

Castlewood Holdings LTD  
Form 424B3  
December 21, 2006

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Filed Pursuant to Rule 424(b)(3)  
Registration No. 333-135699

THE ENSTAR GROUP, INC.

PROXY STATEMENT  
FOR ANNUAL MEETING OF SHAREHOLDERS  
To Be Held on January 30, 2007

**MERGER PROPOSED YOUR VOTE IS VERY IMPORTANT**

This proxy statement/prospectus is being furnished to the shareholders of The Enstar Group, Inc., or Enstar, in connection with the solicitation of proxies by the board of directors of Enstar for use at the Annual Meeting of Shareholders to be held on January 30, 2007, or the Annual Meeting, at Flowers Hall, Huntingdon College, at 1500 East Fairview Avenue, Montgomery, Alabama 36106, at 9:00 a.m., local time, and at any adjournment thereof.

Enstar and Castlewood Holdings Limited, or Castlewood, a partially-owned affiliate of Enstar engaged in the acquisition and management of insurance and reinsurance companies in run-off and the provision of management, consultancy and other services to the insurance and reinsurance industry, have agreed on a merger transaction involving the two companies. If the merger agreement and the transactions contemplated by the merger agreement are approved and the merger is consummated:

each share of Enstar common stock will be exchanged for one ordinary share of Castlewood;

Enstar will be a wholly-owned subsidiary of Castlewood;

Castlewood, which will be renamed Enstar Group Limited and which we sometimes refer to in this proxy statement/prospectus as New Enstar, will be a publicly-traded company;

Enstar shareholders as of the applicable record date will receive a \$3.00 per share cash dividend on their Enstar common stock, which will be paid immediately prior to the merger; and

current shareholders of Enstar will own approximately 48.7% of New Enstar's issued ordinary shares, and current Castlewood shareholders, other than Enstar, will own the remaining approximately 51.3% of New Enstar's issued ordinary shares.

Castlewood has applied to have the New Enstar ordinary shares listed on the NASDAQ Global Select Market under the ticker symbol ESGR.

After careful consideration, Enstar's board of directors, including all its independent directors, has determined that the merger agreement and the transactions contemplated by the merger agreement are fair and in the best interest of Enstar and its shareholders. In addition, Enstar's board of directors, with all of Enstar's directors present and voting, has unanimously approved the merger agreement and the transactions contemplated by the merger agreement and unanimously recommends that you vote for the approval of the merger agreement and the transactions contemplated by the merger agreement. Some of Enstar's directors and executive officers have interests in the merger and relationships that are different from, or in addition to, yours. These interests and relationships are discussed in **Interests of Certain Persons in the Merger** beginning on page 60 and **Certain Relationships and Related Transactions**

beginning on page 182 of the enclosed proxy statement/prospectus. In order to consummate the merger, Enstar's shareholders must approve the merger agreement and the transactions contemplated by the merger agreement.

As of December 12, 2006, Enstar's directors and executive officers owned 1,904,763 shares of Enstar common stock, representing approximately 33.2% of the voting power of Enstar common stock on that date. Three of those directors, who owned Enstar common stock representing 30.1% of the voting power on that date, have entered into a support agreement with Castlewood pursuant to which such directors have agreed to vote their shares of Enstar common stock in favor of the merger agreement and the transactions contemplated by the merger agreement. All other Enstar directors and officers have also indicated that they intend to vote their shares of Enstar common stock in favor of the merger agreement and the transactions contemplated by the merger agreement.

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Enstar's annual meeting, at which shareholders were to elect directors and ratify the appointment of Enstar's independent registered public accounting firm, was originally scheduled for June 2, 2006. On May 21, 2006, Enstar's board of directors voted to postpone the June 2, 2006 annual meeting so that the merger transaction could be described to Enstar shareholders and voted on by them at the same meeting. This proxy statement/prospectus describes the merger transaction.

Enstar's board of directors also recommends that you vote for T. Whit Armstrong and T. Wayne Davis to hold office as directors of Enstar until the 2009 annual meeting of shareholders of Enstar, or until their successors are duly elected and qualified, and to vote for the proposal to ratify the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar for 2006. If the merger is consummated, New Enstar, as the sole shareholder of Enstar, will be able to determine the composition of the board of directors of Enstar and select the independent auditors of Enstar in the future.

All shareholders of Enstar are invited to attend the Annual Meeting. **Your participation at the Annual Meeting, in person or by proxy, is very important.** Even if you only own a few shares, we want your shares to be represented at the Annual Meeting. The merger cannot be consummated without the approval of the holders of a majority of the outstanding voting power of the common stock of Enstar.

The affirmative vote of a plurality of the shares of Enstar common stock present in person or by proxy at the Annual Meeting and entitled to vote is required to elect directors. The affirmative vote of the majority of the shares of Enstar common stock represented at the Annual Meeting and entitled to vote on the subject matter is required with respect to the ratification of the appointment of Deloitte & Touche LLP as Enstar's independent registered public accounting firm and the approval of any other matter that may properly come before the Annual Meeting.

Whether or not you plan to attend the Annual Meeting, please take the time to vote by completing, signing, dating and returning the enclosed proxy card in the enclosed postage-prepaid envelope. If you sign, date and mail your proxy card without indicating how you want to vote, your proxy will be counted as a vote for approval of the merger agreement and the transactions contemplated by the merger agreement, for the election of T. Whit Armstrong and T. Wayne Davis as directors and for the ratification of the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar for 2006. If you fail to return your card, the effect will be a vote against the merger. Each proxy is revocable and will not affect your right to vote in person in the event you attend the Annual Meeting.

This document is a prospectus of Castlewood relating to the issuance of its ordinary shares in connection with the merger and a proxy statement for Enstar to use in soliciting proxies for its Annual Meeting. It contains answers to frequently asked questions beginning on page Q-1 and a summary description of the merger beginning on page 1, followed by a more detailed discussion of the merger and related matters. **You should also consider the matters discussed under RISK FACTORS commencing on page 21 of the enclosed proxy statement/prospectus.** We urge you to review the entire document carefully.

Nimrod T. Frazer  
Chairman of the Board and Chief Executive Officer  
The Enstar Group, Inc.

**None of the Securities and Exchange Commission, any state securities regulators, the Registrar of Companies in Bermuda or the Bermuda Monetary Authority has approved or disapproved of these securities or passed on the adequacy or accuracy of this proxy statement/prospectus. Any representation to the contrary is a criminal offense.**

**This proxy statement/prospectus is dated December 15, 2006, and is first being mailed to shareholders on or about December 20, 2006.**

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**THE ENSTAR GROUP, INC.**

**NOTICE OF ANNUAL MEETING OF SHAREHOLDERS  
To Be Held on January 30, 2007**

To the Shareholders of The Enstar Group, Inc.:

The Annual Meeting of Shareholders of The Enstar Group, Inc., or Enstar, will be held on January 30, 2007 at Flowers Hall, Huntingdon College, at 1500 East Fairview Avenue, Montgomery, Alabama 36106, at 9:00 a.m., local time, for the following purposes:

- (i) to consider and vote upon a proposal to approve the Agreement and Plan of Merger, or merger agreement, dated as of May 23, 2006, by and among Castlewood Holdings Limited, CWMS Subsidiary Corp. and Enstar, and the transactions contemplated by the merger agreement;
- (ii) to elect two directors for three-year terms expiring at the annual meeting of shareholders in 2009 or until their successors are duly elected and qualified;
- (iii) to ratify the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar to serve for 2006; and
- (iv) to transact such other business as may properly come before the Annual Meeting or any adjournment thereof.

Enstar will not be able to consummate the merger unless its shareholders approve the merger agreement and the transactions contemplated by the merger agreement.

The board of directors of Enstar has fixed the close of business on December 12, 2006 as the record date for the determination of shareholders entitled to receive notice of, and to vote at, the Annual Meeting and any adjournment thereof. A list of shareholders as of the record date will be open for examination during the Annual Meeting.

The board of directors of Enstar, with all of Enstar's directors present and voting, has unanimously approved the merger agreement and the transactions contemplated by the merger agreement and unanimously recommends that the shareholders of Enstar vote for the approval of the merger agreement and the transactions contemplated by the merger agreement. The board of directors of Enstar also recommends that you vote for T. Whit Armstrong and T. Wayne Davis to hold office until the 2009 annual meeting of shareholders, or until their successors are duly elected and qualified, and that you vote for the proposal to ratify the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar for 2006.

Your attention is directed to the proxy statement/prospectus submitted with this notice. This notice is being given at the direction of the board of directors of Enstar.

By Order of the Board of Directors

Cheryl D. Davis  
Chief Financial Officer, Vice-President of  
Corporate Taxes and Secretary

Montgomery, Alabama  
December 15, 2006

**WHETHER OR NOT YOU EXPECT TO ATTEND THE ANNUAL MEETING, PLEASE COMPLETE, SIGN AND DATE THE ENCLOSED PROXY AND RETURN IT PROMPTLY IN THE ENCLOSED ENVELOPE. IF YOU ATTEND THE MEETING, YOU MAY REVOKE THE PROXY AND VOTE IN PERSON IF YOU WISH, EVEN IF YOU HAVE PREVIOUSLY RETURNED YOUR PROXY.**

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**NOTE ON REFERENCES TO ADDITIONAL INFORMATION**

THIS PROXY STATEMENT/PROSPECTUS INCORPORATES IMPORTANT BUSINESS AND FINANCIAL INFORMATION ABOUT THE ENSTAR GROUP, INC. THAT MAY NOT BE INCLUDED IN OR DELIVERED WITH THIS DOCUMENT. THIS INFORMATION IS AVAILABLE WITHOUT CHARGE TO SHAREHOLDERS OF ENSTAR AT A WEBSITE MAINTAINED BY THE SECURITIES AND EXCHANGE COMMISSION AT [HTTP://WWW.SEC.GOV](http://www.sec.gov), AS WELL AS UPON WRITTEN OR ORAL REQUEST TO:

THE ENSTAR GROUP, INC.  
CORPORATE SECRETARY  
401 MADISON AVENUE  
MONTGOMERY, ALABAMA 36104  
(334) 834-5483

IF YOU WOULD LIKE TO REQUEST DOCUMENTS, PLEASE DO SO BY JANUARY 12, 2007 IN ORDER TO RECEIVE THEM BEFORE THE ANNUAL MEETING.

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**QUESTIONS AND ANSWERS ABOUT THE MERGER AND THE ANNUAL MEETING**

The following are some questions that you, as a shareholder of The Enstar Group, Inc., or Enstar, may have regarding the merger and the other matters being considered at the Annual Meeting of Enstar's shareholders and the answers to those questions. You are urged to read carefully the remainder of this proxy statement/prospectus because information in this section does not provide all the information that might be important to you with respect to the merger and the other matters being considered at the Annual Meeting. Additional important information is contained in the remainder of this proxy statement/prospectus, the annexes to this proxy statement/prospectus and the documents referred to or incorporated by reference in this proxy statement/prospectus.

**Q: When is the Annual Meeting?**

**A:** Enstar's Annual Meeting of shareholders will take place on January 30, 2007, at 9:00 a.m., local time, at Flowers Hall, Huntingdon College, at 1500 East Fairview Avenue, Montgomery, Alabama 36106.

**Q: What am I being asked to vote upon?**

**A:** You are being asked to approve the merger agreement entered into among Enstar, Castlewood Holdings Limited, or Castlewood, and CWMS Subsidiary Corp. and the transactions contemplated by that agreement. Castlewood, after the merger, is sometimes referred to in this proxy statement/prospectus as New Enstar. You are also being asked to vote for T. Whit Armstrong and T. Wayne Davis to hold office as directors of Enstar until the 2009 annual meeting of shareholders of Enstar, or until their successors are duly elected and qualified, and to vote for the proposal to ratify the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar for 2006. If the merger is consummated, the composition of the board of directors of New Enstar will be different from the current composition of Enstar's board of directors. Following the merger, New Enstar's board of directors will consist of ten members. Four of these individuals—Messrs. T. Whit Armstrong, Paul J. Collins, Gregory L. Curl and T. Wayne Davis—are current directors of Enstar, three of these individuals—Messrs. J. Christopher Flowers, Nimrod T. Frazer and John J. Oros—are current directors of both Enstar and Castlewood, and the other three individuals—Messrs. Nicholas A. Packer, Paul J. O'Shea and Dominic F. Silvester—are current directors and/or executive officers of Castlewood. In addition, New Enstar, as the sole shareholder of Enstar following the merger, will be able to determine the composition of Enstar's board of directors and select the independent auditors of Enstar after the merger.

**Q: Does the Enstar board of directors support the merger?**

**A:** Yes. The Enstar board of directors, including all of its independent directors, has determined that the merger agreement and the transactions contemplated by the merger agreement are fair and in the best interests of Enstar and its shareholders and that the merger agreement is advisable. In addition, the Enstar board of directors, with all of Enstar's directors present and voting, has unanimously approved the merger agreement and the transactions contemplated by the merger agreement and unanimously recommends that the Enstar shareholders vote FOR the approval of the merger agreement and the transactions contemplated by the merger agreement. Some of Enstar's directors and executive officers have interests in the merger and relationships that are different from, or in addition to, yours. See *Interests of Certain Persons in the Merger* beginning on page 60 and *Certain Relationships and Related Transactions* beginning on page 182.

**Q: Will I be able to trade New Enstar ordinary shares that I receive in connection with the merger?**

**A:** Yes. The New Enstar ordinary shares issued in connection with the merger will be freely tradeable, unless you are an affiliate of Enstar. Generally, persons who are deemed to be affiliates of Enstar must comply with Rule 145 under the U.S. Securities Act of 1933, as amended, if they wish to sell or otherwise transfer any of the New Enstar ordinary shares received in connection with the merger. You will be notified if you are an affiliate of Enstar.

**Q: Can I dissent and require appraisal of my shares of Enstar common stock?**

**A:** No. Enstar shareholders have no dissenters' rights under Georgia law in connection with the merger.

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**Q: When should I send in my Enstar share certificates?**

**A:** After the merger is consummated, the exchange agent for the merger will send written instructions to Enstar shareholders that explain how to exchange Enstar share certificates for New Enstar share certificates. The exchange agent will also send a letter of transmittal that must be executed by Enstar shareholders in order to obtain New Enstar share certificates. Please do not send in any share certificates until you receive these written instructions and the letter of transmittal.

**Q: What will happen at the Annual Meeting?**

**A:** At the Annual Meeting, holders of Enstar common stock will vote on whether to approve the merger agreement and the transactions contemplated by the merger agreement. Approval of the merger agreement and the transactions contemplated by the merger agreement requires the affirmative vote of the holders of a majority of the outstanding voting power of Enstar's common stock on December 12, 2006, or the Record Date.

As of the Record Date, Enstar's directors and executive officers owned 1,904,763 shares of Enstar common stock, representing approximately 33.2% of the voting power of Enstar common stock on that date. Three of those directors, who owned Enstar common stock representing 30.1% of the voting power on that date, have entered into a support agreement with Castlewood pursuant to which such directors have agreed to vote their shares of Enstar common stock in favor of the merger agreement and the transactions contemplated by the merger agreement. All other Enstar directors and officers have also indicated that they intend to vote their shares of Enstar common stock in favor of the merger agreement and the transactions contemplated by the merger agreement. For a more detailed description of the support agreement, see *Material Terms of Related Agreements - Support Agreement* beginning on page 76.

The holders of Enstar common stock will also vote at the Annual Meeting on the election of T. Whit Armstrong and T. Wayne Davis to hold office as directors of Enstar until the 2009 annual meeting of Enstar's shareholders, or until their successors are duly elected and qualified, and on the proposal to ratify the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar for 2006.

**Q: What do I need to do to vote?**

**A:** Mail your signed and dated proxy card in the enclosed return envelope as soon as possible so that your shares may be represented at the Annual Meeting. In order to assure that Enstar obtains your vote, please follow the voting instructions on your proxy card even if you currently plan to attend the Annual Meeting in person. The Enstar board of directors recommends that Enstar's shareholders vote **FOR** the approval of the merger agreement and the transactions contemplated by the merger agreement. The Enstar board also recommends that Enstar's shareholders vote **FOR** T. Whit Armstrong and T. Wayne Davis to hold office as directors until the 2009 annual meeting of Enstar's shareholders, or until their successors are duly elected and qualified, and that Enstar's shareholders vote **FOR** the proposal to ratify the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar for 2006.

**Q: How do I vote my shares of Enstar common stock if they are held in the name of a bank, broker or other fiduciary?**

**A:** Your bank, broker or other fiduciary will vote your shares of Enstar common stock with respect to the merger agreement and the transactions contemplated by the merger agreement only if you provide written instructions to them on how to vote, so it is important that you provide them with instructions. Your bank, broker or other fiduciary has the discretion to vote your shares of Enstar common stock in favor of the election of



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T. Whit Armstrong and T. Wayne Davis as directors and the ratification of the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar for 2006. If you wish to vote in person at the Annual Meeting and hold your shares of Enstar common stock in the name of a bank, broker or other fiduciary, you must contact your bank, broker or other fiduciary and request a legal proxy. You must bring this legal proxy to the Annual Meeting in order to vote in person.

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**Q: May I change my vote even after returning a proxy card?**

**A:** Yes. If you are a record holder, you can change your vote by:

completing, signing and dating a new proxy card and returning it by mail so that it is received before the Annual Meeting;

sending a written notice to Enstar's Secretary that is received before the Annual Meeting stating that you revoke your proxy; or

attending the Annual Meeting and voting in person or by legal proxy.

If your shares of Enstar common stock are held in the name of a bank, broker or other fiduciary and you have directed such person(s) to vote your shares of Enstar common stock, you should instruct such person(s) to change your vote or obtain a legal proxy to do so yourself.

**Q: What if I do not vote, abstain from voting or do not instruct my broker to vote my shares of Enstar common stock?**

**A:** If you do not vote your shares, it will have the same effect as a vote against the merger agreement and the transactions contemplated by the merger agreement, but will not affect the outcome of the voting on any other matter presented to Enstar's shareholders at the Annual Meeting assuming that a quorum for the transaction of business at the Annual Meeting has been achieved.

If you return your proxy card, but mark it that you wish to **ABSTAIN** from the vote on the proposal to approve the merger agreement and the transactions contemplated by the merger agreement it will also have the same effect as a vote against the merger agreement and the transactions contemplated by the merger agreement. Similarly, if you mark your proxy card **ABSTAIN** on the proposal to ratify the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar for 2006, it will have the same effect as a vote against that proposal. If you **ABSTAIN** on these proposals, your shares will still be counted for purposes of determining the presence of a quorum for the transaction of business at the Annual Meeting.

Broker non-votes are proxies from brokers or nominees indicating that those persons have not received instructions from the beneficial owners of the shares as to certain proposals on which the beneficial owners are entitled to vote, but with respect to which the brokers or nominees have no discretionary power to vote without instructions. Broker non-votes will be counted for purposes of determining the presence of a quorum for the transaction of business at the Annual Meeting but will not be counted for purposes of determining the number of votes cast with respect to the particular proposal on which the broker has expressly not voted. Consequently, if you do not instruct your broker to vote your shares, it too will have the same effect as a vote against the merger agreement and the transactions contemplated by the merger agreement. Brokers or nominees, however, can exercise their discretion to vote your shares in favor of T. Whit Armstrong and T. Wayne Davis to hold office as directors until the 2009 annual meeting of Enstar's shareholders, or until their successors are duly elected and qualified, as well as in favor of the ratification of the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar for 2006.

If you sign your proxy card but do not indicate how you want to vote, your shares of Enstar common stock will be voted **FOR** the approval of the merger agreement and the transactions contemplated by the merger agreement, **FOR** T. Whit Armstrong and T. Wayne Davis to hold office as directors until the 2009 annual meeting of Enstar's shareholders, or until their successors are duly elected and qualified, and **FOR** the proposal to ratify the

appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar for 2006.

**Q: Where can I find more information about Enstar and Castlewood?**

**A:** Business and financial information about Enstar and Castlewood is contained in this proxy statement/prospectus. You can also find more information about Enstar and Castlewood from various sources described under **Where You Can Find More Information** on page 231.

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**SUMMARY**

This summary highlights selected information from this proxy statement/prospectus and may not contain all of the information that is important to you. To fully understand the Agreement and Plan of Merger, or the merger agreement, dated as of May 23, 2006, among Castlewood Holdings Limited, CWMS Subsidiary Corp. and The Enstar Group, Inc. and the transactions contemplated by the merger agreement, you should carefully read this entire document and the documents to which we refer you. See **Where You Can Find More Information** on page 231. See also the **Glossary of Selected Insurance and Reinsurance Terms** beginning on page G-1 for an explanation of terms related to the insurance industry.

**The Companies (see **Information About Castlewood** on page 81 and **Information About Enstar** on page 158)**

Castlewood Holdings Limited  
P.O. Box HM 2267  
Windsor Place, 3<sup>rd</sup> Floor  
18 Queen Street  
Hamilton HM JX  
Bermuda  
(441) 292-3645

Castlewood Holdings Limited, or Castlewood, is a Bermuda company that acquires and manages insurance and reinsurance companies in run-off (insurance and reinsurance companies that have ceased underwriting new policies) and provides management, consultancy and other services to the insurance and reinsurance industry. Castlewood currently is privately owned, and its shares do not trade on any stock exchange or other quotation system. Upon completion of the merger and the other transactions contemplated by the merger agreement, Castlewood will change its name to **Enstar Group Limited** and will continue to engage in the business of acquiring and managing insurance and reinsurance companies in run-off and providing management, consultancy and other services to the insurance and reinsurance industry. Castlewood has applied to have its ordinary shares listed on the NASDAQ Global Select Market, or Nasdaq, under the symbol **ESGR**. The listing will take effect at the effective time of the merger. As of December 12, 2006, Castlewood had approximately 44 shareholders of record.

The terms **New Enstar**, **we**, **us** and **our** in this proxy statement/prospectus generally refer to Castlewood following the merger.

CWMS Subsidiary Corp.  
401 Madison Avenue  
Montgomery, Alabama 36104  
(334) 834-5483

CWMS Subsidiary Corp., or Merger Sub, is a recently-formed Georgia corporation that is a direct wholly-owned subsidiary of Castlewood. At the time of the merger, Merger Sub will have conducted no business other than in connection with the merger agreement.

The Enstar Group, Inc.  
401 Madison Avenue  
Montgomery, Alabama 36104  
(334) 834-5483

Internet address: [www.enstargroup.com](http://www.enstargroup.com)

The Enstar Group, Inc., or Enstar, is a Georgia corporation engaged in the operation of partially-owned affiliates in financial services businesses, including principally the acquisition and management, through Castlewood and another such affiliate, of insurance and reinsurance companies in run-off. Enstar's common stock trades on Nasdaq under the symbol ESGR. As of December 12, 2006, Enstar had 2,592 shareholders of record.

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Currently, Enstar owns an approximately 32.0% economic interest and 50.0% voting interest in Castlewood. Enstar's investment in Castlewood represents a very substantial portion of Enstar's business. After the merger, Enstar will be a wholly-owned subsidiary of Castlewood and will change its name to Enstar USA, Inc.

Nimrod T. Frazer, John J. Oros, Cheryl D. Davis and J. Christopher Flowers, current officers and/or directors of Enstar, serve on Castlewood's board of directors. As of December 12, 2006, certain of Castlewood's officers, directors and employees owned, directly or indirectly, a total of 115,139 shares of Enstar's common stock, including 110,239 shares of Enstar common stock owned by Dominic Silvester, Castlewood's Chief Executive Officer.

**The Proposed Merger (see page 44)**

Under the terms of the proposed merger, Merger Sub, a direct wholly-owned subsidiary of Castlewood, will merge with and into Enstar with Enstar surviving as a direct wholly-owned subsidiary of Castlewood. The merger agreement is attached as Annex A to this proxy statement/prospectus. We encourage you to read the merger agreement carefully and fully as it is the legal document that governs the merger.

The following charts depict (1) the organizational structures of Castlewood and Enstar, prior to the merger, and (2) the organizational structure of New Enstar upon consummation of the merger.

**Prior to the Merger**

\* Percentages are not calculated on a fully-diluted basis. Unless otherwise indicated, percentages reflect voting and economic interest. Inactive subsidiaries of The Enstar Group, Inc. are omitted.

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**Upon Consummation of the Merger**

- \* Percentages are not calculated on a fully-diluted basis. Unless otherwise indicated, percentages reflect voting and economic interest, except that the ownership percentages of New Enstar may, in some cases, be subject to the limitations on voting power that will be set forth in New Enstar's by-laws. Inactive subsidiaries of Enstar USA, Inc. are omitted.

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**Recommendation of Enstar's Board of Directors Relating to the Merger (see page 53)**

Enstar's board of directors, including all of its independent directors, has determined that the merger agreement and the transactions contemplated by the merger agreement are fair and in the best interests of Enstar and its shareholders and that the merger agreement is advisable. In addition, Enstar's board of directors, with all of Enstar's directors present and voting, has unanimously approved the merger agreement and the transactions contemplated by the merger agreement and unanimously recommends that Enstar shareholders vote FOR the approval of the merger agreement and the transactions contemplated by the merger agreement.

**Interests of Certain Persons in the Merger; Certain Relationships and Related Transactions (see pages 60 and 182)**

When you consider the recommendation of Enstar's board of directors that you vote in favor of approval of the merger agreement and the transactions contemplated by the merger agreement, you should be aware that Messrs. Flowers, Frazer and Oros, officers and/or directors of Enstar who also serve on Castlewood's board of directors, negotiated the terms of the merger on behalf of Enstar, and some of Enstar's directors and executive officers have interests in the merger and relationships that are different from, or in addition to, yours. These interests include:

A new employment agreement between New Enstar, Castlewood (US) Inc., a subsidiary of Castlewood, and Mr. Oros, Enstar's President and Chief Operating Officer, that will take effect at the effective time of the merger. Under the terms of Mr. Oros' employment agreement, he will be paid a salary of \$282,500 and will be entitled to participate in New Enstar's incentive compensation programs. He will also receive other employee benefits consistent with those provided to New Enstar's other executive officers. New Enstar expects that Mr. Oros will spend approximately 50% of his working time on matters related to New Enstar, but there is no minimum work commitment set forth in his employment agreement.

Accelerated vesting of 80,000 options granted to certain Enstar directors and officers pursuant to one of Enstar's equity incentive plans. Of these options, options to purchase 30,000 shares of Enstar common stock are held by Mr. Frazer, Enstar's Chief Executive Officer, and options to purchase 50,000 shares of Enstar common stock are held by Mr. Oros.

A severance payment of \$350,000 to Mr. Frazer under his existing employment agreement.

A tax indemnification by Castlewood of Mr. Flowers, a director of Enstar and its largest shareholder, pursuant to which Castlewood will reimburse and indemnify Mr. Flowers for, and hold him harmless on an after-tax basis against, any increase in Mr. Flowers' U.S. federal, state or local income tax liability (including any interest or penalties relating thereto), and reasonable attorneys' fees, incurred by Mr. Flowers as a result of certain dispositions by Enstar or New Enstar of shares or assets of Enstar, within the period beginning immediately after the effective time of the merger and ending five years after the last day of the taxable year that includes the effective time.

Registration rights expected to be granted by New Enstar to Mr. Flowers and other holders of New Enstar ordinary shares, pursuant to which Mr. Flowers and such other holders may request after the first anniversary of the merger that New Enstar effect the registration under the U.S. Securities Act of 1933, as amended, or the Securities Act, of certain of their ordinary shares of New Enstar, and registration rights expected to be granted by New Enstar to the other directors of Enstar pursuant to which they may participate in certain registration statements filed by New Enstar under the Securities Act and sell their ordinary shares of New Enstar acquired



in the merger pursuant to such registration statements.

Rights of T. Whit Armstrong and T. Wayne Davis, directors of Enstar, to each sell up to 25,000 ordinary shares of New Enstar to New Enstar.

Service of the current Enstar directors on New Enstar's board of directors following the merger.

Indemnification by New Enstar of past and present directors and officers of Enstar for losses in connection with any action arising out of or pertaining to acts or omissions, or alleged acts or omissions, by them in their capacities as such at or before the effective time of the merger.

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Payments on the first anniversary of the merger to Ms. Davis, the Chief Financial Officer, Vice President of Corporate Taxes and Secretary of Enstar, and Amy Dunaway, the Treasurer and Controller of Enstar, in an amount equal to 75% of their annual salary in consideration for their waiver of certain severance payouts to which they are entitled in connection with the merger pursuant to their severance benefits agreements with Enstar.

In addition, each of Enstar and Castlewood has entered into transactions with companies and partnerships that are affiliated with Messrs. Flowers and/or Oros, and an entity of which Mr. Flowers is a director and the largest shareholder owns a minority interest in a subsidiary of Castlewood. See Certain Relationships and Related Transactions beginning on page 182.

While Enstar does not believe that such interests and relationships adversely affected the efforts of representatives of Enstar to negotiate favorable merger terms, or the terms that were ultimately negotiated, you should take into account the possibility that such efforts or terms were adversely affected by such interests or relationships. The board of directors of Enstar considered such interests and relationships and considered whether it should appoint a special committee of independent directors to evaluate and negotiate the transactions and whether interested directors should participate in the deliberations concerning, and vote on, the proposed transactions. Enstar's board of directors concluded that it should not create a special committee and that interested directors should participate in the deliberation concerning, and vote on, the proposed transactions. Enstar's board of directors based such conclusions on its judgment that, notwithstanding such interests and relationships, Enstar and its shareholders would be better served by:

having Messrs. Flowers, Frazer and Oros assume principal responsibility for the negotiation of the merger, given their expertise, experience and familiarity with Castlewood, the relative immateriality, in the board's view, of such interests and relationships to them personally, when compared to their interests as Enstar shareholders, and that their interests as Enstar shareholders were aligned with those of the other Enstar shareholders;

having all of the Enstar directors participate in the board's deliberations concerning the merger, given the directors' expertise, experience and familiarity with Castlewood, the relative immateriality, in the board's view, of such interests and relationships to them personally, the fact that Georgia law permits interested directors to participate in deliberations so long as their interests are disclosed and the fact that, in the board's view, with disclosure, the board would be able to appropriately weigh the views expressed by interested directors and not be inappropriately influenced; and

having all of the Enstar directors vote on the merger, given the board's desire to know, and the advisability of being able to advise the shareholders of, the positions of all directors regarding the merger, the relative immateriality, in the board's view, of such interests and relationships to them personally, the fact that Georgia law permits interested directors to vote so long as their interests are disclosed, and the fact that the merger would only be approved if a majority of the disinterested directors approved the merger.

The board did determine that the merger agreement and the transactions contemplated by the merger agreement would not be approved unless they were approved by a majority of the four independent Enstar directors.

Enstar's board of directors also considered whether to retain an independent financial adviser to review the terms of the proposed transaction, but concluded that the cost of doing so outweighed the potential benefits provided. In part because of Enstar's existing investment in Castlewood, Enstar's board of directors believed that it was sufficiently familiar with Castlewood's business and, therefore, did not need assistance in analyzing the financial terms of the

transaction from a third-party that was not familiar with Castlewood's business. Further, the board believed that because Enstar's investment in Castlewood constituted a very substantial portion of Enstar's business and because the other assets that Enstar would effectively transfer to the combined company in the merger, which principally consist of cash and other investments, are relatively easy to value, the board did not need third-party assistance to evaluate the fairness of Enstar's shareholders effectively

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exchanging their interest in such other assets and their indirect interest of approximately 32.0% in Castlewood for a direct interest of approximately 48.7% in Castlewood.

You should also note that, as of December 12, 2006, Messrs. Flowers, Frazer and Oros control in the aggregate approximately 30.1% of the shares of Enstar's common stock entitled to vote on the merger agreement and the transactions contemplated by the merger agreement. Further, Enstar's shareholders are not entitled to dissenters' rights under applicable Georgia law.

**Reasons for the Merger (see page 51)**

The boards of directors of Castlewood and Enstar believe that the merger potentially will result in increased revenues and enhanced shareholder value for New Enstar. Specifically, Enstar's board of directors believes that the merger will:

Enhance the existing and proven close working relationship between Enstar and Castlewood management and further align the incentives of Castlewood management with the interests of Enstar's shareholders. Castlewood's current ownership structure consists of several classes of shares that provide different voting rights to shareholders, with Enstar directly (and the Enstar shareholders indirectly) owning approximately 32.0% of the economic interest and 50.0% of the voting interest in Castlewood. Each of Enstar, Trident II, L.P. and certain of its affiliates, or Trident, and members of Castlewood senior management who own Castlewood shares has the right, among other things, to nominate a certain number of members of Castlewood's board of directors. Major transactions are required to be approved by one or more directors representing each of Enstar, Trident and Castlewood senior management. The merger will eliminate these approval rights and is expected to better align the incentives of the management of Castlewood and Enstar by having all parties own shares with the same rights.

Provide a positive economic result for Enstar's shareholders, as a result of a one-time \$3.00 per share dividend and the opportunity for Enstar's shareholders to participate in approximately 48.7% (on an undiluted basis) of the earnings and cash flows of New Enstar. As noted above, Enstar's shareholders currently own an approximately 32.0% indirect economic interest in Castlewood. Enstar's board of directors determined that the value to Enstar's shareholders of converting their approximately 32.0% indirect economic interest in Castlewood into an approximately 48.7% direct interest in New Enstar exceeded the value of Enstar's other assets that would be effectively transferred to New Enstar by virtue of the merger.

Simplify the ownership and management structure of Castlewood, Enstar and B.H. Acquisition Ltd., or B.H. Acquisition, a company that Castlewood and Enstar partially own with an affiliate of Trident II, L.P., by forming one public company with one board of directors and a consolidated management team. In particular, the board of directors of Enstar believes the merger will:

consolidate the financial and management resources and thereby expand the capabilities of Castlewood and Enstar to pursue additional acquisitions in the insurance and reinsurance run-off business;

enhance New Enstar's access to capital as a result of both its larger asset base and simplified ownership structure;

expand the opportunities for New Enstar to deploy its capital in attractive investments; and

increase the focus of the time and energy of the directors and management of New Enstar on identifying and consummating attractive acquisitions and managing existing businesses.

The board of directors of Enstar also identified and considered potentially negative factors concerning the merger, including the following:

The costs to be incurred in connection with the merger, including customary transaction expenses and the diversion of management and employee attention during the period after the signing of the merger agreement.

The risk that the merger might not be completed or that the closing might be delayed, which could result in Enstar incurring the costs described above but not realizing the potential benefits of the merger, or in any event incurring increases in such costs.

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The other risks described in **Risk Factors** beginning on page 21, which the Enstar board of directors took notice of generally in the course of its oversight of Enstar's business. The following risks were specifically discussed during the board's deliberations regarding the merger:

the risk that the merger will result in the holders of Enstar's common stock owning a smaller percentage of New Enstar than they currently own of Enstar, which could reduce their ability to affect changes to New Enstar's board of directors, management and policies;

the risk that regulatory agencies may delay or impose conditions on approval of the merger, which may increase the costs or diminish the anticipated benefits of the merger;

the risk that if the merger does not constitute a reorganization under section 368(a) of the U.S. Internal Revenue Code, or the Code, then Enstar shareholders may be responsible for payment of U.S. federal income taxes; and

the risk that certain of Enstar's officers and directors have interests in the merger and relationships that may have influenced their approval of the merger agreement and the transactions contemplated by the merger agreement.

After deliberation, the Enstar board of directors concluded that, on balance, the potential benefits of the transactions to the Enstar shareholders outweighed these risks and potential disadvantages.

### **What Enstar Shareholders Will Receive in the Merger**

If the merger is consummated, as an Enstar shareholder you will receive one New Enstar ordinary share in exchange for each share of Enstar common stock, including the associated rights issued under the Enstar shareholder rights plan, that you own.

### **The Enstar Dividend**

If the merger is consummated, Enstar shareholders as of the applicable record date will receive a one-time \$3.00 per share dividend on their Enstar common stock, payable immediately prior to the merger.

### **Treatment of Enstar Stock Options and Restricted Stock Units (see page 63)**

Each outstanding option to purchase shares of Enstar common stock granted under the Enstar stock plans will be assumed by New Enstar and converted into an option to purchase ordinary shares of New Enstar. The per share exercise price of each new option will be set at a ratio to the trading price of the ordinary shares of New Enstar immediately following the closing of the merger that equals the ratio of the exercise price of the corresponding Enstar stock option to the trading price of the shares of Enstar common stock immediately prior to the closing of the merger. The number of New Enstar ordinary shares underlying the new option will be set so that the aggregate spread value of the new option approximately equals the spread value of the former Enstar stock option.

Each restricted stock unit issued under Enstar's Deferred Compensation and Stock Plan for Non-employee Directors that is outstanding immediately prior to the closing of the merger will automatically convert from a right in respect of a share of Enstar common stock into a right in respect of one ordinary share of New Enstar.

### **Ownership of New Enstar after the Merger**

Immediately following the consummation of the merger, New Enstar will have approximately 11.8 million ordinary shares issued, of which current Enstar shareholders will own approximately 48.7% and current Castlewood shareholders, other than Enstar, will own the remaining approximately 51.3%. Prior to the merger, Enstar's directors and officers own approximately 33.2% of Enstar's outstanding common stock and Enstar's non-affiliated public shareholders own approximately 66.8% of Enstar's outstanding common stock. Following the merger, Enstar's directors and officers will own approximately 16.2% of New Enstar's issued ordinary shares and Enstar's current non-affiliated public shareholders will own approximately 32.5% of New Enstar's issued ordinary shares.

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Also following the merger, directors, officers and certain employees of New Enstar (which will include individuals who are directors, officers or employees of Enstar and Castlewood prior to the merger) and their affiliates will own approximately 49.8% of New Enstar's issued ordinary shares.

Unless otherwise indicated, the ownership percentage calculations set forth above and throughout this proxy statement/prospectus treat the non-voting convertible shares of New Enstar owned by Enstar following the merger as if they were treasury shares and not outstanding because Enstar will be a wholly-owned subsidiary of New Enstar.

## **Listing of New Enstar Ordinary Shares**

Castlewood has filed an application to have New Enstar's ordinary shares listed on Nasdaq under the ticker symbol ESGR.

## **Effects of the Merger on the Rights of Enstar Shareholders**

If the merger is consummated, New Enstar will be governed by its memorandum of association and second amended and restated bye-laws. The memorandum of association and form of the second amended and restated bye-laws have been filed by Castlewood as exhibits to the registration statement of which this proxy statement/prospectus is a part. The memorandum of association and second amended and restated bye-laws of New Enstar differ from Enstar's current articles of incorporation and amended and restated bylaws. In particular, the second amended and restated bye-laws of New Enstar provide that U.S. persons and certain foreign shareholders or groups of foreign shareholders may not hold the power to vote more than 9.5% of New Enstar's ordinary shares. Shareholders of New Enstar holding shares in excess of that limit will have the voting power of their ordinary shares reduced. In addition, New Enstar's board of directors will have the power to decline to register a transfer of any ordinary shares if it has reason to believe that any *non-de minimis* adverse tax, regulatory or legal consequence to New Enstar, any of its subsidiaries or any of its shareholders may occur as a result of such transfer. See *Description of New Enstar's Share Capital Limitation on Voting Power of Shares* and *Restrictions on Transfer* beginning on pages 210 and 211, respectively. To Enstar's knowledge, J. Christopher Flowers is currently the only shareholder of Enstar who will be subject to this limitation following the merger.

In addition, while Enstar is presently governed by Georgia corporate law, New Enstar will be governed by Bermuda corporate law. Because New Enstar is a Bermuda company, it may be difficult for shareholders to serve process or enforce judgments against New Enstar or its directors or officers and it may be more difficult for shareholders to protect their interests. For a description of the differences between the rights of shareholders under Georgia and Bermuda law see *Comparison of Shareholder Rights* beginning on page 194 and *Description of New Enstar's Share Capital Differences in Corporate Law* beginning on page 213.

Enstar's board considered the rights and obligations of the shareholders under New Enstar's memorandum of association and second amended and restated bye-laws in connection with its consideration of the merger agreement, and Enstar retained Bermuda counsel to advise Enstar regarding such matters and other matters of Bermuda law. Enstar's board also took notice of the fact that Enstar's shareholders had been indirectly invested in a Bermuda company Castlewood for the past five years without suffering adverse impacts as a result of Bermuda law in determining that such differences in rights did not, together with other negative factors, outweigh the benefits of the proposed transaction.

In addition, the current non-affiliated public shareholders of Enstar currently own approximately 66.8% of Enstar's outstanding shares. Following the merger, those non-affiliated shareholders will own approximately 32.5% of New Enstar's issued shares. The board of directors of Enstar considered this change in voting power of the non-affiliated public shareholders of Enstar as a result of the merger, but did not believe that it, together with other negative factors,



outweighed the benefits of the proposed transaction. In reaching such conclusion the board took into account particularly that (1) Castlewood constitutes a very substantial portion of Enstar's business, (2) the influence of Enstar's non-affiliated public shareholders on the governance of Castlewood is currently limited by

the fact that such influence must be exercised through Enstar,

the fact that Enstar does not own a majority of the Castlewood voting shares, and

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the fact that Trident and the Castlewood management shareholders have substantial governance rights under the Castlewood shareholders agreement,

(3) the former Enstar non-affiliated public shareholders will own directly approximately 32.5% of the New Enstar voting shares following the merger, and (4) the former Enstar non-affiliated public shareholders will have a direct economic interest in New Enstar of approximately 32.5% following the merger, compared to their current indirect interest in Castlewood of approximately 21.4%.

**Risk Factors (see page 21)**

Shareholders voting on the merger should consider, among other things, the risks associated with ownership of New Enstar ordinary shares and the other risks set forth in the Risk Factors section of this proxy statement/prospectus.

**Conditions to the Consummation of the Merger (see page 68)**

Castlewood's and Enstar's respective obligations to consummate the merger are subject to the satisfaction or, to the extent legally permissible, the waiver of the following conditions:

the receipt of all governmental and regulatory consents, clearances, approvals and actions necessary for the merger and the other transactions contemplated by the merger agreement unless failure to obtain those consents, clearances, approvals and actions would not reasonably be expected to have a material adverse effect on New Enstar, which consents, clearances, approvals and actions have been obtained;

the absence of any law, order or injunction prohibiting consummation of the merger in the United States, Bermuda or the European Union;

the U.S. Securities and Exchange Commission, or the Commission, having declared effective the Castlewood registration statement of which this proxy statement/prospectus is a part;

the approval for listing by Nasdaq of the New Enstar ordinary shares to be issued in the merger, subject to official notice of issuance;

the adoption and approval of the merger agreement and the transactions contemplated by the merger agreement by the Enstar shareholders;

the approval of the Recapitalization Agreement, dated as of May 23, 2006, among Castlewood, Enstar, Trident, Dominic F. Silvester and certain other shareholders of Castlewood, or the recapitalization agreement, and certain actions contemplated by the recapitalization agreement by the Castlewood shareholders, which approval has been obtained;

the completion of the recapitalization of Castlewood pursuant to the recapitalization agreement (see Material Terms of Related Agreements Recapitalization Agreement beginning on page 72);

no event having occurred which would trigger a distribution under Enstar's shareholders rights plan;

the receipt by Enstar and Castlewood of an opinion of Enstar's tax counsel to the effect that the merger should qualify as a reorganization within the meaning of section 368(a) of the Code;

the representations and warranties of the other party contained in the merger agreement which are qualified as to material adverse effect being true and correct as of the date of the merger agreement and as of the closing date of the merger, except to the extent that such representation or warranty speaks as of another date, and the representations and warranties of the other party which are not qualified as to material adverse effect being true and correct (disregarding materiality qualifiers), except where the failure to be true and correct, individually or in the aggregate, would not have a material adverse effect on the party making the representation, as of the date of the merger agreement and as of the closing date of the merger as if they were made on that date, except to the extent that such representation or warranty speaks as of another date; and

the other party having performed or complied in all material respects with all agreements or covenants required to be performed by it under the merger agreement (other than such party's covenants regarding the issuance of securities, and Enstar's covenant regarding dividends and changes in share capital, which must be complied with in all respects), in each case, on or before the closing date.

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**Termination of Merger Agreement (see page 70)**

The merger agreement may be terminated at any time before the consummation of the merger in any of the following ways:

by mutual written consent of Enstar and Castlewood;

by either Enstar or Castlewood:

if the merger has not been consummated by January 31, 2007; except that a party may not terminate the merger agreement if the cause of the merger not being consummated is that party's failure to fulfill its material obligations under the merger agreement;

if a governmental authority or a court in the United States or European Union permanently enjoins or prohibits the consummation of the merger, except that a party that seeks to terminate the merger agreement upon such an event must have used its reasonable best efforts to obtain the government approvals required for the consummation of the merger; or

if Enstar's shareholders fail to approve the merger agreement and the transactions contemplated by the merger agreement.

by Castlewood:

if Enstar has breached in any material respect any of its representations or warranties, or has failed to perform in any material respect any of its covenants or other agreements under the merger agreement and such breach:

is incapable of being cured by or remains uncured prior to January 31, 2007; or

would result in the failure of certain closing conditions to the merger being satisfied; or

if:

Enstar or Enstar's board of directors materially breaches the covenant regarding no solicitation of competing acquisition proposals and such breach is not cured within five business days after receiving notice of such breach;

Enstar's board of directors changes its recommendation to the Enstar shareholders to approve the merger agreement and the transactions contemplated by the merger agreement; or

Enstar fails to call the annual meeting of shareholders to vote on the merger on or before January 31, 2007; or

by Enstar:

if Castlewood or Merger Sub has breached in any material respect any of its representations or warranties, or has failed to perform in any material respect any of its covenants or other agreements under the merger agreement and such breach:

is incapable of being cured by or remains uncured prior to January 31, 2007; or

would result in the failure of certain closing conditions to the merger being satisfied; or

if there has been a change in the recommendation by Enstar's board of directors in respect of the merger agreement and the transactions contemplated by the merger agreement and:

Enstar notifies Castlewood in writing that it intends to approve and enter into an agreement concerning a different business combination transaction that constitutes a superior proposal, attaching the most current version of such agreement or a description of its material terms; and

Castlewood, within five business days of receiving such notice from Enstar, does not make an offer that Enstar's board of directors determines is at least as favorable to the Enstar shareholders as the superior proposal Enstar received from the third party.

Termination of the merger agreement also terminates certain obligations under the support agreement described below.

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**Support Agreement (see page 76)**

Castlewood and Messrs. Flowers, Oros and Frazer, three of Enstar's largest shareholders, have entered into the Support Agreement, dated as of May 23, 2006, or the support agreement, pursuant to which such shareholders have agreed to vote all of their shares of Enstar common stock in favor of the approval of the merger agreement and the transactions contemplated by the merger agreement and against any business combination with a third party.

The support agreement is attached as Annex B to this proxy statement/prospectus.

**Recapitalization Agreement (see page 72)**

In connection with the merger, Castlewood, Enstar, Trident and certain other shareholders of Castlewood entered into the recapitalization agreement which provides, among other things, for:

a recapitalization of Castlewood in which all issued shares will be exchanged for newly-created ordinary shares;

the appointment of the board of directors of New Enstar immediately following the merger;

the repurchase of certain shares of Castlewood from Trident;

payments to certain officers and employees of Castlewood;

the purchase by Castlewood or its designee of the shares of B.H. Acquisition beneficially owned by an affiliate of Trident II, L.P.; and

the adoption of new bye-laws that will include, among other things, certain restrictions on transfers and voting of the ordinary shares.

Castlewood shareholders have approved the recapitalization agreement and the transactions contemplated thereby.

The recapitalization agreement also restricts the transfer by the Castlewood shareholders party thereto of the New Enstar ordinary shares they receive in the recapitalization for one year, subject to certain exceptions. The recapitalization agreement also provides that at the time of the recapitalization, certain shareholders of Castlewood will enter into the Registration Rights Agreement, between and among New Enstar, Trident, Mr. Flowers, Mr. Silvester and certain other shareholders of New Enstar, or the registration rights agreement, entitling them, after the expiration of one year from the date of the registration rights agreement, to require that New Enstar effect the registration under the Securities Act of their New Enstar ordinary shares, although after the expiration of 90 days from the date of the registration rights agreement and prior to the first anniversary of such date, Trident has the right to require that New Enstar register up to 750,000 of Trident's New Enstar ordinary shares. The directors of Enstar have agreed to similar transfer restrictions on their shares of New Enstar, and will receive registration rights pursuant to the same registration rights agreement.

The recapitalization agreement is attached as Annex C to this proxy statement/prospectus.

**Other Related Agreements**

Castlewood has agreed, subject to the consummation of the merger agreement, to repurchase from two directors of Enstar, Messrs. T. Whit Armstrong and T. Wayne Davis, upon their request, during a 30-day period commencing January 15, 2007, at the then prevailing market price, such number of ordinary shares as provides an amount sufficient for Mr. Armstrong and Mr. Davis to pay taxes on compensation income resulting from the exercise of options by them on May 23, 2006 for 50,000 shares of Enstar common stock in the aggregate. Castlewood's obligation to repurchase ordinary shares is limited to 25,000 ordinary shares from each of Mr. Armstrong and Mr. Davis. Since the letter agreement provides for the sale of such shares at then prevailing market prices, each of Enstar and Castlewood believe that the value of the rights of Messrs. Armstrong and Davis under such agreement is not significant.

Castlewood has also entered into a tax indemnification agreement with Mr. Flowers, a director of Castlewood and Enstar and Enstar's largest shareholder, pursuant to which Castlewood will reimburse and indemnify Mr. Flowers for, and hold him harmless on an after-tax basis against, any increase in Mr. Flowers' U.S. federal, state or local income tax liability (including any interest or penalties relating thereto), and reasonable attorneys' fees, incurred by Mr. Flowers as a result of certain dispositions by Enstar or New Enstar of shares or assets of Enstar, within the period beginning immediately after the effective time of the merger

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and ending five years after the last day of the taxable year that includes the effective time. Because Mr. Flowers will be the only greater-than-5% U.S. shareholder of New Enstar after the merger, he is in a different position than the other current shareholders of Enstar with regard to treating the merger as a tax-free reorganization. Under IRS regulations issued pursuant to section 367(a) of the Code, as a 5% U.S. shareholder Mr. Flowers may treat the merger as a tax-free reorganization only if he enters into a gain recognition agreement with the IRS under which he agrees he will treat the merger as taxable if New Enstar disposes of certain stock or assets of Enstar within the five years following the merger. Such dispositions may be effected without Mr. Flowers' consent. Other shareholders of Enstar are not subject to these additional conditions, and their tax treatment would not be affected by such dispositions. The Enstar board of directors approved such agreement because it determined that it would be fair to put Mr. Flowers in the same position as the other shareholders of Enstar with respect to such tax treatment and that such agreement would increase the likelihood that Mr. Flowers, in his capacity as an Enstar shareholder, would support the proposed transaction. While the agreement is significant to Mr. Flowers, New Enstar believes it is unlikely to incur any liability under the agreement because it believes the likelihood that it will dispose of stock or assets of Enstar within the next five years to be remote.

