

Star Health

Refer to important disclosures at the end of this report

In good health

Star Health reported a good set of numbers in Q1FY23, with combined ratio (CoR) of 98.2%, profit after tax of Rs2.13bn, and a much-improved solvency ratio of 187%. Beyond the finer details, the bigger message from the result is that the company is well on track to execute its profitable growth strategy, focusing on the retail and SME segments. Notwithstanding slightly higher combined ratio in Q1FY23, management commentary is upbeat about achieving 63-65% claims ratio and 93-95% combined ratio in FY23. Q1 trend and management guidance increases our confidence about the company achieving ~96% CoR 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 Buy on the stock with an unchanged TP of Rs945.

- On the right track:** Star Health's Q1FY23 combined ratio of 98.2% and claims ratio of 66.2% were broadly in line with our estimates of 97.5% and 66.0%, respectively. However, underwriting profit of Rs 1.57bn and PAT of Rs 2.13bn were higher than our estimates of Rs1.4bn and Rs1.8bn, respectively. The beat in underwriting results and PAT were largely led by Unexpired Risk Reserve (URR) decline on account of seasonality factors – meaning lower new business in Q1. The impact of ESOP 2021 was negative Rs 0.55bn in Q1. This impact should be negative Rs0.55bn in Q2 and negative Rs0.37bn in Q3. On the growth front, GDPI growth in Q1 was ~13% YoY, primarily due to strategic choices made by the company in the group health business that saw a material decline. Retail health premium grew ~20% YoY vs. industry growth of 11% YoY. In the retail health segment, the company's market share was 32% in Q1FY23. (**Exhibit 1-8**)
- Many moving parts to quarterly numbers, annual numbers present clearer picture:** Given the seasonality in retail health insurance (Q4 being 35-40%) and Indian GAAP requiring upfronting of acquisition and operating expenses (OpEx), the accrual accounting of premium recognition means that there are too many anomalies in quarterly ratios, underwriting results, and PAT flow. A higher net earned premium (NEP) and lower net written premium (NWP) in Q1 mean that OpEx ratio is artificially inflated and, thus, underwriting results are higher or better in Q1 than other quarters for the same combined ratio. Q1 NEP will mostly be meaningfully higher than NWP, as retail health insurance sees the highest new business being written in Q4 and the lowest in Q1. To cut these noises, it is better to focus on the annual trend; and the trend here will be that OpEx ratio will moderate from Q1 in general and claims ratio should move as per claims experience and pricing trends. As far as PAT is concerned, lowering of OpEx should help in the coming quarters; and by Nov'22, ~Rs0.185bn monthly ESOP cost will be concluded and, thus, would further lift profits.
- Solvency ratio at 187%; Comfortable capital position:** Star Health improved its solvency ratio to 187% as of Q1FY23-end from 167% in FY22-end. The jump in solvency ratio is on our forecasted lines and puts the capital raise talks to rest. The available solvency margin (ASM) benefitted from profit before tax accrual (as deferred tax asset did not count in solvency margin); and with Q1FY22 (Delta Wave) losses going out from required solvency margin (RSM) calculation, RSM moderated from FY22. Going forward, with RSM moving to premium factors from current claims factor, FY23 solvency should be ~200%. This comfortable solvency will put the capital raise talks to rest for the medium term. (**Exhibit 9**)
- Our high conviction thesis remains intact:** 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 healthy growth rate of ~20% in the next decade; 2) Star Health's dominant market share (>3x its 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 Q1 turnaround in performance underscores our high conviction thesis.
- Reiterate Buy:** Factoring in the developments of Q1FY23, we have made some minor changes to our FY23-25 estimates. We reiterate our Buy rating on the stock with an unchanged Sep'23E TP of Rs945, translating into FY25E P/E of 41x and P/GWP of 2.8x. (**Exhibit 10-12**).

