

CMP: ₹697

Target: ₹ 850(22%)

Target Period: 12 months

BUY

November 11, 2022

Retail health remains in focus; growth to drive valuation

About the stock: Star Health is the largest standalone insurer engaged in health insurance segment with relatively superior market share, operating performance.

- Star Health is a market leader in the retail health insurance segment with ~33% market share, as of September 2022
- Star Health has 815 branches and 14000+ network hospitals, with a presence in 25 states and five union territories

Q2FY23 Results: Modest growth; market share improved; claims trending down.

- GWP up 10.7% YoY to ₹ 3193 crore, NWP up 11.3% & NEP up 15.6% YoY
- Incurred claims decline 7.9% YoY to ₹ 1906 crore. Claims ratio down from 76% to 62.7%
- Combined ratio witnessed improvement, underwriting loss at ₹ 13.1 crore
- Net profit was at ₹ 93.1 crore vs. a loss of ₹ 170.5 crore YoY

What should investors do? Star Health is expected to maintain its leadership in retail health segment with sustainable long term growth opportunity. Anticipated growth of 20-25% in retail health segment coupled with a gradual improvement in claim ratio to further improve combined ratio and support RoE.

- We maintain **BUY** rating on the stock

Target Price and Valuation: We value Star Health at ~2.8x FY24E GDPI (58x FY24E EPS) to arrive at a revised target price of ₹ 850 from ₹ 860 earlier.

Key triggers for future price performance:

- Market leadership to be maintained in under-penetrated segment with long term growth opportunity
- With de-growth in group segment largely done, expect ~10-12% volume based and 8-10% value based growth to aid premium growth at 20-22%
- Improving footprints in rural India, increase in bancassurance tie-up along with strengthening of own agency channel to propel business momentum
- Lower group business and moderation in monsoon related reported claims to keep claim ratio at 62-65%

Alternate Stock Idea: Apart from Star Health, we like HDFC Life Insurance.

- It is among the most dominant players in the Indian life insurance industry
- BUY with a target price of ₹ 635



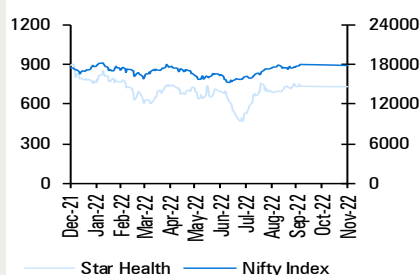
Particulars

Particulars	Amount
Market Capitalisation	₹ 40347 crore
52 week H/L	940/469
Net Worth	₹ 4876 crore
Face Value	₹ 10

Shareholding Pattern

(in %)	Dec-21	Mar-22	Jun-22	Sep-22
Promoter	58.9	58.9	58.8	58.6
FII	9.9	9.8	9.6	10.3
DII	27.4	27.3	27.2	1.5
Others	3.75	4.02	4.34	29.58

Price performance



Key Highlights

- Claims ratio down to 62.7% from 76% in Q1FY23
- Key risk:** i) Slower volume growth amid price hike ii) Higher than guided claim ratio

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Key Financial Summary

	FY20	FY21	FY22	3 year CAGR (FY19-FY22)	FY23E	FY24E	2 year CAGR (FY22-FY24E)
Gross written premium (GWP)	6890.7	9388.5	11739.6	29.4	13865.2	16906.2	20.0
Net Incurred Claims	3087.4	4369.5	8727.5	56.0	8150.4	9881.3	6.4
Underwriting Profit/Loss	168.4	(1331.8)	(2127.2)	NA	300.1	553.8	NA
Profit after Tax	272.0	(825.6)	(1203.6)	NA	514.4	848.3	NA
NWP/Net Worth (x)	3.2	1.7	1.8		1.6	1.5	
Price/Float (x)	1.0	0.6	0.4		0.3	0.2	
P/GWP (x)	0.6	0.5	0.4		0.3	0.3	
P/E (x)	150.7	(49.6)	(34.1)		80.1	48.6	

