

Enstar Group LTD
Form 10-Q
November 04, 2011
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

**▶ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the Quarterly Period Ended September 30, 2011

OR

**• TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the Transition Period From _____ to _____

001-33289 Commission File Number

ENSTAR GROUP LIMITED

(Exact name of registrant as specified in its charter)

Bermuda
*(State or other jurisdiction
of incorporation or organization)*

N/A
*(I.R.S. Employer
Identification No.)*

P.O. Box HM 2267

Windsor Place, 3rd Floor

18 Queen Street

Hamilton HM JX

Bermuda

(Address of principal executive office, including zip code)

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(441) 292-3645

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 3, 2011, the registrant had outstanding 13,714,129 voting ordinary shares and 749,869 non-voting convertible ordinary shares, each par value \$1.00 per share.

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Table of Contents**PART I FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****ENSTAR GROUP LIMITED****UNAUDITED CONDENSED CONSOLIDATED BALANCE SHEETS**

As of September 30, 2011 and December 31, 2010

	September 30, 2011	December 31, 2010
	(expressed in thousands of U.S. dollars, except share data)	
ASSETS		
Short-term investments, available-for-sale, at fair value (amortized cost: 2011 \$ nil; 2010 \$7,209)	\$	\$ 7,263
Short-term investments, trading, at fair value	410,694	507,978
Fixed maturities, available-for-sale, at fair value (amortized cost: 2011 \$702,842; 2010 \$1,068,540)	716,656	1,094,947
Fixed maturities, trading, at fair value	1,887,557	524,122
Equities, trading, at fair value	81,535	60,082
Other investments, at fair value	200,399	234,714
Total investments	3,296,841	2,429,106
Cash and cash equivalents	762,577	799,154
Restricted cash and cash equivalents	452,429	656,200
Accrued interest receivable	29,767	19,980
Accounts receivable	24,627	24,790
Income taxes recoverable	12,186	7,968
Reinsurance balances receivable	1,939,300	961,442
Funds held by reinsured companies	202,844	274,699
Goodwill	21,222	21,222
Other assets	33,818	41,343
TOTAL ASSETS	\$ 6,775,611	\$ 5,235,904
LIABILITIES		
Losses and loss adjustment expenses	\$ 4,739,841	\$ 3,291,275
Reinsurance balances payable	203,383	231,435
Accounts payable and accrued liabilities	49,225	94,390
Income taxes payable	6,160	50,075
Loans payable	314,569	245,278
Other liabilities	124,916	107,630
TOTAL LIABILITIES	5,438,094	4,020,083
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS EQUITY		
Share capital		
Authorized, issued and fully paid, par value \$1 each (authorized 2011: 156,000,000; 2010: 156,000,000)		
Ordinary shares (issued and outstanding 2011: 13,521,018; 2010:12,940,021)	13,521	12,940

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Non-voting convertible ordinary shares:		
Series A (issued 2011: 2,972,892; 2010: 2,972,892)	2,973	2,973
Series B, C and D (issued and outstanding 2011: 749,869; 2010: nil)	750	
Treasury shares at cost (Series A non-voting convertible ordinary shares 2011: 2,972,892; 2010: 2,972,892)	(421,559)	(421,559)
Additional paid-in capital	775,471	667,907
Accumulated other comprehensive income	25,453	35,017
Retained earnings	676,085	651,143
Total Enstar Group Limited Shareholders Equity	1,072,694	948,421
Noncontrolling interest	264,823	267,400
TOTAL SHAREHOLDERS EQUITY	1,337,517	1,215,821
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	\$ 6,775,611	\$ 5,235,904

See accompanying notes to the unaudited condensed consolidated financial statements

Table of Contents**ENSTAR GROUP LIMITED****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS****For the Three and Nine Month Periods Ended September 30, 2011 and 2010**