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

Financial Snapshot

Y/E March (Rs mn)	FY20	FY21	FY22E	FY23E	FY24E	FY25E
GWP	68,907	93,490	1,14,635	1,33,115	1,62,464	1,96,687
Combined ratio (%)	93.2	114.8	117.9	95.8	95.0	94.1
U/W result	1,684	-13,318	-20,616	2,705	2,665	5,302
Net profit	2,720	-8,256	-10,407	7,180	9,722	13,401
RoE (%)	18.9	-32.1	-25.6	14.3	16.5	19.3
Solvency ratio (%)	150.0	223.0	167.0	199.8	212.0	209.7
EPS (Rs)	5.6	-16.5	-18.7	12.5	16.8	23.2
P/GWP	5.3	4.4	3.8	3.2	2.7	2.2
P/E	133.7	-45.2	-40.1	60.0	44.4	32.2
P/B	22.3	11.7	9.3	8.0	6.8	5.7

Source: Company, Emkay Research

CMP	Target Price
Rs 747 as of (July 30, 2022)	Rs 945 (■) 12 months
Rating	Upside
BUY (■)	26.5 %

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	12.5	16.8
Consensus	10.7	17.0
Mean Consensus TP (12M)	Rs 732	

Stock Details

Bloomberg Code	STARHEAL IN
Face Value (Rs)	10
Shares outstanding (mn)	576
52 Week H/L	940 / 469
M Cap (Rs bn/USD bn)	430 / 5.42
Daily Avg Volume (nos.)	8,38,854
Daily Avg Turnover (US\$ mn)	6.5

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	50	5	(6)	-
Rel. to Nifty	38	5	(7)	-

Relative price chart



Source: Bloomberg

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Avinash Singh

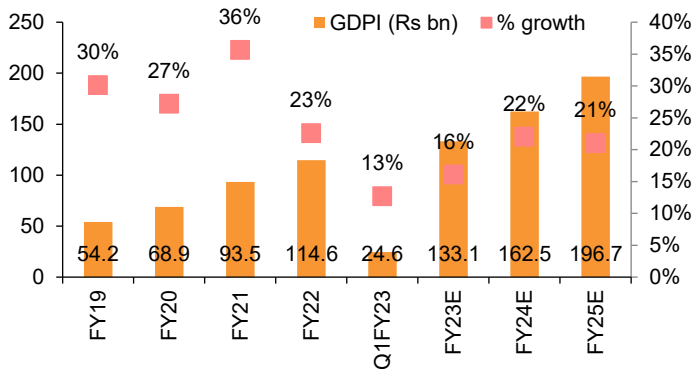
avinash.singh@emkayglobal.com
+91 22 6612 1327

