

Dominant player in the under penetrated health insurance market

We interacted with the management of Star Health and Allied Insurance Company Ltd (STARH). Below are the key takeaways from the meeting.

Sector and positioning

- STARH is the largest pure-play health insurer in India with a market share of 15.8% (in FY21).
- Operating in the fast-growing health insurance space in India (characterised by under-penetration and large opportunity size), STARH has compounded its Gross Written Premium (GWP) by 32% over FY18-21. Within the health insurance industry, Standalone Health Insurers (SAHIs) have clocked the strongest growth (albeit on a relatively lower base) over FY15-21, clocking a 39% CAGR in GWP.
- Within the health insurance segment, STARH focuses on the retail health business (which has better profitability – industry-level loss ratios in the range of 71-73% over FY18-20 as opposed to 99-107% for group health and 92-115% for government business – and stronger growth due to under-penetration and increasing awareness). STARH's market share in the retail health segment was at 31% in FY21.
- In the group segment, Management focuses on the SMEs given the higher profitability as compared to the highly-competitive corporate segment. SME business is an offshoot of STARH's retail business and is driven by agency channel. This also provides the company opportunities to cross-sell its retail health products through digital marketing initiatives.
- Management is confident of maintaining the growth momentum demonstrated in the pre-pandemic period. However, being a bottom-line focused company, STARH will ensure that underwriting quality remains under control and that growth will not come at the expense of profitability.

Products and channels

- Given STARH's focus on retail business (contributed 89% of STARH's FY21 GWP and having 31% market share), and the complex nature of products, the company largely depends on agents as the key channel partner (79% of STARH's FY21 GWP), who provide assisted sales to customers. With ~464k agents, the company has second largest agency force in the country, only behind LIC.
- Company designs and manufactures innovative products which would be attractive for customers, focusing on flexibility and comprehensiveness of coverage, and yet keeping it affordable. This also plays key role in agent retention as per management.
- Some examples of innovative products are specialized products (like product for critical illness, products for people with pre-existing illness like diabetes and hypertension, treatment for infertility and organ transplant, cover for new born from day 1 etc.)
- STARH has 779 branch offices and single person offices attached to the branch offices. This branch network is the largest among non-public health insurance providers.
- Further, the company has Banca arrangements with Bank of Baroda, Karur Vyasa Bank, Punjab National Bank, integration with Fintech partners like Paytm, PhonePe, Policybazaar, as well as ICICI Securities. Company expects to make some positive announcement in the banca space going ahead.
- While digital channels will gain prominence, management is of the opinion that the importance of face-to-face interactions before closing sales of health insurance (due to the complex nature of products requiring assisted sales) highlights the importance of traditional channels. Along the same lines,

management does not expect Fintech companies to be major disruptor in the retail health insurance space.

- Customers' trust in the brand and efficient service has led to renewal ratios at 95-98% over FY19-21.

Pricing and profitability

- Product profitability stems from increasing scale and volume, alignment to underwriting norms, and the company's research and analysis, along with hospitals that participate in the network.
- STARH identifies hospitals with better medical traffic and undertakes financial arrangement with them for three years. This helps them to keep claims costs in control, and has a positive impact on loss ratio.
- Products are repriced once in four years when the loss ratio goes below threshold (medical inflation being the key reason).
- Further, to sustain profitability, sum assured for policies are enhanced over time.
- Additional levers for pricing are (a) when people move from one age bracket to another; and (b) differential pricing based on geography and location.
- This has helped the company make underwriting profits for five years prior to the pandemic (while FY21 combined ratio was higher due to one-offs like impact of accounting treatment related to discontinuation of reinsurance treaty and higher claims due to covid, on an adjusted basis, the numbers tracked prior performance). Expense ratios have also improved consistently driven by efficiency and scale benefits.
- The pandemic has helped the company improve competence and knowledge of handling claims, which could help in better combined ratio in future.
- STARH has done away with quota sharing reinsurance for core business (apart from the regulatory mandate of 5%) which is a reflection of the company's faith in its underwriting capabilities. However, the company does undertake Facultative reinsurance for its specialized products.
- In terms of the final product pricing, the company's products are comparably priced to that of the peer set.
- With combined ratio in the range of 94-95% range and investment leverage of 2.3-2.5x (which is characteristic of health insurance companies), normalized ROE can be in the range of 18-20%.

