

Star Health

Refer to important disclosures at the end of this report

Growth, profitability and capital outlook remain robust

We hosted management of Star Health and Allied Insurance Company in London on June 23-24 for meetings with a large number of FPIs to discuss the company's business performance and growth trajectory and address investor concerns. The key highlights: 1) investors remain positive on the retail health insurance business in India; 2) the possible entry of life insurers into health indemnity would only mean a little extra competition and nothing more; 3) the company should continue to focus on granular distribution rather than relying on any large distributor.

- Investors positive on retail health insurance in India:** Most of the investors were confident about the strong growth potential of the retail health insurance business in India and acknowledged Star Health's MOAT in this business segment. Notwithstanding short-term volatility in growth, investors were broadly of the view that constantly increasing affluence and rising medical inflation, along with a demand for good healthcare, will keep driving retail health insurance in India over the medium to long term.
- A few external and intrinsic developments explain the material underperformance of STARHEALTH's stock price:** Investors acknowledged that Star Health shares have underperformed since listing, despite improved financial performance and the absence of major Covid-related challenges. Investors attributed the underperformance to a host of factors, including: 1) equity outflow from emerging markets amid rising interest rates; 2) a relative shift of funds from growth to value strategy; and 3) possible mispricing of the shares in the IPO amid euphoric equity markets. However, investors acknowledged that these developments are in the past now and has no bearings on company's future fundamentals.
- Possible permission for life insurers to offer health indemnity products means increased competition but nothing radical:** There was a great amount of interest among investors in media reports that life insurers may be allowed to sell health indemnity products. In this context, Star Health management believes that the regulatory and legislative changes will take their own time. If approved, the move would result in more players offering health products, but given the different nature of health indemnity products, there will still be a reasonable ask for the life insurers to make a mark in incremental health business. It is worth noting here that life insurers were allowed to sell health indemnity products till mid-2016 and yet they did not have much success. At this juncture, it is yet to be seen if life insurers will be allowed to manufacture and distribute or only distribute health indemnity products.
- Granular and Omni-channel distribution is the way forward:** A majority of investors were of the view that it serves the company better to have a granular distribution channel like its current extensive agency distribution. Investors acknowledged the need for an omnichannel distribution network, including banca and direct online. However, with developments in the UK General Insurance sector in the back of their mind, investors appreciated the fact that STARHEALTH has done really well by not building its distribution model heavily reliant on any large bank distributors or large web aggregators/brokers. Investors were of the view that efforts in building own digital distribution would also pay off better in future.
- Growth, profitability and capital on the right track:** Management appeared confident about the company's growth, profitability and capital position in FY23 and beyond. The turnaround in profitability has already started from Q4FY22. On the growth front, management remained confident of achieving ~22-24% retail premium growth, driven by the combination of new customer acquisitions and upselling to existing customers. On the profitability front, management is confident of achieving a ~63-65% claims ratio and a ~93-95% combined ratio in the absence of a major Covid-19 wave in the future. On capital, management is comfortable with the current developments. With organic capital accrual and the solvency requirement moving to the premium factor from the current claims factor, solvency should improve to ~190% by FY23 and then may decline by ~7-8% annually as growth will outstrip the RoE. Overall, management does not see any need for an equity capital raise over the next 3 years to support its envisaged growth of ~22-24%.

CMP	Target Price
Rs 515 as of (June 27, 2022)	Rs 945 (■) 12 months
Rating	Upside
BUY (■)	83.5 %

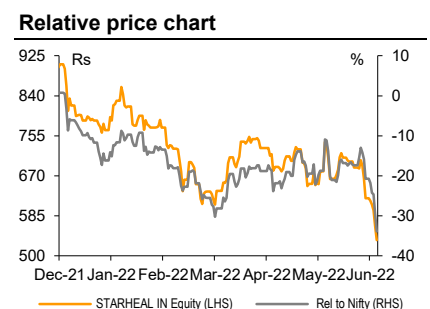
Change in Estimates	
EPS Chg FY23E/FY24E (%)	-/
Target Price change (%)	NA
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus		
EPS Estimates		
	FY23E	FY24E
Emkay	11.9	16.9
Consensus	10.7	17.1
Mean Consensus TP (12M)	Rs 774	

Stock Details	
Bloomberg Code	STARHEAL IN
Face Value (Rs)	10
Shares outstanding (mn)	576
52 Week H/L	940 / 516
M Cap (Rs bn/USD bn)	299 / 3.81
Daily Avg Volume (nos.)	358,596
Daily Avg Turnover (US\$ mn)	3.1

