

Star Health and Allied Insurance

Disciplined approach to drive profitability

We attended STARHEAL's analyst day where the management showcased its policy underwriting and claims management processes and articulated its focus on incrementally raising persistency post the recent price hike in its flagship product. We like STARHEAL for its strong moats, including a dominant agency-led distribution network, retail business mix, and best-in-class opex ratios. We expect STARHEAL to deliver revenue/APAT CAGRs of 21%/26% and RoEs in the range of 14.7-16.8% over FY23-FY25E; maintain BUY with a target price of INR795 (DCF derived multiple at 44x Sep24E AEPS and 6.8x Sep24E P/ABV).

- Renewals – a focus area:** Following a price hike that the company undertook in FHO, its flagship product STARHEAL is incrementally focusing on boosting renewals with a dedicated team of 200 people. The company also leverages data from CIBIL to identify and prioritise high-intent consumers to improve hit rates. While renewals from the third year onwards are usually stable, the majority of the team's efforts are concentrated on the first- and second-year renewals.
- Underwriting guardrails in place:** STARHEAL has a dedicated, centralised medical team to improve underwriting quality, focused on cases with pre-existing medical diseases (PED) or adverse medical histories. For customers with PED and/or a claim history, renewals undergo additional layers of scrutiny in cases of a request for an increase in SA.
- Disciplined claims assessment to drive healthy loss ratios:** STARHEAL has a team of 300 doctors to assess the genuine nature of lodged claims. Multiple checks have been put in place to identify irregularities basis customer scores, hospital scores, agent scores, and policy vintage, aside from strict processes that are put in place to blacklist agent/hospitals for any serious red flags.
- “Composite License” risk overdone:** Health insurance is a capital-intensive business with thin margins, where even a small deviation in underwriting margins can derail earnings. With a large back book in the overall mix, the company is in a uniquely advantageous position to dial down commissions on the old book to counter competition. Given the manually-intensive nature of operations, constant claim monitoring and negotiations with hospitals, and the need for expertise to balance claims management and underwriting, we believe that the health insurance business poses high entry barriers.
- Price hike in flagship plan to moderately impact sales:** Management expects a 2-3% impact on FHO renewals (policy count) due to a sharp jump in pricing (+20%-25% on renewals); impact on NOPs was ~4% for a similar price hike in FHO in FY19. A lower mix of FHO policies in <2yr vintage bucket is likely to drive healthy persistency; however, growth in new policy sales is likely to be soft. Given a favourable base and price hike in FHO, we expect a positive surprise to our FY24 NEP growth estimate (+20% YoY) and loss ratios (65%).

Financial summary

(INR bn)	FY21	FY22	FY23E	FY24E	FY25E
Net earned premium (NEP)	46.3	98.1	115.2	138.3	168.5
Underwriting profits	(18.1)	(21.5)	0.7	2.4	3.2
EBIT	(14.2)	(13.6)	10.3	13.6	16.0
EBIT margin (%)	(30.7)	(13.9)	9.0	9.8	9.5
PAT	(10.9)	(10.4)	7.3	9.7	11.6
P/B (x)	8.1	6.5	5.7	4.8	4.0
P/E (x)	NM	NM	40.9	30.8	25.8
ROE (%)	(40.2)	(25.7)	14.7	16.7	16.8

Source: Company, HSIE Research

BUY

CMP (as on 31 Mar 2023)	INR 519
Target Price	INR 795
NIFTY	17,360

KEY CHANGES	OLD	NEW
Rating	BUY	BUY
Price Target	INR795	INR795
EPS %	FY23E	FY24E
	+0%	+0%

KEY STOCK DATA

Bloomberg code	STARHEAL IN
No. of Shares (mn)	582
MCap (INR bn) / (\$ mn)	301/3,667
6m avg traded value (INR mn)	234
52 Week high / low	INR 780/451

STOCK PERFORMANCE (%)