	Three Months Ended		Nine Months Ended	
	September	September	September	September
	30,	30,	30,	30,
	2011	2010	2011	2010
	(expressed in thousands of U.S. dollars, except share and per share data)			
INCOME				
Consulting fees	\$ 1,623	\$ 2,119	\$ 7,704	\$ 19,747
Net investment income	18,966	20,165	60,436	69,284
Net realized and unrealized (losses) gains	(8,980)	10,635	(348)	8,610
Gain on bargain purchase			13,105	
	11,609	32,919	80,897	97,641
EXPENSES				
Net reduction in ultimate loss and loss adjustment expense liabilities:				
Reduction in estimates of net ultimate losses	(42,467)	(20,890)	(72,908)	(57,936)
Reduction in provisions for bad debt	(2,399)	(1,304)	(4,071)	(14,411)
Reduction in provisions for unallocated loss adjustment expense liabilities	(14,113)	(10,171)	(37,433)	(30,832)
Amortization of fair value adjustments	8,865	6,250	25,911	25,102
	(50,114)	(26,115)	(88,501)	(78,077)
Salaries and benefits	20,923	18,012	48,028	47,456
General and administrative expenses	20,759	13,185	66,720	39,473
Interest expense	2,435	2,961	6,098	8,160
Net foreign exchange (gains) losses	(8,878)	(586)	388	1,387
	(14,875)	7,457	32,733	18,399
EARNINGS BEFORE INCOME TAXES AND SHARE OF NET EARNINGS OF PARTLY OWNED COMPANY				
	26,484	25,462	48,164	79,242
INCOME TAXES	(4,436)	(979)	(6,028)	(23,016)
SHARE OF NET EARNINGS OF PARTLY OWNED COMPANY				
		1,351		10,704
NET EARNINGS	22,048	25,834	42,136	66,930
Less: Net earnings attributable to noncontrolling interest	(9,984)	(4,391)	(17,194)	(17,136)
NET EARNINGS ATTRIBUTABLE TO ENSTAR GROUP LIMITED	\$ 12,064	\$ 21,443	\$ 24,942	\$ 49,794
EARNINGS PER SHARE BASIC:				
Net earnings attributable to Enstar Group Limited ordinary shareholders	\$ 0.85	\$ 1.56	\$ 1.81	\$ 3.64

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EARNINGS PER SHARE DILUTED

Net earnings attributable to Enstar Group Limited ordinary shareholders	\$	0.83	\$	1.53	\$	1.78	\$	3.57
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Weighted average shares outstanding basic		14,270,003		13,704,832		13,743,191		13,676,113
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Weighted average shares outstanding diluted		14,559,164		14,019,768		14,025,144		13,956,948
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See accompanying notes to the unaudited condensed consolidated financial statements

Table of Contents**ENSTAR GROUP LIMITED****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME****For the Three and Nine Month Periods Ended September 30, 2011 and 2010**

	Three Months Ended September 30, 2011	September 30, 2010 (expressed in thousands of U.S. dollars)	Nine Months Ended September 30, 2011	September 30, 2010
NET EARNINGS	\$ 22,048	\$ 25,834	\$ 42,136	\$ 66,930
Other comprehensive income, net of tax:				
Unrealized holding (losses) gains on investments arising during the period	(15,060)	29,161	(485)	23,509
Reclassification adjustment for net realized and unrealized losses (gains) included in net earnings	8,980	(10,635)	348	(8,610)
Decrease in defined benefit pension liability			272	
Currency translation adjustment	(25,526)	36,662	(13,271)	19,546
Total other comprehensive (loss) income:	(31,606)	55,188	(13,136)	34,445
Comprehensive (loss) income	(9,558)	81,022	29,000	101,375
Less comprehensive income attributable to noncontrolling interest	(3,262)	(19,422)	(13,623)	(26,547)
COMPREHENSIVE (LOSS) INCOME ATTRIBUTABLE TO ENSTAR GROUP LIMITED	\$ (12,820)	\$ 61,600	\$ 15,377	\$ 74,828

