

Star Health

Refer to important disclosures at the end of this report

Accelerated return to normalization

CMP	Target Price
Rs 702 as of (May 3, 2022)	Rs 945 (▼) 12 months
Rating	Upside
BUY (■)	34.7 %

Star Health reported an impressive set of numbers in Q4FY22, with the combined ratio of 98.4% marking its return to a below 100% combined ratio sooner than our expectations. With management commentary suggesting an encouraging claims ratio trend for Q1FY23, we are increasingly confident of the company hitting a ~95-96% combined ratio in FY23. With Covid-19-led abnormalities in the business behind, by leveraging its moat, STAR Health will embark on a long-term profitable growth journey. We reiterate our Buy rating on the stock with a revised TP of Rs945.

- Quicker return to normalcy:** Star Health's Q4FY22 combined ratio of 98.4% and the claims ratio of 68.1% were much better than our estimates of 103% and 75%, respectively (**Exhibit 8**). Driven by this positive surprise in underwriting, the loss after tax stood at Rs0.82bn, materially lower than our estimate of a Rs2.45bn loss. It's important to note here that the loss before tax of Rs1.16bn in Q4 had a ~Rs0.55bn negative impact of ESOP 2021 expenses that will continue till Nov'22 at a monthly run rate of Rs0.185bn. On the growth front, the GDP growth in Q4 moderated to ~13% YoY, primarily due to strategic choices made by the company in the Group Health business that saw a decline. In the retail health segment, the company increased its market share to 33% in FY22. (**Exhibit 1-8**)
- Solvency ratio at 167% tells only half of the story; capital position comfortable:** FY22 saw a host of adjustments regarding solvency, including the IPO-led fresh capital infusion of Rs20bn to shore up the solvency position. The decline in Solvency over the last two quarters post the IPO has been attributed to a combination of factors: 1) Elevated loss levels meant that the Required Solvency Capital is being driven by Net Claims (of last 4 quarters) factor; 2) Elevated claims driven losses are reducing net worth and hence depleting available solvency capital; 3) The depletion of available solvency capital is a loss before tax and not a loss after tax as deferred tax assets are deducted while calculating available solvency margin. This means once the company returns to profitability, the required solvency margin calculation will move to the net premium factor in the next 2-3 quarters and growth in available solvency margin will be led by a profit before tax (higher than PAT). All this put together, we expect the Solvency ratio to reach ~198% by FY23, with ~21% premium growth, 95.8% combined ratio (66% claims ratio) and PBT of Rs9.6bn (**Exhibit 9**)
- Q4 performance supports our high conviction on the stock:** Our high-conviction Buy on Star Health is underpinned by three factors: 1) the health insurance industry is still in its infancy - we expect a heady growth rate of ~20% in the next decade; 2) Star Health's dominant market share (>3x nearest competitor) in the sticky retail sector offers network effects – the trio of hospitals, customers and agents feed off each other in a virtuous cycle. Sub-scale competitors will struggle to outdo this moat; and 3) we expect margin gains with scale. The Q4 turnaround in performance underscores our high conviction thesis.
- Management guidance encouraging:** Management remains confident about the growth trajectory even after capturing a 1/3rd of the retail health market. However, management has also made it clear that they will exit unprofitable group health businesses even if that affects overall growth. On claims, management said that Apr'22 claims ratios hovered around 64-65%. And with profitability returning, management remains very comfortable with the capital position.
- Reiterate Buy; Revised TP of Rs945:** Factoring in the developments of Q4FY22, we have made some minor changes to our FY23-25 estimates. To reflect the recent increase in risk-free rates, we have increased our cost of equity to 12.5% and we roll forward our TP to Jun'23. Based on the method of discounting future profits, we reduce our Jun'23 TP to Rs945, implying an FY25E P/E of ~42x and P/GWP of 2.6x. We reiterate our Buy rating on the stock. (**Exhibit 10-12**).