Shareholding Pattern Mar '22	
Promoters	58.9%
FIIIs	9.8%
DIIIs	27.3%
Public and Others	4.0%

Price Performance				
(%)	1M	3M	6M	12M
Absolute	(22)	(27)	(35)	-
Rel. to Nifty (19)	(21)	(30)		-



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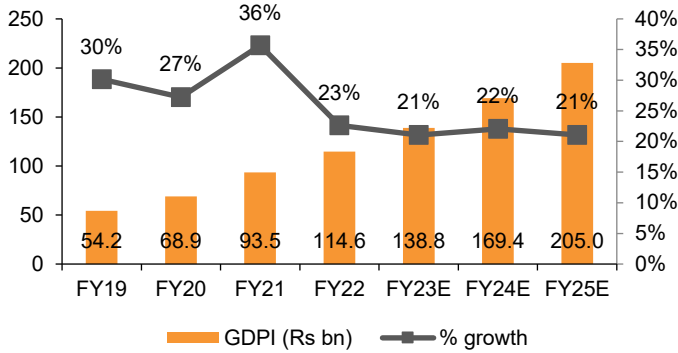
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- **Growth has a long runway:** On growth, the company sees a long runway and has reiterated its focus on the retail segment. Management is confident of delivering above-industry growth at ~22-24% in retail health. On the group side, the company will focus on the profitable SME segment but will reduce its already small exposure to large corporate group health. On retail health, Star Health has reiterated its focus on volume (new policy)-led growth and sees a large demand base in rural and younger population. In the post-pandemic world, the company is seeing increasing demand for health insurance from youngsters and increasing demand for higher sum assured.
- **Capital position comfortable:** On capital, management does not see the need for any capital raise in the next three years as once profitability normalizes, the required solvency margin will move to premium from claim, and the available solvency margin will benefit from profit before tax accrual (deferred tax assets don't count for available solvency capital). Beyond this, a risk transfer-based reinsurance treaty may be considered as another alternative to manage capital. If at all needed, Star Health can resort to raising sub-debt as well.
- **Agency remains core of distribution:** On the distribution front, the agency channel remains the core of its distribution strategy. With ~50% of its strong 550,000 agency force being less than 3 years vintage, the scope for productivity improvement is substantial. The company is working to strengthen its bancassurance channel. However, management clarified that its approach is driven by profitable growth and not just topline growth, and hence it will not go for any large bank distribution channel if terms make business unprofitable. The company today announced that it has entered into a bancassurance tie-up with IDFC First Bank. A few months ago, it entered into a tie-up with Federal Bank. In the web aggregator and direct online segment, the company is doing well and growth in these channels will be faster than overall company growth.
- **Hospital network expansion in selective manner, new addition with pre-agreed rates only:** With ~12,800 hospitals under its network, Star Health has a reasonably expansive hospital network. The company is expanding its hospital network selectively in some geographies, mostly semi-urban and smaller towns. The company maintains its focus on increasing the network of hospitals with pre-agreed rates for a list of standard medical procedures, and the addition of hospitals is done on this basis only. Existing network hospitals that currently do not have pre-agreed rates are also being transitioned to pre-agreed rates. This helps the company manage the claims costs better.
- **Product innovation and shift to Wellness from Illness to be key growth drivers:** Star Health has been a pioneer in product innovation. It was the first company to offer products focused on senior citizens and people with pre-existing conditions. It continues to innovate in product offerings. It has launched a women-centric product on the International Women's Day in 2022. In the initial weeks of the launch, the product saw good traction. Star Health is also actively looking to expand the product horizon by offering Wellness products vs. the current Illness-focused mix.
- **Star Health remains an attractive and profitable growth story:** Overall, Star Health remains an attractive story in a sunrise sector. In our view, 1-2 quarters of profitable growth delivery will likely lead to a material outperformance of Star Health's shares. The recent steep fall in the share prices provides an attractive entry point. We have a Buy rating on the stock with a TP of Rs945.

