

CMP: ₹ 470

Target: ₹ 600 (28%)

Target Period: 12 months

BUY

November 11, 2024

Mixed Q2FY25; favourable external outcome watchful

About the stock: Star Health is the largest standalone health insurer in the country with a robust in-house claim management system and strong agency network

- Strong geographical presence with 742 thousand agents, 902 branches, and 20,000-plus healthcare footprint this includes 14,200 network hospitals

Q2FY25 performance: Star Health reported muted performance in Q2FY25 wherein increase in combined ratio impacted earnings momentum. Gross premium growth remained at 17.1% YoY, with market share in retail health insurance broadly maintained at 32%. Investment income remained healthy, however, higher claim ratio at 72.8% vs 68.65% YoY, led to ~280 bps increases in combined ratio at ~103%, resulting in 11.2% YoY de-growth in earnings at ₹111.3 crore. Investment assets have increased to ~₹16,430 crore with leverage remaining steady at 1.72x.

Investment Rationale

- Steady growth amid value & volume levers:** Star Health reported steady market share with ~17.5% growth in premium in H1FY25. Management aspires to grow faster than industry owing to 1) focus on fresh business, 2) 10-15% increase in pricing across products forming ~60% of gross premium, 3) increased focus on group business in SME & MSME segment by opening of banca and digital distribution channel and 4) Enhancing existing distribution strength of agency with penetration in tier 2 & 3. Guidance for business growth maintained at ~18% for FY25E and doubling of GWP by FY28E. Expect 17-18% CAGR in gross premium in FY25-27E.
- Combined ratio could remain volatile:** Higher claims, led by severity & frequency, resulted in rise in combined ratio from 99.2% in Q2FY24 to 103% in Q2FY25. However, opex (EoM) remained well under norms. While tech upgradation, improving penetration in tier 2&3 cities and control on opex remains in focus, claims are expected to remain a challenge amid rising medical inflation and increase in frequency especially in group segment. Thus, expect combined ratio at 97-99% and earnings growth at 12-13% CAGR in FY25-26E, support by healthy investment leverage at 2.3-2.4x.
- Any favourable external factor could act as catalyst:** Any reduction in GST on insurance products (currently at 18%) and approval of composite license scheme (parliament approval awaited) are some of the major developments which could act as catalyst.

Rating and Target Price

Existing moats in terms of focussed approach, distribution strength and network tie-ups coupled with technology adoption remains core and is seen to aid business growth. Any favourable regulation could act as catalyst for sustained growth ahead. Given elevated competition and probability of higher-than-expected combined ratio warrants downgrade in target price to ₹600, valuing the stock at ~1.5x FY27E float (~33x FY27E EPS). Maintain Buy recommendation amid recent decline in valuation.

Key Financial Summary

	FY21	FY22	FY23	FY24	3 year CAGR (FY21-FY24)	FY25E	FY26E	FY27E	3 year CAGR (FY24-FY27E)
Gross written premium (GWP)	9388.5	11463.5	12952.5	15254.5	17.6	17657.6	20659.4	24068.2	16.4
Net Incurred Claims	4369.5	8540.0	7320.9	8600.0	25.3	9996.8	11627.7	13946.5	17.5
Underwriting Profit/Loss	(1331.8)	(2061.6)	204.7	90.3		65.9	148.7	449.7	
Profit after Tax	(825.6)	(1040.6)	618.6	845.0		951.5	1065.3	1149.8	
NWP/Net Worth (x)	1.7	1.7	1.9	2.1		2.2	2.2	2.3	
Price/Float (x)	0.4	2.7	2.1	1.6		1.6	1.4	1.3	
P/GWP (x)	3.0	2.4	2.2	1.8		1.6	1.4	1.2	
P/E (x)	(33.7)	(23.1)	38.6	34.6		30.7	27.4	25.4	

Source: Company, ICICI Direct Research



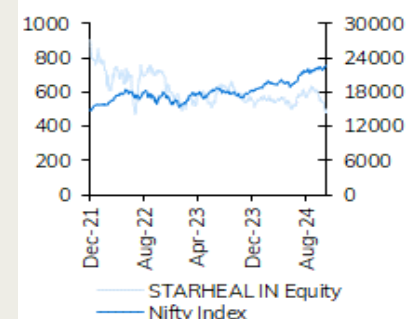
Particulars

Particulars	Amount
Market Capitalisation	₹ 27535 crore
52 week H/L	₹ 648/ 455
Net Worth	₹ 6628 crore
Face Value	10.0
DII Holding (%)	17.1
FII Holding (%)	17.7

Shareholding pattern

(in %)	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24
Promoter	58.0	57.9	57.9	57.9	57.7
FII	30.6	31.0	26.6	21.6	17.7
DII	6.1	6.1	11.1	15.1	17.1
Public	5.23	4.96	4.38	5.42	7.60

