US$9.86bn	51.62%	US$8.57mn
Market Cap.	Free Float	Avg. Daily Value traded

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Bupa Arabia

Company explores levers other than price hikes to improve loss ratio in the medium term

Neutral

Price Target (SAR): 260.0

CMP as of 24th April 2024: 248.0
Upside/Downside: 4.8% above current

Valuation Multiples	23	24E	25E
P/E (x)	39.4	32.5	26.7
P/B (x)	7.9	6.4	5.7
ROE (%)	21.2	21.8	22.5

Major Shareholders	% Ownership
Bupa Investments Overseas Ltd.	43.3
Nazer Holding Group	5.0

Price Performance	1M	3M	YTD
Absolute	2.2%	10.9%	16.2%
Relative to TASI	4.6%	9.3%	13.0%

Earnings

Period End (SAR)	2023	2024E	2025E
GWP	16,669	18,483	20,925
Growth	*20%*	*11%*	*13%*
Insurance Revenue	15,888	17,476	19,806
Growth	*23%*	*10%*	*13%*
Insurance Expenses	(15,023)	(16,395)	(18,419)
Loss Ratio	*95%*	*94%*	*93%*
Insurance service result	865	1,081	1,386
Growth	*36%*	*25%*	*28%*
Net insurance & investment results	1,378	1,672	1,990
Growth	*16%*	*21%*	*19%*
Profit Before Tax	1,117	1,374	1,671
Growth	*15%*	*23%*	*22%*
Net Profit	940	1,142	1,389
Growth	*17%*	*21%*	*22%*
ROE	21.2%	21.8%	22.5%
P/E	39.4x	32.5x	26.7x
P/B	7.9x	6.4x	5.7x

Source: Company data, Al Rajhi Capital

After a weak Q4 2023, that was hurt by a spike in claims, we expect earnings to improve in Q1 2024 supported by double digit growth in revenues and benefits of lower claims. Given that Q1 would have positive impact from Ramadan (lower hospital visits) we expect bottom-line to grow by 32% y-o-y and 137% q-o-q. Moreover, investment income should also support the earnings as interest rates have stayed elevated. Following the Q4 2023 results, the stock price declined for a brief period of time, but recovered as investors continue to stay optimistic on the long-term structural story. Going forward, two factors could determine the trajectory of the stock price from this level, one is the recovery in the insured lives and second are actions to improve the loss ratio. The insured lives were flattish in 2023 (+1% y-o-y) despite the growth in the private employment, thus further widening the enforcement gap (Saudis: 30% gap, expats: 23% gap). As the new insurance regulator is focused on developing the sector, we could see positive measures in terms of reducing this gap. Moreover, the long-term story remains intact driven by employment growth in the private sector and the government's move to corporatize its entities.

As claims have stayed elevated in the last two quarters, we believe the company can resort to further price hikes. However, in case the company decides not to raise the prices notably due to competitive reasons, the move to ramp up its telemedicine service, CareConnect should also help in reducing loss ratio. CareConnect is a wholly owned subsidiary, that will leverage on Bupa's book (current members of 3.7m) and the vast amount of data that is available. CareConnect will study the data and stratify the members into different segments based on health risk category. The business model will be to engage with the members proactively and incentivize them to undergo preventive medical tests and promote healthy habits. The company will be investing in doctors and medical experts, but will not be investing in physical infrastructure such as polyclinics yet, instead it will form partnerships with diagnostic centers and polyclinics. Thus, it would be an asset light model with bulk of the investments in the IT infrastructure. As per the company, they plan to target 500-600k of its members in the first year and cover about 1.0m by the second year. Although, it is a bit early to judge the impact on the loss ratio, Tawuniya, its key peer did get some success through its Vitality program, which is a wellness program that promotes fitness goals by rewarding its members monetarily if the fitness goals are met.

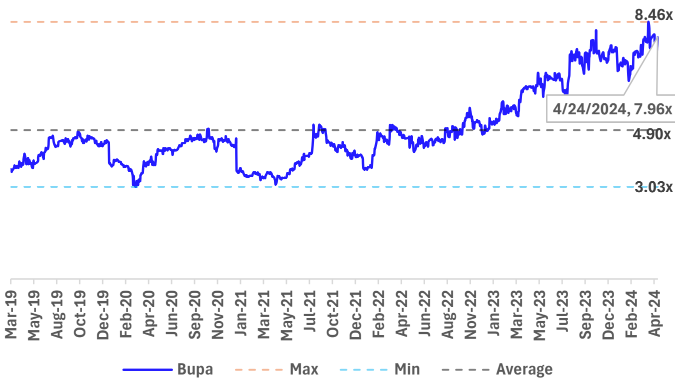
Another key development that can help the entire sector to improve their loss ratio could be the implementation of diagnostic related groups (DRG). In our view, it could have similar impact on insurance service margin as price hikes. Given that insurance has an independent regulator now, the DRG system which has been under study by CHI for the last few years (mainly from 2017) could get implemented soon. As per the CHI, 2024 will be the testing phase and it plans to implement it starting 2025 and onwards. The DRG is considered to be more efficient in terms of keeping a lid on the claims versus fee for service. Bupa has in the past complained about the abuse of insurance by hospital operators, thus DRG could be a solution for the same. In DRG, the claim limit is standardized for each treatment and the profile of the insured. Thus, the hospitals would be less incentivized to keep the patients in the hospital for a long period of time as the total insurance claims would be capped.