	3M	6M	12M
Absolute (%)	(8.5)	(26.6)	(27.0)
Relative (%)	(5.4)	(29.3)	(27.6)

SHAREHOLDING PATTERN (%)

	Sep-22	Dec-22
Promoters	58.6	58.3
FIs & Local MFs	0.4	1.3
FPIs	10.3	10.4
Public & Others	32.2	30.1
Pledged Shares	0.0	0.0

Source : BSE

Sahej Mittal

sahej.mittal@hdfcsec.com

+91-22-6171-7325

Krishnan ASV

venkata.krishnan@hdfcsec.com

+91-22-6171-7314

Renewals remain a focus area

- STARHEAL has a dedicated team of 200 employees to boost FHO renewals. The company also uses CIBIL data and ML capabilities to identify and prioritise high-intent and potentially right-fit customers to improve the renewal rate
- For instance, the company does not focus on customers with low or declining CIBIL scores as the customer is already struggling to repay his or her credit dues
- While third-year renewals are stable, the majority of the efforts are concentrated on the first- and second-year renewals

Underwriting guardrails in place

- A centralised medical underwriting (CMU) team is in place, primarily focussed on cases with pre-existing medical diseases (PED) or adverse medical histories, to tighten the underwriting quality. The underwriting team comprises 67 doctors, supported by Super Special panellists
- We are encouraged by the fact that any increase in sum assured during renewals for PED or claim-based customers goes through the CMU team, reducing the potential of fraud and allowing for the risk to be priced appropriately

Exhibit 1: Underwriting safeguards at STARHEAL

Underwriting Safeguards

UW & Actuarial

- Agent's Confidentiality Report
- Document Management System (DMS)
- Proof of age for Proposals above 45 years
- Alert in Premia (If, Agents / SMs incurred claims ratio is adverse)
- Centralized Medical Underwriting portal

- Tele Verification Cell
- Zonal Underwriting Audit Cell -100% audit of fresh cases
- Surprise audit by Corporate UW cell
- PA proposals above Rs 3 crs SI are underwritten post Vigilance department report
- System based Approval authority matrix for prudent underwriting of Health policies