**Regulatory Approvals (see page 57)**

Castlewood has received the requisite approval of the merger and the recapitalization from the insurance regulatory authority in the United Kingdom. In addition, Castlewood has provided notice of the merger and the recapitalization to the insurance regulatory authorities in Switzerland and Belgium. Castlewood has also received approval from the Bermuda Monetary Authority to issue the ordinary shares in connection with the recapitalization and the merger.

**Material U.S. Federal Income Tax Consequences of the Merger (see page 55)**

The merger is intended to qualify as a reorganization for U.S. federal income tax purposes. Accordingly, it is expected that the exchange of Enstar common stock for New Enstar ordinary shares in the merger should not result in the recognition of gain or loss for U.S. federal income tax purposes.

However, this proxy statement/prospectus does not address all tax consequences that may be relevant to persons who exchange Enstar common stock for New Enstar ordinary shares in the merger. In particular, this proxy statement/prospectus does not address any of the tax consequences associated with:

the exercise of options to purchase Enstar common stock before the effective time of the merger;

the exchange of options to purchase Enstar common stock for options to purchase New Enstar ordinary shares in the merger; or

the exchange of Enstar restricted stock units for a right to receive restricted stock units in respect of New Enstar ordinary shares.

Any person who may exchange Enstar common stock for New Enstar ordinary shares in the merger is urged to carefully read the discussions under "The Proposed Merger - Material U.S. Federal Income Tax Consequences of the Merger" and "Material Tax Considerations of Holding and Disposing of New Enstar Ordinary Shares" beginning on pages 55 and 219, respectively, and to consult his or her tax advisor with respect to the tax consequences of participating in the merger and holding and disposing of New Enstar ordinary shares.

**Accounting Treatment of the Merger (see page 55)**



New Enstar will account for the merger under the purchase method of accounting for business combinations under accounting principles generally accepted in the United States.

**No Dissenters Rights**

Under Georgia law, Enstar shareholders are not entitled to dissenters rights in connection with the merger.

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**Information about the Enstar Annual Meeting and Voting (see page 37)**

Enstar's Annual Meeting of Shareholders, or the Annual Meeting, will be held on January 30, 2007, at 9:00 a.m., local time, at Flowers Hall, Huntingdon College at 1500 East Fairview Avenue, Montgomery, Alabama 36106, for the following purposes:

to consider and vote upon a proposal to approve the merger agreement and the transactions contemplated by the merger agreement;

to elect two directors for three-year terms expiring at the annual meeting of shareholders of Enstar in 2009 or until their successors are duly elected and qualified;

to ratify the appointment of Deloitte & Touche LLP as the independent registered public accounting firm of Enstar to serve for 2006; and

to transact such other business as may properly come before the Annual Meeting or any adjournment thereof.

Enstar will not be able to consummate the merger unless its shareholders approve the merger agreement and the transactions contemplated by the merger agreement.

If the merger is consummated, the composition of the board of directors of New Enstar will be different from the current composition of Enstar's board of directors. Following the merger, the board of directors of New Enstar will consist of ten individuals. Four of these individuals—Messrs. T. Whit Armstrong, Paul J. Collins, Gregory L. Curl and T. Wayne Davis—are current directors of Enstar, three of these individuals—Messrs. J. Christopher Flowers, Nimrod T. Frazer and John J. Oros—are current directors of both Enstar and Castlewood, and the other three individuals—Messrs. Nicholas A. Packer, Paul J. O'Shea and Dominic F. Silvester—are current directors and/or executive officers of Castlewood. In addition, New Enstar, as the sole shareholder of Enstar, will be able to determine the composition of Enstar's board of directors and select independent auditors of Enstar after the merger.

**Enstar Shareholder Votes Required**

Approval of the merger agreement and the transactions contemplated by the merger agreement requires the affirmative vote of the holders of a majority of the outstanding voting power of Enstar's common stock on the close of business on December 12, 2006, or the Record Date.

As of the Record Date, Enstar's directors and executive officers owned 1,904,763 shares of Enstar common stock, representing approximately 33.2% of the voting power of Enstar common stock on that date. Three of those directors, who owned Enstar common stock representing 30.1% of the voting power on that date, have entered into a support agreement with Castlewood pursuant to which such directors have agreed to vote their shares of Enstar common stock in favor of the merger agreement and the transactions contemplated by the merger agreement. All other Enstar directors and officers have also indicated that they intend to vote their shares of Enstar common stock in favor of the merger agreement and the transactions contemplated by the merger agreement.

**Recent Developments (see page 118)**

On June 16, 2006, a wholly-owned subsidiary of Castlewood entered into a definitive agreement with Dukes Place Holdings, L.P., a portfolio company of GSC Partners, for the purchase of a minority interest in a U.S. holding company that owns two property and casualty insurers based in the United States, both of which are in run-off.

Completion of the transaction is conditioned on, among other things, governmental and regulatory approvals and satisfaction of various other closing conditions. As a consequence, Castlewood cannot predict if or when this transaction will be completed.

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Also on June 16, 2006, a wholly-owned subsidiary of Castlewood entered into a definitive agreement for the purchase of Cavell Holdings Limited, or Cavell, a U.K. company, from Dukes Place Holdings, L.P. for a purchase price of approximately £31.8 million (approximately \$59.5 million). Cavell owns a U.K. reinsurance company and a Norwegian reinsurer, both of which are currently in run-off. Cavell had total consolidated assets of approximately £101 million at March 31, 2006, as reported in its U.K. regulatory statements. Castlewood completed this transaction on October 4, 2006. A wholly-owned subsidiary of Castlewood borrowed \$24.5 million under a facility loan agreement with a London-based bank to partially fund this acquisition. The interest rate on the loan is LIBOR plus 2% and the loan is repayable within four years.

On November 20, 2006, a wholly-owned subsidiary of Castlewood completed the acquisition of Unione Italiana (U.K.) Reinsurance Company Limited, a U.K. company, for a purchase price of \$17.2 million. The purchase price was funded from cash on hand.

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**SUMMARY HISTORICAL AND PRO FORMA FINANCIAL DATA**

Castlewood and Enstar are providing the following financial data to assist you in your analysis of the financial aspects of the proposed merger. The information is only a summary and should be read in conjunction with each company's historical consolidated financial statements and related notes included or incorporated by reference in this proxy statement/prospectus, as well as the Unaudited Pro Forma Condensed Combined Financial Information for New Enstar beginning on page 166.

**Castlewood Summary Historical Financial Data**

The following selected historical financial information of Castlewood for each of the past five fiscal years has been derived from Castlewood's audited historical financial statements. The financial information as of September 30, 2006 and 2005, and for each of the three and nine month periods then ended, has been derived from Castlewood's unaudited financial statements which include, in management's opinion, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the results of operations and financial position of Castlewood for the periods and dates presented. This information is only a summary and should be read in conjunction with management's discussion and analysis of results of operations and financial condition of Castlewood and the audited and unaudited consolidated financial statements and notes thereto of Castlewood included elsewhere in this proxy statement/prospectus. The selected historical financial information has been revised for the effects of the restatement discussed in Note 24 to the consolidated financial statements of Castlewood on page F-30.

Since its inception, Castlewood has made several acquisitions which impact the comparability of the information reflected in the Castlewood Summary Historical Financial Data. See Information About Castlewood Business Acquisitions to Date beginning on page 85 for information about Castlewood's acquisitions.

|                | <b>Three Months Ended</b>                                    |             | <b>Nine Months Ended</b>      |             |             | <b>Year Ended December 31,</b> |             |             |    | <b>200</b> |
|----------------|--|-------------|-------------------------------|-------------|-------------|--------------------------------|-------------|-------------|----|------------|
|                | <b>September 30,<br/>2006</b>                                | <b>2005</b> | <b>September 30,<br/>2006</b> | <b>2005</b> | <b>2005</b> | <b>2004</b>                    | <b>2003</b> | <b>2002</b> |    |            |
|                | <b>(in thousands of U.S. dollars, except per share data)</b> |             |                               |             |             |                                |             |             |    |            |
| Primary        |  |             |                               |             |             |                                |             |             |    |            |
| ment of        |  |             |                               |             |             |                                |             |             |    |            |
| ngs Data:      |  |             |                               |             |             |                                |             |             |    |            |
| lting fee      | \$ 9,350   | \$ 5,180    | \$ 20,950                     | \$ 13,525   | \$ 22,006   | \$ 23,703                      | \$ 24,746   | \$ 20,627   | \$ |            |
| vestment       |  |             |                               |             |             |                                |             |             |    |            |
| e and net      |  |             |                               |             |             |                                |             |             |    |            |
| d gain         | 12,712   | 7,866       | 33,438                        | 21,149      | 29,504      | 10,502                         | 7,072       | 8,927       |    |            |
| duction in     |  |             |                               |             |             |                                |             |             |    |            |
| d loss         |  |             |                               |             |             |                                |             |             |    |            |
| ment expense   |  |             |                               |             |             |                                |             |             |    |            |
| ies            | 3,920  | 1,043       | 10,700                        | 6,466       | 96,007      | 13,706                         | 24,044      | 48,758      |    |            |
| other expenses | (12,599)   | (9,880)     | (26,942)                      | (31,938)    | (57,299)    | (35,160)                       | (21,782)    | (27,772)    | (2 |            |
| ity interest   | (2,619)  | (439)       | (7,805)                       | (1,430)     | (9,700)     | (3,097)                        | (5,111)     | 0           |    |            |
|                | 232  | 63          | 495                           | 142         | 192         | 6,881                          | 1,623       | 10,079      |    |            |

|  |           |           |             |           |             |             |             |             |       |
|--|-----------|-----------|-------------|-----------|-------------|-------------|-------------|-------------|-------|
| of income of<br>owned<br>panies                |           |           |             |           |             |             |             |             |       |
| come from<br>uing<br>ions                      | 10,996    | 3,833     | 30,836      | 7,914     | 80,710      | 16,535      | 30,592      | 60,619      |       |
| rdinary gain<br>ve goodwill<br>minority<br>(t) | 0         | 0         | 4,347       | 0         | 0           | 21,759      | 0           | 0           |       |
| come   | \$ 10,996 | \$ 3,833  | \$ 35,183   | \$ 7,914  | \$ 80,710   | \$ 38,294   | \$ 30,592   | \$ 60,619   | \$    |
| <b>Share Data(2):</b>                          |           |           |             |           |             |             |             |             |       |
| e per ordinary<br>before<br>rdinary gain       | \$ 587.02 | \$ 208.47 | \$ 1,660.33 | \$ 431.62 | \$ 4,397.89 | \$ 914.49   | \$ 1,699.56 | \$ 3,367.72 | \$ (2 |
| rdinary gain                                   |           |           | 234.06      |           |             | 1,203.42    |             |             |       |
| come per<br>ry share                           | \$ 587.02 | \$ 208.47 | \$ 1,894.39 | \$ 431.62 | \$ 4,397.89 | \$ 2,117.91 | \$ 1,699.56 | \$ 3,367.72 | \$ (2 |

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|  | <b>Three Months Ended</b>                                    |             | <b>Nine Months Ended</b>  |             |             | <b>Year Ended December 31,</b> |             |             |    | <b>2001(1)</b> |
|--|--|-------------|---------------------------|-------------|-------------|--------------------------------|-------------|-------------|----|----------------|
|  | <b>September 30, 2006</b>                                    | <b>2005</b> | <b>September 30, 2006</b> | <b>2005</b> | <b>2005</b> | <b>2004</b>                    | <b>2003</b> | <b>2002</b> |    |                |
|  | <b>(in thousands of U.S. dollars, except per share data)</b> |             |                           |             |             |                                |             |             |    |                |
| Income per share before extraordinary                |  |             |                           |             |             |                                |             |             |    |                |
| Income diluted                                       | \$ 580.64  | \$ 204.73   | \$ 1,637.54               | \$ 422.70   | \$ 4,304.30 | \$ 906.13                      | \$ 1,699.56 | \$ 3,367.72 | \$ | \$ (22.61)     |
| Income diluted                                       |  |             | 230.85                    |             |             | 1,192.40                       |             |             |    |                |
| Net income per ordinary share diluted                | \$ 580.64  | \$ 204.73   | \$ 1,868.39               | \$ 422.70   | \$ 4,304.30 | \$ 2,098.53                    | \$ 1,699.56 | \$ 3,367.72 | \$ | \$ (22.61)     |
| Weighted average ordinary shares outstanding         | 18,732   | 18,387      | 18,572                    | 18,335      | 18,352      | 18,081                         | 18,000      | 18,000      |    | 18,000         |
| Weighted average ordinary shares outstanding diluted | 18,938   | 18,722      | 18,831                    | 18,722      | 18,751      | 18,248                         | 18,000      | 18,000      |    | 18,000         |
| Cash dividends paid per share                        | \$ 0   | \$          | \$ 1,552.67               | \$          | \$          | \$ 645.83                      | \$ 4,483.41 | \$          | \$ | \$             |

**As of  
September 30,  
2006**

**As of December 31,**

**2005      2004      2003      2002      2001**  
**(in thousands of U.S. dollars, except per share data)**

**Summary Balance Sheet****Data:**

|                           |            |            |            |            |           |           |
|---------------------------|------------|------------|------------|------------|-----------|-----------|
| Cash and cash equivalents | \$ 466,703 | \$ 345,329 | \$ 350,456 | \$ 127,228 | \$ 85,916 | \$ 71,906 |
| Investments               | 618,001    | 539,568    | 591,635    | 268,417    | 258,429   | 175,068   |
| Reinsurance recoverable   | 315,223    | 250,229    | 341,627    | 175,091    | 122,937   | 238,162   |
| Total assets              | 1,466,646  | 1,199,963  | 1,347,853  | 632,347    | 514,597   | 527,845   |
|                           | 1,003,825  | 806,559    | 1,047,313  | 381,531    | 284,409   | 419,717   |

|  |           |           |          |          |          |          |
|--|-----------|-----------|----------|----------|----------|----------|
| Reserves for losses and loss adjustment expenses |           |           |          |          |          |          |
| Total shareholder equity                         | 267,448   | 260,906   | 177,338  | 147,616  | 167,473  | 63,696   |
| <b>Book Value per Share:</b>                     |           |           |          |          |          |          |
| Basic  | 14,277.60 | 14,189.70 | 9,721.41 | 8,200.89 | 9,304.06 | 3,538.67 |
| Diluted  | 14,122.29 | 13,921.67 | 9,461.05 | 8,200.89 | 9,304.06 | 3,538.67 |

- (1) For the period between August 16, 2001 (date of incorporation) and December 31, 2001.
- (2) Earnings per share is a measure based on net earnings divided by weighted average ordinary shares outstanding. Basic earnings per share is defined as net earnings available to ordinary shareholders divided by the weighted average number of ordinary shares outstanding for the period, giving no effect to dilutive securities. Diluted earnings per share is defined as net earnings available to ordinary shareholders divided by the weighted average number of shares and share equivalents outstanding calculated using the treasury stock method for all potentially dilutive securities. When the effect of dilutive securities would be anti-dilutive, these securities are excluded from the calculation of diluted earnings per share.
- (3) Basic book value per share is defined as total shareholders' equity available to ordinary shareholders divided by the number of ordinary shares outstanding as at the end of the period, giving no effect to dilutive securities. Diluted book value per share is defined as total shareholders' equity available to ordinary shareholders divided by the number of ordinary shares and ordinary share equivalents outstanding at the end of the period, calculated using the treasury stock method for all potentially dilutive securities. When the effect of dilutive securities would be anti-dilutive, these securities are excluded from the calculation of diluted book value per share.



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**Enstar Summary Historical Financial Data**

The following selected historical financial information of Enstar for each of the past five fiscal years has been derived from Enstar's audited historical financial statements. The financial information as of September 30, 2006 and 2005, and for each of the three-month and nine-month periods then ended, has been derived from Enstar's unaudited financial statements which include, in management's opinion, all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the results of operations and financial position of Enstar for the periods and dates presented. This information is only a summary and should be read in conjunction with management's discussion and analysis of results of operations and financial condition of Enstar and the audited and unaudited consolidated financial statements and notes thereto of Enstar incorporated by reference into this proxy statement/prospectus.

|  | <b>Three Months Ended</b>                             |                      | <b>Nine Months Ended</b> |                      |                      | <b>Year Ended December 31,</b> |             |             |             |
|--|---|----------------------|--------------------------|----------------------|----------------------|--------------------------------|-------------|-------------|-------------|
|  | <b>September 30,</b>                                  | <b>September 30,</b> | <b>September 30,</b>     | <b>September 30,</b> | <b>September 30,</b> | <b>2005</b>                    | <b>2004</b> | <b>2003</b> | <b>2002</b> |
|  | <b>2006</b>   | <b>2005</b>          | <b>2006</b>              | <b>2005</b>          | <b>2005</b>          | <b>2005</b>                    | <b>2004</b> | <b>2003</b> | <b>2002</b> |
|  | (in thousands of U.S. dollars, except per share data) |                      |                          |                      |                      |                                |             |             |             |
|  | \$ 2,243  | \$ 970               | \$ 5,203                 | \$ 1,805             | \$ 19,045            | \$ 5,977                       | \$ 13,226   | \$ 21,526   | \$          |
|  |   |                      | 875                      |                      |                      | 4,415                          |             |             |             |
|  |   |                      |                          |                      |                      |                                |             |             | 967         |
|  | \$ 2,243  | \$ 970               | \$ 6,078                 | \$ 1,805             | \$ 19,045            | \$ 10,392                      | \$ 13,226   | \$ 22,493   | \$          |
|  | \$ 0.39   | \$ 0.18              | \$ 0.92                  | \$ 0.33              | \$ 3.45              | \$ 1.09                        | \$ 2.42     | \$ 3.94     | \$          |

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|                            | <b>As of<br/>September 30,<br/>2006</b> |            | <b>As of December 31,<br/>2005      2004      2003      2002      2001</b> |            |            |           |
|----------------------------|---|------------|--|------------|------------|-----------|
|                            | <b>(in thousands of U.S. dollars)</b>   |            |  |            |            |           |
| <b>Balance Sheet Data:</b> |   |            |  |            |            |           |
| Total assets               | \$ 200,279                              | \$ 185,220 | \$ 158,977   | \$ 152,620 | \$ 128,609 | \$ 99,621 |
| Total liabilities          | 20,811                                  | 20,097     | 12,803   | 6,688      | 8,360      | 1,964     |
| Minority interest          |   |            |  | 11,449     |            |           |
| Shareholders equity        | 179,468                                 | 165,123    | 146,174  | 134,483    | 120,249    | 97,657    |

(1) Income per share is a measure based on net income divided by weighted average shares of common stock outstanding. Basic income per share is defined as net income available to common stockholders divided by the weighted average number of shares of common stock outstanding for the period, giving no effect to dilutive securities. Diluted income per share is defined as net income available to common stockholders divided by the weighted average number of shares of common stock and common stock equivalents outstanding calculated using the treasury stock method for all potentially dilutive securities. When the effect of dilutive securities would be anti-dilutive, these securities are excluded from the calculation of diluted income per share.

**Summary Unaudited Pro Forma Condensed Combined Financial Data**

The following summary unaudited pro forma condensed combined financial information was prepared using the purchase method of accounting, with Castlewood treated as the acquirer for accounting purposes. The table below presents summary financial information from the unaudited pro forma condensed combined financial statements as of and for the nine months ended September 30, 2006 and for the year ended December 31, 2005 included elsewhere in this proxy statement/prospectus. The unaudited pro forma condensed combined financial information is presented as if the merger and related transactions had occurred on September 30, 2006 for purposes of the unaudited pro forma condensed combined balance sheet data and as of January 1, 2005 for purposes of the unaudited pro forma condensed combined operating data.

The unaudited pro forma condensed combined financial information is based on estimates and assumptions set forth in the notes to such financial information, which are preliminary and have been made solely for the purpose of developing such pro forma information. The unaudited pro forma condensed combined financial information is not necessarily indicative of the financial position or operating results of New Enstar that would have been achieved had the merger and related transactions been consummated as of the dates noted above, nor are they necessarily indicative of the future financial position or operating results of New Enstar. This information should be read in conjunction with the unaudited pro forma condensed combined financial information and related notes and the historical financial statements and related notes included elsewhere or incorporated by reference in this proxy statement/prospectus.

**Enstar Group Limited****Summary Unaudited Pro Forma Condensed  
Combined Financial Information**

**Nine Months  
Ended**

**Year Ended**

|                                  | <b>September 30,<br/>2006</b>         | <b>December 31, 2005</b> |
|----------------------------------|---------------------------------------|--------------------------|
|                                  | <b>(in thousands of U.S. dollars)</b> |                          |
| <b>Income</b>                    |                                       |                          |
| Income before extraordinary gain | \$ 31,125                             | \$ 81,859                |
| Cash dividends paid per share    |                                       |                          |

|                            | <b>As of<br/>September 30, 2006</b> |
|----------------------------|-------------------------------------|
| <b>Balance sheet data:</b> |                                     |
| Total assets               | \$ 1,613,839                        |
| Total liabilities          | 1,229,230                           |
| Minority interest          | 50,116                              |
| Shareholders' equity       | 334,493                             |

**Table of Contents****Comparative Per Share Information**

The following table presents historical per share data for Castlewood and Enstar individually and on a pro forma basis after giving effect to the merger. The pro forma combined amounts are based on using the purchase method of accounting. The pro forma combined per share data of New Enstar was derived from the Unaudited Pro Forma Condensed Combined Financial Statements beginning on page 166. The assumptions related to the preparation of the Unaudited Pro Forma Condensed Combined Financial Statements are described beginning on page 170. The data presented below should be read in conjunction with the historical consolidated financial statements of Enstar incorporated by reference in this proxy statement/prospectus and with the historical consolidated financial statements of Castlewood included in this proxy statement/prospectus. The pro forma data below is presented for informational purposes. You should not rely on the pro forma amounts as being indicative of the operating results or financial position of New Enstar that would have actually occurred had the merger and related transactions been consummated as of the dates noted above, nor are the pro forma amounts necessarily indicative of the future operating results or financial position of New Enstar.

|  | <b>Castlewood</b> | <b>Enstar</b>     | <b>Combined</b> | <b>Equivalent</b> |
|--|-------------------|-------------------|-----------------|-------------------|
|  | <b>Historical</b> | <b>Historical</b> | <b>Pro</b>      | <b>Pro</b>        |
|  |                   |                   | <b>Forma</b>    | <b>Forma(1)</b>   |
| Net income per ordinary share                          |                   |                   |                 |                   |
| Year ended December 31, 2005                           |                   |                   |                 |                   |
| Basic  | \$ 4,397.89       | \$ 3.45           | \$ 6.95         | \$ 6.95           |
| Diluted  | \$ 4,304.30       | \$ 3.25           | \$ 6.59         | \$ 6.59           |
| Nine months ended September 30, 2006                   |                   |                   |                 |                   |
| Basic  | \$ 1,894.39       | \$ 1.08           | \$ 2.64         | \$ 2.64           |
| Diluted  | \$ 1,868.39       | \$ 1.02           | \$ 2.51         | \$ 2.51           |
| Book value per ordinary share as of September 30, 2006 |                   |                   |                 |                   |
| Basic  | \$ 14,277.60      | \$ 31.27          | \$ 27.52        | \$ 27.52          |
| Diluted  | \$ 14,122.29      | \$ 29.90          | \$ 26.13        | \$ 26.13          |
| Cash dividends per ordinary share                      |                   |                   |                 |                   |
| Year ended December 31, 2005                           | \$                | \$                | \$              | \$                |
| Nine months ended September 30, 2006                   |                   |                   |                 |                   |
| Basic(2)   | \$ 1,552.67       | \$                | \$ 3.84         | \$ 3.84           |
| Diluted(2)   | \$ 1,552.67       | \$                | \$ 3.65         | \$ 3.65           |

(1) Equivalent pro forma is equal to the combined pro forma because the share exchange ratio is one-to-one.

(2) Cash dividends in the pro forma column include the proposed \$3.00 per share dividend to be paid by Enstar to its shareholders as of the applicable record date if the merger is consummated and dividends paid by Castlewood to its shareholders in April of 2006.

**Per Share Market Price Information**

The closing price per share of Enstar common stock on May 23, 2006, the last trading day before the announcement of the execution of the merger agreement, was \$76.36. The closing price per share of Enstar common stock as reported

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on Nasdaq on December 12, 2006, the most recent trading day practicable before the printing of this proxy statement/prospectus, was \$92.43.

There is no established public trading market for Castlewood's shares. In connection with the merger, New Enstar has applied to have New Enstar's ordinary shares listed for trading on the Nasdaq Global Select Market under the symbol ESGR, subject to official notice of issuance.

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**Dividend Information**

If the merger is consummated, Enstar shareholders as of the applicable record date will receive a one-time \$3.00 per share cash dividend on their Enstar common stock, payable immediately prior to the merger. Enstar has not declared or paid any other cash dividend on any of its securities since 1989. If the merger is not consummated, Enstar currently intends to retain its earnings to finance the growth and development of its future business and does not anticipate paying cash dividends in the foreseeable future. If the merger is not consummated, the payment of cash dividends in the future will depend upon such factors as Enstar earnings, capital requirements, financial condition, contractual restrictions and other factors deemed relevant by Enstar's board of directors.

In March 2003, Castlewood's board of directors declared a dividend of \$3,471 per share to holders of Class A Shares and \$5,495.83 per share to holders of its Class B Shares, which dividends were paid on March 24, 2003.

In March 2004, Castlewood's board of directors declared a dividend of \$500 per share to holders of its Class A Shares and \$791.67 per share to holders of its Class B Shares, which dividends were paid on May 10, 2004.

In April 2006, Castlewood's board of directors declared a dividend of \$3,356 per share to holders of its Class A Shares, \$490.75 per share to holders of its Class B Shares and \$811.22 per share to holders of its Class C Shares, which dividends were paid on April 26, 2006. Also in April 2006, Castlewood's board of directors approved the redemption of all of Castlewood's outstanding Class E shares for \$22.4 million.

Castlewood paid no dividends during the fiscal years ended December 31, 2001, 2002 and 2005.



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**RISK FACTORS**

*Shareholders of Enstar voting in favor of the merger agreement and the transactions contemplated by the merger agreement will be choosing to invest in New Enstar's ordinary shares and to combine the business of Enstar with that of Castlewood. In deciding whether to vote in favor of the merger and the transactions contemplated by the merger agreement, you should consider the following risks related to the merger, to New Enstar's business and to certain other matters. You should carefully consider these risks along with the other information included in this proxy statement/prospectus, including the matters addressed in the section entitled "Forward-Looking Statements" beginning on page 35, and the other information incorporated by reference into this proxy statement/prospectus.*

**Risks Relating to the Merger**

*The value of the New Enstar ordinary shares that you receive in the merger may be less than the current value of your shares of Enstar common stock.*

The value of the New Enstar ordinary shares that you will receive in the merger may be less than the market price of your Enstar common stock on the date of this proxy statement/prospectus or on the date of the Enstar Annual Meeting. If the merger is consummated, each share of Enstar common stock will be converted into one ordinary share of New Enstar. The exchange ratio is a fixed ratio that will not be adjusted as a result of any increase or decrease in the market price of shares of Enstar common stock. The value of the New Enstar ordinary shares that you receive in the merger will depend on the public trading price of the New Enstar ordinary shares after the merger. The New Enstar ordinary shares will not be publicly traded until the merger is consummated. As a result, at the time of the Annual Meeting, you will not know the market value of the New Enstar ordinary shares that you will receive in the merger.

*The merger will result in the holders of Enstar's common stock owning a smaller percentage of New Enstar than they currently own of Enstar, which could reduce their ability to affect changes to New Enstar's board of directors, management and policies.*

As a result of the merger, the non-affiliated public shareholders of Enstar will own a 32.5% interest in New Enstar rather than a 66.8% interest in Enstar. Given the ownership of New Enstar by its officers, directors and their respective affiliates, this diminution in ownership may result in the former non-affiliated public shareholders of Enstar having a significantly reduced ability to effect changes in New Enstar's board of directors, management and policies. For example, under New Enstar's second amended and restated bye-laws many corporate actions require the approval of the holders of a majority of New Enstar's ordinary shares and such actions may be approved without the approval of New Enstar's non-affiliated public shareholders.

*We may not realize the anticipated benefits of the merger.*

The success of the merger will depend, in part, on the ability of New Enstar to realize the anticipated growth opportunities, expanded market visibility and increased access to capital that we expect to result from combining the business of Enstar with that of Castlewood. If we fail to realize the anticipated benefits of the merger, holders of New Enstar ordinary shares may receive lower returns.

*If the merger does not constitute a reorganization under section 368(a) of the Code, then Enstar shareholders may be responsible for payment of U.S. federal income taxes.*

The merger is conditioned upon the receipt by Castlewood and Enstar of an opinion of Debevoise & Plimpton LLP, counsel to Enstar, to the effect that the merger should constitute a reorganization under section 368(a) of the Code. This opinion of counsel will be based on, among other things, current law and certain representations as to factual matters made by Castlewood and Enstar, which, if incorrect, may jeopardize the conclusions reached by such counsel in its opinion. In addition, this legal opinion will not be binding upon the U.S. Internal Revenue Service. Counsel is providing an opinion that the merger should constitute a reorganization rather than an opinion that the merger will constitute a reorganization because there is no controlling interpretation directly on point. The uncertainty results from the lack of direct authority

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and not from the presence of contrary authority. If for any reason the merger does not qualify as a tax-free reorganization under section 368(a) of the Code, then each Enstar shareholder would recognize a gain or loss equal to the difference between the fair market value of the New Enstar ordinary shares received by the shareholder in the merger and the shareholder's adjusted tax basis in the shares of Enstar common stock exchanged therefor.

### ***Certain of Enstar's officers and directors have interests in the merger and relationships that may have influenced their approval of the merger agreement and the transactions contemplated by the merger agreement.***

Certain of Enstar's directors and executive officers have interests in the merger that are different from, or in addition to, yours. These interests include, among others: a new employment agreement between New Enstar, Castlewood (US) Inc., a subsidiary of Castlewood, and John J. Oros; accelerated vesting of 80,000 options granted to certain Enstar directors and officers; a severance payment of \$350,000 to Nimrod T. Frazer under his existing employment agreement; tax indemnification by Castlewood of J. Christopher Flowers; registration rights granted to Enstar's directors; rights of two directors of Enstar to each sell up to 25,000 ordinary shares of New Enstar back to New Enstar; service of the current Enstar directors on New Enstar's board of directors; and indemnification by New Enstar of past and present directors and officers of Enstar. See *Interests of Certain Persons in the Merger* beginning on page 60. In addition, each of Enstar and Castlewood has entered into transactions with companies and partnerships that are affiliated with Messrs. Flowers and/or Oros, and an entity of which Mr. Flowers is a director and the largest shareholder owns a minority interest in a subsidiary of Castlewood. See *Certain Relationships and Related Transactions* beginning on page 182. While Enstar does not believe that such interests and relationships adversely affected the efforts of representatives of Enstar to negotiate favorable merger terms, or the terms that were ultimately negotiated, you should take into account the possibility that such efforts or terms were adversely affected by such interests or relationships.

### ***Failure to consummate the merger could negatively impact the share price and the future business and financial results of Enstar.***

If the merger is not consummated, the ongoing business of Enstar may be adversely affected and Enstar will be subject to several risks, including the following:

Enstar may be required to pay certain costs relating to the merger, such as legal, accounting and printing fees; and

management of Enstar may be focused on the merger instead of pursuing other opportunities that could be beneficial to it.

If the merger is not consummated, Enstar cannot ensure its shareholders that these risks will not materialize and will not materially affect the business, financial results and share price of Enstar.

## **Risks Relating to New Enstar's Business**

### ***If we are unable to implement our business strategies, our business and financial condition may be adversely affected.***

New Enstar's future results of operations will depend in significant part on the extent to which we can implement our business strategies successfully. Our business strategies after the merger include continuing to operate Castlewood's portfolio of run-off insurance and reinsurance companies and related management engagements, as well as pursuing additional acquisitions and management engagements in the run-off segment of the insurance and reinsurance market. We may not be able to implement our strategies fully or realize the anticipated results of our strategies as a result of

significant business, economic and competitive uncertainties, many of which are beyond our control.

The effects of emerging claims and coverage issues may result in increased provisions for loss reserves and reduced profitability in New Enstar's insurance and reinsurance subsidiaries. Such adverse business issues

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may also reduce the level of incentive-based fees generated by New Enstar's consulting operations. Adverse global economic conditions, such as rising interest rates and volatile foreign exchange rates, may cause widespread failure of our insurance and reinsurance subsidiaries' reinsurers ability to satisfy their obligations as well as failure of companies to meet their obligations under debt instruments held by our subsidiaries. If the run-off industry becomes more attractive to investors, competition for run-off acquisitions and management and consultancy engagements may increase and, therefore, reduce our ability to continue to make profitable acquisitions or expand our consultancy operations. If we are unable to successfully implement our business strategies, we may not be able to achieve future growth in our earnings and our financial condition may suffer.

***Our inability to successfully manage our portfolio of insurance and reinsurance companies in run-off may adversely impact our ability to grow our business and may result in losses.***

Castlewood was founded to acquire and manage companies and portfolios of insurance and reinsurance in run-off. Our run-off business differs from the business of traditional insurance and reinsurance underwriting in that our insurance and reinsurance companies in run-off no longer underwrite new policies and are subject to the risk that their stated provisions for losses and loss adjustment expense will not be sufficient to cover future losses and the cost of run-off. Because our companies in run-off no longer collect underwriting premiums, our sources of capital to cover losses are limited to our stated reserves, reinsurance coverage and retained earnings. As of September 30, 2006, our gross reserves for losses and loss adjustment expense totaled \$1.0 billion, and our reinsurance receivables totaled \$315.2 million.

In order for us to achieve positive operating results, we must first price acquisitions on favorable terms relative to the risks posed by the acquired portfolio and then successfully manage the acquired portfolios. Our inability to price acquisitions on favorable terms, efficiently manage claims, collect from reinsurers and control run-off expenses could result in us having to cover losses sustained under assumed policies with retained earnings, which would materially and adversely impact our ability to grow our business and may result in losses.

***Our inability to successfully manage the companies and portfolios for which we have been engaged as a third-party manager may adversely impact our financial results and our ability to win future management engagements.***

In addition to acquiring insurance and reinsurance companies in run-off, we have entered into several management agreements with third parties to manage their portfolios or companies in run-off. The terms of these management engagements typically include incentive payments to us based on our ability to successfully manage the run-off of these companies or portfolios. We may not be able to accomplish our objectives for these engagements as a result of unforeseen circumstances such as the length of time for claims to develop, the extent to which losses may exceed reserves, changes in the law that may require coverage of additional claims and losses, our ability to commute reinsurance policies on favorable terms and our ability to manage run-off expenses. If we are not successful in meeting our objectives for these management engagements, we may not receive incentive payments under our management agreements, which could adversely impact our financial results, and we may not win future engagements to provide these management services, which could slow the growth of our business. Consulting fees generated from management agreements amounted to \$22.0 million, \$23.7 million and \$24.7 million for the years ended December 31, 2005, December 31, 2004 and December 31, 2003, respectively.

***If our insurance and reinsurance subsidiaries' loss reserves are inadequate to cover their actual losses, our insurance and reinsurance subsidiaries' net income and capital and surplus would be reduced.***

Our insurance and reinsurance subsidiaries are required to maintain reserves to cover their estimated ultimate liability for losses and loss adjustment expenses for both reported and unreported claims incurred. These reserves are only estimates of what our subsidiaries think the settlement and administration of claims will cost based on facts and

circumstances known to the subsidiaries. Our commutation activity and claims settlement and development in recent years has resulted in net reductions in provisions for loss and loss adjustment expenses of \$96.0 million, \$13.7 million and \$24.0 million for the years ended December 31,

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2005, December 31, 2004 and December 31, 2003, respectively. Although this recent experience indicates that our loss reserves have been more than adequate to meet our liabilities, because of the uncertainties that surround estimating loss reserves and loss adjustment expenses, our insurance and reinsurance subsidiaries cannot be certain that ultimate losses will not exceed these estimates of losses and loss adjustment expenses. If the subsidiaries' reserves are insufficient to cover their actual losses and loss adjustment expenses, the subsidiaries would have to augment their reserves and incur a charge to their earnings. These charges could be material and would reduce our net income and capital and surplus.

The difficulty in estimating the subsidiaries' reserves is increased because the subsidiaries' loss reserves include reserves for potential asbestos and environmental liabilities. At December 31, 2005 our insurance and reinsurance companies recorded gross asbestos and environmental loss reserves of \$578.1 million, or 71.7% of the total gross loss reserves. Net asbestos and environmental loss reserves at December 31, 2005 amounted to \$384.0 million, or 64.7% of total net loss reserves. Asbestos and environmental liabilities are especially hard to estimate for many reasons, including the long waiting periods between exposure and manifestation of any bodily injury or property damage, the difficulty in identifying the source of the asbestos or environmental contamination, long reporting delays and the difficulty in properly allocating liability for the asbestos or environmental damage. Developed case law and adequate claim history do not always exist for such claims, especially because significant uncertainty exists about the outcome of coverage litigation and whether past claim experience will be representative of future claim experience. In view of the changes in the legal and tort environment that affect the development of such claims, the uncertainties inherent in valuing asbestos and environmental claims are not likely to be resolved in the near future. Ultimate values for such claims cannot be estimated using traditional reserving techniques and there are significant uncertainties in estimating the amount of our subsidiaries' potential losses for these claims. Our subsidiaries have not made any changes in reserve estimates that might arise as a result of any proposed U.S. federal legislation related to asbestos. We increased our insurance and reinsurance subsidiaries' asbestos and environmental gross loss reserves by \$32.4 million in 2003 (\$38.9 million net increase) primarily as a result of industry-wide adverse claims developments. We reduced these gross loss reserves by \$13.7 million in 2004 and \$172.3 million in 2005 (\$33.4 million net reduction in 2004 and \$100.6 million net reduction in 2005) as a result of subsequent successful commutations, policy buybacks and favorable claims settlements. There can be no assurance that the reserves established by our subsidiaries will be adequate to cover future losses or will not be adversely affected by the development of other latent exposures. To further understand this risk, see [Information about Castlewood's Reserves for Unpaid Losses and Loss Adjustment Expense](#) beginning on page 87.

***Our insurance and reinsurance subsidiaries' reinsurers may not satisfy their obligations to our insurance and reinsurance subsidiaries.***

Our insurance and reinsurance subsidiaries are subject to credit risk with respect to their reinsurers because the transfer of risk to a reinsurer does not relieve our subsidiaries of their liability to the insured. In addition, reinsurers may be unwilling to pay our subsidiaries even though they are able to do so. As at September 30, 2006, the balances receivable from reinsurers amounted to \$315.2 million, of which \$167.2 million was associated with a single reinsurer with a Standard & Poor's credit rating of A+. The failure of one or more of our subsidiaries' reinsurers to honor their obligations in a timely fashion may affect our cash flows, reduce our net income or cause us to incur a significant loss. Disputes with our reinsurers may also result in unforeseen expenses relating to litigation or arbitration proceedings.

***The value of our insurance and reinsurance subsidiaries' investment portfolios and the investment income that our insurance and reinsurance subsidiaries receive from these portfolios may decline as a result of market fluctuations and economic conditions.***

The fair market value of the fixed-income securities and equity securities classified as available-for-sale in our subsidiaries' investment portfolios, amounting to \$224.3 million at September 30, 2006, and the investment income

from these assets fluctuate depending on general economic and market conditions. For example, the fair market value of our subsidiaries' fixed-income securities generally increases or decreases in an inverse relationship with fluctuations in interest rates. The fair market value of our subsidiaries' fixed-



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income securities can also decrease as a result of any downturn in the business cycle that causes the credit quality of those securities to deteriorate. The net investment income that our subsidiaries realize from investments in fixed income securities will generally increase or decrease with interest rates. The changes in the market value of our subsidiaries' securities that are classified as available-for-sale are reflected in our financial statements. Permanent impairments in the value of our subsidiaries' fixed income securities are also reflected in our financial statements. As a result, a decline in the value of the securities in our subsidiaries' portfolio may reduce our net income or cause us to incur a loss.

***Fluctuations in the reinsurance industry may cause our operating results to fluctuate.***

The reinsurance industry historically has been subject to significant fluctuations and uncertainties. Factors that affect the industry in general may also cause our operating results to fluctuate. The industry's profitability may be affected significantly by:

fluctuations in interest rates, inflationary pressures and other changes in the investment environment, which affect returns on invested capital and may affect the ultimate payout of loss amounts and the costs of administering books of reinsurance business;

volatile and unpredictable developments, which may adversely affect the recoverability of reinsurance from our reinsurers;

changes in reserves resulting from different types of claims that may arise and the development of judicial interpretations relating to the scope of insurers' liability; and

the overall level of economic activity and the competitive environment in the industry.

***The effects of emerging claim and coverage issues on our business are uncertain.***

As industry practices and legal, judicial, social and other environmental conditions change, unexpected and unintended issues related to claims and coverage may emerge. These issues may adversely affect the adequacy of our provision for losses and loss adjustment expenses by either extending coverage beyond the intent of insurance policies and reinsurance contracts envisioned at the time they were written, or by increasing the number or size of claims. In some instances, these changes may not become apparent until some time after we have acquired companies or portfolios of insurance or reinsurance contracts that are affected by the changes. As a result, the full extent of liability under these insurance or reinsurance contracts may not be known for many years after a contract has been issued. To further understand this risk, see Information about Castlewood's Reserves for Unpaid Losses and Loss Adjustment Expense beginning on page 87.

***Insurance laws and regulations restrict our ability to operate, and any failure to comply with these laws and regulations may have a material adverse effect on our business.***

We are subject to extensive regulation under insurance laws of a number of jurisdictions. These laws limit the amount of dividends that can be paid to us by our insurance and reinsurance subsidiaries, prescribe solvency standards that they must meet and maintain, impose restrictions on the amount and type of investments that they can hold to meet solvency requirements and require them to maintain reserves. Failure to comply with these laws may subject our subsidiaries to fines and penalties and restrict them from conducting business. The application of these laws may affect our liquidity and ability to pay dividends on our ordinary shares and may restrict our ability to expand our business operations through acquisitions. At December 31, 2005, the required statutory capital and surplus of our Bermuda, U.K. and Swiss insurance and reinsurance companies amounted to \$48.9 million compared to the actual

statutory capital and surplus of \$285.6 million. As at December 31, 2005, \$1.8 million of our total investments of \$539.6 million was not admissible for statutory solvency purposes.

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***If we fail to comply with applicable insurance laws and regulations, we may be subject to disciplinary action, damages, penalties or restrictions that may have a material adverse effect on our business.***

We cannot assure you that our subsidiaries have or can maintain all required licenses and approvals or that their businesses fully comply with the laws and regulations to which they are subject, or the relevant insurance regulatory authority's interpretation of those laws and regulations. In addition, some regulatory authorities have relatively broad discretion to grant, renew or revoke licenses and approvals. If our subsidiaries do not have the requisite licenses and approvals or do not comply with applicable regulatory requirements, the insurance regulatory authorities may preclude or suspend our subsidiaries from carrying on some or all of their activities, or impose monetary penalties on them. These types of actions may have a material adverse effect on our business and may preclude us from making future acquisitions or obtaining future engagements to manage companies and portfolios in run-off.

***Castlewood has made, and New Enstar expects to continue to make, strategic acquisitions of insurance and reinsurance companies in run-off, and these activities may not be financially beneficial to us or our shareholders.***

Castlewood has pursued and, as part of our strategy, we will continue to pursue growth through acquisitions and/or strategic investments in insurance and reinsurance companies in run-off. Castlewood and its subsidiaries have made several acquisitions and investments and we expect to continue to make such acquisitions and investments. See Information About Castlewood Business Acquisition of Insurers or Portfolios in Run-Off beginning on page 84. We cannot be certain that any of these acquisitions or investments will be financially advantageous for us or our shareholders.

The negotiation of potential acquisitions or strategic investments as well as the integration of an acquired business or portfolio could result in a substantial diversion of management resources. Acquisitions could involve numerous additional risks such as potential losses from unanticipated litigation or levels of claims, an inability to generate sufficient revenue to offset acquisition costs and financial exposures in the event that the sellers of the entities we acquire are unable or unwilling to meet their indemnification, reinsurance and other obligations to us.

Our ability to manage our growth through acquisitions or strategic investments will depend, in part, on our success in addressing these risks. Any failure by us to effectively implement our acquisition or strategic investment strategies could have a material adverse effect on our business, financial condition or results of operations.

***Future acquisitions may expose us to operational risks such as cash flow shortages, challenges to recruit appropriate levels of personnel, financial exposures to foreign currencies, additional integration costs and management time and effort.***

We may in the future make additional strategic acquisitions, either of other companies or selected portfolios of insurance or reinsurance in run-off. Any future acquisitions may expose us to operational challenges and risks, including:

funding cash flow shortages that may occur if anticipated revenues are not realized or are delayed, whether by general economic or market conditions or unforeseen internal difficulties;

funding cash flow shortages that may occur if expenses are greater than anticipated;

the value of assets being lower than expected or diminishing because of credit defaults or changes in interest rates, or liabilities assumed being greater than expected;

integrating financial and operational reporting systems, including assurance of compliance with Section 404 of the Sarbanes-Oxley Act of 2002;

establishing satisfactory budgetary and other financial controls;

funding increased capital needs and overhead expenses;

obtaining management personnel required for expanded operations; and

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the assets and liabilities we may acquire may be subject to foreign currency exchange rate fluctuation.

Our failure to manage successfully these operational challenges and risks could have a material adverse effect on our business, financial condition or results of operations.

***Exit and finality opportunities provided by solvent schemes of arrangement may not continue to be available which may result in the diversion of our resources to settle policyholder claims for a substantially longer run-off period and increase the associated costs of run-off of our insurance and reinsurance subsidiaries.***

With respect to our U.K. and Bermudian insurance and reinsurance subsidiaries, Castlewood is able to pursue strategies to achieve complete finality and conclude the run-off of a company by promoting solvent schemes of arrangement. Solvent schemes of arrangement have been a popular means of achieving financial certainty and finality, for insurance and reinsurance companies incorporated or managed in the U.K. and Bermuda, by making a one-time full and final settlement of an insurance and reinsurance company's liabilities to policyholders. A solvent scheme of arrangement is an arrangement between a company and its creditors or any class of them. For a solvent scheme of arrangement to become binding on the creditors, a meeting of each class of creditors must be called, with the permission of the local court, to consider and, if thought fit, approve the solvent scheme arrangement. The requisite statutory majority of creditors of not less than 75% in value and 50% in number of those creditors actually attending the meeting, either in person or by proxy, must vote in favor of a solvent scheme of arrangement. Once the solvent scheme of arrangement has been approved by the statutory majority of voting creditors of the company it requires the sanction of the local court.

In July 2005, the case of British Aviation Insurance Company, or BAIC, was the first solvent scheme of arrangement to fail to be sanctioned by the English High Court, following opposition by certain creditors. The primary reason for the failure of the BAIC arrangement was the failure to adequately provide for different classes of creditors to vote separately on the arrangement. It was thought at the time that the BAIC judgment may signal the decline of solvent schemes of arrangement. However, since BAIC four solvent schemes of arrangement have been sanctioned, such that the prevailing view is that the BAIC judgment was very fact-specific to the case in question, and solvent schemes generally should continue to be promoted and sanctioned as a viable means for achieving finality for our insurance and reinsurance subsidiaries. Following the BAIC judgment, insurance and reinsurance companies must now take more care in drafting a solvent scheme of arrangement to fit the circumstances of the company including the determination of the appropriate classes of creditors. Should a solvent scheme of arrangement promoted by an insurance or reinsurance subsidiary of New Enstar fail to receive the requisite approval by creditors or sanction by the court, we will have to run off these liabilities until expiry, which may result in the diversion of our resources to settle policyholder claims for a substantially longer run-off period and increase the associated costs of run-off, resulting potentially in a material adverse effect on our financial condition and results of operations.

***We are dependent on our executive officers, directors and other key personnel and the loss of any of these individuals could adversely affect our business.***

Our success substantially depends on our ability to attract and retain qualified employees and upon the ability of our senior management and other key employees to implement our business strategy. We believe that there are only a limited number of available qualified personnel in the business in which we compete. We rely substantially upon the services of Dominic F. Silvester, our Chief Executive Officer, Paul J. O'Shea and Nicholas A. Packer, our Executive Vice Presidents, Richard J. Harris, our Chief Financial Officer, John J. Oros, who will become our Executive Chairman, and our other executive officers and directors to identify and consummate the acquisition of insurance and reinsurance companies and portfolios in run-off on favorable terms and to implement our run-off strategy. Each of Messrs. Silvester, O'Shea and Packer has an employment agreement with us. Mr. Oros will also have an employment

agreement with us that will go into effect upon consummation of the merger. In addition to serving as our Executive Chairman following the merger, Mr. Oros is a managing director of J.C. Flowers & Co. LLC, an investment firm specializing in privately negotiated equity and equity-related investments in the financial services industry. Mr. Oros will split his time commitment between New Enstar and J.C. Flowers & Co. LLC, with the expectation that Mr. Oros will spend

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approximately 50% of his working time with New Enstar; however, there is no minimum work commitment set forth in Mr. Oros's employment agreement with New Enstar. J. Christopher Flowers, one of Enstar's and Castlewood's directors and, following the merger, a director of New Enstar and one of its largest shareholders, is a Managing Director of J.C. Flowers & Co. LLC. We believe that our relationships with Mr. Oros and Mr. Flowers and their affiliates provide us with access to additional acquisition and investment opportunities, as well as sources of co-investment for acquisition opportunities that we do not have the resources to consummate on our own. The loss of the services of any of our management or other key personnel, or the loss of the services of or our relationships with any of our directors, including in particular Mr. Oros and Mr. Flowers, or their affiliates could have a material adverse effect on our business.