Moreover, the hospitals would also be selective in terms of suggesting tests and treatments which sometimes are considered to be not required. To offset the negative impact, the hospitals might focus on reducing the average length of stay. Based on the paper published by CHI in October 2022 (DRG), many European countries that implemented DRG saw reduction in length of stay between 1995 and 2008. In the near term, there could be some hiccups as proper staff training would be required to identify the right DRG code while billing, however, over the years DRG should help in managing the claims.

As of now, we consider only minor improvement in the loss ratio due to DRG starting 2025 as we wait for clarity and more data points. Nevertheless, we raise our estimates for 2025 and 2026 slightly. And as we roll forward our valuations, we raise our target price to SAR 260/share from SAR 232/share before. As mentioned in our November 2023 note, when we had upgraded the stock to Buy, the company is entering into a phase of improving ROEs and maintain low double-digit growth in GWP. Thus, the current historically high multiples are justified to a large extent. We continue to value the stock at 6.5x P/B applied on rolling 12 months forward book value per share. At our new target price, the implied upside from the last closing is around 5%, thus we turn neutral from Overweight.

Valuations: Bupa's unparallel moats in terms of leading market share, pricing power, robust client portfolio, etc. was evident in the recent cycle of price hikes. In the near term, the implementation of DRG should help to curtail the loss ratio. In addition to this, one major structural change which would be more prominently visible in the near term is the contribution of the investment income. Driven by better insurance margin and high investment income, we estimate net profit to grow at a rate of 16% CAGR over the next 7 years (2023-2030E). We anticipate Bupa's ROE to improve from about 19% average levels in the last 3-4 years and stabilise around 22%-24% in the near future. In the past, the stock has traded closer to its justified P/B, thus we believe the concern over its high valuations relative to history is unwarranted. Given that the ROE levels are expected to remain elevated, and the overall growth story is intact, we value the stock at a multiple, which is closer to its justified P/B. At 22% ROE, 8% growth and cost of equity of 10.15%, the justified forward P/B is 6.5x. We are valuing the stock closer to its justified P/B at 6.5x on rolling 12 months forward book value per share of SAR 40.1, that yields a fair value of SAR 260/share.

Figure 1 **Bupa trading close to all-time high**



Source: Bloomberg, Al Rajhi Capital

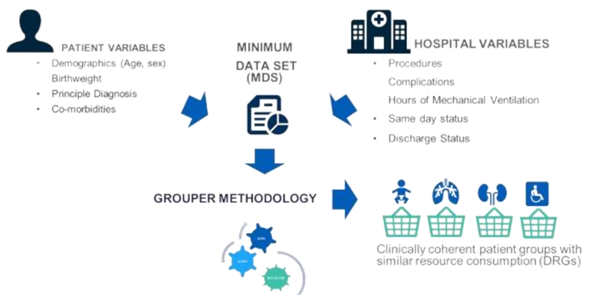
Figure 2 **Valuations**

P/B Valuation	Multiple
PB	6.5x
12M forward BVPS	40.1
Fair value	**260.0**
CMP	248.0
Upside	4.8%

Source: Company Data, Al Rajhi Capital

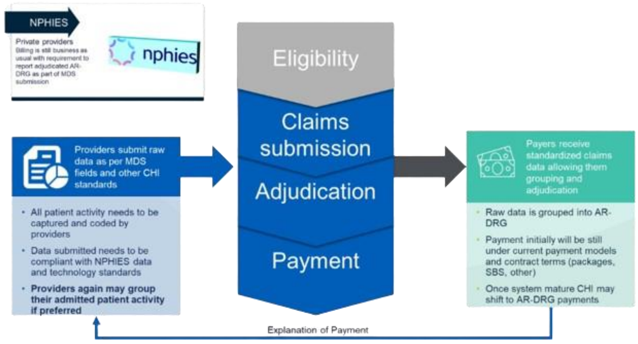
DRG: The AR-DRG is a classification system that provides a clinically meaningful way to relate or group the number and types of admitted care patients treated in a hospital to the resources required by the hospital. In CHI, the admitted patient episodes are classified using ICD-10-AM diagnoses codes and SBS interventions along with other routinely collected MDS data including age, gender, birth weight, length of stay, admission weight, hours of mechanical ventilation, discharge status, and encounter type. The grouping process consists of the following steps: • Demographic and clinical edits; • Major Diagnostic Category (MDC) assignment; • Pre-MDC processing with potential MDC reassignment; • ADRG assignment; • Diagnosis Complexity Level (DCL) assignment and Episode Clinical Complexity Level (ECCL) scoring; and finally, • DRG assignment.

