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PETALING JAYA: The utilities sector's financial performance in the fourth quarter of last year (4Q23) has been a disappointment, prompting a downgrade by analysts.

Kenanga Research, which downgraded the sector to "neutral" from "overweight", said the sector's earnings delivery in the recently concluded 4Q23 results season failed to excite, with 60% coming in within its forecasts and 40% below.

It pointed out that Tenaga Nasional Bhd's 4Q23 results were hit by high fuel costs while Malakoff Corp Bhd reported a share of losses from its 40%-owned associate Al Hidd Independent Water and Power Producer (Al-Hidd IWPP) in Bahrain, and impairment losses on the carrying value of its investment in Al-Hidd IWPP.

"Despite the weak numbers from Tenaga and Malakoff, we believe their long-term earnings resilience is intact backed by their regulated assets.

"With coal prices stabilising, Tenaga saw its first positive fuel margin in the quarter since 4Q22 while the latest Imbalance Cost Pass-through under-recovery of RM2.11bil was 67% off the peak of RM6.40bil in 4Q22.

"Similarly, Malakoff also reported the first positive fuel margin in a year as coal prices stabilised," Kenanga Research said.

Meanwhile, the research house said YTL Power International Bhd's 2Q24 results and the 4Q23 results of Gas Malaysia Bhd and PETRONAS Gas Bhd were largely within its expectations.

Despite the sector downgrade, Kenanga Research continues to like the sector for its earnings defensiveness and resilience backed by regulated assets that generate recurring cash flow to anchor decent dividend yields of 3%-6%.

Its top pick for the sector is YTL Power given its geographically diversified regulated-asset base, strong near-term earnings prospects of PowerSeraya backed by gas inventory locked in at low prices and its long-term growth potential driven by its data centre and digital banking ventures.