See accompanying notes to the unaudited condensed consolidated financial statements

Table of Contents**ENSTAR GROUP LIMITED****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY****For the Nine Month Periods Ended September 30, 2011 and 2010**

	Nine Months Ended September 30, 2011 2010 (expressed in thousands of U.S. dollars)	
Share Capital - Ordinary Shares		
Balance, beginning of period	\$ 12,940	\$ 13,581
Issue of shares	539	47
Share awards granted/vested	42	79
Balance, end of period	\$ 13,521	\$ 13,707
Share Capital - Series A Non-Voting Convertible Ordinary Shares		
Balance, beginning and end of period	\$ 2,973	\$ 2,973
Share Capital - Series B, C and D Non-Voting Convertible Ordinary Shares		
Balance, beginning of period	\$	\$
Preferred shares converted	750	
Balance, end of period	\$ 750	\$
Share Capital - Preference Shares		
Balance, beginning of period	\$	\$
Issue of shares	750	
Shares converted	(750)	
Balance, end of period	\$	\$
Treasury Shares		
Balance, beginning and end of period	\$ (421,559)	\$ (421,559)
Additional Paid-in Capital		
Balance, beginning of period	\$ 667,907	\$ 721,120
Share awards granted/vested	168	5,286
Issue of shares and warrants, net	105,439	501
Amortization of share awards	1,957	599
Balance, end of period	\$ 775,471	\$ 727,506
Accumulated Other Comprehensive Income Attributable to Enstar Group Limited		
Balance, beginning of period	\$ 35,017	\$ 8,709
Foreign currency translation adjustments	(9,623)	13,726
Net movement in unrealized holdings gains (losses) on investments	(213)	11,308
Decrease in defined benefit pension liability	272	
Balance, end of period	\$ 25,453	\$ 33,743

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Retained Earnings		
Balance, beginning of period	\$ 651,143	\$ 477,057
Net earnings attributable to Enstar Group Limited	24,942	49,794
Balance, end of period	\$ 676,085	\$ 526,851
Noncontrolling Interest		
Balance, beginning of period	\$ 267,400	\$ 274,271
Return of capital	(16,200)	(32,963)
Contribution of capital		28,742
Dividends paid		(7,000)
Net earnings attributable to noncontrolling interest	17,194	17,136
Foreign currency translation adjustments	(3,647)	5,821
Net movement in unrealized holding gains on investments	76	3,591
Balance, end of period	\$ 264,823	\$ 289,598

See accompanying notes to the unaudited condensed consolidated financial statements

Table of Contents**ENSTAR GROUP LIMITED****UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****For the Nine Month Periods Ended September 30, 2011 and 2010**

	Nine Months Ended September 30,	
	2011	2010
	(expressed in thousands of U.S. dollars)	
OPERATING ACTIVITIES:		
Net earnings	\$ 42,136	\$ 66,930
Adjustments to reconcile net earnings to cash flows used in operating activities:		
Gain on bargain purchase	(13,105)	
Share of undistributed net earnings of partly owned company		(10,704)
Net realized and unrealized investment loss (gain)	348	(8,610)
Share of net gain from other investments	(7,331)	(11,225)
Other items	5,404	(663)
Depreciation and amortization	1,194	1,053
Amortization of bond premiums and discounts	16,717	6,540
Net movement of trading securities held on behalf of policyholders	(1,039)	22,772
Sales and maturities of trading securities	993,125	313,654
Purchases of trading securities	(1,535,777)	(1,072,799)
Changes in assets and liabilities:		
Reinsurance balances receivable	88,289	(18,743)
Other assets	75,142	(80,229)
Losses and loss adjustment expenses	(210,735)	184,212
Reinsurance balances payable	(29,683)	24,343
Accounts payable and accrued liabilities	(45,348)	(19,142)
Other liabilities	(62,877)	(27,541)
Net cash flows used in operating activities	(683,540)	(630,152)
INVESTING ACTIVITIES:		
Acquisitions, net of cash acquired	(88,505)	155,435
Sales and maturities of available-for-sale securities	332,560	57,335
Purchase of held-to-maturity securities		(780,848)
Maturity of held-to-maturity securities		786,651
Movement in restricted cash and cash equivalents	210,968	73,354
Funding of other investments	(25,703)	(89,426)
Redemption of bond funds	66,925	
Sale of investment in partly owned company		31,554
Other investing activities	(282)	(467)
Net cash flows provided by investing activities	495,963	233,588
FINANCING ACTIVITIES:		
Net proceeds from issuance of shares	105,921	
Distribution of capital to noncontrolling interest	(16,200)	(32,963)
Contribution to surplus of subsidiary by noncontrolling interest		28,742
Dividends paid to noncontrolling interest		(7,000)
Receipt of loans	274,150	46,400
Repayment of loans	(207,016)	(93,560)