Mahek Shah

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

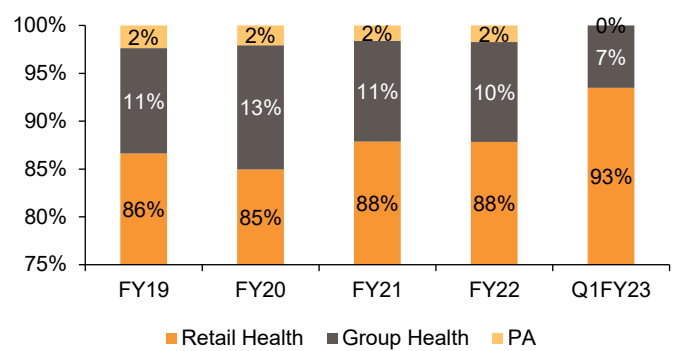
Story in Charts

Exhibit 1: GDP growth at ~13% as a result of exit from large corporates



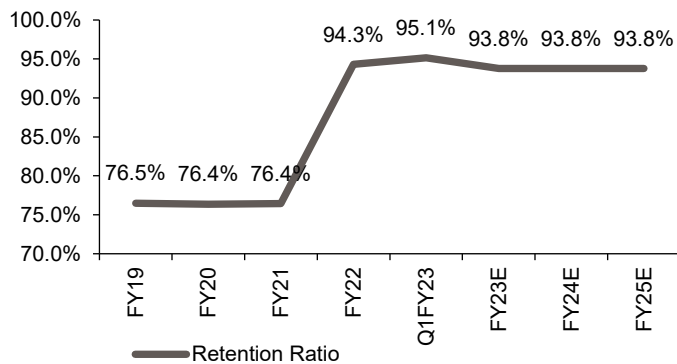
Source: Company, Emkay Research

Exhibit 2: Focus remains on the retail health segment



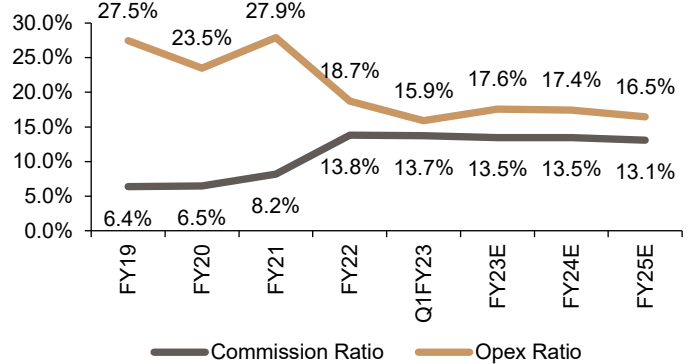
Source: Company, Emkay Research

Exhibit 3: Retention ratio stands at 95.1% for Q1FY23



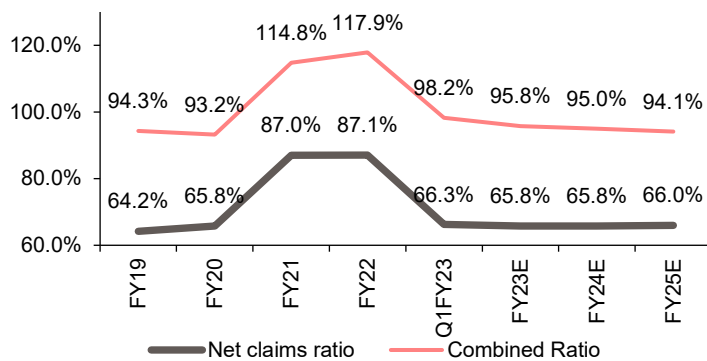
Source: Emkay Research, Company

Exhibit 4: Opex and commission ratios improve marginally



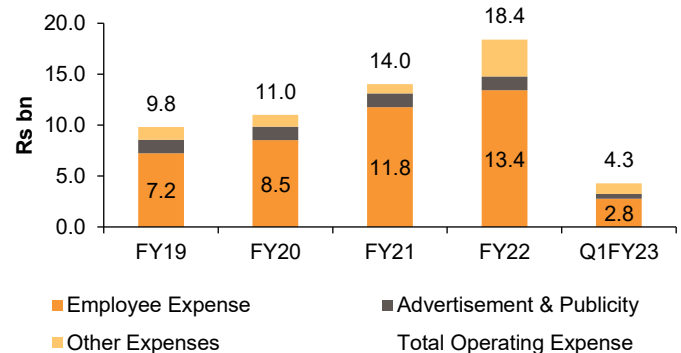
Source: Emkay Research, Company

Exhibit 5: Combined ratio sees improvement as a result of improvement in claims ratio