Please see our sector model portfolio (Emkay Alpha Portfolio): [BFSI-Insurance \(Page 7\)](#)

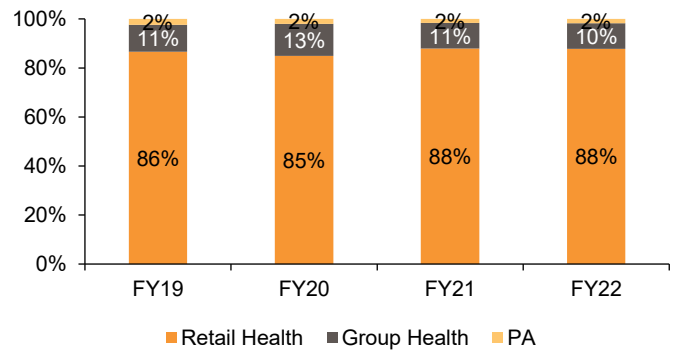
Story in Charts

Exhibit 1: GDP witnesses consistent growth above ~20% levels.



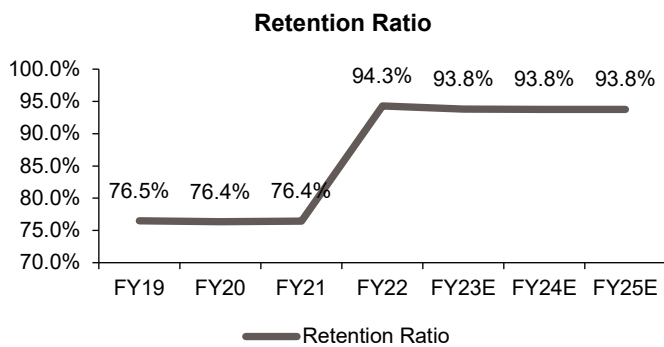
Source: Company, Emkay Research

Exhibit 2: Retail Health remains at the core



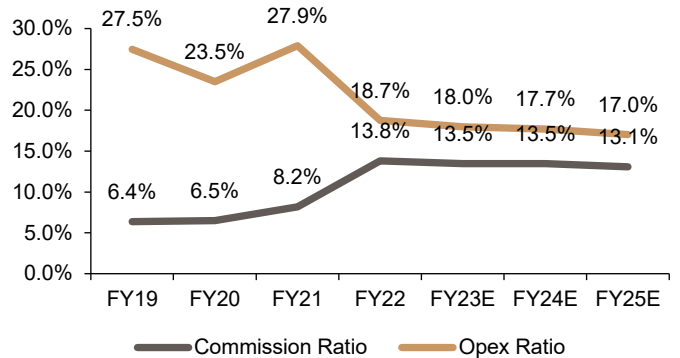
Source: Company, Emkay Research

Exhibit 3: Retention Ratio Stands at 94.3% for FY22



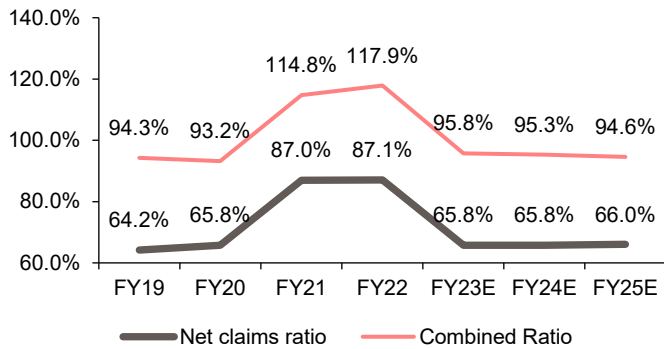
Source: Company, Emkay Research

Exhibit 4: Higher retention means increased net commission cost



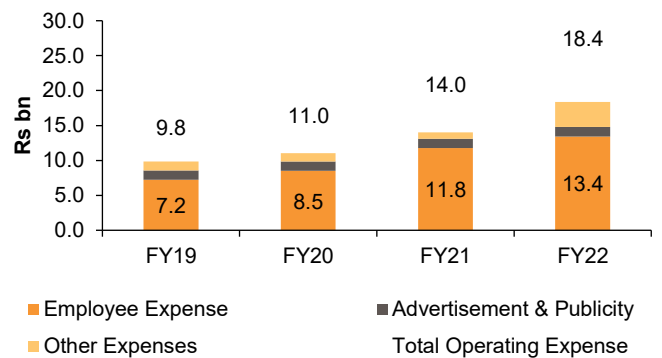