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Net cash flows provided by (used in) financing activities	156,855	(58,381)
TRANSLATION ADJUSTMENT	(5,855)	12,277
NET DECREASE IN CASH AND CASH EQUIVALENTS	(36,577)	(442,668)
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	799,154	1,266,445
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 762,577	\$ 823,777

Supplemental Cash Flow Information

Net income taxes paid	\$ 59,700	\$ 58,625
Interest paid	\$ 6,359	\$ 8,103

See accompanying notes to the unaudited condensed consolidated financial statements

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ENSTAR GROUP LIMITED

NOTES TO THE UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2011 and December 31, 2010

(Tabular information expressed in thousands of U.S. dollars except share and per share data)

(unaudited)

1. BASIS OF PREPARATION AND CONSOLIDATION

The Company's condensed consolidated financial statements have not been audited. These statements have been prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, these financial statements reflect all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the Company's financial position and results of operations as at the end of and for the periods presented. Results of operations for subsidiaries acquired are included from the dates of their acquisition by the Company. The results of operations for any interim period are not necessarily indicative of the results for a full year. Inter-company accounts and transactions have been eliminated. In these notes, the terms we, us, our, or the Company refer to Enstar Group Limited and its direct and indirect subsidiaries. The following information should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

Adoption of New Accounting Standards

Effective January 1, 2011, the Company adopted the new guidance issued by the U.S. Financial Accounting Standards Board (FASB), which provides additional guidance for performing Step 1 of the test for goodwill impairment when an entity has reporting units with zero or negative carrying values. As of September 30, 2011, none of the Company's reporting units were at risk of failing Step 1 of the test for goodwill impairment. Under the new guidance, Step 2 of the goodwill impairment test must be performed when adverse qualitative factors indicate that goodwill is more likely than not impaired. The adoption of the revised guidance did not have a material impact on the consolidated financial statements.

Effective January 1, 2011, the Company adopted the new guidance issued by FASB, which specifies that if a public entity presents comparative financial statements, the entity should disclose, in its supplementary pro-forma information, revenue and earnings of the combined entity as though the business combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The adoption of the revised guidance did not have a material impact on the consolidated financial statements.

Recently Issued Accounting Standards Not Yet Adopted

In May 2011, FASB issued amendments to disclosure requirements for common fair value measurement. These amendments, effective for the interim and annual periods beginning on or after December 15, 2011 (early adoption is prohibited), result in a common definition of fair value and common requirements for measurement of and disclosure requirements under U.S. GAAP and International Financial Reporting Standards. Consequently, the amendments change some fair value measurement principles and disclosure requirements. The implementation of this amended accounting guidance is not expected to have a material impact on the consolidated financial statements.