Source: Company, ICICI Direct Research

Key takeaways of recent quarter & conference call highlights

Q2FY23 Results: Modest business growth; market share improves

- Star Health reported modest numbers on the business growth front as gross written premium (GWP) was up 10.7% YoY (up 29.6% QoQ due to seasonality) to ₹3193 crore
- Growth from the retail health segment was higher than overall GDP growth at 21.1% YoY (H1FY23). This segment formed 93.6% of total GDP premium. Continued focus on retail health segment led to 190 bps YoY improvement in market share (H1FY23) to 32.9%. However, slower growth in non-retail segment led to decline of 86 bps in overall market share to 12.7% (according to provisional data from General Insurance Council)
- Net written premium (NWP) was up 11.3% YoY while earned premium growth was higher at 15.6% YoY to ₹ 2795 crore, indicating higher flow from previously written policies
- Incurred claims declined 7.9% to ₹ 1906 crore. Thus, the claims ratio for the quarter came in at 62.7% vs. 76% in the previous quarter and 75.8% YoY. Net commission expense were up 10.2% YoY while other operating expenses witnessed a marginal increase of 0.4% YoY; as a result, management expense ratio declined from 30.9% in Q2FY22 to 29% in Q2FY23. Combined ratio witnessed an improvement. Underwriting loss came in at ₹ 13.1 crore
- Total float was up 36% YoY to ₹ 11700 crore. Star Health posted a net profit of ₹ 43.9 crore vs. a loss of ₹ 170.5 crore YoY

Q2FY23 Earnings Conference Call highlights

- Introduced a new product - Star Extra Protect. Expect yield accretion from new product launches to accrue ahead
- With de-growth in the group segment largely done, premium growth is seen at 20-22%
- Retail renewal remains healthy at 94%. Top up policies bought last year (owing to heightened fear) have not been renewed by some customers
- Focus continued on SME clients in group segment, though selective business approach has led to slower growth in H1FY23
- Retail business saw 8-10% value based and remaining 10-12% volume based. Normally H2 is heavier in terms of volumes. In Star Medi-classic product, the company has taken a 25% price hike. It contributed 7-8% to total retail premium
- Added 36000 agents in H1FY23. Agency channel contributed 82% of overall business. Further, aims to add 80000 agents in FY23E. Opened new branches (including five branches in J&K) and witnessing healthy premium accretion in new geographies
- Continue to focus on digital business. Appointed Chief Digital Officer. App download 1.7 million, 83% of distributors using digital resources
- Average rise in sum insured increased ~14%. Cashless claims are 66% of total claims
- Average claim size remains one of the lowest among peers. Claim size continues to decline sequentially. Expect claim ratio to decline further by 1% ahead
- Reported claims related to monsoon relatively lower in September and October 2022. Not witnessing higher claims in early days of Q3FY23. Thus, loss ratio guidance maintained at 62-65% for FY23E. Further, lower group business should also enable better claim ratio. Guidance for combined ratio is at 93-95% in FY23E
- Repaid ₹ 200 crore of borrowing. Despite this payment, solvency continued to remain robust. Tenure of subordinate debt is seven years with call option at five years. Thus, subordinate debt will continue to stay on balance sheet
- Higher reserve release is higher led by de-growth in group business
- Median age of insured remains steady at 41 years
- Reinsurance arrangement on travel and critical insurance products. Reinsurance largely with GIC Re
- Modified duration in investment book at 4.2 years

Peer comparison

Exhibit 3: Peer Comparison

Sector / Company	CMP		Rating	M Cap	EPS (₹)				P/E (x)				P/EV (x)				RoE (%)			
	(₹)	TP(₹)		(₹ bn)	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E	FY21	FY22	FY23E	FY24E
SBI Life Insurance	1243	1500	Buy	1244	14.6	15.1	16.3	20.0	85.4	82.6	76.1	62.0	3.7	3.1	2.8	2.4	15.2	8.5	10.9	13.0
HDFC Life	542	635	Buy	1165	6.7	5.7	6.8	8.2	80.5	94.8	79.2	66.2	4.1	3.8	3.0	2.5	17.6	18.0	18.1	18.2
Star Health	697	850	Buy	403	-14.1	-20.5	8.7	14.4	-49.5	-34.0	79.9	48.4	11.7	9.5	5.9	4.0	-23.6	-27.8	7.3	8.3
ICICI Lombard	1131	1300	Hold	555	23.4	-20.1	18.8	16.9	48.4	-56.3	60.3	66.8	6.9	6.1	5.3	4.7	21.3	14.5	14.5	14.6