Please see our sector model portfolio (Emkay Alpha Portfolio): [BFSI-Insurance \(Page 9\)](#)

Financial Snapshot (Standalone)

Y/E March, in Rs mn	FY20	FY21	FY22	FY23E	FY24E	FY25E
GWP	68,907	93,490	1,14,635	1,38,762	1,69,353	2,05,023
Combined ratio (%)	93.2	114.8	117.9	95.8	95.3	94.6
U/W result	1,684	-13,318	-20,616	1,864	2,366	4,547
Net profit	2,720	-8,256	-10,407	6,873	9,761	13,122
RoE (%)	18.9	-32.1	-25.6	13.8	16.7	18.8
Solvency ratio (%)	150.0	223.0	167.0	198.0	203.0	205.5
EPS (Rs)	5.6	-16.5	-18.7	11.9	16.9	22.7
P/GWP	5.0	4.1	3.5	2.9	2.4	2.0
P/E	125.5	-42.4	-37.6	58.8	41.5	30.9
P/B	20.9	11.0	8.7	7.5	6.4	5.3

Source: Company, Emkay Research. Team.emkay@whitemarquesolutions.com use and downloaded at 05/05/2022 12:20 PM

Change in Estimates

EPS Chg FY23E/FY24E (%)	-/
Target Price change (%)	(9.1)
Target Period (Months)	12
Previous Reco	BUY

Emkay vs Consensus

	EPS Estimates	
	FY23E	FY24E
Emkay	11.9	16.9
Consensus	11.0	17.1
Mean Consensus TP (12M)	Rs 811	

Stock Details

Bloomberg Code	STARHEAL IN
Face Value (Rs)	10
Shares outstanding (mn)	576
52 Week H/L	940 / 584
M Cap (Rs bn/USD bn)	404 / 5.28
Daily Avg Volume (nos.)	293,106
Daily Avg Turnover (US\$ mn)	2.7

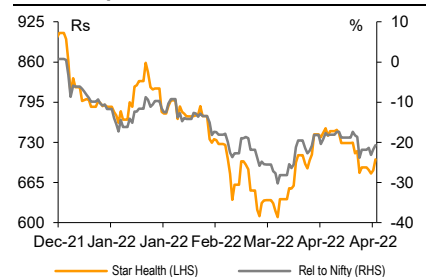
Shareholding Pattern Dec '21

Promoters	58.9%
FIIIs	9.5%
DIIIs	0.4%
Public and Others	31.3%

Price Performance

(%)	1M	3M	6M	12M
Absolute	(6)	(10)	-	-
Rel. to Nifty	(2)	(6)	-	-

Relative price chart



Source: Bloomberg

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Avinash Singh

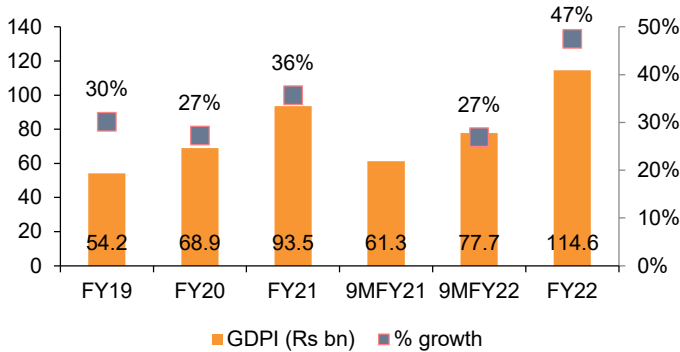
avinash.singh@emkayglobal.com
+91 22 6612 1327