Source: Company, Emkay Research

Exhibit 5: Driven by improving claims costs, the combined ratio sees improvement



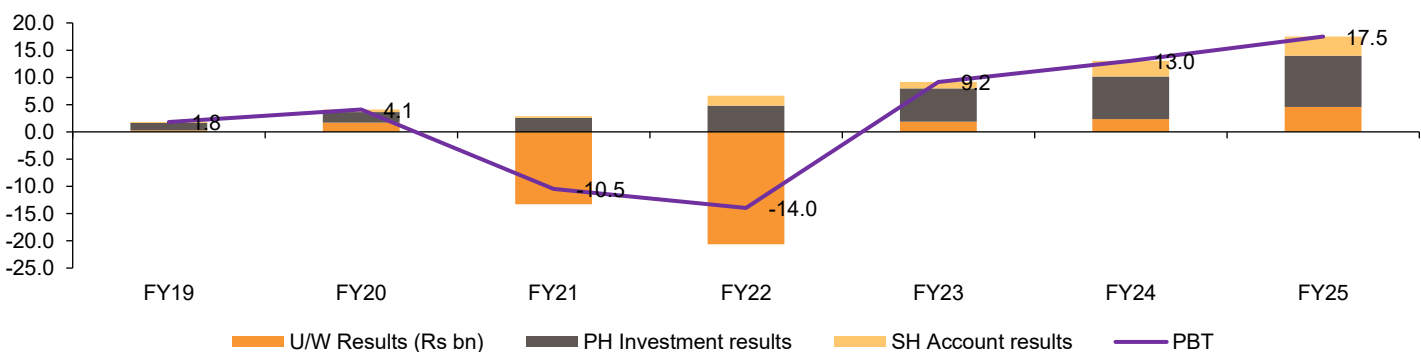
Source: Company, Emkay Research

Exhibit 6: Operating Expense Constitution



Source: Company, Emkay Research

Exhibit 7: Affected by Covid-19 delta wave and once time accounting changes, underwriting results were the biggest drag on profitability in the last two years

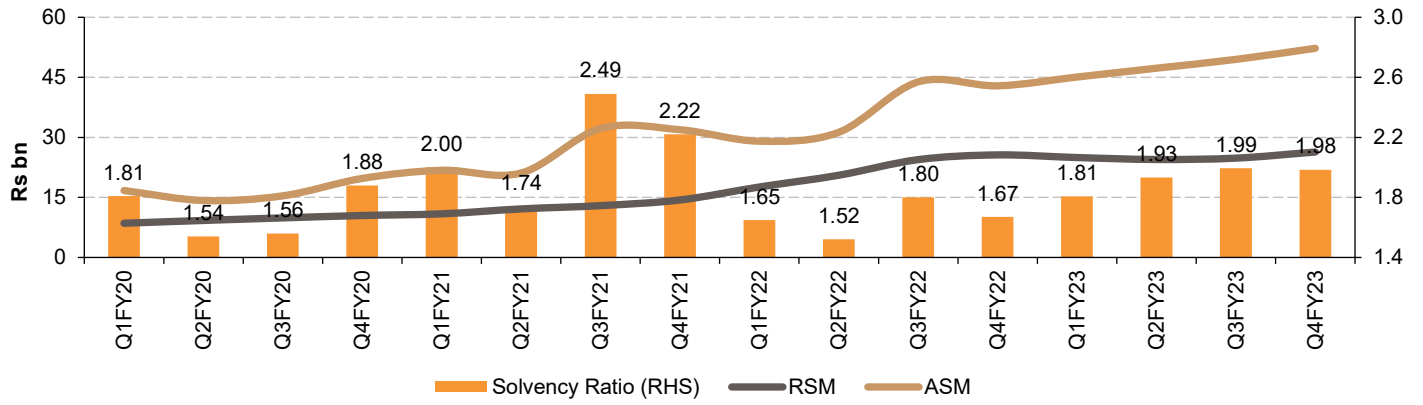


Source: Company, Emkay Research

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Exhibit 8: Solvency Ratio to reach 198 levels by FY23



