INITIATING COVERAGE

Star Health and Allied Insurance: Bellwether health insurer with inimitable moats

Star Health and Allied Insurance

Bellwether health insurer with inimitable moats

Capitalising on an early-mover advantage and significant regulatory arbitrage, STARHEAL is positioned as the largest standalone health insurer (FY22:33% market-share), anchored on an extremely strong and highly productive agency-dominated distribution network and retail-dominated business mix (FY22: ~90% of GDPI). Despite potential regulatory convergence, we believe that STARHEAL has meaningful headroom to pivot to a high-quality franchise, translating into better quality of earnings. Having aced the agency channel, we argue that the company now needs to build a credible banca strategy in order to sustain its lead in the long term. We expect STARHEAL to deliver revenue/APAT CAGRs of 32%/38% over FY20-FY24E and healthy RoEs in the range of 10%/16% in FY23E/24E. We initiate with a BUY and a DCF derived target price of INR 860 (53x FY24E AEPS and 10x FY24E P/ABV).

- **Unrivalled distribution network:** On the back of an unrivalled granular agency network (33% market-share, +20pps over FY14-FY22), STARHEAL is slated to grow retail GDPI at 21% CAGR over FY22-32E. Best-in-class agent productivity underlines seasoned agency channel (agent vintage >2yrs). With seasoning of the new agents, blended productivity would further inch up, driving retail GDPI growth and market share gains.
- **High stickiness a virtuous cycle:** Granularity and personal connect have been the two key pillars for high stickiness and renewal rates (FY22: ~95%). We believe that substantial back-book accretion is the key driver to retaining and growing high vintage, high-productivity agents. However, we also highlight the need for STARHEAL to fix its claims rejection ratio in order to improve its customer experience, a long-term catalyst for stickiness.
- **Multiple levers to improve CORs:** Having operated in a tight "loss ratios" band (pre-COVID), STARHEAL's elevated loss ratios (FY22: 87%) are expected to gradually improve with normalising environment to 65.6-66.5% over FY23E-24E. Non-linearity in staff costs is expected to improve opex ratio by 131bps (% of NWP); this, coupled with dialling down of agency commissions in line with long-term growth trends, is expected to improve CORs to 94.1% by FY32E.
- **Key risks**: (1) Disproportionate dependence on agency channel, (2) continued poor claims experience, (3) slower-than-expected growth impacting loss ratios, and (4) rising competitive intensity on indemnity products.
- **Valuation:** We initiate with a BUY rating on the stock and a target price of INR 860, assigning a DCF derived 53x FY24E EPS (10x Mar-24E P/ABV) on account of its formidable and entrenched distribution network with high customer stickiness and a predictable secular growth outlook. Our target PE multiple implies a 65% premium to ICICIGI on the back of STARHEAL's inimitable distribution network, 90% retail mix offering secular growth, and strong moats derived from its vintage and scale.

Financial summary

(INR bn)	FY20	FY21	FY22	FY23E	FY24E
Net earned premium (NEP)	46.8	46.3	98.1	117.3	144.3
Underwriting profits	1.3	(18.1)	(21.5)	(2.4)	1.1
EBIT	4.3	(14.2)	(13.6)	7.5	13.3
EBIT margin (%)	9.2	(30.7)	(13.9)	6.4	9.2
PAT	2.6	(10.9)	(10.4)	5.2	9.5
P/B (x)	19.1	11.6	9.3	8.2	6.8
P/E (x)	138.4	(37.5)	(41.1)	82.9	45.0
RoE (%)	16.8	(40.2)	(25.7)	10.4	16.3

Source: Company, HSIE Research

BUY

CMP *(as on 29 Jul 2022)*	INR 747
Target Price	INR 860
NIFTY	17,158

KEY CHANGES	OLD	NEW
Rating	-	BUY
Price Target	-	INR 860
EPS %	FY23E	FY24E
	NIL	NIL

KEY STOCK DATA	
Bloomberg code	STARHEAL IN
No. of Shares (mn)	576
MCap (INR bn) / ($ mn)	430/5,779
6m avg traded value (INR mn)	368
52 Week high / low	INR 940/469

STOCK PERFORMANCE (%)	3M	6M	12M
Absolute (%)	5.0	(6.3)	-
Relative (%)	4.1	(7.0)	-

SHAREHOLDING PATTERN (%)	Mar-22	Jun-22
Promoters	58.9	58.8
FIs & Local MFs	0.1	0.1
FPIs	9.8	9.6
Public & Others	31.2	31.4
Pledged Shares	0.0	0.0

Source : BSE

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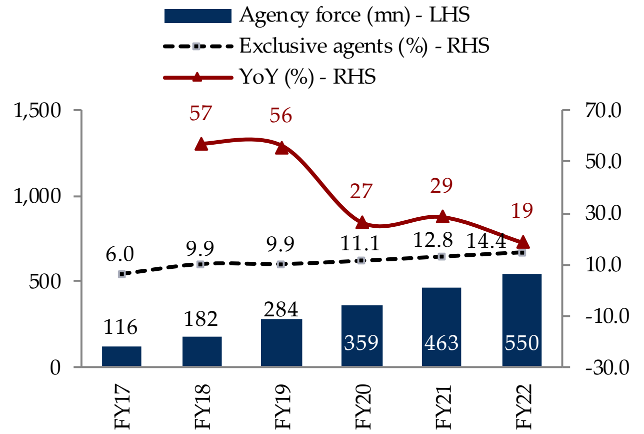
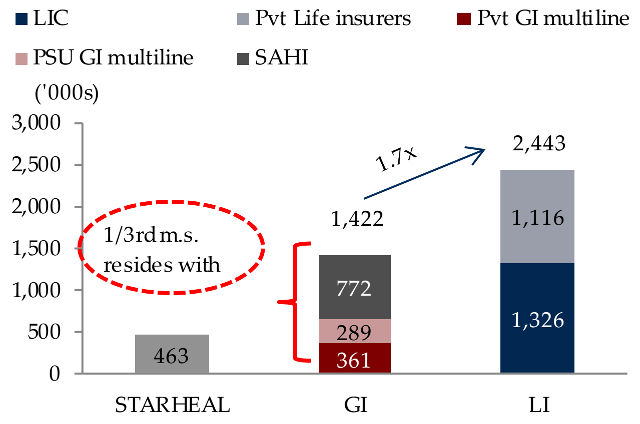
Focus Charts

Exhibit 1 : Laser focussed to expand agency network



Source: Company, HSIE Research

Exhibit 2: Under-penetrated despite a large agency base



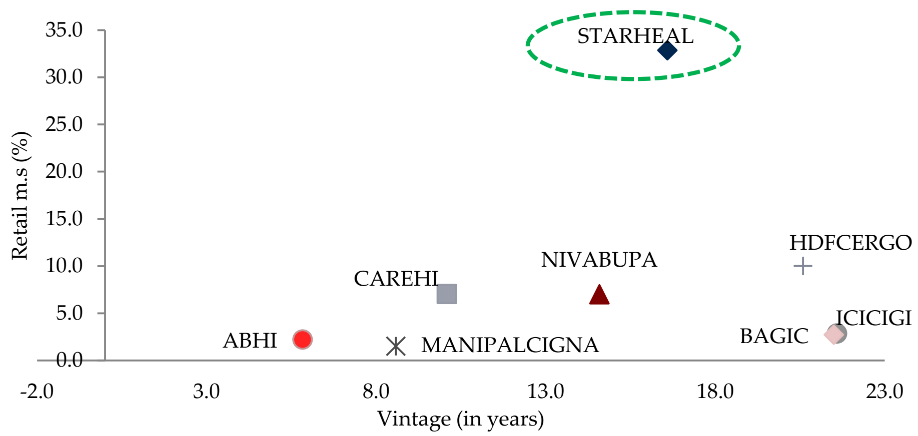
Source: GICouncil, HSIE Research | Note: Data as on 31-Mar-21

Exhibit 3: Retail GDPI market-share- Massive gains for STARHEAL

(%)	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY14-22 (bps)
HDFCERGO	4.2	4.7	4.5	4.5	5.1	3.1	3.1	10.5	10.0	586
BAGIC	3.5	3.4	3.5	3.3	3.2	3.7	3.6	3.4	2.7	-76
ICICIGI	7.8	8.0	7.3	7.2	7.1	5.5	2.9	2.8	2.9	-490
NIA	20.0	18.4	16.5	14.4	13.4	12.7	11.3	9.6	8.7	-1,128
NIC	14.3	14.3	13.0	11.6	10.1	9.4	8.7	8.1	7.3	-707
OIC	10.9	9.8	9.6	9.8	8.4	7.6	6.8	6.3	5.6	-526
STARHEAL	**12.7**	**14.8**	**17.3**	**19.7**	**23.6**	**26.7**	**29.2**	**31.8**	**32.9**	2,020
NIVABUPA	3.3	3.9	4.2	4.2	4.1	4.2	4.4	5.3	7.0	370
CAREHI	0.9	1.7	2.7	3.4	4.0	5.0	5.7	6.3	7.1	617

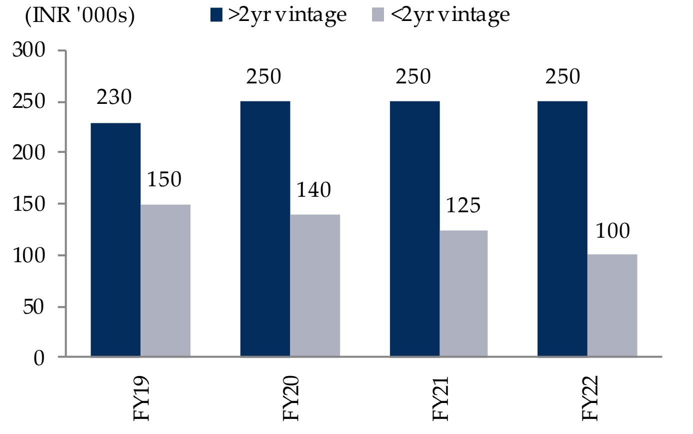
Source: IRDAI, HSIE Research

Exhibit 4: Vintage vs. Market-share: STARHEAL's remains best placed



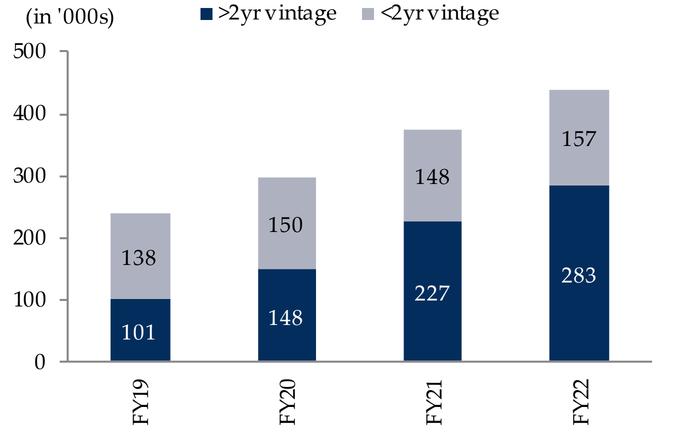
Source: IRDAI, Company, HSIE Research | Note: Retail Health market-share (m.s.) as of FY22

Exhibit 5: Active agent productivity: New agents are less productive



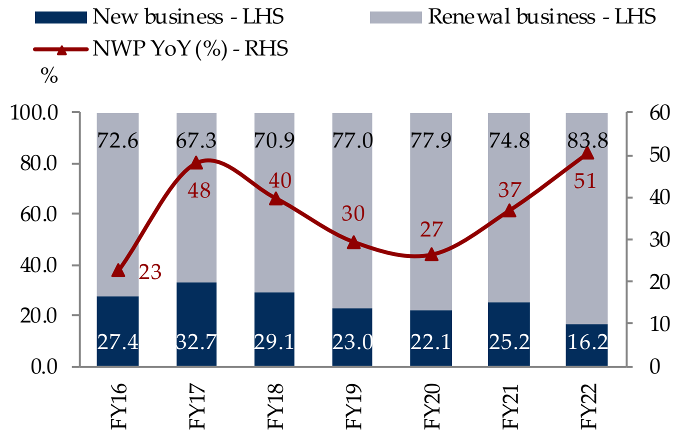
Source: HSIE Research | Note: Estimated

Exhibit 6: Active agents split: Increasing share of high vintage agents



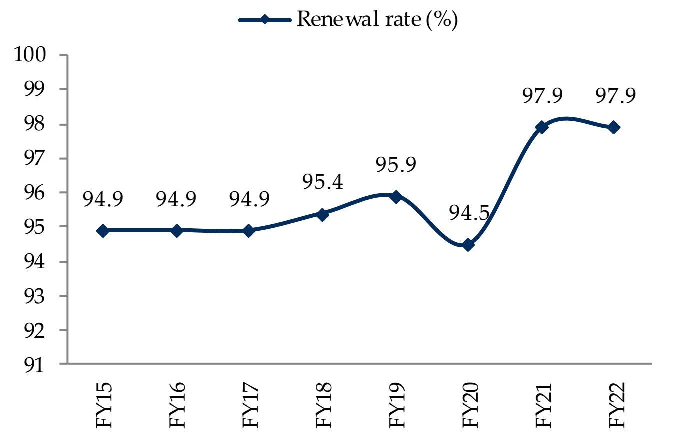
Source: HSIE Research | Note: Estimated

Exhibit 7 : Strong premium growth with ~80% renewal book



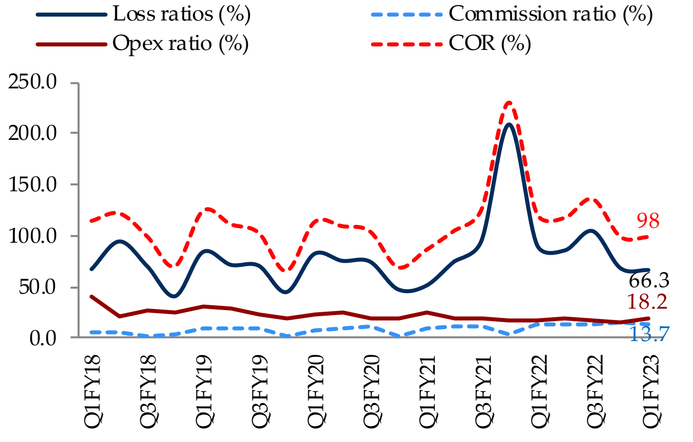
Source: HSIE Research | Note: Estimated

Exhibit 8: Renewal rates inched up during the pandemic



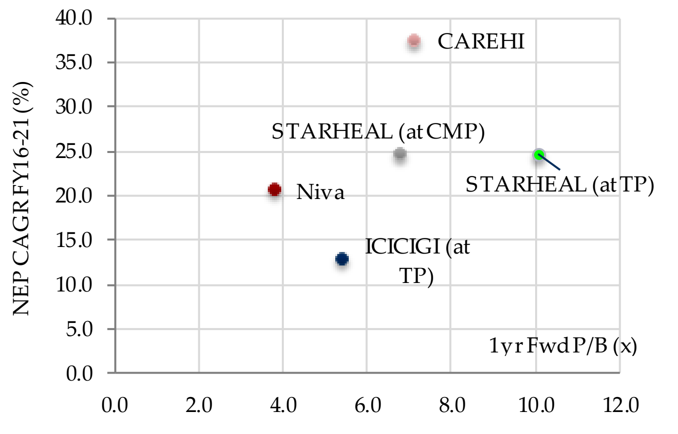
Source: HSIE Research | Note: Estimated

Exhibit 9 : Quarterly trends indicate improvement in loss ratios as claims subside