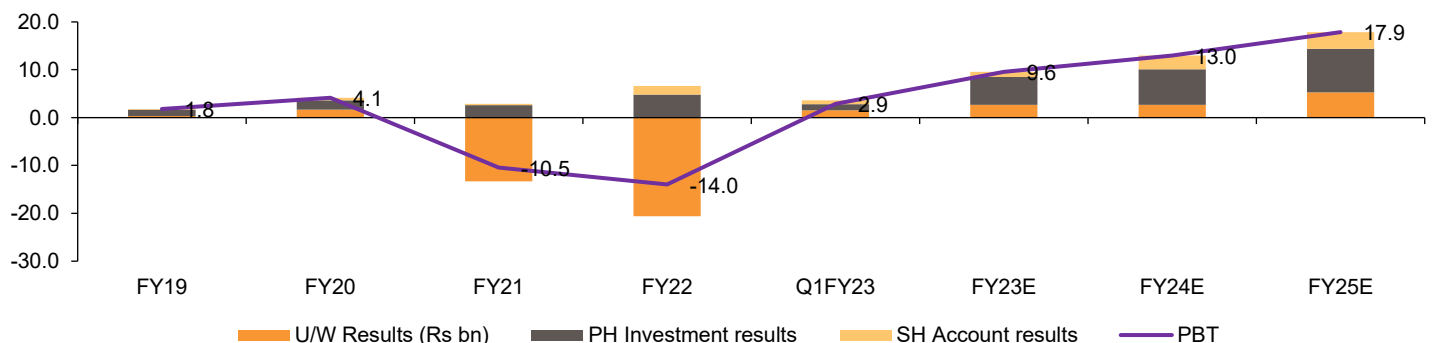
Source: Company, Emkay Research

Exhibit 6: Operating expense constitution



Source: Company, Emkay Research

Exhibit 7: Underwriting profit improves the overall profit before tax



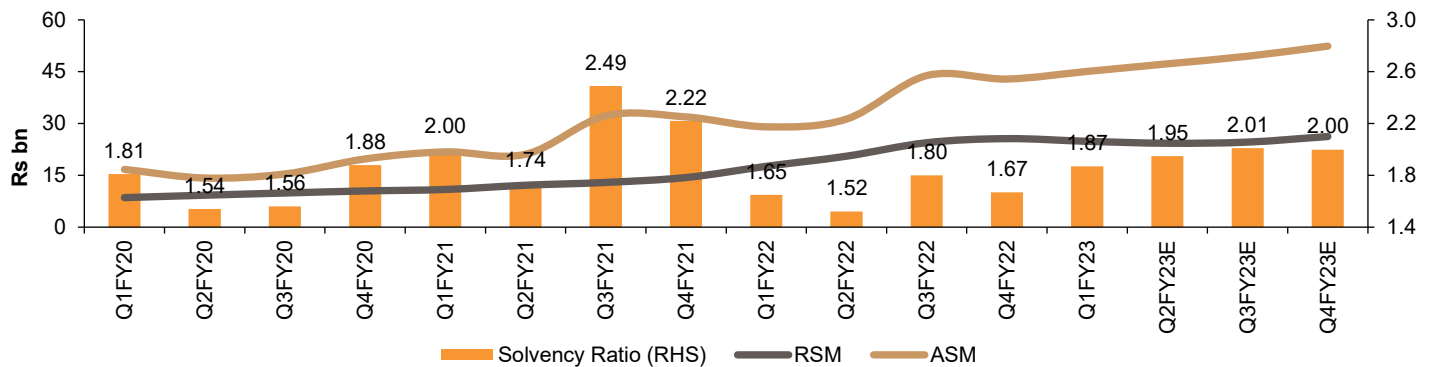
Source: Company, Emkay Research

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Exhibit 8: Quarterly financials

in Rs bn except %	1QFY23	1QFY22	%yoy	4QFY22
Gross written premium (GWP)	24,637	21,851	12.7	36,892
Net Written Premium (NWP)	23,441	20,496	14.4	34,738
Net earned Premium (NEP) - A	26,871	22,430	19.8	26,212
Expenses				
Claims Incurred (Net)	17,811	20,414	-12.8	17,848
Commission (Net)	3,220	2,665	20.8	5,072
Operating Expenses	4,272	3,510	21.7	5,464
Total expense - B	25,303	26,590	-4.8	28,384
U/W Profit/(Loss) C = A-B	1,568	-4,160	NM	-2,172
Policyholder investment income	1,220	889	37.2	1,192
Operating Profit	2,788	-3,270	-185.2	-980
PBT	2,880	-2,803	NM	-1,169
PAT	2,132	-2,098	NM	-821
Combined ratio (%)	98.2	121.1	-22.9ppts	98.4
Retention Ratio	95.1	93.8	1.3ppts	94.2
NEP/NWP (%)	115	109	5.2ppts	75
Net claims ratio	66.3	91.0	-24.7ppts	68.1
Net commission ratio	13.7	13.0	0.7ppts	15
Management expense ratio	18.2	17.1	1.1ppts	16
Solvency ratio (%)	1.87	1.65	22.0ppts	1.67