Source: Company, ICICI Direct Research

Exhibit 4: Variance Analysis

Policyholder's Account	Q2FY23	Q2FY23E	Q2FY22	YoY%	Q1FY23	QoQ%	
Gross Premium Written	3192.9	4403.5	2884.7	10.7	2463.7	29.6	Largely driven by 21.1% YoY uptick in retail health
(-) Reinsurance ceded	154.0	(264.2)	155.4	(0.9)	119.6	28.8	
Net written premium (NWP)	3038.9	4139.2	2729.3	11.3	2344.1	29.6	
Net earned premium (NEP)	2794.8	3156.1	2416.7	15.6	2687.1	4.0	
(-) Net Incurred Claims	1906.0	1856.2	2069.6	(7.9)	1781.1	7.0	Claim ratio steady at 62.7%
(-) Net Commission Expense	396.4	310.9	359.7	10.2	322.0	23.1	Commission ratio at 12.4%
(-) Operating expenses related to insurance business	505.4	415.2	503.4	0.4	427.2	18.3	
(-) Total expense	2807.9	2582.4	2932.6	(4.3)	2530.3	11.0	
Underwriting Profit/Loss	(13.1)	45.5	(515.9)	(97.5)	156.8	(108.3)	Combined ratio declines at 91.8%
Investment Income	123.3	150.0	181.3	(32.0)	82.1	50.2	
Operating Profit/Loss	110.2	195.5	(334.6)	(132.9)	278.8	(60.5)	
Transfer to Shareholder's Account	110.2	195.5	(334.6)	(132.9)	278.8	(60.5)	

Shareholder's Account	Q2FY23	Q2FY23E	Q2FY22	YoY%	Q1FY23	QoQ%	
Operating Profit/Loss	110.2	195.5	(334.6)	(132.9)	278.8	(60.5)	
Investment Income	83.7	60.0	104.4	(19.8)	82.1	2.0	Investment income remained flattish QoQ
Other Income	0.9	0.0	6.9	(87.0)	1.76	(49.4)	
(-) Expense and Provision	74.1	80.0	9.0	727.2	74.7	(0.8)	
Profit before tax	120.6	175.5	(232.3)	(151.9)	287.9	(58.1)	
(-) Provision for Taxation	27.6	33.8	(61.9)	(144.5)	74.7	(63.1)	
Profit after Tax	93.1	141.7	(170.5)	(154.6)	213.2	(56.3)	Net profit as lower claims drive performance

Source: Company, ICICI Direct Research

Exhibit 5: Change in estimates

	FY23E			FY24E		
	Old	New	% change	Old	New	% change
Gross written premium (GWP)	14356.8	13865.2	-3.4%	17664.0	16906.2	-4.3%
Net earned premium (NEP)	12298.4	12092.7	-1.7%	14735.9	14639.0	-0.7%
Net Incurred Claims	8239.9	8150.4	-1.1%	9946.7	9881.3	-0.7%
Underwriting Profit/Loss	326.1	300.1	-8.0%	395.9	553.8	39.9%
Operating Profit/Loss	848.5	820.9	-3.3%	1019.0	1237.3	21.4%
Profit after Tax	705.4	514.4	-27.1%	832.2	848.3	1.9%

Source: Company, ICICI Direct Research

Exhibit 6: Assumption

	Current		Earlier	
	FY23E	FY24E	FY23E	FY24E
NWP growth (%)	16.9	21.9	21.0	23.0
NEP growth (%)	21.9	21.1	24.0	19.8
Claims ratio (%)	67.4	67.5	67.0	67.5
Commission ratio (%)	13.0	12.5	12.7	12.5
Expenses ratio (%)	16.5	15.7	16.1	15.2
Combined ratio (%)	96.9	95.7	95.8	95.2
Underwriting Profit (%)	0.9	1.9	1.5	1.3
EBIT/NEP (%)	7.4	9.0	7.9	7.8

Source: Company, ICICI Direct Research

Financial summary

Exhibit 44: Policy holder's Account					
₹ crore					
Policyholder's Account	FY20	FY21	FY22	FY23E	FY24E
Gross written premium (GWP)	6890.7	9388.5	11739.6	13865.2	16906.2
(-) Reinsurance ceded	1629.3	2204.2	704.4	970.6	1183.4
Net written premium (NWP)	5261.4	7144.8	11035.2	12894.7	15722.8
Net earned premium (NEP)	4693.0	5022.8	9917.7	12092.7	14639.0
(-) Net Incurred Claims	3087.4	4369.5	8727.5	8150.4	9881.3
(-) Net Commission Expense	340.9	583.8	1467.7	1676.3	1965.4
(-) Operating expense	1102.0	1401.4	1849.6	1965.8	2238.5
(-) Other expense	(5.8)	0.0	0.0	0.0	0.0
(-) Total expense	4524.5	6354.6	12044.8	11792.6	14085.2
Underwriting Profit/Loss	168.4	(1331.8)	(2127.2)	300.1	553.8
Investment Income	192.4	260.6	420.6	520.8	683.4
Operating Profit/Loss	360.8	(1071.2)	(1706.6)	820.9	1237.3
Transfer to Shareholder's Account	360.8	(1071.2)	(1706.6)	820.9	1237.3