Mahek Shah

mahek.shah@emkayglobal.com
+91 22 6612 1218

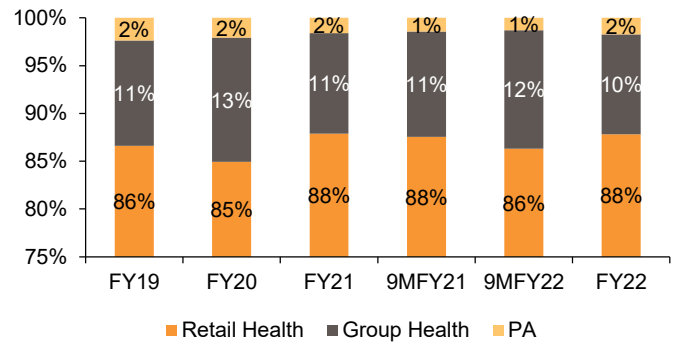
Results in Charts

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



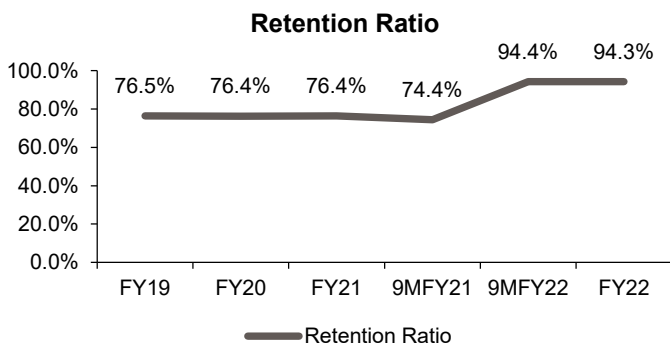
Source: Company, Emkay Research

Exhibit 2: Retail Health remains at the core



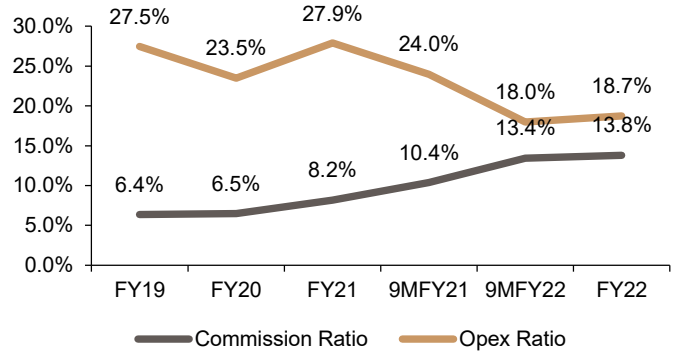
Source: Company, Emkay Research

Exhibit 3: Retention Ratio Stands at 94.3%



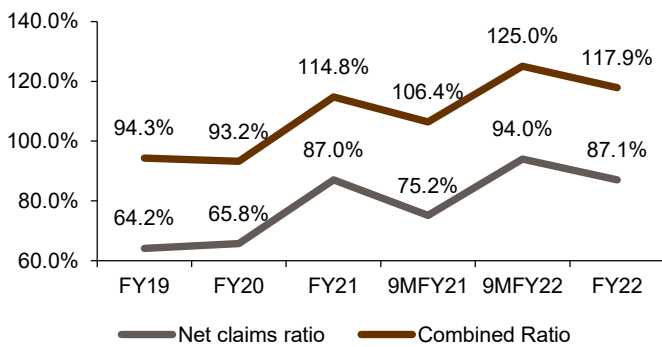
Source: Company, Emkay Research

Exhibit 4: Increasing Net Commission and Opex Ratios



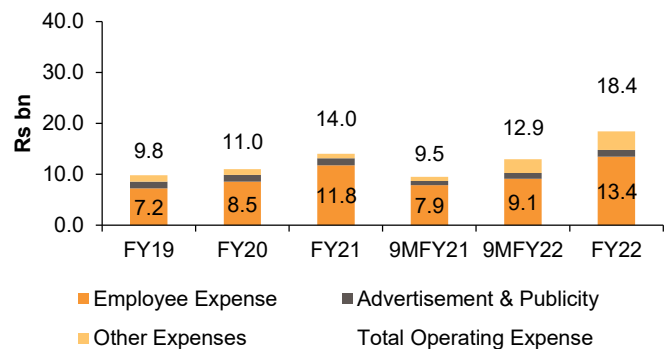
Source: Company, Emkay Research

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



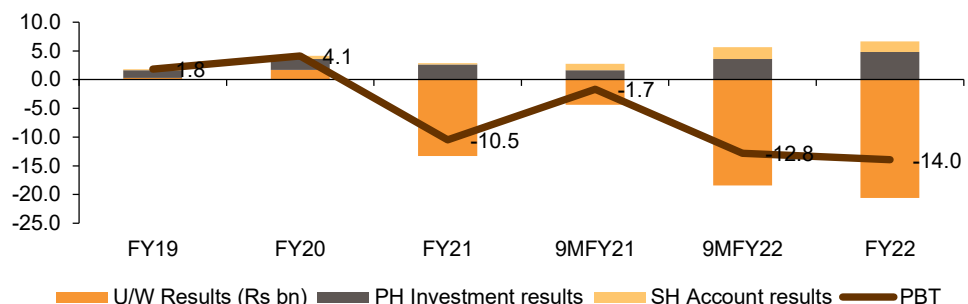
Source: Company, Emkay Research

Exhibit 6: Operating Expense Constitution



Source: Company, Emkay Research

Exhibit 7: Underwriting result is currently the biggest drag on overall profitability



Source: Company, Emkay Research

Concall highlights

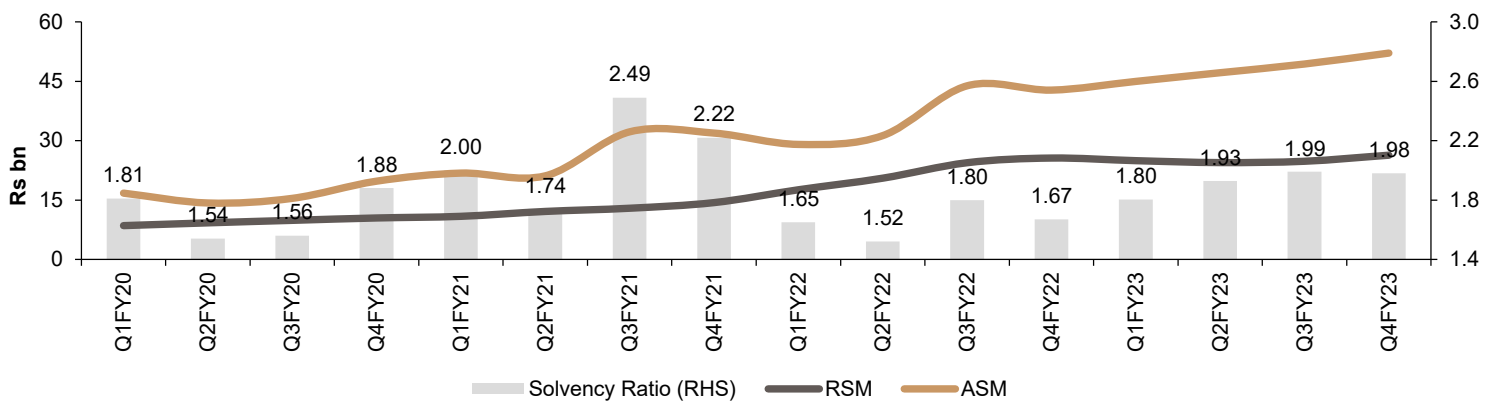
- Management in its opening remarks said that the general insurance industry had reached a gross premium of Rs2,200bn and registered a growth of 11% for FY22, driven by 31% growth in group health business, and 39% growth in the government health insurance business. With respect to Star Health, GWP grew by 22.1% in FY22 to Rs114.63bn, with the retail health segment growing by 22.4% in FY22 and registering a market share of 13%.
- With respect to the agency channel contributing around 80% of the overall business, management said that the agency strength increased to 549,000 agents, with an addition of 87,000 agents in FY22.
- Star Health launched two new products, namely Star Women Care Policy and Star Health Senior policy (For aged above 50 years), and saw encouraging results. With its conscious effort to reduce the Group business, the company exited some of the large group health insurance policies during the quarter, as evident in the 28% reduction in group health premiums.
