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CURRENT CRACK



When a single customer accounts for more than half of a company's revenue and profit, it poses a real risk for a company, whereby the loss of this single primary client will trigger an immediate, existential crisis.

THE PERILS OF SINGLE CUSTOMER CONCENTRATION RISK

In today's fast-paced business environment, PLCs must strive to develop multiple business channels or clientele, or even diversify their business base within their realm of expertise, to reduce business risk.

This will enable them to circumvent the pitfalls of single customer concentration risk, whereby they are subject to financial vulnerability, which is a situation where a large percentage of revenue and profit (typically >50%) is dependent on one or a handful of clients.

In a nutshell, having a limited customer base equals high business risk. It creates earnings risk, cash flow risk, reduces bargaining power, lowers company valuation, and can lead to business failure if that client leaves.

Generally, if a single major customer accounts for 50% or more of revenue and profit, a high-risk, low-diversification situation exists. This can spark earnings volatility, with the loss of a primary client triggering an immediate, existential crisis that may prompt abrupt cost-cutting or layoffs.

Given such challenges, it is imperative for boards to shoulder the responsibility of providing the necessary oversight and guidance by resetting business direction (if it has gone off tangent) while closely overseeing management implementation.

Massive prospect downgrade

One relevant example is uncertainty surrounding ACE Market-listed SMRT Holdings Bhd, after its management recently revealed that its deployment pace for Tenaga Nasional Berhad (TNB) is expected to slow materially in the coming years following the opening up of TNB's Supervisory Control and Data Acquisition (SCADA) vendor base.

With this possible increase in vendor base, SMRT may face greater competition in tendering for new deployment contracts with its major customer, which may result in a slowdown in one-off revenue from deployments.

This came as a negative surprise as it indicates a sharp earnings reset ahead for the IoT (Internet of Things) solutions outfit. This is given that 38% of SMRT's earnings were previously driven by one-off deployment revenue, with managed services contributing the remaining 62%.

As a reference, TNB contributed 68% (RM47.65 million) of SMRT's RM65.77 million revenue in FY2024.

Against such a backdrop, it is little wonder that Hong Leong Investment Bank (HLIB) Research, in its research note dated 19 January, downgraded the stock to “Sell” from “Buy” and set a drastically lower target price (-72.4%) of 32 sen, down from RM1.24 previously.

The downgrade coupled with a massive slash in target price sent SMRT's share price down by 65% or 29 sen to a three-year low of 15.5 sen before paring losses to end that day 58.43% or 26 sen lower at 18.5 sen.

HLIB Research further substantiated that its previous “buy” thesis on SMRT was anchored on earnings upside from TNB, driven by a large pool of unconnected sites and TNB's Smart Grid roll-out.

As new site deployment is now expected to slow materially amid greater competition, HLIB said its earlier thesis was no longer intact, notwithstanding growth from the financial services industry and early-stage penetration into Indonesia's power sector, which could provide alternative earnings drivers given the limited upside in these areas.

SMRT unperturbed

On the same day that HLIB Research published its report on SMRT, three institutional investors walked away from the Company.

Aberdeen Group PLC disposed of its entire 6.63% stake, or 30.04 million shares, followed by Urusharta Jamaah Sdn Bhd (a special purpose vehicle set up under the Ministry of Finance) and the Employees Provident Fund Board (EPF), which ceased to be substantial shareholders on the same day after disposing of 35.75 million shares and 20.99 million shares, respectively.

While acknowledging that the Group may face greater competition in tendering for new deployment contracts with its major customer (TNB), SMRT reassured investors that it is on BAU (business as usual) with TNB, and that the anticipated slowdown in revenue will affect only the one-off deployment segment.

SMRT stated that the Group will continue tendering for new deployment contracts with its major customer while continuing to provide managed services to existing sites – a recurring income stream for the Group.

It emphasised that it is unable to quantify the impact on its revenue from FY2027 onwards, as this depends on the timing and volume of future deployment contracts awarded to the Company.

Additionally, the Group continues to expand its footprints beyond Malaysia into Indonesia and the Philippines, with revenue from foreign customers having grown to RM11.3 million in FY2025 from RM9.9 million earlier, supported by both managed services and deployment activities to foreign customers.

Pursue multi-dimensional diversification

Taking a leaf from SMRT, it is imperative that PLCs be aware and not take lightly the risk of relying on a single customer base whose financial contribution could dictate the sole survival of a PLC.

Another notable example is electronics manufacturing service (EMS) provider WaveFront Bhd (formerly ATA IMS Bhd), which at one time relied too heavily on Dyson before the UK consumer product brand terminated its dealings due to labour concerns.

Since Dyson's termination, Wavefront has been struggling to return to its former glory days. Revenue slid from RM4.22 billion in FY2021 (before the termination) to RM2.6 billion and further to RM273.04 million in FY2025. The Company has been in the red for the past four years.

PLCs should humbly accept that concentration risk is fundamentally multi-dimensional, for it extends beyond simple, single-name exposure to encompass a variety of interconnected/intertwined and often hidden factors that can threaten the financial stability of a business entity.

These risks can be categorised into various dimensions, including name, sector, geography, and technology stack, which require a holistic approach to identification and mitigation.

In a nutshell, effective management requires a multi-dimensional approach, including tracking top-customer revenue, diversifying across geographies and sectors, and using stress testing to identify hidden dependencies.

At the end of the day, proactive, multi-dimensional assessment goes a long way in aligning portfolio strategies with the overall risk appetite.

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