Technology

- While STARH has a strong offline distribution model, they have adopted technology in their processes to enable production efficiency.
- Including the technology stack, everything has been built from scratch, with the data collected over the years.
- 63% of policies are now issued digitally, a trend which has been accelerated due to the onset of the pandemic.

Capital and Solvency

- STARH's solvency post the INR20.0bn infusion will remain at a comfortable level of ~2.5x and the company will not need to raise additional capital for the next 3-5 years.

Income Statement

Yr end 31 Mar (Rs mn)	FY18	FY19	FY20	FY21
Gross Premium Written	41,611	54,154	68,907	93,490
Net Premium written	31,960	41,415	52,614	71,448
Premium Earned (Net)	27,396	35,795	46,930	50,228
Income from investments (net)	888	1,340	1,924	2,606
Total income	28,284	37,135	48,854	52,834
<i>Growth (%)</i>	43.3	31.3	31.6	8.1
Commission	1,366	2,638	3,409	5,838
Operating expenses	8,614	9,874	10,963	14,014
Incurred Claims	16,920	22,976	30,874	43,695
Total expenses	26,900	35,488	45,246	63,546
Underwriting Profit/Loss	496	307	1,684	(13,318)
Operating profit	1,384	1,647	3,608	(10,712)
<i>Growth (%)</i>	43.4	19.0	119.0	(396.9)
Income in shareholder's account	1,976	2,263	4,620	(9,078)
Total expenses	264	440	485	1,382
PBT	1,712	1,822	4,134	(10,460)
<i>Growth (%)</i>	45.2	6.5	126.8	(353.0)
PAT	1,702	1,282	2,680	(8,256)
<i>Growth (%)</i>	44.3	(24.6)	109.0	(408.1)

Balance Sheet

Yr end 31 Mar (Rs mn)	FY18	FY19	FY20	FY21
Shareholders' funds	12,096	12,282	16,437	34,996
Fair value change account	0	0	31	(76)
Borrowings	0	2,500	2,500	2,500
Current Liabilities	5,375	9,003	11,794	15,643
Provisions	16,001	24,939	30,506	51,946
Total Liabilities	33,472	48,725	61,267	105,010
Investments				
Shareholders' fund	8,659	9,523	14,782	26,321
Policyholders' funds	12,988	20,778	28,117	42,046
Fixed assets	970	981	1,019	990
Deferred tax asset	0	1,420	1,467	4,213
Cash and bank balances	5,020	8,930	6,114	18,790
Advances and other assets	5,835	7,093	9,767	12,650
Total Assets	33,472	48,725	61,267	105,010

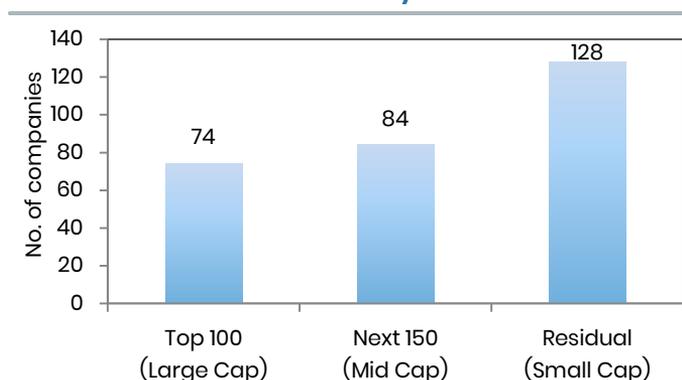
Key ratios

Yr end 31 Mar	FY18	FY19	FY20	FY21
Product mix - GWP (%)				
Retail Health	-	86.4	84.7	87.9
Group Health	-	11.0	12.9	10.5
Government Health	-	0.0	0.1	0.0
Personal Accident	-	2.4	2.1	1.6
Travel	-	0.2	0.2	0.0
Total	-	100.0	100.0	100.0
Key calculated ratios (%)				
Retention ratio	76.8	76.5	76.4	76.4
Net incurred claims ratio	61.8	64.2	65.8	87.0
Net commission ratio	4.3	6.4	6.5	8.2
Operating expense ratio	27.0	23.8	20.8	19.6
Combined ratio	93.0	94.4	93.1	114.8
Investment yield	6.8	6.4	6.8	6.2
Investment leverage (x)	1.8	2.3	2.5	1.9

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