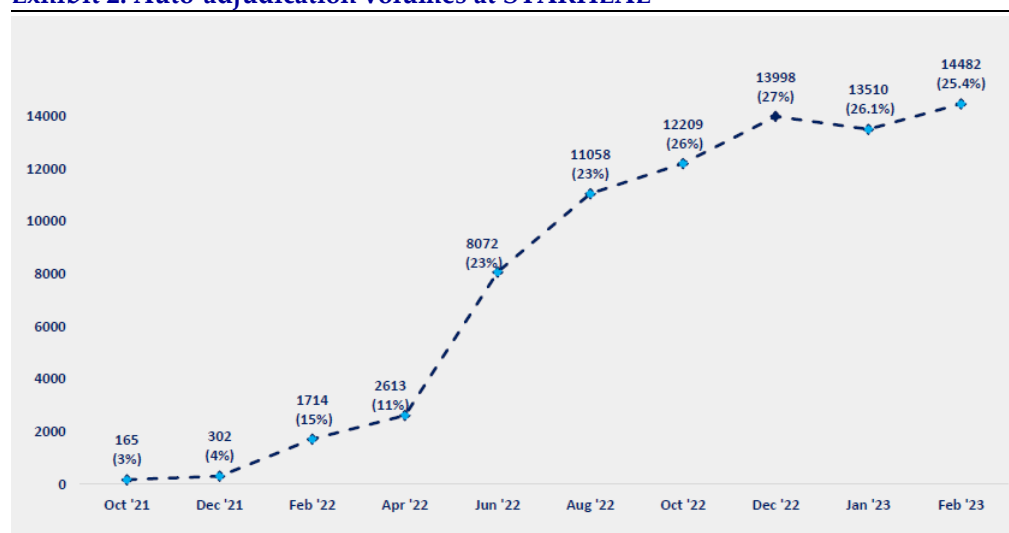
Tele-verification - Automation

Source: Company, HSIE Research

Disciplined claims assessment to drive structurally healthy loss ratios

- The company has a team of 300 doctors to determine the validity of claims; these doctors evaluate claims basis customer score, hospital score, agent score, vintage of policy, etcetera, and in case of any red flags, a physical inspection is triggered
- During our walkthrough at the claims assessment unit of STARHEAL, we came across cases where doctors meticulously approve pre-authorisation requests to eliminate claims from customers who try to defraud by colluding with the hospital
- Hospitals that are involved in over-billing or other malpractices are warned for minor to moderate irregularities on the pretext of signing an undertaking for future and blacklisted for serious fraud
- Management highlighted that Q3FY23 saw a 1.7x YoY rise in savings on the back of lower fraud-related claims; we believe a disciplined approach could structurally improve loss ratios, offering comfort on long-term profitability
- Increasingly, STARHEAL is nudging customers to visit network hospitals, which are less prone to fraud and consequently pose a lower risk of deductibles on claims

Exhibit 2: Auto-adjudication volumes at STARHEAL



Source: Company, HSIE Research

Relaxation in EoM guidelines to increase competitive intensity mildly

- Removal of commission caps within the overall expense of management (EoM) limit is expected to increase the competitive intensity to an extent; however, a majority of the multi-line players and SAHI players (aside from five general insurers) have an EoM that exceeds the permitted limits of 30% and 35%, respectively, leaving little room for higher commissions
- Management reaffirmed its commitment towards profitable growth, by calibrating commissions on old and new business. The company currently offers a 35% commission for new business, and 13-14% on the back book, thereby driving blended commissions at ~17%
- With most players already operating at the top end of the permissible EoM limit, we anticipate a mild upward risk to the commission pay-out pool

Threat from “Composite License” overdone

- Health insurance is a capital-intensive business and offers thin margins, whereby even a minor deviation in underwriting margins can derail earnings
- With a substantial back book, dominant market share, and a high proportion of commissions within the overall expenses, we believe STARHEAL is in a uniquely advantageous position to dial down commissions on an old book in order to counter competition.
- Given the manually-intensive nature of operations, continuous claims monitoring and negotiations with hospitals, and the need for high medical expertise to balance growth and profitability through proper underwriting and claims management, we believe this remains a business with high operational entry barriers

Price hike in flagship family floater to cause a moderate impact on sales

- The company expects a 2-3% impact on FHO renewals on policy count due to a sharp jump in pricing (+25% on renewals). A similar price hike undertaken in the FHO plan during FY19 impacted NOPs by ~4%
- Our comparative analysis in Exhibit 3 shows that the pricing in Star Health FHO is on the higher side vis-à-vis peers; however, we expect healthy persistency in > 2 years policy vintage bucket. Given a favourable base and a massive price hike in the flagship product, we expect a positive surprise to our NEP growth estimate (+20% YoY) and loss ratios at 65% for FY24E