Figure 3 **DRG Grouping Process**



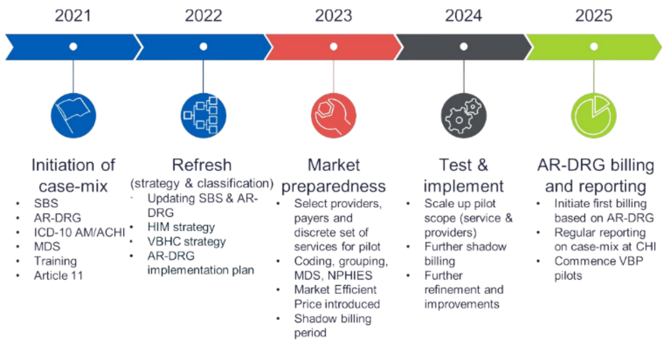
Source: CHI, Al Rajhi Capital

Figure 4 **High level business processes for claims submission and adjudication via NPHIES**



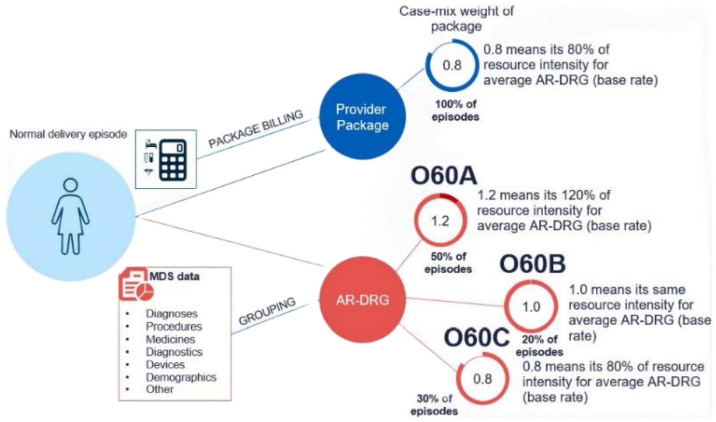
Source: CHI, Al Rajhi Capital

Figure 5 **CHI AR-DRG implementation timelines**



Source: CHI, Al Rajhi Capital

Figure 6 **Shadow billing process**



Source: CHI, Al Rajhi Capital

Financials

Figure 7 **Income Statement**

	2023	2024E	2025E
GWP	**16,669**	**18,483**	**20,925**
Growth	*20%*	*11%*	*13%*
Insurance Revenue	**15,888**	**17,476**	**19,806**
Growth	*23%*	*10%*	*13%*
Insurance Expenses	(15,023)	(16,395)	(18,419)
Loss Ratio	*95%*	*94%*	*93%*
Insurance service result	**865**	**1,081**	**1,386**
Growth	*36%*	*25%*	*28%*
Investment Income	513	590	603
Growth	*-7%*	*15%*	*2%*
Net insurance and investment result	**1,378**	**1,672**	**1,990**
Growth	*16%*	*21%*	*19%*
Other operating expenses	(317)	(352)	(388)
Other Income	55	54	69
Profit Before Tax	**1,117**	**1,374**	**1,671**
Growth	*15%*	*23%*	*22%*
Zakat & taxes	(177)	(232)	(282)
Net Profit	**940**	**1,142**	**1,389**
Growth	*17%*	*21%*	*22%*
EPS	6.3	7.6	9.3

Source: Al Rajhi Capital estimates

Figure 8 **Balance sheet**

	2023	2024E	2025E
Cash & Cash Equivalents	1,256	1,472	1,402
Reinsurance contract assets	74	23	54
Investments	4,834	5,863	7,863
Prepayment and other assets	475	516	580
Term Deposits	7,223	7,223	7,223
Fixtures, Furniture and Right-of-use assets	213	182	150
Goodwill & Intangible assets	165	148	136
Statutory deposits	150	150	150
Other	47	47	47
Total Assets	**14,438**	**15,624**	**17,606**
Accrued expenses and other liabilities	735	798	897
Insurance contract liabilities	8,267	8,216	9,366
Others	761	792	824
Total Liabilities	**9,763**	**9,807**	**11,087**
Total Equity	**4,676**	**5,818**	**6,520**
Total Liabilities & Equity	**14,438**	**15,624**	**17,606**

Source: Al Rajhi Capital estimates

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"Neutral": We expect the share price to settle at a level between 10% below the current share price and 10% above the current share price on a 12 month time horizon.

"Underweight": Our target price is more than 10% below the current share price, and we expect the share price to reach the target on a 12 month time horizon.

"Target price": We estimate target value per share for every stock we cover. This is normally based on widely accepted methods appropriate to the stock or sector under consideration, e.g. DCF (discounted cash flow) or SoTP (sum of the parts) analysis.

Please note that the achievement of any price target may be impeded by general market and economic trends and other external factors, or if a company's profits or operating performance exceed or fall short of our expectations.

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