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Consolino and Noonan say Core Specialty has no need to rush to IPO

Adam McNestrie *July 28, 2021*

Core Specialty has a future in the public markets but the firm has no need to expedite an IPO to catch the tailwind provided by the firming phase of the pricing cycle, CEO Jeff Consolino and executive chairman Ed Noonan have said.

Speaking on ***Inside P&C's*** podcast series Unreserved, Consolino said that IPOs are very much on the management team's mind, and that they are meeting quarterly with institutional investors to provide updates on the firm.

But Consolino rejected the idea of a rushed timeline. "As we build what we think will be the leading specialty P&C insurance company, we will be able to tell our story to investors whenever the right time comes.

"So we don't need to focus just at a point of time of the tailwind that may be present, or not present."

Consolino added that he and Noonan had built a track record of delivering for investors, with initial Validus investors receiving 5x-6x their money by the time of the AIG exit, and IPO investors more than 3.5x.

"We think there is a lot of demand to invest behind what you could colloquially call the Ed and Jeff show based on our track record at Validus and elsewhere," the Core Specialty CEO said.

Core Specialty was created last year through the recapitalization of StarStone US, with former AFG CFO Consolino joining as CEO, and former Validus CEO Noonan becoming executive chairman.

The business - which has backing from SkyKnight, Dragoneer, Aquiline and Enstar – has pro forma equity of $1.1bn based on its April merger with commercial auto insurer Lancer.

In the wide-ranging interview, Consolino and Noonan:

• Warn that anyone who doesn't pay careful attention to inflation right now is "whistling past the graveyard", with the idea that inflation is a transitory phenomenon "ludicrous"

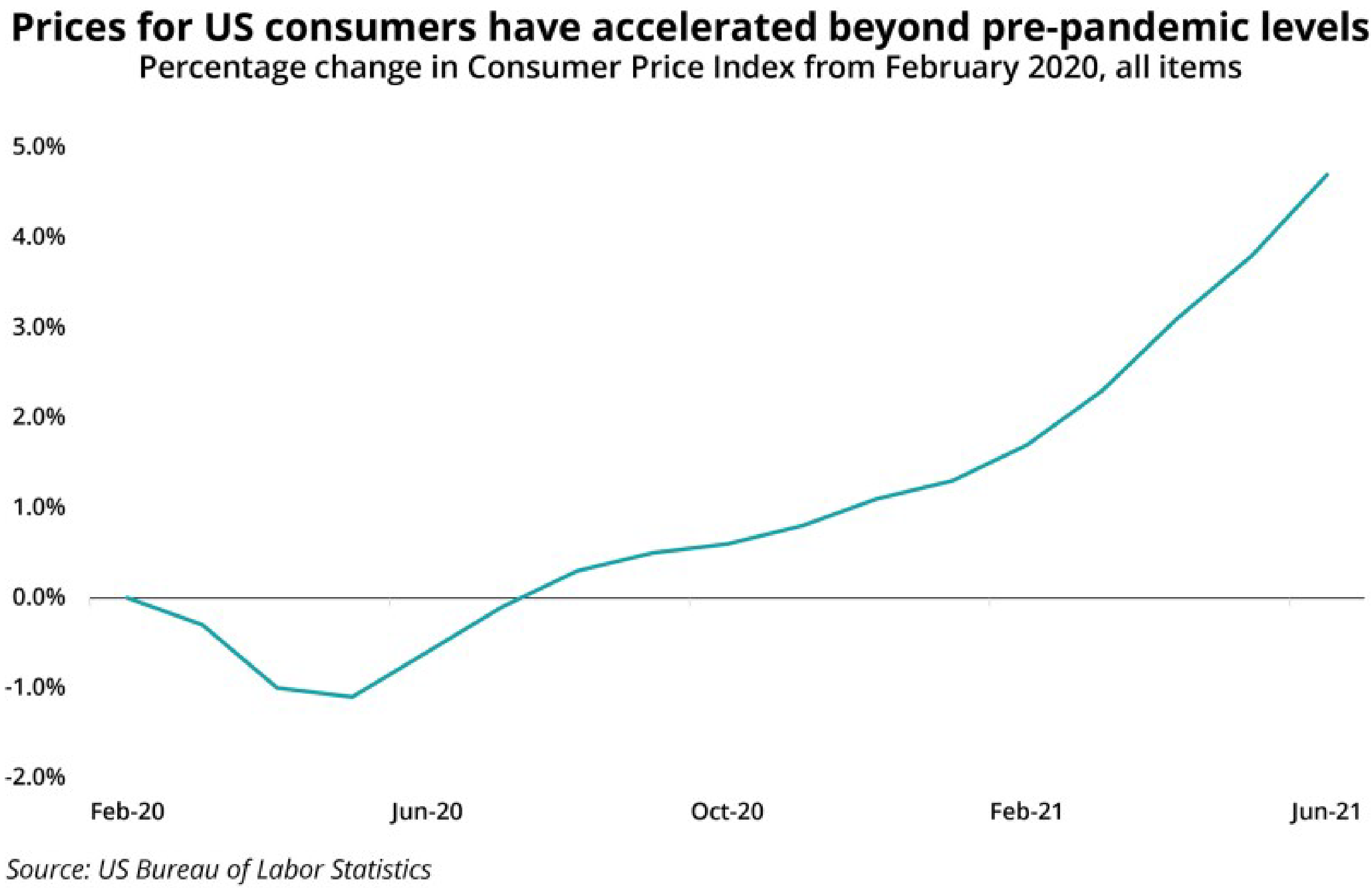
• Talk about the near-doubling of the firm through organic growth, new business unit launches and the merger with Lancer, one of the "handful" of companies that make money in commercial auto