Exhibit 3: Family floater pricing comparison

Company	Product name	Policy features	Premium per month (INR)
Star	Star Comprehensive	Single pvt ac room, 10l NCB, restoration once, no co-pay	2,058
	Family Health Optima	Single pvt ac room, 2.5l NCB, restoration 3times a year, no co-pay (only 10% over 60yrs)	2,548
	Star Health Assure	Single pvt ac room, 2.5l NCB, unlimited restoration	2,451
	Young Star Gold	Single pvt ac room, 2l NCB, restoration once	1,710
Care	Care Supreme	No RRL, 5l NCB, Unlimited restoration	1,693
	Care Classic	Single pvt ac room, 2.5l NCB, Unlimited restoration	1,942
	Care	Single pvt ac room, 1l NCB, restoration once	1,863
ABHI	Activ Fit Plus	No RRL, 6l NCB, Unlimited restoration	1,603
Niva	Health ReAssure	No RRL, 5l NCB, Unlimited restoration	2,052
	Reassure 2.0	No RRL, 10l NCB, Unlimited restoration	2,198
	Health Pulse enhanced	Single pvt ac room, 1l NCB, restoration once	1,626
BAGIC	Health Guard Family Floater-Gold	No RRL, 1l NCB, restoration once	2,105
	Health Health - Platinum	No RRL, 5l NCB, restoration once	2,351
TATA	Medicare Premier	No RRL, 5l NCB, restoration once	2,612
	Medicare	No RRL, 5l NCB, restoration once	2,232
Digit	Super Care Option	No RRL, 0.5l NCB, restoration once	1,476
Royal Sundaram	Lifeline Supreme	No RRL, 2l NCB, restoration once	1,728
SBIG	Arogya Supreme	Single pvt ac room, 1.5l NCB, restoration once	2,769
NIA	Floater Mediclaim	RRL 10k, 2.5L NCB, restoration once	1,508
OIC	Happy Family Floater Diamond	RRL 16k, ZNCB, no restoration	1,951

Source: Policybazaar.com | Note: Policy rates for families with parents with age 35 yrs and 33 yrs, and 2 children with ages 2 and 1 | Sum-assured of 1mn

Competitors offer cashless settlements across hospitals

- Historically, cashless claim settlement has been limited to network hospitals; however, ICICIGI in its industry-first move has come out with a unique offering providing cashless treatments across the network and non-network hospitals subject to acceptability at the hospital level.
- While this is the right move towards enhancing customer experience, we believe non-network hospitals will be reluctant to go cashless, given no pre-set agreement with the hospital and claims settlement subject to deductibles.
- We believe it will take some time before this offering can enhance the customer experience materially. Additionally, we believe that this is easily replicable and commoditised.

Financials

Consolidated Income Statement

(INR mn)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
Net earned premiums	27,396	35,795	46,841	46,266	98,092	115,195	138,271	168,492
Growth (%)	43.3%	30.7%	30.9%	-1.2%	112.0%	17.4%	20.0%	21.9%
Claims incurred	16,920	22,976	30,874	43,695	85,400	74,876	90,014	109,857
Commission (net)	1,366	2,638	3,404	5,858	14,922	16,722	20,401	24,654
Operating expenses	8,740	9,971	11,274	14,813	19,270	22,854	25,465	30,805
Underwriting profit/(loss)	370	211	1,289	(18,099)	(21,501)	742	2,391	3,176
Investment Income	1,479	1,954	2,935	4,237	7,928	9,620	11,183	12,890
Provisions (Other than taxation)	-	88	(92)	344	18	19	20	21
Operating profit	1,850	2,077	4,316	(14,205)	(13,591)	10,343	13,553	16,045
Operating profit margin (%)	6.8	5.8	9.2	(30.7)	(13.9)	9.0	9.8	9.5
Interest expense	137	256	256	256	457	667	667	667
Other income	-	1	2	3	81	83	84	86
PBT	1,712	1,822	4,062	(14,458)	(13,966)	9,759	12,971	15,464
Tax	10	540	1,429	(3,601)	(3,560)	2,459	3,269	3,897
PAT	1,702	1,282	2,633	(10,857)	(10,407)	7,299	9,702	11,567
PAT Growth (%)	44.3%	-24.6%	105.3%	-512.3%	-4.1%	NM	32.9%	19.2%
AEPS	3.7	2.8	5.4	(19.8)	(18.1)	12.7	16.9	20.1
EPS Growth (%)	44.3%	-24.6%	90.7%	-469.1%	-8.7%	NM	32.9%	19.2%