- The digital initiatives of the company resulted in 1.46mn downloads of their app. Premium collected digitally grew by 34%, accounting for around 6% of the total premium. The company launched WhatsApp services in Jan'22, which provided sales renewal mechanisms and customer engagement. The company also developed in-house machine learning models to predict whether a customer will renew his or her policy before the due date.
- Management said that the claims ratio in Q4FY22 stood at 68.1%, which is almost normalized to pre-Covid levels, and expects the trend to continue, with a provisional claims ratio of ~65% in Apr'22.
- Considering that the fourth quarter for 2022 was the biggest quarter in terms of premiums and the cost of acquisition is accounted at once, management said that the solvency ratio of the company was much within its expectations of 167%. The provisional Apr'22 solvency would be around 1.77 times, and is estimated to improve going forward.
- Management said that they are very focused on retail health and are confident of growing faster than the industry. The company showcased growth in mid-20s in the past and management expects to sustain that growth rate in FY23 also.
- Management expects the Solvency to jump by 10% to 177% in April and expects to keep it moving forward to 190% levels in the next 3 to 4 months.
- Management said that the focus is right now not only on growth but also on quality of growth that they want to definitely change. As a result, underwriting in certain areas have become stringent with some exit plans for certain loss making areas, especially the large corporate side.
- Growth drivers include: 1) focus on retail side, 2) agency channel of distribution, along with banca, digital and a new vertical for semi urban and rural, 3) higher sum insured.
- With respect to non-Covid claims, management mentioned that although hospitals are in the mindset of charging for some of the protective equipment and Covid-related tests and verification measures, the company is able to have a better control with the hospital and could see a month-on-month progressive gentle decline in the average pay per claims.
- With respect to empanelment of hospitals, management mentioned that they preferred valuable service providers rather than having more hospitals with a focus on pricing arrangements.