In June 2011, FASB issued amendments to disclosure requirements for presentation of comprehensive income. This guidance, effective retrospectively for the interim and annual periods beginning on or after December 15, 2011 (early adoption is permitted), requires presentation of total comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The implementation of this amended accounting guidance is not expected to have a material impact on the consolidated financial statements.

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ENSTAR GROUP LIMITED
NOTES TO THE UNAUDITED CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS (Continued)

1. BASIS OF PREPARATION AND CONSOLIDATION (cont d)

In September 2011, FASB issued amendments that simplify the current two-step goodwill impairment test previously required by permitting entities to first perform a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If the entity determines that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, it would then perform the first step of the goodwill impairment test; otherwise, no further impairment test would be required. The amended guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011 (early adoption is permitted). The implementation of this amended accounting guidance is not expected to have a material impact on the consolidated financial statements.

The Company has determined that all other recently issued accounting pronouncements do not apply to its operations.

2. ACQUISITIONS

The Company accounts for acquisitions using the purchase method of accounting, which requires that the acquirer record the assets and liabilities acquired at their estimated fair value. The fair values of reinsurance assets and liabilities acquired are derived from probability weighted ranges of the associated projected cash flows, based on actuarially prepared information and management's run-off strategy. Any amendment to the fair values resulting from changes in such information or strategy will be recognized when the changes occur.

Laguna

On March 25, 2011, the Company, through its wholly-owned subsidiary, Kenmare Holdings Ltd., completed the acquisition of Laguna Life Limited, formerly known as CitiLife Financial Limited (Laguna), from Citigroup Insurance Holding Corporation (Citigroup), an affiliate of Citigroup Inc. Laguna is an Ireland-based life insurer that is in run-off. The purchase price was 15.0 million (approximately \$21.2 million) and was funded from available cash on hand. The previously disclosed purchase price of 30.0 million (approximately \$42.4 million) was reduced, prior to completion of the acquisition, after Citigroup received approval from Laguna's regulator to distribute 15.0 million (approximately \$21.2 million) to its shareholders.

The purchase price and fair value of the net assets acquired in the Laguna acquisition were as follows:

Purchase price	\$ 21,223
Net assets acquired at fair value	\$ 34,328
Excess of net assets over purchase price (gain on bargain purchase)	\$ (13,105)

The gain on bargain purchase of approximately \$13.1 million, relating to the acquisition of Laguna, arose primarily as a result of the reassessment by the Company, upon acquisition, of the total required estimated costs to manage the business to expiry. The Company's assessment of costs was lower than the acquired costs recorded by the vendor in the financial statements of Laguna.

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ENSTAR GROUP LIMITED
NOTES TO THE UNAUDITED CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. ACQUISITIONS (cont d)

The following summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition:

Cash	\$ 13,274
Investments:	
Short-term investments, trading	1,154
Fixed maturities, trading	30,765
Total investments	31,919
Reinsurance balances receivable	1,459
Other assets	1,325
Losses and loss adjustment expenses	(11,898)
Accounts payable	(1,751)
 Net assets acquired at fair value	 \$ 34,328

From March 25, 2011, the date of acquisition, to September 30, 2011, the Company has recorded \$2.4 million in revenues and \$nil net earnings related to Laguna in its consolidated statement of earnings.

Clarendon

On July 12, 2011, the Company, through its wholly-owned subsidiary, Clarendon Holdings, Inc., completed the acquisition of 100% of the shares of Clarendon National Insurance Company (Clarendon) from Clarendon Insurance Group, Inc., an affiliate of Hannover Re (Hannover). Clarendon is a New Jersey-domiciled insurer that is in run-off. Clarendon owns three other insurers, two domiciled in New Jersey and one domiciled in Florida, that are also in run-off. The purchase price was \$219.1 million and was financed in part by \$106.5 million under a four-year term loan facility provided by National Australia Bank Limited (NAB) and the remainder from available cash on hand.