Further, if we were to lose any of our key employees in Bermuda, we would likely hire non-Bermudians to replace them. Under Bermuda law, non-Bermudians (other than spouses of Bermudians, holders of permanent resident's certificates or holders of a working resident's certificate) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Work permits may be granted or extended by the Bermuda government upon showing that, after proper public advertisement in most cases, no Bermudian (or spouse of a Bermudian, holder of a permanent resident's certificate or holders of a working resident's certificate) is available who meets the minimum standard requirements for the advertised position. The Bermuda government's policy limits the duration of work permits to six years, with certain exemptions for key employees and job categories where there is a worldwide shortage of qualified employees.

***Conflicts of interest might prevent us from pursuing desirable investment and business opportunities.***

Our directors and executive officers may have ownership interests or other involvement with entities that could compete against us, either in the pursuit of acquisition targets or in general business operations. On occasion, we have also participated in transactions in which one or more of our directors or executive officers had an interest. In particular, we have invested, and expect to continue to invest, in or with entities that are affiliates of or otherwise related to Mr. Oros and/or Mr. Flowers. The interests of our directors and executive officers in such transactions or such entities may result in a conflict of interest for those directors and officers. We intend to have the independent members of our board of directors review any material transaction involving a conflict of interest, as well as take other actions as may be deemed appropriate by our board of directors in particular circumstances, such as forming a special committee of independent directors or engaging third party financial advisers to evaluate such transactions. We may not be able to pursue all advantageous transactions that we would otherwise pursue in the absence of a conflict should our board of directors be unable to determine that any such transaction is on terms as favorable as we could otherwise obtain in the absence of a conflict.

***We may require additional capital in the future that may not be available or may only be available on unfavorable terms.***

Our future capital requirements depend on many factors, including our ability to manage the run-off of our assumed policies and to establish reserves at levels sufficient to cover losses. We may need to raise additional funds through financings in the future. Any equity or debt financing, if available at all, may be on terms that are not favorable to us. In the case of equity financings, dilution to our shareholders could result, and, in any case, such securities may have rights, preferences and privileges that are senior to those of our already outstanding securities. If we cannot obtain adequate capital, our business, results of operations and financial condition could be adversely affected.

***We are a holding company, and we are dependent on the ability of our subsidiaries to distribute funds to us.***

We are a holding company and conduct substantially all of our operations through subsidiaries. Our only significant assets are the capital stock of our subsidiaries. As a holding company, we are dependent on distributions of funds from

our subsidiaries to pay dividends, fund acquisitions or fulfill financial obligations in the normal course of our business. Our subsidiaries may not generate sufficient cash from operations to enable us to make dividend payments, acquire additional companies or insurance or reinsurance portfolios or fulfill other financial obligations. The ability of our insurance and reinsurance subsidiaries to make



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distributions to us is limited by applicable insurance laws and regulations, and the ability of all of our subsidiaries to make distributions to us may be restricted by, among other things, other applicable laws and regulations.

***Fluctuations in currency exchange rates may cause us to experience losses.***

We maintain a portion of our investments, insurance liabilities and insurance assets denominated in currencies other than U.S. dollars. Consequently, we and our subsidiaries may experience foreign exchange losses.

We publish our consolidated financial statements in U.S. dollars. Therefore, fluctuations in exchange rates used to convert other currencies, particularly other European currencies including the Euro and British pound, into U.S. dollars will impact our reported consolidated financial condition, results of operations and cash flows from year to year.

**Risks Relating to Ownership of New Enstar Ordinary Shares**

***There is no existing market for our ordinary shares.***

There is no current public trading market for New Enstar ordinary shares. We cannot predict the prices at which our ordinary shares may trade following the merger. Such trading prices will be determined by the marketplace and may be influenced by many factors, including the depth and liquidity in the market for such shares, investor perceptions of us and the industry in which we participate, our dividend policy and general economic and market conditions. Until an orderly market develops, the trading prices for our shares may fluctuate significantly.

***The market value of our ordinary shares may decline if large numbers of shares are sold following the merger.***

If, following the merger, large amounts of our ordinary shares are sold, the price of our ordinary shares may decline. Enstar's common stock historically has been thinly traded with an average daily trading volume between January 1, 2005 and December 12, 2006 of less than 5,000 shares. In addition, Enstar generally has not received meaningful analyst coverage. Because Enstar's common stock historically has been thinly traded, we expect that, at least initially, New Enstar's ordinary shares will also be thinly traded because following the merger, 49.8% of our ordinary shares will be held by certain of our directors and executive officers and their respective affiliates, and, therefore, the public float will be relatively low. Further, we anticipate that initially New Enstar may not attract meaningful analyst coverage. Consequently, if relatively small amounts of our ordinary shares are sold, the price of our ordinary shares may decline. Current shareholders of Castlewood and Enstar may not wish to continue to invest in New Enstar or for other reasons may wish to dispose of some or all of their interests in New Enstar. Actual or potential sales by officers, directors or large shareholders of New Enstar may be viewed negatively by other investors.

Castlewood, Trident, Messrs. Flowers and Silvester and certain other shareholders of Castlewood will enter into a registration rights agreement in connection with the transactions contemplated by the merger agreement and the recapitalization agreement. The registration rights agreement will become effective immediately upon the consummation of the merger. The registration rights agreement will provide that, after the expiration of one year from the date of the registration rights agreement, Trident, Mr. Flowers and Mr. Silvester may request that New Enstar effect the registration under the Securities Act of certain of such holder's New Enstar shares. Notwithstanding the preceding sentence, the registration rights agreement further provides that, after the expiration of 90 days from the date of the registration rights agreement and prior to the first anniversary of such date, Trident has the right to require New Enstar to effect the registration of up to 750,000 of Trident's New Enstar shares.

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***Our stock price may experience volatility, thereby causing a potential loss of value to our investors.***

The market price for our ordinary shares may fluctuate substantially due to, among other things, the following factors:

announcements with respect to an acquisition or investment;

changes in the value of our assets;

our quarterly operating results;

changes in general conditions in the economy;

the financial markets; and

adverse press or news announcements.

There is no current public trading market for New Enstar ordinary shares, and assuming a market develops, that market may be characterized by significant price volatility. Enstar has experienced price volatility in the past. For example, during the period from January 1, 2006 through December 12, 2006, the lowest closing price for shares of Enstar common stock was \$65.00 (occurring on January 5, 2006) and the highest closing price for shares of Enstar common stock was \$100.91 (occurring on August 17, 2006). During 2005, the lowest closing price for shares of Enstar common stock was \$49.40 (occurring on April 20) and the highest closing price for shares of Enstar common stock was \$72.58 (occurring on December 15, 2005). In addition, from time to time, the stock market experiences significant price and volume fluctuations. This volatility affects the market prices of securities issued by many companies for reasons unrelated to their operating performance.

***A few significant shareholders may influence or control the direction of our business. If the ownership of our ordinary shares continues to be highly concentrated, it may limit your ability and the ability of other shareholders to influence significant corporate decisions.***

The interests of Trident and Messrs. Flowers, Silvester, Packer and O Shea may not be fully aligned with your interests, and this may lead to a strategy that is not in your best interest. Following the consummation of the merger, Trident will beneficially own approximately 17.6% of the outstanding New Enstar ordinary shares, and Messrs. Flowers, Silvester, Packer and O Shea will beneficially own approximately 10.4%, 18.9%, 6.0% and 6.0%, respectively, of the outstanding New Enstar ordinary shares. Although they do not act as a group, Trident and each of Messrs. Flowers, Silvester, Packer and O Shea will exercise significant influence over matters requiring shareholder approval. Although they do not act as a group, the concentrated holdings of Trident and Messrs. Flowers, Silvester, Packer, and O Shea may delay or deter possible changes in control of New Enstar, which may reduce the market price of New Enstar ordinary shares. For further information on aspects of our bye-laws that may discourage changes of control of New Enstar, see Some aspects of our corporate structure may discourage third-party takeovers and other transactions or prevent the removal of our board of directors and management below.

***As a result of the merger, we will be subject to financial reporting and other requirements for which our accounting and other management systems and resources may not be adequately prepared.***

Enstar's reporting and control systems are appropriate for that of a public company. However, as a private company, Castlewood has not been directly subject to reporting and other requirements of the Exchange Act. As a result of the merger, New Enstar will be directly subject to reporting and other obligations under the Exchange Act, including the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, which will require annual management assessments

of the effectiveness of our internal controls over financial reporting and a report by our independent auditors addressing these assessments. These reporting and other obligations will place significant demands on our management, administrative and operational resources, including accounting resources. If we are unable to integrate and upgrade our financial and management controls, reporting systems, information technology and procedures in a timely and effective fashion, our ability to comply with financial reporting requirements and other rules that apply to reporting companies may be impaired. Any failure to achieve and maintain effective internal controls may have a material adverse effect on our business, operating results and stock price.

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***Some aspects of our corporate structure may discourage third-party takeovers and other transactions or prevent the removal of our board of directors and management.***

Some provisions of our bye-laws have the effect of making more difficult or discouraging unsolicited takeover bids from third parties or preventing the removal of our current board of directors and management. In particular, our bye-laws make it difficult for any U.S. shareholder or Direct Foreign Shareholder Group (a shareholder or group of commonly controlled shareholders of New Enstar that are not U.S. persons) to own or control ordinary shares that constitute 9.5% or more of the voting power of all of our ordinary shares. The votes conferred by such shares will be reduced by whatever amount is necessary so that after any such reduction the votes conferred by such shares will constitute 9.5% of the total voting power of all ordinary shares entitled to vote generally. The primary purpose of this restriction is to reduce the likelihood that we will be deemed a controlled foreign corporation within the meaning of the Code, for U.S. federal tax purposes. However, this limit may also have the effect of deterring purchases of large blocks of our ordinary shares or proposals to acquire us, even if some or a majority of our shareholders might deem these purchases or acquisition proposals to be in their best interests. In addition, our bye-laws provide for a classified board, whose members may be removed by our shareholders only for cause by a majority vote, and contain restrictions on the ability of shareholders to nominate persons to serve as directors, submit resolutions to a shareholder vote and request special general meetings.

These bye-law provisions make it more difficult to acquire control of us by means of a tender offer, open market purchase, proxy contest or otherwise. These provisions are designed to encourage persons seeking to acquire control of us to negotiate with our directors, which we believe would generally best serve the interests of our shareholders. However, these provisions may have the effect of discouraging a prospective acquirer from making a tender offer or otherwise attempting to obtain control of us. In addition, these bye-law provisions may prevent the removal of our current board of directors and management. To the extent these provisions discourage takeover attempts, they may deprive shareholders of opportunities to realize takeover premiums for their shares or may depress the market price of the shares.

***Because we are incorporated in Bermuda, it may be difficult for shareholders to serve process or enforce judgments against us or our directors and officers.***

We are a Bermuda company. In addition, certain of our officers and directors reside in countries outside the United States. All or a substantial portion of our assets and the assets of these officers and directors are or may be located outside the United States. Investors may have difficulty effecting service of process within the United States on our directors and officers who reside outside the United States or recovering against us or these directors and officers on judgments of U.S. courts based on civil liabilities provisions of the U.S. federal securities laws even if we appoint an agent in the United States to receive service of process.

Further, no claim may be brought in Bermuda against us or our directors and officers in the first instance for violation of U.S. federal securities laws because these laws have no extraterritorial jurisdiction under Bermuda law and do not have force of law in Bermuda. A Bermuda court may, however, impose civil liability, including the possibility of monetary damages, on us or our directors and officers if the facts alleged in a complaint constitute or give rise to a cause of action under Bermuda law.

We have been advised by Conyers Dill & Pearman, our Bermuda counsel, that there is doubt as to whether the courts of Bermuda would enforce judgments of U.S. courts obtained in actions against us or our directors and officers, as well as the experts named in this proxy statement/prospectus, predicated upon the civil liability provisions of the U.S. federal securities laws or original actions brought in Bermuda against us or these persons predicated solely upon U.S. federal securities laws. Further, we have been advised by Conyers Dill & Pearman that there is no treaty in effect between the United States and Bermuda providing for the enforcement of judgments of U.S. courts, and there are

grounds upon which Bermuda courts may not enforce judgments of U.S. courts.

Some remedies available under the laws of U.S. jurisdictions, including some remedies available under the U.S. federal securities laws, may not be allowed in Bermuda courts as contrary to that jurisdiction's public

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policy. Because judgments of U.S. courts are not automatically enforceable in Bermuda, it may be difficult for you to recover against us based upon such judgments.

***Shareholders who own our ordinary shares may have more difficulty in protecting their interests than shareholders of a U.S. corporation.***

The Bermuda Companies Act, or the Companies Act, which applies to us, differs in certain material respects from laws generally applicable to U.S. corporations and their shareholders. As a result of these differences, shareholders who own our shares may have more difficulty protecting their interests than shareholders who own shares of a U.S. corporation. For example, class actions and derivative actions are generally not available to shareholders under Bermuda law. Under Bermuda law and our second amended and restated bye-laws, only shareholders holding 5% or more of our outstanding ordinary shares or numbering 100 or more are entitled to propose a resolution at a New Enstar general meeting. Shareholders of Enstar do not have to satisfy such requirements to propose a resolution at a Enstar shareholders meeting. To further understand this risk, see [Comparison of Shareholder Rights](#) beginning on page 194 for more information on the differences between Bermuda and Georgia corporate laws.

***We do not intend to pay cash dividends on our ordinary shares.***

We do not intend to pay a cash dividend on our ordinary shares. Rather, we intend to use any retained earnings to fund the development and growth of our business. From time to time, our board of directors will review our alternatives with respect to our earnings and seek to maximize value for our shareholders. In the future, we may decide to commence a dividend program for the benefit of our shareholders. Any future determination to pay dividends will be at the discretion of our board of directors and will be limited by our position as a holding company that lacks direct operations, significant regulatory restrictions, the results of operations of our subsidiaries, our financial condition, cash requirements and prospects and other factors that our board of directors deems relevant. As a result, capital appreciation, if any, on our ordinary shares may be your sole source of gain for the foreseeable future. In addition, there are regulatory and other constraints that could prevent us from paying dividends in any event.

***Our board of directors may decline to register a transfer of our ordinary shares under certain circumstances.***

Our board of directors may decline to register a transfer of ordinary shares under certain circumstances, including if it has reason to believe that any non-de minimis adverse tax, regulatory or legal consequences to us, any of our subsidiaries or any of our shareholders may occur as a result of such transfer. Further, our bye-laws provide us with the option to repurchase, or to assign to a third party the right to purchase, the minimum number of shares necessary to eliminate any such non-de minimis adverse tax, regulatory or legal consequence. In addition, our board of directors may decline to approve or register a transfer of shares unless all applicable consents, authorizations, permissions or approvals of any governmental body or agency in Bermuda, the United States or any other applicable jurisdiction required to be obtained prior to such transfer shall have been obtained. The proposed transferor of any shares will be deemed to own those shares for dividend, voting and reporting purposes until a transfer of such shares has been registered on our shareholders register.

Conyers Dill & Pearman has advised us that while the precise form of the restrictions on transfer contained in our bye-laws is untested, as a matter of general principle, restrictions on transfers are enforceable under Bermuda law and are not uncommon.

These restrictions on transfer may also have the effect of delaying, deferring or preventing a change in control.

**Table of Contents****Risks Relating to Taxation**

***We might incur unexpected U.S. or U.K. tax liabilities if companies in our group that are incorporated outside of those jurisdictions are determined to be carrying on a trade or business there.***

We and a number of our subsidiaries are companies formed under the laws of Bermuda or other jurisdictions that do not impose income taxes; it is our contemplation that these companies will not incur substantial income tax liabilities from their operations. Because the operations of these companies generally involve, or relate to, the insurance or reinsurance of risks that arise in higher tax jurisdictions, such as the United States or the United Kingdom, it is possible that the taxing authorities in those jurisdictions may assert that the activities of one or more of these companies creates a sufficient nexus in that jurisdiction to subject the company to income tax there. There are uncertainties in how the relevant rules apply to insurance businesses, and in our eligibility for favorable treatment under applicable tax treaties. Accordingly, it is possible that we could incur substantial unexpected tax liabilities. For further information on these subjects, see *Material Tax Considerations of Holding and Disposing of New Enstar Ordinary Shares Taxation of New Enstar and Subsidiaries United Kingdom* and *Material Tax Considerations of Holding and Disposing of New Enstar Ordinary Shares Taxation of New Enstar and Subsidiaries United States* beginning on page 219.

***U.S. persons who own our ordinary shares might become subject to adverse U.S. tax consequences as a result of related party insurance income, or RPII, if any, of our non-U.S. insurance company subsidiaries.***

If the RPII rules of the Code were to apply to us, a U.S. person who owns our ordinary shares directly or indirectly through foreign entities on the last day of the taxable year would be required to include in income for U.S. federal income tax purposes the shareholder's pro rata share of our non-U.S. subsidiaries' RPII for the entire taxable year, determined as if that RPII were distributed proportionately to the U.S. shareholders at that date regardless whether any actual distribution is made. In addition, any RPII that is includible in the income of a U.S. tax-exempt organization would generally be treated as unrelated business taxable income. Although we and our subsidiaries intend to generally operate in a manner so as to qualify for certain exceptions to the RPII rules, there can be no assurance that these exceptions will be available. Accordingly, there can be no assurance that U.S. Persons who own our ordinary shares will not be required to recognize gross income inclusions attributable to RPII. See *Material Tax Considerations of Holding and Disposing of New Enstar Ordinary Shares Taxation of Shareholders United States Taxation* beginning on page 223.

In addition, the RPII rules provide that if a shareholder who is a U.S. Person disposes of shares in a foreign insurance company that has RPII and in which U.S. Persons collectively own 25% or more of the shares, any gain from the disposition will generally be treated as dividend income to the extent of the shareholder's share of the corporation's undistributed earnings and profits that were accumulated during the period that the shareholder owned the shares (whether or not those earnings and profits are attributable to RPII). Such a shareholder would also be required to comply with certain reporting requirements, regardless of the amount of shares owned by the shareholder. These rules should not apply to dispositions of our ordinary shares because New Enstar will not itself be directly engaged in the insurance business. The RPII rules, however, have not been interpreted by the courts or the IRS, and regulations interpreting the RPII rules exist only in proposed form. Accordingly, there is no assurance that our views as to the inapplicability of these rules to a disposition of our ordinary shares will be accepted by the IRS or a court. See *Material Tax Considerations of Holding and Disposing of New Enstar Ordinary Shares Taxation of Shareholders United States Taxation* beginning on page 223.

***U.S. persons who own our ordinary shares would be subject to adverse tax consequences if we or one or more of our non-U.S. subsidiaries were considered a passive foreign investment company, or PFIC, for U.S. federal income tax purposes.***

We believe that we and our non-U.S. subsidiaries will not be PFICs for U.S. federal income purposes for the current year. Moreover, we do not expect to conduct our activities in a manner that will cause us or any of



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our non-U.S. subsidiaries to become a PFIC in the future. However, there can be no assurance that the IRS will not challenge this position or that a court will not sustain such challenge. Accordingly, it is possible that we or one or more of our non-U.S. subsidiaries might be deemed a PFIC by the IRS or a court for the current year or any future year. If we or one or more of our non-U.S. subsidiaries were a PFIC, it could have material adverse tax consequences for an investor that is subject to U.S. federal income taxation, including subjecting the investor to a substantial acceleration and/or increase in tax liability. There are currently no regulations regarding the application of the PFIC provisions of the Code to an insurance company, so the application of those provisions to insurance companies remains unclear in certain respects. See *Material Tax Considerations of Holding and Disposing of New Enstar Ordinary Shares* *Taxation of Shareholders* *United States Taxation* *Passive Foreign Investment Companies* beginning on page 227.

***We may become subject to taxes in Bermuda after March 28, 2016.***

The Bermuda Minister of Finance, under the Exempted Undertakings Tax Protection Act 1966, as amended, of Bermuda, has given us and each of our Bermuda subsidiaries an assurance that if any legislation is enacted in Bermuda that would impose tax computed on profits or income, or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax, then the imposition of any such tax will not be applicable to us or our Bermuda subsidiaries or any of our or their respective operations, shares, debentures or other obligations until March 28, 2016. See *Material Tax Considerations of Holding and Disposing of New Enstar Ordinary Shares* *Taxation of New Enstar and Subsidiaries* *Bermuda* beginning on page 219. Given the limited duration of the Minister of Finance's assurance, we cannot be certain that we will not be subject to any Bermuda tax after March 28, 2016. In the event that we become subject to any Bermuda tax after such date, it could have a material adverse effect on our financial condition and results of operations.

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**FORWARD-LOOKING STATEMENTS**

This proxy statement/prospectus and the documents incorporated by reference into this proxy statement/prospectus contain statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act and Section 21E of the Exchange Act with respect to the financial condition, results of operations, business strategies, operating efficiencies, competitive positions, growth opportunities, plans and objectives of the management of each of Enstar, Castlewood and New Enstar, as well as the merger, the markets for Enstar common stock and New Enstar ordinary shares and the insurance and reinsurance sectors in general. Statements that include words such as estimate, project, plan, intend, expect, anticipate, believe, would, should, could, seek, and similar statements of a forward-looking nature identify forward-looking statements for purposes of the federal securities laws or otherwise. All forward-looking statements are necessarily estimates or expectations, and not statements of historical fact, reflecting the best judgment of the respective managements of Enstar and Castlewood and, following the merger, New Enstar, and involve a number of risks and uncertainties that could cause actual results to differ materially from those suggested by the forward-looking statements. These forward-looking statements should, therefore, be considered in light of various important factors, including those set forth in and incorporated by reference in this proxy statement/prospectus.

Factors that could cause actual results to differ materially from those suggested by the forward-looking statements include:

risks associated with implementing our business strategies and initiatives;

the adequacy of our loss reserves and the need to adjust such reserves as claims develop over time;

risks relating to the availability and collectibility of our reinsurance;

tax, regulatory or legal restrictions or limitations applicable to Castlewood, Enstar or New Enstar or the insurance and reinsurance business generally;

increased competitive pressures, including the consolidation and increased globalization of reinsurance providers;

emerging claim and coverage issues;

lengthy and unpredictable litigation affecting assessment of losses and/or coverage issues;

loss of key personnel;

changes in Castlewood's, Enstar's or New Enstar's plans, strategies, objectives, expectations or intentions, which may happen at any time at management's discretion;

operational risks, including system or human failures;

risks that we may require additional capital in the future which may not be available or may be available only on unfavorable terms;

the risk that ongoing or future industry regulatory developments will disrupt our business, or mandate changes in industry practices in ways that increase our costs, decrease our revenues or require us to alter aspects of the way we do business;

changes in Bermuda law or regulation or the political stability of Bermuda;

changes in regulations or tax laws applicable to us or our subsidiaries, or the risk that we or one of our non-U.S. subsidiaries become subject to significant, or significantly increased, income taxes in the United States or elsewhere;

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losses due to foreign currency exchange rate fluctuations;

changes in accounting policies or practices; and

changes in economic conditions, including interest rates, inflation, currency exchange rates, equity markets and credit conditions which could affect our investment portfolio.

*The factors listed above should not be construed as exhaustive. Certain of these factors are described in more detail in Risk Factors above. We undertake no obligation to release publicly the results of any future revisions we may make to forward-looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.*

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**INFORMATION ABOUT THE ANNUAL MEETING AND VOTING**

**General**

This proxy statement/prospectus is being furnished to the shareholders of Enstar in connection with the solicitation of proxies by the board of directors of Enstar for use at the Annual Meeting to be held on January 30, 2007 at Flowers Hall, Huntingdon College, at 1500 East Fairview Avenue, Montgomery, Alabama 36106, at 9:00 a.m., local time, and at any adjournment thereof.

**Record Date**

The Enstar board of directors has fixed December 12, 2006 as the Record Date for the determination of shareholders entitled to notice of, and to vote at, the Annual Meeting. Only holders of common stock, par value \$.01 per share, of Enstar, as of the Record Date are entitled to vote at the Annual Meeting. On the Record Date, Enstar had issued and outstanding 5,739,384 shares of common stock. Each share of common stock is entitled to one vote on each matter being considered at the Annual Meeting. No cumulative voting rights are authorized, and appraisal rights for dissenting shareholders are not applicable to the matters being proposed. It is anticipated that this proxy statement/prospectus will be first mailed to shareholders of Enstar on or about December 20, 2006.

**Voting and Proxies**

When the enclosed form of proxy is properly executed and returned, the Enstar common stock it represents will be voted as directed at the Annual Meeting or, if no direction is indicated on an executed proxy, such shares will be voted in favor of the proposals set forth in the notice attached hereto. Any Enstar shareholder giving a proxy has the power to revoke it at any time before it is voted. All proxies delivered pursuant to the solicitation are revocable at any time at the option of the persons executing them by giving written notice to the Secretary of Enstar, by delivering a later-dated proxy or by voting in person at the Annual Meeting. Any beneficial owner of shares of Enstar common stock as of the Record Date who intends to vote such shares in person at the Annual Meeting must obtain a legal proxy from the record owner and present such proxy at the Annual Meeting in order to vote such shares. Votes cast by proxy or in person at the Annual Meeting will be tabulated by the inspector of elections appointed for the meeting who will also determine whether a quorum is present for the transaction of business.

The presence in person or by proxy of holders of a majority of the shares of Enstar common stock outstanding on the Record Date will constitute a quorum for the transaction of business at the Annual Meeting.

Approval of the merger agreement and the transactions contemplated by the merger agreement requires the affirmative vote of the holders of a majority of the outstanding voting power of Enstar's common stock on the Record Date.

As of the Record Date, Enstar's directors and executive officers owned 1,904,763 shares of Enstar common stock, representing approximately 33.2% of the voting power of Enstar common stock on that date. Three of those directors, who owned Enstar common stock representing 30.1% of the voting power on that date, have entered into a support agreement with Castlewood pursuant to which such directors have agreed to vote their shares of Enstar common stock in favor of the merger agreement and the transactions contemplated by the merger agreement. All other Enstar directors and officers have also indicated that they intend to vote their shares of Enstar common stock in favor of the merger agreement and the transactions contemplated by the merger agreement.

The affirmative vote of a plurality of the shares of Enstar common stock present in person or by proxy and entitled to vote is required to elect directors. The affirmative vote of the majority of the shares of Enstar common stock represented at the Annual Meeting and entitled to vote on the subject matter is required with respect to the ratification of the appointment of Deloitte & Touche LLP as Enstar's independent registered public accounting firm and the approval of any other matter that may properly come before the Annual Meeting.

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At the Annual Meeting, votes cast for or against any matter may be cast in person or by proxy. Shares of Enstar common stock that are voted FOR, AGAINST or WITHHOLD at the Annual Meeting will be treated as being present at such meeting for purposes of establishing a quorum and will also be treated as votes eligible to be cast by the Enstar common stock present in person at the Annual Meeting and entitled to vote. Abstentions will be counted for purposes of determining both the presence or absence of a quorum for the transaction of business and the total number of votes cast with respect to a particular matter. Broker non-votes will be counted for purposes of determining the presence or absence of a quorum for the transaction of business but will not be counted for purposes of determining the number of votes cast with respect to the particular proposal on which the broker has expressly not voted. Broker non-votes are proxies from brokers or nominees indicating that those persons have not received instructions from the beneficial owners of the shares as to certain proposals on which the beneficial owners are entitled to vote but with respect to which the brokers or nominees have no discretionary voting power to vote without instructions.

As of the date of this proxy statement/prospectus, management of Enstar has no knowledge of any business other than that described herein which will be presented for consideration at the Annual Meeting. In the event any other business is properly presented at the Annual Meeting, the persons named in the enclosed proxy will have authority to vote such proxy in accordance with their judgment on such business.

## **Expenses of Solicitation**

The cost of solicitation of proxies by the Enstar board of directors in connection with the Annual Meeting will be borne by Enstar. As part of its services as Enstar's transfer agent, American Stock Transfer & Trust Company will assist in the solicitation of proxies. In addition, Enstar may engage the services of Georgeson Shareholder Communications Inc. to assist in the solicitation of proxies. Enstar estimates the costs of these solicitation services should be approximately \$9,000. Enstar will reimburse brokers, fiduciaries and custodians for reasonable expenses incurred by them in forwarding proxy materials to beneficial owners of common stock held in their names.

## **Approval of the Merger Agreement and the Transactions Contemplated by the Merger Agreement**

On May 23, 2006, Enstar entered into the merger agreement with Castlewood and Merger Sub, pursuant to which Merger Sub will be merged with and into Enstar, and Enstar, which will be renamed Enstar USA, Inc., will become a direct wholly-owned subsidiary of Castlewood. Holders of shares of Enstar common stock will be entitled to receive one ordinary share of Castlewood in the merger for each share of Enstar common stock they own. Immediately following the merger, current shareholders of Enstar will hold approximately 48.7% of the issued ordinary shares of Castlewood, which will be renamed Enstar Group Limited.

At the Annual Meeting, holders of Enstar common stock will be asked to vote to approve the merger agreement and the transactions contemplated by the merger agreement.

THE MERGER WILL NOT BE CONSUMMATED UNLESS ENSTAR'S SHAREHOLDERS APPROVE THE MERGER AGREEMENT AND THE TRANSACTIONS CONTEMPLATED BY THE MERGER AGREEMENT.

## ***Recommendation of the Board of Directors of Enstar***

THE ENSTAR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT ENSTAR SHAREHOLDERS VOTE FOR THE APPROVAL OF THE MERGER AGREEMENT AND THE TRANSACTIONS CONTEMPLATED BY THE MERGER AGREEMENT.

Details surrounding the proposed merger, including the background of the merger, the reasons for the merger, the accounting treatment of the merger, material U.S. federal income tax consequences of the merger, regulatory matters

relating to the merger and other matters concerning the New Enstar ordinary shares in connection with the merger, can be found in the section entitled "The Proposed Merger" beginning on page 44.



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***Dissenters' Rights***

Under Georgia law, Enstar shareholders are not entitled to dissenters' rights in connection with the merger.

**Election of Enstar Directors**

In accordance with the bylaws of Enstar, Enstar's board of directors currently consists of seven members. Enstar's articles of incorporation divide Enstar's board of directors into three classes. Directors for each class are elected to serve a term of three years at the annual meeting of shareholders held in the year in which the term for such class expires. Nominees for vacant or newly created director positions stand for election at the next annual meeting following the vacancy or creation of such director positions, to serve for the remainder of the term of the class in which their respective positions are apportioned. The terms of two current directors, T. Whit Armstrong and T. Wayne Davis, expire at the Annual Meeting. At the Annual Meeting, T. Whit Armstrong and T. Wayne Davis will stand for re-election to serve as directors for three-year terms expiring at the 2009 annual meeting of shareholders, or until their successors are duly elected and qualified. In accordance with the bylaws of Enstar, a director who is not also an employee of Enstar may serve as a director only until the next annual meeting following such director's 70th birthday.

Enstar's board of directors has no reason to believe that any of the nominees for the office of director will be unavailable for election as directors. However, if at the time of the Annual Meeting any nominee should be unable or decline to serve, the persons named in the proxy will vote as recommended by Enstar's board of directors either (1) to elect a substitute nominee recommended by Enstar's board of directors, (2) to allow the vacancy created thereby to remain open until filled by Enstar's board of directors or (3) to reduce the number of directors for the ensuing year. In no event, however, can a proxy be voted to elect more than two directors. The election of directors requires the affirmative vote of a plurality of the shares held by shareholders present and voting at the Annual Meeting in person or by proxy.

If the merger is consummated, New Enstar, as the sole shareholder of Enstar following the merger, will be able to determine the composition of Enstar's board of directors after the merger.

***Recommendation of Enstar's Board of Directors***

ENSTAR'S BOARD OF DIRECTORS RECOMMENDS A VOTE FOR T. WHIT ARMSTRONG AND T. WAYNE DAVIS TO HOLD OFFICE UNTIL THE 2009 ANNUAL MEETING OF SHAREHOLDERS, OR UNTIL THEIR SUCCESSORS ARE DULY ELECTED AND QUALIFIED.

***Nominees for Election - Terms Expiring 2009***

*T. Whit Armstrong* was elected to the position of director at Enstar in June of 1990. Mr. Armstrong has been President, Chief Executive Officer and Chairman of the Board of The Citizens Bank, Enterprise, Alabama, and its holding company, Enterprise Capital Corporation, Inc. for more than five years. Mr. Armstrong is also a director of Alabama Power Company of Birmingham, Alabama. Mr. Armstrong is 59 years old.

*T. Wayne Davis* was elected to the position of director at Enstar in June of 1990. Mr. Davis was Chairman of the Board of General Parcel Service, Inc., a parcel delivery service, from January of 1989 to September of 1997 and was Chairman of the Board of Momentum Logistics, Inc. from September of 1997 to March of 2003. He also is a director of Winn-Dixie Stores, Inc. and MPS Group, Inc. Mr. Davis is 60 years old.



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***Continuing Directors Terms Expiring 2008***

*Nimrod T. Frazer* was elected to the position of director of Enstar in August of 1990. Mr. Frazer was named Chairman of the Board, Acting President and Chief Executive Officer of Enstar on October 26, 1990 and served as President of Enstar from May 26, 1992 to June 6, 2001. Mr. Frazer has served on the board of directors of Affirmative Insurance Holdings, Inc. since November 2005. Mr. Frazer is 77 years old.

*John J. Oros* has served as a director of Enstar since March of 2000. Mr. Oros was named to the position of Executive Vice President of Enstar in March of 2000 and on June 6, 2001, Mr. Oros was named President and Chief Operating Officer of Enstar. Before joining Enstar, Mr. Oros was an investment banker at Goldman, Sachs & Co. in the Financial Institutions Group. Mr. Oros joined Goldman, Sachs & Co. in 1980 and was made a General Partner in 1986. Mr. Oros resigned from Goldman, Sachs & Co. in March 2000 to join Enstar. In February 2006, Mr. Oros became a Managing Director of J.C. Flowers & Co. LLC, which serves as investment advisor to J.C. Flowers II L.P., a newly formed private equity fund affiliated with J. Christopher Flowers. Mr. Oros splits his time between J.C. Flowers & Co. LLC and Enstar. Mr. Oros is 59 years old.

***Continuing Directors Terms Expiring 2007***

*J. Christopher Flowers* was elected to the position of director of Enstar in October of 1996. Mr. Flowers became a general partner of Goldman, Sachs & Co. in 1988 and a Managing Director in 1996. He resigned from Goldman, Sachs & Co. in November 1998 in order to pursue his own business interests. Mr. Flowers was named Vice Chairman of the Board of Enstar in December 1998; Mr. Flowers resigned from such position in July 2003 but remains a member of Enstar's board of directors. Mr. Flowers has been a Managing Director of J.C. Flowers & Co., LLC, a financial services advisory firm since 2002. Mr. Flowers is a director of Shinsei Bank, Ltd. (since 2000), NIBC Bank N.V. (since 2005), Fox-Pitt, Kelton (2006) and HSH-Nordbank AG (2006). Mr. Flowers is 49 years old.

*Gregory L. Curl* was elected to the position of director of Enstar in July of 2003. Mr. Curl has been Director of Corporate Planning and Strategy for Bank of America since December 1998. Previously, Mr. Curl was Vice Chairman of Corporate Development and President of Specialized Lending for Bank of America from 1997 to 1998. Mr. Curl is 58 years old.

*Paul J. Collins* was elected to the position of director of Enstar in May of 2004. Mr. Collins retired as a Vice Chairman and member of the Management Committee of Citigroup Inc. in September 2000. From 1985 to 2000, Mr. Collins served as a director of Citicorp and its principal subsidiary, Citibank; from 1988 to 1998 he also served as Vice Chairman of such entities. Mr. Collins currently serves as a director of Nokia Corporation and BG Group, as a member of the supervisory board of Actis Capital LLP and as a trustee of the University of Wisconsin Foundation and the Glyndebourne Arts Trust. He is also a member of the Advisory Board of Welsh, Carson, Anderson & Stowe, a private equity firm. Mr. Collins is 70 years old.

***Enstar's Code of Conduct and Code of Ethics***

Enstar has a Code of Conduct which is applicable to all directors, officers and employees of Enstar. Enstar has an additional Code of Ethics for Senior Executive and Financial Officers, or the Code of Ethics, which contains provisions specifically applicable to its chief executive officer, chief financial officer, chief accounting officer and persons performing similar functions. The Code of Ethics is attached as an exhibit to Enstar's Annual Report on Form 10-K for the year ended December 31, 2003. Upon request to the following address, Enstar will furnish without charge a copy of the Code of Conduct and the Code of Ethics:

THE ENSTAR GROUP, INC.  
401 Madison Avenue  
Montgomery, Alabama 36104  
Attention: Amy M. Dunaway  
Treasurer and Controller

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***Enstar's Board of Directors***

Enstar's board of directors has determined that each of T. Whit Armstrong, T. Wayne Davis, Gregory L. Curl, and Paul J. Collins is an independent director as such term is defined in Nasdaq Marketplace Rule 4200(a)(15).

During 2005, Enstar had an Audit Committee that was comprised of T. Whit Armstrong, Chairman, T. Wayne Davis, Gregory L. Curl and Paul J. Collins. Enstar's board of directors has determined that each Audit Committee member meets the independence standards for audit committee members, as set forth in the Sarbanes-Oxley Act of 2002 and the Nasdaq listing standards, and the Nasdaq's financial knowledge requirements. Enstar's board of directors has determined that Mr. Curl is an audit committee financial expert, as such term is defined in Commission regulations, and that Mr. Curl and Mr. Armstrong meet the Nasdaq's professional experience requirements. Enstar's Audit Committee is responsible for, among other things, appointing (subject to shareholder ratification) the accounting firm that will serve as the independent registered public accounting firm of Enstar and reviewing and pre-approving all audit and non-audit services provided to Enstar by its independent auditors. Enstar's Audit Committee is also responsible for overseeing Enstar's financial reporting and accounting practices and monitoring the adequacy of internal accounting, compliance and control systems. Enstar's board of directors has adopted a written charter for the Audit Committee which complies with the applicable requirements of the Sarbanes-Oxley Act of 2002 and related rules of the Commission and the Nasdaq.

During 2005, Enstar had a Compensation Committee that was composed of T. Wayne Davis, Chairman, T. Whit Armstrong and Gregory L. Curl. In addition, J. Christopher Flowers served on Enstar's Compensation Committee until Mr. Curl was appointed to the Compensation Committee in June 2005. Other than Mr. Flowers, each director who served on Enstar's Compensation Committee during fiscal 2005 qualifies as a non-employee director as such term is defined in Rule 16b-3 promulgated under the Exchange Act, and an independent director as such term is defined in Nasdaq Marketplace Rule 4200(a)(15). Enstar's Compensation Committee is responsible for, among other things, reviewing, determining and establishing, upon the recommendation of the Chief Executive Officer (with the exception of the compensation of the Chief Executive Officer) salaries, bonuses and other compensation for Enstar's executive officers and for administering Enstar's stock option plans.

Enstar does not have a nominating committee or a nominating committee charter. It is the position of Enstar's board of directors that, given the small size of the board, it is appropriate for the independent directors, rather than a separate committee comprised of most or all of such independent directors, to recommend director candidates. In November 2003, Enstar's board of directors adopted a resolution regarding the nomination of directors. Pursuant to such resolution, director nominees must be recommended to Enstar's board of directors by a majority of the independent directors as such term is defined in Nasdaq Marketplace Rule 4200(a)(15). Enstar's board of directors has determined that each of T. Wayne Davis, T. Whit Armstrong, Paul J. Collins and Gregory L. Curl is an independent director. When identifying and reviewing director nominees, the independent directors consider the nominees' personal and professional integrity, ability and judgment and other factors deemed appropriate by the independent directors. For incumbent directors, the independent directors review each director's overall service to Enstar during such director's term, including the number of meetings attended, level of participation and quality of performance. The independent directors considered and nominated the candidates proposed for election as directors at the Annual Meeting, with Enstar's board of directors unanimously agreeing on all actions taken in this regard.

During 2005, Enstar's board of directors held a total of five meetings, Enstar's Audit Committee held a total of four meetings and Enstar's Compensation Committee held one meeting. In addition, the independent directors met in an executive session of Enstar's board of directors a total of four times. All directors attended all of the meetings of Enstar's board of directors and all committees on which they served during 2005, except for Gregory L. Curl, who did not attend two meetings of the board of directors of Enstar, and Paul J. Collins, who did not attend one meeting of the

Audit Committee. Directors are encouraged but are not required to attend Enstar's annual meetings. Except for Gregory L. Curl, all directors attended the 2005 annual meeting of shareholders.

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### ***Communications with Enstar's Board of Directors***

Shareholders may communicate with Enstar's board of directors by sending an email to [treasurer@enstargroup.com](mailto:treasurer@enstargroup.com) or by sending a letter to Enstar board of directors, c/o the Treasurer, 401 Madison Avenue, Montgomery, Alabama 36104. Enstar's Treasurer will receive the correspondence and forward it to Enstar's Chairman of the Audit Committee or to any individual director or directors to whom the communication is directed. Enstar's Treasurer has the authority to discard or disregard any inappropriate communications or to take other appropriate actions with respect to such inappropriate communications.

### ***Compensation of Enstar Directors***

Directors who are not employees of Enstar receive a quarterly retainer fee of \$6,250 and per meeting fees as follows: (1) \$2,500 for each board meeting attended other than a telephone board meeting; (2) \$1,000 for each telephone board meeting attended; (3) \$1,000 for each committee meeting attended; and (4) \$1,500 for each committee meeting attended by a committee chairperson. In addition, each committee chairperson receives a quarterly retainer fee of \$500. Such outside directors' fees are payable in cash. Until May 23, 2006, such fees to Enstar's outside directors were payable at the election of the director either in cash or in stock units under Enstar's Deferred Compensation and Stock Plan for Non-Employee Directors, as amended. If a director elected to receive stock units instead of cash, the stock units were payable only upon the director's termination. The number of shares to be distributed in connection with such termination would be equal to one share of common stock for each stock unit, with cash paid for any fractional units. The distribution of stock units was also subject to acceleration upon certain events constituting a change in control of Enstar. All current non-employee directors, other than Gregory L. Curl, had elected to receive 100% of their compensation in stock units in lieu of cash payments. Mr. Curl had elected to receive a portion of his compensation in cash. As of December 31, 2005, a total of \$853,000 in retainer and meeting fees had been deferred under this deferred compensation plan. In addition, directors are entitled to reimbursement for out-of-pocket expenses incurred in attending all meetings.

In April 2005, Paul J. Collins was granted options to purchase 5,000 shares of common stock at an exercise price of \$57.81 per share (which was the market price of the common stock at that time). During 2005, no other options to purchase shares of common stock were granted to directors for their service as directors.

### **Ratification of Appointment of the Independent Registered Public Accounting Firm of Enstar**

Enstar's Audit Committee has appointed the firm of Deloitte & Touche LLP to serve as the independent registered public accounting firm of Enstar for the year ending December 31, 2006, subject to ratification of this appointment by the shareholders of Enstar. Deloitte & Touche LLP has served as the independent registered public accounting firm of Enstar from 1990 through 2005 and is considered by management of Enstar to be well qualified. Enstar has been advised by Deloitte & Touche LLP that neither it nor any member thereof has any financial interest, direct or indirect, in Enstar or any of its subsidiaries in any capacity. One or more representatives of Deloitte & Touche LLP will be present at the Annual Meeting, will have an opportunity to make a statement if he or she desires to do so and will be available to respond to appropriate questions.

If the merger is consummated, New Enstar, as the sole shareholder of Enstar following the merger, will be able to select the independent auditors of Enstar after the merger.

### ***Recommendation of Enstar's Board of Directors***

ENSTAR'S BOARD RECOMMENDS A VOTE FOR THE PROPOSAL TO RATIFY THE APPOINTMENT OF DELOITTE & TOUCHE LLP AS THE INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM OF

ENSTAR FOR 2006.



**Table of Contents*****Principal Accounting Firm Fees and Services for Enstar***

The following table sets forth the aggregate fees billed to Enstar for the fiscal years ended December 31, 2005 and December 31, 2004 by Enstar's principal accounting firm, Deloitte & Touche LLP, the member firms of Deloitte Touche Tohmatsu, and their respective affiliates, or collectively, Deloitte.

| <b>Type of Fees</b> | <b>2005</b>       | <b>2004</b>       |
|---------------------|-------------------|-------------------|
| Audit Fees          | \$ 227,000        | \$ 245,355        |
| Audit-Related Fees  | 0                 | 1,500(1)          |
| Tax Fees            | 40,500(2)         | 68,123(2)         |
| All Other Fees      | 0                 | 0                 |
| <b>Total</b>        | <b>\$ 267,500</b> | <b>\$ 314,978</b> |

- (1) Represents fees related to financial accounting and Commission advisory services arising in connection with matters outside the scope of the audit.
- (2) Represents fees related to the preparation of Enstar's federal and state income tax returns, consultation on federal tax planning and other income tax issues.

***Pre-Approval of Audit and Permissible Non-Audit Services***

The amended and restated charter of the Audit Committee, adopted on May 29, 2003, charges Enstar's Audit Committee with review of all aspects of Enstar's relationship with Deloitte, including the provision of and payment for all services. All audit and non-audit services provided by Deloitte are pre-approved by Enstar's Audit Committee, which concluded that the provision of non-audit services was compatible with maintaining the accountants independence in the conduct of its auditing functions.

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**THE PROPOSED MERGER**

**General**

On May 23, 2006, Enstar entered into the merger agreement with Castlewood and Merger Sub, pursuant to which Merger Sub will be merged with and into Enstar, and Enstar, which will be renamed Enstar USA, Inc., will become a direct wholly-owned subsidiary of Castlewood. Holders of shares of Enstar common stock will be entitled to receive one ordinary share of Castlewood, or New Enstar, in the merger for each share of Enstar common stock they own. Immediately following the merger, current shareholders of Enstar will hold approximately 48.7% of the issued ordinary shares of New Enstar. Also following the merger, management and members of the boards of directors of New Enstar (which will include individuals who are directors, officers or employees of Enstar or Castlewood prior to the merger) and their respective affiliates will own 49.8% of the outstanding ordinary shares of New Enstar.

Enstar's board of directors is using this proxy statement/prospectus to solicit proxies from the holders of Enstar common stock for use at the Annual Meeting. Castlewood's board of directors has approved the merger agreement and the transactions contemplated by the merger agreement and Castlewood's shareholders have approved the recapitalization agreement and the transactions contemplated by the recapitalization agreement.

**Enstar Proposal**

At the Annual Meeting, holders of Enstar common stock will be asked to vote to approve the merger agreement and the transactions contemplated by the merger agreement.

THE MERGER WILL NOT BE CONSUMMATED UNLESS ENSTAR'S SHAREHOLDERS APPROVE THE MERGER AGREEMENT AND THE TRANSACTIONS CONTEMPLATED BY THE MERGER AGREEMENT.

**Background of the Merger**

In 1993, Mr. Silvester, who was joined by Mr. Packer and Mr. O'Shea in 1993 and 1994, respectively, began a business venture in Bermuda to provide run-off services to the insurance and reinsurance industry. In 1995 this business was assumed by Castlewood Limited.

In 1996, Castlewood Limited formed a wholly-owned subsidiary, Castlewood (EU) Ltd., based in Guildford and London in the United Kingdom, to extend the services provided by Castlewood Limited.

In 2000, Castlewood Limited entered into a joint venture with Enstar and an affiliate of Trident II, L.P. to acquire, and for Castlewood Limited to manage, B.H. Acquisition. In connection with the formation of the joint venture, Castlewood, Enstar and the affiliate of Trident II, L.P. acquired 45%, 33% and 22% economic interests, respectively, in B.H. Acquisition.

In November 2001, Enstar, together with Trident and senior management of Castlewood Limited, completed the formation of a new venture, Castlewood, to acquire and manage insurance and reinsurance companies, including companies in run-off, and to provide management, consulting and other services to the insurance and reinsurance industry. Enstar owns 50.0% of the voting stock of Castlewood and Castlewood's senior management and Trident each own 25.0% of Castlewood's voting stock. Enstar owns an approximately 32.0% economic interest in Castlewood. In connection with the formation of Castlewood, its shareholders agreed, and its bye-laws provide, that any distributions made by Castlewood to its shareholders would be in accordance with the following proportions and priorities, or the

Waterfall Distribution Provisions:

First, until Trident receives cumulative distributions equal to its capital contributions to Castlewood, distributions are allocated 30% to Enstar, 47.5% to Trident and 22.5% to Castlewood management;

Second, until Enstar receives cumulative distributions equal to its capital contributions to Castlewood, distributions are allocated 50% to Enstar and 50% to Castlewood management;

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Third, until Castlewood management receives cumulative distributions equal to its capital contributions to Castlewood, distributions are made 100% Castlewood management; and

Fourth, distributions are made to each of the shareholders pro rata to their shareholding.

Since the formation of Castlewood, senior management of Enstar and Castlewood have discussed a potential business combination between Castlewood and Enstar from time to time in connection with the ordinary course discussions about the business of Castlewood. Enstar's senior management also explored with third parties possible acquisitions of Enstar and Castlewood, most of which also involved combinations of Enstar and Castlewood. Enstar management believed that such a combination would be advantageous for a variety of reasons.

Castlewood's current ownership structure consists of several classes of shares, each with different voting rights. Under the organizational documents of Castlewood, each of Enstar, Trident and members of Castlewood senior management who own Castlewood shares has the right, among other things, to nominate a certain number of members of Castlewood's board of directors. Pursuant to Castlewood's organizational documents and an agreement among its shareholders, major transactions must be approved by one or more directors, depending on the shareholder group, representing each of Enstar, Trident and Castlewood senior management. Since the formation of Castlewood, Enstar's senior management sought out potential transactions that would simplify Castlewood's ownership structure. Enstar's senior management believed that the incentives of the management of Castlewood and Enstar would be better aligned with the interests of Enstar's shareholders if all parties owned shares with the same rights. Enstar and Castlewood senior management also sought a transaction in which Trident would be able to sell its interest. Enstar's senior management kept Enstar's board of directors apprised of developments relating to Enstar's search for a suitable transaction.