Exhibit 8: Q4/FY22 Financial Results

in Rs bn except %	FY22	FY21	%yoy	4QFY22	4QFY21	%yoy	FY21	FY20	%yoy
Gross written premium (GWP)	1,14,635	93,490	22.6	36,892	32,222	14.5	93,490	68,907	35.7
Net Written Premium (NWP)	1,08,095	71,448	51.3	34,738	25,858	34.3	71,448	52,614	35.8
Net earned Premium (NEP) - A	98,092	50,228	95.3	26,212	10,600	147.3	50,228	46,930	7.0
Expenses									
Claims Incurred (Net)	85,400	43,695	95.4	17,848	13,904	28.4	43,695	30,874	41.5
Commission (Net)	14,922	5,838	155.6	5,072	1,106	358.5	5,838	3,409	71.3
Operating Expenses	18,385	14,014	31.2	5,464	4,513	21.1	14,014	11,020	27.2
Total expense - B	1,18,707	63,546	86.8	28,384	19,522	45.4	63,546	45,246	40.4
U/W Profit/(Loss) C = A-B	-20,616	-13,318	54.8	-2,172	-8,922	-75.7	-13,318	1,684	-890.9
Policyholder investment income	4,796	2,606		1,192	948		2,606	1,924	
Operating Profit	-15,820	-10,712	47.7	-980	-7,975	-87.7	-10,712	3,608	-396.9
PBT	-13,967	-10,460	33.5	-1,169	-8,785	-86.7	-10,460	4,134	-353.0
PAT	-10,407	-8,256	26.1	-821	-6,968	-88.2	-8,256	2,720	-403.6
Combined ratio (%)	117.9	114.8	3.1ppts	98.4	152.9	-54.5ppts	114.8	93.2	21.6ppts
Retention Ratio	94.3	76.4	17.9ppts	94.2	80.2	13.9ppts	76.4	76.4	0.1ppts
NEP/NWP (%)	91	70	20.4ppts	75	41	34.5ppts	70.3	89.2	-18.9ppts
Net claims ratio	87.1	87.0	0.1ppts	68.1	131.2	-63.1ppts	87.0	65.8	21.2ppts
Net commission ratio	14	8	5.6ppts	15	4	10.3ppts	8.2	6.5	1.7ppts
Management expense ratio	17	20	-2.6ppts	16	17	-1.7ppts	19.6	20.9	-1.3ppts
Solvency ratio (%)	1.67	2.23	-0.6ppts	1.67	2.23	-0.6ppts	2.2	1.5	0.7ppts