In addition, on July 12, 2011, the Company, through its wholly-owned subsidiary, Fitzwilliam Insurance Limited (Fitzwilliam), in connection with the acquisition of Clarendon, entered into a reinsurance agreement with Hannover, which provides adverse development cover (ADC) to Clarendon to reinsure Hannover for the first \$80.0 million of the ADC. The Company provided a parental guarantee to Hannover in the amount of \$80.0 million supporting the obligations of Fitzwilliam.

The purchase price and fair value of the net assets acquired in the Clarendon acquisition were as follows:

Purchase price	\$ 219,077
 Net assets acquired at fair value	 \$ 219,077

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ENSTAR GROUP LIMITED
NOTES TO THE UNAUDITED CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. ACQUISITIONS (cont d)

The following summarizes the preliminary estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition, pending finalization of certain valuations:

Cash ..	\$ 138,518
Restricted cash	7,198
Investments:	
Short-term investments, trading	60,376
Fixed maturities, trading	623,530
Equities	5,014
Total investments	688,920
Reinsurance balances receivable	1,065,341
Accrued interest and other receivables	9,655
Losses and loss adjustment expenses	(1,654,436)
Insurance balances payable	(1,942)
Funds withheld	(26,277)
Other liabilities	(7,900)
Net assets acquired at fair value	\$ 219,077

From July 12, 2011, the date of acquisition, to September 30, 2011, the Company has recorded \$3.0 million in revenues and a \$1.1 million net loss related to Clarendon in its consolidated statement of earnings.

Because Clarendon's revenues and net loss are included in the Company's statement of earnings for the three months ended September 30, 2011, the Company has not included pro forma financial information for such period. The following pro forma condensed combined income statement for the nine months ended September 30, 2011 combines the historical consolidated statements of earnings of the Company with those of Clarendon, giving effect to the business combinations and related transactions as if they had occurred on January 1, 2011.

Nine Months Ended September 30, 2011	Enstar Group Limited	Clarendon	Proforma Adjustments	Enstar Group Limited - Proforma
Total income	\$ 80,897	\$ 9,720	\$	\$ 90,617
Total expenses	(38,761)	(43,425)	(4,562)(a)	(86,748)
Noncontrolling interest	(17,194)			(17,194)
Net earnings (loss)	\$ 24,942	\$ (33,705)	\$ (4,562)	\$ (13,325)

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Net loss per ordinary share basic	\$ (0.97)
Weighted average shares outstanding basic	13,743,191

Notes to the Nine Months Ended September 30, 2011 Pro Forma Condensed Consolidated Statement of Earnings:

Expenses:

(a) (i) Adjustment to interest expense to reflect the financing costs of the acquisition for the period	\$ (1,772)
(ii) Adjustment to recognize amortization of fair value adjustments	(3,410)
(iii) Adjustment to income taxes for proforma adjustments	620
	\$ (4,562)

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ENSTAR GROUP LIMITED
NOTES TO THE UNAUDITED CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. ACQUISITIONS (cont d)

The following pro forma condensed combined income statements for the three and nine months ended September 30, 2010 combines the historical consolidated statements of earnings of the Company with those of Clarendon, giving effect to the business combination and related transactions as if they had occurred on January 1, 2010.

Three Months Ended September 30, 2010	Enstar Group Limited	Clarendon	Proforma Adjustments	Enstar Group Limited - Proforma
Total income	\$ 32,919	\$ 9,194	\$	\$ 42,113
Total expenses	(8,436)	(8,813)	(2,272) (a)	(19,521)
Share of net earnings of partly owned company	1,351			1,351
Noncontrolling interest	(4,391)			(4,391)
Net earnings (loss)	\$ 21,443	\$ 381	\$ (2,272)	\$ 19,552
Net earnings per ordinary share basic				\$ 1.43
Net earnings per ordinary share diluted				\$ 1.39
Weighted average shares outstanding basic				13,704,832
Weighted average shares outstanding diluted				14,019,768