Source: Company, Emkay Research

Exhibit 9: Key Financials

Policyholder Account (Y/E Mar, Rs mn)	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Gross Direct Premium (GDPI)	54,154	68,907	93,490	1,14,635	1,38,762	1,69,353	2,05,023
Gross Written Premium (GWP)	54,154	68,907	93,490	1,14,635	1,38,762	1,69,353	2,05,023
Net Written Premium (NWP)	41,415	52,614	71,448	1,08,095	1,30,142	1,58,824	1,92,261
Net Earned Premium (NEP)	35,795	46,930	50,228	98,092	1,19,516	1,43,776	1,75,124
Net incurred claims	22,976	30,874	43,695	85,400	78,633	94,587	1,15,630
Net commission expense	2,638	3,409	5,838	14,922	17,534	21,397	25,130
Operating expense	9,827	11,020	14,014	18,385	21,485	25,425	29,817
Other expense	48	-58	0	0	0	0	0
Total Expense	35,488	45,246	63,546	1,18,707	1,17,652	1,41,410	1,70,577
Underwriting result	307	1684	(13318)	(20616)	1864	2366	4547
Investment income	1,340	1,924	2,606	4,796	6,114	7,801	9,453
Insurance result	1,647	3,608	-10,712	-15,820	7,979	10,167	14,000
Operating profit	1,647	3,608	-10,712	-15,820	7,979	10,167	14,000
Shareholder Account							
(Y/E Mar, Rs mn)	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Operating profit	1,647	3,608	-10,712	-15,820	7,979	10,167	14,000
Investment income	614	1,011	1,631	3,133	3,545	3,727	4,376
Expenses and provisions	440	485	1,382	1,360	2,360	880	880
Profit before tax	1,822	4,134	-10,460	-13,967	9,164	13,014	17,496
Tax expense	540	1,415	-2,204	-3,560	2,291	3,254	4,374
Profit after Tax	1,282	2,720	-8,256	-10,407	6,873	9,761	13,122
Balance Sheet							
(Y/E Mar, Rs mn)	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Source of Funds							
Shareholders fund	13,926	16,437	42,242	63,693	64,432	64,432	76,536
Fair value gains	0	31	-76	267	0	0	0
Net worth including fair value gains	13,926	16,468	42,166	63,959	64,432	64,432	76,536
Borrowings	2,500	2,500	2,500	7,200	7,200	7,200	7,200
Total	16,426	18,968	44,666	71,159	71,632	71,632	83,736
Application of Funds							
Investments	30,301	42,900	68,367	1,13,734	1,36,851	1,63,196	1,96,926
Shareholders	9,523	14,782	26,321	44,939	42,597	49,430	58,615
Policyholders	20,778	28,117	42,046	68,796	94,254	1,13,766	1,38,311
Other Assets	2,401	2,486	5,203	8,938	6,706	3,514	1,356
Cash & Bank Balances	8,930	6,114	18,790	5,635	6,291	9,459	11,563
Other current assets	7,093	9,767	12,650	6,828	7,000	8,400	10,080
Current liabilities	9,003	11,794	15,643	19,607	20,512	23,426	28,523
Provisions	24,939	30,506	51,946	62,022	75,482	90,529	1,07,666
Net Current Assets	-17,920	-26,418	-36,149	-69,165	-82,704	-96,096	-1,14,546
Accumulated losses	1,644	0	7,245	17,652	10,779	1,019	0
Total	16,426	18,968	44,666	71,159	71,632	71,632	83,736
Net worth	12,282	16,437	34,996	46,041	53,653	63,414	76,536
Key ratios							
(Y/E Mar, %)	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Retention ratio	76.5	76.4	76.4	94.3	93.8	93.8	93.8
Incurred claims ratio	64.2	65.8	87.0	87.1	65.8	65.8	66.0
Net commission ratio	6.4	6.5	8.2	13.8	13.5	13.5	13.1
Expense ratio	23.7	20.9	19.6	17.0	16.5	16.0	15.5
Combined ratio	94.3	93.2	114.8	117.9	95.8	95.3	94.6
NWP/Net worth	3.0	3.2	1.7	1.7	2.0	2.5	2.5
Return on Equity	11.7	18.9	-32.1	-25.7	13.8	16.7	18.8
Solvency ratio	153	150	223	167	198	203	206
Investment leverage (x)	3.1	2.5	2.1	2.5	2.5	2.4	2.4