At the beginning of September 2005, to memorialize ongoing discussions between senior management of Enstar and Castlewood, Mr. Flowers, on behalf of Enstar, provided to Mr. Silvester a letter outlining a proposal for a merger of Enstar into Castlewood. The proposal contemplated (1) distributions to Castlewood management, Enstar and Trident of amounts sufficient to return all of their respective capital contributions, (2) the issuance of additional Castlewood shares to management and employees of Castlewood sufficient to bring their aggregate interest in Castlewood to 44.0%, (3) Castlewood's purchase of Enstar's and Trident's equity stake in B.H. Acquisition, (4) the issuance by Castlewood of new Castlewood shares to acquire Enstar (as a result of which Enstar shareholders would own approximately 49.9% of the combined company) and (5) the addition of current members of Enstar senior management to the senior management of the combined company and the corresponding adoption of new Castlewood compensation plans for the new management team.

On September 13, 2005, Mr. Silvester met with Mr. Flowers and Mr. Oros to discuss Mr. Flowers' letter of early September 2005 and to consider various options and alternatives to the proposal made by Mr. Flowers on behalf of Enstar. Discussions of the options and alternatives included negotiations over (1) the proposed allocation of equity ownership of the combined company following the transaction, and the basis for such allocation, (2) the value to be attributed to the shareholders of Enstar in consideration of other businesses owned by Enstar, (3) the value to be attributed to all shareholders of Enstar in consideration of value added to the combined entity, through Enstar's association with Mr. Flowers and otherwise, (4) the composition and compensation of the combined entity's senior management and (5) the suggestion by Enstar senior management that a cash dividend be paid to the existing Enstar shareholders in connection with the transaction.

During a regular meeting of Enstar's board of directors held on September 20, 2005, Mr. Oros reported to Enstar's board of directors that Enstar and Castlewood were considering a possible merger and briefly discussed the overall approach to the transaction. Key items presented to the board were (1) the approximate allocation of equity ownership

of the combined company following the transaction, (2) the fact that there may be value to be attributed to the shareholders of Enstar in consideration of other businesses owned by Enstar, (3) the fact that there may be value to be attributed to all shareholders of Enstar in consideration of value added to the combined entity, through Enstar's association with Mr. Flowers and otherwise, (4) the fact that the composition of the combined entity's senior management and board of directors would include certain members of the current senior management and board of directors of Enstar and (5) the suggestion by Enstar senior management that a cash dividend be paid to the existing Enstar shareholders in connection with the transaction.

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On November 6, 2005, Mr. Silvester, responding to Mr. Flowers' early September letter and the discussions held on September 13, 2005, wrote to Mr. Flowers, with copies to Messrs. Oros and Frazer, to provide certain suggestions and amendments to Mr. Flowers' original proposal. These suggestions and amendments included (1) not changing the current ownership structure of B.H. Acquisition, (2) highlighting the need for the proposed transaction to address the treatment of unvested Castlewood ordinary shares, (3) suggestions for payments to be made in the proposed transaction to the shareholders of Castlewood, including Enstar, pursuant to the Waterfall Distribution Provisions and (4) rejecting the suggestion that Enstar should pay a dividend to its existing shareholders in connection with the transaction. Mr. Silvester's letter also outlined certain other key considerations such as the proposed name of the combined entity, key executives, board composition and future compensation.

During November and December 2005, discussions continued between Mr. Flowers and Mr. Oros, on behalf of Enstar, and Mr. Silvester and Mr. O'Shea, on behalf of Castlewood. Mr. Oros updated Enstar board members on the discussions at a meeting on December 7, 2005. In early December, Mr. Flowers called, and on December 12, 2005 met with, Mr. Charles A. Davis and Mr. James D. Carey, Chief Executive Officer and Principal, respectively, of Stone Point Capital LLC, on behalf of Trident, to determine Trident's interest in such a transaction as proposed. During this time, Mr. Silvester and Mr. O'Shea also spoke with Mr. Carey and Mr. Davis about Trident's possible interest in such a transaction.

During January 2006, Messrs. Flowers, Oros and Frazer and Messrs. Silvester, O'Shea and Packer reached a general consensus regarding the terms of a possible merger transaction. On January 25, 2006, Messrs. Flowers, Oros and Frazer met with Messrs. Silvester, O'Shea, Packer and Richard J. Harris, Chief Financial Officer of Castlewood, and Mr. Carey and David J. Wermuth, the General Counsel of Stone Point Capital LLC, on behalf of Trident. During this meeting, Mr. Silvester presented the key terms of a possible merger transaction to the Stone Point Capital LLC representatives. The key terms presented included (1) the proposed allocation of equity ownership of the combined company following the transaction, (2) an analysis of the value each party to the proposed transaction would bring to New Enstar, and (3) the purchase from an affiliate of Trident II, L.P. of its B.H. Acquisition shares.

At a meeting on February 16, 2006, Mr. Oros provided an update to the Enstar board members regarding the possible merger. The update included a summary of discussions among Enstar, Castlewood and Trident regarding the transaction since the last Enstar board meeting.

During February and March 2006, discussions between Mr. Silvester, Mr. O'Shea and Mr. Carey continued. Trident sought additional consideration in connection with the merger. It was eventually agreed that, in addition to the issuance of shares of New Enstar to Trident in the merger, Castlewood would, prior to the merger, repurchase from Trident Castlewood shares for \$20 million and B.H. Acquisition shares for approximately \$6.2 million. Following these discussions, Enstar and Castlewood agreed that, in connection with the merger, Enstar would pay approximately \$5 million to Castlewood, which amount would be paid by Castlewood to certain of its executive officers and employees. The parties agreed in principle with respect to the matters discussed. Such agreement also contemplated that Castlewood would distribute amounts sufficient to return its shareholders' respective capital contributions.

On April 5, 2006, Enstar's board of directors held a special meeting, during which the directors reviewed at length the proposed economic terms of a transaction with Castlewood and the status of the negotiations. The directors considered, among other things,

Distributions proposed to be made to Castlewood shareholders prior to the merger in the amounts of approximately \$20.1 million to Enstar, \$2.9 million to Trident and \$27.0 million to the Castlewood management and employee shareholders (these amounts were paid on April 26, 2006).

A cash dividend of \$2.47 per share proposed to be paid to Enstar shareholders prior to the merger.

The proposed repurchase by Castlewood from Trident, prior to the merger, of Castlewood shares for \$20 million and B.H. Acquisition shares for approximately \$6.2 million.

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The proposed payment by Enstar to Castlewood of approximately \$5 million and the payment of such amount by Castlewood to certain of its executive officers and employees.

The value of the cash and cash equivalents approximately \$73.5 million as of September 30, 2005 and of the investments other than its interest in Castlewood that Enstar would effectively be transferring to Castlewood in the merger the directors did not consider the value of such other investments material to the transaction.

The proposed allocation of equity ownership in New Enstar following the merger: 49.9% to former Enstar shareholders, 17.0% to Trident and 33.1% to Castlewood management and employees.

The negotiations regarding the allocation of equity ownership in New Enstar and the board's evaluation of the merits of the transaction focused principally on the foregoing factors and the question of whether the increase in the Enstar shareholders' interest in Castlewood from an indirect interest of approximately 32.0% to a direct interest of approximately 49.9% was fair and in the best interests of the Enstar shareholders, given the other transfers of value described above. However, Enstar management also utilized and presented to the board a contributions analysis that examined differences between the proposed allocation of equity ownership in the combined company and the allocation that would have been indicated based solely on Castlewood's and Enstar's book net asset values. The contribution analysis showed that:

Based on Castlewood's estimated pro forma shareholders' equity as of December 31, 2005 of approximately \$261 million, after giving effect to the distributions to shareholders referred to above, each of Enstar's and Trident's allocable share of Castlewood's shareholders' equity would be approximately \$66 million and the share allocable to Castlewood management and employees (in their capacity as Castlewood shareholders) would be \$76 million.

The proposed allocation of New Enstar shares post-merger reflects the following differences:

an additional \$126 million of book value was credited to New Enstar in respect of the value that Enstar brings to New Enstar in addition to its existing investment in Castlewood.

an additional \$52 million of book value was credited to Castlewood management and employees in respect of the value that they bring to New Enstar in addition to their existing investment in Castlewood.

At the same meeting, representatives of Enstar's outside legal counsel, Parker, Hudson, Rainer & Dobbs, and special legal counsel, Debevoise & Plimpton LLP, or Debevoise, reviewed in detail the board's fiduciary duties, both generally and in the specific context of the proposed transaction. As outside legal counsel, Parker, Hudson, Rainer & Dobbs advised Enstar with respect to Georgia law, general corporate matters and other matters relating to the proposed transaction. As special legal counsel, Debevoise advised Enstar with respect to law other than Georgia law, general corporate matters and other matters relating to the proposed transaction. Debevoise also drafted and/or negotiated the transaction documents in connection with the proposed transaction. The board discussed the advisability of engaging an outside financial adviser and determined that it would not be in the best interests of Enstar and its shareholders to do so, because the board concluded that the cost of doing so outweighed the potential benefits provided. In part because of Enstar's existing investment in Castlewood, the board believed that it was sufficiently familiar with Castlewood's business and, therefore, did not need assistance in analyzing the financial terms of the transaction from a third-party that was not familiar with Castlewood's business. Further, the board believed that because Enstar's investment in Castlewood constituted a very substantial portion of Enstar's business and because the other assets that Enstar would effectively transfer to the combined company in the merger, which principally consist of cash and other investments, are relatively easy to value, the board did not need third-party assistance to evaluate the



fairness of Enstar's shareholders effectively exchanging their interest in such other assets and their indirect interest of approximately 32.0% in Castlewood for a direct interest of approximately 49.9% in Castlewood.

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At this meeting, the board also discussed certain interests and relationships of Enstar directors and officers that are different from those of non-affiliated Enstar shareholders, including:

A new employment agreement between New Enstar, Castlewood (US) Inc., a subsidiary of Castlewood, and Mr. Oros, that will take effect at the effective time of the merger. Under the terms of Mr. Oros' employment agreement, he will be paid a salary of \$282,500 and will be entitled to participate in New Enstar's incentive compensation programs. He will also receive other employee benefits consistent with those provided to New Enstar's other executive officers. New Enstar expects that Mr. Oros will spend approximately 50% of his working time on matters related to New Enstar, but there is no minimum work commitment set forth in his employment agreement.

Accelerated vesting of 80,000 options granted to certain Enstar directors and officers pursuant to one of Enstar's equity incentive plans. Of these options, options to purchase 30,000 shares of Enstar common stock are held by Mr. Frazer and options to purchase 50,000 shares of Enstar common stock are held by Mr. Oros.

A severance payment of \$350,000 to Mr. Frazer under his existing employment agreement.

Tax indemnification by Castlewood of Mr. Flowers pursuant to which Castlewood will reimburse and indemnify Mr. Flowers for, and hold him harmless on an after-tax basis against, any increase in Mr. Flowers' U.S. federal, state or local income tax liability (including any interest or penalties relating thereto), and reasonable attorneys' fees, incurred by Mr. Flowers as a result of (1) certain dispositions of shares of Enstar by New Enstar or any successor or assign of New Enstar or (2) dispositions of all or substantially all of the Enstar assets by Enstar or any successor or assign of Enstar, within the period beginning immediately after the effective time of the merger and ending five years after the last day of the taxable year that includes the effective time. Because Mr. Flowers will be the only greater-than-5% U.S. shareholder of New Enstar after the merger, he is in a different position than the other current shareholders of Enstar with regard to treating the merger as a tax-free reorganization. Under IRS regulations issued pursuant to section 367(a) of the Code, as a 5% U.S. shareholder Mr. Flowers may treat the merger as a tax-free reorganization only if he enters into a gain recognition agreement with the IRS under which he agrees he will treat the merger as taxable if New Enstar disposes of certain stock or assets of Enstar within the five years following the merger. Such dispositions may be effected without Mr. Flowers' consent. Other shareholders of Enstar are not subject to these additional conditions, and their tax treatment would not be affected by such dispositions. The Enstar board of directors approved such agreement because it determined that it would be fair to put Mr. Flowers in the same position as the other shareholders of Enstar with respect to such tax treatment, and that such agreement would increase the likelihood that Mr. Flowers, in his capacity as an Enstar shareholder, would support the proposed transaction. While the agreement is significant to Mr. Flowers, New Enstar believes it is unlikely to incur any liability under the agreement because it believes the likelihood that it will dispose of stock or assets of Enstar within the next five years to be remote.

Registration rights expected to be granted by New Enstar to Mr. Flowers and other holders of New Enstar ordinary shares pursuant to which Mr. Flowers and such other holders may request after the first anniversary of the merger that New Enstar effect the registration under the Securities Act of certain of their ordinary shares of New Enstar, and the registration rights expected to be granted by New Enstar to the other directors of Enstar (which rights are also expected to be granted to other large shareholders of Castlewood) pursuant to which they may participate in certain registration statements filed by New Enstar under the Securities Act and sell their ordinary shares of New Enstar pursuant to such registration statements.

Service of the current Enstar directors on New Enstar's board of directors following the merger.

Indemnification by New Enstar of past and present directors and officers of Enstar for losses in connection with any action arising out of or pertaining to acts or omissions, or alleged acts or omissions, by them in their capacities as such at or before the effective time of the merger.

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In addition, each of Enstar and Castlewood has entered into transactions with companies and partnerships that are affiliated with Messrs. Flowers and/or Oros, and an entity of which Mr. Flowers is a director and the largest shareholder owns a minority interest in a subsidiary of Castlewood. See Certain Relationships and Related Transactions beginning on page 182.

As of December 12, 2006, Enstar directors and officers that have the interests and relationships described above owned, or had voting control over, 1,904,763 shares of Enstar common stock, representing approximately 33.2% of the voting power of Enstar common stock on that date. Upon consummation of the merger, these directors will own 1,904,763 ordinary shares of New Enstar, representing approximately 16.2% of the voting power of New Enstar ordinary shares.

The board considered such interests and relationships and considered whether it should appoint a special committee of independent directors to evaluate and negotiate the transactions and whether interested directors should participate in the deliberations concerning, and vote on, the proposed transactions. The board concluded that it should not create a special committee and that interested directors should participate in the deliberation concerning, and vote on, the proposed transactions. The board based such conclusions on its judgment that, notwithstanding such interests and relationships, Enstar and its shareholders would be better served by:

having Messrs. Flowers, Frazer and Oros assume principal responsibility for the negotiation of this merger, given their expertise, experience and familiarity with Castlewood, the relative immateriality, in the board's view, of such interests and relationships to them personally, when compared to their interests as Enstar shareholders, and that their interests as Enstar shareholders were aligned with those of the other Enstar shareholders;

having all of the Enstar directors participate in the board's deliberation concerning the merger, given the directors' expertise, experience and familiarity with Castlewood, the relative immateriality, in the board's view, of such interests and relationships to them personally, the fact that Georgia law permits interested directors to participate in deliberations so long as their interests are disclosed and the fact that, in the board's view, with disclosure, the board would be able to appropriately weigh the views expressed by interested directors and not be inappropriately influenced; and

having all of the Enstar directors vote on the merger, given the board's desire to know, and the advisability of being able to advise the shareholders of, the positions of all directors regarding the merger, the relative immateriality, in the board's view, of such interests and relationships to them personally, the fact that Georgia law permits interested directors to vote so long as their interests are disclosed, and the fact that the merger would only be approved if a majority of the disinterested directors approved the merger.

The board did determine that the merger agreement and the transactions contemplated by the merger agreement would not be approved unless they were approved by a majority of the four independent directors.

On April 24, 2006, representatives of Castlewood and Enstar, along with their respective special legal counsel, Drinker Biddle & Reath LLP, or Drinker, and Debevoise, met in person and by telephone to discuss the material terms of the recapitalization and the merger. These discussions included a review of the recapitalization transaction, including the allocation of Castlewood's ordinary shares in exchange for its existing outstanding shares, and the consideration to be issued to the shareholders of Enstar.

On April 26, 2006, Enstar's board of directors held a special meeting, during which the directors reviewed in detail the financial and other aspects of the proposed transaction. The board focused principally on the increase in the Enstar

shareholders' interest in Castlewood from an indirect interest of approximately 32.0% to a direct interest of approximately 49.9% and in the other transfers of value in the proposed transactions, but also considered several financial analyses of the transactions prepared by management, including the following:

A comparison of Enstar's tangible book value per share as of December 31, 2005 of \$27.21 with New Enstar's pro forma tangible book value per share as of such date, after giving effect to the merger, of \$22.50, a decrease of \$4.71 per share. The board discussed such decrease in tangible book value per

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share, noted that it was offset by the anticipated dividend to Enstar shareholders of \$2.47 per share and concluded that the net decrease, together with other negative factors, did not outweigh the anticipated benefits of the transaction. The amount of the dividend was ultimately increased to \$3.00 per share.

A contributions analysis similar to that presented to the board at its April 5 meeting and reflecting substantially the same premium for Enstar shareholders in the merger consideration as was reflected in the April 5 presentation.

A returns analysis that considered the transaction as a contribution by Enstar shareholders of their interests in Enstar's assets other than its investment in Castlewood in exchange for the additional 17% interest in Castlewood and, based on certain assumptions regarding future Castlewood earnings that management deemed reasonable for purposes of the analysis, reflected internal rates of returns on such contribution in excess of 50% over time.

A fair value analysis that applied a range of valuations to the non-Castlewood assets, including goodwill, that Enstar is contributing to New Enstar and showed that, as of the date the analysis was done, the implied market value of the New Enstar shares that Enstar shareholders are receiving exceeds the value of Enstar's market capitalization at any valuation of such non-Castlewood assets up to approximately \$185 million. The book value of such non-Castlewood assets, and in the opinion of Enstar management, the fair value (other than value attributable to goodwill) of such non-Castlewood assets as of such date was approximately \$85 million; accordingly, the analysis indicated a premium to Enstar shareholders of approximately \$100 million.

Enstar's board of directors also discussed different alternatives for listing the shares of New Enstar after the merger and reviewed the proposed principal transaction documents and the status of negotiations respecting such documents.

On May 5, 2006, Castlewood and Enstar entered into a confidentiality agreement, after which both parties began providing requested due diligence materials, and due diligence investigations by executives and legal advisors for both companies began and continued through May 22, 2006.

The due diligence investigations by both parties included the reciprocal exchange of information and documents regarding the two companies' businesses, including: historical financial information and financial forecasts; tax records; descriptions of properties; human resources and employee benefits information, including benefit plans and employment agreements; pending and settled litigation matters; material contracts, including contracts relating to acquisitions and dispositions of businesses; and general corporate matters, including corporate governance documents, material governmental filings, auditor response letters, real estate documents and descriptions of securities. Such investigations also included interviews of some of the executive officers of Castlewood and Enstar.

From the beginning of April 2006 to the beginning of May 2006, Debevoise provided drafts of the principal transaction documents to Drinker. The draft merger agreement contained customary representations, warranties and covenants with no post-closing indemnification by either party. Specifically, on April 8, 2006, Debevoise delivered initial drafts of the form of merger agreement and support agreement, which Castlewood and Drinker reviewed. On April 13, 2006, Debevoise delivered an initial draft of the recapitalization agreement, which Castlewood and Drinker reviewed. On April 27 and 28 of 2006, Debevoise delivered drafts of the merger agreement, the recapitalization agreement and the support agreement to Skadden, Arps, Slate, Meagher & Flom LLP, or Skadden, special outside counsel to Trident II, L.P. in connection with the recapitalization, and a conference call was held among Drinker, Debevoise and Skadden to discuss issues related to the recapitalization and merger. During the week of May 1, 2006, Castlewood, Enstar and their legal representatives held several telephone conferences to discuss preliminary comments and issues raised in the merger agreement, support agreement and recapitalization agreement.

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From the beginning of May 2006 through May 21, 2006, the parties, together with their respective legal advisors, negotiated the principal terms of the transaction documents, including valuation and the proposed exchange ratio, and continued to conduct due diligence. During the week of May 8, 2006, Castlewood sought the advice of its local counsel in foreign jurisdictions concerning the nature of any regulatory consents or

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filings that may be required in connection with the proposed merger. During the week of May 15, 2006, the parties and their respective counsel held several conference calls to discuss outstanding due diligence items and their respective comments to the transaction documents. During this week, the parties also exchanged their respective disclosure schedules for review. The negotiation of the merger agreement and other transaction documents was handled primarily by Messrs. Oros, Frazer and Flowers, on behalf of Enstar, and Messrs. Silvester, O Shea and Harris, on behalf of Castlewood, together with each party's legal advisors.

On May 20, 2006, Castlewood's board of directors met to consider the merger agreement and the proposed transactions related to the merger agreement and voted unanimously to approve the merger agreement and the other transaction documents.

On May 21, 2006, Enstar's board of directors met to consider the merger agreement and the proposed transactions related to the merger agreement. The directors reviewed the results of negotiations since their last meeting, including the proposed share allocation among the Enstar and Castlewood shareholders, and, due to the passage of time and minor changes in the terms of the proposed transaction, discussed the continued validity of the financial analyses of the proposed transaction presented at their last meeting. Changes in the terms of the proposed transactions since the last presentation to Enstar's board of directors included (1) a minor difference between the proposed and actual payments made to the shareholders of Castlewood, including Enstar, pursuant to the Waterfall Distribution Provisions, (2) increase of the cash dividend payable upon consummation of the merger to Enstar shareholders from \$2.47 to \$3.00 per share, (3) minor changes to the treatment in the proposed transaction of Enstar stock options and restricted stock units outstanding prior to the merger and (4) a change in the method of calculating the percentage of equity ownership of New Enstar to be owned by Enstar's shareholders such that the percentage of such ownership is 48.7% instead of 49.9% as originally proposed. Enstar's board of directors, with all of Enstar's directors present and voting, voted unanimously to approve the merger agreement and the transactions contemplated by the merger agreement.

On May 22, 2006, the parties finalized the merger agreement, the recapitalization agreement, the registration rights agreement, the support agreement and the other transaction documents. The parties also agreed on the initial composition of the board of directors and executive officers of New Enstar, as well as other employee compensation and benefit matters, including amendments to the employment agreements of Messrs. O Shea, Packer and Silvester and the terms of the new employment agreement for Mr. Oros.

## **Enstar's Reasons for the Merger**

At a special meeting held on May 21, 2006, the Enstar board of directors, with all of Enstar's directors present and voting, unanimously determined that it was advisable and fair to and in the best interests of Enstar and its shareholders for Enstar to enter into and consummate the proposed transactions and approved the merger agreement and the transactions contemplated by the merger agreement. Some of Enstar's directors and executive officers have interests in the proposed transactions and relationships that are different from, or in addition to, yours. The Enstar board of directors considered these interests and relationships when approving the proposed transactions and the merger agreement and concluded that such interests could be appropriately addressed through disclosure and that no director should recuse himself from the deliberations and decisions of the board regarding the merger. These interests and relationships are discussed in "Interests of Certain Persons in the Merger" beginning on page 60 and "Certain Relationships and Related Transactions" beginning on page 182.

In reaching its decision, the Enstar board of directors considered a number of factors, including the following:

The merger is expected to enhance the existing and proven close working relationship between Enstar and Castlewood management and to further align the incentives of Castlewood management with the interests of Enstar's shareholders. Castlewood's current ownership structure consists of several classes of shares that provide



different voting rights to shareholders, with Enstar directly (and the Enstar shareholders indirectly) owning approximately 32.0% of the economic interest and 50.0% of the voting interest in Castlewood. Each of Enstar, Trident, and members of Castlewood senior management who own Castlewood shares has the right, among other things, to nominate a certain number of members of

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Castlewood's board of directors. Major transactions are required to be approved by one or more directors representing each of Enstar, Trident and Castlewood senior management. The merger will eliminate these approval rights and is expected to better align the incentives of the management of Castlewood and Enstar by having all parties own shares with the same rights.

The transaction would provide a positive economic result for Enstar's shareholders, including the one-time \$3.00 per share dividend to be paid to shareholders of Enstar and the one-for-one exchange ratio contemplated by the merger agreement. In reaching such conclusion, the directors focused, among other things, on:

the increase in the Enstar shareholders' proportionate economic ownership of Castlewood from approximately 32.0% to 48.7% (on an undiluted basis);

the implied internal rate of return if the contribution to the combined entity of Enstar's assets other than its investment in Castlewood were viewed as an investment in Castlewood in exchange for the increased economic ownership in Castlewood; and

comparison of the public market value of Enstar to the implied public market value of Castlewood based on Enstar's approximately 32.0% economic ownership of Castlewood, which supported the fairness of the economic terms of the transaction.

The ownership and management structure of Castlewood, Enstar and B.H. Acquisition, a company that Castlewood and Enstar partially own with an affiliate of Trident II, L.P., would be simplified by forming one public company with one board of directors and a consolidated management team. In particular, the board of directors of Enstar believes the merger will:

consolidate the financial and management resources and thereby expand the capabilities of New Enstar to pursue additional acquisitions in the insurance and reinsurance run-off business;

enhance New Enstar's access to capital as a result of both its larger asset base and simplified ownership structure;

expand the opportunities for New Enstar to deploy its capital in attractive investments; and

increase the focus of the time and energy of the directors and management of New Enstar on identifying and consummating attractive acquisitions and managing the existing businesses.

The belief of Enstar's board of directors and management that the other terms of the merger agreement, including the parties' representations, warranties, covenants and conditions to their respective obligations, were reasonable.

Enstar was familiar with Castlewood through its existing ownership interest.

The merger was expected to qualify as a tax-free reorganization for U.S. federal income purposes and, accordingly, should not be taxable either to Castlewood, Enstar or Enstar's shareholders.

The Enstar board of directors also identified and considered potentially negative factors concerning the potential transactions, including the following:

The costs to be incurred in connection with the merger, including customary transaction expenses and the diversion of management and employee attention during the period after the signing of the merger agreement.

The risk that the merger might not be completed or that the closing might be delayed, which could result in Enstar incurring the costs described above but not realizing the potential benefits of the merger, or in any event incurring increases in such costs.

The other risks described in *Risk Factors* beginning on page 21, which the Enstar board of directors takes notice of generally in the course of its oversight of Enstar's business. The following risks were specifically discussed during the board's deliberations regarding the merger:

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the risk that the merger will result in the holders of Enstar's common stock owning a smaller percentage of New Enstar than they currently own of Enstar, which could reduce their ability to affect changes to New Enstar's board of directors, management and policies;

the risk that regulatory agencies may delay or impose conditions on approval of the merger, which may increase the cost or diminish the anticipated benefits of the merger;

the risk that if the merger does not constitute a reorganization under section 368(a) of the Code, then Enstar shareholders may be responsible for payment of U.S. federal income taxes; and

the risk that certain of Enstar's officers and directors have interests in the merger and relationships that may have influenced their approval of the merger agreement and the transactions contemplated by the merger agreement.

After deliberation, the Enstar board of directors concluded that, on balance, the potential benefits of the transactions to the Enstar shareholders outweighed these risks and potential disadvantages.

The foregoing discussion of the information and factors considered by the Enstar board of directors is not intended to be exhaustive, but includes the material factors considered by the Enstar board of directors. In reaching its decision to approve the merger agreement and the transactions contemplated by the merger agreement, the Enstar board did not view any single factor as determinative and did not find it necessary or practicable to assign any relative or specific weights to the various factors considered. In addition, individual directors may have given different weights to different factors. The board did not make any determination as to how any specific benefit or risk contributed to its conclusion that the transaction was advisable and fair, but rather considered the benefits and risks in the aggregate.

**Recommendation of the Board of Directors of Enstar**

**THE ENSTAR BOARD OF DIRECTORS UNANIMOUSLY RECOMMENDS THAT ENSTAR SHAREHOLDERS VOTE FOR THE APPROVAL OF THE MERGER AGREEMENT AND THE TRANSACTIONS CONTEMPLATED BY THE MERGER AGREEMENT.**

In considering the recommendation of Enstar's board of directors with respect to the merger, you should be aware that some officers and directors of Enstar have interests in the merger and relationships that are different from, or in addition to, the interests of Enstar shareholders generally. Enstar's board of directors considered these interests and relationships in approving the merger agreement and the transactions contemplated by the merger agreement and concluded that such interests could be appropriately addressed through disclosure and that no director should recuse himself from the deliberations and decisions of the board regarding the merger. See "Interests of Certain Persons in the Merger" beginning on page 60 and "Certain Relationships and Related Transactions" beginning on page 182.

In addition, you should be aware that as of December 12, 2006, Enstar's directors and executive officers owned 1,904,763 shares of Enstar common stock, representing approximately 33.2% of the voting power of Enstar common stock on that date. Three of those directors, who owned Enstar common stock representing 30.1% of the voting power on that date, have entered into a support agreement with Castlewood pursuant to which such directors have agreed to vote their shares of Enstar common stock in favor of the merger agreement and the transactions contemplated by the merger agreement. All other Enstar directors and officers have also indicated that they intend to vote their shares of Enstar common stock in favor of the merger agreement and the transactions contemplated by the merger agreement.



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**Castlewood's Reasons for the Merger**

At a special meeting held on May 20, 2006, the Castlewood board of directors determined that it was advisable and fair to and in the best interest of Castlewood and its shareholders for Castlewood to enter into the merger agreement and consummate the transactions contemplated by the merger agreement. In reaching its decision, the Castlewood board of directors considered a number of factors, including the following:

New Enstar is expected to have a significantly increased equity market capitalization, which Castlewood's board of directors believes would provide greater financial flexibility and improved access to both debt and equity capital;

New Enstar's ordinary shares will be listed on Nasdaq and, subject to contractually agreed upon restrictions on transfer and other restrictions under Bermuda law, would be substantially more liquid for Castlewood's existing shareholders than their current Castlewood shares;

New Enstar would benefit from the expertise and extensive experience of the combined management team;

the increased size of New Enstar could allow it to participate in the acquisition and management of larger companies or portfolios in run-off than would be available to Castlewood on a stand-alone basis;

as a result of the simplified shareholder structure, New Enstar would be easier to analyze and value, which would provide for increased market visibility for New Enstar and, ultimately, may enhance the market valuation of New Enstar's ordinary shares relative to the shares privately held by Castlewood's existing shareholders;

holders of substantially all of Castlewood's existing shares were directly involved in the negotiations in respect of the proposed merger and were supportive of the transaction and the related recapitalization of Castlewood;

the potential financial benefits stemming from the enhanced growth prospects of New Enstar; and

the merger is expected to qualify as a tax-free reorganization for U.S. federal income tax purposes and, accordingly, should not be taxable either to Castlewood, Enstar or Enstar's shareholders.

The Castlewood board of directors also identified and considered the potentially negative factors concerning the potential transactions, including the following:

the risk that the merger might not be consummated or that the closing might be delayed;

the costs to be incurred in connection with the merger, including transaction expenses; and

the cost of Castlewood becoming directly subject to the reporting and other requirements of the Exchange Act, including Section 404 of the Sarbanes-Oxley Act of 2002.

After deliberation, the Castlewood board of directors concluded that, on balance, the potential benefits of the transactions to Castlewood and its shareholders outweighed these risks and potential disadvantages.

Some of Castlewood's directors and executive officers have interests in the merger that are different from, or in addition to, Castlewood's shareholders. The Castlewood board of directors considered these interests when approving the proposed transactions and the merger agreement. These interests are discussed in "Interests of Certain Persons in the Merger" beginning on page 60.

The foregoing discussion of the information and factors considered by the Castlewood board of directors is not intended to be exhaustive, but does include the material positive and negative factors considered by the Castlewood board of directors. In view of the wide variety of factors considered by the Castlewood board of directors in connection with its evaluation of the merger and the complexity of these matters, the board did not attempt to quantify, rank or otherwise assign relative weights to the specific factors it considered in reaching its decision. Rather, the Castlewood board of directors made its determination based on the totality of information presented to it and the deliberations engaged in by it. In considering the factors discussed above, individual directors may have given different weights to different factors.

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**Accounting Treatment**

The merger will be accounted for as a purchase by Castlewood under accounting principles generally accepted in the United States. Under the purchase method of accounting, the assets and liabilities of Enstar will be recorded, as of consummation of the merger, at their respective fair values and combined with those of Castlewood.

**Material U.S. Federal Income Tax Consequences of the Merger**

The following is a discussion of the material U.S. federal income tax consequences to holders of Enstar common stock who exchange such stock for New Enstar ordinary shares in the merger and who hold Enstar common stock and will hold New Enstar ordinary shares as capital assets (as defined in section 1221 of the Code). The statements of United States Federal tax law or legal conclusions with respect thereto set forth under this heading **Material U.S. Federal Income Tax Consequences of the Merger** represent the opinion of Debevoise & Plimpton LLP, or Debevoise, Enstar's tax counsel. This discussion is based on the Code, U.S. Treasury regulations, administrative rulings and pronouncements, and judicial decisions, all as in effect as of the date hereof and all of which are subject to change, possibly with retroactive effect. Any such change could alter the tax consequences discussed below. This discussion does not cover any issues arising under any state, local or non-U.S. tax laws.

This discussion is based in part on facts described in this proxy statement/prospectus; the provisions of the merger agreement, the recapitalization agreement and other related agreements; and representations made by Castlewood and Enstar. If any of these facts or representations is inaccurate, the U.S. federal income tax consequences of the merger could differ from those described below.

This discussion does not address all U.S. federal income tax issues that may be relevant to all holders in light of their particular circumstances or the consequences to holders who are subject to special federal income tax treatment, such as:

tax-exempt organizations;

individuals who hold Enstar common stock received pursuant to the exercise of any incentive stock options or who hold Enstar common stock subject to certain restrictions received in connection with the performance of services; or

non-U.S. holders who have held more than 5% of the Enstar common stock (taking into account the applicable attribution rules of the Code and U.S. Treasury regulations) at any time within the five-year period ending at the consummation of the merger.

In addition, this discussion does not address any tax consequences associated with:

the exercise of options to purchase Enstar common stock before the effective time of the merger;

the exchange of options to purchase Enstar common stock for options to purchase New Enstar ordinary shares in the merger; or

the exchange of Enstar restricted stock units for a right to receive restricted stock units in respect of New Enstar ordinary shares.



**We urge you to consult your own tax advisor concerning the specific U.S. federal, state and local, as well as non-U.S., tax consequences to you of the exchange of Enstar common stock for New Enstar ordinary shares in the merger in light of your own particular circumstances.**

*Tax Opinions*

It is a condition to the closing of the merger that Enstar and Castlewood receive an opinion from Enstar's tax counsel, Debevoise, on or prior to the date on which Castlewood's registration statement of which this proxy statement/prospectus is a part becomes effective, or the effective date opinion, to the effect that the merger should be treated for U.S. federal income tax purposes as a reorganization within the meaning of

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section 368(a) of the Code. It is also a condition to the consummation of the merger that Enstar and Castlewood receive a second opinion from Debevoise, dated as of the closing date of the merger, or the closing date opinion, confirming the effective date opinion. The effective date opinion is, and the closing date opinion will be, based on Section 368(a) (defining reorganization ) and other provisions of the Code, U.S. Treasury Regulations, administrative rulings and pronouncements, and judicial decisions, all as in effect on the date hereof and on representation letters provided by Enstar and Castlewood to Debevoise at the effective time and the closing date, respectively, and on customary factual assumptions. Counsel is providing opinions that the merger should constitute a reorganization, rather than opinions that the merger will constitute a reorganization because there is no controlling interpretation directly on point. The uncertainty results from a lack of direct authority and not from the presence of contrary authority.

If any of the necessary representations or assumptions is inaccurate or incomplete, Debevoise's effective date opinion or its closing date opinion, or both, may be invalid. If any of these representations or assumptions cannot be made, Debevoise may not be able to provide its closing date opinion. If Debevoise cannot provide its closing date opinion, the merger cannot close unless Enstar and Castlewood waive the requirement that they receive such opinion. If Enstar and Castlewood waive the requirement that they receive such closing date opinion, or if Debevoise's closing date opinion would differ materially from Debevoise's effective date opinion, and there is a material change in the expected U.S. federal income tax consequences associated with the exchange of Enstar common stock for New Enstar ordinary shares in the merger as described in this proxy statement/prospectus, then this proxy statement/prospectus will be revised and recirculated and the approval of Enstar's shareholders will be resolicited.

Debevoise has rendered the effective date opinion stating that the merger should be treated for U.S. federal income tax purposes as a reorganization within the meaning of section 368(a) of the Code. The full text of Debevoise's effective date opinion is filed as an exhibit to Castlewood's registration statement of which this proxy statement/prospectus is a part. For information on how to obtain a copy of exhibits filed with Castlewood's registration statement, see *Where You Can Find More Information* on page 231. Debevoise's closing date opinion will also confirm the opinion rendered in Debevoise's effective date opinion.

No assurance can be given that the IRS will agree with the tax consequences described in the Debevoise opinions or that, if the IRS were to take a contrary position, that position would not ultimately be sustained by the courts. Neither Enstar nor Castlewood intends to obtain a ruling from the IRS regarding the tax consequences of the merger.

***Tax Consequences to Exchanging Shareholders***

As noted above, Debevoise has provided an opinion that the merger should be treated for U.S. federal income tax purposes as a reorganization within the meaning of Section 368(a) of the Code. Accordingly,

Enstar shareholders should not recognize any gain or loss on the exchange of Enstar common stock for New Enstar ordinary shares in the merger;

the tax basis to an Enstar shareholder of New Enstar ordinary shares received in exchange for Enstar common stock pursuant to the merger should equal such Enstar shareholder's tax basis in the Enstar common stock surrendered in exchange therefor; and

the holding period of an Enstar shareholder for New Enstar ordinary shares received pursuant to the merger should include the holding period of the Enstar common stock surrendered in exchange therefor.

Under applicable U.S. Treasury regulations (§1.368-3(b)), each Enstar exchanging shareholder will be required to attach to its federal income tax return for the current taxable year a statement setting forth certain specified

information about the exchange, including a statement of such shareholder's tax basis in its Enstar common stock and a description of the New Enstar ordinary shares it receives in the merger.

A U.S. holder who will own 5% or more of either the total voting power or the total value of the outstanding New Enstar ordinary shares after the merger (determined after taking into account the applicable

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attribution rules of the Code and U.S. Treasury regulations) and who would otherwise qualify for non-recognition of gain in connection with the merger (and the related basis and holding period consequences described above) will so qualify only if such holder enters into a gain recognition agreement with the IRS in accordance with the U.S. Treasury regulations under section 367(a) of the Code. Certain subsequent dispositions of Enstar shares or assets by New Enstar may result in gain recognition to such a holder. Each such U.S. holder should consult its own tax advisors regarding these matters.

### ***Certain Tax Consequences to Enstar and Castlewood***

As noted above, Debevoise has provided an opinion that the merger should be treated for U.S. federal income tax purposes as a reorganization within the meaning of section 368(a) of the Code. Accordingly no income, gain or loss should be recognized by Castlewood or Enstar as a result of the transfer to the Enstar shareholders of New Enstar ordinary shares pursuant to the merger.

**For a discussion of the material tax considerations of holding and disposing of New Enstar ordinary shares, see the discussion under Material Tax Considerations of Holding and Disposing of New Enstar Ordinary Shares beginning on page 219.**

### **Regulatory Matters Relating to the Merger**

#### ***Antitrust and Competition Filings***

The merger is not subject to notification to the U.S. Department of Justice and U.S. Federal Trade Commission under the Hart-Scott-Rodino Antitrust Improvements Act. Castlewood and Enstar conduct operations in a number of foreign jurisdictions, and the merger may be subject to notification and approval by governmental authorities under the antitrust or competition laws of those jurisdictions. We recognize that some of these approvals may not be obtained before the completion of the merger and may impact New Enstar's ability to conduct business in those jurisdictions until such approvals are obtained. We cannot assure you that the governmental reviewing authorities will clear the merger at all or without restrictions or conditions that would have a material adverse effect on New Enstar if the merger is consummated. These restrictions and conditions could include a complete or partial license, divestiture or spin-off of some of New Enstar's assets or businesses.

In addition, even after completion of all notification and approval requirements, the U.S. Department of Justice, the U.S. Federal Trade Commission or another governmental authority could challenge or seek to block the merger under the antitrust laws, as it deems necessary or desirable in the public interest. Other agencies with authority over antitrust or other comparable anti-competition laws with jurisdiction over the merger could also initiate action to challenge or block the merger. In addition, in some jurisdictions, a competitor, customer or other third party could initiate a private action under the antitrust laws challenging or seeking to enjoin the merger, before or after it is consummated. Castlewood and Enstar cannot be sure that a challenge to the merger will not be made or that, if a challenge is made, Castlewood and Enstar will prevail.

#### ***Other Regulatory Considerations***

The consummation of the merger is conditioned upon Castlewood's receipt of approval of the recapitalization and the merger from the Financial Services Authority of the United Kingdom, which Castlewood received on September 1, 2006. Castlewood and its shareholders have also provided the requisite notice of the transaction to the Federal Office of Private Insurance in Switzerland and the Banking Finance and Insurance Commission in Belgium. Castlewood has already received approval from the Bermuda Monetary Authority to issue its ordinary shares in connection with the recapitalization and the merger.

Other than the filings and approvals described above, neither Enstar nor Castlewood is aware of any regulatory approvals required to be obtained, or waiting periods to expire, to consummate the merger or the recapitalization. If the parties discover that other approvals are needed, however, they may not be able to obtain them. Even if Enstar and Castlewood could obtain all necessary approvals, and the necessary approval

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of the Enstar shareholders, conditions may be placed on any such approval that could cause either Castlewood or Enstar to abandon the merger.

## **Rights Agreement**

Enstar entered into a rights agreement dated as of January 20, 1997, as amended, with American Stock Transfer & Trust Company as rights agent. Under this agreement, Enstar effected a dividend distribution of shareholder rights that carry certain conversion rights in the event of a significant change in beneficial ownership of Enstar. One right is attached to each share of Enstar's outstanding common stock and is not detachable until such time as a person or group of affiliated or associated persons either acquires beneficial ownership of 15% or more of Enstar's outstanding common stock or announces an intention to commence a tender or exchange offer the consummation of which would result in beneficial ownership of 15% or more of the outstanding Enstar common stock. The exercise price of each right was fixed at \$40. If an acquirer purchases an equity position in Enstar equal to or greater than a 15% interest or engages in certain other types of transactions with Enstar, each right not beneficially owned by the acquirer is converted into the right to buy that number of shares of Enstar common stock which has a market value shortly after such triggering event of two times the exercise price of the right. If the acquiring company were to merge or otherwise combine with Enstar, or Enstar were to sell or transfer 50% of its cash flow or earnings power, each right is converted into the right to buy that number of shares of common stock of the acquiring company which has a market value of two times the exercise price of the right.

At the time of the execution and delivery of the merger agreement, Enstar and the rights agent amended the terms of the rights agreement so that the execution and delivery of the merger agreement, recapitalization agreement, support agreement and any other agreement or transaction entered into in connection with the merger would not constitute a triggering event. The amended terms of the rights agreement also provide for the cancellation of all rights under the rights agreement upon the effectiveness of the merger and in accordance with the merger transaction documents. This means that holders of Enstar's common stock will not obtain the detachable rights in connection with the merger.

## **Federal Securities Laws Consequences; Stock Transfer Restriction Agreements**

All New Enstar ordinary shares received by Enstar shareholders in the merger will be freely transferable, except that New Enstar ordinary shares received by persons who are deemed to be affiliates of Enstar under the Securities Act at the time of the Annual Meeting may be resold by them only in transactions permitted by Rule 145 under the Securities Act or as otherwise permitted under the Securities Act. Persons who may be deemed to be an affiliate of Enstar for such purposes generally include individuals or entities that control, are controlled by or are under common control with, Enstar, as the case may be, and include directors, certain executive officers and principal shareholders of Enstar. These affiliates may resell the New Enstar ordinary shares they receive in the merger only:

under an effective registration statement under the Securities Act covering the resale of those shares;

in transactions permitted by Rule 145(d) under the Securities Act; or

as otherwise permitted under the Securities Act.

Castlewood's registration statement, of which this proxy statement/prospectus is a part, does not cover the resale of New Enstar ordinary shares to be received in connection with the merger by persons who may be deemed to be affiliates of Enstar before the merger, and no person is authorized to make any use of this document in connection with any such sale. The merger agreement also requires that Enstar use reasonable best efforts to cause each affiliate to execute a written agreement to the effect that such persons will not offer, sell or otherwise dispose of any of the New Enstar ordinary shares issued to them in the merger in violation of the Securities Act or the related rules and

regulations promulgated thereunder. However, Trident and Messrs. Flowers and Silvester and certain other shareholders of Castlewood (including the current directors of Enstar), some of whom may be deemed to be affiliates of Enstar, have agreed to enter into a registration rights agreement with Castlewood and certain of its current shareholders concurrently with the closing of the recapitalization. The registration rights agreement will give such persons the right to require, in certain instances, New Enstar to register their New Enstar ordinary shares or to participate in registered offerings of

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shares by New Enstar and other shareholders of New Enstar. See Material Terms of Related Agreements Registration Rights Agreement on page 77.

**Stock Exchange Listing; Delisting and Deregistration of Enstar Common Stock**

It is a condition to the merger that the New Enstar ordinary shares issuable in the merger be approved for listing on Nasdaq, subject to official notice of issuance. If the merger is consummated, Enstar common stock will cease to be listed on Nasdaq and its shares will be deregistered under the Exchange Act.



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**INTERESTS OF CERTAIN PERSONS IN THE MERGER**

Certain of Enstar's and Castlewood's directors and executive officers have interests in the merger as individuals in addition to, and that may be different from, your interests as shareholders of Enstar or New Enstar. The Enstar and Castlewood boards of directors were aware of these interests and considered them in their respective decisions to approve the merger agreement and the transactions contemplated by the merger agreement.

**New Employment Agreements with John J. Oros, Paul J. O'Shea, Nicholas A. Packer and Dominic F. Silvester**

On May 23, 2006, Castlewood entered into a new employment agreement with Mr. O'Shea and amended its employment agreements with Messrs. Packer and Silvester. Mr. O'Shea's employment agreement, which will become effective when the merger is consummated, supersedes the employment agreement between Castlewood and Mr. O'Shea, dated November 29, 2001. Messrs. Packer's and Silvester's amended and restated employment agreements, which will also become effective when the merger is consummated, supersedes their respective employment agreements, each dated as of April 1, 2006. New Enstar also expects that it and its subsidiary, Castlewood (US) Inc., will enter into a new employment agreement with John J. Oros, to become effective when the merger is consummated. Mr. Oros is currently the President and Chief Operating Officer of Enstar and a director of Castlewood and Enstar.

Following the merger, Messrs. O'Shea and Packer will serve as New Enstar's Executive Vice Presidents, Mr. Silvester will serve as its Chief Executive Officer and Mr. Oros will serve as its Executive Chairman. As compensation for their services, each executive officer will (1) receive a base salary (Mr. Silvester's salary will be \$565,000, Messrs. O'Shea's and Packer's salary will each be \$440,000, and Mr. Oros's salary is expected to be \$282,500), (2) be eligible for incentive compensation under Castlewood's incentive compensation programs and (3) be entitled to certain employee benefits, including a housing allowance, a life insurance policy in the amount of five times his base salary, medical, dental and long-term disability insurance, payment of an amount equal to 10% of his base salary each year contributed to his retirement savings plan and, for Messrs. Packer and Silvester, the executive will be reimbursed for one round trip for his family to/from Bermuda each calendar year.

For additional details on the terms of these employment agreements, see section "Management of New Enstar Following the Merger and Other Information - Employment Agreements" beginning on page 180.

**Enstar Director and Executive Benefit Plans**

Under Enstar's 1997 Amended Incentive Plan, as amended in 2001 and 2003, and Enstar's 2001 Outside Director's Stock Option Plan, 500,000 options to purchase Enstar shares have been granted to various directors and officers of Enstar. Of the 500,000 options outstanding, as of December 12, 2006, 80,000 options have yet to vest, of which options to purchase 30,000 shares of Enstar common stock are held by Nimrod T. Frazer, Enstar's Chief Executive Officer, and options to purchase 50,000 shares of Enstar common stock are held by Mr. Oros. All of these options that remain unvested as of immediately prior to the closing of the merger will vest immediately upon a change of control triggered by the merger. Other than options issued by New Enstar in exchange for the options to acquire Enstar common stock set forth above, no additional or new options will be granted in connection with the merger.

**Payments to, and Other Interests of, Certain Executive Officers and Directors**

Pursuant to the recapitalization agreement, Castlewood will pay, immediately prior to the merger, \$5,076,000 to certain of its executive officers and employees. Of the \$5,076,000, Messrs. O'Shea, Packer and Silvester will receive \$989,956, \$989,956 and \$2,969,868, respectively. The remaining \$126,220 will be paid to Messrs. David Grisley,

David Hackett and David Rocke, employees of Castlewood. These payments are intended to provide certain Castlewood executives and employees with a cash incentive to remain with New Enstar following the merger in lieu of any other cash payments to which they may have been entitled. Both Castlewood and Enstar view these executives and employees as integral for the success of New Enstar.

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Upon completion of the merger, Castlewood, Trident, J. Christopher Flowers, a director of Castlewood and Enstar, Mr. Silvester, and certain other employee shareholders of Castlewood and the members of Enstar's board of directors receiving New Enstar ordinary shares in connection with the merger will enter into a registration rights agreement. The registration rights agreement will provide that, after the expiration of one year from the date of the registration rights agreement, Trident, Mr. Flowers and Mr. Silvester may request that New Enstar effect a registration under the Securities Act of all or any part of the New Enstar shares received by such holder in connection with the recapitalization and/or the merger. Trident will be entitled to make three requests to effect registration, while Messrs. Flowers and Silvester will each be entitled to two such requests. In addition, the registration rights agreement further provides that, after the expiration of 90 days from the date of the registration rights agreement and prior to the first anniversary of such date, Trident shall have the right to use one of its registration requests to require New Enstar to effect the registration of up to 750,000 New Enstar shares. For additional details on the terms of registration rights agreement, see **Material Terms of Related Agreements Registration Rights Agreement** beginning on page 77.

Two directors of Enstar, T. Whit Armstrong and T. Wayne Davis, have entered into a letter agreement, dated May 23, 2006, with Castlewood pursuant to which Castlewood, subject to the consummation of the merger, agreed to repurchase from Messrs. Armstrong and Davis, upon their request, during a 30-day period commencing January 15, 2007, at then prevailing market prices, such number of New Enstar ordinary shares as provides an amount sufficient for Messrs. Armstrong and Davis to pay taxes on compensation income resulting from the exercise of options by them on May 23, 2006 for 50,000 shares of Enstar common stock in the aggregate. Castlewood's obligation to repurchase ordinary shares is limited to 25,000 ordinary shares from each of Messrs. Armstrong and Davis. Since the letter agreement provides for the sale of such shares at then prevailing market prices, each of Enstar and Castlewood believe that the value of the rights of Messrs. Armstrong and Davis under such agreement is not significant.