Source: Company, Emkay Research; Note: For comparability we have used the adjusted numbers of FY21 that was reported in the company's IPO Prospectus. These numbers were normalized for the one time impact of moving from ½ accounting of URR to 1/365 method.

Exhibit 9: High claims losses spiked RSM and also depleted ASM by pre-tax losses quantum. Solvency to turnaround quicker with return to profitability



Source: Company data, Emkay research

Exhibit 10: Appraisal value method valuation of Star Health

Cost of Equity	12.50%
FY23 PAT (Rs mn)	6,873
FY25 PAT (Rs mn)	13,122
PAT CAGR FY25-38	16.3%
Terminal growth	7.5%
Mar-23 Fair value (Rs mn)	5,28,976
No. of shares (mn)	577.2
Mar-23 Fair value per share (Rs)	916
Jun-23E Target Price	945
CMP	702
Upside	34.7%
	BUY

Source: Emkay Research

Exhibit 11: Implied valuation multiples

Valuation multiple on Target price	Rs 945
FY25E P/E	42x
FY25E P/B	7.1x
RoE (%)	18.8%
FY25E P/GWP	2.7x
Valuation multiple on CMP	Rs 702
FY25E P/E	31x
FY25E P/B	5.3x
RoE (%)	18.8%
FY25E P/GWP	2.0x

Source: Emkay Research

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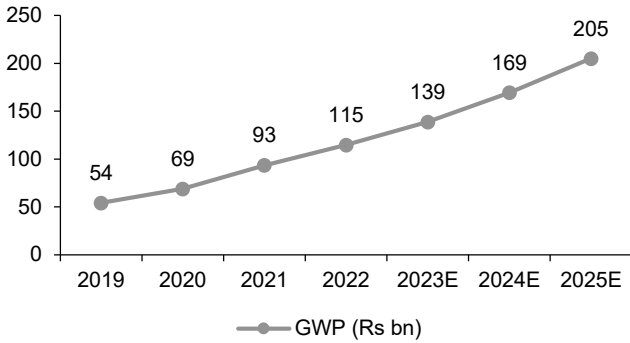
Exhibit 12: Changes in Estimates

Rs mn	Old			Revised			% Change		
	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e
GWP	1,43,600	1,76,671	2,17,359	1,38,762	1,69,353	2,05,023	-3.4	-4.1	-5.7
U/W Result	1,372	2,493	5,074	1,864	2,366	4,547	35.9	-5.1	-10.4
Net Profit	6,895	9,255	13,048	6,873	9,761	13,122	-0.3	5.5	0.6
Claims ratio (%)	66.8	67.0	67.1	65.8	65.8	66.0	-1.0ppts	-1.2ppts	-1.1ppts
Combined Ratio (%)	95.8	95.2	94.5	95.8	95.3	94.6	0.0ppts	0.1ppts	0.1ppts
Solvency Ratio (%)	187.8	177.0	173.0	198.0	203.0	205.5	10.2ppts	26.0ppts	32.5ppts