Price Chart



Key risks

- Competitive intensity could impact growth
- Price revision could result in higher rate of customer attrition

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Concall highlights and outlook

Highlights

- Management remains confident of doubling GWP and tripling PAT by FY28E. Company expects it to be fueled by ABCD growth engine, expanding distribution network, and cost leadership.
- Guidance for FY25 on premium growth remained unchanged at 18%, however, caution remains on 100 bps reduction in combined ratio owing to higher claims.
- New business growth in H1-FY25 has been healthy at 31% with 14% growth in number of policies. Agency fresh GWP has grown at 23% for Q2FY25.
- Digital business contributed 7.4% of overall business in H1FY25. Digital segment reported 41% YoY growth in fresh business. Direct-to consumer channel contributed 72% to GWP and 28% came from online brokers and web aggregators.
- Total agent count increased from 701 thousand in FY24 to 742 thousand in Q2FY25 and sponsored health agency force increased from 1.11 lakhs in FY24 to 1.15 lakhs in Q2FY25. Branches increased from 887 to 902 in Q2FY25.
- Banca channel contributed 8% of GWP, reported fresh business growth of 25%.
- The company had responded swiftly and decisively on cyberattack and is working with all authorities to investigate the breach. The exposed data has been taken down and necessary measures are being implemented to improve security. Trust among customers can be seen in encouraging numbers for fresh growth rates, renewal rates, and healthy agency activation.
- Investment assets have grown by 17.2% and has reached ₹16,431 crores in Q2FY25 and investment income in Q2FY25 has grown to ₹354 crores versus ₹255 crores in Q2FY24. The yield for Q2FY25 stood at 8.8% versus 7.5% in Q2FY24.
- Increase in loss ratio was due to seasonal diseases impact. The 21% increase in claims incurred was driven by 10% increase in severity, 6% increase in frequency, and 5% increase in number of policies.
- Industry is facing challenges of a shift in consumer behaviour and high medical inflation. With changing dynamics, company has plans to increase prices of ~50-60% of current portfolio. Company will continue to hike prices across products.
- Company launched new product 'Superstar Plan', a personalised long-term health insurance solution. This product features a 5-year policy term with modular coverage that adapts to customers' needs throughout different life stages allowing for customisation and scalability.

Exhibit 1: Variance Analysis

Policyholder's Account	Q2FY25	Q2FY24	YoY%	Q1FY25	QoQ%	
Gross Premium Written	4371.3	3731.7	17.1	3475.9	25.8	Retail health market share remained steady at 32%
(-) Reinsurance ceded	396.3	187.1	111.8	305.8	29.6	
Net written premium (NWP)	3975.0	3544.6	12.1	3170.2	25.4	
Net earned premium (NEP)	3703.9	3205.6	15.5	3520.3	5.2	Improved renewal retention
(-) Net Incurred Claims	2695.9	2202.2	22.4	2378.9	13.3	Claim ratio increased at 72.8% vs 68.7% YoY
(-) Net Commission Expense	548.9	485.4	13.1	428.8	28.0	Comissions ratio at 13.8%
(-) Operating expenses related to insurance business	653.8	596.3	9.6	572.2	14.3	
(-) Total expense	3898.6	3283.9	18.7	3380.0	15.3	
Underwriting Profit/Loss	(194.7)	(78.3)	148.5	140.4	(238.7)	Combined ratio increased at 103% vs 99.2% YoY
Investment Income	208.4	116.7	78.6	171.3	21.7	Higher yield benefit investment income
Operating Profit/Loss	15.6	72.6	(78.5)	312.1	(95.0)	
Transfer to Shareholder's Account	15.6	72.6	(78.5)	312.1	(95.0)	
Shareholder's Account	Q2FY25	Q2FY24	YoY%	Q1FY25	QoQ%	
Operating Profit/Loss	15.6	72.6	(78.5)	312.1	(95.0)	
Investment Income	146.1	105.2	38.9	124.1	17.8	
Other Income	0.31	1.43	(78.3)	0.99	(68.7)	
Profit before tax	148.8	167.1	(11.0)	426.2	(65.1)	
(-) Provision for Taxation	37.5	41.8	(10.4)	107.2	(65.1)	
Profit after Tax	111.3	125.3	(11.2)	318.9	(65.1)	Lower net profit led by rise in claims ratio