Pursuant to the Severance Benefits Agreement, dated May 21, 1998, between Enstar and Mr. Frazer, Mr. Frazer will be entitled to \$350,000 upon the expected termination of his employment with Enstar immediately following the effective time of the merger.

On the first anniversary of the merger, Enstar will pay to each of Cheryl D. Davis, the Chief Financial Officer, Vice President of Corporate Taxes and Secretary of Enstar, and Amy Dunaway, the Treasurer and Controller of Enstar, an amount equal to 75% of their annual salary in consideration of their waiver of certain severance payments to which they are entitled in connection with the merger pursuant to their severance benefits agreements with Enstar.

## **New Enstar Board of Directors**

Under the terms of the recapitalization agreement, the board of directors of New Enstar after the consummation of the merger will consist of ten individuals. Four of these individuals Messrs. T. Whit Armstrong, Paul J. Collins, Gregory L. Curl and T. Wayne Davis are current directors of Enstar, three of these individuals Messrs. J. Christopher Flowers, Nimrod T. Frazer and John J. Oros are current directors of both Enstar and Castlewood, and the other three individuals Messrs. Paul J. O Shea, Nicholas A. Packer and Dominic F. Silvester are current directors and/or executive officers of Castlewood.

## **Indemnification of Directors and Officers; Directors Indemnity Agreements**

From and after the effective time of the merger, Castlewood has agreed that New Enstar will indemnify and hold harmless all past and present directors, officers, employees and agents of Enstar and its subsidiaries before the consummation of the merger for losses in connection with any action arising out of or pertaining to acts or omissions, or alleged acts or omissions, by them in their capacities as such at or before the effective time of the merger.

New Enstar will indemnify or advance expenses to such persons to the same extent such persons are indemnified or have the right to advancement of expenses under Enstar's articles of incorporation, bylaws and indemnification agreements, if any, on the date of the merger agreement, and to the fullest extent permitted by law. Castlewood also has agreed that it will include and cause to be maintained in effect in its memorandum

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of association and bye-laws and Enstar USA's articles of incorporation and bylaws for a period of six years after the consummation of the merger, provisions substantially similar to (in the case of Castlewood, to the fullest extent permitted by Bermuda law) the current provisions regarding elimination of liability of directors, indemnification of officers, directors and employees and advancement of expenses contained in the articles of incorporation and bylaws of Enstar.

In addition, Castlewood has agreed that it will cause to be maintained, for a period of six years after the consummation of the merger, the current policies of directors' and officers' liability insurance and fiduciary liability insurance maintained by Enstar with respect to claims arising from facts or events that occurred at or before the effective time of the merger. New Enstar may substitute policies of at least the same coverage and amounts containing terms and conditions which are, in the aggregate, no less advantageous to the insured. Such substitute policies must be issued by insurance companies having the same or better ratings and levels of creditworthiness as the insurance companies that have issued the current policies.

**Tax Indemnification Agreement**

Mr. Flowers, a director of Castlewood and Enstar and Enstar's largest shareholder, has entered into a tax indemnification agreement, dated May 23, 2006, with Castlewood and Enstar pursuant to which Castlewood will reimburse and indemnify Mr. Flowers for, and hold him harmless on an after-tax basis against, any increase in Mr. Flowers' U.S. federal, state or local income tax liability (including any interest or penalties relating thereto), and reasonable attorneys' fees, incurred by Mr. Flowers as a result of certain dispositions of shares of Enstar or dispositions of all or substantially all of Enstar's assets by New Enstar, Enstar or any successor or assign of either, within the period beginning immediately after the effective time of the merger and ending five years after the last day of the taxable year that includes the effective time. Because Mr. Flowers will be the only greater-than-5% U.S. shareholder of New Enstar after the merger, he is in a different position than the other current shareholders of Enstar with regard to treating the merger as a tax-free reorganization. Under IRS regulations issued pursuant to section 367(a) of the Code, as a 5% U.S. shareholder Mr. Flowers may treat the merger as a tax-free reorganization only if he enters into a gain recognition agreement with the IRS under which he agrees he will treat the merger as taxable if New Enstar disposes of certain stock or assets of Enstar within the five years following the merger. Such dispositions may be effected without Mr. Flowers' consent. Other shareholders of Enstar are not subject to these additional conditions, and their tax treatment would not be affected by such dispositions. The Enstar board of directors approved such agreement because it determined that it would be fair to put Mr. Flowers in the same position as the other shareholders of Enstar with respect to such tax treatment and that such agreement would increase the likelihood that Mr. Flowers, in his capacity as an Enstar shareholder, would support the proposed transaction. While the agreement is significant to Mr. Flowers, New Enstar believes it is unlikely to incur any liability under the agreement because it believes the likelihood that it will dispose of stock or assets of Enstar within the next five years to be remote.

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**THE MERGER AGREEMENT**

The following is a summary of the material terms of the merger agreement. This summary does not purport to describe all the terms of the merger agreement and is qualified in its entirety by reference to the complete text of the merger agreement which is attached as Annex A to this proxy statement/prospectus and incorporated herein by reference. All shareholders of Enstar are urged to read carefully the merger agreement in its entirety.

The merger agreement has been attached to provide investors with information regarding its terms. It is not intended to provide any other factual information about Enstar or Castlewood. In particular, the assertions embodied in the representations and warranties contained in the merger agreement were intended principally to allocate risk between Enstar and Castlewood or establish closing conditions, rather than to establish matters of fact. Such assertions may be subject to important qualifications and limitations agreed to by the parties in connection with negotiating the terms of the merger agreement. Moreover, the representations and warranties are subject to a contractual standard of materiality that may be different from what may be viewed as material to shareholders of Enstar. Accordingly, you should not rely on the representations and warranties in the merger agreement as characterizations of the actual state of facts regarding Enstar or Castlewood.

**General**

Under the merger agreement, Merger Sub, a wholly-owned subsidiary of Castlewood, will merge with and into Enstar, with Enstar surviving as a wholly-owned subsidiary of Castlewood. Enstar will change its name to Enstar USA, Inc.

**Closing Matters**

Unless the parties agree otherwise, the consummation of the merger will take place as promptly as practicable (but no later than the third business day) after all closing conditions have been satisfied or waived, unless the merger agreement has been terminated or another time or date is agreed to in writing by the parties. See Conditions to the Consummation of the Merger below for a more complete description of the conditions that must be satisfied or waived before consummation of the merger.

As soon as practicable after the satisfaction or waiver of the conditions to the merger, on the closing date, Merger Sub and Enstar will file a certificate of merger with the Georgia Secretary of State in accordance with the relevant provisions of the Georgia Business Corporation Code, and make all other required filings or recordings. The merger will become effective when the certificate of merger is filed or at such later time as Castlewood and Enstar agree and specify in the certificate of merger.

**Merger Consideration; Treatment of Stock Options and Restricted Stock Units; Board and Management**

The merger agreement further provides that, at the consummation of the merger:

Each share of Enstar common stock issued and outstanding immediately before the consummation of the merger, together with the associated rights issued under the Enstar shareholder rights plan, will be converted into the right to receive one New Enstar ordinary share.

Each outstanding option to purchase shares of Enstar common stock will be assumed by New Enstar and converted into an option to purchase New Enstar ordinary shares.

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The per share exercise price of each new option will be set at a ratio to the trading price of the ordinary shares of New Enstar immediately following the closing of the merger that equals the ratio of the exercise price of the corresponding Enstar stock option to the trading price of shares of Enstar common stock immediately prior to the closing of the merger. The number of New Enstar ordinary shares underlying the new option will be set so that the aggregate spread value of the new option approximately equals the spread value of the former Enstar stock option.

Each assumed New Enstar option will be vested to the same extent the Enstar stock option was vested immediately prior to the closing, except if the option agreement provides for acceleration of vesting as

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a result of the merger. New Enstar options will otherwise be subject to the same terms and conditions as the Enstar stock options.

Each restricted stock unit issued under Enstar's Deferred Compensation and Stock Plan for Non-Employee Directors that is outstanding immediately prior to the closing will automatically convert from a right in respect of a share of Enstar common stock into a right in respect of a New Enstar ordinary share.

Each share of common stock of Merger Sub issued and outstanding immediately prior to the consummation of the merger will be converted into one share of common stock of Enstar USA.

The articles of incorporation of Enstar will be amended and restated at the consummation of the merger and will be the articles of incorporation of Enstar USA until thereafter amended.

The bylaws of Merger Sub in effect immediately prior to the consummation of the merger will be the bylaws of Enstar USA until thereafter amended.

Until successors are duly elected or appointed and qualified, Cheryl D. Davis and John J. Oros will be the directors of Enstar USA.

Until successors are duly elected or appointed and qualified, the officers of Enstar immediately prior to the consummation of the merger will be the officers of Enstar USA.

## **Exchange of Stock in the Merger**

Before the consummation of the merger, Castlewood will appoint an exchange agent (which will be reasonably acceptable to Enstar) to handle the exchange of Enstar common stock for New Enstar ordinary shares. Promptly after the completion of the merger, the exchange agent will send a letter of transmittal, which is to be used to exchange Enstar common stock for New Enstar ordinary shares, to each former Enstar shareholder of record.

The letter of transmittal will be accompanied by instructions explaining the procedures for surrendering Enstar share certificates. **PLEASE DO NOT RETURN STOCK CERTIFICATES WITH THE ENCLOSED PROXY CARD.**

Enstar shareholders who surrender their common stock in accordance with the instructions, together with a properly completed letter of transmittal, will receive one New Enstar ordinary share for each share of Enstar common stock held by such shareholder as of the effective time. After the merger, each share of Enstar common stock will only represent the right to receive one New Enstar ordinary share into which that share of Enstar common stock will have been converted, except as otherwise described below.

Dividends or distributions declared with respect to New Enstar ordinary shares with a record date that is after the consummation of the merger will not be paid to any holder of any Enstar share certificates until the holder surrenders the Enstar share certificates in exchange for New Enstar ordinary shares. Upon surrender and subject to applicable law, New Enstar will pay to the holder, without interest, any dividends or distributions that have been declared on New Enstar ordinary shares with a record date after the consummation of the merger and before the date of such surrender and a payment date before the date of such surrender.

After the consummation of the merger, Enstar will not register any transfers of the shares of Enstar common stock. Castlewood shareholders will not exchange their share certificates in the merger.

## **Listing of New Enstar Ordinary Shares**



Castlewood has agreed to use its reasonable best efforts to cause the New Enstar ordinary shares to be issued in the merger and the New Enstar ordinary shares to be reserved for issuance upon exercise of the stock options exchanged for Enstar stock options to be approved for listing on Nasdaq, subject to official notice of issuance, before the consummation of the merger. Approval for listing on Nasdaq of the New Enstar ordinary shares issuable to the Enstar shareholders in the merger, subject only to official notice of issuance, is a condition to the obligations of Castlewood and Enstar to consummate the merger.

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**Covenants**

Castlewood and Enstar have each undertaken certain covenants in the merger agreement, which, among other things, concern the conduct of their respective businesses between the date the merger agreement was signed and the consummation of the merger. The following summarizes the more significant of these covenants:

***No Solicitation***

Enstar has agreed that Enstar, and each of its subsidiaries, officers and directors, will use reasonable best efforts to ensure that their respective employees, agents and representatives (including any investment banker, attorney or accountant retained by it or any of its subsidiaries) do not directly or indirectly:

- initiate inquiries regarding, or solicit the making of, any takeover proposal, as defined below; or
- engage in any negotiations concerning a takeover proposal.

However, Enstar and its board of directors are permitted to disclose to its shareholders its position with respect to any takeover proposal as may be required under the federal securities laws. In addition, Enstar is permitted to engage in any discussions or negotiations with, or provide information to, any person in response to an unsolicited takeover proposal, if:

- before providing any information to any person in connection with a takeover proposal, such person is required to enter into a customary confidentiality agreement with Enstar containing terms no less restrictive than the terms contained in the confidentiality agreement between Castlewood and Enstar; and

Enstar provides Castlewood with copies of all information provided to such person to the extent such information has not been previously provided to Castlewood.

A takeover proposal means any proposal or offer in respect of:

- a merger, consolidation, business combination, share exchange, reorganization, recapitalization, sale of substantially all of the assets, liquidation, dissolution or similar transaction involving Enstar, any of the foregoing referred to as a business combination transaction, with a third party;

Enstar's acquisition of any third party in a business combination transaction in which the shareholders of the third party immediately prior to consummation of such business combination transaction will own more than 35% of Enstar's outstanding capital stock immediately following such business combination transaction, including the issuance by Enstar of more than 35% of any class of its voting equity securities as consideration for assets or securities of a third party; or

- any acquisition, whether by tender or exchange offer or otherwise, by any third party of 35% or more of any class of capital stock of Enstar or of 35% or more of the consolidated assets of Enstar, in a single transaction or a series of related transactions.

Enstar has agreed to notify Castlewood in writing of the receipt of any takeover proposal or request for information or inquiry that would reasonably be expected to lead to the receipt of a takeover proposal, the terms and conditions of any takeover proposal, and the identity of the person making a takeover proposal, request or inquiry. Enstar has also

agreed to inform Castlewood on the status and material terms of any discussions regarding, or relating to, any takeover proposal and of any change in the price or material terms of and conditions regarding the takeover proposal.

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***Board of Directors Covenant to Recommend***

Enstar has agreed that its board of directors will recommend adoption and approval of the merger agreement to the Enstar shareholders. However, Enstar's board of directors is permitted to withdraw, or qualify in any material respect its recommendation in any manner adverse to Castlewood, before the Annual Meeting, if:

its board of directors determines in good faith, after consultation with its outside legal counsel, that the failure to do so would be reasonably likely to be inconsistent with the fiduciary duties owed by the board to Enstar's shareholders under applicable law; or

if the change in recommendation is in response to a superior proposal, as defined below, only (i) after Enstar provides to Castlewood a written notice advising Castlewood that the Enstar board of directors has received a superior proposal, specifying the terms and conditions of such superior proposal and including a copy thereof and identifying the person making such superior proposal, (ii) after negotiating in good faith with Castlewood to make such adjustments in the terms and conditions of the merger agreement as would enable Enstar to proceed with its recommendation without a change in such recommendation if and to the extent Castlewood elects to seek to make such adjustments and (iii) if Castlewood does not, within the earlier of five days of Castlewood's receipt of notice of a superior proposal or three business days prior to the special shareholders meeting of Enstar, make an offer that the board of directors of Enstar determines in good faith to be as favorable to the Enstar shareholders as such superior proposal.

A superior proposal means a bona fide written proposal or offer made by a third party in respect of a business combination transaction involving, or any purchase or acquisition of all or substantially all of the voting power of Enstar's capital stock, or all or substantially all of the consolidated assets of Enstar, which business combination transaction or other purchase or acquisition contains terms and conditions that the board of directors determines in good faith, after consultation with its outside counsel, would result in a transaction that if consummated would be more favorable, from a financial point of view, to the shareholders of Enstar than the merger.

***Operations of Castlewood and Enstar Pending Closing***

Castlewood and Enstar have each undertaken covenants that place restrictions on them and their respective subsidiaries until either the consummation of the merger or the termination of the merger agreement. In general, Castlewood, Enstar and their respective subsidiaries are required to conduct their respective businesses in the usual, regular and ordinary course in all material respects substantially in the same manner as conducted before the date of the merger agreement and to use their reasonable best efforts to preserve intact their present lines of business and relationships with third parties.

Each of them has agreed to restrictions that, except as expressly contemplated by the merger agreement, or with the written consent of the other party, prohibit them and their respective subsidiaries from:

declaring or paying dividends or distributions (except for a \$3.00 per share dividend payable in cash to the shareholders of Enstar immediately prior to the consummation of the merger);

making changes in their share capital, including, among other things, stock splits, combinations or reclassifications;

repurchasing or redeeming their capital stock;

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issuing or selling any shares of their capital stock or other equity interests, except Castlewood may issue up to 198 of its Class D non-voting ordinary shares to up to 35 employees of Castlewood and may enter into agreements reasonably acceptable to Enstar related to the issuance of such shares; or

amending their respective governing documents.

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Enstar also agreed to additional restrictions that, except as expressly contemplated by the merger agreement, or with the written consent of Castlewood (not to be unreasonably withheld), prohibits them and their respective subsidiaries from:

acquiring any person or division (other than an entity that is a wholly-owned subsidiary of Enstar) or disposing of assets; and

incurring or guaranteeing debt, making loans or capital contributions or investments in any other person (other than to wholly-owned subsidiaries of Enstar) and entering into any material commitment or transaction requiring a capital expenditure by Enstar or its subsidiaries.

### ***Reasonable Best Efforts Covenant***

Castlewood and Enstar have agreed to cooperate with each other and to use their reasonable best efforts to take all actions and do all things necessary, proper or advisable under the merger agreement and applicable laws to consummate the merger and the other transactions contemplated by the merger agreement. Reasonable best efforts include (but are not limited to) filing for governmental consents and taking actions necessary to resolve any objections or challenge any governmental entity may have to the contemplated transactions so as to permit their consummation.

### **Other Covenants and Agreements**

#### ***Expenses***

Castlewood and Enstar have each agreed to pay their own costs and expenses incurred in connection with the merger and the merger agreement, except that if the merger is consummated, Castlewood or its relevant subsidiary will pay all property or transfer taxes imposed on Enstar and its subsidiaries.

#### ***Other Covenants***

The merger agreement contains certain other covenants, including covenants relating to cooperation between Castlewood and Enstar in the preparation of this proxy statement/prospectus, making governmental filings, public announcements and certain tax matters. The merger agreement also contains customary covenants by Castlewood relating to indemnification of directors, officers, employees and agents of Enstar and its subsidiaries from and after the effective time of the merger and maintaining, for a period of six years after the consummation of the merger, the current policies of directors and officers liability insurance and fiduciary liability insurance.

### **Representations and Warranties**

The merger agreement contains substantially mutual representations and warranties, certain of which are qualified by material adverse effect limitation, made by each of Castlewood and Enstar to the other. The representations and warranties include those relating to:

corporate existence, qualification to conduct business and corporate standing and power;

ownership of subsidiaries;

capital structure;

corporate authority to enter into, and carry out the obligations under, the merger agreement and enforceability of the merger agreement;

absence of any conflict with or violation under their organizational documents or any law or agreement to which they are subject or bound as a result of the merger agreement and the transactions contemplated by the merger agreement;

governmental and regulatory approvals required to consummate the merger and the other transactions contemplated by the merger agreement;

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in the case of Enstar, filings made with the Commission;

financial statements;

accuracy of information supplied for use in this proxy statement/prospectus;

board of directors approval;

required shareholder votes;

litigation;

compliance with laws;

absence of certain changes or events since December 31, 2005;

employee benefit plans and related matters;

inapplicability of anti-takeover statutes;

environmental matters;

intellectual property matters;

payment of fees to finders or brokers in connection with the merger agreement;

tax matters;

material contracts;

assets;

real property;

insurance;

affiliate transactions; and

disclosures made by them.

The merger agreement also contains certain representations and warranties of Castlewood with respect to Merger Sub, including those relating to organization, authorization, absence of a breach of the organizational documents and no prior business activities.

**Conditions to the Consummation of the Merger**

***Mutual Conditions***



Castlewood's and Enstar's respective obligations to consummate the merger are subject to the satisfaction or the waiver of the following conditions:

the receipt of all governmental and regulatory consents, clearances, approvals and actions necessary for the merger and the other transactions contemplated by the merger agreement unless failure to obtain those consents, clearances, approvals and actions would not reasonably be expected to have a material adverse effect on New Enstar (except for a limited number of consents, clearances, approvals and actions of, filings with and notices to the governmental entities listed in Castlewood's disclosure letter that must be obtained regardless of their materiality), which consents, clearances, approvals and actions have been obtained;

the absence of any law, order or injunction prohibiting the consummation of the merger in the United States, Bermuda or the European Union;

the Commission having declared effective the Castlewood registration statement of which this proxy statement/prospectus is a part;

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the approval for listing by Nasdaq of the New Enstar ordinary shares to be issued in the merger, subject to official notice of issuance;

the receipt of all securities and blue sky permits and approvals necessary to consummate the merger;

the adoption and approval of the merger agreement and the transactions contemplated by the merger agreement by the Enstar shareholders;

the affirmative votes of the holders of a majority of the outstanding share capital of Castlewood necessary to consummate the transactions contemplated by the recapitalization agreement, which vote has been obtained;

the completion of the recapitalization of Castlewood pursuant to the recapitalization agreement (see Material Terms of Related Agreements Recapitalization Agreement beginning on page 72);

no event having occurred which would trigger a distribution under Enstar's shareholders rights plan;

the receipt by Enstar and Castlewood of Debevoise's opinion to the effect that the merger should qualify as a reorganization within the meaning of section 368(a) of the Code (see discussion under The Proposed Merger Material U.S. Federal Income Tax Consequences of the Merger Tax Opinions beginning on page 55);

the representations and warranties of the other party contained in the merger agreement which are qualified as to material adverse effect being true and correct as of the date of the merger agreement and as of the closing date of the merger, except to the extent that such representation or warranty speaks as of another date, and the representations and warranties of the other party which are not qualified as to material adverse effect being true and correct (disregarding materiality qualifiers) except where the failure to be true and correct, individually or in the aggregate, would not have a material adverse effect on the party making the representation, as of the date of the merger agreement and as of the closing date of the merger as if they were made on that date, except to the extent that such representation or warranty speaks as of another date; and

the other party having performed or complied in all material respects with all agreements or covenants required to be performed by it under the merger agreement (other than the parties' covenants regarding the issuance of securities, and Enstar's covenant regarding dividends and changes in share capital, which will have been complied with in all respects), in each case, on or before the closing date.

As used in the merger agreement, the term material adverse effect means with respect to either Castlewood or Enstar, as applicable, any event, change, circumstance or effect that, individually or in the aggregate, is or would be reasonably likely to be materially adverse to:

the business, financial condition, assets or results of operations of such entity and its subsidiaries, taken as a whole, other than any event, change, circumstance or effect relating:

to the economy or financial markets in general;

to changes in general in the industries in which such entity operates (provided, however, that the effect of such changes shall be included to the extent of, and in the amount of, the disproportionate impact (if any) they have on such entity relative to the other participants in such industry);

to changes in applicable law or regulations or in generally accepted accounting principles (provided, however, that the effect of such changes shall be included to the extent of, and in the amount of, the disproportionate impact (if any) they have on such entity relative to other persons with similar lines of business); or

to the announcement of the merger agreement or the transactions contemplated by the merger agreement; or

the ability of such entity and its subsidiaries to complete the transactions contemplated by the merger agreement and the recapitalization agreement.

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***Additional Conditions***

In addition, Enstar's obligation to consummate the merger is subject to the satisfaction or waiver of the receipt by Mr. Flowers of an indemnity agreement with respect to the gain recognition agreement anticipated to be filed by Mr. Flowers in accordance with Treasury regulation § 1.367(a)-8. Mr. Flowers, Castlewood and Enstar entered into such indemnity agreement on May 23, 2006. See *Material Terms of Related Agreements - Tax Indemnification Agreement* beginning on page 80 for a description of the tax indemnity agreement.

**Termination of Merger Agreement**

***Right to Terminate***

The merger agreement may be terminated at any time before the consummation of the merger in any of the following ways:

by mutual written consent of Enstar and Castlewood;

by either Enstar or Castlewood:

if the merger has not been consummated by January 31, 2007; except that a party may not terminate the merger agreement if the cause of the merger not being consummated is that party's failure to fulfill its material obligations under the merger agreement;

if a governmental authority or a court in the United States or European Union permanently enjoins or prohibits the consummation of the merger, except that a party that seeks to terminate the merger agreement upon such an event must have used its reasonable best efforts to obtain the government approvals required for the consummation of the merger; or

if Enstar's shareholders fail to approve the merger agreement and the transactions contemplated by the merger agreement.

by Castlewood:

if Enstar has breached in any material respect any of its representations or warranties or has failed to perform in any material respect any of its covenants or other agreements under the merger agreement and such breach:

is incapable of being cured by or remains uncured prior to January 31, 2007; or

would result in the failure of certain closing conditions in the merger agreement being satisfied; or

if:

Enstar or Enstar's board of directors materially breaches the covenant regarding no solicitation of competing acquisition proposals and such breach is not cured within five business days after receiving such notice of breach;

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Enstar's board of directors changes its recommendation to the Enstar shareholders to approve the merger agreement and the transactions contemplated by the merger agreement; or

Enstar fails to hold the Annual Meeting to vote on the merger on or before January 31, 2007; or

by Enstar:

if Castlewood or Merger Sub has breached in any material respect any of its representations or warranties, or has failed to perform in any material respect any of its covenants or other agreements under the merger agreement and such breach:

is incapable of being cured by or remains uncured prior to January 31, 2007; or

would result in the failure of certain closing conditions in the merger agreement being satisfied; or

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if there has been a change in the recommendation by the Enstar board of directors in respect of the merger agreement and:

Enstar notifies Castlewood in writing that it intends to approve and enter into an agreement concerning a different business combination transaction that constitutes a superior proposal, attaching the most current version of such agreement or a description of its material terms; and

Castlewood, within five business days of receiving such notice from Enstar, does not make an offer that the board of directors of Enstar determines is at least as favorable to the Enstar shareholders as the superior proposal Enstar received from the third party.

Termination of the merger agreement also terminates certain obligations under the support agreement described in Material Terms of Related Agreements Support Agreement on page 76.

***Obligations in Event of Termination***

In the event of termination as provided for above, the merger agreement will become void and of no further force and effect (except with respect to certain designated sections of the merger agreement) and there will be no liability on behalf of Enstar, Castlewood or Merger Sub, except for liabilities arising from a willful breach of the merger agreement.

**Amendments, Extensions and Waivers**

The merger agreement may be amended by the parties at any time before or after the Annual Meeting and the Castlewood shareholders meeting, except that any amendment after the shareholders meetings, which requires approval by shareholders, may not be made without such approval.

At any time before the consummation of the merger, the parties may, to the extent legally allowed, extend the time for the performance of any of the obligations or other acts of the other parties, waive any inaccuracies in the representations and warranties contained in the merger agreement, and waive compliance with any of the agreements or conditions contained in the merger agreement.

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**MATERIAL TERMS OF RELATED AGREEMENTS**

**Recapitalization Agreement**

Castlewood and certain of its shareholders entered into a recapitalization agreement, dated as of May 23, 2006, pursuant to which the series of transactions described below will be effected immediately prior to the consummation of the merger. The following is a summary of the material terms of the recapitalization agreement. This summary does not purport to describe all the terms of the recapitalization agreement and is qualified in its entirety by reference to the complete text of the agreement, which is attached as Annex C to this proxy statement/prospectus and incorporated herein by reference.

***Events***

Immediately prior to the consummation of the merger, the following events will occur:

The repurchase by Castlewood of 1,797,555 of its Class B shares held by Trident for \$20,000,000 in cash.

A payment of \$5,076,000 by Enstar to Castlewood.

A payment of \$5,076,000 by Castlewood to certain of its executive officers and employees.

The amendment and restatement of Castlewood's bye-laws and the change of Castlewood's name to Enstar Group Limited.

The exchange of all outstanding Class A shares of Castlewood held by Enstar for 2,972,892 non-voting convertible ordinary shares of Castlewood.

The exchange of all remaining outstanding Class B shares of Castlewood held by Trident for 2,082,236 ordinary shares of Castlewood.

The exchange of all outstanding Class C shares of Castlewood, including Class C-1 shares, Class C-2 shares, Class C-3 shares and Class C-4 shares, held by certain Castlewood shareholders for 3,636,612 ordinary shares of Castlewood.

The exchange of all outstanding Class D shares of Castlewood, including Class D-1 shares, Class D-2 shares, Class D-3 shares, Class D-4 shares and Class D-5 shares, of Castlewood held by certain employee shareholders for 420,577 ordinary shares of Castlewood. To the extent any Class D shares that are exchanged are unvested, an entity designated by Castlewood and Enstar will hold and/or have the right to purchase the ordinary shares issued upon the exchange thereof for \$0.001 per share from the holder thereof if the holder's employment with Castlewood is terminated prior to the time the Class D shares would have become vested. This right must be exercised within 60 days of any such termination.

The purchase by Castlewood or its designee of all of the shares of B.H. Acquisition beneficially owned by an affiliate of Trident II, L.P. for \$6,200,167 in cash. B.H. Acquisition is partially owned by Castlewood, Enstar and an affiliate of Trident II, L.P.

As of the consummation of the merger, the following events will occur:

The automatic termination of the share purchase and capital commitment agreement, dated as of October 1, 2001, among Castlewood, Enstar and certain shareholders of Castlewood and the agreement among members, dated November 29, 2001, among Castlewood, Enstar and certain shareholders of Castlewood.

The appointment of the members of the board of directors of New Enstar immediately following the merger. Such directors will include Messrs. T. Whit Armstrong, Paul J. Collins, Gregory L. Curl, T. Wayne Davis, J. Christopher Flowers, Nimrod T. Frazer, John J. Oros, Paul J. O Shea, Nicholas A. Packer and Dominic F. Silvester.



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***Mutual Representations and Warranties***

The recapitalization agreement contains substantially mutual representations and warranties made by each of Castlewood and its shareholders that are a party thereto related to:

authority to enter into, and carry out the obligations under, the recapitalization agreement and the enforceability of the recapitalization agreement;

absence of any breach of their organizational documents or any law or agreement to which they are subject or bound as a result of the transactions contemplated by the recapitalization agreement; and

approvals required to carry out the obligations under the recapitalization agreement.

***Additional Representations and Warranties***

In addition, Castlewood made representations and warranties related to:

due authorization and issuance of all issued and outstanding shares of Castlewood, including all ordinary shares issued in connection with the recapitalization;

the sufficiency of the number of ordinary shares available for issuance upon conversion of all of the non-voting convertible ordinary shares; and

the sufficiency of voting power held by shareholders party to the agreement to effect the transactions contemplated by the recapitalization agreement.

In addition, the Castlewood shareholders party to the recapitalization agreement made representations and warranties related to:

ownership of shares;

acquisition of shares for investment purpose; and

the shareholder being an accredited investor.

In addition, Trident II, L.P. represented and warranted to certain ownership matters with respect to the shares of B.H. Acquisition beneficially owned by its affiliate.

***Covenants***

Castlewood and its shareholders party to the recapitalization agreement agreed to the following covenants under the recapitalization agreement:

to use their reasonable best efforts to take all actions and do all things necessary, proper and advisable under the recapitalization agreement, the merger agreement and applicable laws to complete the transactions contemplated in the recapitalization agreement and the merger agreement;

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to execute and deliver any additional documents and take any further action as may be reasonably necessary or desirable to effect the matters contemplated in the recapitalization agreement or merger agreement;

to consent to the completion of the transactions contemplated by the recapitalization agreement and to waive any requirements, restrictions or obligations under the share purchase and capital commitment agreement or the agreement among members (each as described above) arising out of the transactions contemplated by the recapitalization agreement;

to waive any dissenters, appraisal or similar rights such party may have in respect of the transactions contemplated by the recapitalization agreement or the merger agreement; and

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to waive and release all directors and officers of Castlewood from all actions, claims and liabilities for any actions or omissions in respect of the recapitalization agreement, the merger agreement and the other transactions contemplated by the recapitalization agreement or the merger agreement (other than any actions, claims or liabilities based on fraud, bad faith or intentional misconduct).

***Other Covenants and Agreements***

Castlewood has also agreed to the following covenants:

to use its reasonable best efforts to cause all ordinary shares issued in the recapitalization to be approved for listing on Nasdaq;

to take all reasonable steps to cause any disposition of its Class B shares or acquisitions of its ordinary shares in the transactions contemplated by the recapitalization agreement to be exempt from Section 16(b) of the Exchange Act;

to take all action to call and hold a special meeting of Castlewood shareholders to vote on the approval of the recapitalization agreement and the transactions contemplated in the recapitalization agreement;

to use reasonable efforts to cause each holder of Class D shares of Castlewood to become a party to the recapitalization agreement or take such actions necessary to cause all of the outstanding Class A shares, Class B shares, Class C shares and Class D shares of Castlewood to be exchanged for the consideration described above;

to either establish (1) an entity with the sole purpose of holding and/or having the right to purchase the ordinary shares issued in exchange for unvested Class D shares from holders whose employment has been terminated prior to the time such unvested Class D shares would become vested or (2) at the option of Enstar, alternative arrangements to accomplish a similar administrative process for exercising such rights; and

to use its reasonable best efforts to obtain letter agreements from all holders of Class D shares of Castlewood who are not parties to the recapitalization agreement that restrict the holders from transferring the ordinary shares they receive in the recapitalization for a period of one year.

***Irrevocable Proxy***

Under the recapitalization agreement, each Castlewood shareholder that is a party thereto has agreed to designate and appoint Messrs. Frazer and Oros, in their respective capacities as officers of Enstar, and any individual who shall thereafter succeed to any such office of Enstar, and each of them individually, as such shareholder's proxy and attorney-in-fact to vote on the recapitalization agreement and the transactions contemplated by the recapitalization agreement on the shareholder's behalf.

***Conditions***

Castlewood's and the shareholders' respective obligations to complete the transactions contemplated by the recapitalization agreement are subject to the satisfaction of the following conditions:

the absence of any law, order or injunction prohibiting completion of the transactions contemplated by the recapitalization agreement;

the receipt of all permits, consents, approvals and authorizations required for the performance;

the satisfaction or waiver of the closing conditions under Article VI (conditions precedent) of the merger agreement;

delivery of Debevoise's opinion to the effect that the recapitalization will qualify as a reorganization under section 368(a) of the Code;

the requisite approval of Castlewood's shareholders to the recapitalization agreement and the transactions contemplated in the recapitalization agreement, which approval has been obtained;

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the representations and warranties of Castlewood (in the case of the shareholders) or of each shareholder (in the case of Castlewood) contained in the recapitalization agreement being true and correct in all material respects, as of the date of the recapitalization agreement and as of the closing date; and

Castlewood (in the case of the shareholders) or each shareholder (in the case of Castlewood) having performed or complied in all material respects with all agreements or covenants required to be performed by it under the recapitalization agreement at or prior to the completion of the transactions contemplated by the recapitalization agreement.

***Employee Bonuses***

Upon the closing of the merger, Castlewood's current annual incentive compensation plan will be cancelled (and any accruals under such plan will be reversed) and replaced with a new annual incentive compensation plan. It was anticipated at the time the recapitalization agreement was negotiated that, with respect to services to be performed in each of calendar years 2006 through 2010, the plan would permit eligible employees to share in a bonus pool, which was anticipated to represent, in the aggregate, 15% of New Enstar's consolidated net after-tax profits and from which distributions were anticipated to be made in cash, ordinary shares or other securities of New Enstar, or the right to acquire ordinary shares or other securities of New Enstar, in such amounts per employee and in such form as shall be determined by New Enstar's compensation committee. On September 15, 2006, Castlewood's board of directors and shareholders approved the Castlewood Holdings Limited 2006-2010 Annual Incentive Compensation Plan the terms of which are set forth in Information about Castlewood's Annual Incentive Compensation Plan beginning on page 117. The board of directors of New Enstar will determine whether and, if so, on what terms and conditions, the plan will continue in effect with respect to calendar years after 2010.

***Transfer Restrictions***

Under the recapitalization agreement, each shareholder of Castlewood has agreed not to transfer or agree to transfer its ordinary shares or non-voting convertible ordinary shares of New Enstar received pursuant to the recapitalization for a period of one year. Pursuant to a separate letter agreement, this one year transfer restriction also applies to directors of Enstar with respect to shares of New Enstar that they receive pursuant to the merger. Directors of Enstar also agreed not to exercise any options for one year following the merger. The following are exceptions to the general prohibition on transfers:

transfers to Castlewood;

following the consummation of the merger, other than in the case of an employee shareholder, transfers to another party to the recapitalization agreement, other than an employee shareholder, or to any party to the letter agreement containing similar transfer restrictions on members of the board of directors of Enstar;

transfers to a trust under which distributions may be made only to such shareholder or his or her immediate family members;

transfers to a charitable remainder trust, the income from which will be paid to such shareholder during his or her life;

transfers to a corporation, partnership, limited liability company or other entity, all of the equity interests in which are held, directly or indirectly, by such shareholder and his or her immediate family members; and

transfers in connection with a tender offer, merger, amalgamation, recapitalization, reorganization or similar transaction involving New Enstar;

provided that, with regard to some of the transfers listed above, such shareholder has sole, ultimate control of the entity referred to and such entity agrees to be bound by the recapitalization agreement or the letter agreement referred to above.

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### ***Registration Rights***

Concurrently with the closing, Castlewood and certain shareholders of Castlewood and Enstar will enter into a registration rights agreement pursuant to which those shareholders will be granted registration rights following the closing of the merger with respect to the ordinary shares received pursuant to the recapitalization and the merger. For more information on the registration rights agreement, see [Registration Rights Agreement](#) below.

### ***Expenses***

All fees and expenses incurred in connection with the recapitalization agreement, the merger agreement and the transactions contemplated in the recapitalization agreement and merger agreement will be paid by the party incurring such fees and expenses. However, Castlewood will reimburse all reasonable out-of-pocket fees and expenses incurred in connection with the recapitalization agreement, the merger agreement and the transactions contemplated in the recapitalization agreement and merger agreement by the holders of its Class B shares, its Class C shares and its Class D shares, except that the reimbursement for the holders of its Class B shares is subject to a maximum of \$150,000.

### ***Termination***

The recapitalization agreement will terminate on the earlier of the termination of the merger agreement and the termination of the support agreement (other than the termination of the support agreement upon the completion of the merger). If the recapitalization agreement is terminated, its provisions will cease to have effect, except that no such termination will relieve any party from any liability arising from a willful breach of the recapitalization agreement.

### ***Support Agreement***

Castlewood and Messrs. Flowers, Oros and Frazer, three of Enstar's largest shareholders, have entered into the support agreement, with respect to the Enstar common stock owned by them and acquired during the term of the support agreement. The following is a summary of the material terms of the support agreement and is qualified in its entirety by reference to the complete text of the agreement, which is attached as Annex B to this proxy statement/prospectus and incorporated herein by reference.

### ***Voting of Shares***

Each of Messrs. Flowers, Oros and Frazer agreed that, at any meeting of the shareholders of Enstar called to vote upon the merger, the merger agreement and the other transactions contemplated by the merger agreement, he will vote all of the shares of Enstar common stock owned by him in favor of the approval of the merger agreement and the transactions contemplated by the merger agreement. Each of the three shareholders further agreed that at any meeting of the shareholders of Enstar, he will vote all of the shares of Enstar common stock owned by him against:

any takeover proposal other than as contemplated by the merger agreement;

any other transaction or proposal involving Enstar or any of its subsidiaries that would prevent, nullify, materially interfere with or delay the merger agreement, the merger and the other transactions contemplated by the merger agreement.

As of the Record Date, Messrs. Flowers, Oros and Frazer held an aggregate of 1,726,556 shares of Enstar's outstanding common stock, representing approximately 30.1% of the voting power of Enstar's capital stock.

***Irrevocable Proxy***

Each of Messrs. Flowers, Oros and Frazer has agreed to designate and appoint Mr. Richard J. Harris and Mr. Paul J. O Shea, in their respective capacities as officers of Castlewood, and any individual who shall



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thereafter succeed to any such office of Castlewood, and each of them individually, as the shareholder's proxy and attorney-in-fact to vote on the matters described above.

### ***Transfer Restrictions***

Each of Messrs. Flowers, Oros and Frazer has agreed not to transfer any of the shares of Enstar common stock owned by him, or grant any proxies or enter into any voting agreements with respect to such shares other than the support agreement with Castlewood. Exceptions to the general prohibition on transfer include transfers to a trust under which distributions may be made only to such shareholder or his immediate family members, to a charitable remainder trust, the income from which will be paid to such shareholder during his life, or to an entity, all of the equity interests in which are held by such shareholder and his immediate family members, and provided, in each of the exceptions, such shareholder has sole record ownership and control of the entity referred to and such entity agrees to be bound by the support agreement.

### ***Termination***

The support agreement will terminate on the earlier of the consummation of the merger, at the option of at least two of the shareholders party to the support agreement if Enstar's board of directors has effected a change in its recommendation to the Enstar shareholders to approve the merger agreement and the transactions contemplated by the merger agreement, the termination of the merger agreement and January 31, 2007. If the support agreement is terminated, its provisions will cease to have effect, except that no such termination will relieve any party from liability for any breach prior to such termination.

### ***Shareholder Capacity***

The parties acknowledged that each of Messrs. Flowers, Oros and Frazer executed the support agreement solely in his capacity as a record holder or beneficial owner of shares of Enstar common stock and not in his capacity as an officer or director of Enstar.

### **Registration Rights Agreement**

Castlewood, Trident, Mr. Flowers, Mr. Silvester and certain other shareholders of Castlewood, and the directors of Enstar, will enter into a registration rights agreement in connection with the transactions contemplated by the merger agreement and the recapitalization agreement. The registration rights agreement will become effective immediately upon the consummation of the merger. The following is a summary of the material terms of the registration rights agreement. This summary does not purport to describe all of the terms of the registration rights agreement and is qualified in its entirety by reference to the complete text of the agreement, which is filed as an exhibit to the registration statement of which this proxy statement/prospectus is a part and incorporated herein by reference.

The registration rights agreement will provide that, after the expiration of one year from the date of the registration rights agreement, any of Trident, Mr. Flowers and Mr. Silvester, each referred to as a requesting holder, may require that New Enstar effect the registration under the Securities Act of all or any part of such holder's registrable securities, as defined below. Trident is entitled to make three requests and Messrs. Flowers and Silvester are each entitled to make two requests. Notwithstanding the preceding sentence, the registration rights agreement further provides that, after the expiration of 90 days from the date of the registration rights agreement and prior to the first anniversary of such date, Trident has the right to require New Enstar to effect the registration of up to 750,000 shares of registrable securities, referred to as the Trident demand.

Upon receipt of a registration request (other than the Trident demand), New Enstar is required as promptly as reasonably practicable (but in any event within 7 days of such request) to give written notice of such request to all other holders of registrable securities. New Enstar must then use its reasonable best efforts to register all registrable securities that have been requested to be registered by the requesting holder in the registration request or by any other holder of registrable securities by written notice to New Enstar in accordance with the provisions of the registration rights agreement.

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New Enstar will not be required to effect a registration request unless the aggregate number of ordinary shares proposed to be registered constitutes at least the lesser of: (1) 25% of the total number of registrable securities held by the requesting holder (or 15% in the case of the Trident demand) or (2) 10% of the total number of registrable securities held by all holders of registrable securities on the date of the registration rights agreement, or if the total number of registrable securities then outstanding is less than such amount, all of the registrable securities then outstanding. In addition, New Enstar will not be obligated to effect a registration more than once in any nine month period except that any request for registration that immediately follows the registration pursuant to the Trident demand may be as soon as six months following registration pursuant to the Trident demand. With respect to the Trident demand, New Enstar cannot include any securities other than registrable securities owned by Trident without Trident's prior written consent.

Registrable securities means:

any ordinary shares of New Enstar issued pursuant to the merger;

any ordinary shares of New Enstar issued pursuant to the recapitalization agreement;

any ordinary shares of New Enstar issued upon exercise, exchange or conversion of any options, restricted stock units or other rights to acquire ordinary shares of New Enstar that are issued in connection with the merger or the recapitalization agreement; or

any equity securities issued or issuable with respect to the ordinary shares referred to above by way of conversion, exercise or exchange thereof or share dividend or share split or in connection with a combination of shares, recapitalization, reclassification, merger, amalgamation, arrangement, consolidation or other reorganization.

A request for registration will not constitute the use of a registration request by a requesting holder pursuant to the registration rights agreement if:

the requesting holder and the other holders of registrable securities holding 50% or more of the outstanding registrable securities determine in good faith to withdraw (prior to the effective date of the registration statement relating to such request) the proposed registration;

the registration statement relating to such request is not declared effective within 90 days of the date such registration statement is first filed with the Commission;

prior to the sale of at least 90% of the registrable securities included in the registration relating to such request, such registration is adversely affected by any stop order, injunction or other order or requirement of the Commission or other governmental agency, quasi-governmental agency or self-regulatory body or court for any reason and New Enstar fails to cure such stop order, injunction or other order or requirement within 30 days;

more than 20% of the registrable securities requested by the requesting holder to be included in the registration of an underwritten offering are not included in such offering on the advice of the managing underwriter of such offering;

the conditions to closing specified in any underwriting agreement or purchase agreement entered into in connection with the registration relating to such request are not satisfied (other than as a result of a material breach by the requesting holder); or

in the case of an underwritten offering, the failure of New Enstar to cooperate fully.

New Enstar may postpone for a reasonable period of time, not to exceed 90 days, the filing or the effectiveness of a registration statement if New Enstar furnishes to the holders of registrable securities covered by such registration statement a certificate signed by the chief executive officer of New Enstar stating that the board of directors of New Enstar has determined that such registration is reasonably likely to have a material adverse effect on any proposal or plan by New Enstar to engage in any acquisition of assets or any merger, amalgamation, consolidation, tender offer or similar transaction, or otherwise would have a material adverse effect on the business, assets, operations, prospects or financial condition of New Enstar.

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New Enstar cannot grant registration rights to any holder or prospective holder of any securities of New Enstar which are senior to or otherwise conflict in any material respect with the registration rights that will be provided pursuant to the registration rights agreement, without the prior written consent of either each of the requesting holders or shareholders to the agreement holding 50% or more of outstanding registrable securities and, for such time as Trident owns at least 20% of the registrable securities it owned as of the date of the registration rights agreement, Trident. New Enstar may grant additional demand or piggyback registration rights that are *pari passu* with the rights that will be set forth in the registration rights agreement, and any dilution of the registration rights resulting from any such *pari passu* rights will not be deemed to conflict with the rights that will be set forth in the registration rights agreement.

Whenever New Enstar proposes to register ordinary shares (other than a registration pursuant to a registration request under the registration rights agreement, a registration on Form S-4 or a registration relating solely to employee benefit plans), whether for its own account or for the account of one or more securityholders of New Enstar, and the registration form to be filed may be used for the registration or qualification for distribution of registrable securities, New Enstar is required to give prompt written notice to all holders of registrable securities of its intention to effect such a registration and must include in such registration, all registrable securities with respect to which New Enstar receives from the holders of registrable securities written requests for inclusion, or a piggyback registration. New Enstar may terminate or withdraw any registration initiated by it prior to the effectiveness of such registration, whether or not any holder of registrable securities has elected to include registrable securities in such registration, and except for the obligation to pay certain registration expenses, New Enstar will have no liability to any holder of registrable securities in connection with such termination or withdrawal.

For a period of 180 days from the effective date of the effectiveness of a registration statement filed in connection with a request for registration, New Enstar cannot file or cause to be effected any registration of any of its equity securities or securities convertible or exchangeable into or exercisable for its equity securities under the Securities Act (except on Form S-4 or S-8 or any successor or similar forms).

If a requesting holder requests registration of any of its shares, New Enstar is required to prepare and file a registration statement with the Commission as expeditiously as possible, and no later than 45 days after receipt of such request. New Enstar is required to keep such registration statement effective for a period of either a minimum of six months (or if such registration statement relates to an underwritten offering, such longer period as in the opinion of counsel for the underwriters a prospectus is required by law to be delivered in connection with sales of registrable securities by an underwriter or dealer) or such shorter period as will terminate when all the securities covered by such registration statement have been disposed of.

New Enstar will pay certain expenses in connection with any request for registration or piggyback registration in accordance with the registration rights agreement.

In the event of a requested underwritten offering, the holders of a majority of the registrable securities being registered will have the right to select the investment banker(s) and manager(s) to administer the offering, subject to New Enstar's approval which cannot be unreasonably withheld, conditioned or delayed.

In addition to the provisions set forth above, the registration rights agreement contains other terms and conditions including those customary in agreements of this kind.

## ***Termination***

The registration rights agreement will terminate on the earliest of its termination by the consent of the holders of registrable securities holding 50% or more of the outstanding registrable securities and each of the requesting holders (but only if such requesting holder holds any registrable securities at such time) or in each case, their respective

successors in interest, the date on which no shares subject to the agreement are outstanding, and the dissolution, liquidation or winding up of New Enstar.

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**No Transfers Letter Agreement**

In connection with the merger, each of the members of the board of directors of Enstar entered into a letter agreement with Enstar, pursuant to which the directors agreed not to (1) transfer any of such director's shares of Enstar common stock or New Enstar ordinary shares or any option to purchase shares of Enstar common stock or any option to purchase ordinary shares of New Enstar upon the assumption of any such Enstar stock options by New Enstar or (2) exercise any Enstar stock option or New Enstar option held by such person, for a period of one year following the effective time of the merger. The letter agreement contains certain exceptions to the general prohibition of transfers that are described above under the heading "Recapitalization Agreement - Transfer Restrictions" beginning on page 75.

**Tax Indemnification Agreement**

Mr. Flowers, a director of Castlewood and Enstar and Enstar's largest shareholder, has entered into a tax indemnification agreement, dated May 23, 2006, with Castlewood and Enstar pursuant to which Castlewood will reimburse and indemnify Mr. Flowers for, and hold him harmless on an after-tax basis against, any increase in Mr. Flowers' U.S. federal, state or local income tax liability (including any interest or penalties relating thereto), and reasonable attorneys' fees, incurred by Mr. Flowers as a result of certain dispositions of shares of Enstar or dispositions of all or substantially all of Enstar's assets by New Enstar, Enstar or any successor or assign of either, within the period beginning immediately after the effective time of the merger and ending five years after the last day of the taxable year that includes the effective time. Because Mr. Flowers will be the only greater-than-5% U.S. shareholder of New Enstar after the merger, he is in a different position than the other current shareholders of Enstar with regard to treating the merger as a tax-free reorganization. Under IRS regulations issued pursuant to section 367(a) of the Code, as a 5% U.S. shareholder Mr. Flowers may treat the merger as a tax-free reorganization only if he enters into a gain recognition agreement with the IRS under which he agrees he will treat the merger as taxable if New Enstar disposes of certain stock or assets of Enstar within the five years following the merger. Such dispositions may be effected without Mr. Flowers' consent. Other shareholders of Enstar are not subject to these additional conditions, and their tax treatment would not be affected by such dispositions. The Enstar board of directors approved such agreement because it determined that it would be fair to put Mr. Flowers in the same position as the other shareholders of Enstar with respect to such tax treatment and that such agreement would increase the likelihood that Mr. Flowers, in his capacity as an Enstar shareholder, would support the proposed transaction. While the agreement is significant to Mr. Flowers, New Enstar believes it is unlikely to incur any liability under the agreement because it believes the likelihood that it will dispose of stock or assets of Enstar within the next five years to be remote.