Source: Company, HSIE Research

Exhibit 10: Valuations attractive for STARHEAL



Source: Company, media reports, HSIE Research | Note: Valuation of NivaBupa and Care Health is as of last disclosed transaction (~Mar-20)

Exhibit 11: Health Insurance Franchise Scorecard (HSIE-HIFS)

	SAHI			Pvt multiline GI					PSU
Particulars	**STARHEAL**	**Care HI**	**Niva**	**ABHI**	**ICICIGI**	**BAGIC**	**HDFCERGO**	**SBI GI**	**NIA**
Pillar I - Quality of business underwritten									
Retail mix in health ^									
Retail health m.s. (FY22)									
Δ in retail health m.s. (FY14-22)									
Pillar II - Profitability of business									
Loss ratios ^									
Commission ratios ^									
Opex ratios ^									
Health CoRs ^									
Investment yield (FY17-21)									
Investment leverage (FY17-21)									
Solvency (FY17-21)									
RoEs ^								NA	
Pillar III - Distribution strength & quality									
Number of agents $									
Agent productivity (FY21)									
Agent m.s. $									
Branch network $									
Agents per branch									
Branch productivity									
Branch m.s. $									
Hospital tie-ups									
Claims settlement ratio									
Pillar IV: Customer stickiness									
Claims rejection ratio									

Source: IRDAI, GI Council, Web-aggregator, respective companies, HSIE Research
Note: A fuller bar represents a strong franchise and a empty bar represents a weak franchise. m.s. stands for market share, ^ is average FY19-21, $ is as on Dec-21, Investment leverage and investment yield on overall basis for multiline players, RoEs for health insurance segment and calculated using ASM in denominator

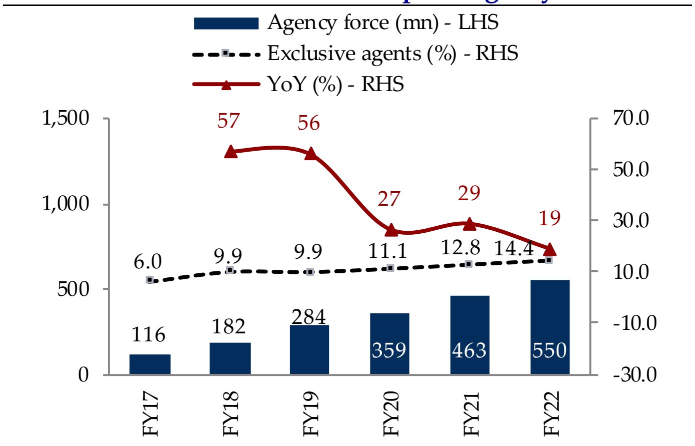
Contents

Investment Thesis

'Moat'worthy distribution network

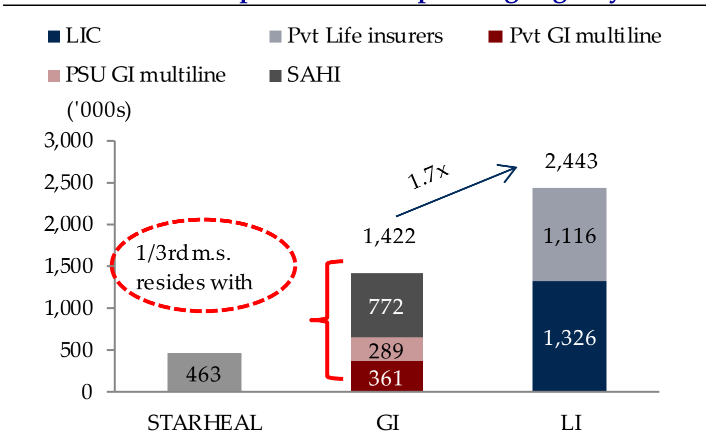
- Star Health Insurance has built an enviable agency network with market share at 34% in Dec-21 (~3x the size of second largest player), resulting in a strong footprint beyond the metropolitan cities and an extremely high policy renewal rate. Due to inherent complexities in choosing the right product and the right insurer, health insurance remains an agency-driven product. Against this backdrop, we expect STARHEAL's unparalleled leadership in agency network to result in further market share gains in the medium term from PSUs players.

Exhibit 12 : Laser focussed to expand agency network



Source: Company, HSIE Research

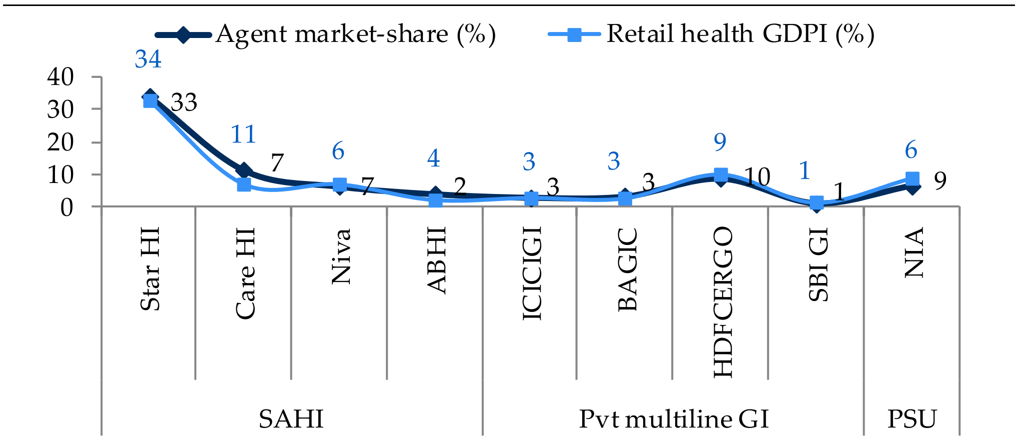
Exhibit 13: Under-penetrated despite large agency base



Source: GICouncil, HSIE Research | Note: Data as on 31-Mar-21

- **Significant regulatory arbitrage:** STARHEAL enjoys significant regulatory arbitrage on the back of IRDAI's relaxation allowing the SAHI players to appoint a life insurance agent without undergoing IC-38 examination and training. A large portion of STARHEAL's agents are LIC agents; 13% of the overall agency base are STARHEAL exclusive agents (i.e., 87% agents are LIC agents).
- Retail health GDPI market share has been largely synonymous with the agency market share, and even with current LIC agent's penetration in general insurance, SAHI players still have a large headroom to grow agency network.

Exhibit 14: Retail health GDPI market share synonymous with agency market share



Source: GICouncil, HSIE Research

Exhibit 15: Retail GDPI market share: massive gains for STARHEAL

(%)	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY14-22 (bps)
HDFCERGO	4.2	4.7	4.5	4.5	5.1	3.1	3.1	10.5	10.0	586
BAGIC	3.5	3.4	3.5	3.3	3.2	3.7	3.6	3.4	2.7	-76
ICICIGI	7.8	8.0	7.3	7.2	7.1	5.5	2.9	2.8	2.9	-490
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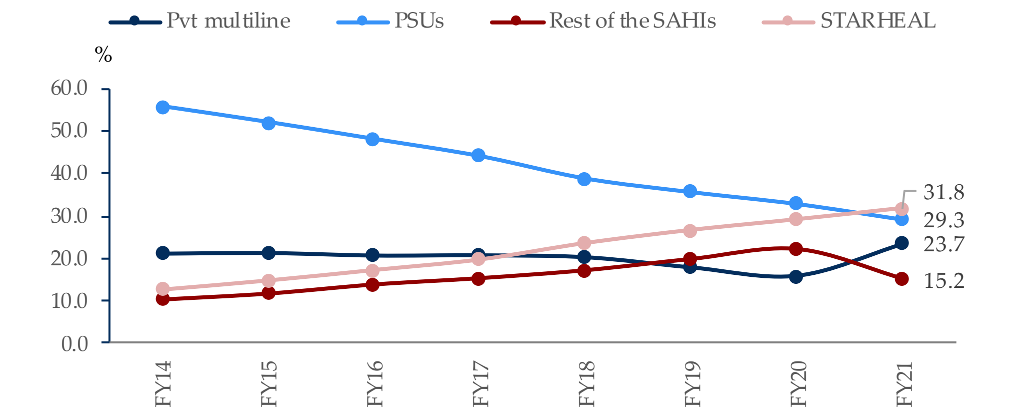
NIVABUPA	3.3	3.9	4.2	4.2	4.1	4.2	4.4	5.3	7.0	370
CAREHI	0.9	1.7	2.7	3.4	4.0	5.0	5.7	6.3	7.1	617

Source: GICouncil, HSIE Research

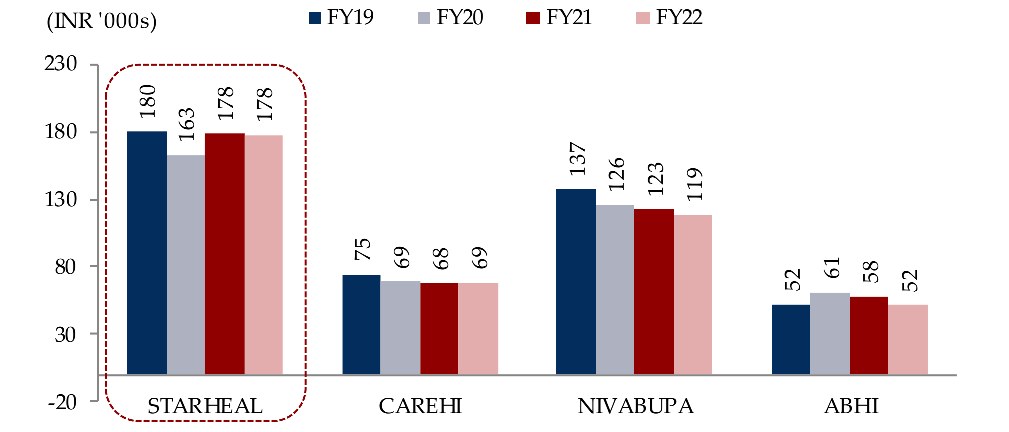
Exhibit 16: Retail GDPI market share: STARHEAL vs. peers



Source: GICouncil, HSIE Research

- STARHEAL's agent productivity at INR 178k is ~50% higher than the next best SAHI player (NIVABUPA at INR119k) as a result of strong focus on training sessions and educating agents on various products and underwriting principles.

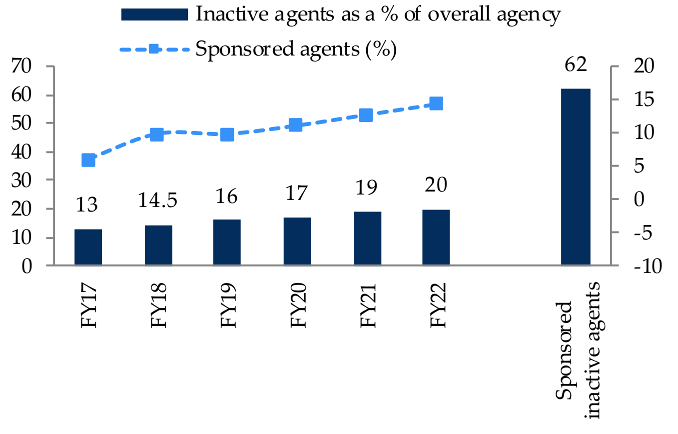
Exhibit 17: Agent productivity: Best in class agent across SAHIs



Source: Respective companies, HSIE Research

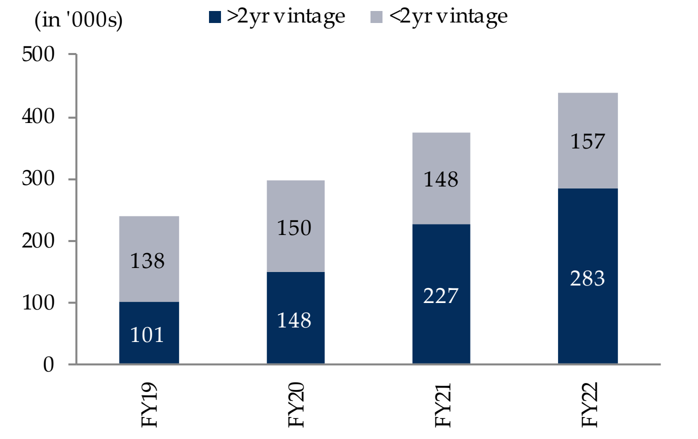
- Since GDPI growth is a function of agency base and productivity per agent, the premium per agent from these newly-onboarded LIC-originated agents becomes key. Our analysis suggests that despite STARHEAL mastering the science of growing the agency network, ~20% of the agency base is currently inactive. Exhibit 21 clearly demonstrates that productivity of agents in ">2years of vintage" cohort is far superior to less experienced agents. **As the agent base seasons out, we expect** the blended productivity per active agent to improve and contribute further to GDPI growth.