Source: Company, HSIE Research

Consolidated Balance Sheet

(INR mn)	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
SOURCES OF FUNDS								
Share Capital	4,556	4,556	4,906	5,481	5,755	5,755	5,755	5,755
Reserves	5,040	4,226	14,132	29,513	39,529	47,585	57,287	68,854
Share application money pending allotment	-	3,500	-	3	757	-	-	-
Total Shareholders Funds	9,596	12,282	19,038	34,996	46,041	53,340	63,042	74,609
Fair Value Change Account	-	-	31	(76)	267	267	267	267
Long-term Debt								
Short-term Debt	2,500	2,500	2,500	2,500	7,200	5,200	5,200	5,200
Total Debt	2,500	2,500	2,500	2,500	7,200	5,200	5,200	5,200
Net Deferred Tax Liability	-	(1,420)	(70)	(4,213)	(7,768)	(5,826)	(4,369)	(2,359)
TOTAL SOURCES OF FUNDS	12,096	13,362	21,437	33,359	45,206	52,447	63,606	77,183
APPLICATION OF FUNDS								
Net Block	970	981	1,019	990	1,171	1,237	1,364	1,548
Investments	21,647	30,301	42,838	68,519	113,200	129,337	149,081	175,890
Total Non-current Assets								
Cash & Equivalents	5,020	8,930	6,114	18,790	5,635	4,608	11,338	16,849
Advances and Other assets	5,835	7,093	9,827	12,650	6,828	9,637	11,335	13,410
Debit balance in PL account								
Total Current Assets	10,855	16,023	15,942	31,440	12,464	14,244	22,673	30,259
Current Liabilities	5,375	9,003	12,164	15,643	19,607	21,832	25,913	31,308
Provisions	16,001	24,939	26,197	51,946	62,022	70,539	83,599	99,206
Total Current Liabilities	21,376	33,943	38,361	67,589	81,629	92,371	109,512	130,514
Net Current Assets	(10,521)	(17,920)	(22,419)	(36,149)	(69,165)	(78,127)	(86,839)	(100,255)
TOTAL APPLICATION OF FUNDS	12,096	13,362	21,437	33,359	45,206	52,447	63,606	77,183