Source: Emkay Research

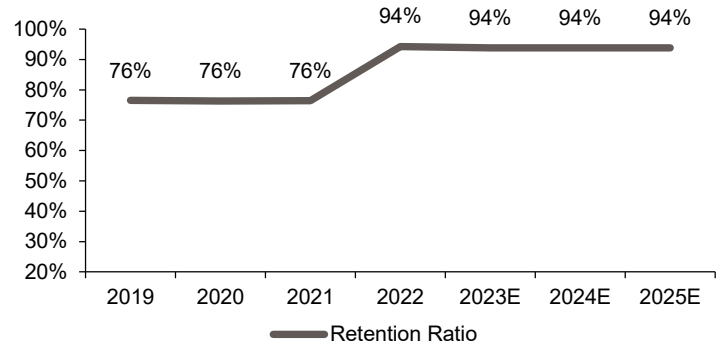
Story in Charts

Exhibit 13: Premium growth to remain strong



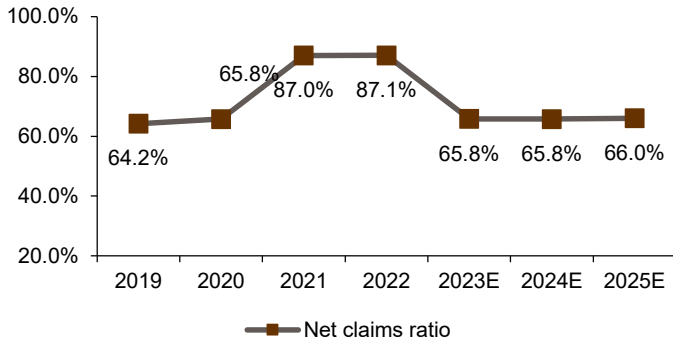
Source: Company, Emkay Research

Exhibit 14: Retention ratio is a reflection of changed reinsurance strategy



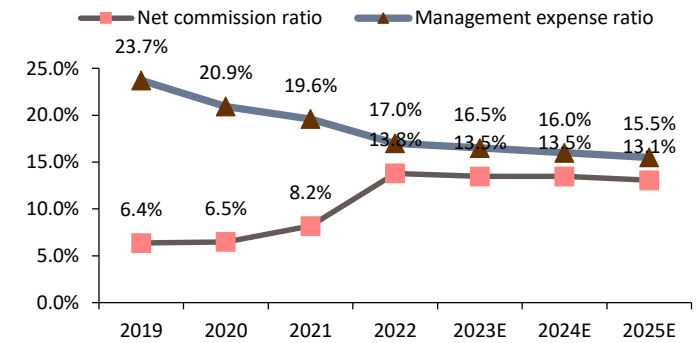
Source: Company, Emkay Research

Exhibit 15: With the Normalizing of Covid-19, Claims ratio to go to ~ 65-66% levels



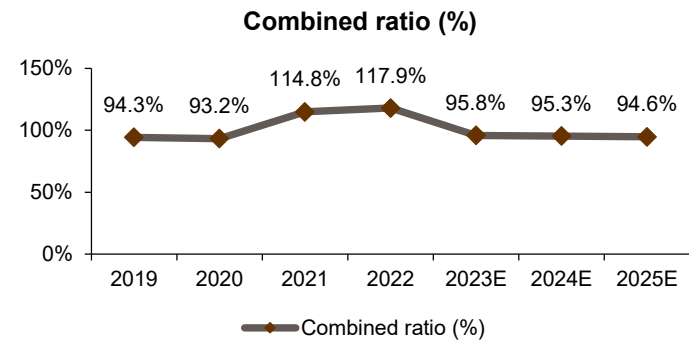
Source: Company, Emkay Research

Exhibit 16: Operating leverage to continue to play out



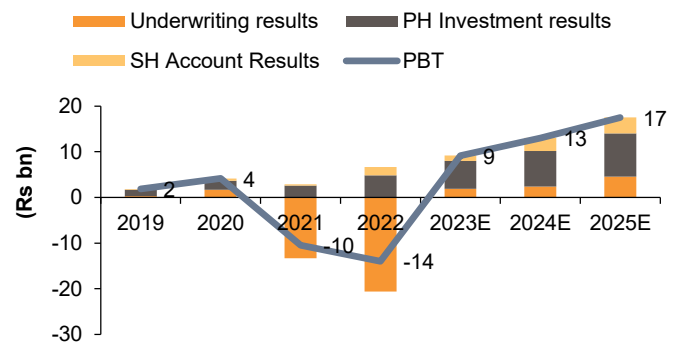
Source: Company, Emkay Research

Exhibit 17: Combined ratio to come back to ~95% levels



Source: : Company, Emkay Research

Exhibit 18: Reversal in underwriting results to drive strong profitability



Source: : Company, Emkay Research

Key Financials (Standalone)