Exhibit 18 : Sponsored network has the maximum number of inactive agents



Source: HSIE Research | Note: Estimated, Sponsored agents of STARHEAL

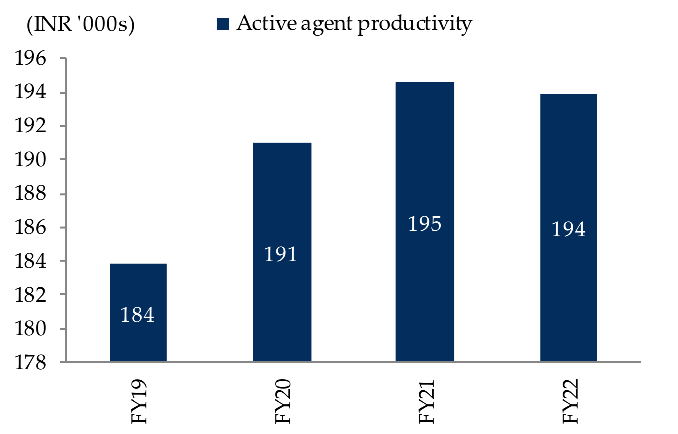
Exhibit 19: Active agents split: increasing share of high vintage agents



Source: HSIE Research | Note: Estimated

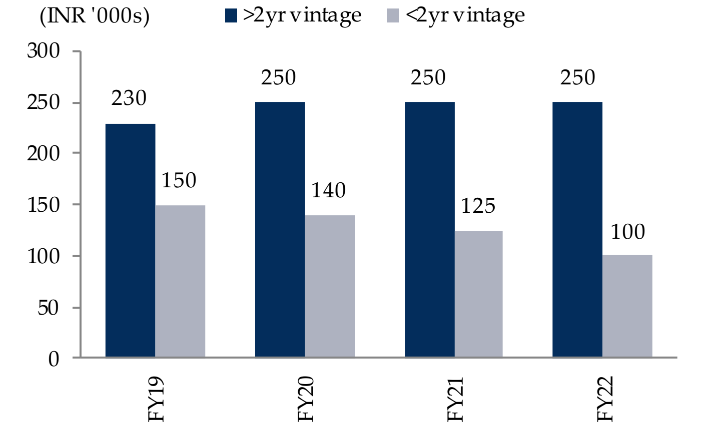
- Exhibit 19 shows that the share of high vintage-high productivity agents is inching up in the mix; however, the productivity of the newly-acquired agents is sliding down sharply, underscoring the company's blitz scale approach.

Exhibit 20 : Active agents productivity: high vintage agents support blended productivity



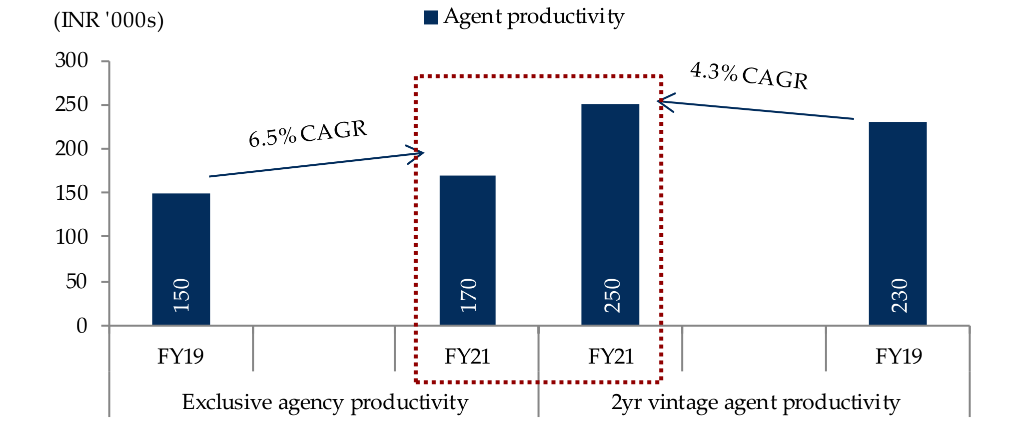
Source: HSIE Research | Note: Estimated

Exhibit 21: Active agent productivity: new agents are less productive



Source: HSIE Research | Note: Estimated

Exhibit 22: Agent productivity: massive scope for improvement

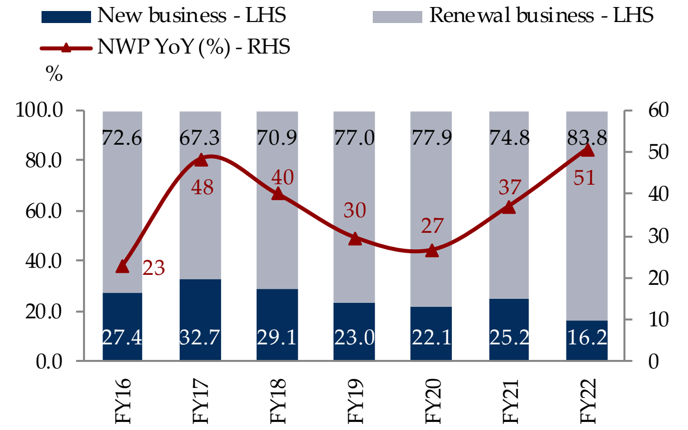


Source: Company, HSIE Research

Inherent stickiness and longevity to drive long-term growth

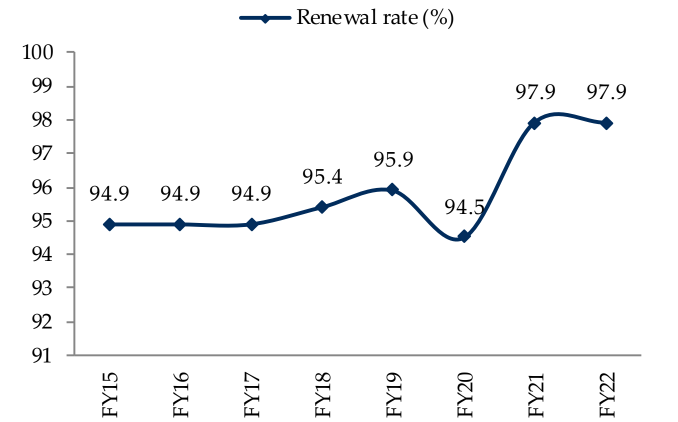
- STARHEAL derives ~80% of its GDPI from the agency channel, which is highly commission driven. Sourcing business from the agency channel means (1) the business is extremely granular and (2) agents maintain a personal connect with customers, resulting in higher persistency.
- Additionally, portability in retail health policies is rare (unlike motor insurance where customers switch for better pricing) unless the customer is dissatisfied or there are some operational issues such as inadequate hospital network in the required area, etc. ~80% of STARHEAL's NWP is originated from renewal business.

Exhibit 23 : Strong premium growth with ~80% renewal book



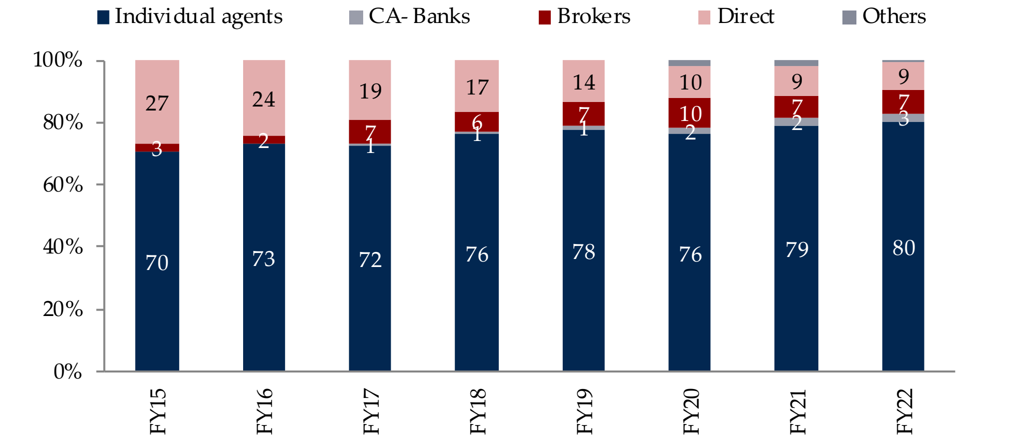
Source: HSIE Research | Note: Estimated

Exhibit 24: Renewal rates inched up during the pandemic



Source: HSIE Research | Note: Estimated

Exhibit 25: STARHEAL's channel mix continues to remain agency heavy

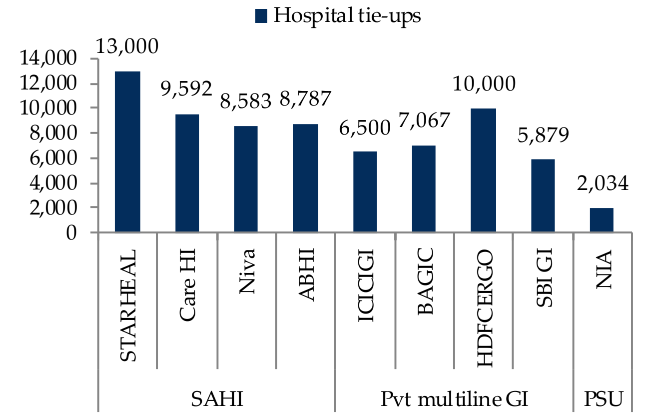


Source: Company, HSIE Research

- **Back-book accretion to drive stickiness:** STARHEAL has built a formidable agency channel at 500k agents as of 31 Mar 2022, and these agents demonstrate an extremely high stickiness due to back-book accretion, meaning that agents lose out the annuity commission income if they move to another SAHI player.

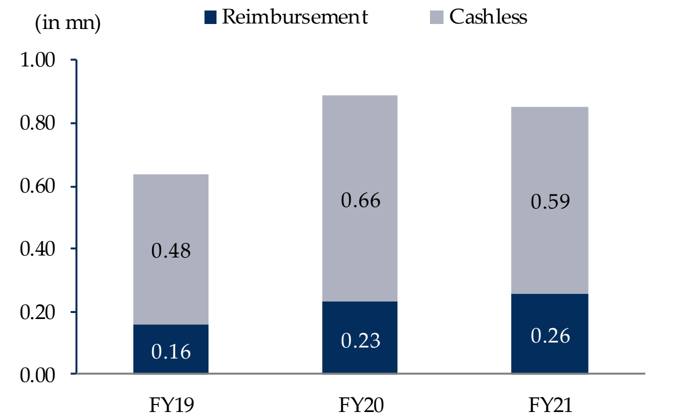
- **Large network of pre-agreed hospitals offer twin benefits:** A health insurer with a large hospital network means that a customer is offered a host of options in multiple geographies to obtain cashless treatment. This stimulates customer stickiness compared to a situation where customer has to claim reimbursement.
- Within the hospitals empanelled, STARHEAL has a higher share of agreed network hospitals (ANH) that offer a package at a pre-agreed pricing (STARHEAL's average claim size with ANH is 6% lower than non-agreed network hospital {NANH}). **STARHEAL currently has ~11k hospitals, of which 74% are under the pre-agreed network, aiding average claims per treatment.**
- Incrementally, STARHEAL has been focusing on adding quality-driven hospitals with a target mix of 90% ANH. Within network hospitals, currently ~55% of the claims are being serviced through the ANH network. The increasing share of ANH hospitals in the mix will drive higher claims servicing at ANH hospitals, improving the claims ratio.

Exhibit 26 : Higher hospital tie-ups mean increased access to cashless treatments



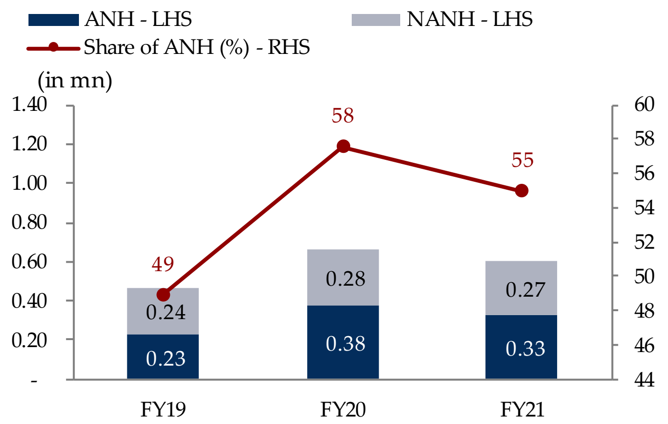
Source: Web-aggregator, HSIE Research

Exhibit 27: Claims split: Bulk claims are settled with network hospitals



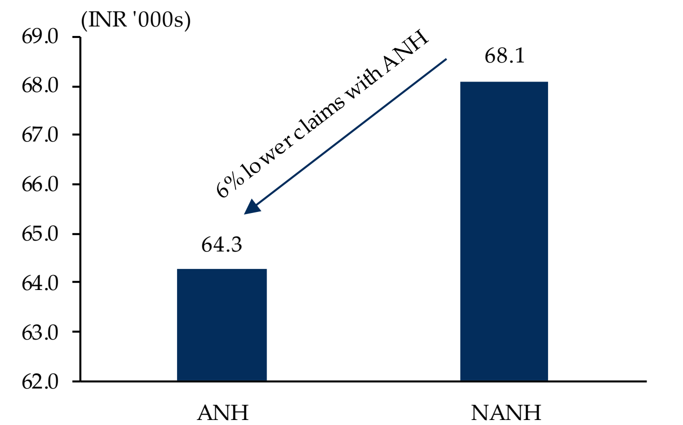
Source: Company, HSIE Research

Exhibit 28 : Cashless claims (ANH vs. NANH)



Source: Company, HSIE Research | Note: ANH stands for agreed network hospitals and NANH stands for non-agreed network hospitals

Exhibit 29: Claims size: ANH vs. NANH

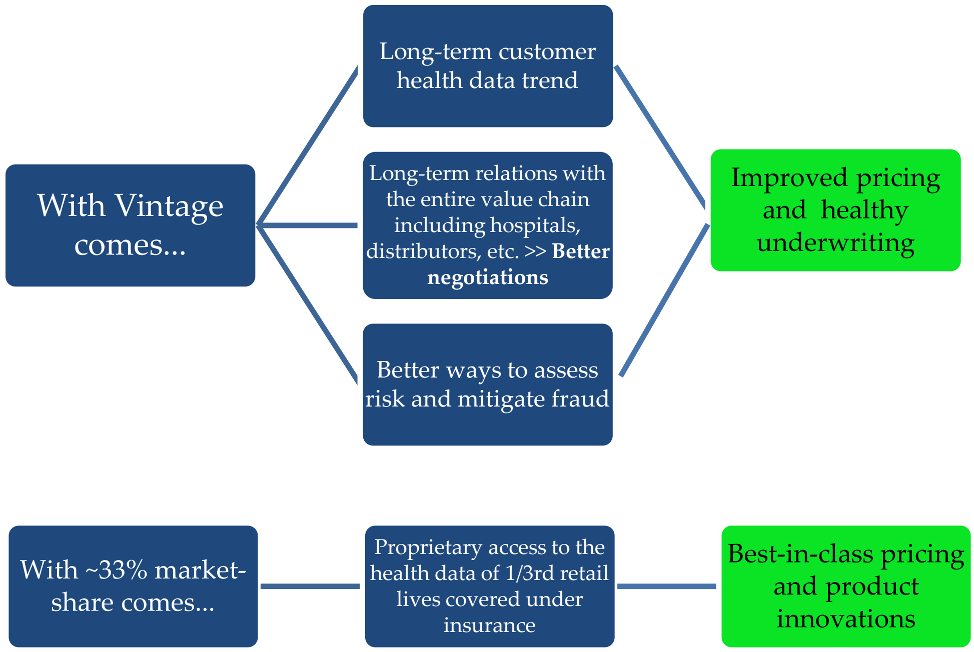


Source: Company, HSIE Research

Vintage and scale support best-in-class operating efficiencies

- Health insurance is an operationally rigorous business requiring relentless efforts right from product pricing, marketing through the right channels, assessing the risk while policy issuance, assessing the claims reported to segregate fraudulent claims, continuous negotiations with hospital network and working on agent's productivity through trainings and seminars.
- Against this backdrop, "vintage" and "market share" become powerful weapons for a successful and well-run general insurer.