Source: Company, Emkay Research

Exhibit 9: Solvency ratio jumps to 1.87 for Q1FY23 and likely to reach 2.00 levels by Q4FY23

Source: Company, Emkay Research

Exhibit 10: Appraisal method valuation of Star Health

Cost of Equity	12.5%
FY23 PAT (Rs mn)	7,180
FY25 PAT (Rs mn)	13,401
PAT CAGR FY25-38	15.0%
Terminal growth	8.0%
Mar-23 Fair value (Rs mn)	5,14,534
No. of shares (mn)	577.2
Mar-23 Fair value per share (Rs)	891
Sep-23E Target Price	945
CMP	747
Upside	26.5%
	BUY

Source: Company, Emkay Research

Exhibit 11: Implied valuation multiples

Valuation multiple on target price	Rs 945
FY25E P/E	41x
FY25E P/B	7.2x
RoE (%)	19.3%
FY25E P/GWP	2.8x
Valuation multiple on CMP	Rs 747
FY25E P/E	32x
FY25E P/B	5.7x
RoE (%)	19.3%
FY25E P/GWP	2.2x

Source: Company, Emkay Research

Exhibit 12: Changes in Estimates

Rs mn	Old			Revised			% Change		
	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e	FY23e	FY24e	FY25e
GWP	1,38,762	1,69,353	2,05,023	1,33,115	1,62,464	1,96,687	-4.1	-4.1	-4.1
U/W Result	1,864	2,366	4,547	2,705	2,665	5,302	45.1	12.6	16.6
Net Profit	6,873	9,761	13,122	7,180	9,722	13,401	4.5	-0.4	2.1
Claims ratio (%)	65.8	65.8	66.0	65.8	65.8	66.0	0.0ppts	0.0ppts	0.0ppts
Combined Ratio (%)	95.8	95.3	94.6	95.8	95.0	94.1	0.0ppts	-0.3ppts	-0.5ppts
Solvency Ratio (%)	198.4	203.4	205.9	199.8	212.0	209.7	1.4ppts	8.5ppts	3.8ppts

Source: Company, Emkay Research

Conference call Highlights

- Management stated that products launched in Q4FY22, namely Star Women Care Policy and Star Premier Policy, were doing very well and contribution from specialized products has increased to 17%.
- The average sum assured for policies increased by 19% YoY to Rs0.81mn. The company launched a new product, Star Health Assured policy – an upgraded version of the Family Health Optima policy with extended features at an attractive price.
- Management announced a price revision for Star Mediclassic Policy with a 25% increase in prices effective from July 2022. The Star Mediclassic product contributed to 6% of the retail GWP.
- Management stated that the combined ratio improved to 98.2% as a result of improved claims ratio to 66.3%. The impact of Covid claims amounted to 0.7% of total claims and gross Covid claims stood at Rs0.2bn.
- Management stated that the company would converge towards a premium-based factor for the calculation of solvency ratio likely by September 2022. Management also stated that a premium-based solvency ratio for the quarter could have been 207%.
- With respect to Covid-Related Precautionary Expenses (RTPCR kits etc.), management stated that efforts are being taken by the company to negotiate with hospitals and a very basic price for these expenses is being paid. Covid-Related Precautionary Expenses amount to 2-4% of every claim incurred.
- Management said that the company is able to control the average claims paid to the Agreed Network Hospitals on a QoQ basis. Considering the medical inflation vis-à-vis the average increase in the claims paid by the company, the price hike compared to the inflation is on a lower side, which is a result of the company's experience in the industry for over 15 years and its arrangement with the hospitals.
- Management remains confident to achieve the guided targets of 93-95% combined ratio and 63-65% claims ratio. With its focus on retail health and SME and mid-size corporates on the group side, management is confident of achieving 22-25% growth for the year; however, overall growth shall remain muted on account of its exit from large unprofitable corporates.
- Management stated that the rural business showed a positive sign with loss ratios in line with the company's expectations. Moreover, the average ticket size for rural customers was close to that of semi-urban customers.
- Regarding its partnership with CSC, management stated that Star Health is the only SAHI on its platform. This partnership will help the company grow its rural business. Management stated that the company is targeting middle and upper class customers in the rural segment and, hence, would not be in direct competition with the government, which targets the Below Poverty Line customers.
- Management believes that Star's brand reach and hospital network will keep stickiness among agents. Hence, despite the regulator allowing life insurers to manufacture or distribute health insurance in future, it would not have a major impact on the company.
- Management guided that solvency margins would remain at 193-198% by year-end and expense ratio remains at 30%.
- Management said that the direct channel contributed to ~60% of the total digital business done by the company and the remaining was contributed by other digital partners. While the direct digital business grew by 35% YoY, other digital partners reported 20% YoY growth.