• Stress E&S is still a good place to be with a continued increase in new business flows and rates that are more buoyant than in the admitted market

• Set out their philosophy for making a success of carrier M&A, including finding targets others miss, moving quickly and taking an owner's perspective

“Whistling past the graveyard”

As the economy emerges from the pandemic, the confluence of supply chain disruptions, pent-up demand and accommodative government policy has stoked inflation with the Consumer Price Index measure of inflation in the US up 5.4% in June.



Questioned on whether Core was afraid of the inflation monster, Noonan said: “I do have a really healthy respect for inflation. And that is a function of just having been in the business a long time, and living through some really vicious periods of claims inflation.”

He continued: “Anyone who isn’t focused on inflation in all of its components and its affect on claims costs is whistling past the graveyard.”

The executive dismissed talk from the Fed and others that inflation would be a transitory event as “ludicrous”.

“We are very focused on it [at Core],” he said. “We think it’s taking place today; it will be a 2022 phenomenon for the industry and a 2023 phenomenon for the industry. God help us – I hope it doesn't continue on for five or six years.”

Growth levers

With the business in its early build-out phase, the management team is focused on delivering growth. As a reference point, Consolino cited the 30% annual growth rate Validus sustained over its first five years in operation, noting that year-to-date Core had almost doubled its top line.

Consolino said that management was focused on using “all the tools at its disposal” with a view to “building a great company”. This has included organic growth in the business units it got via StarStone US, as well as the creation of new units including property and agriculture.

“And with the Lancer merger, we have proven we can grow through sensible M&A,” the Core Specialty CEO said.

Challenged on the industry’s weak track record in commercial auto, Noonan said: “The very nature of your question is why we bought Lancer - people don't make money in commercial auto.

He continued: “We talked about commercial auto as another class that would ostensibly fit our business mode. But on the idea of starting a commercial auto division, we just said we might as well dig a hole, fill it with hundred dollar bills, and burn it and repeat that process every day.”

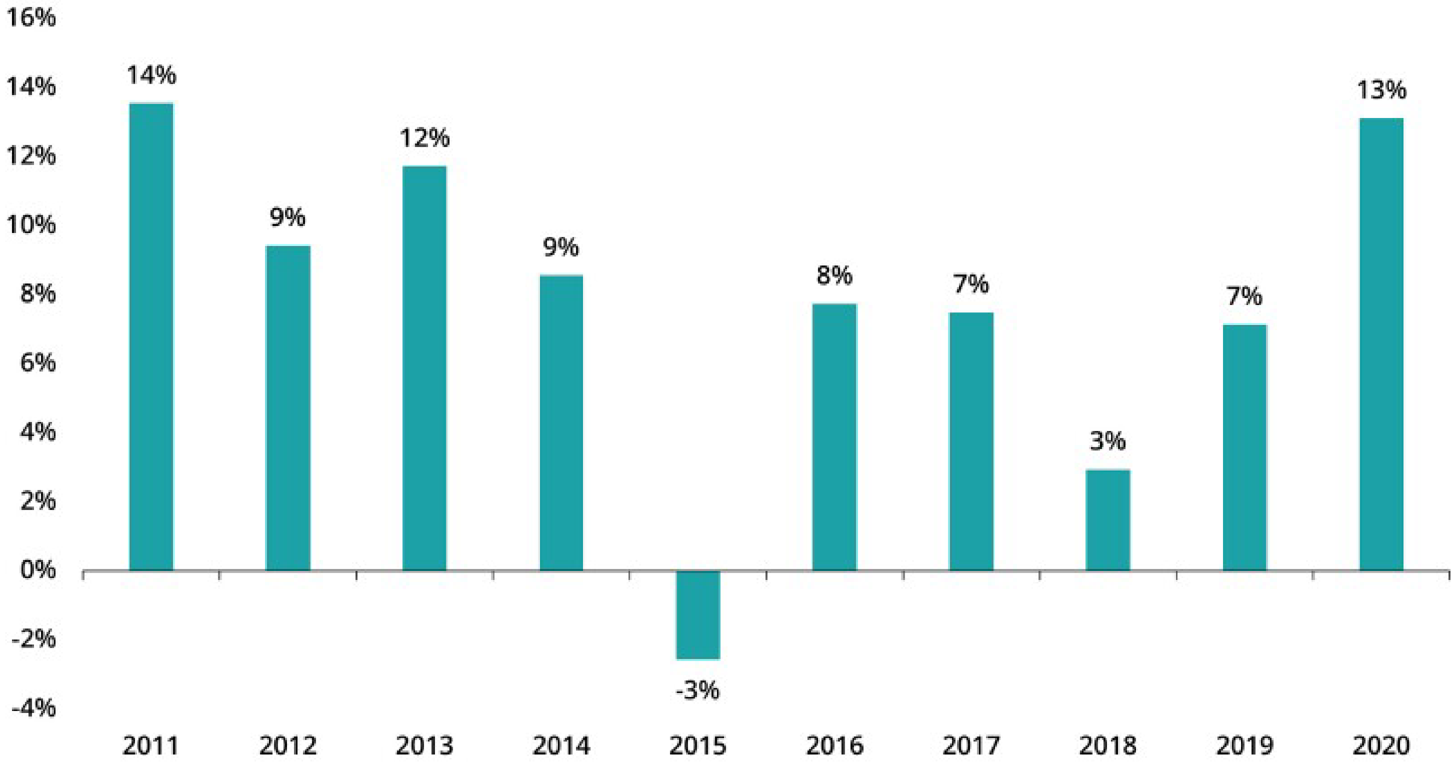
Noonan said that Lancer has outperformed the industry in commercial auto by 7 points, and has done it through “old school underwriting”, including spending real time with clients and creating an “extraordinary” claims network around the country.