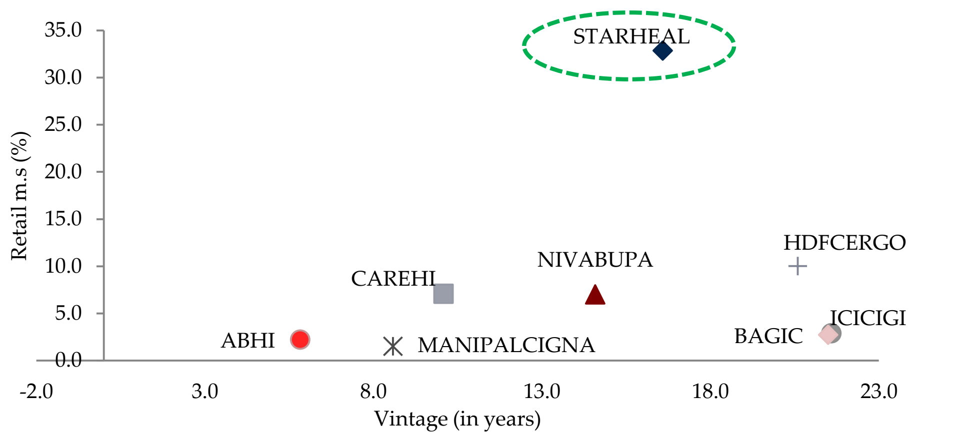
Benefits from vintage and market share for a health insurer



Source: HSIE Research

- STARHEAL is in a uniquely positioned with a one-third retail health market share and a long vintage of ~16 years. Given STARHEAL's market share is already 3x the next largest player and it has a massive agency base (~3x the next largest agency), we believe it enjoys heavy moats.

Exhibit 30: Vintage vs. market share: STARHEAL's remains best-placed



Source: Company, HSIE Research | Note: Retail Health market-share (m.s.) as of FY22

Consistent product innovation

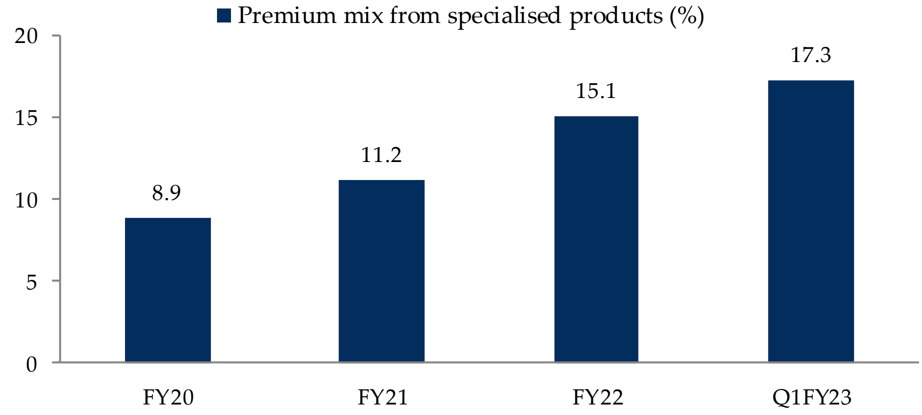
- STARHEAL has been a pioneer in launching industry-first specialised insurance policies aimed at covering specific diseases, age group, wellness benefits and outpatient department (OPD) policies. The advantages are two-fold: (1) **FIRST-MOVER ADVANTAGE** from launching specialised products offering cover for diseases not normally covered in a HI policy; (2) the policies have a low incidence rate and are loss ratio accretive.
- With IRDAI's move on allowing "Use and File" for all the health insurance products, we expect STARHEAL to have a pole position in speeding up its new product launches. During Q1FY23, STARHEAL has taken a 25% price hike in one of its flagship products (Health Optima forming 6% of GWP) effective 22nd'Jul-22.

List of specialised insurance policies

Sr. No.	Name of policy
1	Star Cancer Care policy
2	Star Senior Citizens Red Carpet Health Insurance Policy
3	Star Cardiac Care Policy
4	Young Star Policy
5	Star Diabetes Safe Policy
7	Women Care Policy

Source: Company, HSIE Research

Exhibit 31 : Increasing share of specialised products in the mix

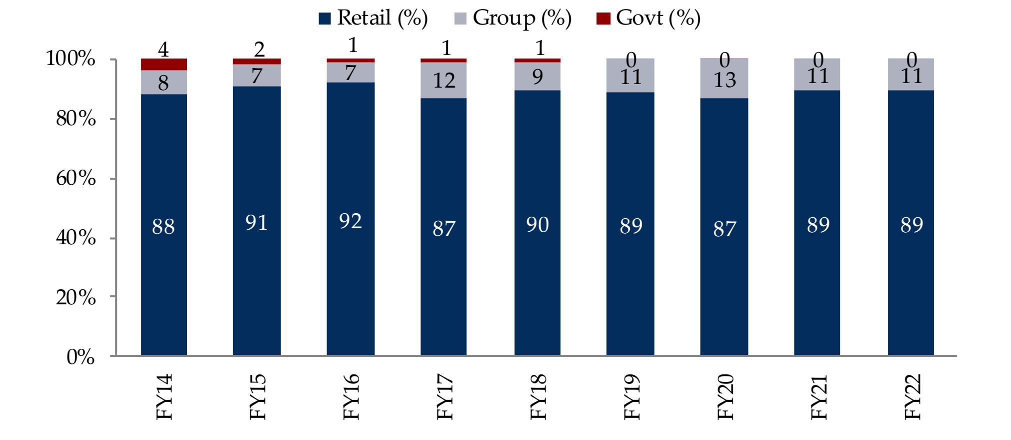


Source: Company, HSIE Research

COR improvement to drive underwriting profitability

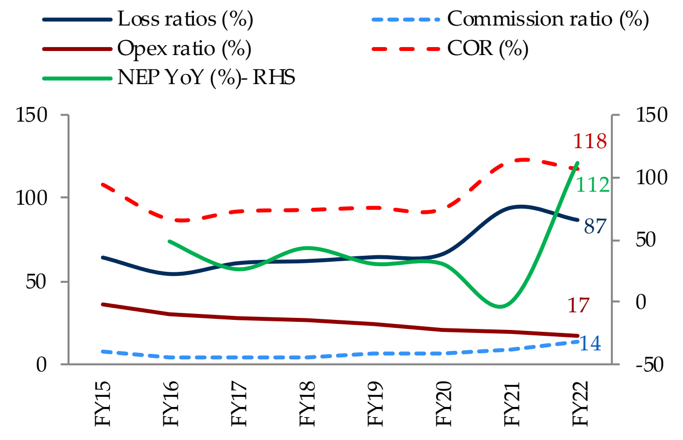
- STARHEAL has inherently focussed on growing its high-margin retail book on the one hand and prudent risk underwriting on the other, resulting in healthy loss ratios (54-66% over FY15-FY20).
- Controlled loss ratios in a tight band (pre-COVID) and operating leverage kicking in with improving scale have resulted in CORs at 94.7% (average FY15-20).

Exhibit 32: Retail portfolio dominates the book



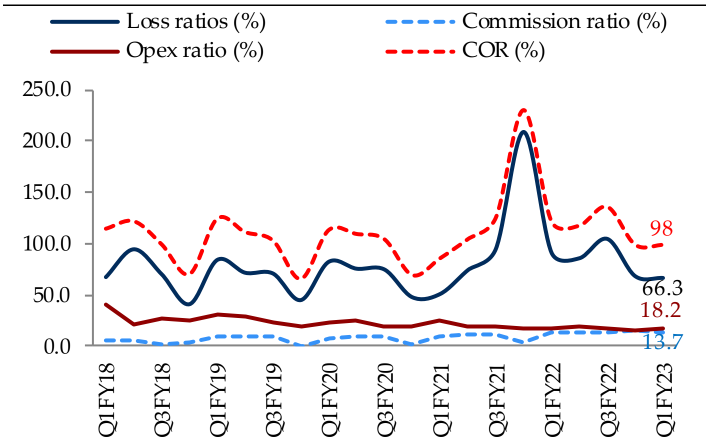
Source: Company, HSIE Research

Exhibit 33 : CORs saw a sharp spike due to COVID claims



Source: Company, HSIE Research

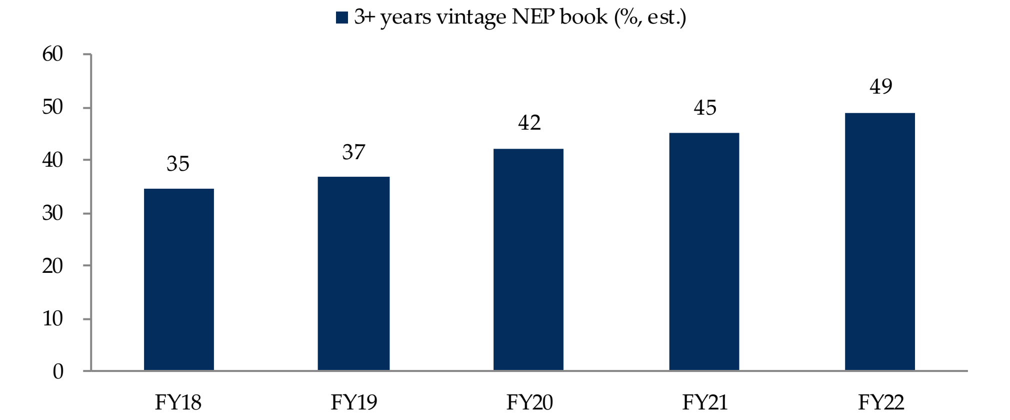
Exhibit 34: Quarterly trends indicate improvement in loss ratios as claims subside



Source: Company, HSIE Research

- Controlled loss ratios have been a function of high GWP growth, resulting in a healthy share of new book in the overall book. **Our calculations suggest that while ~50% of the book has seasoned out, ~50% still has a vintage of less than three years.**
- **One-offs during pandemic dented profitability:** Loss ratios shot up to 94%/87% during FY21/FY22 as a consequence of increase in COVID claims (STARHEAL wrote a large number of COVID only policies). Loss ratios during the past two quarters (Q4FY22/Q1FY23) indicate a reversion to pre-COVID levels. We expect loss ratios to improve further to 65.6-66.5% over FY23E-24E as the environment further normalises and the share of specialised products increases in the mix.

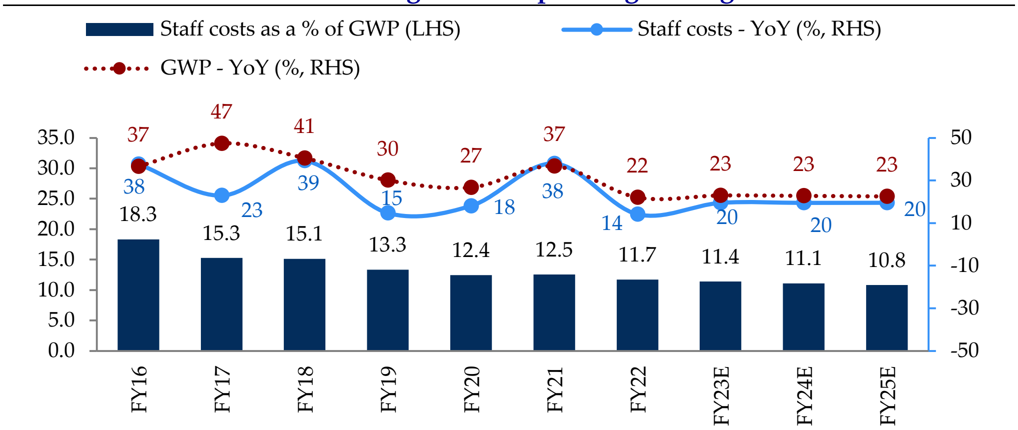
Exhibit 35: Increasing share of vintage book



Source: HSIE Research | Note: Estimated

- **Use and File regulation to cushion growth slowdown**: With IRDAI's new regulation extending Use and File to all health insurance products, we believe this will benefit the health insurers in multiple ways:
  - ✓ **Pricing pressure to ease:** Historically, health insurers have faced high friction at the time of getting approvals for (a) price revisions on any of the existing products and (b) new products. We are extremely positive with IRDAI's move and believe that the pricing pressure on health insurers is largely over and it will improve/cushion profitability.
  - ✓ **Product innovation:** Market leaders like STARHEAL who focus on product innovation will not have to wait 3-6 months to get an approval, facilitating increased focus on dynamic and innovative products such as cancer health insurance, OPD policies, etc.
- **Significant room to improve opex ratio:** Of the total operating expenses, staff costs as a percentage of GWP at 11.7% in FY22 constitute a major portion of the opex ratio and has improved by 659bps, from 18.3% in FY16. Since staff costs are non-linear in nature, we expect it to grow at a slower pace than the GWP growth, resulting in further operating leverage.
- In addition, staff costs in FY22 included one-time ESOP expenses to Mr. V. Jagannathan (CEO) in ESOP 2021 scheme to the tune of INR750mn, which further dented PBT margins; these expenses will end in Nov-22. We expect opex ratios (ex-commission) in the range of 16.2-15.7% in FY23E/24E, driving CORs to 96.6/95.2%.