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Exhibit 13: 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	1,33,115	1,62,464	1,96,687
Gross Written Premium (GWP)	54,154	68,907	93,490	1,14,635	1,33,115	1,62,464	1,96,687
Net Written Premium (NWP)	41,415	52,614	71,448	1,08,095	1,24,834	1,52,348	1,84,425
Net Earned Premium (NEP)	35,795	46,930	50,228	98,092	1,17,287	1,37,913	1,67,985
Net incurred claims	22,976	30,874	43,695	85,400	77,156	90,718	1,10,900
Net commission expense	2,638	3,409	5,838	14,922	16,817	20,522	24,103
Operating expense	9,827	11,020	14,014	18,385	20,608	24,008	27,680
Total Expense	35,488	45,246	63,546	1,18,707	1,14,582	1,35,248	1,62,683
Underwriting result	307	1684	(13318)	(20616)	2705	2665	5302
Investment income	1,340	1,924	2,606	4,796	5,762	7,434	9,096
Insurance result	1,647	3,608	-10,712	-15,820	8,467	10,100	14,398
Operating profit	1,647	3,608	-10,712	-15,820	8,467	10,100	14,398
Shareholder Account							
(Y/E Mar, Rs mn)	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Operating profit	1,647	3,608	-10,712	-15,820	8,467	10,100	14,398
Investment income	614	1,011	1,631	3,133	3,466	3,743	4,350
Expenses and provisions	440	485	1,382	1,360	2,360	880	880
Profit before tax	1,822	4,134	-10,460	-13,967	9,573	12,963	17,868
Tax expense	540	1,415	-2,204	-3,560	2,393	3,241	4,467
Profit after Tax	1,282	2,720	-8,256	-10,407	7,180	9,722	13,401
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	75,352
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	75,352
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	82,552
Application of Funds							
Investments	30,301	42,900	68,367	1,13,734	1,34,060	1,59,297	1,90,667
Shareholders	9,523	14,782	26,321	44,939	42,812	49,618	57,786
Policyholders	20,778	28,117	42,046	68,796	91,247	1,09,679	1,32,881
Other Assets	2,401	2,486	5,203	8,938	6,604	3,424	1,356
Cash & Bank Balances	8,930	6,114	18,790	5,635	6,172	9,072	11,090
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	20,272	22,472	27,363
Provisions	24,939	30,506	51,946	62,022	72,404	86,838	1,03,278
Net Current Assets	-17,920	-26,418	-36,149	-69,165	-79,503	-91,839	-1,09,471
Accumulated losses	1,644	0	7,245	17,652	10,472	750	0
Total	16,426	18,968	44,666	71,159	71,632	71,632	82,552
Net worth	12,282	16,437	34,996	46,041	53,960	63,683	75,352
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	15.8	15.0
Combined ratio	94.3	93.2	114.8	117.9	95.8	95.0	94.1
NWP/Net worth	3.0	3.2	1.7	1.7	1.9	2.4	2.4
Return on Equity	11.7	18.9	-32.1	-25.7	14.4	16.5	19.3
Solvency ratio	153	150	223	167	200	212	210
Investment leverage (x)	3.1	2.5	2.1	2.5	2.4	2.3	2.3