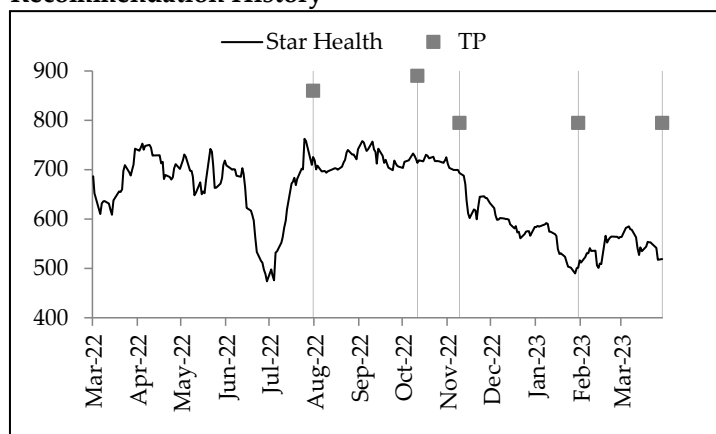
Source: Company, HSIE Research

Key ratios

	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E	FY25E
PROFITABILITY (%)								
Claims ratio	61.8	64.2	65.9	94.4	87.1	65.0	65.1	65.2
Commission ratio	4.3	6.4	6.5	8.2	13.8	13.5	13.5	13.4
Expenses ratio	27.0	23.7	21.0	19.5	17.0	17.2	16.8	16.7
Combined ratio	93.0	94.3	93.4	122.1	117.9	95.7	95.4	95.3
Underwriting profit	1.4	0.6	2.8	(39.1)	(21.9)	0.6	1.7	1.9
Investment yield	8.2	7.5	8.1	7.4	9.1	7.9	8.0	7.9
Investment Income /NEP	5.4	5.5	6.3	9.2	8.1	8.4	8.1	7.7
EBIT	6.8	5.8	9.2	(30.7)	(13.9)	9.0	9.8	9.5
PAT	6.2	3.6	5.6	(23.5)	(10.6)	6.3	7.0	6.9
ROE	19.5	11.7	16.8	(40.2)	(25.7)	14.7	16.7	16.8
EFFICIENCY								
Tax Rate (%)	0.6	29.6	35.2	24.9	25.5	25.2	25.2	25.2
Asset Turnover (x)	2.7	2.7	2.6	1.6	2.2	2.1	2.2	2.3
Claims os/NEP (x)	0.07	0.10	0.11	0.19	0.10	0.11	0.11	0.11
Investment leverage (x)	2.1	2.4	2.3	2.1	2.2	2.4	2.4	2.4
Debt/EBIT (x)	1.3	1.1	0.5	(0.2)	(0.6)	0.4	0.4	-
Net D/E	(0.3)	(0.7)	(0.2)	(0.5)	0.0	0.0	(0.1)	-
PER SHARE DATA								
AEPS (INR/sh)	3.7	2.8	5.4	(19.8)	(18.1)	12.7	16.9	20.1
DPS (INR/sh)	-	-	-	-	-	-	-	-
BV (INR/sh)	21.1	27.0	38.8	63.9	80.0	91.6	108.2	128.1
VALUATION								
P/E	138.8	184.2	96.6	NM	NM	40.9	30.8	25.8
P/BV	24.6	19.2	13.4	8.1	6.5	5.7	4.8	4.0

Source: Company, HSIE Research

Recommendation History



Date	CMP	Reco	Target
2-Aug-22	743	BUY	860
13-Oct-22	720	BUY	890
11-Nov-22	699	BUY	795
1-Feb-23	500	BUY	795
3-Apr-23	519	BUY	795

Rating Criteria

- BUY: >+15% return potential
- ADD: +5% to +15% return potential
- REDUCE: -10% to +5% return potential
- SELL: >10% Downside return potential

Disclosure:

We, **Sahej Mittal, ACA & Krishnan ASV, PGDM** authors and the names subscribed to this report, hereby certify that all of the views expressed in this research report accurately reflect our views about the subject issuer(s) or securities. SEBI conducted the inspection and based on their observations have issued advise/warning. The said observations have been complied with. We also certify that no part of our compensation was, is, or will be directly or indirectly related to the specific recommendation(s) or view(s) in this report.

Research Analyst or his/her relative or HDFC Securities Ltd. does have/ does not have any financial interest in the subject company. Also Research Analyst or his relative or HDFC Securities Ltd. or its Associate may have beneficial ownership of 1% or more in the subject company at the end of the month immediately preceding the date of publication of the Research Report. Further Research Analyst or his relative or HDFC Securities Ltd. or its associate does have/does not have any material conflict of interest.

Any holding- NO

HDFC Securities Limited (HSL) is a SEBI Registered Research Analyst having registration no. INH000002475.

Disclaimer:

This report has been prepared by HDFC Securities Ltd and is solely for information of the recipient only. The report must not be used as a singular basis of any investment decision. The views herein are of a general nature and do not consider the risk appetite or the particular circumstances of an individual investor; readers are requested to take professional advice before investing. Nothing in this document should be construed as investment advice. Each recipient of this document should make such investigations as they deem necessary to arrive at an independent evaluation of an investment in securities of the companies referred to in this document (including merits and risks) and should consult their own advisors to determine merits and risks of such investment. The information and opinions contained herein have been compiled or arrived at, based upon information obtained in good faith from sources believed to be reliable. Such information has not been independently verified and no guaranty, representation of warranty, express or implied, is made as to its accuracy, completeness or correctness. All such information and opinions are subject to change without notice. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete. HSL is not obliged to update this report for such changes. HSL has the right to make changes and modifications at any time.

This report is not directed to, or intended for display, downloading, printing, reproducing or for distribution to or use by, any person or entity who is a citizen or resident or located in any locality, state, country or other jurisdiction where such distribution, publication, reproduction, availability or use would be contrary to law or regulation or what would subject HSL or its affiliates to any registration or licensing requirement within such jurisdiction.