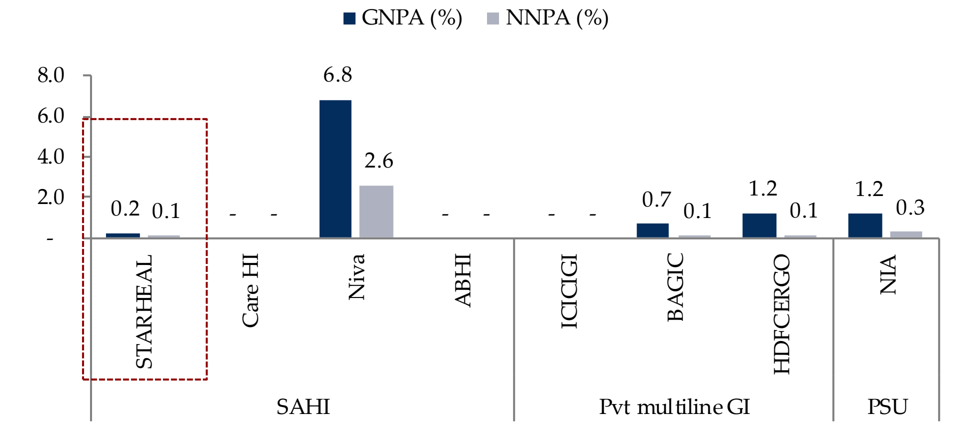
Exhibit 36: Staff costs to drive significant operating leverage



Source: Company, HSIE Research

- **Sales in agency channel are highly granular, which means that as the back-book accretion increases, STARHEAL will be in a uniquely advantageous position to exercise outcome-based commissions by dialling down commissions of agents writing an inferior quality book, thereby bringing dual benefits by improving claims ratio and/or moderating commission ratios.**
- Having emerged largely unscathed and incident-free from the corporate default episodes during FY18-20, STARHEAL has demonstrated a relatively pristine investment portfolio vs. peers; refer exhibit 37. <u>This becomes extremely important given high dependence of overall profitability on UW profitability.</u>

Exhibit 37: GNPA/NNPA: STARHEAL faring well on investment performance



Source: Respective companies, HSIE Research | Note: Data represents avg over FY18-22

RoEs across major players

Exhibit 38: Decrypting profitability in health segment across players

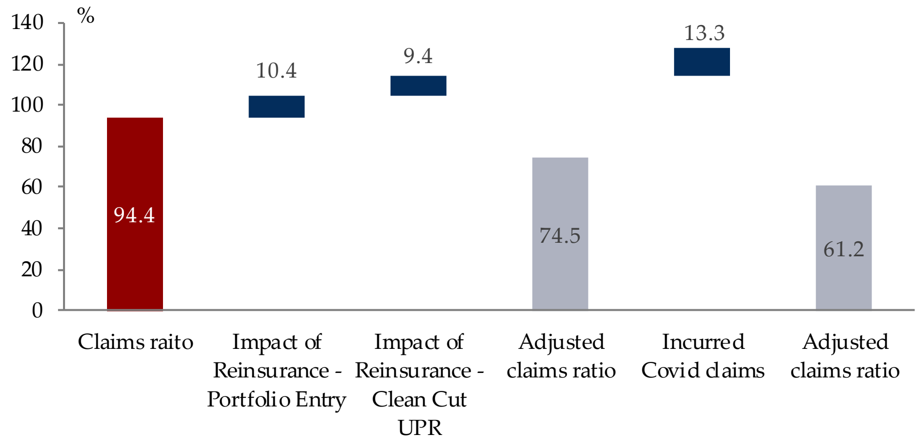
(%)	STARHEAL			CAREHI			NIVABUPA			ABHI			ICICIGI			BAGIC			HDFCERGO		NIA		
	FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY21	FY19	FY20	FY19	FY20	FY21
Claims (A)	64.5	66.1	95.4	58.8	62.3	58.9	54.3	55.6	58.6	62.1	53.8	54.8	85.0	80.5	89.0	89.5	85.6	81.7	80.0	94.6	99.5	99.7	95.0
Commission (B)	7.2	7.3	12.8	-3.8	-3.1	-0.3	4.3	4.6	5.0	15.3	7.5	4.6	-17.8	-12.0	1.2	4.5	2.7	5.0	-21.9	-19.6	6.8	6.7	6.4
Opex (C)	27.5	23.5	30.2	48.8	45.3	48.0	53.7	49.6	48.2	97.1	91.7	79.5	25.8	27.7	24.4	24.2	26.2	26.0	24.4	31.4	19.1	16.8	21.6
Total expenses	99.2	96.9	138.5	103.8	104.4	106.6	112.3	109.8	111.8	174.5	153.0	138.9	93.0	96.2	114.6	118.3	114.6	112.7	82.5	106.4	125.4	123.3	123.0
UW profits/(loss)	**0.8**	**3.1**	**-38.5**	**-3.8**	**-4.4**	**-6.6**	**-12.3**	**-9.8**	**-11.8**	**-74.5**	**-53.0**	**-38.9**	**7.0**	**3.8**	**-14.6**	**-18.3**	**-14.6**	**-12.7**	**17.5**	**-6.4**	**-25.4**	**-23.3**	**-23.0**
Investment income	5.3	7.0	9.1	8.4	7.6	9.4	7.4	7.8	7.7	10.0	11.3	14.3	19.0	20.4	19.7	4.6	4.9	3.5	8.7	19.2	12.3	12.6	9.9
PBT	**6.1**	**10.0**	**-29.3**	**4.6**	**3.2**	**2.8**	**-5.0**	**-2.0**	**-4.1**	**-64.5**	**-41.8**	**-24.6**	**26.0**	**24.1**	**5.1**	**-13.7**	**-9.7**	**-9.2**	**26.2**	**12.8**	**-13.1**	**-10.6**	**-13.1**
*Pre-tax RoE (%)	18	33	-57	15	10	6	-13	-6	-10	-197	-121	-68	72	55	9	-37	-22	-30	68	14	NA	-28	-22
Solvency (%)																							

Source: Respective company filings, HSIE Research | Note: *Used ASM as denominator for RoE calculation

Impact of exit from VQST and other adjustments

- STARHEAL has terminated its reinsurance agreement with General Insurance Corporation of India after IRDAI's circular IRDA/F&A/CIR/MISC/ 076/03/2020 dated 28th Mar'20 putting a ban on all the general insurance players (including specialist and health insurers) from entering into any fresh capital gearing treaty 28th Mar'20 onwards.
- Capital gearing treaties are in the nature of financial arrangements to shore up the solvency without passing on the risks.
- **Impact of VQST**: Negative impact of INR 483mn and INR437mn on profit and loss account in FY21 on account of portfolio entry and creation of reserves on account of exit from clean cut treaty. Simultaneously, reserves and surplus stand increased on account of increased reserves.
- **Change in UPR methodology:** The company has moved to 1/365 day method from 1 Apr-20 onwards from 50% method to better its align books of accounts with the nature of policies and also comparable with other players (ex-SAHI players). This has resulted in additional reserves to the tune of INR576mn and simultaneous reduction in NEP and PBT for FY21.
- These adjustments are one-off in nature and resulted in a negative impact on CORs in FY21.

Exhibit 39: Adjusted Claims ratio (FY22): Exit from VQST resulted in ~19.8% higher claims ratio

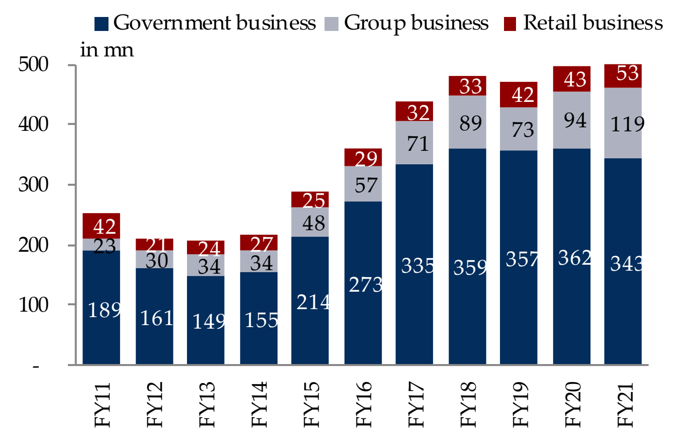


Source: Company RHP, HSIE Research

Health Insurance - Industry Overview

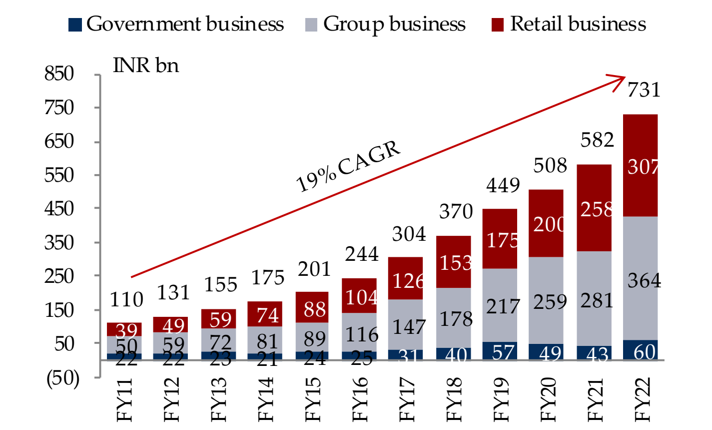
- Having showcased our investment thesis on STARHEAL, we now present the macro top-down opportunity for SAHIs within the health insurance landscape.

Exhibit 40 Lives covered: Govt business has the highest coverage



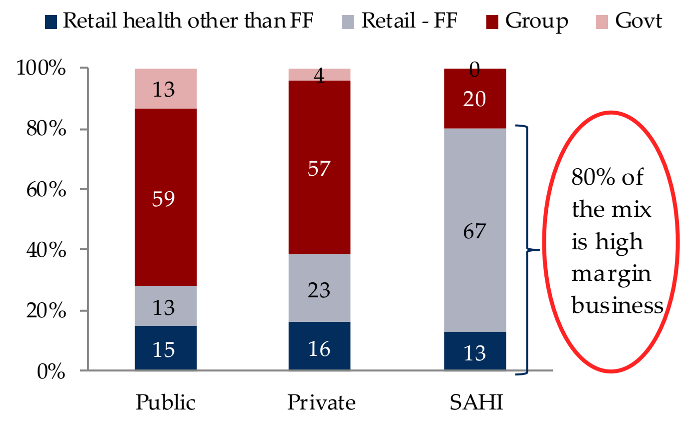
Source: IRDAI, HSIE Research

Exhibit 41: Despite lowest share in lives covered, retail contributes maximum GDPI



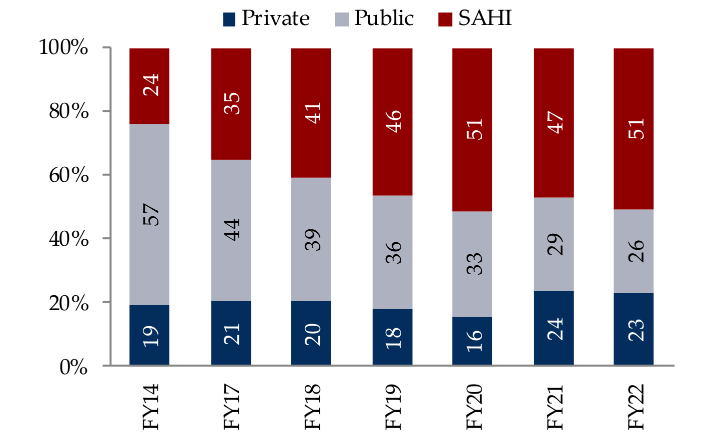
Source: IRDAI, HSIE Research

Exhibit 42: Health GDPI mix: SAHIs are retail heavy



Source: IRDAI, HSIE Research | Note: Basis FY21 GDPI data

Exhibit 43: Retail health market share: SAHIs dominate



Source: GI Council, HSIE Research | Note: In FY21 Apollo Munich was merged with HDFC ERGO

Exhibit 44: Current penetration levels (FY21)

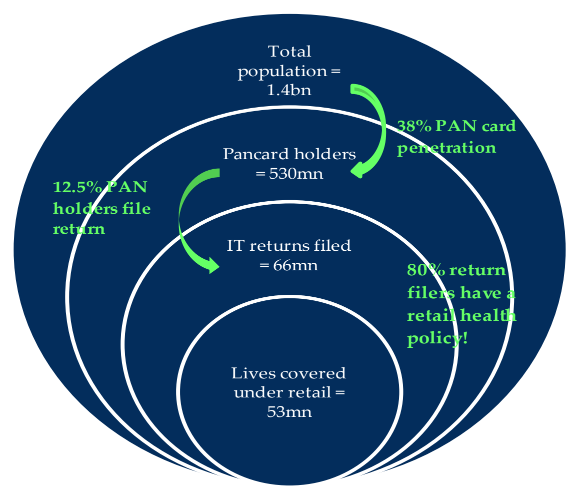
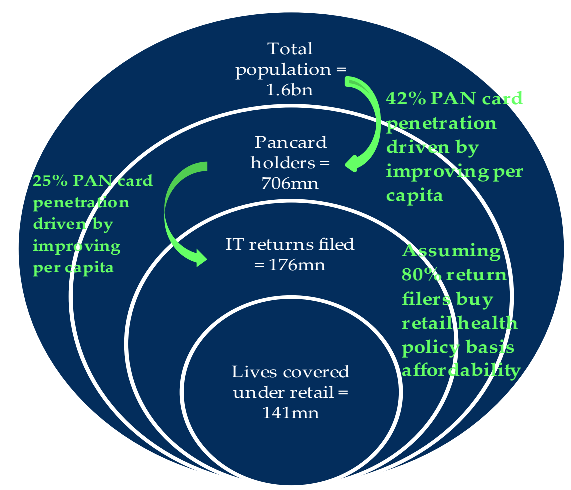
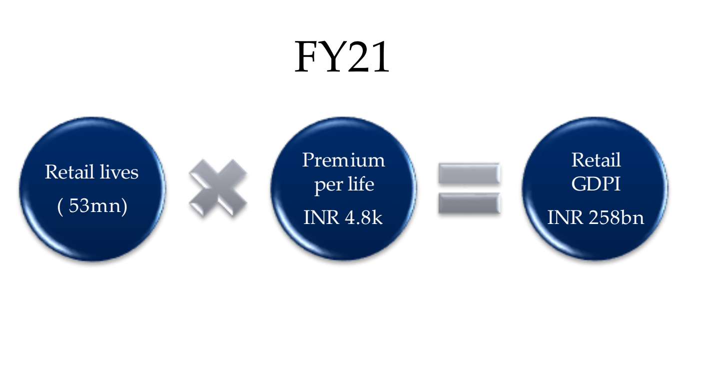


Exhibit 45: Projected penetration levels (FY32E)

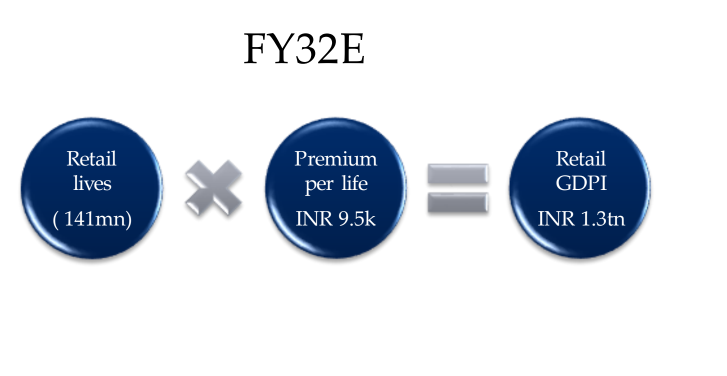


Source: IRDAI, Media reports, HSIE Research

Exhibit 46: Current retail GDPI (FY21)