Source: Company, Emkay Research

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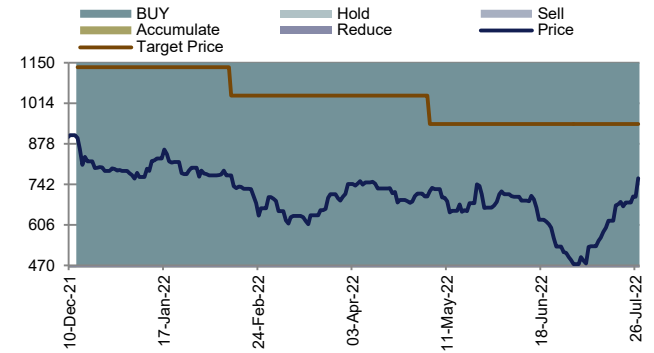
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RECOMMENDATION HISTORY TABLE

Date	Closing Price	TP	Period (months)	Rating	Analyst
27-Jun-22	515	945	12m	Buy	Avinash Singh
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

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.

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	1.58	1.37	-13%	-20	100.00	
HDFC Life Insurance	0.52	0.32	-38%	-20	20.36	0
ICICI Pru Life	0.21	0.11	-47%	-10	6.93	0
LIC	0.11	0.13	18%	2	8.25	0
Max Financial	0.18	0.21	18%	3	13.51	0
SBI Life	0.53	0.60	15%	8	38.21	0
Star Health	0.03	0.20	475%	17	12.75	0
Cash	0.00	0.20	NA	20	12.75	0

Source: Emkay Research

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

Sector portfolio NAV

	Base					Latest
	1-Apr-19	28-Jul-21	28-Jan-22	28-Apr-22	28-Jun-22	28-Jul-22
EAP - BFSI-Insurance	100.0	181.3	171.0	157.1	155.9	168.2
BSE200 Neutral Weighted Portfolio (ETF)	100.0	182.3	171.0	157.5	154.5	159.4

*Performance measurement base date 1st April 2019

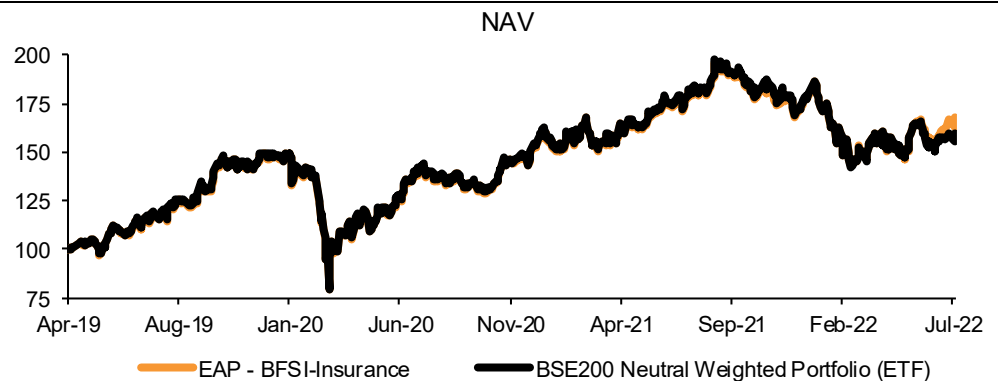
Source: Emkay Research

Price Performance (%)

	1m	3m	6m	12m
EAP - BFSI-Insurance	7.9%	7.0%	-1.7%	-7.3%
BSE200 Neutral Weighted Portfolio (ETF)	3.2%	1.2%	-6.8%	-12.6%

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”

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