**Repurchase of Shares Letter Agreement**

Two directors of Enstar, Messrs. Armstrong and Davis, have entered into a letter agreement, dated May 23, 2006, with Castlewood pursuant to which Castlewood, subject to the consummation of the merger, agreed to repurchase from Messrs. Armstrong and Davis, upon their request, during a 30-day period commencing January 15, 2007, at the then prevailing market prices, such number of New Enstar ordinary shares as provides an amount sufficient for Messrs. Armstrong and Davis to pay taxes on compensation income resulting from the exercise of options by them on May 23, 2006 for 50,000 shares of Enstar common stock in the aggregate. Castlewood's obligation to repurchase ordinary shares is limited to 25,000 ordinary shares from each of Messrs. Armstrong and Davis. Since the letter agreement provides for the sale of such shares at the then prevailing market prices, each of Enstar and Castlewood believe that the value of the rights of Messrs. Armstrong and Davis under such agreement is not significant.

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**INFORMATION ABOUT CASTLEWOOD**

**Business**

***Company Overview***

In 1993, Mr. Silvester, who was joined by Mr. Packer and Mr. O Shea in 1993 and 1994, respectively, began a business venture in Bermuda to provide run-off services to the insurance and reinsurance industry. In 1995 this business was assumed by Castlewood Limited.

In 1996, Castlewood Limited formed a wholly-owned subsidiary, Castlewood (EU) Ltd. based in Guildford and London in the United Kingdom, to extend the services provided by Castlewood Limited.

In 2000, Castlewood Limited entered into a joint venture with Enstar and an affiliate of Trident II, L.P. to acquire, and for Castlewood Limited to manage, B.H. Acquisition. In connection with the formation of the joint venture, Castlewood, Enstar and an affiliate of Trident II, L.P. acquired 45%, 33% and 22% economic interests, respectively, in B.H. Acquisition.

Castlewood was formed in August 2001 under the laws of Bermuda to acquire and manage insurance and reinsurance companies in run-off, and to provide management, consulting and other services to the insurance and reinsurance industry. In connection with Castlewood's formation, Enstar and Trident made an initial investment in Castlewood and the senior executives of Castlewood contributed their equity interests in Castlewood Limited.

Since its formation, Castlewood, through its subsidiaries, has completed several acquisitions of insurance and reinsurance companies and is now administering those businesses in run-off. Castlewood derives its net earnings from the ownership and management of these companies primarily by settling insurance and reinsurance claims below the recorded loss reserves and from returns on the portfolio of investments retained to pay future claims. In addition, Castlewood has formed other businesses that provide management and consultancy services, claims inspection services and reinsurance collection services to Castlewood affiliates and third-party clients for both fixed and success-based fees.

In the primary (or direct) insurance business, the insurer assumes risk of loss from persons or organizations that are directly subject to the given risks. Such risks may relate to property, casualty, life, accident, health, financial or other perils that may arise from an insurable event. In the reinsurance business, the reinsurer agrees to indemnify an insurance or reinsurance company, referred to as the ceding company, against all or a portion of the insurance risks arising under the policies the ceding company has written or reinsured. When an insurer or reinsurer stops writing new insurance business or a particular line of business, the insurer, reinsurer, or the line of discontinued business is in run-off.

In recent years, the insurance industry has experienced significant consolidation. As a result of this consolidation and other factors, the remaining participants in the industry often have portfolios of business that are either inconsistent with their core competency or provide excessive exposure to a particular risk or segment of the market (i.e., property/casualty, asbestos, environmental, director and officer liability, etc.). These non-core and/or discontinued portfolios are often associated with potentially large exposures and lengthy time periods before resolution of the last remaining insured claims resulting in significant uncertainty to the insurer or reinsurer covering those risks. These factors can distract management, drive up the cost of capital and surplus for the insurer or reinsurer, and negatively impact the insurer's or reinsurer's credit rating, which makes the disposal of the unwanted company or portfolio an



attractive option. Alternatively, the insurer may wish to maintain the business on its balance sheet, yet not divert significant management attention to the run-off of the portfolio. The insurer or reinsurer, in either case, is likely to engage a third party, such as Castlewood, that specializes in run-off management to purchase the company or portfolio, or to manage the company or portfolio in run-off.

In the sale of a run-off company, a purchaser, such as Castlewood, typically pays a discount to the book value of the company based on the risks assumed and the relative value to the seller of no longer having to manage the company in run-off. Such a transaction can be beneficial to the seller because it receives an

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up-front payment for the company, eliminates the need for its management to devote any attention to the disposed company and removes the risk that the established reserves for the business may prove to be inadequate. The seller is also able to redeploy its management and financial resources to its core businesses.

Alternatively, if the insurer or reinsurer hires a third party, such as Castlewood, to manage its run-off business, the insurer or reinsurer will, unlike in a sale of the business, receive little or no cash up front. Instead, the management arrangement may provide that the insurer or reinsurer will share in the profits, if any, derived from the run-off with certain incentive payments allocated to the run-off manager. By hiring a run-off manager, the insurer or reinsurer can outsource the management of the run-off business to experienced and capable individuals, while allowing its own management team to focus on the insurer's or reinsurer's core businesses. Although Castlewood's desired approach to managing run-off business is to align its interests with the interests of the owners, under certain management arrangements to which Castlewood is a party, it only receives a fixed management fee and does not receive incentives.

Following the purchase of a run-off company or the engagement to manage a run-off company or portfolio of business, it is incumbent on the new owner or manager to conduct the run-off in a disciplined and professional manner in order to efficiently discharge the liabilities associated with the business while preserving and maximizing its assets. Castlewood's approach to managing its acquired companies in run-off as well as run-off companies or portfolios of businesses on behalf of third-party clients includes negotiating with third-party insureds and reinsureds to commute their insurance or reinsurance agreement for an agreed upon up-front payment by Castlewood, or the third-party client, and to more efficiently manage payment of insurance and reinsurance claims. Castlewood attempts to commute policies with direct insureds or reinsureds in order to eliminate uncertainty over the amount of future claims. Commutations and policy buy-backs provide an opportunity for the company to exit exposures to certain policies and insureds generally at a discount to the ultimate liability and provide the ability to eliminate exposure to further losses. Such a strategy also contributes to the reduction in the length of time and future cost of the run-off.

Following the acquisition of a company in run-off, or new consulting engagement, Castlewood will spend time analyzing the acquired exposures and reinsurance receivables on a policyholder-by-policyholder basis. This analysis enables Castlewood to identify a target list, based on the nature and value of exposures, of those policyholders and reinsurers it wishes to approach to discuss commutation or policy buy-back. Furthermore, following the acquisition of a company in run-off, or new consulting engagement, Castlewood will often be approached by policyholders or reinsurers requesting commutation or policy buy-back. In these instances Castlewood will also carry out a full analysis of the underlying exposures in order to determine the viability of a proposed commutation or policy buy-back. From the initial analysis of the underlying exposures it may take several months, or even years, before a commutation or policy buy-back is completed. In a number of cases, if Castlewood and the policyholder or reinsurer are unable to reach a commercially acceptable settlement, the commutation or policy buy-back may not be achievable, in which case Castlewood will continue to settle valid claims from the policyholder, or collect reinsurance receivables from the reinsurer, as they become due.

Insureds and reinsureds are often willing to commute with Castlewood, subject to receiving an acceptable settlement, as this provides certainty of recovery of what otherwise may be claims that are disputed in the future, and often provides a meaningful up-front cash receipt that, with the associated investment income, can provide a source of funds to meet future claim payments or even commutation of their underlying exposure. As such, subject to negotiating an acceptable settlement, all of Castlewood's insurance and reinsurance liabilities and reinsurance receivables are able to be either commuted or settled by way of policy buy-back over time. Many sellers of companies that Castlewood acquires have secure claims paying ratings and ongoing underwriting relationships with insureds and reinsureds which often hinders their ability to commute the underlying insurance or reinsurance policies. Castlewood's lack of claims paying rating and its lack of potential conflicts with insureds and reinsureds of companies it acquires provides a greater ability to commute the newly acquired policies than that of the sellers.

Castlewood also attempts, where appropriate, to negotiate favorable commutations with reinsurers by securing the receipt of a lump-sum settlement from the reinsurer in complete satisfaction of the reinsurer's liability in respect of any future claims. Castlewood, or the third-party client, is then fully responsible for any

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claims in the future. Castlewood typically invests proceeds from reinsurance commutations with the expectation that such investments will produce income, which, together with the principal, will be sufficient to satisfy future obligations with respect to the acquired company or portfolio.

### ***Competitive Strengths***

Castlewood believes that its competitive strengths have enabled, and will continue to enable, it to capitalize on the opportunities that exist in the run-off market. These strengths include:

*Experienced Management Team with Proven Track Record.* Dominic F. Silvester, Castlewood's Chief Executive Officer, Paul J. O'Shea, an Executive Vice President of Castlewood, Nicholas A. Packer, an Executive Vice President of Castlewood and Richard J. Harris, Castlewood's Chief Financial Officer, each has over 18 years of experience in the insurance and reinsurance industry. The extensive depth and knowledge of Castlewood's management team provide it with the ability to identify, select and price companies and portfolios in run-off and to successfully manage companies and portfolios in run-off.

*Highly Qualified, Experienced and Ideally Located Employee Base.* Castlewood has been successful in recruiting a highly qualified team of experienced claims, reinsurance, financial, actuarial and legal staff located in three of the major insurance and reinsurance centers in the world: London, New York and Bermuda. The quality and breadth of experience of Castlewood's staff enable it to offer a wide range of professional services to the industry.

*Long-Standing Market Relationships.* Castlewood's management team has well-established personal relationships across the insurance and reinsurance industry. Castlewood uses these market relationships to identify and source business opportunities and establish itself as a leader in the run-off business.

*Disciplined Approach to Acquisitions and Claims Management.* Castlewood believes in generating profitability through a disciplined, conservative approach to both acquisitions and claims management. Castlewood closely analyzes new business opportunities to determine a company's inherent value and Castlewood's ability to profitably manage that company or a portfolio in run-off. Castlewood believes that its review and claims management process, combined with management of global exposures across product lines, allow it to price acquisitions on favorable terms and to profitably run-off the businesses that it acquires and manages.

*Financial Strength.* As of September 30, 2006, Castlewood had \$267.4 million of shareholders' equity. This financial strength allows Castlewood to aggressively price acquisitions that fit within its core competency and hire and retain additional management talent when necessary. Castlewood believes that its financial strength has allowed it to be recognized as a leader in the acquisition and management of run-off companies and portfolios. Castlewood's conservative approach to managing its balance sheet reflects its commitment to maintaining its financial strength.

### ***Strategy***

Castlewood's corporate objective is to generate returns on capital that appropriately reward it for risks it assumes. Castlewood intends to achieve this objective by executing the following strategies:

*Establish Leadership Position in the Run-Off Market by Leveraging Management's Experience and Relationships.* Castlewood intends to continue to utilize the extensive experience and significant relationships of its senior management team to establish itself as a leader in the run-off segment of the insurance and

reinsurance market. The strength and reputation of Castlewood's management team is expected to generate opportunities for Castlewood to acquire or manage companies and portfolios in run-off, to price effectively the acquisition or management of such businesses, and, most importantly, to manage the run-off of such businesses efficiently and profitably.

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*Professionally Manage Claims.* Castlewood is professional and disciplined in managing claims against run-off companies and portfolios it owns or manages. Castlewood's management understands the need to dispose of certain risks expeditiously and cost-effectively by constantly analyzing changes in the market and efficiently settling claims with the assistance of its experienced claims adjusters and in-house and external legal counsel. When Castlewood acquires or begins managing a company or portfolio it initially determines which claims are valid through the use of experienced in-house adjusters and claims experts. Castlewood pays valid claims on a timely basis, and looks to well-documented policy exclusions and coverage issues where applicable and litigates when necessary to avoid invalid claims under existing policies and reinsurance agreements.

*Commutation of Assumed Liabilities and Ceded Reinsurance Assets.* Using detailed analysis and actuarial projections, Castlewood negotiates with the policyholders of the insurance and reinsurance companies or portfolios it owns or manages with a view to commuting insurance and reinsurance liabilities for an agreed upon up-front payment at a discount to the ultimate liability. Such commutations can take the form of policy buy-backs and structured settlements over fixed periods of time. Castlewood also negotiates with reinsurers to commute their reinsurance agreements providing coverage to Castlewood's subsidiaries on terms that Castlewood believes to be favorable based on then-current market knowledge. Castlewood invests the proceeds from reinsurance commutations with the expectation that such investments will produce income, which, together with the principal, will be sufficient to satisfy future obligations with respect to the acquired company or portfolio.

*Continue Commitment to Highly Disciplined Acquisition, Management and Reinsurance Practices.* Castlewood utilizes a disciplined approach to minimize risk and increase the probability of positive operating results from acquisitions and companies and portfolios it manages. Castlewood carefully reviews acquisition candidates and management engagements for consistency with accomplishing its long-term objective of producing positive operating results. Castlewood focuses its investigation on the risk exposure, claims practices, reserve requirements, outstanding claims and its ability to price an acquisition or engagement on terms that will provide positive operating results. In particular, Castlewood carefully reviews all outstanding claims and case reserves, and follows a highly disciplined approach to managing allocated loss adjustment expenses, such as the cost of defense counsel, expert witnesses, and related fees and expenses.

*Manage Capital Prudently.* Castlewood manages its capital prudently relative to its risk exposure and liquidity requirements to maximize profitability and long-term growth in shareholder value. Castlewood's capital management strategy is to deploy capital efficiently to acquisitions, reinsurance opportunities and to establish (and re-establish, when necessary) adequate loss reserves to protect against future adverse developments.

***Acquisition of Insurers or Portfolios in Run-Off***

Castlewood specializes in the negotiated acquisition and management of insurance and reinsurance companies and portfolios in run-off. Castlewood approaches, or is approached by, primary insurers or reinsurance providers with portfolios of business to be sold or managed in run-off. Castlewood evaluates each opportunity presented by carefully reviewing the portfolio's risk exposures, claim practices, reserve requirements and outstanding claims, and seeking an appropriate discount or seller indemnification to reflect the uncertainty contained in the portfolio's reserves. Based on this initial analysis, Castlewood can determine if a company or portfolio of business would add value to its current portfolio of run-off business. If Castlewood determines to pursue the purchase of a company in run-off, it then proceeds to price the acquisition in a manner it believes will result in positive operating results based on certain assumptions including, without limitation, its ability to favorably resolve claims, negotiate with direct insureds and reinsurers, and otherwise manage the nature of the risks posed by the business.

With respect to its U.K. and Bermudian insurance and reinsurance subsidiaries, Castlewood is able to pursue strategies to achieve complete finality and conclude the run-off of a company by promoting a solvent scheme of arrangement whereby a local court-sanctioned scheme, approved by a statutory majority of voting

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creditors, provides for a one-time full and final settlement of an insurance or reinsurance company's obligations to its policyholders.

***Acquisitions to Date***

In November 2001, a wholly-owned subsidiary of Castlewood completed the acquisition of two reinsurance companies in run-off, River Thames Insurance Company Limited, or River Thames, based in London, England, and Overseas Reinsurance Corporation Limited, or Overseas Reinsurance, based in Bermuda. The total purchase price of River Thames and Overseas Reinsurance was approximately \$15.2 million.

In August 2002, Castlewood purchased Hudson Reinsurance Company Limited, or Hudson, a Bermuda-based company, for approximately \$4.1 million. Hudson reinsured risks relating to property, casualty and workers compensation on a worldwide basis, and Castlewood is now administering the run-off of its claims.

In March 2003, Castlewood and Shinsei Bank, Limited, or Shinsei, completed the acquisition of The Toa-Re Insurance Company (UK) Limited, a London-based subsidiary of The Toa Reinsurance Company, Limited, for approximately \$46.4 million. Upon completion of the transaction, Toa-Re's name was changed to Hillcot Re Limited. Hillcot Re Limited underwrote reinsurance business throughout the world between 1980 and 1994, when it stopped writing new business and went into run-off. The acquisition was effected through Hillcot Holdings Ltd., or Hillcot, a Bermuda company, in which Castlewood has a 50.1% economic interest and a 50% voting interest. Hillcot is included in Castlewood's consolidated financial statements, with the remaining 49.9% economic interest reflected as minority interest. J. Christopher Flowers, a member of Castlewood's board of directors and, following the merger, one of New Enstar's largest shareholders, is a director and the largest shareholder of Shinsei. Castlewood's results of operations include the results of Hillcot Re Limited from the date of acquisition in March 2003.

During 2004, Castlewood, through one of its subsidiaries, completed the acquisition of Mercantile Indemnity Company Ltd., or Mercantile, Harper Insurance Limited, or Harper (formerly Turegum Insurance Company) and Longmynd Insurance Company Ltd., or Longmynd (formerly Security Insurance Company (UK) Ltd.) for a total purchase price of approximately \$4.5 million. Castlewood recorded an extraordinary gain of approximately \$21.8 million in 2004 relating to the current excess of the fair value of the net assets acquired over the cost of these acquisitions.

In May 2005, Castlewood, through one of its subsidiaries, purchased Fieldmill Insurance Company Limited (formerly known as Harleysville Insurance Company (UK) Limited) for approximately \$1.4 million.

In March 2006, Castlewood and Shinsei, through Hillcot, completed the acquisition of Aioi Insurance Company of Europe Limited, or Aioi Europe, a London-based subsidiary of Aioi Insurance Company, Limited. Aioi Europe has underwritten general insurance and reinsurance business in Europe for its own account from 1982 until 2002 when it generally ceased underwriting and placed its general insurance and reinsurance business into run-off. The aggregate purchase price paid for Aioi Europe was £62 million (approximately \$108.9 million), with £50 million in cash paid upon the closing of the transaction and £12 million in the form of a promissory note, payable twelve months from the date of the closing. Upon completion of the transaction, Aioi Europe changed its name to Brampton Insurance Company Limited. Castlewood recorded an extraordinary gain of approximately \$4.3 million, net of minority interest, in 2006 relating to the current excess of the fair value of the net assets acquired over the cost of this acquisition. In April 2006, Hillcot Holdings Limited borrowed approximately \$44 million from a London-based bank to partially assist with the financing of the Aioi Europe acquisition. Following a repurchase by Aioi Europe of its shares valued at £40 million in May 2006, Hillcot Holdings repaid the promissory note and reduced the bank borrowings to \$19.2 million, which is repayable in 2010.



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In October 2006, Castlewood, through its subsidiary Virginia Holdings Ltd., or Virginia, purchased Cavell Holdings Limited (U.K.), or Cavell, for approximately £31.8 million (approximately \$59.5 million). Cavell owns a U.K. reinsurance company and a Norwegian reinsurer, both of which are currently in run-off. The purchase price was funded by \$24.5 million borrowed under a facility loan agreement and available cash on hand.

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In November 2006, Castlewood, through Virginia, purchased Unione Italiana (U.K.) Reinsurance Company Limited, a U.K. company, for approximately \$17.2 million. The purchase price was funded by cash on hand.

In connection with the recapitalization, Castlewood will purchase the interest of an affiliate of Trident II, L.P., in B.H. Acquisition, a company partially owned by Castlewood, Enstar and an affiliate of Trident. Following the merger, B.H. Acquisition will be an indirect wholly-owned subsidiary of Castlewood. In July 2000, B.H. Acquisition acquired as an operating business two reinsurance companies, Brittany Insurance Company Ltd., or Brittany, and Compagnie Européenne d Assurances Industrielles S.A., or CEAI. Brittany and CEAI are principally engaged in the active management of books of reinsurance business from international markets.

### ***Management of Run-Off Portfolios***

Castlewood is a party to several management engagements pursuant to which it has agreed to manage the run-off portfolio of a third party. Such arrangements are advantageous for third-party insurers because they allow a third-party insurer to focus their management efforts on their core competency while allowing them to maintain the portfolio of business on their balance sheet. In addition, Castlewood's expertise in managing portfolios in run-off allows the third-party insurer the opportunity to potentially realize positive operating results if Castlewood achieves its objectives in management of the run-off portfolio. Castlewood specializes in the collection of reinsurance receivables through its indirect subsidiary Kinsale Brokers Limited. Through Castlewood's subsidiaries, Castlewood (US) Inc. and Cranmore Adjusters Limited, Castlewood also specializes in providing claims inspection services whereby Castlewood is engaged by third-party insurance and reinsurance providers to review certain of their existing insurance and reinsurance exposures, relationships, policies and/or claims history.

Castlewood's primary objective in structuring its management arrangements is to align the third-party insurer's interests with those of Castlewood. Consequently, management agreements typically are structured so that Castlewood receives fixed fees in connection with the management of the run-off portfolio and also typically receives certain incentive payments based on a portfolio's positive operating results.

### ***Management Agreements***

Castlewood has entered into approximately 15 management agreements with third-party clients to manage certain run-off portfolios with gross loss reserves (as of September 30, 2006) of approximately \$3 billion. The fees generated by these engagements include both fixed and incentive-based remuneration based on Castlewood's success in achieving certain objectives. These agreements do not include the recurring engagements managed by Castlewood's special claims inspection and reinsurance collection subsidiaries, Cranmore Adjusters Limited and Kinsale Brokers Limited, respectively.

### ***Claims Management and Administration***

An integral factor to Castlewood's success is its ability to analyze, administer, manage and settle claims and related expenses, such as loss adjustment expenses. Castlewood's claims teams are located in different offices within its organization and provide global claims support. Castlewood has implemented claims handling guidelines and claims reporting and control procedures in all of its claims units. To ensure that claims are handled and reported in accordance with these guidelines, all claims matters are reviewed regularly, with all material claims matters being circulated to and reviewed by management prior to any action being taken.

When Castlewood receives notice of a claim, regardless of size and regardless of whether it is a paid claim request or a reserve advice, it is reviewed and recorded within its claims system reserving Castlewood's rights where appropriate. Claims reserve movements and payments are reviewed daily, with any material movements being reported to

management for review. This enables flash reporting of significant events and potential insurance or reinsurance losses to be communicated to senior management worldwide on a timely basis irrespective from which geographical location or business unit location the exposure arises.

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Castlewood also is able to efficiently manage claims and obtain savings through its extensive relationships with defense counsel (both in-house and external), liquidators, third-party claims administrators and other professional advisors and experts. Castlewood has developed relationships and protocols to reduce the number of outside counsel by consolidating claims of similar types and complexity with appropriate law firms specializing in the particular type of claim. This approach has enabled Castlewood to more efficiently manage outside counsel and other third parties, thereby reducing expenses, and to establish closer relationships with ceding companies.

When appropriate, Castlewood negotiates with direct insureds to buy back policies either on favorable terms or to mitigate against potential future indemnity exposures and legal costs in an uncertain and constantly evolving legal environment. Where appropriate, Castlewood also pursues commutations on favorable terms with ceding companies of reinsurance business in order to realize savings or to mitigate against potential future indemnity exposures and legal costs. Such buy-backs and commutations eliminate all past, present and future liability to direct insureds and reinsureds in return for a lump sum payment.

With regard to reinsurance receivables, Castlewood manages cash flow by working with reinsurers, brokers and professional advisors to achieve fair and prompt payment of reinsured claims, taking appropriate legal action to secure receivables where necessary. Castlewood also attempts where appropriate to negotiate favorable commutations with its reinsurers by securing a lump sum settlement from reinsurers in complete satisfaction of the reinsurer's past, present and future liability in respect of such claims. Properly priced commutations reduce the expense of adjusting direct claims and pursuing collection of reinsurance receivables (both of which may often involve extensive legal expense), realize savings, remove the potential future volatility of claims and reduce required regulatory capital.

### ***Reserves for Unpaid Losses and Loss Adjustment Expense***

Applicable insurance laws require Castlewood to maintain reserves to cover its estimated losses under insurance policies that it has assumed and for loss adjustment expense, or LAE, relating to the investigation, administration and settlement of policy claims. Castlewood's LAE reserves consist of both reserves for allocated loss adjustment expenses, or ALAE, and for unallocated loss adjustment expenses, or ULAE. ALAE are linked to the settlement of an individual claim or loss, whereas ULAE reserve is based on the Company's estimates of future costs to administer the claims.

Castlewood and its subsidiaries establish losses and LAE reserves for individual claims by evaluating reported claims on the basis of:

its knowledge of the circumstances surrounding the claim;

the severity of the injury or damage;

the jurisdiction of the occurrence;

the potential for ultimate exposure;

the type of loss; and

its experience with the line of business and policy provisions relating to the particular type of claim.

Because a significant amount of time can lapse between the assumption of risk, the occurrence of a loss event, the reporting of the event to an insurance or reinsurance company and the ultimate payment of the claim on the loss event, the liability for unpaid losses and LAE is based largely upon estimates. Castlewood's management must use

considerable judgment in the process of developing these estimates. The liability for unpaid losses and LAE for property and casualty business includes amounts determined from loss reports on individual cases and amounts for losses incurred but not reported, or IBNR. Such reserves, including IBNR reserves, are estimated by management based upon loss reports received from ceding companies, supplemented by Castlewood's own estimates of losses for which no ceding company loss reports have yet been received.

In establishing reserves, management also considers actuarial estimates of ultimate losses. Castlewood's actuaries employ generally accepted actuarial methodologies and procedures to estimate ultimate losses and

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loss expenses. In addition, a loss reserve study is prepared by an independent actuary annually in order to provide additional insight into the reasonableness of Castlewood's reserves for losses and loss expenses.

Castlewood's loss reserves are largely related to casualty exposures including latent exposures primarily relating to asbestos and environmental, or A&E, as discussed below. In establishing the reserves for unpaid claims, management considers facts currently known and the current state of the law and coverage litigation. Liabilities are recognized for known claims (including the cost of related litigation) when sufficient information has been developed to indicate the involvement of a specific insurance policy, and management can reasonably estimate its liability. In addition, reserves are established to cover loss development related to both known and unasserted claims.

The estimation of unpaid claim liabilities is subject to a high degree of uncertainty for a number of reasons. Unpaid claim liabilities for property and casualty exposures in general are impacted by changes in the legal environment, jury awards, medical cost trends, and general inflation. Moreover, for latent exposures in particular, developed case law and adequate claims history do not exist. There is significant coverage litigation involved with these exposures which creates further uncertainty in the estimation of the liabilities. As such, for these types of exposures, it is especially unclear whether past claim experience will be representative of future claim experience. Ultimate values for such claims cannot be estimated using reserving techniques that extrapolate losses to an ultimate basis using loss development factors, and the uncertainties surrounding the estimation of unpaid claim liabilities are not likely to be resolved in the near future. There can be no assurance that the reserves established by Castlewood will be adequate or will not be adversely affected by the development of other latent exposures. The actuarial methods used to estimate ultimate loss and ALAE for Castlewood's latent exposures are discussed below.

Non-latent claims are less significant to Castlewood, both in terms of reserves held, and in terms of risk of significant reserve deficiency. For the non-latent loss exposures, a range of traditional loss development extrapolation techniques is applied. Incremental paid and incurred loss development methodologies are the most commonly used methods. Traditional cumulative paid and incurred loss development methods are used where inception-to-date, cumulative paid and reported incurred loss development history is available.

These methods assume that cohorts, or groups, of losses from similar exposures will increase over time in a predictable manner. Historical paid and incurred loss development experience is examined for earlier underwriting years to make inferences about how later underwriting years' losses will develop. Where company-specific loss information is not available or not reliable, industry loss development information published by reliable industry sources such as the Reinsurance Association of America is considered.

The reserving process is intended to reflect the impact of inflation and other factors affecting loss payments by taking into account changes in historical payment patterns and perceived trends. However, there is no precise method for the subsequent evaluation of the adequacy of the consideration given to inflation, or to any other specific factor, or to the way one factor may affect another.

The loss development tables below show changes in Castlewood's gross and net loss reserves in subsequent years from the prior loss estimates based on experience as of the end of each succeeding year. The estimate is increased or decreased as more information becomes known about the frequency and severity of losses for individual years. A redundancy means the original estimate was higher than the current estimate; a deficiency means that the current estimate is higher than the original estimate. The first table shows, in the first section of the table, Castlewood's gross reserve for unpaid losses (including IBNR losses) and LAE. The second table shows, in the first section of the table, Castlewood's reserve for unpaid losses (including IBNR losses) and LAE net of reinsurance. The second section of each table shows Castlewood's re-estimates of the reserve in later years. The third section of each table shows the cumulative amounts of losses paid as of the end of each succeeding year. The cumulative redundancy line in each table represents, as of the date indicated, the difference between the latest re-estimated liability and the reserves as

originally estimated.

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|   | 2001                           | 2002       | 2003       | 2004         | 2005       |
|---|--------------------------------|------------|------------|--------------|------------|
|   | (in thousands of U.S. dollars) |            |            |              |            |
| <b>Gross reserve</b> for unpaid losses and loss adjustment expenses | \$ 419,717                     | \$ 284,409 | \$ 381,531 | \$ 1,047,313 | \$ 806,559 |
| 1 Yr Later  | 348,279                        | 302,986    | 365,913    | 900,274      |            |
| 2 Yrs Later   | 360,558                        | 299,281    | 284,583    |              |            |
| 3 Yrs Later   | 359,771                        | 278,020    |            |              |            |
| 4 Yrs Later   | 332,904                        |            |            |              |            |
| <b>Gross paid losses</b>  |                                |            |            |              |            |
| 1 Yr Later  | 97,036                         | 43,721     | 19,260     | 110,193      |            |
| 2 Yrs Later   | 123,844                        | 64,900     | 43,082     |              |            |
| 3 Yrs Later   | 142,282                        | 84,895     |            |              |            |
| 4 Yrs Later   | 160,193                        |            |            |              |            |
| Cumulative redundancy   | 86,813                         | 6,389      | 96,948     | 147,039      |            |

|   | 2001                           | 2002       | 2003       | 2004       | 2005       |
|---|--------------------------------|------------|------------|------------|------------|
|   | (in thousands of U.S. dollars) |            |            |            |            |
| <b>Net reserve</b> for unpaid losses and loss adjustment expenses | \$ 224,507                     | \$ 184,518 | \$ 230,155 | \$ 736,660 | \$ 593,160 |
| 1 Yr Later  | 190,768                        | 176,444    | 220,712    | 653,039    |            |
| 2 Yrs Later   | 176,118                        | 178,088    | 164,319    |            |            |
| 3 Yrs Later   | 180,635                        | 138,251    |            |            |            |
| 4 Yrs Later   | 135,219                        |            |            |            |            |
| <b>Net paid losses</b>  |                                |            |            |            |            |
| 1 Yr Later  | 38,634                         | 10,557     | 11,354     | 78,488     |            |
| 2 Yrs Later   | 32,291                         | 24,978     | 6,312      |            |            |
| 3 Yrs Later   | 44,153                         | 17,304     |            |            |            |
| 4 Yrs Later   | 34,483                         |            |            |            |            |
| Cumulative redundancy   | 89,288                         | 46,267     | 65,836     | 83,621     |            |

The following table provides a reconciliation of the liability for losses and LAE, net of reinsurance ceded:

|   | Nine Months Ended              |            | Year Ended December 31, |            |            |            | 2001 |
|---|--------------------------------|------------|-------------------------|------------|------------|------------|------|
|   | 2006                           | 2005       | 2005                    | 2004       | 2003       | 2002       |      |
|   | (in thousands of U.S. dollars) |            |                         |            |            |            |      |
| Net reserves for losses and loss adjustment expenses, beginning of period | \$ 593,160                     | \$ 736,660 | \$ 736,660              | \$ 230,155 | \$ 184,518 | \$ 224,507 | \$   |
|   | (10,700)                       | (6,466)    | (96,007)                | (13,706)   | (24,044)   | (48,758)   | (90) |



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|   |            |            |            |            |            |            |            |
|---|------------|------------|------------|------------|------------|------------|------------|
| Incurring related to prior years                                    |            |            |            |            |            |            |            |
| Paid related to prior years   | (43,771)   | (59,963)   | (69,007)   | (19,019)   | (4,094)    | (32,272)   | (2,260)    |
| Effect of exchange rate movement                                    | 8,434      | (23,325)   | 3,652      | 4,124      | 10,575     | 6,774      | 2,750      |
| Acquired on acquisition of subsidiaries                             | 208,248    | 17,862     | 17,862     | 535,106    | 63,200     | 34,267     | 224,107    |
| Net reserves for losses and loss adjustment expenses, end of period | \$ 755,371 | \$ 664,768 | \$ 593,160 | \$ 736,660 | \$ 230,155 | \$ 184,518 | \$ 224,507 |

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In the table above, incurred losses and loss adjustment expenses related to prior years represents changes in estimates of prior period net loss and loss adjustment expense liabilities comprising net incurred loss movements during a period and changes in estimates of net IBNR liabilities. Net incurred loss movements during a period comprise increases or reductions in specific case reserves advised during the period to Castlewood by its policyholders and attorneys, or by Castlewood to its reinsurers, less claims settlements made during the period by Castlewood to its policyholders, plus claim receipts made to Castlewood by its reinsurers. Prior period estimates of net IBNR liabilities may change as Castlewood's management considers the combined impact of commutations, policy buy-backs, settlement of losses on carried reserves and the trend of incurred loss development compared to prior forecasts. The trend of incurred loss development in any period comprises the movement in net case reserves less net claims settled during the period. See Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies - Loss and Loss Adjustment Expenses beginning on page 124 for an explanation of how the loss reserving methodologies are applied to the movement, or development, of net incurred losses during a period to estimate IBNR liabilities.

Commutations provide an opportunity for Castlewood to exit exposures to entire policies with insureds and reinsureds at a discount to the previously estimated ultimate liability. Castlewood's internal and external actuaries eliminate all prior historical loss development that relates to commuted exposures and apply their actuarial methodologies to the remaining aggregate exposures and revised historical loss development information to reassess estimates of ultimate liabilities.

Policy buy-backs provide an opportunity for Castlewood to settle individual policies and losses usually at a discount to carried advised loss reserves. As part of Castlewood's routine claims settlement operations, claims will settle at either below or above the carried advised loss reserve. The impact of policy buy-backs and the routine settlement of claims updates historical loss development information to which actuarial methodologies are applied often resulting in revised estimates of ultimate liabilities. Castlewood's actuarial methodologies include industry benchmarking which, under certain methodologies (discussed further under Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies beginning on page 124), compares the trend of Castlewood's loss development to that of the industry. To the extent that the trend of Castlewood's loss development compared to the industry changes in any period it is likely to have an impact on the estimate of ultimate liabilities.

Net reduction in loss and loss adjustment expense liabilities for the nine months ended September 30, 2006 and 2005 were \$10.7 million and \$6.5 million, respectively. The net reduction in loss and loss adjustment expense liabilities for both nine-month periods was primarily attributable to the reduction in estimates of loss adjustment expense liabilities relating to 2006 and 2005 run-off activity partially offset by reductions in estimates of reinsurance balances receivable.

Net reduction in loss and loss adjustment expense liabilities for the year ended December 31, 2005 was \$96.0 million, excluding the impacts of adverse foreign exchange rate movements of \$3.7 million and including both net reduction in loss and loss adjustment expense liabilities of \$7.4 million relating to companies acquired during the year and premium and commission adjustments triggered by incurred losses of \$1.3 million. The net reduction in loss and loss adjustment expense liabilities for 2005 was primarily attributable to a reduction in estimates of net ultimate losses of \$65.3 million, comprised of favorable incurred loss development during the year of \$5.9 million and reductions in estimates of IBNR reserves of \$59.4 million. The favorable incurred loss development, whereby advised case and LAE reserves of \$74.9 million were settled for net paid losses of \$69.0 million, arose from approximately 68 commutations of assumed and ceded exposures at less than case and LAE reserves and the settlement of non-commuted losses in the year below carried reserves. Castlewood adopts a disciplined approach, through claims adjusting and the inspection of underlying policyholder records, to the review and settlement of non-commuted claims such that settlements may often be achieved below the level of the originally advised loss. The \$59.4 million reduction in the estimate of IBNR loss and loss adjustment expense liabilities resulted from the application of Castlewood's

reserving methodologies to (i) the reduced historical incurred loss development information relating to remaining exposures after the 68 commutations, and (ii) reduced case and LAE reserves in the aggregate. The application of Castlewood's reserving methodologies to the reduced historical incurred loss development information relating to Castlewood's remaining exposures after

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elimination of the historical loss development relating to the 68 commuted exposures had the following effects (with the methodologies that weighed most heavily in the analysis for this period listed first):

Under the Ultimate-to-Incurred Method, the application of the ratio of estimated industry ultimate losses to industry incurred-to-date losses to Castlewood's reduced incurred-to-date losses resulted in reduced estimates of loss reserves.

Application of the Paid Survival Ratio Method to the reduced historical loss development information resulted in lower expected average annual payment amounts compared to the previous year, which, when multiplied by the expected industry benchmark for future number of payment years, led to reductions in Castlewood's estimated loss reserves.

Under the Paid Market Share Method, Castlewood's reduced historical calendar year payments resulted in a reduction of Castlewood's indicated market share of industry paid losses and thus Castlewood's market share of estimated industry loss reserves.

Under the Reserve-to-Paid Method, the application of the ratio of industry reserves to industry paid-to-date losses to Castlewood's reduced paid-to-date losses resulted in reduced estimates of loss reserves.

Under the IBNR:Case Ratio Method, the application of ratios of industry IBNR reserves to industry case reserves to Castlewood's case reserves resulted in reduced estimates of IBNR loss reserves as a result of the aggregate reduction, combining the impact of commutations and settlement of non-commuted losses, in Castlewood's case and LAE reserves of \$74.9 million during the year. As such case and LAE reserves were settled for less than \$74.9 million, the IBNR reserves determined under the IBNR:Case ratio method associated with such case reserves were eliminated. See

Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies - Loss and Loss Adjustment Expense Liabilities beginning on page 124 for a further explanation of how the loss reserving methodologies are applied to the movement, or development, of net incurred losses during a period to estimate IBNR liabilities. Of the 68 commutations completed during 2005, ten were among the top ten cedant and/or reinsurance exposures of the individual Castlewood reinsurance subsidiaries involved. The remaining 58 were of smaller size, consistent with Castlewood's approach of targeting significant numbers of cedant and reinsurer relationships as well as targeting significant individual cedant and reinsurer relationships. As a result of the collection of certain reinsurance receivables, against which bad debt provisions had been provided in earlier periods, Castlewood reduced its aggregate provisions for bad debt by \$20.2 million in 2005. During 2005, Castlewood reduced its estimate of loss adjustment expense liabilities by \$10.5 million relating to 2005 run-off activity.

Net reduction in loss and loss adjustment expense in 2004 amounted to \$13.7 million, excluding the impacts of adverse foreign exchange rate movements of \$4.1 million and including premium and commission adjustments triggered by incurred losses of \$0.1 million. Total favorable net incurred loss development during 2004 of \$14.7 million, whereby advised case and LAE reserves of \$33.7 million were settled for net paid losses of \$19.0 million, included adverse incurred development of asbestos and environmental exposures the combination of which resulted in a net increase in IBNR loss reserves of \$15.7 million. The increase in IBNR of \$15.7 million offset by the favorable incurred development of \$14.7 million resulted in an increase in net ultimate losses of \$1.0 million. The favorable incurred loss development arose from approximately 36 commutations of assumed and ceded exposures at less than case and LAE reserves and the settlement of losses in the year below carried reserves. Of the 36 commutations completed during 2004, three were among the top ten cedant and/or reinsurance exposures of the individual Castlewood reinsurance subsidiaries involved. The remaining 33 were of smaller size, consistent with Castlewood's approach of targeting significant numbers of cedant and reinsurer relationships as well as targeting significant individual cedant and reinsurer relationships. There was no change to the provisions for bad debts in 2004. In 2004, Castlewood reduced its estimate of loss adjustment expense liabilities by \$14.7 million relating to 2004

run-off activity.

Net reduction in loss and loss adjustment expense liabilities for the year ended December 31, 2003 was \$24.0 million, excluding the impacts of adverse foreign exchange rate movements of \$10.6 million and including net reduction in loss and loss adjustment expense liabilities of \$5.4 million relating to companies

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acquired during the year. The net reduction in loss and loss adjustment expense liabilities for 2003 was primarily attributable to a reduction in estimates of ultimate net losses of \$13.6 million, partly comprised of favorable incurred loss development during the year of \$5.8 million, whereby advised case and LAE reserves of \$9.9 million were settled for net paid losses of \$4.1 million. The favorable incurred loss development arose from approximately 13 commutations of assumed and ceded exposures at less than case and LAE reserves and the settlement of losses in the year below carried reserves which contributed to reductions in actuarial estimates of IBNR losses of \$7.8 million. Of the 13 commutations completed during 2003, two were among the top ten cedant and/or reinsurance exposures of the individual Castlewood reinsurance subsidiaries involved. The remaining 11 were of smaller size, consistent with Castlewood's approach of targeting significant numbers of cedant and reinsurer relationships as well as targeting significant individual cedant and reinsurer relationships. During 2003, Castlewood reduced its estimate of loss adjustment expense liabilities by \$10.4 million relating to 2003 run-off activity.

Net reduction in loss and loss adjustment expense liabilities for the year ended December 31, 2002 was \$48.8 million, excluding the impacts of adverse foreign exchange rate movements of \$6.8 million and including premium and commission adjustments triggered by incurred losses of \$8.2 million. The net reduction in loss and loss adjustment expense liabilities for 2002 was primarily attributable to a reduction in estimates of ultimate net losses of \$50.7 million, primarily as a result of the commutation of Castlewood's single largest reinsurance liability and reinsurance receivable with one counter party as well as favorable incurred loss development during the year, whereby advised case and LAE reserves of \$21.7 million were settled for net paid losses of \$32.3 million. The commutation of Castlewood's largest liability and receivable together with favorable incurred loss development, that arose from approximately ten commutations of assumed and ceded exposures and the settlement of losses below carried reserves which contributed to reductions in actuarial estimates of IBNR losses of \$61.2 million. Of the ten commutations completed during 2002, excluding the largest, one was among the top ten cedant and/or reinsurance exposures. The remaining nine were of smaller size, consistent with Castlewood's approach of targeting significant numbers of cedant and reinsurer relationships as well as targeting significant individual cedant and reinsurer relationships. During 2002, Castlewood increased its estimate of loss adjustment expense liabilities by \$1.9 million relating to 2002 run-off activity.

The loss development tables below relate to B.H. Acquisition. The first table shows, in the first section of the table, B.H. Acquisition's gross reserve for unpaid losses (including IBNR losses) and LAE. The second table shows, in the first section of the table, B.H. Acquisition's reserve for unpaid losses (including IBNR losses) and LAE net of reinsurance. The second section of each table shows B.H. Acquisition's re-estimates of the reserve in later years. The third section of each table shows the cumulative amounts of losses paid as of the end of each succeeding year. The cumulative redundancy (deficiency) line in each table represents, as of the date indicated, the difference between the latest re-estimated liability and the reserves as originally estimated.

|   | 2000                           | 2001       | 2002      | 2003      | 2004      | 2005      |
|---|--------------------------------|------------|-----------|-----------|-----------|-----------|
|   | (in thousands of U.S. dollars) |            |           |           |           |           |
| <b>Gross reserve</b> for unpaid losses and loss adjustment expenses | \$ 114,813                     | \$ 100,635 | \$ 72,421 | \$ 71,217 | \$ 62,349 | \$ 58,470 |
| 1 Yr Later  | 111,047                        | 77,741     | 86,975    | 69,372    | 64,263    |           |
| 2 Yrs Later   | 90,404                         | 80,324     | 87,351    | 71,539    |           |           |
| 3 Yrs Later   | 92,987                         | 80,699     | 91,495    |           |           |           |
| 4 Yrs Later   | 93,363                         | 84,844     |           |           |           |           |
| 5 Yrs Later   | 97,507                         |            |           |           |           |           |
| <b>Gross paid losses</b>  |                                |            |           |           |           |           |
| 1 Yr Later  | 10,412                         | 5,320      | 15,759    | 7,023     | 5,793     |           |
| 2 Yrs Later   | 17,983                         | 9,107      | 25,002    | 15,046    |           |           |
| 3 Yrs Later   | 21,770                         | 18,350     | 33,025    |           |           |           |

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|                                       |        |        |          |       |         |
|---------------------------------------|--------|--------|----------|-------|---------|
| 4 Yrs Later                           | 31,013 | 26,374 |          |       |         |
| 5 Yrs Later                           | 39,037 |        |          |       |         |
| Cumulative Redundancy<br>(Deficiency) | 17,306 | 15,792 | (19,074) | (323) | (1,914) |

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|   | 2000                           | 2001      | 2002      | 2003      | 2004      | 2005      |
|---|--------------------------------|-----------|-----------|-----------|-----------|-----------|
|   | (in thousands of U.S. dollars) |           |           |           |           |           |
| <b>Net reserve</b> for unpaid losses and loss adjustment expenses | \$ 82,988                      | \$ 72,540 | \$ 48,579 | \$ 42,712 | \$ 38,832 | \$ 55,712 |
| 1 Yr Later  | 76,348                         | 51,649    | 52,837    | 41,269    | 36,439    |           |
| 2 Yrs Later   | 57,708                         | 43,935    | 53,615    | 39,129    |           |           |
| 3 Yrs Later   | 49,994                         | 44,713    | 53,452    |           |           |           |
| 4 Yrs Later   | 50,772                         | 44,550    |           |           |           |           |
| 5 Yrs Later   | 50,609                         |           |           |           |           |           |
| <b>Net paid losses</b>  |                                |           |           |           |           |           |
| 1 Yr Later  | 3,808                          | 3,070     | 10,125    | 2,437     | (19,273)  |           |
| 2 Yrs Later   | 9,129                          | 1,223     | 14,782    | (14,606)  |           |           |
| 3 Yrs Later   | 7,282                          | 5,881     | (2,260)   |           |           |           |
| 4 Yrs Later   | 11,939                         | (11,162)  |           |           |           |           |
| 5 Yrs Later   | (5,103)                        |           |           |           |           |           |
| Cumulative Redundancy   | 32,379                         | 27,990    | (4,873)   | 3,582     | 2,393     |           |

The following table provides a reconciliation of the liability for losses and LAE, net of reinsurance ceded for B.H. Acquisition.

|  | Nine Months Ended              |                    | Year Ended December 31, |           |           |           |           |
|--|--------------------------------|--------------------|-------------------------|-----------|-----------|-----------|-----------|
|  | September 30, 2006             | September 30, 2005 | 2005                    | 2004      | 2003      | 2002      | 2001      |
|  | (in thousands of U.S. dollars) |                    |                         |           |           |           |           |
| Net reserves for losses and loss expenses, beginning of period | \$ 55,712                      | \$ 38,832          | \$ 38,832               | \$ 42,712 | \$ 48,578 | \$ 72,540 | \$ 82,988 |
| Incurred related to prior years                                | 260                            | (130)              | (50)                    | (1,713)   | 2,068     | (23,588)  | (2,711)   |
| Paid related to prior years                                    | (1,741)                        | 13,079             | 19,274                  | (2,437)   | (10,125)  | (3,071)   | (3,808)   |
| Effect of exchange rate movement                               | 1,317                          | (1,783)            | (2,344)                 | 270       | 2,191     | 2,697     | (3,929)   |
| Net reserves for losses and loss expenses, end of period       | \$ 55,548                      | \$ 49,998          | \$ 55,712               | \$ 38,832 | \$ 42,712 | \$ 48,578 | \$ 72,540 |

During 2005, B.H. Acquisition negotiated and completed a commutation transaction with a major reinsurer whereby B.H. Acquisition's right to recover future losses ceded to the reinsurer was exchanged for a payment of \$23 million. The paid loss recoveries in the year, including the \$23 million commutation receipt, exceeded the gross paid losses resulting in a net paid recovery in the year.

**Asbestos and Environmental (A&E) Exposure**



*General A&E Exposures*

A number of Castlewood's subsidiaries wrote general liability policies and reinsurance prior to their acquisition by Castlewood under which policyholders continue to present asbestos-related injury claims and claims alleging injury, damage or clean-up costs arising from environmental pollution. These policies, and the associated claims, are referred to as A&E exposures. The vast majority of these claims are presented under policies written many years ago.

There is a great deal of uncertainty surrounding A&E claims. This uncertainty impacts the ability of insurers and reinsurers to estimate the ultimate amount of unpaid claims and related LAE. The majority of these claims differ from any other type of claim because there is inadequate loss development and there is significant uncertainty regarding what, if any, coverage exists, to which, if any, policy years claims are attributable and which, if any, insurers/reinsurers may be liable. These uncertainties are exacerbated by lack of clear judicial precedent and legislative interpretations of coverage that may be inconsistent with the intent of

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the parties to the insurance contracts and expand theories of liability. The insurance and reinsurance industry as a whole is engaged in extensive litigation over these coverage and liability issues and is, thus, confronted with continuing uncertainty in its efforts to quantify A&E exposures.

Castlewood's A&E exposure is managed out of its offices in the United Kingdom and Rhode Island and centrally managed from the United Kingdom. In light of the intensive claim settlement process for these claims, which involves comprehensive fact gathering and subject matter expertise, management believes it is prudent to have a centrally managed claim facility to handle A&E claims on behalf of all of Castlewood's subsidiaries. Castlewood's A&E claims staff, headed by a U.S.-qualified attorney experienced in A&E liabilities, proactively manages, on a cost effective basis, the A&E claims submitted to Castlewood's insurance and reinsurance subsidiaries. The staff employs professional and disciplined claim handling strategies to achieve favorable results for Castlewood's insurance and reinsurance subsidiaries and its clients while minimizing costs.

Castlewood's independent, external actuaries use industry benchmarking methodologies to estimate appropriate IBNR reserves for Castlewood's A&E exposures. These methods are based on comparisons of Castlewood's loss experience on A&E exposures relative to industry loss experience on A&E exposures. Estimates of IBNR are derived separately for each relevant Castlewood subsidiary and, for some subsidiaries, separately for distinct portfolios of exposure. The discussion that follows describes, in greater detail, the primary actuarial methodologies used by Castlewood's independent actuaries to estimate IBNR for A&E exposures.