If this report is inadvertently sent or has reached any person in such country, especially, United States of America, the same should be ignored and brought to the attention of the sender. This document may not be reproduced, distributed or published in whole or in part, directly or indirectly, for any purposes or in any manner.

Foreign currencies denominated securities, wherever mentioned, are subject to exchange rate fluctuations, which could have an adverse effect on their value or price, or the income derived from them. In addition, investors in securities such as ADRs, the values of which are influenced by foreign currencies effectively assume currency risk. It should not be considered to be taken as an offer to sell or a solicitation to buy any security.

This document is not, and should not, be construed as an offer or solicitation of an offer, to buy or sell any securities or other financial instruments. This report should not be construed as an invitation or solicitation to do business with HSL. HSL may from time to time solicit from, or perform broking, or other services for, any company mentioned in this mail and/or its attachments.

HSL and its affiliated company(ies), their directors and employees may; (a) from time to time, have a long or short position in, and buy or sell the securities of the company(ies) mentioned herein or (b) be engaged in any other transaction involving such securities and earn brokerage or other compensation or act as a market maker in the financial instruments of the company(ies) discussed herein or act as an advisor or lender/borrower to such company(ies) or may have any other potential conflict of interests with respect to any recommendation and other related information and opinions.

HSL, its directors, analysts or employees do not take any responsibility, financial or otherwise, of the losses or the damages sustained due to the investments made or any action taken on basis of this report, including but not restricted to, fluctuation in the prices of shares and bonds, changes in the currency rates, diminution in the NAVs, reduction in the dividend or income, etc.

HSL and other group companies, its directors, associates, employees may have various positions in any of the stocks, securities and financial instruments dealt in the report, or may make sell or purchase or other deals in these securities from time to time or may deal in other securities of the companies / organizations described in this report.

HSL or its associates might have managed or co-managed public offering of securities for the subject company or might have been mandated by the subject company for any other assignment in the past twelve months.

HSL or its associates might have received any compensation from the companies mentioned in the report during the period preceding twelve months from the date of this report for services in respect of managing or co-managing public offerings, corporate finance, investment banking or merchant banking, brokerage services or other advisory service in a merger or specific transaction in the normal course of business.

HSL or its analysts did not receive any compensation or other benefits from the companies mentioned in the report or third party in connection with preparation of the research report. Accordingly, neither HSL nor Research Analysts have any material conflict of interest at the time of publication of this report. Compensation of our Research Analysts is not based on any specific merchant banking, investment banking or brokerage service transactions. HSL may have issued other reports that are inconsistent with and reach different conclusion from the information presented in this report.

Research entity has not been engaged in market making activity for the subject company. Research analyst has not served as an officer, director or employee of the subject company. We have not received any compensation/benefits from the subject company or third party in connection with the Research Report.

HDFC securities Limited, I Think Techno Campus, Building - B, "Alpha", Office Floor 8, Near Kanjurmarg Station, Opp. Crompton Greaves, Kanjurmarg (East), Mumbai 400 042 Phone: (022) 3075 3400 Fax: (022) 2496 5066

Compliance Officer: Murli V Karkera Email: complianceofficer@hdfcsec.com Phone: (022) 3045 3600

HDFC Securities Limited, SEBI Reg. No.: NSE, BSE, MSEI, MCX: INZ000186937; AMFI Reg. No.: 13549; PFRDA Reg. No. POP: 11092018; IRDA Corporate Agent License No.: CA0062; SEBI Research Analyst Reg. No.: INH000002475; SEBI Investment Adviser Reg. No.: INA000011538; CIN - U67120MH2000PLC152193

Mutual Funds Investments are subject to market risk. Please read the offer and scheme related documents carefully before investing.

HDFC securities**Institutional Equities**

Unit No. 1602, 16th Floor, Tower A, Peninsula Business Park,

Senapati Bapat Marg, Lower Parel, Mumbai - 400 013

Board: +91-22-6171-7330 www.hdfcsec.com