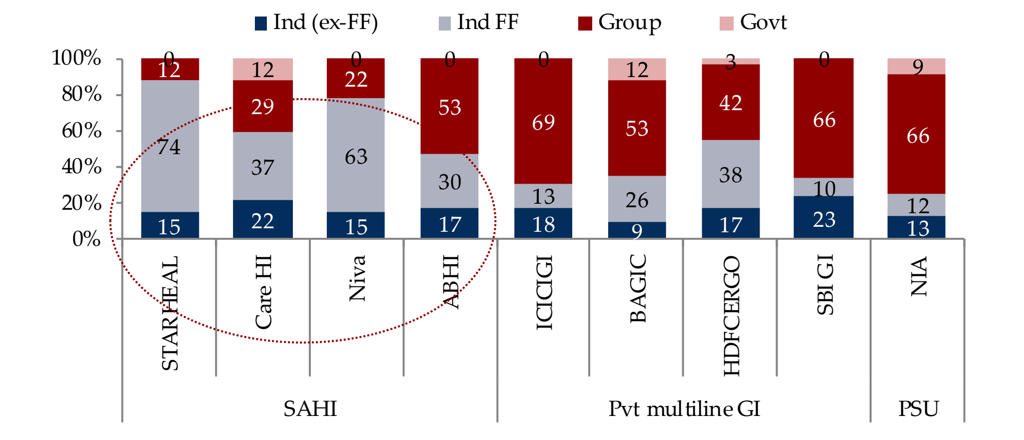


Projected retail GDPI (FY32E)



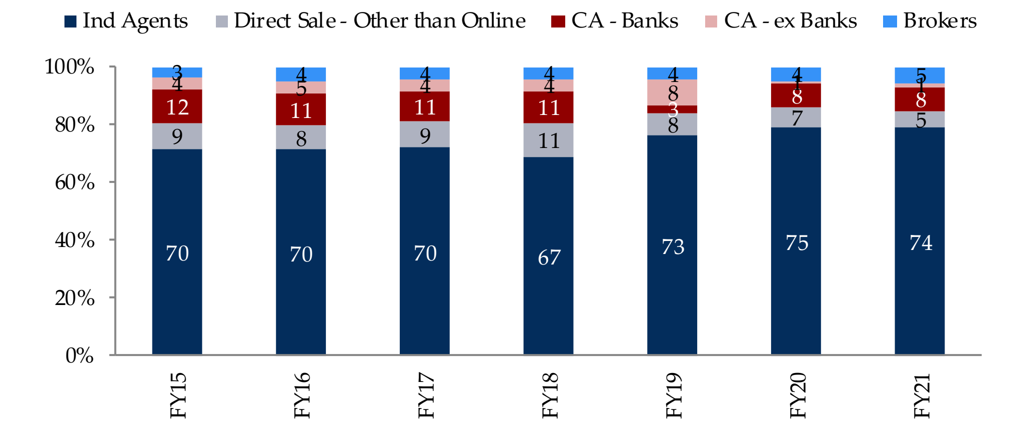
Source: IRDAI, HSIE Research

Exhibit 47: Health GDPI mix: SAHIs retail heavy, private multiline and PSUs group heavy



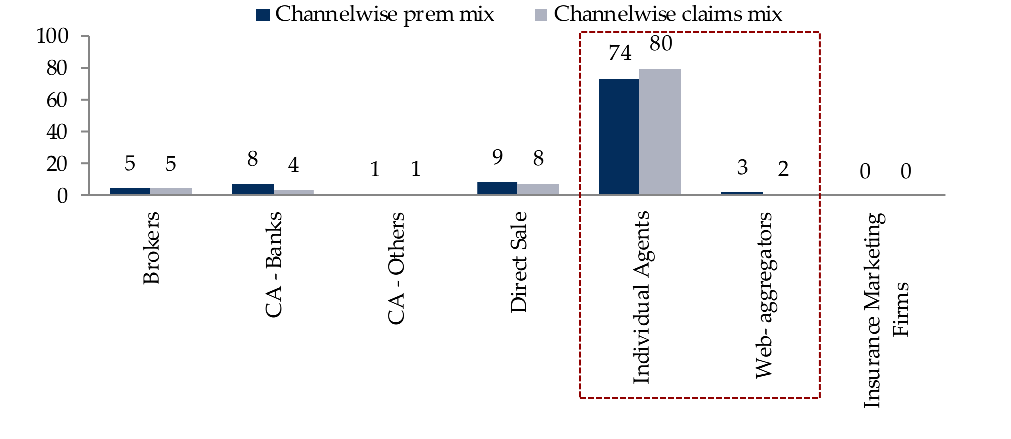
Source: IRDAI, HSIE Research | Note: Data is avg over FY19-21

Exhibit 48: Retail health insurance sales across channels



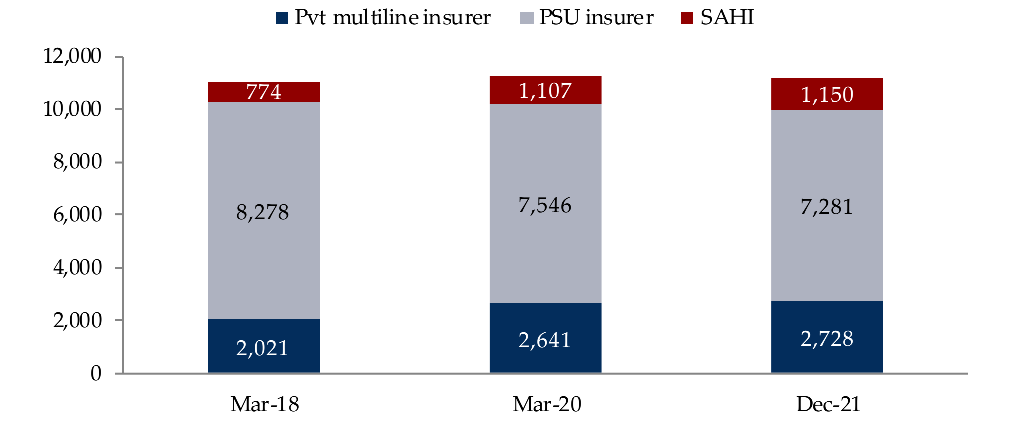
Source: IRDAI, HSIE Research

Exhibit 49: Channel-wise GDPI vs. claims: agency more prone to claims



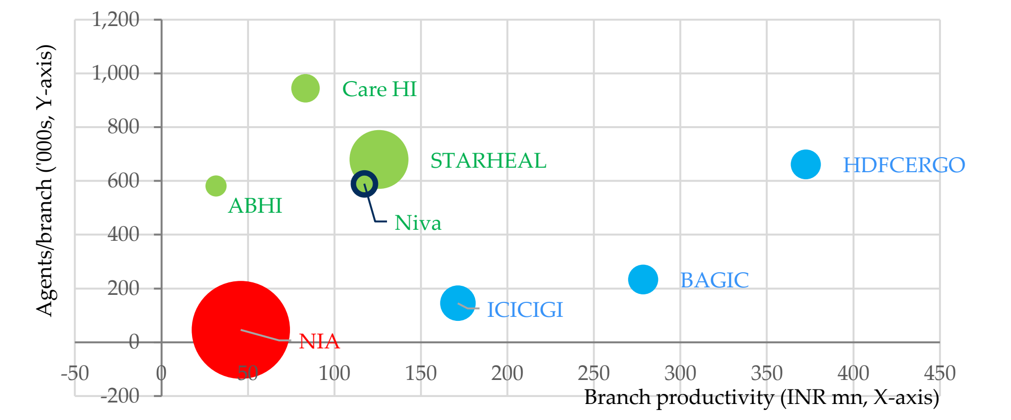
Source: IRDAI, HSIE Research | Note: Data for retail health (including family floater)

Exhibit 50: Branch network: PSU insurers have a well-penetrated branch network



Source: GICouncil, HSIE Research

Exhibit 51: PSUs have a strong branch footprint, albeit low agents per branch

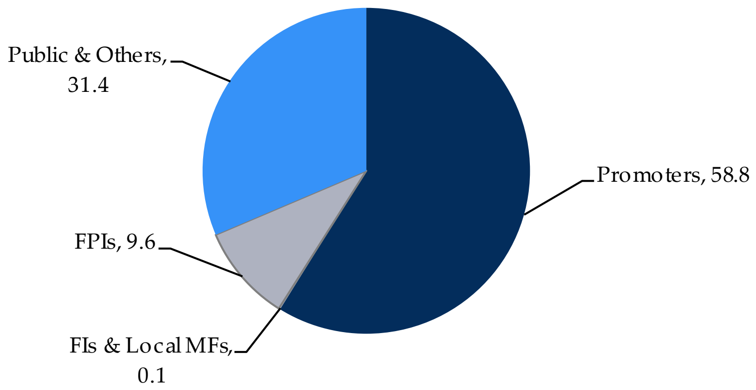


Source: Respective companies, GICouncil, HSIE Research | Note: Size of circle denotes branch count

Shareholding pattern

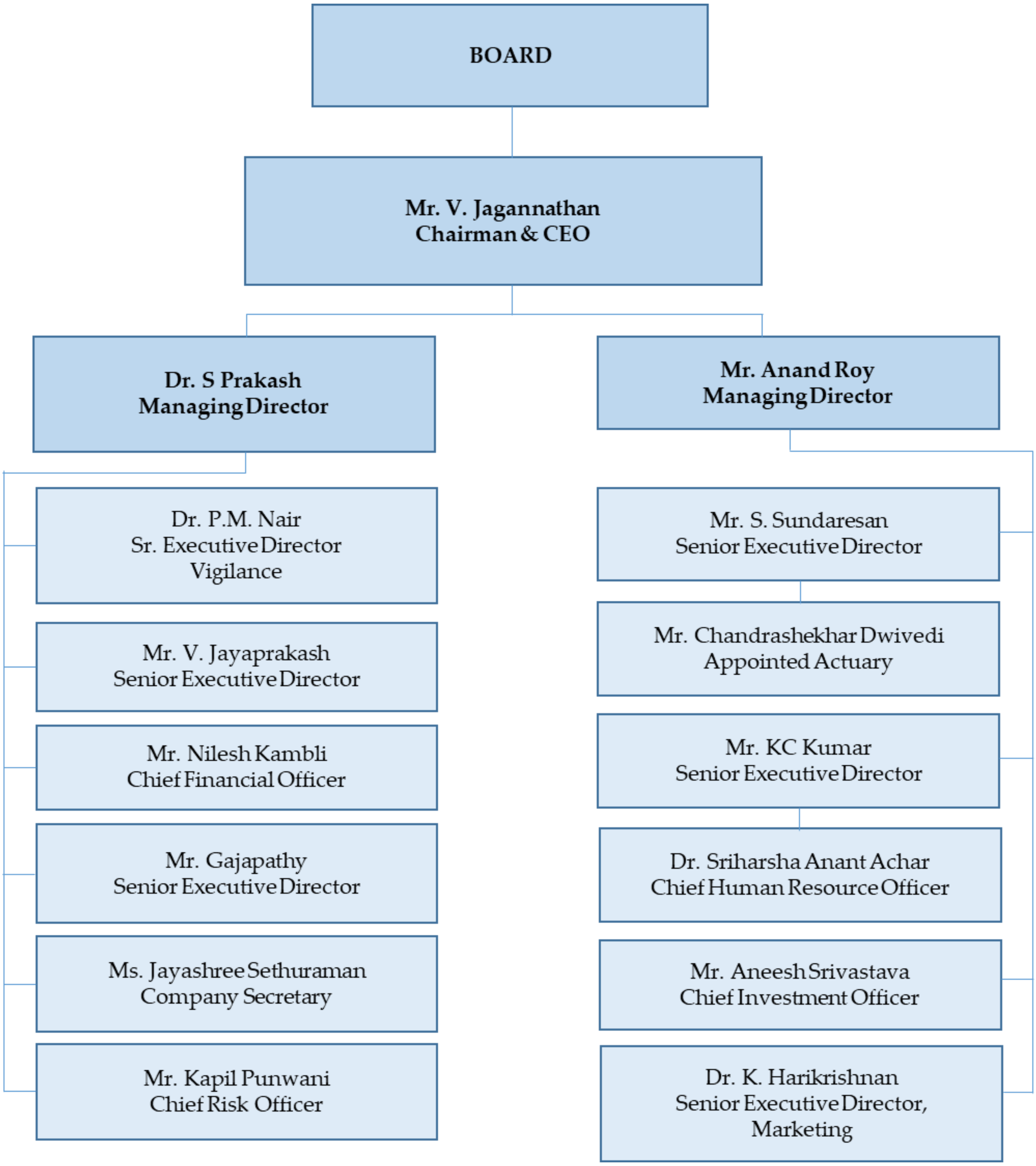
- Promoters include investment industry veterans like Rakesh Jhunjunwala, Westbridge Capital (through Safecrop Investments India LLP), Konark Trust and MNPL Trust.