Source: Company, Emkay Research

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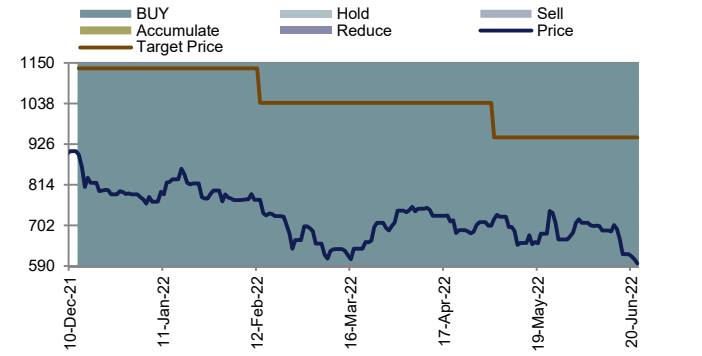
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RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
04-May-22	720	945	12m	Buy	Avinash Singh
24-Mar-22	697	1,040	12m	Buy	Avinash Singh
13-Feb-22	772	1,040	12m	Buy	Avinash Singh
13-Dec-21	897	1,135	12m	Buy	Avinash Singh

Source: Company, Emkay Research

RECOMMENDATION HISTORY CHART



Source: Bloomberg, Company, Emkay Research

Emkay Alpha Portfolio – BFSI-Insurance



Analyst: Avinash Singh

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Sector

Insurance and Non-lending Financials

Analyst bio

Avinash Singh holds a PGDM and CFA. He has over 13 years of experience, including 10 years of research experience on the sell side. His team currently covers four insurance and one asset management stocks.

EAP sector portfolio

Company Name	BSE200 Weight	EAP Weight	OW/UW (%)	OW/UW (bps)	EAP Weight based on Current NAV	Change vs last published EAP (bps)
BFSI-Insurance	1.51	1.51	0%	0	100.00	
HDFC Life Insurance	0.59	0.30	-50%	-30	19.74	0
ICICI Pru Life	0.21	0.23	8%	2	14.93	0
Max Financial	0.19	0.34	78%	15	22.75	0
SBI Life	0.52	0.64	25%	13	42.58	0
Cash	0.00	0.00	NA	0	0.00	0

Source: Emkay Research

■ High Conviction/Strong Over Weight ■ High Conviction/Strong Under Weight

Sector portfolio NAV

	Base					Latest
	1-Apr-19	24-Jun-21	24-Dec-21	24-Mar-22	24-May-22	24-Jun-22
EAP - BFSI-Insurance	100.0	175.2	170.7	148.6	150.7	155.8
BSE200 Neutral Weighted Portfolio (ETF)	100.0	176.2	171.5	148.2	151.0	154.1

*Performance measurement base date 1st April 2019

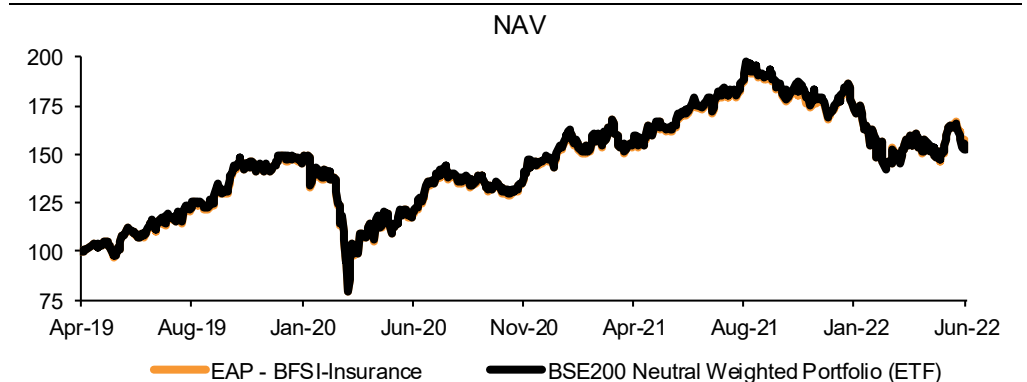
Source: Emkay Research

Price Performance (%)

	1m	3m	6m	12m
EAP - BFSI-Insurance	3.3%	4.8%	-8.8%	-11.1%
BSE200 Neutral Weighted Portfolio (ETF)	2.0%	4.0%	-10.2%	-12.5%

Source: Emkay Research

NAV chart



Please see our model portfolio (Emkay Alpha Portfolio): [Nifty](#)

Please see our model portfolio (Emkay Alpha Portfolio): [SMID](#)

“Emkay Alpha Portfolio – SMID and Nifty are a supporting document to the Emkay Alpha Portfolios Report and is updated on regular intervals”

Emkay Rating Distribution

Ratings	Expected Return within the next 12-18 months.
BUY	Over 15%
HOLD	Between -5% to 15%
SELL	Below -5%

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