD Research

Crude Oil: local production vs. total demand (k tons)



Source: MoE & AKD Research

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