Exhibit 52: Shareholding pattern (Jun-22)



Source: BSE, HSIE Research

Organisational chart



Key management personnel

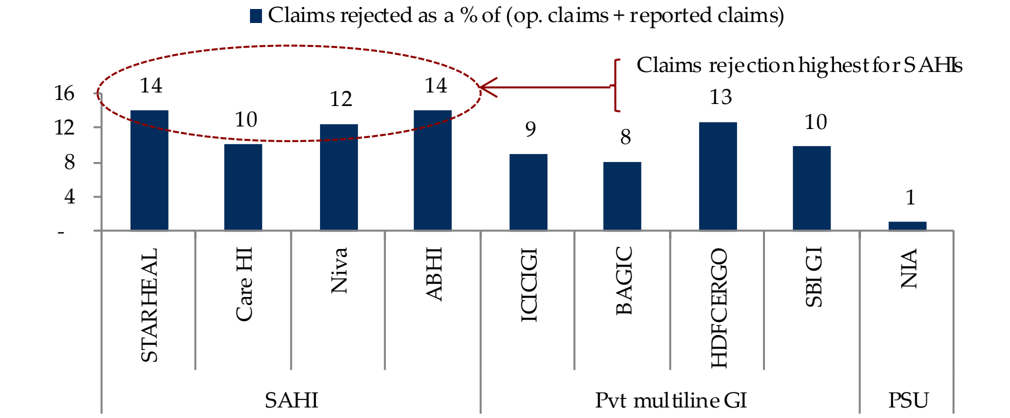
Name	Designation	Joined in	Brief description
Mr. V.Jagannathan	Chairman and CEO		He holds a master's degree of arts in economics from the Annamalai University, Tamil Nadu. He has ~47 years of experience in the insurance industry. He has previously worked with United India Insurance Company in the capacity of chairman cum MD.
Dr. Subbarayan Prakash	MD		He holds a bachelor's degree in medicine and surgery from the Bharathidasan University, Tamil Nadu and a master's degree in surgery in the branch of general surgery from the Tamil Nadu Dr. M.G.R. Medical University. Further, he has been admitted as a fellow qua surgeon of the Royal College of Physicians and Surgeons of Glasgow. He has also been registered in the Tamil Nadu Medical Register. He has several years of experience as a surgeon and has previously worked with Saudi Operation & Maintenance Company Limited as a specialist in general surgery/traumatology.
Mr. Anand Shankar Roy	MD		He holds a bachelor's degree in commerce from the University of Madras and a PGDM from IMI, New Delhi. He has 21 years of rich experience in the insurance industry and has previously worked with American Express Travel Related Services and ICICI Lombard General Insurance Company Limited.
Mr. Subramanian Sundaresan	SED		He holds a bachelor's degree in commerce from the University of Delhi. He is also an associate of the Federation of Insurance Institutes. He has previously worked with United India Insurance Company Limited. He joined STARHEAL as the VP- Claims Department in 2007.
Dr. P.M Nair	Senior Executive Director - Vigilance	2015	He holds a bachelor's degree in science from the University of Kerala, a bachelor's degree in law from the University of Delhi and a master's degree in sociology from the University of Kerala. He was previously the director general of National Disaster Response Force and Civil Defence, Ministry of Home Affairs, Government of India. He joined the Company in 2015.
Mr. A G Gajapathy	Senior Executive Director - Claims		He holds a bachelor's degree in law from the University of Madras. He has previously worked with National Insurance Company Limited and Golden Enterprises.
Mr. K C Kumar	Senior Executive Director – HR		He holds a bachelor's degree in commerce from the University of Kerala and a MBA degree from the National Institute of Business Management, Chennai. He has previously worked with Bharat Overseas Bank Limited and was awarded for overall performance by Bharat Overseas Bank Limited.
Dr. K. Harikrishnan	Senior Executive Director - Marketing	2008	He holds a bachelor's and a master's degree in veterinary sciences from the Tamil Nadu Agricultural University; and is also an associate of the Insurance Institute of India. He has previously worked with United India Insurance.
Mr. Nilesh Kambli	CFO	2020	He holds a bachelor's degree in commerce from the University of Mumbai and has cleared chartered accountancy from the ICAI. Previous work experience includes Bharti AXA General Insurance, Citicorp Finance (India) and ICICI Lombard General Insurance.
Mr. Aneesh Srivastava	CIO	2020	He holds a bachelor's degree in science and a master's degree in BA from the Lucknow University. He also holds a certificate in quantitative finance from the CQF Institute and is a financial risk manager certified from GARP. He has over 25 years of experience and has previously worked with Bajaj Allianz Life Insurance, IDBI Fortis Life Insurance, India Advisory Partners and Sahara India.
Mr.Chandrashekhar Dwivedi	Appointed Actuary	2019	He holds a bachelor's degree in technology from the Kanpur University and a MBA degree from the SMU, Sikkim. He has qualified the risk management certificate examination conducted by the RMS, National Insurance Academy, Pune. He also holds a COP from the Institute of Actuaries of India and has been admitted as a fellow of the Institute of Actuaries of India. He has previously worked with Universal Sompo General Insurance and KA Pandit Consultants and Actuaries.
Mr. Kapil Punwani	Chief Risk Officer	Oct-2021	He holds a bachelor's degree in science from the University of Mumbai. He has previously worked with Reliance Nippon Life Insurance and Citigroup Global Services.

Note: SED stands for Senior executive director. Source: Company, HSIE Research

Key risks

- **Mis-selling by insurance agents:** STARHEAL has the highest claims rejection at (12% in FY22), indicating lack of customer awareness on exclusions. This, to us, reflects mis-selling by agents and high opacity around exclusions. We flag this as one of the major risks for the company. While health insurance business is built on customer trust, this will reduce persistency (customer stickiness) and can have huge negative network effects. We believe STARHEAL should focus on training its agents to better educate customers on policy coverage and sell only the right fit.

Exhibit 53: Claims rejection rate across players



Source: Respective companies, HSIE Research | Note: Data is avg over FY19-21

- **Deceleration could mean faster-than-expected claims deterioration:** Historically, STARHEAL's fast-paced growth has resulted in increasing share of new book and, hence, lower loss ratios. However, faster-than-expected deceleration in growth could result in seasoning and higher old book and, consequently, higher loss ratios.

- **Rising competitive intensity in indemnity products:** Currently, life insurers are allowed to sell only fixed-benefit plans; however, the life insurance players are lobbying the regulator to be allowed to sell indemnity products. We do not expect a major shift in market share given the different dynamics of running a health insurance business.

- **Regulatory overhang on agency arbitrage**: SAHI players are currently allowed to onboard any life insurance agent without training, resulting in significant arbitrage vs. multiline players in terms of time-to-market for growing their distribution network. Recent media reports suggest that the regulator is looking to curb this exception, which could be negative for STARHEAL, given its disproportionate dependence on the agency network.

- **IRDAI's draft circular on MD/CEO poses transition uncertainty:** IRDAI has proposed that the post of MD & CEO or WTD of a private sector Indian insurance company cannot be held by the same incumbent for more than 15 years. Also, an MD & CEO or WTD cannot hold office beyond the age of 70 years. STARHEAL's MD & CEO Venkatasamy Jagannathan is ~77 years old and has been in the system for 17 years. This remains an overhang on the potential transition.

Exhibit 54: MDs and CEOs to get impacted from IRDAI's draft proposal

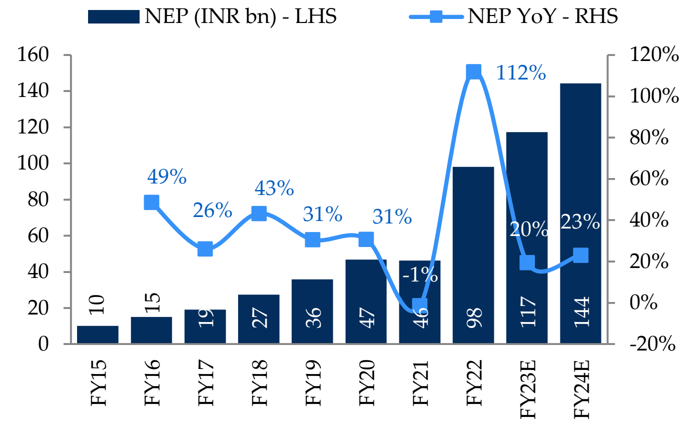
Name	Designation	Age (yrs)	Tenure after being appointed as MD or CEO (yrs)
Mr. Venkatasamy Jagannathan	Chairman & CEO	78	~17
Dr. Subbarayan Prakash	MD	56	~3
Mr. Anand Shankar Roy	MD	47	~3

Source: Company, HSIE Research

Valuation and financial summary

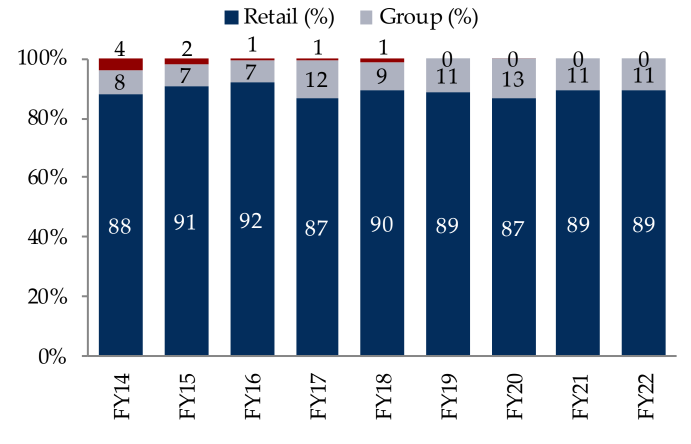
- We expect the net earned premiums to grow at 21% CAGR over FY22-24E, with retail policies continuing to dominate the mix at ~90%.

Exhibit 55: NEP to grow faster than the industry



Source: Company, HSIE Research

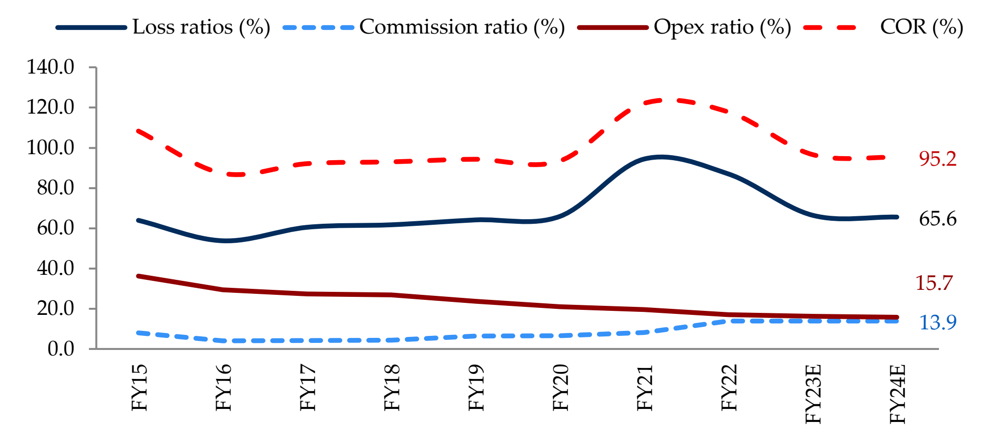
Exhibit 56: High margin retail business to dominate mix



Source: Company, HSIE Research

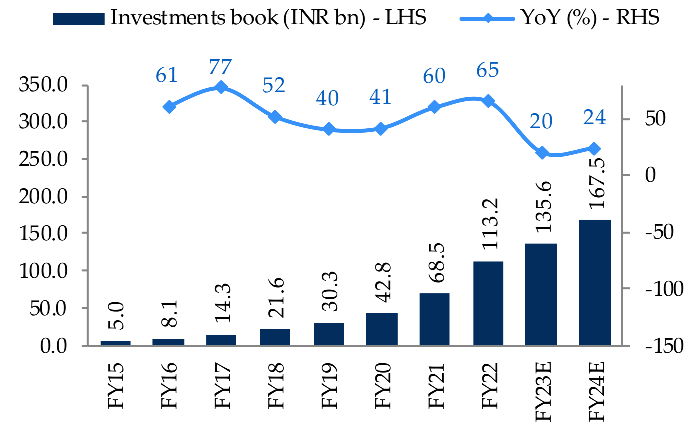
- STARHEAL is slated to grow at a faster clip (21% CAGR FY22-FY32E), translating into further market share gains.
- The loss ratios are expected to hover in the range of 65.6-66.5% over FY23E-FY24E as COVID-related claims and medical expenses subside; however, we expect a spike in elective surgeries to slightly offset the impact of receding COVID claims in the near term. In the long-term, we expect the loss ratios to slightly inch up as the growth slows down and the proportion of old book increases in the mix.
- We expect expense ratios (including commissions) to moderate in the medium-to-long term on the back of calibrated agent commissions and scale base benefits, resulting in CORs in the range of 95.2-96.6% over FY23E-24E. CORs have historically remained in the range of 93-95% on the back of extremely fast-paced growth; however, moving back to pre-pandemic levels seems unlikely on the back of slower-than-historical NEP growth.

Exhibit 57: Revenue and profitability



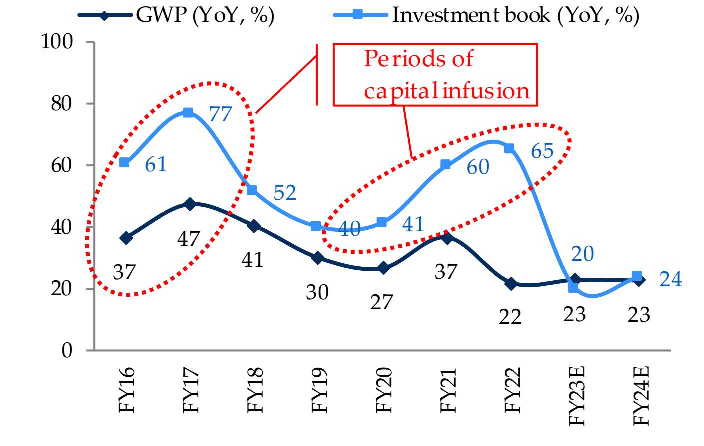
Source: Company, HSIE Research

Exhibit 58: Robust AUM growth



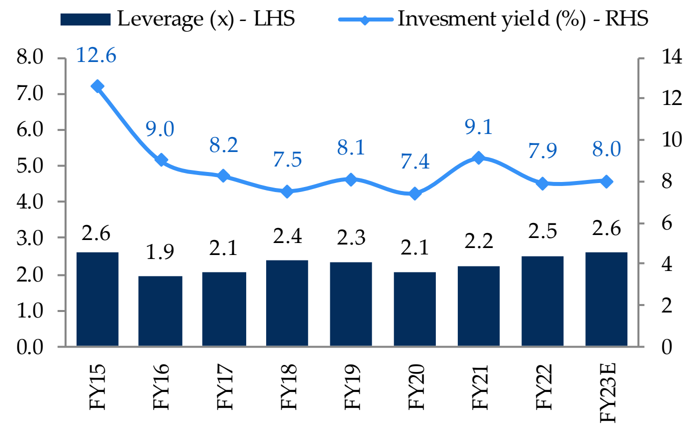
Source: Company, HSIE Research

Exhibit 59: Spike in AUM growth was led by capital infusion



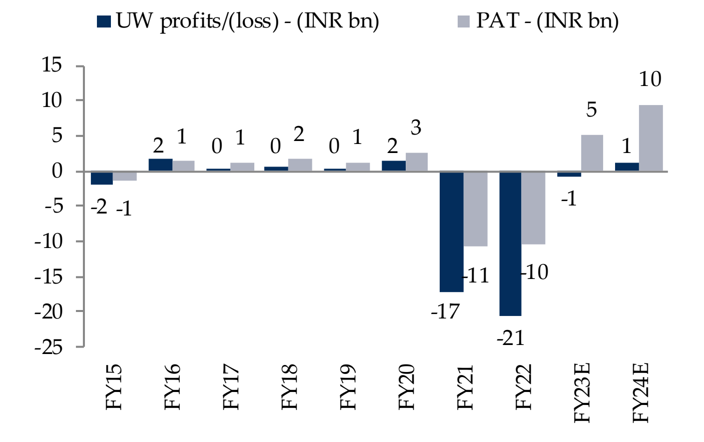
Source: Company, HSIE Research

Exhibit 60: Healthy investment yields with negligible NPAs



Source: Company, HSIE Research

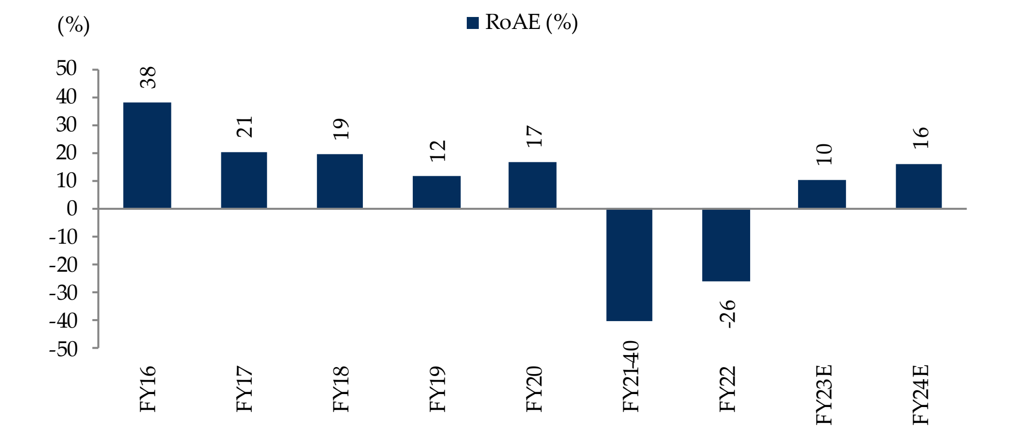
Exhibit 61: UW and PAT margins set to improve



Source: Company, HSIE Research

- We expect STARHEAL to record a FY20-24E 33% PBT CAGR and the business to deliver RoEs in the range of 10.4-16.3% over FY23E-24E.

