

Russia – Ukraine war rattles stretched supply chains

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RUSSIAN troops' recent shelling of Europe's largest nuclear power station in Ukraine shows that the nine-day war could get out of control and possibly turn into a nuclear nightmare for the rest of the world.

The geopolitical tensions between both the countries accompanied with extensive sanctions would add more chaos to the stretched global supply chains, disrupting the supply of goods such as natural gas, critical metals and agriculture products.

It is important to note that Russia is the second-largest exporter of crude oil and is also one the largest producers of critical metals.

Both Russia and Ukraine are also significant agriculture producers and their combined wheat, barley and maize exports comprise 21% of the global total. They also supply 60% of the world's sunflower oil.



Big providers: Farmers are seen harvesting wheat in Russia. Both Russia and Ukraine are significant agriculture producers and their combined wheat, barley and maize exports comprise 21% of the global total. — AP

The Russia-Ukraine war is making things worse to the stretched global supply chains with extensive sanctions in place.

As such, businesses are grappling with the rising cost of doing business from higher crude oil and natural gas prices, a spike in commodity prices and raw materials and the impact from the strong sanctions in place for Russia.

Thus far, there has been a number of companies in Malaysia that have been negatively affected already by the global supply chain disruptions.

Which companies are going to feel it worse with the ongoing war?

According to Scott Lim of investment firm Omni Capital Partners, companies that are "price-takers" would see their margins being squeezed, as they are unable to transfer the rising cost of production to customers.

"These companies include manufacturing companies which have no ownership of natural resources or commodities, not fully integrated in operations and therefore are exposed to hikes in prices of inputs," Lim says.

One example of a price-taker company that is feeling the heat from the rising cost of raw materials and the added stress of the Russia-

Ukraine war is PPB Group Bhd.

This week, its managing director Lim Soon Huat disclosed that the group's grain and agribusiness segment, which is the largest revenue contributor, may continue to take a hit as the raw material cost of flour, feed and maize products soar.

And, in turn, he foresees the group's profit margins being squeezed as it struggles with supply chain disruptions and labour shortages.

"The fact that we can't pass on all the cost to consumers is going to be challenging for our agri business," explains Lim.

It is noteworthy that wheat makes up about 85% to 90% of the production cost for the group's flour mills, making it a challenge for it to absorb the prices.

Notably, Russia and Ukraine supply about 30% of all wheat exports globally, as well as 19% of corn exports and 80% of sunflower oil exports.

For the financial year ended Dec 31, 2021 (FY21), PPB Group's grains and agribusiness segment turned in a loss of RM21.27mil.

Another key sector that has been hit badly is the poultry industry from the disruption in supply chains over the past two years

amid the pandemic.

With the prolonged supply chain disruptions coupled with rising fuel oil and fertiliser prices, AmBank Research chief economist Anthony Dass says there will be upward pressure on the cost of doing business both direct and indirect.

"With upward pressure expected from the business ecosystem, the question now will be how long can they absorb the higher cost? How much transfer pricing will take place? How much can the government increase its subsidy budget?" he asks.

It is important to note that even before the Russia-Ukraine conflict, farmers and chicken breeders were experiencing upward pressure on their cost of doing business.

And now with the Russia-Ukraine conflict, Dass believes there will be a strong upward pressure on the cost of running a poultry business. These businesses now face the risk of incurring losses because of higher chicken feed prices, namely, corn, soybean and palm oil.

"This could be a step up in bankruptcies. Some of them may move into new businesses. As a result, the supply of chicken will reduce causing another upward pressure on chicken

prices. It does not stop there. This will spill over into other related products," he notes.

Notably, poultry industry player Leong Hup International Bhd's net profit fell nearly 28% to RM37.99mil for the fourth quarter ended Dec 31, 2021 from RM52.56mil a year ago dragged by elevated input cost of feed which affected the group's livestock and poultry-related product segment.

Nonetheless, there are also companies that would be beneficiaries from the ongoing war.

With commodity prices booming, economist Manokaran Mottain points out that planters such as Sime Darby Plantation Bhd, IOI Corp Bhd and Kuala Lumpur Kepong Bhd would see a rise in their earnings this year amid the all-time high crude palm oil prices.

He adds that Petronas Chemicals Group Bhd (PetChem), which produces urea, would also see earnings improve partly due to the skyrocketing urea prices.

Note that PetChem's share price rose past RM10 for the first time to a record high on March 3 to RM10.08 on the back of rising oil prices due to the ongoing Russia-Ukraine war.

In addition, analysts reckon Press Metal Aluminium Holdings Bhd would register another record profit for FY22 ending Dec 31, driven by elevated aluminium prices amid the conflict.

The Russia-Ukraine war pushed aluminium prices to above US\$3,500 (RM14,623) per tonne on March 3 as investors worried that logistics difficulties would block metal supplies due to strong sanctions on major producer Russia.

On the equities market, Rakuten Trade head of equity sales Vincent Lau says Malaysia would benefit with more foreign funds flowing into the market as evidenced by the foreign fund inflow of over RM3bil year-to-date.

"The danger to the FBM KLCI is if the Russia-Ukraine conflict turns into a prolonged conflict, with more investors then buying into safe-haven assets," he points out.

That said, AmBank's Dass says the current correction in the market provides an interesting entry opportunity for long-term investors.

"However, they must be mindful of the inflationary impact on corporate earnings, which might see some pressure over the next few quarters," he notes.