In addition to the specific considerations for each method described below, many general factors are considered in the application of the methods and the interpretation of results for each portfolio of exposures. These factors include the mix of product types (e.g. primary insurance versus reinsurance of primary versus reinsurance of reinsurance), the average attachment point of coverages (e.g. first-dollar primary versus umbrella over primary versus high-excess), payment and reporting lags related to the international domicile of Castlewood subsidiaries, payment and reporting pattern acceleration due to large wholesale settlements (e.g. policy buy-backs and commutations) pursued by Castlewood, lists of individual risks remaining and general trends within the legal and tort environments.

1. *Paid Survival Ratio Method.* In this method, Castlewood's expected annual average payment amount is multiplied by an expected future number of payment years to get an indicated reserve. Castlewood's historical calendar year payments are examined to determine an expected future annual average payment amount. This amount is multiplied by an expected number of future payment years to estimate a reserve. Trends in calendar year payment activity are considered when selecting an expected future annual average payment amount. Accepted industry benchmarks are used in determining an expected number of future payment years. Each year, annual payments data is updated, trends in payments are re-evaluated and changes to benchmark future payment years are reviewed. This method has advantages of ease of application and simplicity of assumptions. A potential disadvantage of the method is that results could be misleading for portfolios of high excess exposures where significant payment activity has not yet begun.

2. *Paid Market Share Method.* In this method, Castlewood's estimated market share is applied to the industry estimated unpaid losses. The ratio of Castlewood's historical calendar year payments to industry historical calendar year payments is examined to estimate Castlewood's market share. This ratio is then applied to the estimate of industry unpaid losses. Each year, calendar year payment data is updated (for both Castlewood and industry), estimates of industry unpaid losses are reviewed and the selection of Castlewood's estimated market share is revisited. This method has the advantage that trends in calendar-year market share can be incorporated into the selection of company share of remaining market payments. A potential disadvantage of this method is that it is particularly sensitive to assumptions regarding the time-lag between industry payments and Castlewood payments.

3. *Reserve-to-Paid Method.* In this method, the ratio of estimated industry reserves to industry paid-to-date losses is multiplied by Castlewood's paid-to-date losses to estimate Castlewood's reserves. Specific considerations in the

application of this method include the completeness of Castlewood's paid-to-date loss information, the potential acceleration or deceleration in Castlewood's payments (relative to the industry)

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due to Castlewood's claims handling practices, and the impact of large individual settlements. Each year, paid-to-date loss information is updated (for both Castlewood and the industry) and updates to industry estimated reserves are reviewed. This method has the advantage of relying purely on paid loss data and so is not influenced by subjectivity of case reserve loss estimates. A potential disadvantage is that the application to Castlewood portfolios which do not have complete inception-to-date paid loss history could produce misleading results.

4. *IBNR:Case Ratio Method.* In this method, the ratio of estimated industry IBNR reserves to industry case reserves is multiplied by Castlewood's case reserves to estimate Castlewood IBNR reserves. Specific considerations in the application of this method include the presence of policies reserved at policy limits, changes in overall industry case reserve adequacy and recent loss reporting history for Castlewood. Each year, Castlewood case reserves are updated, industry reserves are updated and the applicability of the industry IBNR:case ratio is reviewed. This method has the advantage that it incorporates the most recent estimates of amounts needed to settle open cases included in current case reserves. A potential disadvantage is that results could be misleading where Castlewood case reserve adequacy differs significantly from overall industry case reserve adequacy.

5. *Ultimate-to-Incurred Method.* In this method, the ratio of estimated industry ultimate losses to industry incurred-to-date losses is applied to Castlewood incurred-to-date losses to estimate Castlewood's IBNR reserves. Specific considerations in the application of this method include the completeness of Castlewood's incurred-to-date loss information, the potential acceleration or deceleration in Castlewood's incurred losses (relative to the industry) due to Castlewood's claims handling practices and the impact of large individual settlements. Each year incurred-to-date loss information is updated (for both Castlewood and the industry) and updates to industry estimated ultimate losses are reviewed. This method has the advantage that it incorporates both paid and case reserve information in projecting ultimate losses. A potential disadvantage is that results could be misleading where cumulative paid loss data is incomplete or where Castlewood case reserve adequacy differs significantly from overall industry case reserve adequacy.

Within the annual loss reserve studies produced by Castlewood's external actuaries, exposures for each subsidiary are separated into homogeneous reserving categories for the purpose of estimating IBNR. Each reserving category contains either direct insurance or assumed reinsurance reserves and groups relatively similar types of risks and exposures (for example asbestos, environmental, casualty, property) and lines of business written (for example marine, aviation, non-marine). Based on the exposure characteristics and the nature of available data for each individual reserving category, a number of methodologies are applied. Recorded reserves for each category are selected from the indications produced by the various methodologies after consideration of exposure characteristics, data limitations and strengths and weaknesses of each method applied. This approach to estimating IBNR has been consistently adopted in the annual loss reserve studies for each period presented.

As of December 31, 2005, Castlewood had nine separate insurance and/or reinsurance subsidiaries whose reserves are categorized into approximately 170 reserve categories in total, including 15 distinct asbestos reserving categories and 18 distinct environmental reserving categories.

The five methodologies described above are applied for each of the 15 asbestos reserving categories and each of the 18 environmental reserving categories. As is common in actuarial practice, no one methodology is exclusively or consistently relied upon when selecting a recorded reserve. Consistent reliance on a single methodology to select a recorded reserve would be inappropriate in light of the dynamic nature of both the asbestos and environmental liabilities in general, and the actual Castlewood exposure portfolios in particular.

In selecting a recorded reserve, management considers the range of results produced by the methods, and the strengths and weaknesses of the methods in relation to the data available and the specific characteristics of the portfolio under consideration. Trends in both Castlewood data and industry data are also considered in the reserve selection process.

Recent trends or changes in the relevant tort and legal environments are also considered when assessing methodology results and selecting an appropriate recorded reserve amount for each portfolio.

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The liability for unpaid losses and LAE, inclusive of A&E reserves, reflects Castlewood's best estimate for future amounts needed to pay losses and related LAE as of each of the balance sheet dates reflected in the financial statements herein in accordance with GAAP. As of December 31, 2005, Castlewood had net loss reserves of \$325.9 million for asbestos-related claims and \$58.1 million for environmental pollution-related claims. The following table provides an analysis of Castlewood's gross and net loss and ALAE reserves from A&E exposures at year-end 2005, 2004 and 2003 and the movement in gross and net reserves for those years:

|  | 2005       |            | Year Ended December 31,<br>2004 |            | 2003       |           |
|--|------------|------------|---------------------------------|------------|------------|-----------|
|  | Gross      | Net        | Gross                           | Net        | Gross      | Net       |
| Provision for A&E claims and ALAE at January 1             | \$ 743,294 | \$ 479,048 | \$ 196,217                      | \$ 92,745  | \$ 154,856 | \$ 48,746 |
| A&E losses and ALAE incurred during the year               | (93,705)   | (31,566)   | (4,216)                         | (29,348)   | 44,660     | 43,035    |
| A&E losses and ALAE paid during the year                   | (78,635)   | (69,014)   | (9,436)                         | (4,087)    | (12,220)   | (4,177)   |
| Provision for A&E claims and ALAE acquired during the year | 7,125      | 5,489      | 560,729                         | 419,738    | 8,921      | 5,141     |
| Provision for A&E claims and ALAE at December 31           | \$ 578,079 | \$ 383,957 | \$ 743,294                      | \$ 479,048 | \$ 196,217 | \$ 92,745 |

Asbestos continues to be the most significant and difficult mass tort for the insurance industry in terms of claims volume and expense. Castlewood believes that the insurance industry has been adversely affected by judicial interpretations that have had the effect of maximizing insurance recoveries for asbestos claims, from both a coverage and liability perspective. Generally, only policies underwritten prior to 1986 have potential asbestos exposure, since most policies underwritten after this date contain an absolute asbestos exclusion.

In recent years, especially from 2001 through 2003, the industry has experienced increasing numbers of asbestos claims, including claims from individuals who do not appear to be impaired by asbestos exposure. Since 2003, however, new claim filings have been fairly stable. It is possible that the increases observed in the early part of the decade were triggered by various state tort reforms (discussed immediately below). At this point, Castlewood can not predict whether claim filings will return to pre-2004 levels, remain stable, or begin to decrease.

Since 2001, several U.S. states have proposed, and in many cases enacted, tort reform statutes that impact asbestos litigation by, for example, making it more difficult for a diverse group of plaintiffs to jointly file a single case, reducing forum-shopping by requiring that a potential plaintiff must have been exposed to asbestos in the state in which he/she files a lawsuit, or permitting consolidation of discovery. These statutes typically apply to suits filed after a stated date. When a statute is proposed or enacted, asbestos defendants often experience a marked increase in new lawsuits, as plaintiffs' attorneys seek to file suit before the effective date of the legislation. Some of this increased claim volume likely represents an acceleration of valid claims that would have been brought in the future, while some claims will likely prove to have little or no merit. As many of these claims are still pending, Castlewood cannot predict what portion of the increased number of claims represent valid claims. Also, the acceleration of claims increases the uncertainty surrounding projections of future claims in the affected jurisdictions.

During the same timeframe as tort reform, the U.S. federal and various U.S. state governments sought comprehensive asbestos reform to manage the growing court docket and costs surrounding asbestos litigation, in addition to the increasing number of corporate bankruptcies resulting from overwhelming asbestos liabilities. Whereas the federal government has thus far unsuccessfully pursued the establishment of a national

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asbestos trust fund at an estimated cost of \$140 billion, states, including Texas and Florida, have implemented a medical criteria approach that only permits litigation to proceed when a plaintiff can establish and demonstrate actual physical impairment.

Much like tort reform, asbestos litigation reform has also spurred a significant increase in the number of lawsuits filed in advance of the law's enactment. Castlewood cannot predict whether the drop off in the number of filed claims is due to the accelerated number of filings or an actual trend decline in alleged asbestos injuries.

### *Environmental Pollution Exposures*

Environmental pollution claims represent another significant exposure for Castlewood. However, environmental claims have been developing as expected over the past few years as a result of stable claim trends. Claims against Fortune 500 companies are generally declining, and while insureds with single-site exposures are still active, in many cases claims are being settled for less than initially anticipated due to improved site remediation technology and effective policy buy-backs.

Despite the stability of recent trends, there remains significant uncertainty involved in estimating liabilities related to these exposures. First, the number of waste sites subject to cleanup is unknown. Approximately 1,200 sites are included on the National Priorities List (NPL) of the United States Environmental Protection Agency. State authorities have separately identified many additional sites and, at times, aggressively implement site cleanups. Second, the liabilities of the insureds themselves are difficult to estimate. At any given site, the allocation of remediation cost among the potentially responsible parties varies greatly depending upon a variety of factors. Third, as with asbestos liability and coverage issues, judicial precedent regarding liability and coverage issues regarding pollution claims does not provide clear guidance. There is also uncertainty as to the federal Superfund law itself and, at this time, Castlewood cannot predict what, if any, reforms to this law might be enacted by the U.S. Congress, or the effect of any such changes on the insurance industry.

### *Other Latent Exposures*

While Castlewood does not view health hazard exposures such as silica and tobacco as becoming a material concern, recent developments in lead litigation have caused Castlewood to watch these matters closely. Recently, municipal and state governments have had success, using a public nuisance theory, pursuing the former makers of lead pigment for the abatement of lead paint in certain home dwellings. As lead paint was used almost exclusively into the early 1970's, large numbers of old housing stock contain lead paint that can prove hazardous to people and, particularly, children. Although governmental success has been limited thus far, Castlewood continues to monitor developments carefully due to the size of the potential awards sought by plaintiffs.

## ***Investments***

### *Investment Strategy and Guidelines*

Castlewood derives a significant portion of its income from its invested assets. As a result, its operating results depend in part on the performance of its investment portfolio. Because of the unpredictable nature of losses that may arise under Castlewood's insurance and reinsurance subsidiaries' insurance or reinsurance policies and as a result of Castlewood's opportunistic commutation strategy, Castlewood's liquidity needs can be substantial and may arise at any time. Castlewood generally follows a conservative investment strategy designed to emphasize the preservation of its invested assets and provide sufficient liquidity for the prompt payment of claims and settlement of commutation payments. Castlewood's cash and cash equivalent portfolio is mainly comprised of high-grade fixed deposits and commercial paper with maturities of less than three months, liquid reserve funds and money market funds.



Castlewood's investment portfolio consists primarily of high investment grade-rated, liquid, fixed-maturity securities of short-to-medium term duration and an enhanced cash mutual fund. 94.6% of Castlewood's total investment portfolio as of September 30, 2006 consisted of investment grade securities. In addition, Castlewood has investments in a limited partnership, and has committed to invest in two private investment funds that are non-investment grade securities. These

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investments accounted for 5.4% of Castlewood's total investment portfolio as of September 30, 2006. Assuming the commitments to the two private investment funds were fully funded as of September 30, 2006 out of cash balances on hand at that time, the percentage of investments held in other than investment grade securities would increase to 16.0%.

Castlewood strives to structure its investments in a manner that recognizes its liquidity needs for future liabilities. In that regard, Castlewood attempts to correlate the maturity and duration of its investment portfolio to its general liability profile. If Castlewood's liquidity needs or general liability profile unexpectedly change, it may not continue to structure its investment portfolio in its current manner and would adjust as necessary to meet new business needs.

Castlewood's investment performance is subject to a variety of risks, including risks related to general economic conditions, market volatility, interest rate fluctuations, liquidity risk and credit and default risk. Interest rates are highly sensitive to many factors, including governmental monetary policies, domestic and international economic and political conditions and other factors beyond Castlewood's control. A significant increase in interest rates could result in significant losses, realized or unrealized, in the value of Castlewood's investment portfolio. Alternative investments, such as the commitment to J.C. Flowers II L.P., subject Castlewood to restrictions on redemption, which may limit its ability to withdraw funds for some period of time after the initial investment. The values of, and returns on, such investments may also be more volatile.

### *Investment Committee and Investment Manager*

The investment committee of Castlewood's board of directors supervises its investment activity. The investment committee regularly monitors Castlewood's overall investment results which it ultimately reports to the board of directors.

Castlewood has engaged Goldman Sachs to provide discretionary investment management services. Castlewood has agreed to pay investment management fees based on the month-end market values of a portion of the investments in the portfolio. The fees, which vary depending on the amount of assets under management, are included in net investment income. Castlewood also pays investment advisory fees to Enstar. These fees are also included as part of net investment income.

### *Castlewood's Portfolio*

#### *Accounting Treatment*

Castlewood's investments primarily consist of fixed income securities. Castlewood's fixed income investments are comprised of both available-for-sale investments and held to maturity investments as defined in FAS 115, Accounting for Certain Investments in Debt and Equity Securities. Available-for-sale investments are carried at their fair market value on the balance sheet date and held to maturity investments are carried at their amortized cost. Unrealized gains and losses on available-for-sale investments, which represent the difference between the amortized cost and the fair market value of securities, are reported in the balance sheet, as accumulated other comprehensive income in a separate component of shareholders' equity.

#### *Composition as of September 30, 2006*

As of September 30, 2006, Castlewood's aggregate invested assets totaled approximately \$1,084.7 million. Aggregate invested assets include cash and cash equivalents, restricted cash and cash equivalents, fixed-maturity securities, an enhanced cash mutual fund which invests in fixed income and money market securities denominated in U.S. dollars with average target duration of nine months, an investment in a limited partnership and an investment in a private

investment fund.

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The following table shows the types of securities in Castlewood's portfolio, including cash equivalents, and their fair market values and amortized costs as of September 30, 2006:

|                                   | Amortized<br>Cost | September 30, 2006  |                      | Fair Market<br>Value |
|-----------------------------------|-------------------|---------------------|----------------------|----------------------|
|                                   |                   | Unrealized<br>Gains | Unrealized<br>Losses |                      |
| (in thousands of U.S. dollars)    |                   |                     |                      |                      |
| Cash and cash equivalents(1)      | \$ 466,703        | \$ 0                | \$ 0                 | \$ 466,703           |
| U.S. government & agencies        | 177,340           | 20                  | (2,565)              | 174,795              |
| Non-U.S. government securities    | 79,190            | 0                   | (118)                | 79,072               |
| Corporate securities              | 69,490            | 0                   | (1,891)              | 67,599               |
| Fixed income                      | 326,020           | 20                  | (4,574)              | 321,466              |
| Enhanced cash fund                | 210,275           | 0                   | 0                    | 210,275              |
| Investment in limited partnership | 31,512            | 0                   | 0                    | 31,512               |
| Private investment fund           | 1,818             | 0                   | 0                    | 1,818                |
| Short term investments            | 48,392            | 0                   | 0                    | 48,392               |
| Total investments(2)              | 618,017           | 20                  | (4,574)              | 613,463              |
| Total cash and investments        | \$ 1,084,720      | \$ 20               | \$ (4,574)           | \$ 1,080,166         |

(1) Includes restricted cash and cash equivalents of \$64,155.

(2) The difference between the total amortized cost of investments above and the investments recorded under U.S. GAAP, shown on pages 15 and F-32, is attributable to the net unrealized gain on certain investments classified as available-for-sale under U.S. GAAP, which are recorded at fair market value.

*U.S. Government and Agencies*

U.S. government and agency securities are comprised primarily of bonds issued by the U.S. Treasury, the Federal Home Loan Bank, the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.

*Non-U.S. Government Securities*

Non-U.S. government securities represent the fixed income obligations of non-U.S. governmental entities.

*Corporate Securities*

Corporate securities are comprised of bonds issued by corporations that are diversified across a wide range of issuers and industries. The largest single issuer of corporate securities in Castlewood's portfolio was Goldman Sachs Group Inc., which represented 37.6% of the aggregate amount of corporate securities and had a credit rating of AAA by Standard & Poor's, as of September 30, 2006.

*Enhanced Cash Fund*

Enhanced cash mutual funds invest in fixed income and money market securities denominated in U.S. dollars with average target duration of nine months.

*Investment in Limited Partnership*

In December 2005, Castlewood invested approximately \$24.5 million in New NIB Partners LP, or NIB Partners, a Province of Alberta limited partnership, in exchange for an approximately 1.4% limited partnership interest. NIB Partners was formed for the purpose of purchasing, together with certain affiliated entities, 100% of the outstanding share capital of NIBC N.V. (formerly, NIB Capital N.V.) and its affiliates, or NIBC. NIBC is a merchant bank focusing on the mid-market segment in northwest Europe with a global distribution

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network. New NIB Partners and certain related entities are indirectly controlled by New NIB Limited, an Irish corporation. Mr. Flowers is a director of New NIB Limited and is on the supervisory board of NIBC. Certain affiliates of J.C. Flowers I LP also participated in the acquisition of NIBC. Certain officers and directors of Castlewood made personal investments in NIB Partners.

*Private Investment Funds*

Castlewood has made a capital commitment of up to \$10 million in the GSC European Mezzanine Fund II, LP, or GSC. GSC invests in mezzanine securities of middle and large market companies throughout Western Europe. As at September 30, 2006, the capital contributed to the Fund was \$1.8 million with the remaining commitment being \$8.2 million. The \$10 million represents 8.9% of the total commitments made to GSC.

Castlewood has also committed to invest \$75 million in J.C. Flowers II, L.P., a private investment fund formed by J.C. Flowers & Co. LLC. The fund held an initial closing in June 2006 and, in August 2006, Castlewood funded \$5.7 million of its \$75 million commitment. In October and November 2006, the Company funded a total of \$14.3 million of additional capital contributions to J.C. Flowers II, L.P. and received a \$1.0 million refund of excess contributions originally paid in August 2006. Castlewood intends to use cash on hand to fund its remaining commitment. J.C. Flowers & Co. LLC is controlled by Mr. Flowers.

*Short-Term Investments*

Short-term investments are comprised of commercial paper with maturities ranging between three months and one year issued by financial institutions. The largest single issuer of commercial paper in Castlewood's portfolio was Anglo Irish Bank Ltd, which represented 30.2% of the aggregate amount of short-term investments and had a credit rating of P1 by Moody's, as at September 30, 2006.

*Ratings as of September 30, 2006*

The investment ratings (provided by major rating agencies) for Castlewood's investments held as of September 30, 2006 and the percentage of investments they represented on that date were as follows:

|   | <b>September 30, 2006</b>             |                              |  |
|---|---------------------------------------|------------------------------|--|
|   | <b>Amortized<br/>Cost</b>             | <b>Fair Market<br/>Value</b> | <b>Percentage<br/>of<br/>Total Fair<br/>Market<br/>Value</b> |
|   | <b>(in thousands of U.S. dollars)</b> |                              |  |
| U.S. government & agencies<br>AAA or equivalent | \$ 177,340                            | \$ 174,795                   | 28.5%  |
| AA  | 368,964                               | 367,207                      | 59.9%  |
| A or equivalent                                 | 3,369                                 | 3,283                        | 0.5%   |
| BBB   | 34,074                                | 33,931                       | 5.5%   |
| Not rated                                       | 940                                   | 917                          | 0.2%   |
|   | 33,330                                | 33,330                       | 5.4%   |
| <b>Total</b>                                    | <b>\$ 618,017</b>                     | <b>\$ 613,463</b>            | <b>100%</b>  |

The amounts shown as not rated relate to Castlewood's investment in the limited partnership and private investment funds.

**Table of Contents***Maturity Distribution as of September 30, 2006*

The maturity distribution for total investments held as of September 30, 2006 was as follows:

|                                       | Amortized<br>Cost | September 30, 2006             |                      | Fair Market<br>Value |
|---------------------------------------|-------------------|--------------------------------|----------------------|----------------------|
|                                       |                   | Unrealized<br>Gains            | Unrealized<br>Losses |                      |
|                                       |                   | (in thousands of U.S. dollars) |                      |                      |
| Due within one year                   | \$ 342,042        | 0                              | \$ (139)             | \$ 341,903           |
| Due after one year through five       | 244,919           | 20                             | (3,481)              | 241,458              |
| Due after five year through ten years | 15,000            | 0                              | (218)                | 14,782               |
| Due after ten years                   | 16,056            | 0                              | (736)                | 15,320               |
| Total                                 | \$ 618,017        | 20                             | \$ (4,574)           | \$ 613,463           |

*Investment Returns for the Three and Nine Months Ended September 30, 2006*

Castlewood's investment returns for the three and nine months ended September 30, 2006 and year ended December 31, 2005 were as follows:

|  | Three Months<br>Ended<br>September 30,<br>2006 | Nine Months<br>Ended<br>September 30,<br>2006 | Year Ended<br>December 31,<br>2005 |
|--|--|---|------------------------------------|
|  |  | (in thousands of U.S. dollars)                |                                    |
| Net investment income  | \$ 12,697                                      | \$ 33,502                                     | \$ 28,236                          |
| Net realized gains (losses) on sale                              | 15   | (64)  | 1,268                              |
| Net investment income and net realized<br>gains (losses) on sale | \$ 12,712                                      | \$ 33,438                                     | \$ 29,504                          |
| Effective annualized yield(1)                                    | 4.64%  | 4.38%   | 3.23%                              |

(1) Effective annualized yield is calculated by dividing net investment income by the average balance of aggregate invested assets, on an amortized cost basis.

**Regulation***General*

The business of insurance and reinsurance is regulated in most countries, although the degree and type of regulation varies significantly from one jurisdiction to another. Castlewood is subject to extensive regulation under applicable statutes in the United Kingdom, Bermuda, Belgium and other jurisdictions.



*Bermuda*

As a holding company, Castlewood is not subject to Bermuda insurance regulations. However, the Insurance Act 1978 of Bermuda and related regulations, as amended, or, together, the Insurance Act, regulate the insurance business of Castlewood's operating subsidiaries in Bermuda and provide that no person may carry on any insurance business in or from within Bermuda unless registered as an insurer by the Bermuda Monetary Authority under the Insurance Act. Insurance as well as reinsurance is regulated under the Insurance Act. The Bermuda Monetary Authority, in deciding whether to grant registration, has broad discretion to act as it deems in the public interest. The Bermuda Monetary Authority is required by the Insurance Act to determine whether the applicant is a fit and proper body to be engaged in the insurance business and, in particular, whether it has, or has available to it, adequate knowledge and expertise to operate an insurance business. The continued registration of an applicant as an insurer is subject to it complying with the terms of its registration and any other conditions the Bermuda Monetary Authority may impose from time to time.

An Insurance Advisory Committee appointed by the Bermuda Minister of Finance advises the Bermuda Monetary Authority on matters connected with the discharge of the Bermuda Monetary Authority's functions. Sub-committees of the Insurance Advisory Committee supervise and review the law and practice of insurance

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in Bermuda, including reviews of accounting and administrative procedures. The day-to-day supervision of insurers is the responsibility of the Bermuda Monetary Authority.

The Insurance Act also imposes on Bermuda insurance companies certain solvency and liquidity standards and auditing and reporting requirements and grants the Bermuda Monetary Authority powers to supervise, investigate, require information and the production of documents and intervene in the affairs of insurance companies. Certain significant aspects of the Bermuda insurance regulatory framework are set forth below.

*Classification of Insurers.* The Insurance Act distinguishes between insurers carrying on long-term business and insurers carrying on general business. There are four classifications of insurers carrying on general business, with Class 4 insurers subject to the strictest regulation. Castlewood's regulated Bermuda subsidiaries, which are incorporated to carry on general insurance and reinsurance business, are registered as Class 2 or 3 insurers in Bermuda and are regulated as such under the Insurance Act. These regulated Bermuda subsidiaries are not licensed to carry on long-term business. Long-term business broadly includes life insurance and disability insurance with terms in excess of five years. General business broadly includes all types of insurance that are not long-term business.

*Principal Representative.* An insurer is required to maintain a principal office in Bermuda and to appoint and maintain a principal representative in Bermuda. For the purpose of the Insurance Act, each of Castlewood's regulated Bermuda subsidiaries' principal offices is at P.O. Box HM 2267, Windsor Place, 3rd Floor, 18 Queen Street, in Hamilton, Bermuda, and each of their principal representatives is Castlewood Limited. Without a reason acceptable to the Bermuda Monetary Authority, an insurer may not terminate the appointment of its principal representative, and the principal representative may not cease to act in that capacity, unless 30 days' notice in writing is given to the Bermuda Monetary Authority. It is the duty of the principal representative, forthwith on reaching the view that there is a likelihood that the insurer will become insolvent or that a reportable event has, to the principal representative's knowledge, occurred or is believed to have occurred, to notify the Bermuda Monetary Authority and, within 14 days of such notification, to make a report in writing to the Bermuda Monetary Authority setting forth all the particulars of the case that are available to the principal representative. For example, any failure by the insurer to comply substantially with a condition imposed upon the insurer by the Bermuda Monetary Authority relating to a solvency margin or a liquidity or other ratio would be a reportable event.

*Independent Approved Auditor.* Every registered insurer must appoint an independent auditor who will audit and report annually on the statutory financial statements and the statutory financial return of the insurer, both of which, in the case of Castlewood's regulated Bermuda subsidiaries, are required to be filed annually with the Bermuda Monetary Authority. The independent auditor must be approved by the Bermuda Monetary Authority and may be the same person or firm that audits Castlewood's consolidated financial statements and reports for presentation to its shareholders. Castlewood's regulated Bermuda subsidiaries' independent auditor is Deloitte & Touche, who also audits Castlewood's consolidated financial statements.

*Loss Reserve Specialist.* As a registered Class 2 or 3 insurer, each of Castlewood's regulated Bermuda insurance and reinsurance subsidiaries is required, every year, to submit an opinion of its approved loss reserve specialist with its statutory financial return in respect of its losses and loss expenses provisions. The loss reserve specialist, who will normally be a qualified casualty actuary, must be approved by the Bermuda Monetary Authority. Christopher Diamantoukos of Ernst & Young LLP has been approved to act as the loss reserve specialist for each of Castlewood's regulated Bermuda insurance and reinsurance subsidiaries.

*Statutory Financial Statements.* Each of Castlewood's regulated Bermuda subsidiaries must prepare annual statutory financial statements. The Insurance Act prescribes rules for the preparation and substance of these statutory financial statements, which include, in statutory form, a balance sheet, an income statement, a statement of capital and surplus and notes thereto. Each of Castlewood's regulated Bermuda subsidiaries is required to give detailed information and

analyses regarding premiums, claims, reinsurance and investments. The statutory financial statements are not prepared in accordance with U.S. GAAP and are distinct from the financial statements prepared for presentation to an insurer's shareholders under the Companies Act. As a general business insurer, each of Castlewood's regulated Bermuda subsidiaries is required to submit the annual statutory financial statements as part of the annual statutory financial return. The statutory financial statements

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and the statutory financial return do not form part of the public records maintained by the Bermuda Monetary Authority.

*Annual Statutory Financial Return.* Each of Castlewood's regulated Bermuda Class 2 and 3 insurance and reinsurance subsidiaries are required to file with the Bermuda Monetary Authority a statutory financial return no later than six or four months, respectively, after its fiscal year end unless specifically extended upon application to the Bermuda Monetary Authority. The statutory financial return for a Class 2 or 3 insurer includes, among other matters, a report of the approved independent auditor on the statutory financial statements of the insurer, solvency certificates, the statutory financial statements, and the opinion of the loss reserve specialist. The solvency certificates must be signed by the principal representative and at least two directors of the insurer certifying that the minimum solvency margin has been met and whether the insurer has complied with the conditions attached to its certificate of registration. The independent approved auditor is required to state whether, in its opinion, it was reasonable for the directors to make these certifications. If an insurer's accounts have been audited for any purpose other than compliance with the Insurance Act, a statement to that effect must be filed with the statutory financial return.

*Minimum Liquidity Ratio.* The Insurance Act provides a minimum liquidity ratio for general business insurers, like Castlewood's regulated Bermuda insurance and reinsurance subsidiaries. An insurer engaged in general business is required to maintain the value of its relevant assets at not less than 75% of the amount of its relevant liabilities. Relevant assets include, but are not limited to, cash and time deposits, quoted investments, unquoted bonds and debentures, first liens on real estate, investment income due and accrued, accounts and premiums receivable and reinsurance balances receivable. There are some categories of assets which, unless specifically permitted by the Bermuda Monetary Authority, do not automatically qualify as relevant assets, such as unquoted equity securities, investments in and advances to affiliates and real estate and collateral loans. Relevant liabilities are total general business insurance reserves and total other liabilities less deferred income tax and sundry liabilities (i.e., liabilities which are not otherwise specifically defined).

*Minimum Solvency Margin and Restrictions on Dividends and Distributions.* Under the Insurance Act, the value of the general business assets of a Class 2 or 3 insurer, such as Castlewood's regulated Bermuda subsidiaries, must exceed the amount of its general business liabilities by an amount greater than the prescribed minimum solvency margin. Each of Castlewood's regulated Bermuda subsidiaries is required, with respect to its general business, to maintain a minimum solvency margin equal to the greatest of:

For Class 2 insurers:

\$250,000;

20% of net premiums written (being gross premiums written less any premiums ceded by the insurer) if net premiums do not exceed \$6,000,000 or \$1,200,000 plus 10% of net premiums written which exceed \$6,000,000; and

10% of net losses and loss expense reserves.

For Class 3 insurers:

\$1,000,000;

20% of net premiums written (being gross premiums written less any premiums ceded by the insurer) if net premiums do not exceed \$6,000,000 or \$1,200,000 plus 15% of net premiums written which exceed \$6,000,000; and

15% of net losses and loss expense reserves.

Each of Castlewood's regulated Bermuda insurance and reinsurance subsidiaries is prohibited from declaring or paying any dividends during any fiscal year if it is in breach of its minimum solvency margin or minimum liquidity ratio or if the declaration or payment of such dividends would cause it to fail to meet such margin or ratio. In addition, if it has failed to meet its minimum solvency margin or minimum liquidity ratio on the last day of any fiscal year, each of Castlewood's regulated Bermuda subsidiaries will be prohibited,

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without the approval of the Bermuda Monetary Authority, from declaring or paying any dividends during the next financial year.

Each of Castlewood's regulated Bermuda insurance and reinsurance subsidiaries is prohibited, without the approval of the Bermuda Monetary Authority, from reducing by 15% or more its total statutory capital as set out in its previous year's financial statements.

Additionally, under the Companies Act, Castlewood and each of its regulated Bermuda subsidiaries may declare or pay a dividend, or make a distribution from contributed surplus, only if it has no reasonable grounds for believing that it is, or will after the payment be, unable to pay its liabilities as they become due, or that the realizable value of its assets will thereby be less than the aggregate of its liabilities and its issued share capital and share premium accounts.

*Supervision, Investigation and Intervention.* The Bermuda Monetary Authority may appoint an inspector with extensive powers to investigate the affairs of Castlewood's regulated Bermuda insurance and reinsurance subsidiaries if the Bermuda Monetary Authority believes that such an investigation is in the best interests of its policyholders or persons who may become policyholders. In order to verify or supplement information otherwise provided to the Bermuda Monetary Authority, the Bermuda Monetary Authority may direct Castlewood's regulated Bermuda insurance and reinsurance subsidiaries to produce documents or information relating to matters connected with its business. In addition, the Bermuda Monetary Authority has the power to require the production of documents from any person who appears to be in possession of those documents. Further, the Bermuda Monetary Authority has the power, in respect of a person registered under the Insurance Act, to appoint a professional person to prepare a report on any aspect of any matter about which the Bermuda Monetary Authority has required or could require information. If it appears to the Bermuda Monetary Authority to be desirable in the interests of the clients of a person registered under the Insurance Act, the Bermuda Monetary Authority may also exercise the foregoing powers in relation to any company which is, or has at any relevant time been, (1) a parent company, subsidiary company or related company of that registered person, (2) a subsidiary company of a parent company of that registered person, (3) a parent company of a subsidiary company of that registered person or (4) a controlling shareholder of that registered person, which is a person who either alone or with any associate or associates, holds 50% or more of the shares of that registered person or is entitled to exercise, or control the exercise of, more than 50% of the voting power at a general meeting of shareholders of that registered person. If it appears to the Bermuda Monetary Authority that there is a risk of a regulated Bermuda insurance and reinsurance subsidiary becoming insolvent, or that a regulated Bermuda insurance and reinsurance subsidiary is in breach of the Insurance Act or any conditions imposed upon its registration, the Bermuda Monetary Authority may, among other things, direct such subsidiary (1) not to take on any new insurance business, (2) not to vary any insurance contract if the effect would be to increase its liabilities, (3) not to make certain investments, (4) to liquidate certain investments, (5) to maintain in, or transfer to the custody of a specified bank, certain assets, (6) not to declare or pay any dividends or other distributions or to restrict the making of such payments and/or (7) to limit such subsidiary's premium income.

*Disclosure of Information.* In addition to powers under the Insurance Act to investigate the affairs of an insurer, the Bermuda Monetary Authority may require insurers and other persons to furnish information to the Bermuda Monetary Authority. Further, the Bermuda Monetary Authority has been given powers to assist other regulatory authorities, including foreign insurance regulatory authorities, with their investigations involving insurance and reinsurance companies in Bermuda. Such powers are subject to restrictions. For example, the Bermuda Monetary Authority must be satisfied that the assistance being requested is in connection with the discharge of regulatory responsibilities of the foreign regulatory authority. Further, the Bermuda Monetary Authority must consider whether cooperation is in the public interest. The grounds for disclosure are limited and the Insurance Act provides sanctions for breach of the statutory duty of confidentiality. Under the Companies Act, the Minister of Finance has been given powers to assist a foreign regulatory authority that has requested assistance in connection with inquiries being carried out by it in the performance of its regulatory functions. The Minister's powers include requiring a person to furnish him or her with

information, to produce documents to him or her, to attend and answer questions and to give assistance in connection with inquiries. The Minister must be satisfied that the assistance requested by the foreign regulatory authority is for the

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purpose of its regulatory functions and that the request is in relation to information in Bermuda which a person has in his possession or under his control. The Minister must consider, among other things, whether it is in the public interest to give the information sought.

*Certain Other Bermuda Law Considerations.* Although Castlewood is incorporated in Bermuda, it is classified as a non-resident of Bermuda for exchange control purposes by the Bermuda Monetary Authority. Pursuant to its non-resident status, Castlewood may engage in transactions in currencies other than Bermuda dollars and there are no restrictions on its ability to transfer funds (other than funds denominated in Bermuda dollars) in and out of Bermuda or to pay dividends to U.S. residents who are holders of its ordinary shares.

Under Bermuda law, exempted companies are companies formed for the purpose of conducting business outside Bermuda from a principal place of business in Bermuda. As exempted companies, neither Castlewood nor any of its regulated Bermuda subsidiaries may, without the express authorization of the Bermuda legislature or under a license or consent granted by the Minister of Finance, participate in certain business transactions, including: (1) the acquisition or holding of land in Bermuda (except that held by way of lease or tenancy agreement which is required for its business and held for a term not exceeding 50 years, or which is used to provide accommodation or recreational facilities for its officers and employees and held with the consent of the Bermuda Minister of Finance, for a term not exceeding 21 years), (2) the taking of mortgages on land in Bermuda to secure an amount in excess of \$50,000, or (3) the carrying on of business of any kind for which it is not licensed in Bermuda, except in limited circumstances such as doing business with another exempted undertaking in furtherance of its business carried on outside Bermuda. Each of Castlewood's regulated Bermuda subsidiaries is a licensed insurer in Bermuda, and, as such, may carry on activities from Bermuda that are related to and in support of its insurance business.

Ordinary shares may be offered or sold in Bermuda only in compliance with the provisions of the Investment Business Act 2003 of Bermuda, which regulates the sale of securities in Bermuda. In addition, the Bermuda Monetary Authority must approve all issues and transfers of securities of a Bermuda exempted company. Where any equity securities (meaning shares which entitle the holder to vote for or appoint one or more directors or securities which by their terms are convertible into shares which entitle the holder to vote for or appoint one or more directors) of a Bermuda company are listed on an appointed stock exchange (which includes Nasdaq) the Bermuda Monetary Authority has given general permission for the issue and subsequent transfer of any securities of the company from and/or to a non-resident for so long as any such equity securities of the company remain so listed.

The Bermuda government actively encourages foreign investment in exempted entities like Castlewood and its regulated Bermuda subsidiaries that are based in Bermuda, but which do not operate in competition with local businesses. Castlewood and its regulated Bermuda subsidiaries are not currently subject to taxes computed on profits or income or computed on any capital asset, gain or appreciation, or any tax in the nature of estate duty or inheritance tax or to any foreign exchange controls in Bermuda.

Under Bermuda law, non-Bermudians (other than spouses of Bermudians, holders of a permanent resident's certificate or holders of a working resident's certificate) may not engage in any gainful occupation in Bermuda without an appropriate governmental work permit. Work permits may be granted or extended by the Bermuda government upon showing that, after proper public advertisement in most cases, no Bermudian (or spouse of a Bermudian, holder of a permanent resident's certificate or holder of a working resident's certificate) is available who meets the minimum standard requirements for the advertised position. In 2004, the Bermuda government announced a new immigration policy limiting the duration of work permits to six years, with specified exemptions for key employees. The categories of key employees include senior executives (chief executive officers, presidents through vice presidents), managers with global responsibility, senior financial posts (treasurers, chief financial officers through controllers, specialized qualified accountants, quantitative modeling analysts), certain legal professionals (general counsels, specialist attorneys, qualified legal librarians and knowledge managers), senior insurance professionals (senior underwriters,



senior claims adjusters), experienced/specialized brokers, actuaries, specialist investment traders/analysts and senior information technology engineers/managers. All of Castlewood's executive officers who work in its Bermuda office have obtained work permits.

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*United States*

Castlewood has four indirect wholly-owned non-insurance subsidiaries organized under the laws of the State of Delaware. Each of these entities provides services to the insurance industry including the management of insurance portfolios in run-off and forensic claims inspection. Castlewood's United States subsidiaries are not subject to regulation in the United States as insurance companies, and are generally not subject to other insurance regulations.

If Castlewood acquires insurance or reinsurance run-off operations in the United States, those subsidiaries operating in the United States would be subject to extensive regulation.

*United Kingdom*

*General.* On December 1, 2001, the U.K. Financial Services Authority, or the FSA, assumed its full powers and responsibilities as the single statutory regulator responsible for regulating the financial services industry in respect of the carrying on of regulated activities (including deposit taking, insurance, investment management and most other financial services business by way of business in the U.K.), with the purpose of maintaining confidence in the U.K. financial system, providing public understanding of the system, securing the proper degree of protection for consumers and helping to reduce financial crime. It is a criminal offense for any person to carry on a regulated activity in the U.K. unless that person is authorized by the FSA and has been granted permission to carry on that regulated activity or falls under an exemption.

Insurance business (which includes reinsurance business) is authorized and supervised by the FSA. Insurance business in the United Kingdom is divided between two main categories: long-term insurance (which is primarily investment-related) and general insurance. It is not possible for an insurance company to be authorized in both long-term and general insurance business. These two categories are both divided into classes (for example: permanent health and pension fund management are two classes of long-term insurance; damage to property and motor vehicle liability are two classes of general insurance). Under the Financial, Services and Markets Act 2000, or the FSMA, effecting or carrying out contracts of insurance, within a class of general or long-term insurance, by way of business in the United Kingdom, constitutes a regulated activity requiring individual authorization. An authorized insurance company must have permission for each class of insurance business it intends to write.

Certain of Castlewood's regulated U.K. subsidiaries, as authorized insurers, would be able to operate throughout the E.U., subject to certain regulatory requirements of the FSA and in some cases, certain local regulatory requirements. An insurance company with FSA authorization to write insurance business in the United Kingdom can seek consent from the FSA to allow it to provide cross-border services in other member states of the E.U. As an alternative, FSA consent may be obtained to establish a branch office within another member state. Although in run-off, Castlewood's regulated U.K. subsidiaries remain regulated by the FSA, but may not underwrite new business.

As FSA authorized insurers, the insurance and reinsurance businesses of Castlewood's regulated U.K. subsidiaries are subject to close supervision by the FSA. The FSA has implemented specific requirements for senior management arrangements, systems and controls of insurance and reinsurance companies under its jurisdiction, which place a strong emphasis on risk identification and management in relation to the prudential regulation of insurance and reinsurance business in the United Kingdom.

*Supervision.* The FSA carries out the prudential supervision of insurance companies through a variety of methods, including the collection of information from statistical returns, review of accountants' reports, visits to insurance companies and regular formal interviews.

The FSA has adopted a risk-based approach to the supervision of insurance companies. Under this approach the FSA performs a formal risk assessment of insurance companies or groups carrying on business in the U.K. periodically. The periods between U.K. assessments vary in length according to the risk profile of the insurer. The FSA performs the risk assessment by analyzing information which it receives during the normal course of its supervision, such as regular prudential returns on the financial position of the insurance company, or which it acquires through a series of meetings with senior management of the insurance company. After each risk

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assessment, the FSA will inform the insurer of its views on the insurer's risk profile. This will include details of any remedial action that the FSA requires and the likely consequences if this action is not taken.

*Solvency Requirements.* The Integrated Prudential Sourcebook requires that insurance companies maintain a required solvency margin at all times in respect of any general insurance undertaken by the insurance company. The calculation of the required margin in any particular case depends on the type and amount of insurance business a company writes. The method of calculation of the required solvency margin is set out in the Integrated Prudential Sourcebook, and for these purposes, all insurer's assets and liabilities are subject to specific valuation rules which are set out in the Integrated Prudential Sourcebook. Failure to maintain the required solvency margin is one of the grounds on which wide powers of intervention conferred upon the FSA may be exercised. For fiscal years ending on or after January 1, 2004, the calculation of the required solvency margin has been amended as a result of the implementation of the EU Solvency I Directives. In respect of liability business accepted, 150% of the actual premiums written and claims incurred must be included in the calculation, which has had the effect of increasing the required solvency margin of Castlewood's regulated U.K. subsidiaries. Castlewood continuously monitors the solvency capital position of the U.K. subsidiaries and maintains capital in excess of the required solvency margin.

Each insurance company writing various classes of business is required by the Integrated Prudential Sourcebook to maintain equalization provisions calculated in accordance with the provisions of the Integrated Prudential Sourcebook.

Insurers are required to calculate an Enhanced Capital Requirement, or ECR, in addition to their required solvency margin. This represents a more risk-sensitive calculation than the previous required solvency margin requirements and is used by the FSA as its benchmark in assessing its Individual Capital Adequacy Standards. Insurers must maintain financial resources which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they come due. In order to carry out the assessment as to the necessary financial resources that are required, insurers are required to identify the major sources of risk to its ability to meet its liabilities as they come due, and to carry out stress and scenario tests to identify an appropriate range of realistic adverse scenarios in which the risk crystallizes and to estimate the financial resources needed in each of the circumstances and events identified. In addition, the FSA gives Individual Capital Guidance, or ICG, regularly to insurers and reinsurers following receipt of individual capital assessments, prepared by firms themselves. The FSA's guidance may be that a company should hold more or less than its then current level of regulatory capital, or that the company's regulatory capital should remain unaltered. Castlewood calculated the ECR for its regulated U.K. subsidiaries for the period ended December 31, 2005 and submitted those calculations in April 2006 to the FSA as part of their statutory filings. In all instances, Castlewood's U.K. subsidiaries had capital in excess of their ECR requirements.

In addition, an insurer (other than a pure reinsurer) that is part of a group is required to perform and submit to the FSA a solvency margin calculation return in respect of its ultimate parent undertaking, in accordance with the FSA's rules. This return is not part of an insurer's own solvency return and hence will not be publicly available. Although there is no requirement for the parent undertaking solvency calculation to show a positive result, the FSA may take action where it considers that the solvency of the insurance company is or may be jeopardized due to the group solvency position. Further, an insurer is required to report in its annual returns to the FSA all material related party transactions (e.g., intra group reinsurance, whose value is more than 5% of the insurer's general insurance business amount).

*Restrictions on Dividend Payments.* U.K. company law prohibits Castlewood's regulated U.K. subsidiaries from declaring a dividend to their shareholders unless they have profits available for distribution. The determination of whether a company has profits available for distribution is based on its accumulated realized profits less its accumulated realized losses. While the United Kingdom insurance regulatory laws impose no statutory restrictions on a general insurer's ability to declare a dividend, the FSA strictly controls the maintenance of each insurance company's required solvency margin within its jurisdiction. The FSA's rules require Castlewood's regulated U.K. subsidiaries to

obtain FSA approval for any proposed or actual payment of a dividend.

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*Reporting Requirements.* U.K. insurance companies must prepare their financial statements under the Companies Act of 1985 (as amended), which requires the filing with Companies House of audited financial statements and related reports. In addition, U.K. insurance companies are required to file with the FSA regulatory returns, which include a revenue account, a profit and loss account and a balance sheet in prescribed forms. Under the Interim Prudential Sourcebook for Insurers, audited regulatory returns must be filed with the FSA within two months and 15 days (or three months where the delivery of the return is made electronically). Castlewood's regulated U.K. insurance subsidiaries are also required to submit abridged quarterly information to the FSA.

*Supervision of Management.* The FSA closely supervises the management of insurance companies through the approved persons regime, by which any appointment of persons to perform certain specified controlled functions within a regulated entity, must be approved by the FSA.

*Change of Control.* FSMA regulates the acquisition of control of any U.K. insurance company authorized under FSMA. Any company or individual that (together with its or his associates) directly or indirectly acquires 10% or more of the shares in a U.K. authorized insurance company or its parent company, or is entitled to exercise or control the exercise of 10% or more of the voting power in such authorized insurance company or its parent company, would be considered to have acquired control for the purposes of the relevant legislation, as would a person who had significant influence over the management of such authorized insurance company or its parent company by virtue of his shareholding or voting power in either. A purchaser of 10% or more of Castlewood's ordinary shares would therefore be considered to have acquired control of Castlewood's regulated U.K. subsidiaries.

Under FSMA, any person proposing to acquire control over a U.K. authorized insurance company must give prior notification to the FSA of his intention to do so. The FSA would then have three months to consider that person's application to acquire control. In considering whether to approve such application, the FSA must be satisfied that both the acquirer is a fit and proper person to have such control and that the interests of consumers would not be threatened by such acquisition of control. Failure to make the relevant prior application could result in action being taken against Castlewood by the FSA.

*Intervention and Enforcement.* The FSA has extensive powers to intervene in the affairs of an authorized person, culminating in the ultimate sanction of the removal of authorization to carry on a regulated activity. FSMA imposes on the FSA statutory obligations to monitor compliance with the requirements imposed by FSMA, and to enforce the provisions of FSMA-related rules made by the FSA. The FSA has power, among other things, to enforce and take disciplinary measures in respect of breaches of both the Interim Prudential Sourcebook for Insurers and breaches of the conduct of business rules generally applicable to authorized persons.

The FSA also has the power to prosecute criminal offenses arising under FSMA, and to prosecute insider dealing under Part V of the Criminal Justice Act of 1993, and breaches of money laundering regulations. The FSA's stated policy is to pursue criminal prosecution in all appropriate cases.

*Passporting.* European Union directives allow Castlewood's regulated U.K. subsidiaries to conduct business in European Union states other than the United Kingdom in compliance with the scope of permission granted these companies by the FSA without the necessity of additional licensing or authorization in other European Union jurisdictions. This ability to operate in other jurisdictions of the European Union on the basis of home state authorization and supervision is sometimes referred to as passporting. Insurers may operate outside their home member state either on a services basis or on an establishment basis. Operating on a services basis means that the company conducts permitted businesses in the host state without having a physical presence there, while operating on an establishment basis means the company has a branch or physical presence in the host state. In both cases, a company remains subject to regulation by its home regulator, and not by local regulatory authorities, although the company nonetheless may have to comply with certain local rules. In addition to European Union member states,

Norway, Iceland and Liechtenstein (members of the broader European Economic Area) are jurisdictions in which this passporting framework applies.

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### *Belgium and Austria*

Castlewood indirectly owns, through B.H. Acquisition, Paget Holdings Limited, or Paget, an Austrian holding company, which owns Compagnie Européenne d Assurances Industrielles S.A., or CEAI, a registered reinsurer domiciled in Belgium. CEAI currently is in run-off and does not write new business. The insurance operations of CEAI are subject to Belgian insurance laws. CEAI is required to comply with the terms of its registration and any other conditions the banking, finance and insurance commission may impose from time to time. Under the applicable insurance laws and regulations, the banking, finance and insurance commission must be informed about and approve the management structure, the directors, and current management. The banking, finance and insurance commission also regulates solvency and certain operations and activities of Belgian insurers.