Exhibit 62: COR improvement to drive higher RoEs



Source: Company, HSIE Research

Exhibit 63: DuPont analysis

(%)	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
NEP	100	100	100	100	100	100	100	100
Claims	60.5	61.8	64.2	65.9	94.4	87.1	66.5	65.6
Commission	5.0	5.0	7.4	7.3	12.7	15.2	15.8	15.8
Opex	32.7	31.4	27.5	23.5	30.3	18.7	18.4	17.8
UW P/(L)	1.8	1.8	1.0	3.3	-37.4	-21.0	-0.7	0.8
Investment income	5.3	5.4	5.2	6.5	8.4	8.1	8.4	8.4
Management exp	0.9	0.5	0.4	0.6	1.7	0.9	1.3	0.1
Interest	0.0	0.5	0.7	0.5	0.5	0.4	0.5	0.4
PBT	6.2	6.2	5.1	8.7	-31.2	-14.2	5.9	8.8
Tax	0.0	0.0	1.5	3.1	-7.8	-3.6	1.5	2.2
PAT	6.2	6.2	3.6	5.6	-23.5	-10.6	4.4	6.6
Asset turnover (x)	3.3	2.7	2.7	2.6	1.6	2.2	2.1	2.2
Leverage (x)	1.0	1.1	1.2	1.2	1.1	1.1	1.1	1.1
ROE (%)	20.5	19.5	11.7	16.8	-40.2	-25.7	10.4	16.3

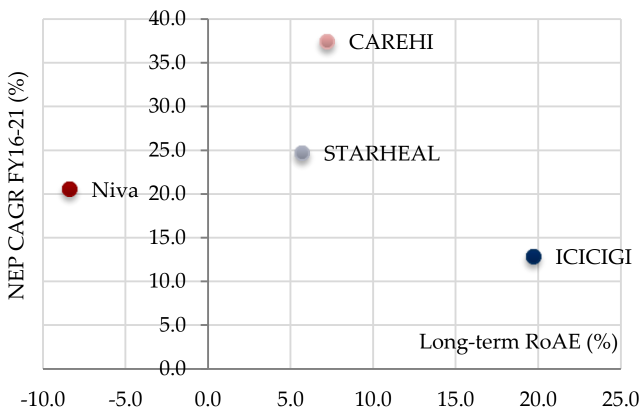
Source: Company, HSIE Research

- While we remain sceptical of high volatility to health insurers' PBT percolating from highly volatile UW profits and lower leverage weighing less on the PBT, we believe STARHEAL enjoys strong moats such as (1) inimitable granular distribution network, (2) rich proprietary database developed over the last 16 years, (3) customer stickiness, and (4) large headroom for COR improvement.
- We build a 15-year DCF and ascribe a 53x FY24E EPS and a 10x FY24E P/ABV (i.e., 65% premium to ICICIGI) on the back of STARHEAL's inimitable distribution network, 90% retail mix offering secular growth, and strong moats derived from vintage and scale. We remain extremely positive on the business model and initiate with a BUY rating on the stock and a target price of INR 860 (+16% downside).

DCF assumptions

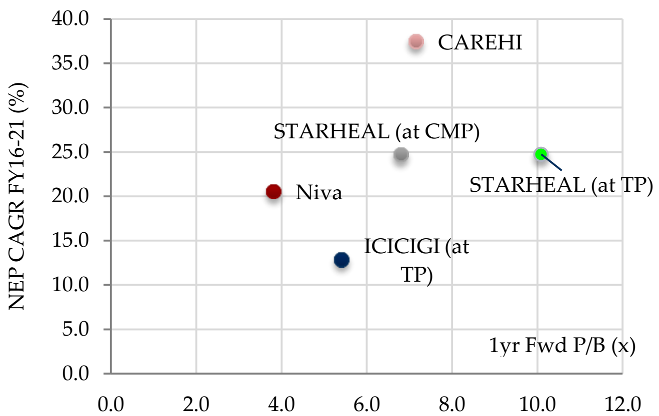
- ✓ NEP growth over FY22-32E: 20.9%
- ✓ NEP growth over FY33E-38E: 17.5%
- ✓ Terminal growth: 4.6%
- ✓ CORs to improve by ~253bps from 96.6% to 94.1% over FY23E-32E.
- ✓ CORs to improve by ~52bps from 94.1% to 93.6% over FY32E-38E.
- ✓ WACC: 13.5%

Exhibit 64: STARHEAL best placed in long-term



Source: Respective companies, HSIE Research | Note: Long-term RoAE is over FY17-FY21

Exhibit 65: Valuations attractive for STARHEAL



Source: Company, media reports, HSIE Research | Note: Valuation of NivaBupa and Care Health is as of last disclosed transaction (~Mar-20)

Financials

Consolidated Income Statement

(INR mn)	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
Net earned premiums	**19,115**	**27,396**	**35,795**	**46,841**	**46,266**	**98,092**	**117,256**	**144,318**
Growth (%)	**26.3%**	**43.3%**	**30.7%**	**30.9%**	**-1.2%**	**112.0%**	**19.5%**	**23.1%**
Claims incurred	11,567	16,920	22,976	30,874	43,695	85,400	77,975	94,672
Commission (net)	953	1,366	2,638	3,404	5,858	14,922	18,521	22,744
Operating expenses	6,422	8,740	9,971	11,274	14,813	19,270	23,135	25,767
Underwriting profit/(loss)	**173**	**370**	**211**	**1,289**	**(18,099)**	**(21,501)**	**(2,375)**	**1,135**
Investment Income	1,006	1,479	1,954	2,935	4,237	7,928	9,868	12,172
Provisions (Other than taxation)	-	-	88	(92)	344	18	19	20
Operating profit	**1,179**	**1,850**	**2,077**	**4,316**	**(14,205)**	**(13,591)**	**7,473**	**13,287**
Operating profit margin (%)	**6.2**	**6.8**	**5.8**	**9.2**	**(30.7)**	**(13.9)**	**6.4**	**9.2**
Interest expense	-	137	256	256	256	457	667	667
Other income	-	-	1	2	3	81	83	84
PBT	**1,179**	**1,712**	**1,822**	**4,062**	**(14,458)**	**(13,966)**	**6,889**	**12,704**
Tax	-	10	540	1,429	(3,601)	(3,560)	1,736	3,201
PAT	**1,179**	**1,702**	**1,282**	**2,633**	**(10,857)**	**(10,407)**	**5,153**	**9,503**
PAT Growth (%)	**-13.6%**	**44.3%**	**-24.6%**	**105.3%**	**-512.3%**	**-4.1%**	**-149.5%**	**84.4%**
AEPS	**2.6**	**3.7**	**2.8**	**5.4**	**(19.8)**	**(18.1)**	**9.0**	**16.5**
EPS Growth (%)	**-26.6%**	**44.3%**	**-24.6%**	**90.7%**	**-469.1%**	**-8.7%**	**-149.5%**	**84.4%**

Source: Company, HSIE Research

Consolidated Balance Sheet

(INR mn)	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
SOURCES OF FUNDS								
Share Capital	4,556	4,556	4,556	4,906	5,481	5,755	5,755	5,755
Reserves	3,339	5,040	4,226	14,132	29,513	39,529	47,174	57,937
Share application money pending allotment	-	-	3,500	-	3	757	-	-
Total Shareholders Funds	**7,894**	**9,596**	**12,282**	**19,038**	**34,996**	**46,041**	**52,929**	**63,693**
Fair Value Change Account	**-**	**-**	**-**	**31**	**(76)**	**267**	**267**	**267**
Long-term Debt								
Short-term Debt	-	2,500	2,500	2,500	2,500	7,200	7,200	7,200
Total Debt	**-**	**2,500**	**2,500**	**2,500**	**2,500**	**7,200**	**7,200**	**7,200**
Net Deferred Tax Liability	-	-	(1,420)	(70)	(4,213)	(7,768)	(5,826)	(4,369)
TOTAL SOURCES OF FUNDS	**7,894**	**12,096**	**13,362**	**21,437**	**33,359**	**45,206**	**54,037**	**66,256**
APPLICATION OF FUNDS								
Net Block	**838**	**970**	**981**	**1,019**	**990**	**1,171**	**1,264**	**1,417**
Investments	14,285	21,647	30,301	42,838	68,519	113,200	135,582	167,477
Total Non-current Assets								
Cash & Equivalents	3,311	5,020	8,930	6,114	18,790	5,635	9,380	11,834
Advances and Other assets	3,692	5,835	7,093	9,827	12,650	6,828	9,962	12,039
Debit balance in PL account								
Total Current Assets	**7,003**	**10,855**	**16,023**	**15,942**	**31,440**	**12,464**	**19,342**	**23,873**
Current Liabilities	2,782	5,375	9,003	12,164	15,643	19,607	24,066	29,015
Provisions	11,450	16,001	24,939	26,197	51,946	62,022	78,085	97,496
Total Current Liabilities	**14,232**	**21,376**	**33,943**	**38,361**	**67,589**	**81,629**	**102,151**	**126,511**
Net Current Assets	**(7,228)**	**(10,521)**	**(17,920)**	**(22,419)**	**(36,149)**	**(69,165)**	**(82,809)**	**(102,638)**
TOTAL APPLICATION OF FUNDS	**7,894**	**12,096**	**13,362**	**21,437**	**33,359**	**45,206**	**54,037**	**66,256**

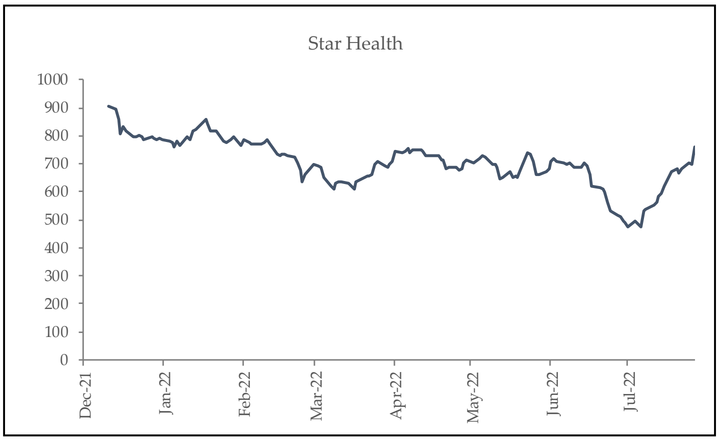
Source: Company, HSIE Research

Key ratios

	FY17	FY18	FY19	FY20	FY21	FY22	FY23E	FY24E
PROFITABILITY (%)								
Claims ratio	60.5	61.8	64.2	65.9	94.4	87.1	66.5	65.6
Commission ratio	4.2	4.3	6.4	6.5	8.2	13.8	13.9	13.9
Expenses ratio	27.4	27.0	23.7	21.0	19.5	17.0	16.2	15.7
Combined ratio	92.1	93.0	94.3	93.4	122.1	117.9	96.6	95.2
Underwriting profit	0.9	1.4	0.6	2.8	(39.1)	(21.9)	(2.0)	0.8
Investment yield	9.0	8.2	7.5	8.1	7.4	9.1	7.9	8.0
Investment Income /NEP	5.3	5.4	5.5	6.3	9.2	8.1	8.4	8.4
EBIT	6.2	6.8	5.8	9.2	(30.7)	(13.9)	6.4	9.2
PAT	6.2	6.2	3.6	5.6	(23.5)	(10.6)	4.4	6.6
ROE	20.5	19.5	11.7	16.8	(40.2)	(25.7)	10.4	16.3
EFFICIENCY								
Tax Rate (%)	0.0	0.6	29.6	35.2	24.9	25.5	25.2	25.2
Asset Turnover (x)	3.3	2.7	2.7	2.6	1.6	2.2	2.1	2.2
Claims os/NEP (x)	0.08	0.07	0.10	0.11	0.19	0.10	0.11	0.11
Investment leverage (x)	1.9	2.1	2.4	2.3	2.1	2.2	2.5	2.6
Debt/EBIT (x)	-	1.3	1.1	0.5	(0.2)	(0.6)	0.8	0.5
Net D/E	(0.4)	(0.3)	(0.7)	(0.2)	(0.5)	0.0	(0.0)	(0.1)
PER SHARE DATA								
AEPS (INR/sh)	2.6	3.7	2.8	5.4	(19.8)	(18.1)	9.0	16.5
DPS (INR/sh)	-	-	-	-	-	-	-	-
BV (INR/sh)	17.3	21.1	27.0	38.8	63.9	80.0	90.8	109.3
VALUATION								
P/E	286.9	198.8	263.9	138.4	-37.5	-41.1	82.9	45.0
P/BV	42.9	35.3	27.5	19.1	11.6	9.3	8.2	6.8

Source: Company, HSIE Research

1Yr Price Movement



Rating Criteria

BUY: >+15% return potential

ADD: +5% to +15% return potential

REDUCE: -10% to +5% return potential

SELL: >10% Downside return potential

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