Notes to the Three Months Ended September 30, 2010 Pro Forma Condensed Consolidated Statement of Earnings:

Expenses:

(a) (i) Adjustment to interest expense to reflect the financing costs of the acquisition for the period	\$ (1,029)
(ii) Adjustment to recognize amortization of fair value adjustments	(1,603)
(iii) Adjustment to income taxes for proforma adjustments	360
	\$ (2,272)

Nine Months Ended September 30, 2010	Enstar Group Limited	Clarendon	Proforma Adjustments	Enstar Group Limited -
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				Proforma
Total income	\$ 97,641	\$ 18,190	\$	\$ 115,831
Total expenses	(41,415)	171,537	(7,445) (a)	122,677
Share of net earnings of partly owned company	10,704			10,704
Noncontrolling interest	(17,136)			(17,136)
Net earnings (loss)	\$ 49,794	\$ 189,727	\$ (7,445)	\$ 232,076
Net earnings per ordinary share basic				\$ 16.97
Net earnings per ordinary share diluted				\$ 16.63
Weighted average shares outstanding basic				13,676,113
Weighted average shares outstanding diluted				13,956,948

Table of Contents**ENSTAR GROUP LIMITED****NOTES TO THE UNAUDITED CONDENSED****CONSOLIDATED FINANCIAL STATEMENTS (Continued)****2. ACQUISITIONS (cont d)****Notes to the Nine Months Ended September 30, 2010 Pro Forma Condensed Consolidated Statement of Earnings:**

Expenses:

(a) (i) Adjustment to interest expense to reflect the financing costs of the acquisition for the period	\$ (3,086)
(ii) Adjustment to recognize amortization of fair value adjustments	(5,439)
(iii) Adjustment to income taxes for proforma adjustments	1,080
	\$ (7,445)

The foregoing pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have been achieved if the acquisition had taken place on January 1, 2011 or 2010, respectively.

3. SIGNIFICANT NEW BUSINESS**Shelbourne RITC Transactions**

In December 2007, the Company, in conjunction with JCF FPK I L.P. (JCF FPK) and a newly-hired executive management team, formed U.K.-based Shelbourne Group Limited (Shelbourne) to invest in Reinsurance to Close or RITC transactions (the transferring of liabilities from one Lloyd's syndicate to another) with Lloyd's of London insurance and reinsurance syndicates in run-off. The Company owns approximately 56.8% of Shelbourne, which in turn owns 100% of Shelbourne Syndicate Services Limited, the Managing Agency for Lloyd's Syndicate 2008, a syndicate approved by Lloyd's of London on December 16, 2007 to undertake RITC transactions with Lloyd's syndicates in run-off.

JCF FPK is a joint investment program between Fox-Pitt, Kelton, Cochran, Caronia & Waller (USA) LLC (FPK) and J.C. Flowers II, L.P. (the Flowers Fund). The Flowers Fund is a private investment fund advised by J.C. Flowers & Co. LLC. J. Christopher Flowers, one of the Company's largest shareholders and formerly a member of the Company's board of directors, is the Chairman and Chief Executive Officer of J.C. Flowers & Co. LLC. In addition, an affiliate of the Flowers Fund controlled approximately 41% of FPK until its sale of FPK in December 2009.

In February 2011, Lloyd's Syndicate 2008 entered into RITC agreements with two Lloyd's syndicates with total gross insurance reserves of approximately \$129.6 million. The capital commitment to Lloyd's Syndicate 2008 with respect to these two RITC agreements amounted to £21.3 million (approximately \$34.1 million), which was fully funded by the Company from available cash on hand.

Claremont

On September 1, 2011, the Company, through its wholly-owned subsidiary, Fitzwilliam, entered into a novation agreement with another of its wholly-owned subsidiaries, Claremont Liability Insurance Company (Claremont), and certain of its reinsurers with respect to three specific quota share contracts. Under the novation agreement, Fitzwilliam replaced those companies as reinsurer of Claremont on the quota share contracts in exchange for total assets and liabilities of approximately \$22.5 million.