“They live and breathe commercial auto – that is the culture of the company," he said.

Consolino added that the combination of Lancer’s “exemplary” track record and rates being higher than at any period going back to 2000 explained why they felt it was an attractive opportunity despite the industry’s overall weak record in the class.

Lancer has had a negative ROE only once in the last decade

Lancer Financial Group's return on average equity (C&S), 2011-20



Source: S&P Global Market Intelligence

E&S is still a good place to be

The E&S market has enjoyed a combination of rapidly rising rates and surging submission flows since 2019, and a number of sources have suggested these positive competitive dynamics are holding up better than in the standard lines market.

Questioned on this dynamic, Consolino said that there is "something to what you are hearing", with evidence of greater buoyancy in E&S rates despite signs of a tapering-off of rises since last year.

Noonan said that there are much narrower limits around how far rate can be pushed in the admitted market, where competition is healthy. "You can push rate only so far then you start to lose business very quickly," he said.

"That phenomenon always exists in the insurance industry, but it is occurring in the standard lines business to a much greater extent than we are seeing in the E&S business at this point."

The former Validus CEO concluded: "So while the really hard peak may have passed in the E&S business, we are still in a really constructive environment, with demand continuing to increase and rates still in firmly positive territory in most classes."

Consolino elaborated on the continued increase in submission flow by pointing to a 117% increase in healthcare in Q1, alongside a 21% increase in D&O and a 15% increase in excess casualty.

M&A playbook

Consolino and Noonan have been amongst the most prolific – and successful – exponents of M&A on the carrier side.

This was most evident at Validus where the company made six meaningful acquisitions, as well as securing a skilful exit. But Consolino was also involved in a number of deals at AFG including the acquisition of workers comp writer Summit and the purchase of the remainder of National Interstate. Prior to his time at Validus, he was a deal banker at Merrill Lynch.

Major Validus acquisitions under Consolino and Noonan

Announcement date	Target	Consideration
14 May 2007	Talbot Underwriting	$382mn
9 July 2009	IPC	$1,785mn
30 August 2012	Flagstone Reinsurance	$896mn
1 February 2013	Longhorn Re	-
23 June 2014	Western World Insurance	$690mn
30 January 2017	ADM Crop Risk Services	$186mn

Source: S&P Global Market Intelligence

Noonan said that one of the keys to successful M&A is proactively identifying targets, and not relying on investment bankers to pitch you ideas from the same deal book that goes to every company.

“Lancer wasn't on anybody's horizon - that wasn't in any banker’s book,” he said, pointing out that decades-long relationships provided the firm the chance to pursue the deal.

He added that it is also important to be able to see value where others don’t, referencing the highly discounted deal for teetering Bermudian reinsurer Flagstone that delivered high returns.

Consolino echoed this and said the same had been true of Talbot where they were able to support a premium valuation owing to their better understanding of reserve redundancies and potential profitability than other suitors.

“So, you know, a lot of life is just paying attention and being diligent doing your work,” he continued. “And for whatever reason, we seem to be better at that than some others.”

Noonan added that having an ownership stake in the business you run, and taking an ownership mentality is also key to acquiring well.

“We take it all very personally. If you're asking me to pay a premium for your company, I know exactly how much is coming out of my pocket and dilution for doing that.

“And you know, it makes decision making much closer to home – it’s not an abstraction where you’re just using capital per se that you’ve been hired to manage or run.”