(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

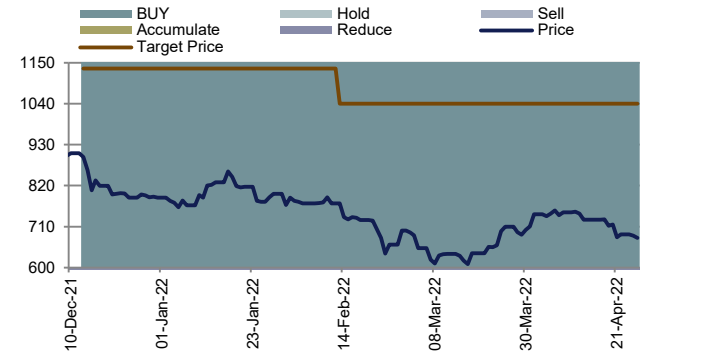
Source: Company, Emkay Research

RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
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

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	1.41	1.41	0%	0	100.00	
HDFC Life Insurance	0.56	0.59	5%	3	41.96	0
ICICI Pru Life	0.20	0.07	-64%	-13	5.10	0
Max Financial	0.16	0.19	18%	3	13.64	0
SBI Life	0.48	0.55	15%	7	39.30	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	30-Apr-21	29-Oct-21	31-Jan-22	31-Mar-22	29-Apr-22
EAP - BFSI-Insurance	100.0	159.2	178.2	174.3	152.7	157.5
BSE200 Neutral Weighted Portfolio (ETF)	100.0	160.0	178.9	174.3	152.3	157.7

*Performance measurement base date 1st April 2019

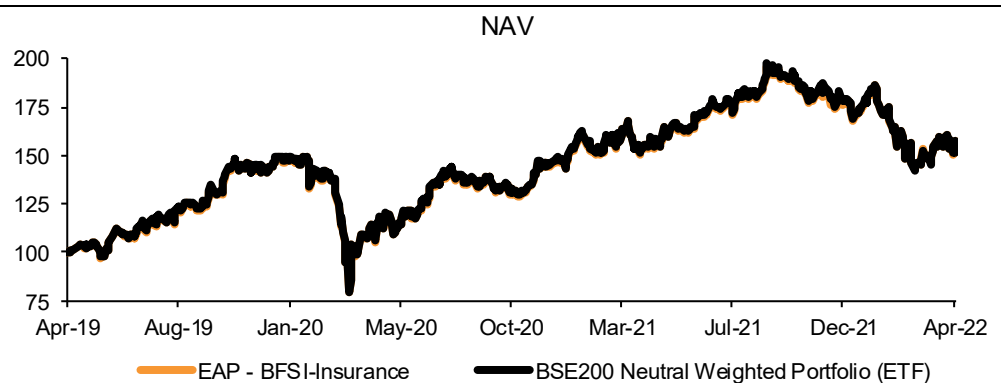
Source: Emkay Research

Price Performance (%)

	1m	3m	6m	12m
EAP - BFSI-Insurance	3.2%	-9.7%	-11.6%	-1.1%
BSE200 Neutral Weighted Portfolio (ETF)	3.6%	-9.5%	-11.8%	-1.4%

Source: Emkay Research

NAV chart



Source: Emkay Research

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”



Analyst: Avinash Singh

Contact Details

avinash.singh@emkayglobal.com
+91 22 66121327

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.

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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Emkay Global Financial Services Ltd.

CIN - L67120MH1995PLC084899

7th Floor, The Ruby, Senapati Bapat Marg, Dadar - West, Mumbai - 400028. India

Tel: +91 22 66121212 Fax: +91 22 66121299 Web: www.emkayglobal.com