Financial Summary

Exhibit 2: Policyholder's Account ₹ crore

Policyholder's Account	FY23	FY24	FY25E	FY26E	FY27E
Gross written premium (GWP)	12952.5	15254.5	17657.6	20659.4	24068.2
Net written premium (NWP)	12319.6	14067.4	16333.3	19213.2	22864.7
Net earned premium (NEP)	11261.6	12938.3	14920.6	17485.2	21131.1
(-) Net Incurred Claims	7320.9	8600.0	9996.8	11627.7	13946.5
(-) Net Commission Expense	1682.8	1853.7	2156.0	2536.1	3018.1
(-) Operating expense	2053.8	2394.4	2701.9	3172.7	3716.7
(-) Other expense	0.0	0.0	0.0	0.0	0.0
(-) Total expense	3736.6	12848.0	14854.8	17336.5	20681.4
Underwriting Profit/Loss	204.7	90.3	65.9	148.7	449.7
Investment Income	501.4	640.7	833.9	877.4	1017.1
Operating Profit/Loss	706.1	730.9	899.8	1026.1	1466.9
Transfer to Shareholder's Account	706.1	730.9	899.8	1026.1	1466.9

Source: Company, ICICI Direct Research

Exhibit 4: Balance sheet ₹ crore

Balance Sheet	FY23	FY24	FY25E	FY26E	FY27E
Source of Funds					
Share Capital	581.7	585.3	587.6	587.6	587.6
Reserves and Surplus	5983.9	6042.9	6994.4	8059.7	9209.5
Net Worth	6565.6	6628.2	7582.0	8647.3	9797.1
Fair value gains	23.4	103.6	63.0	90.6	122.5
Borrowings	470.0	470.0	470.0	470.0	470.0
Deferred Tax Liability	0.0	0.0	0.0	0.0	0.0
Total	7058.9	7201.8	8115.0	9207.8	10389.6
Application of Funds					
Shareholder Investments	5345.9	6336.1	6126.6	7045.6	7761.9
Policyholder Investments	8046.2	9154.8	11378.1	13084.8	14415.0
Total Investments	13392.1	15490.9	17504.7	20130.4	22176.9
Deferred Tax Assets	568.9	358.2	358.2	358.2	358.2
Fixed Assets	111.3	175.1	206.4	217.6	241.2
Cash and Bank balance	309.4	444.6	1641.3	1923.4	2324.4
Other current assets	844.4	1299.0	1273.2	1316.0	1358.8
Total Current Assets	1834.0	2276.8	2914.5	3239.3	3683.2
Current Liabilities	2030.1	2477.9	2045.0	2334.6	2786.3
Provision	7268.7	8374.7	9822.1	11550.0	13283.7
Total Current Liabilities	9298.8	10852.5	11867.0	13884.6	16069.9
Net Current Assets	(8145.1)	(10852.5)	(8952.5)	(10645.3)	(12386.7)
Total	7058.9	7201.8	8116.8	10060.9	10389.6

Source: Company, ICICI Direct Research

Exhibit 3: Shareholder's Account ₹ crore

Shareholder's Account	FY23	FY24	FY25E	FY26E	FY27E
Operating Profit (from Policyholder's a/c)	706.1	730.9	899.8	1026.1	1466.9
Investment Income	333.1	443.4	449.0	472.4	547.7
Other Income	5.7	4.1	0.4	0.4	0.4
(-) Expense and Provision	218.5	49.6	77.6	75.3	478.4
Profit before tax	826.4	1128.9	1271.6	1423.6	1536.6
Provision for Taxation	(207.8)	(283.8)	(320.0)	(358.3)	(386.6)
Profit after Tax	618.6	845.0	951.5	1065.3	1149.8

Source: Company, ICICI Direct Research

Exhibit 5: Key ratios

Key Ratios	FY23	FY24	FY25E	FY26E	FY27E
Incurring Claims ratio (%)	66.4	67.0	67.0	66.5	66.0
Commission Ratio (%)	13.0	12.5	13.2	13.2	13.2
Expense Ratio (%)	16.5	16.7	18.0	18.0	18.0
Combined ratio (%)	95.9	96.2	98.2	97.7	97.2
Investment yield (%)	7.5	7.5	7.4	7.4	8.0
Investment Income / NEP (%)	6.3	7.2	8.5	7.6	7.3
PAT margin (%)	6.2	6.0	6.4	6.1	5.4
RoE (%)	9.9	8.1	12.4	12.2	11.6
RoCE (%)	9.3	7.7	11.7	11.6	11.1
NWP/Net Worth (x)	1.9	2.1	2.2	2.2	2.3
Debt/EBIT (x)	0.5	0.4	0.4	0.3	0.3
Debt/Equity (x)	0.06	0.05	0.06	0.05	0.05
ABV (₹)	126.5	174.0	126.8	144.9	164.4
Valuation					
Price/Float (x)	2.0	1.5	1.6	1.4	1.2
P/GWP (x)	2.1	1.7	1.6	1.3	1.1
P/E (x)	37.4	33.5	29.7	26.5	24.6
P/ABV (x)	3.7	2.7	3.7	3.2	2.9

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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