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Insurance Australia Group

On September 20, 2011, the Company, through its wholly-owned subsidiary, Gordian Run-off Limited (Gordian), acquired an inwards reinsurance portfolio from Insurance Australia Group Ltd via an Australian Federal Court approved scheme. Gordian received total assets and assumed total net reinsurance liabilities of approximately \$8.6 million (approximately \$8.8 million Australian dollars).

Table of Contents**ENSTAR GROUP LIMITED****NOTES TO THE UNAUDITED CONDENSED****CONSOLIDATED FINANCIAL STATEMENTS (Continued)****4. RESTRICTED CASH AND CASH EQUIVALENTS**

Restricted cash and cash equivalents were \$452.4 million and \$656.2 million as of September 30, 2011 and December 31, 2010, respectively. The restricted cash and cash equivalents are used as collateral against letters of credit and as guarantees under trust agreements. Letters of credit and guarantees are issued to ceding insurers as security for the obligations of insurance subsidiaries under reinsurance agreements with those ceding insurers.

5. INVESTMENTS*Available-for-sale*

The amortized cost and estimated fair values of the Company's fixed maturity securities and short-term investments classified as available-for-sale were as follows:

	Amortized Cost	Gross Unrealized Holding Gain	Gross Unrealized Holding Losses Non-OTTI	Fair Value
As at September 30, 2011				
U.S. government and agency	\$ 27,460	\$ 685	\$ (16)	\$ 28,129
Non-U.S. government	178,832	4,769	(327)	183,274
Corporate	446,791	7,954	(1,875)	452,870
Residential mortgage-backed	15,312	307	(117)	15,502
Commercial mortgage-backed	12,904	2,882	(20)	15,766
Asset backed	21,543	75	(503)	21,115
	\$ 702,842	\$ 16,672	\$ (2,858)	\$ 716,656

	Amortized Cost	Gross Unrealized Holding Gain	Gross Unrealized Holding Losses Non-OTTI	Fair Value
As at December 31, 2010				
U.S. government and agency	\$ 65,115	\$ 766	\$ (92)	\$ 65,789
Non-U.S. government	248,487	8,832	(314)	257,005
Corporate	695,372	16,513	(1,615)	710,270
Residential mortgage-backed	20,036	305	(234)	20,107
Commercial mortgage-backed	19,667	2,083	(11)	21,739
Asset backed	27,072	574	(346)	27,300
	\$ 1,075,749	\$ 29,073	\$ (2,612)	\$ 1,102,210

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ENSTAR GROUP LIMITED
NOTES TO THE UNAUDITED CONDENSED
CONSOLIDATED FINANCIAL STATEMENTS (Continued)

5. INVESTMENTS (cont d)

The following tables summarize the Company's fixed maturity securities and short-term investments classified as available-for-sale in an unrealized loss position as well as the aggregate fair value and gross unrealized loss by length of time the security has continuously been in an unrealized loss position:

	000000 12 Months or Greater	000000 Unrealized Losses	000000 Less Than 12 Months	000000 Unrealized Losses	000000 Fair Value	000000 Total Unrealized Losses
<u>As at September 30, 2011</u>						
U.S. government and agency	\$	\$	\$ 10,008	\$ (16)	\$ 10,008	\$ (16)
Non-U.S. government	14,597	(284)	20,975	(43)	35,572	(327)
Corporate	64,040	(1,295)	57,029	(580)	121,069	(1,875)
Residential mortgage-backed	1,579	(110)	353	(7)	1,932	(117)
Commercial mortgage-backed	125	(20)	136		261	(20)
Asset backed	13,731	(503)			13,731	(503)
	\$ 94,072	\$ (2,212)	\$ 88,501			