Source: Company, ICICI Direct Research

Exhibit 46: Balance sheet					
₹ crore					
Balance Sheet	FY20	FY21	FY22E	FY23E	FY24E
Source of Funds					
Share Capital	490.6	548.1	572.9	575.9	575.9
Reserves and Surplus	1157.1	3675.8	5674.5	7653.5	9648.0
Net Worth	1647.7	4223.9	6247.4	8229.4	10223.9
Fair value gains	3.1	(7.6)	0.7	17.0	38.5
Borrowings	250.0	250.0	720.0	520.0	570.0
Deferred Tax Liability	0.0	0.0	0.0	0.0	0.0
Total	1900.8	4466.6	6968.0	8766.4	10832.3
Application of Funds					
Shareholder Investments	1478.2	2632.1	3664.6	4653.9	6183.2
Policyholder Investments	2811.7	4204.6	6805.8	8643.0	11483.1
Total Investments	4290.0	6836.7	10470.4	13297.0	17666.4
Deferred Tax Assets	146.7	421.3	826.1	653.1	367.8
Fixed Assets	101.9	99.0	125.1	182.6	265.4
Cash and Bank balance	611.4	1879.0	1090.9	1330.2	1610.3
Other current assets	976.7	1265.0	682.7	885.6	1051.8
Total Current Assets	1588.2	3144.0	1773.6	2215.8	2662.1
Current Liabilities	1179.4	1564.3	1839.1	1704.5	2034.5
Provision	3050.6	5194.6	6312.2	7114.2	8198.0
Total Current Liabilities	4230.0	6758.9	8151.3	8818.7	10232.4
Net Current Assets	(2641.8)	(3614.9)	(6377.7)	(6602.9)	(7570.3)
Total	1900.8	4466.6	6968.0	8766.4	10832.3

Source: Company, ICICI Direct Research

Exhibit 45: Shareholder's Account					
₹ crore					
Shareholder's Account	FY20	FY21	FY22E	FY23E	FY24E
Operating Profit (from Policyholder's)	360.8	(1071.2)	(1706.6)	820.9	1237.3
Investment Income	101.1	163.1	226.5	280.4	368.0
Other Income	0.0	0.3	0.3	0.4	0.4
(-) Expense and Provision	48.6	138.2	128.7	414.3	472.1
Profit before tax	413.4	(1046.0)	(1608.4)	687.4	1133.6
Provision for Taxation	(141.4)	220.4	404.8	(173.0)	(285.3)
Profit after Tax	272.0	(825.6)	(1203.6)	514.4	848.3

Source: Company, ICICI Direct Research

Exhibit 47: Key Ratios					
Key Ratios	FY20	FY21	FY22E	FY23E	FY24E
Incurd Claims ratio (%)	65.8	87.0	88.0	67.4	67.5
Commission Ratio (%)	6.5	8.2	13.3	13.0	12.5
Expense Ratio (%)	21.4	20.7	17.3	16.5	15.7
Combined ratio (%)	93.7	115.9	118.6	96.9	95.7
Investment yield (%)	8.1	7.4	9.6	8.0	8.2
Investment Income / NEP (%)	6.5	7.8	6.4	6.5	7.1
PAT margin (%)	5.8	(16.4)	(12.1)	4.3	5.8
RoE (%)	16.5	(23.6)	(27.8)	7.3	8.3
ROCE (%)	14.3	(22.0)	(23.9)	6.8	7.9
NWP/Net Worth (x)	3.2	1.7	1.8	1.6	1.5
Debt/EBIT (x)	0.6	(0.2)	(0.5)	0.6	0.4
Debt/Equity (x)	0.15	0.06	0.12	0.06	0.06
ABV (₹)	28.1	59.6	73.7	118.9	172.2
Valuation					
Price/Float (x)	1.0	0.6	0.4	0.3	0.2
P/GWP (x)	0.6	0.5	0.4	0.3	0.3
P/E (x)	150.7	(49.6)	(34.1)	80.1	48.6
P/ABV (x)	24.8	11.7	9.5	5.9	4.1

Source: Company, ICICI Direct Research

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Buy: >15%

Hold: -5% to 15%;

Reduce: -15% to -5%;

Sell: <-15%



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