Paget is generally subject to the laws of Austria. Because the principal activity of Paget is owning CEAI, Paget is not required to be licensed by Austrian authorities.

### *Switzerland and Luxembourg*

Castlewood indirectly owns Harper Holding SARL, or Harper Holding, a Luxembourg holding company, which owns Harper Insurance Limited, or Harper Insurance, a reinsurer domiciled in Switzerland. Because the activities of Harper Insurance are limited to reinsurance run-off, it is not required to be licensed by Swiss authorities.

Harper Holding is a private limited liability company, incorporated under the laws of the Grand-Duchy of Luxembourg, generally subject to the laws of Luxembourg. Because the principal activity of Harper Holding is owning Harper Insurance, Harper Holding is not required to be licensed by Luxembourg authorities.

### *Barbados*

Castlewood indirectly owns Denman Holdings Limited, or Denman, a Barbados holding company. Denman is generally subject to the laws of Barbados. Because Denman is dormant and does not own any insurance or reinsurance companies, it is not subject to Barbados laws that regulate insurance companies.

### ***Competition***

Castlewood competes in international markets with domestic and international reinsurance companies to acquire and manage reinsurance companies in run-off. The acquisition and management of reinsurance companies in run-off is highly competitive. Some of these competitors have greater financial resources than Castlewood, have been operating for longer than Castlewood and have established long-term and continuing business relationships throughout the reinsurance industry, which can be a significant competitive advantage. As such, Castlewood may not be able to compete successfully in the future for suitable acquisition candidates or run-off portfolio management engagements.

### ***Employees***

As of September 30, 2006, Castlewood had approximately 189 employees, 4 of whom were executive officers. All non-Bermudian employees who operate out of Castlewood's Bermuda office are subject to approval of any required work permits. None of Castlewood's employees are covered by collective bargaining agreements, and its management believes that its relationship with its employees is excellent.



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Castlewood leases office space in the locations set forth below. Castlewood believes that this office space is sufficient for the conduct of its business.

| <b>Entity</b>                  | <b>Location</b>    | <b>Square Feet</b> | <b>Lease Expiration</b> |
|--------------------------------|--------------------|--------------------|-------------------------|
| Castlewood Limited             | Hamilton, Bermuda  | 8,250              | August 7, 2009          |
| Castlewood (EU) Limited        | Guildford, England | 11,498             | March 31, 2007          |
| River Thames Insurance Company | London, England    | 6,329              | March 24, 2015          |
| Castlewood Limited             | Dublin, Ireland    | 670                | January 1, 2007         |
| Castlewood (US) Inc.           | Tampa, FL          | 8,859              | October 31, 2008        |
| Castlewood (US) Inc.           | New York, NY       | 378                | October 30, 2014        |

Castlewood owns two apartments in Guildford, England. Castlewood (US) Inc. owns one apartment in New York, NY. Each of these apartments are for use by Castlewood employees while visiting these locations for business purposes.

***Litigation***

Castlewood is, from time to time, involved in various legal proceedings in the ordinary course of business, including litigation regarding claims. Castlewood does not believe that the resolution of any currently pending legal proceedings, either individually or taken as a whole, will have a material adverse effect on its business, results of operations or financial condition. Nevertheless, Castlewood cannot assure you that lawsuits, arbitrations or other litigation will not have a material adverse effect on its business, financial condition or results of operations. Castlewood anticipates that, similar to the rest of the insurance and reinsurance industry, it will continue to be subject to litigation and arbitration proceedings in the ordinary course of business, including litigation generally related to the scope of coverage with respect to A&E claims. There can be no assurance that any such future litigation will not have a material adverse effect on Castlewood's business, financial condition or results of operations.

***Directors of Castlewood***

The names and ages of the current directors of Castlewood are set forth below.

| <b>Name</b>            | <b>Age</b> |
|------------------------|------------|
| Dominic F. Silvester   | 46         |
| Paul J. O' Shea        | 49         |
| John J. Oros           | 59         |
| Nimrod T. Frazer       | 77         |
| J. Christopher Flowers | 49         |
| Cheryl D. Davis        | 47         |
| James D. Carey         | 40         |
| Meryl D. Hartzband     | 52         |

The backgrounds of Dominic F. Silvester, Paul J. O' Shea, John J. Oros and J. Christopher Flowers are described in Management of New Enstar Following the Merger and Other Information Directors and Executive Officers of New

Enstar, beginning on page 177. The backgrounds of Nimrod T. Frazer and Cheryl D. Davis are described in Information About Enstar, beginning on page 158.

James D. Carey is a Principal of Stone Point Capital LLC. Prior to the formation of Stone Point Capital LLC in 2005, Mr. Carey was a Principal of MMC Capital. Before joining MMC Capital in 1997, Mr. Carey was an Associate in the Financial Institutions Group at Merrill Lynch & Co. Mr. Carey is also a director of The ARC Group LLC, Mercator Risk Services, Inc., Paris Re Holdings Limited, Privilege Underwriters, Inc. and Signal Holdings LLC.

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Meryl D. Hartzband is the Chief Investment Officer of Stone Point Capital LLC. Prior to the formation of Stone Point Capital LLC in 2005, Ms. Hartzband was the Investment Director of MMC Capital. Before joining MMC Capital in 1999, Ms. Hartzband was a Managing Director at J.P. Morgan & Co. for 16 years. Ms. Hartzband is also a director of CWI Holdings, Inc. (CompWest), Harbor Point Limited, Wilton Re Holdings Limited and ZC Sterling Corporation.

**Executive Compensation Castlewood Executive Officers**

The following sets forth summary information concerning the compensation paid by Castlewood to Messrs. Silvester, O Shea, Packer and Harris during the last three fiscal years.

*Management Compensation Summary*

| Name  | Year | Annual Compensation |            |                              | Long-Term Compensation Awards Securities |                          |                           |
|---|------|---------------------|------------|------------------------------|--|--------------------------|---------------------------|
|   |      | Salary              | Bonus      | Other Annual Compensation(1) | Restricted Stock Units                   | Underlying Stock Options | All Other Compensation(2) |
| Dominic F. Silvester,<br>President and Chief<br>Executive Officer | 2005 | \$ 549,174          |            |                              | \$                                       | \$                       | \$ 38,438                 |
|   | 2004 | 522,123             |            |                              |  |                          | 37,332                    |
|   | 2003 | 449,625             |            |                              |  |                          | 32,373                    |
| Paul J. O Shea,<br>Executive Vice<br>President                    | 2005 | 384,040             | \$ 631,291 | \$ 90,000                    |  |                          | 38,404                    |
|   | 2004 | 363,125             | 750,000    | 72,000                       |  |                          | 36,313                    |
|   | 2003 | 350,000             | 1,500,000  | 72,000                       |  |                          | 35,000                    |
| Nicholas A. Packer,<br>Executive<br>Vice-President                | 2005 | 429,354             |            |                              |  |                          | 38,438                    |
|   | 2004 | 408,205             |            |                              |  |                          | 37,332                    |
|   | 2003 | 351,525             | 315,646    |                              |  |                          | 32,373                    |
| Richard J. Harris,<br>Chief Financial<br>Officer                  | 2005 | 363,125             | 500,000    | 50,000                       |  |                          | 36,313                    |
|   | 2004 | 350,000             | 200,000    | 37,500                       | 491,390(3)                               |                          | 35,000                    |
|   | 2003 | 204,167             |            |                              |  |                          | 11,667                    |

(1) Housing allowances.

(2) Contributions to retirement savings plan.

(3) Represents the dollar value of restricted shares based on the book value of such shares at the time of issuance of \$5,049 per share. The shares vest in five equal annual installments beginning April 7, 2005, contingent on continued employment on these dates.

*Equity Compensation Plan Information*

Castlewood currently has in place a discretionary bonus plan whereby 15% of its after-tax income is available to be paid to its employees. In addition, Castlewood has an employee share incentive plan whereby up to 7.5% of the outstanding ordinary shares of Castlewood can be awarded to employees. These plans will be terminated upon

completion of the merger and will be replaced by the plans described below.

***Equity Incentive Plan***

On September 15, 2006, Castlewood's board of directors and shareholders adopted the Castlewood Holdings Limited 2006 Equity Incentive Plan, or the Equity Incentive Plan. No incentive awards have been awarded under the Equity Incentive Plan, and 1,200,000 ordinary shares were reserved for future awards under the Equity Incentive Plan. Castlewood does not intend to make any award grants under the Equity Incentive Plan prior to the consummation of the merger. The following description is qualified in its entirety by the form of the Equity Incentive Plan filed as an exhibit to the registration statement of which this proxy statement/prospectus is a part.

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### *Purpose of the Equity Incentive Plan*

The Equity Incentive Plan is intended to provide a means whereby Castlewood may, through the grant of awards to employees, consultants and non-employee directors, attract and retain such individuals and motivate them to exercise their best efforts on behalf of Castlewood and its related companies.

### *Administration of the Equity Incentive Plan*

The Equity Incentive Plan will be administered by a Compensation Committee appointed by Castlewood's board of directors, or the Plan Committee. Castlewood's board of directors intends that the Plan Committee will be composed of directors who qualify as non-employee directors within the meaning of Rule 16b-3 under the Exchange Act, as outside directors within the meaning of Section 162(m) of the Code and as independent directors within the meaning of Nasdaq Marketplace Rule 4200(a)(15). The Plan Committee has the power in its discretion to grant awards under the Equity Incentive Plan, to determine the terms of awards, to interpret the provisions of the Equity Incentive Plan and to take action as it deems necessary or advisable for the administration of the Equity Incentive Plan.

### *Number of Authorized Shares*

The Equity Incentive Plan provides for awards with respect to a maximum of 1,200,000 ordinary shares. The number and class of shares available under the Equity Incentive Plan and/or subject to outstanding awards shall be adjusted, as deemed appropriate, by the Plan Committee to prevent dilution or enlargement of rights in the event of various changes in our capitalization. Ordinary shares attributable to cancelled, forfeited or terminated awards under the Equity Incentive Plan will again be available for grant under the Equity Incentive Plan.

### *Eligibility and Participation*

Eligibility to participate in the Equity Incentive Plan is limited to the employees, consultants and non-employee directors of Castlewood and any subsidiary of Castlewood (each, a participant).

### *Type of Awards under the Equity Incentive Plan*

The Equity Incentive Plan provides that awards may be granted to participants in any of the following forms, subject to such terms, conditions and provisions as the Plan Committee may provide: (i) incentive stock options, or ISOs, (ii) nonstatutory stock options, or NSOs, (iii) stock appreciation rights, or SARs, (iv) Restricted Share Awards, (v) Restricted Share Units, or RSUs, (vi) Bonus Shares and (vii) Dividend Equivalents.

The aggregate number of ordinary shares subject to each of the following types of awards granted to an employee during any calendar year under the plan is 120,000 shares: options, SARs, restricted shares awards and RSUs with performance-based vesting criteria, and Bonus Shares.

### *Grant of Options and SARs*

The Plan Committee may award ISOs and/or NSOs, or, collectively, Options, and SARs to participants.

*Exercise Price.* The exercise price with respect to an Option is determined by the Plan Committee at the time of grant. At the time of grant of a SAR, the Plan Committee will specify the base price of the ordinary shares to be issued for determining the amount of cash, number of ordinary shares or combination thereof to be distributed upon the exercise of such SAR. In no event will the exercise price or base price be less than the fair market value of an ordinary share on the date of grant.

*Vesting.* Unless otherwise determined at the time of grant by the Plan Committee, Options and SARs shall vest and become exercisable in three equal annual installments on the first, second and third anniversaries of the grant date.

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*Special Limitations on ISOs.* ISOs may only be granted to employees and may not be exercisable more than ten years after the grant date. No ISO may be granted to a participant who owns, at the time of the grant, shares representing more than 10% of the total combined voting power of all classes of our shares, or a 10% Shareholder, unless the per share exercise price per ordinary share subject to such ISO is at least 110% of the fair market value of a ordinary share on the date of grant and such ISO award is not exercisable more than five years after its date of grant. In addition, the total fair market value of ordinary shares subject to ISOs which are exercisable for the first time by an eligible participant in a given calendar year shall not exceed \$100,000, valued as of the date of the ISOs grant. ISOs may not be granted more than ten years after the date of adoption of the Equity Incentive Plan by our shareholders.

*Exercise of Options and SARs.* An Option may be exercised by written notice stating the number of ordinary shares with respect to which the Option is being exercised and tendering payment therefor. The Plan Committee may, at its discretion, accept previously owned or newly acquired (upon exercise) ordinary shares as payment (valued at their fair market value on the date of exercise) or through a broker assisted exercise.

SARs are exercisable only to the extent and only for the period determined by the Plan Committee. Upon the exercise of a SAR, the participant will be entitled to receive cash, ordinary shares or a combination thereof, with a value equal to (A) the excess of (i) the fair market value of one ordinary share as of the date the SAR is exercised over (ii) the specified base price, multiplied by (B) the number of ordinary shares subject to the portion of the SAR being exercised.

*Expiration of Options.* Options will expire at such time as the Plan Committee determines; provided, however, that no Option may be exercised more than ten years from the date of grant, provided that an ISO which is held by a 10% Shareholder may not be exercised more than five years from the date of grant.

*Termination of Service.* Unless otherwise determined by the Plan Committee at the time of grant and sets forth in the award agreement, if a participant terminates his or her service with Castlewood:

for cause (as defined in the Equity Incentive Plan), the participant will forfeit any unexercised options and SARs at the time of such termination and the Plan Committee may require that the participant to disgorge any profit, gain or other benefit received in respect of the exercise of any options and SARs for a period of up to twelve months prior to the termination of service;

by reason of approved retirement (as defined in the Equity Incentive Plan), the participant may exercise his or her vested options and SARs at any time prior to the earlier of (i) the expiration date specified for the award, or (ii) one year after the date of termination of service;

for any reason other than for cause, approved retirement, death or disability, the participant may exercise his or her vested options and SARs at any time prior to the earlier of (i) the expiration date specified for the award, or (ii) three months after the date of termination of service;

because the participant becomes disabled, the participant may exercise his or her vested options and SARs at any time prior to the earlier of (i) the expiration date specified for the award, or (ii) one year after the date of termination of service; and

as a result of death, or if the participant dies following his or her termination of service but prior to the expiration of the periods described above, the participant's estate, personal representative, or beneficiary may exercise the participant's vested options and SARs at any time prior to the earlier of (i) the expiration date specified for the award, or (ii) one year after the date of the participant's death.

*Restricted Share Awards*

The Plan Committee may, in its sole discretion, make Restricted Share Awards by granting or selling ordinary shares under the Equity Incentive Plan. Each Restricted Share Award agreement shall set forth the applicable dates and/or events (including performance-based events) on which all or any portion of the Restricted Share Awards shall be vested and non-forfeitable. Holders of Restricted Share Awards shall have voting and dividend rights with respect to such shares (prior to them becoming non-forfeitable). Unless



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otherwise determined by the Plan Committee, Restricted Share Awards shall become non-forfeitable on the third anniversary of the date of grant.

Unless the Plan Committee otherwise determines at the date of grant and sets forth in the award agreement, if a participant terminates his or her service with Castlewood:

by reason of death or disability, the restrictions applicable to the participants Restricted Share Awards will lapse;

for cause, any unvested Restricted Share Awards granted to the participant will be forfeited at the time of such termination, and the Plan Committee may require that the participant disgorge any profit, gain or other benefit received in respect of the lapse of restrictions on any prior grant of Restricted Share Award for a period of up to twelve months prior to the termination of service; and

for any other reason during the applicable vesting period, any unvested Restricted Share Award granted to the participant will be forfeited at the time of such termination.

*RSUs*

The Plan Committee may award RSUs to participants, each representing one notional ordinary share. RSUs so awarded will be credited to an account established and maintained for the participant. Each RSU agreement shall set forth the applicable dates and/or events (including performance-based events) on or after which all or any portion of the RSU award may be vested and settled. Unless otherwise determined by the Plan Committee, RSUs shall vest on the third anniversary of the date of grant.

RSUs will be settled in ordinary shares, in cash equal to the value of the ordinary shares that would otherwise be distributed in settlement of such units, or a combination thereof. The Plan Committee may also grant Dividend Equivalents in tandem with RSUs, which, unless the Plan Committee decides otherwise, shall have (to the extent applicable) the same terms and conditions as the related RSUs.

Unless the Plan Committee otherwise determines at the date of grant and sets forth in the award agreement, if a participant terminates his or her service with Castlewood:

by reason of death or disability, the restrictions applicable to the participants RSUs will lapse;

for cause, any RSUs granted to the participant will be forfeited at the time of such termination, and the Plan Committee may require that the participant disgorge any profit, gain or other benefit received in respect of the lapse of restrictions on any prior grant of RSUs for a period of up to twelve months prior to the termination of service; and

for any other reason during the applicable vesting period, any RSUs granted to the participant will be forfeited at the time of such termination.

*Bonus Shares*

The Plan Committee may grant ordinary shares that are fully vested on the date of grant.

*Dividend Equivalents*

The Plan Committee may grant a Dividend Equivalent award (that is not in tandem with any other award). Unless the Plan Committee determines otherwise, such Dividend Equivalents shall accumulate, vest and be paid on the third anniversary of the grant date, and shall thereafter continue to be paid (until the participant's termination of service or, if earlier, the expiration date of the award) on the same date as corresponding cash dividends are paid to shareholders.

*Nontransferability of Awards*

Awards may not be transferred, assigned, pledged or hypothecated except in compliance with the Equity Incentive Plan and the agreement in which a stock-based award is made.

*Term of Equity Incentive Plan*

Unless earlier terminated by our board of directors, the Equity Incentive Plan will terminate on September 15, 2016.

**Table of Contents***Change in Control*

Unless determined otherwise by the Plan Committee, in the event of a change in control each option and SAR then outstanding will become fully vested, and the restrictions will lapse as to each Restricted Share Award and each RSU then outstanding. In connection with a change in control, the Plan Committee may, in its sole discretion, provide that each option, SAR, Restricted Share Award and/or RSU be cancelled in exchange for a payment per share/unit in an amount based on the highest price per share paid in connection with the change in control or, in the case of a change in control occurring because of a change in the composition of the board of directors, the highest fair market value of the shares on any of the 30 trading days immediately before the change in control. In addition, unless determined otherwise by the Plan Committee, in the event of a change in control, any outstanding Restricted Share Award and RSU with performance based vesting criteria relating to performance periods ending before the change in control which have been earned but not paid will become immediately payable, all then-in-progress performance periods will end, and all participants will be deemed to have earned an award equal to the participant's target award opportunity for the period, and Castlewood may, in its discretion, pay all such awards either in common shares and/or in cash or other property on the 30th day following the change in control, based on the change in control price.

For purposes of the Equity Incentive Plan, a change in control means the first to occur of any of the following events: (i) the acquisition by any person, entity or group required to file a Schedule 13D or Schedule 14D-1 under the Exchange Act (excluding, for this purpose, Castlewood, its subsidiaries, any employee benefit plan of Castlewood or its subsidiaries which acquires ownership of voting securities of Castlewood) of beneficial ownership (within the meaning of Rule 13d-3 under the Exchange Act) of 50% or more of either the then outstanding ordinary shares or the combined voting power of Castlewood's then outstanding voting securities entitled to vote generally in the election of directors; (ii) the election or appointment to the board of directors, or resignation of or removal from the board of directors with the result that the individuals, who as of the date the Equity Incentive Plan was adopted constituted the board, or the Incumbent Board, no longer constitute at least a majority of the board, provided that any person who becomes a director subsequent to the date the Equity Incentive Plan was adopted, whose appointment, election, or nomination for election by Castlewood's shareholders, was approved by a vote of at least a majority of the Incumbent Board (other than an appointment, election or nomination of an individual whose initial assumption of office is in connection with an actual or threatened election contest relating to the election of the directors of Castlewood) will be considered as though such person were a member of the Incumbent Board; or (iii) approval by the shareholders of Castlewood of: (i) a reorganization, merger or consolidation by reason of which persons who were the shareholders of Castlewood immediately prior to such reorganization, merger or consolidation do not, immediately thereafter, own more than 50% of the combined voting power of the reorganized, merged or consolidated company's then outstanding voting securities entitled to vote generally in the election of directors, or (ii) a liquidation or dissolution of Castlewood or the sale, transfer, lease or other disposition of all or substantially all of the assets of Castlewood (whether such assets are held directly or indirectly); and such transaction is consummated.

*Performance Based Compensation*

The Plan Committee may require that Restricted Share Awards and/or RSUs must qualify as other performance based compensation within the meaning of Section 162(m)(4)(c) of the Code. If so required, the Plan Committee will (i) specify and approve the specific terms of any performance goals with respect to such awards in writing no later than 90 days from the commencement of the performance period to which the performance goals relate, and (ii) not be entitled to exercise any subsequent discretion otherwise authorized under the plan (such as the right to authorize payout at a level above that dictated by the achievement of the relevant performance goals) with respect to such award if the ability to exercise discretion (as opposed to the exercise of such discretion) would cause such award to fail to qualify as other performance based compensation. With respect to Restricted Share Awards and RSUs intended to qualify as other performance based compensation, the restricted period will lapse at the end of the applicable period to the extent the applicable performance goals established by the Plan Committee for such awards have been achieved, as

certified by the Plan Committee prior to vesting of the award.

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In creating the applicable performance goals, the Plan Committee will use one or more of the following business criteria: revenues, profit, consolidated net after-tax profit, income from operations, return on assets, return on net assets, return on equity, return on capital, market price appreciation of Castlewood's ordinary shares, economic value added, total shareholder return, net income, pre-tax income, earnings per share, operating profit margin, net income margin, cash flow, market share, revenue growth, net revenue growth, net income growth, expense control and hiring of personnel. The business criteria may apply to the individual, a division, or to Castlewood and/or one or more of its subsidiaries and may be weighted and expressed in absolute terms or relative to the performance of other individuals or companies or an index.

### *Amendment and Termination*

Our board of directors may suspend, amend, modify or terminate the Equity Incentive Plan, provided, however, that any amendment that increases the maximum number of ordinary shares available for issuance with respect to ISOs under the Equity Incentive Plan in the aggregate, modifies the material terms of a performance goal, or which materially changes the class of persons who are eligible for the grant of ISOs or for which shareholder approval is required under the rules of the exchange or market on which Castlewood's ordinary shares are listed or traded shall be subject to the approval of the holders of a majority of the ordinary shares.

Except as our board of directors may deem necessary or desirable in order to comply with any applicable law, approval of the holders of the ordinary shares shall not be required for any other amendment of the Equity Incentive Plan.

Awards granted prior to a termination of the Equity Incentive Plan shall continue in accordance with their terms following such termination. No amendment, suspension or termination of the Equity Incentive Plan shall adversely affect the rights of a participant in awards previously granted without such participant's consent.

### *Federal Income Tax Consequences*

The following is a brief description of the principal federal income tax consequences relating to options awarded under the Equity Incentive Plan. This summary is based on Castlewood's understanding of present federal income tax law and regulations. The summary does not purport to be complete or applicable to every specific situation.

#### *Consequences to Castlewood*

There are no federal income tax consequences to Castlewood by reason of the grant of RSUs, SARs, options or the exercise of an ISO (other than disqualifying dispositions). At the time the participant recognizes ordinary income from the settlement of an RSU or the exercise of a NQSO or SAR, Castlewood will be entitled to a federal income tax deduction in the amount of the ordinary income recognized by the participant, provided that Castlewood satisfies its reporting obligations described below. To the extent the optionholder recognizes ordinary income by reason of a disqualifying disposition of the stock acquired upon exercise of an ISO, Castlewood will be entitled to a corresponding deduction in the year in which the disposition occurs. With respect to Restricted Share Awards, Castlewood will be entitled to a federal income tax deduction in the amount of the ordinary income recognized upon the earlier of the lapse of restrictions applicable to Restricted Share Award or the date of grant if an 83(b) election (described below) is timely filed, provided that Castlewood satisfies its reporting obligations described below.

Castlewood will be required to report to the Internal Revenue Service any ordinary income recognized by any participant. Castlewood will also be required to withhold income and employment taxes (and pay the employer's share of employment taxes) with respect to ordinary income recognized by the participant.

*Stock Options.* There will be no federal income tax consequences to the participant or Castlewood upon the grant of either an ISO or an NSO under the Equity Incentive Plan. Upon exercise of an NSO, a participant generally will recognize ordinary income in an amount equal to (i) the fair market value, on the date of

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exercise, of the acquired ordinary shares less (ii) the exercise price of the NSO. Subject to Section 162(m) of the Code, Castlewood generally will be entitled to a tax deduction in the same amount.

Upon the exercise of an ISO, a participant recognizes no immediate taxable income. Income recognition is generally deferred until the participant sells the ordinary shares. If the ISO is exercised no later than three months after the termination of the participant's employment, and the participant does not dispose of the ordinary shares acquired pursuant to the exercise of the ISO within two years from the date the ISO was granted and within one year after the exercise of the ISO, the gain on the sale will be treated as long-term capital gain. Certain of these holding periods and employment requirements are liberalized in the event of a participant's death or disability while employed by Castlewood. Castlewood is not entitled to any tax deduction with respect to the exercise of ISOs, except that if the ordinary shares are not held for the full term of the holding periods outlined above, the gain on the sale of such ordinary shares, being the lesser of: (i) the fair market value of the ordinary shares on the date of exercise minus the exercise price or (ii) the amount realized on the sale minus the exercise price, will be taxed to the participant as ordinary income and, subject to Section 162(m) of the Code, Castlewood generally will be entitled to a deduction in the same amount. The excess of the fair market value of the ordinary shares acquired upon exercise of an ISO over the exercise price constitutes a tax preference item for purposes of computing the alternative minimum tax under the Code.

*Stock Appreciation Rights.* There will be no federal income tax consequences to either the participant or Castlewood upon the grant of a SAR. However, the participant generally will recognize ordinary income upon the exercise of a SAR in an amount equal to the aggregate amount of cash and the fair market value of the ordinary shares received upon exercise. Subject to Section 162(m) of the Code, Castlewood generally will be entitled to a deduction equal to the amount includible in the participant's income.

*Restricted Share Awards.* Assuming the participant does not make an election under Section 83(b) of the Code (which election is discussed below), there will be no federal income tax consequences to either the participant or Castlewood upon the grant of restricted Share Awards until the shares become non-forfeitable. At that time, the participant generally will recognize taxable income equal to the then fair market value of the ordinary shares and, subject to Section 162(m) of the Code, Castlewood generally will be entitled to a corresponding deduction. However, under Section 83(b) of the Code, the participant may elect, within thirty days after the date of the grant, to recognize ordinary income as of the date of grant and Castlewood will be entitled to a corresponding deduction at that time.

*RSUs.* There will be no federal income tax consequences to the participant or Castlewood upon the grant of RSUs. Participants generally will recognize taxable income at the time when payment for the RSUs is received in an amount equal to the aggregate amount of cash and the fair market value of ordinary shares acquired. Subject to Section 162(m) of the Code, Castlewood generally will be entitled to a deduction equal to the amount includible in the participant's income.

*Bonus Shares.* Participants will generally recognize taxable income at the time Bonus Shares are awarded, in an amount equal to the aggregate fair market value of the ordinary shares on the date of grant. Castlewood, generally, will be entitled to a deduction in the same amount.

*Dividend Equivalents.* Participants will generally recognize taxable income at the time Dividend Equivalents are paid in an amount equal to the aggregate amount of cash and fair market value of ordinary shares acquired, and Castlewood, generally will be entitled to a deductible in the same amount.

*409A.* The Equity Incentive Plan is intended to be administered in a manner consistent with the requirements, where applicable, of Section 409A of the Code. Where reasonably possible and practicable, the plan will be administered in a manner to avoid the imposition on participants of immediate tax recognition and additional taxes pursuant to such

Section 409A.

***Annual Incentive Compensation Plan***

On September 15, 2006, Castlewood's board of directors and shareholders adopted the Castlewood Holdings Limited 2006-2010 Annual Incentive Compensation Plan, or the Annual Incentive Plan. No awards have been granted under the Annual Incentive Plan. The following description of the Annual Incentive Plan is



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qualified in its entirety by the form of the Annual Incentive Plan filed as an exhibit to this registration statement of which this proxy statement/prospectus is a part.

### *Purpose of the Annual Incentive Plan*

The purpose of the Annual Incentive Plan is to motivate certain officers, directors and employees of Castlewood and its subsidiaries to grow Castlewood's profitability.

### *Administration of the Annual Incentive Plan*

The Annual Incentive Plan will be administered by the Plan Committee.

### *Awards under the Annual Incentive Plan*

The Annual Incentive Plan provides for the annual grant of bonus compensation, or a bonus award, to certain of officers and employees of Castlewood and its subsidiaries, including Castlewood's senior executive officers. Bonus awards for each calendar year from 2006 through 2010 will be determined based on Castlewood's consolidated net after-tax profits. The Plan Committee shall determine the amount of bonus awards in any calendar year, based on a percentage of Castlewood's consolidated net after-tax profits. The percentage will be 15% unless the Plan Committee exercises its discretion to change the percentage no later than 30 days prior to the last day of the calendar year. The Plan Committee will determine, in its sole discretion, the amount of Bonus Awards payable to each participant.

Bonus Awards are payable in cash, ordinary shares or a combination of both. Ordinary shares issued in connection with a bonus award will be issued pursuant to the terms and subject to the conditions of the Equity Incentive Plan and the number of shares issued will be determined based on the fair market value of ordinary shares for the thirty calendar days preceding the grant of ordinary shares as a bonus award.

### *Amendment and Termination of the Annual Incentive Plan*

The Annual Incentive Plan may be amended or terminated by Castlewood's board of directors at any time within 90 days of first day of any calendar year in which the Annual Incentive Plan is in effect.

### *Castlewood Compensation Committee Interlocks*

Mr. Silvester, Castlewood's Chief Executive Officer, serves as a member of Castlewood's compensation committee. Following the closing of the merger, Mr. Silvester will not serve on New Enstar's compensation committee and New Enstar's compensation committee will consist only of independent directors as such term is defined in Nasdaq Marketplace Rule 4200(a)(15).

### *Recent Developments*

On June 16, 2006, a wholly-owned subsidiary of Castlewood entered into a definitive agreement with Dukes Place Holdings, L.P., a portfolio company of GSC Partners, for the purchase of a minority interest in a U.S. holding company that owns two property and casualty insurers based in the United States, both of which are in run-off. Completion of the transaction is conditioned on, among other things, governmental and regulatory approvals and satisfaction of various other closing conditions. As a consequence, Castlewood cannot predict if or when this transaction will be completed.

Also on June 16, 2006, a wholly-owned subsidiary of Castlewood entered into a definitive agreement for the purchase of Cavell Holdings Limited, or Cavell, a U.K. company, from Dukes Place Holdings, L.P. for a purchase price of approximately £31.8 million (approximately \$59.5 million). Cavell owns a U.K. reinsurance company and a Norwegian reinsurer, both of which are currently in run-off. Cavell had total consolidated assets of approximately £101 million at March 31, 2006, as reported in its U.K. regulatory statements. Castlewood completed this transaction on October 4, 2006. A wholly-owned subsidiary of Castlewood borrowed \$24.5 million under a facility loan agreement with a London-based bank to partially fund this acquisition. The interest rate on the loan is LIBOR plus 2% and the loan is repayable within four years.

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On November 20, 2006, a wholly-owned subsidiary of Castlewood completed the acquisition of Unione Italiana (U.K.) Reinsurance Company Limited, a U.K. company, for a purchase price of \$17.2 million. The purchase price was funded from cash on hand.

## **Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis of Castlewood's financial condition and results of operations should be read in conjunction with Castlewood's consolidated financial statements and the related notes included elsewhere in this proxy statement/prospectus. Management's Discussion and Analysis has been revised for the effects of the restatement discussed in Note 24 of the Consolidated Financial Statements on page F-30 of this document. Some of the information contained in this discussion and analysis or included elsewhere in this proxy statement/prospectus, including information with respect to Castlewood's plans and strategy for its business, includes forward-looking statements that involve risks, uncertainties and assumptions. Castlewood's actual results and the timing of events could differ materially from those anticipated by these forward-looking statements as a result of many factors, including those discussed under Risk Factors, Forward-Looking Statements and elsewhere in this proxy statement/prospectus.

### ***Business Overview***

Castlewood was formed in August 2001 under the laws of Bermuda to acquire and manage insurance and reinsurance companies in run-off, and to provide management, consulting and other services to the insurance and reinsurance industry. In connection with Castlewood's formation, Enstar and Trident made an initial investment in Castlewood and the senior executives of Castlewood contributed their equity interests in Castlewood Limited.

Since its formation, Castlewood, through its subsidiaries, has completed several acquisitions of insurance and reinsurance companies and is now administering those businesses in run-off. Castlewood derives its net earnings from the ownership and management of these companies primarily by settling insurance and reinsurance claims below the recorded loss reserves and from returns on the portfolio of investments retained to pay future claims. In addition, Castlewood has formed other businesses that provide management and consultancy services, claims inspection services and reinsurance collection services to Castlewood affiliates and third-party clients for both fixed and success-based fees.

In the primary (or direct) insurance business, the insurer assumes risk of loss from persons or organizations that are directly subject to the given risks. Such risks may relate to property, casualty, life, accident, health, financial or other perils that may arise from an insurable event. In the reinsurance business, the reinsurer agrees to indemnify an insurance or reinsurance company, referred to as the ceding company, against all or a portion of the insurance risks arising under the policies the ceding company has written or reinsured. When an insurer or reinsurer stops writing new insurance business or a particular line of business, the insurer, reinsurer, or the line of discontinued business is in run-off.

In recent years, the insurance industry has experienced significant consolidation. As a result of this consolidation and other factors, the remaining participants in the industry often have portfolios of business that are either inconsistent with their core competency or provide excessive exposure to a particular risk or segment of the market (e.g., property/casualty, asbestos, environmental, director and officer liability, etc.). These non-core and/or discontinued portfolios are often associated with potentially large exposures and lengthy time periods before resolution of the last remaining insured claims resulting in significant uncertainty to the insurer or reinsurer covering those risks. These factors can distract management, drive up the cost of capital and surplus for the insurer or reinsurer, and negatively impact the insurer's or reinsurer's credit rating, which makes the disposal of the unwanted company or portfolio an attractive option. Alternatively, the insurer may wish to maintain the business on its balance sheet, yet not divert significant management attention to the run-off of the portfolio. The insurer or reinsurer, in either case, is likely to

engage a third party, such as Castlewood, that specializes in run-off management to purchase the company, or to manage the company or portfolio in run-off.

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In the sale of a run-off company, a purchaser, such as Castlewood, typically pays a discount to the book value of the company based on the risks assumed and the relative value to the seller of no longer having to manage the company in run-off. Such a transaction can be beneficial to the seller because it receives an up-front payment for the company, eliminates the need for its management to devote any attention to the disposed company and removes the risk that the established reserves for the business may prove to be inadequate. The seller is also able to redeploy its management and financial resources to its core businesses.

Alternatively, if the insurer or reinsurer hires a third party, such as Castlewood, to manage its run-off business, the insurer or reinsurer will, unlike in a sale of the business, receive little or no cash up front. Instead, the management arrangement may provide that the insurer or reinsurer will share in the profits, if any, derived from the run-off with certain incentive payments allocated to the run-off manager. By hiring a run-off manager, the insurer or reinsurer can outsource the management of the run-off business to experienced and capable individuals, while allowing its own management team to focus on the insurer's or reinsurer's core businesses. Although Castlewood's desired approach to managing run-off business is to align its interests with the interests of the owners, under certain management arrangements to which Castlewood is a party, it only receives a fixed management fee and does not receive incentives.

Following the purchase of a run-off company or the engagement to manage a run-off company or portfolio of business, it is incumbent on the new owner or manager to conduct the run-off in a disciplined and professional manner in order to efficiently discharge liabilities associated with the business while preserving and maximizing its assets. Castlewood's approach to managing its acquired companies in run-off as well as run-off companies or portfolios of businesses on behalf of third-party clients includes negotiating with third-party insureds and reinsureds to commute their insurance or reinsurance agreement (sometimes called policy buy-backs) for an agreed upon up-front payment by Castlewood, or the third-party client, and to more efficiently manage payment of insurance and reinsurance claims. Castlewood attempts to commute policies with direct insureds or reinsureds in order to eliminate uncertainty over the amount of future claims. Castlewood also attempts, where appropriate, to negotiate favorable commutations with reinsurers by securing the receipt of a lump-sum settlement from the reinsurer in complete satisfaction of the reinsurer's liability in respect of any future claims. Castlewood, or third-party client, is then fully responsible for any claims in the future. Castlewood typically invests proceeds from reinsurance commutations with the expectation that such investments will produce income, which, together with the principal, will be sufficient to satisfy future obligations with respect to the acquired company or portfolio.

With respect to its U.K. and Bermuda insurance and reinsurance subsidiaries, Castlewood is able to pursue strategies to achieve complete finality and conclude the run-off of a company by promoting solvent schemes of arrangement. Solvent schemes of arrangement, or a Solvent Scheme, have been a popular means of achieving financial certainty and finality, for insurance and reinsurance companies incorporated or managed in the U.K. and Bermuda by making a one-time full and final settlement of an insurance and reinsurance company's liabilities to policyholders. Such a Solvent Scheme is an arrangement between a company and its creditors or any class of them. For a Solvent Scheme to become binding on the creditors, a meeting of each class of creditors must be called, with the permission of the local court, to consider and, if thought fit, approve the Solvent Scheme. The requisite statutory majority of creditors of not less than 75% in value and 50% in number of those creditors actually attending the meeting, either in person or by proxy, must vote in favor of a Solvent Scheme. Once a Solvent Scheme has been approved by the statutory majority of voting creditors of the company it requires the sanction of the local court. While a Solvent Scheme provides an alternative exit strategy for run-off companies it is not Castlewood's strategy to make such acquisitions with this strategy solely in mind. Castlewood's preferred approach is to generate earnings from the disciplined and professional management of acquired run-off companies and then consider exit strategies, including a Solvent Scheme, when the majority of the run-off is complete. To understand risks associated with this strategy, see "Risk Factors - Risks Relating to New Enstar's Business - Exit and finality opportunities provided by solvent schemes of arrangement may not continue to be available which may result in the increased length of time and associated cost run-off of our insurance and reinsurance subsidiaries beginning on page 27."

Castlewood manages its business through two operating segments: reinsurance and consulting.

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Castlewood's reinsurance segment comprises the operations and financial results of its insurance and reinsurance subsidiaries. The financial results of this segment primarily consist of investment income less net reductions in loss and loss adjustment expense liabilities, direct expenses (including certain premises costs and professional fees) and management fees paid to Castlewood's consulting segment.

Castlewood's consulting segment comprises the operations and financial results of those subsidiaries which provide management and consulting services, forensic claims inspections services and reinsurance collection services to third party clients. This segment also provides management services to the reinsurance segment in return for management fees. The financial results of this segment primarily consist of fee income less overhead expenses comprised of staff costs, information technology costs, certain premises costs, travel costs and certain professional fees.

As of December 31, 2005, Castlewood had \$1,200.0 million of total assets and \$260.9 million of shareholders' equity. Castlewood operates its business internationally through its insurance and reinsurance subsidiaries and its consulting subsidiaries in the United Kingdom, the United States and Bermuda.

### ***Financial Statement Overview***

#### ***Consulting Fee Income***

Castlewood generates consulting fees based on a combination of fixed and success-based fee arrangements. Consulting income will vary from period to period depending on the satisfaction and timing of completion of success-based fee arrangements. Success-based fees are recorded when targets related to overall project completion or profitability goals are achieved. Castlewood's consulting segment, in addition to providing services to third parties, also provides management services to Castlewood's reinsurance segment based on agreed terms set out in management agreements between the parties. The fees charged by the consulting segment to the reinsurance segment are eliminated against the cost incurred by the reinsurance segment on consolidation.

#### ***Net Investment Income and Net Realized Gains/(Losses)***

Castlewood's net investment income is principally derived from interest earned on cash and investments offset by investment management fees paid. Castlewood's investment portfolio currently consists of the following: (1) a bond portfolio that is classified as held-to-maturity and carried at amortized cost; (2) cash and cash equivalents; (3) other investments that are accounted for on the equity basis; and (4) mutual funds, whose underlying assets consist of investments having maturities of greater than six and less than twelve months when purchased, that are held as available-for-sale securities and are carried at fair value.

Castlewood's current investment strategy seeks to preserve principal and maintain liquidity while trying to maximize investment return through a high-quality, diversified portfolio. The volatility of claims and the effect they have on the amount of cash and investment balances, as well as the level of interest rates and other market factors, affect the return Castlewood generates on its investment portfolio. As it is Castlewood's current investment policy to hold its bond portfolio to maturity, and not to trade or have such portfolio available-for-sale, realized gains or losses are not expected to be generated on a regular basis. However, when Castlewood makes a new acquisition it will often restructure the acquired investment portfolio, which may generate one-time realized gains or losses.

The majority of cash and all of the investment balances are held within Castlewood's reinsurance segment.

#### ***Net Reduction in Loss and Loss Adjustment Expense Liabilities***

Castlewood's insurance-related earnings are primarily comprised of reductions, or potentially increases, of net loss and loss adjustment expense liabilities. These liabilities are comprised of:

outstanding loss or case reserves, or OLR, which represent management's best estimate of the likely settlement amount for known claims, less the portion that can be recovered from reinsurers;



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reserves for losses incurred but not reported, or IBNR reserves, which are reserves established by Castlewood for claims that are not yet reported but can reasonably be expected to have occurred based on industry information, management's experience and actuarial evaluation, less the portion that can be recovered from reinsurers; and

reserves for future loss adjustment expense liabilities which represent management's best estimate of the future costs of managing the run-off of claims liabilities.

Net loss and loss adjustment expense liabilities are reviewed by Castlewood's management each quarter and by independent actuaries annually. Reserves reflect management's best estimate of the remaining unpaid portion of these liabilities. Prior period estimates of net loss and loss adjustment expense liabilities may change as Castlewood's management considers the combined impact of commutations, policy buy-backs, settlement of losses on carried reserves and the trend of incurred loss development compared to prior forecasts.

Commutations provide an opportunity for Castlewood to exit exposures to entire policies with insureds and reinsureds at a discount to the previously estimated ultimate liability. Castlewood's internal and external actuaries eliminate all prior historical loss development that relates to commuted exposures and apply their actuarial methodologies to the remaining aggregate exposures and revised historical loss development information to reassess estimates of ultimate liabilities.

Policy buy-backs provide an opportunity for Castlewood to settle individual policies and losses usually at a discount to carried advised loss reserves. As part of Castlewood's routine claims settlement operations, claims will settle at either below or above the carried advised loss reserve. The impact of policy buy-backs and the routine settlement of claims updates historical loss development information to which actuarial methodologies are applied often resulting in revised estimates of ultimate liabilities. Castlewood's actuarial methodologies include industry benchmarking which, under certain methodologies (discussed further under Critical Accounting Policies below), compares the trend of Castlewood's loss development to that of the industry. To the extent that the trend of Castlewood's loss development compared to the industry changes in any period it is likely to have an impact on the estimate of ultimate liabilities. Additionally, consolidated net reductions, or potentially increases, in loss and loss adjustment expense liabilities include reductions, or potentially increases, in the provisions for future losses and loss adjustment expenses related to the current period's run-off activity. Net reductions in net loss and loss adjustment expense liabilities are reported as negative expenses by Castlewood in its reinsurance segment. The unallocated loss adjustment expenses paid by the reinsurance segment comprise management fees paid to the consulting segment and are eliminated on consolidation. The consulting segment costs in providing run-off services are classified as salaries and general and administrative expenses. For more information on how the reserves are calculated, see Critical Accounting Policies Loss and Loss Adjustment Expenses below.

As Castlewood's reinsurance subsidiaries are in run-off, its premium income is insignificant, consisting primarily of adjustment premiums triggered by loss payments.

*Salaries and Benefits*

Castlewood is a service-based company and, as such, employee salaries and benefits are its largest expense. Castlewood has experienced significant increases in its salaries and benefits expenses as it has grown its operations, and it expects that trend to continue if it is able to successfully expand its operations.

In August 2004, Castlewood implemented an employee equity-based compensation plan. The plan allows for the award of Castlewood's Class D non-voting ordinary shares to certain employees up to a maximum of 7.5% of

Castlewood's total issued share capital. While Castlewood does not expect to issue any new shares under this plan following the closing of the merger, it has adopted a new equity incentive plan for its employees. Until January 1, 2006, Castlewood elected to follow Accounting Principles Board ( APB ) Opinion No. 25, Accounting for Stock Issued to Employees. The intrinsic value method was used to account for stock-based employee compensation. Pursuant to ABP Opinion No. 25, compensation expense for employee

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stock awards is measured at the fair value of the shares at the date of the grant and recognized as the awards vest using the straight-line method.

Castlewood adopted Statement of Financial Accounting Standards No. 123(R) Share Based Payments, or FAS 123(R), in accounting for its employee share awards effective January 1, 2006. FAS 123(R) requires compensation costs related to share-based payment transactions to be recognized in the financial statements based on the grant date fair value of the award. The adoption of FAS 123(R) did not have a material impact on the consolidated financial statements. On May 23, 2006, Castlewood entered into a merger agreement and a recapitalization agreement. As a result of the execution of these agreements, the accounting treatment for share-based awards issued under Castlewood's employee share plan changed from book value to fair value.

Castlewood also has in place a discretionary bonus plan whereby 15% of its after-tax profits are distributable to the employees of Castlewood. While this plan will be cancelled at the closing of the merger, Castlewood's board of directors and shareholders have adopted the Annual Incentive Plan which is expected to provide a similar level of incentive award to its employees, at least through 2010.

With the exception of the expense relating to the bonus plan, which is allocated to both the reinsurance and consulting segments, the costs of all employees of Castlewood are accounted for as part of the consulting segment.

### *General and Administrative Expenses*

General and administrative expenses include rent and rent-related costs, professional fees (legal, investment, audit and actuarial) and travel expenses. Castlewood has operations in multiple jurisdictions and its employees travel frequently in connection with the search for acquisition opportunities and in the general management of the business. As a result of the proposed merger, Castlewood anticipates increases in personnel and, therefore, increases in related general and administrative expenses as well as additional professional fees associated with becoming subject to reporting regulations under the Exchange Act. While certain general and administrative expenses, such as rent and related costs and professional fees, are incurred directly by the reinsurance segment, the remaining general and administrative expenses are incurred by the consulting segment. To the extent that such costs incurred by the consulting segment relate to the management of the reinsurance segment, they are recovered by the consulting segment through the management fees charged to the reinsurance segment.

### *Foreign Exchange Gain/(Loss)*

Castlewood's reporting and functional currency is U.S. dollars. Through its subsidiaries, however, Castlewood holds a variety of foreign (non-U.S.) currency assets and liabilities, the principal exposures being Euros and British pounds. At each balance sheet date, recorded balances that are denominated in a currency other than U.S. dollars are adjusted to reflect the current exchange rate. Revenue and expense items are translated into U.S. dollars at average rates of exchange for the period. The resulting exchange gains or losses are included in Castlewood's net income. Castlewood seeks to manage its exposure to foreign currency exchange by broadly matching foreign currency assets against foreign currency liabilities.

### *Share of Income of Partly-Owned Companies*

Castlewood includes in its net income its proportionate share in the equity of earnings by companies in which it holds a significant influence. Such investments are carried on the equity basis whereby the investment is initially recorded at cost and adjusted to reflect Castlewood's share of net earnings.

### *Income Tax/(Recovery)*

Under current Bermuda law, Castlewood and its Bermuda-based subsidiaries are not required to pay taxes in Bermuda on either income or capital gains. These companies have received an undertaking from the Bermuda government that, in the event of income or capital gains taxes being imposed, they will be exempted

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from such taxes until the year 2016. Castlewood's non-Bermuda subsidiaries record income taxes based on their graduated statutory rates, net of tax benefits arising from tax loss carryforwards.

*Minority Interest*

The acquisitions of Hillcot Re Limited (formerly Toa-Re Insurance Company (UK) Limited) in March 2003 and of Brampton Insurance Company Limited (formerly Aioi Insurance Company of Europe Limited) in March 2006 were effected through Hillcot Holdings Limited, or Hillcot, a Bermuda-based company in which Castlewood has a 50.1% economic interest. The results of operations of Hillcot are included in Castlewood's consolidated statements of operations with the remaining 49.9% economic interest in the results of Hillcot reflected as a minority interest.

*Negative Goodwill*

Negative goodwill represents the excess of the fair value of net assets acquired by Castlewood over the cost of such assets. In accordance with FAS 141 Business Combinations, this amount is recognized upon the acquisition of the assets as an extraordinary gain. The fair values of the reinsurance assets and liabilities acquired are derived from probability-weighted ranges of the associated projected cash flows, based on actuarially prepared information and Castlewood's management run-off strategy. Any amendment to the fair values resulting from changes in such information or strategy will be recognized when they occur. For more information on how the goodwill is determined, see Critical Accounting Policies Goodwill below.

*Critical Accounting Policies*

Certain amounts in Castlewood's consolidated financial statements require the use of best estimates and assumptions to determine reported values. These amounts could ultimately be materially different than what has been provided for in Castlewood's consolidated financial statements. Castlewood considers the assessment of loss reserves and reinsurance recoverable to be the values requiring the most inherently subjective and complex estimates. In addition, the assessment of the possible impairment of goodwill involves certain estimates and assumptions. As such, the accounting policies for these amounts are of critical importance to Castlewood's consolidated financial statements.

*Loss and Loss Adjustment Expenses*

The following table provides a breakdown of gross loss and loss adjustment expense reserves by type of exposure as of December 31, 2005 and 2004:

|               | 2005                           |            |            | 2004                           |            |            |
|---------------|--------------------------------|------------|------------|--------------------------------|------------|------------|
|               | OLR                            | IBNR       | Total      | OLR                            | IBNR       | Total      |
|               | (in thousands of U.S. Dollars) |            |            | (in thousands of U.S. Dollars) |            |            |
| Asbestos      | \$ 149,023                     | \$ 297,807 | \$ 446,830 | \$ 201,497                     | \$ 400,692 | \$ 602,189 |
| Environmental | 43,477                         | 87,772     | 131,249    | 51,776                         | 89,329     | 141,105    |
| All Other     | 110,776                        | 67,629     | 178,405    | 176,131                        | 61,549     | 237,680    |
| Total         | 303,276                        | 453,208    | 756,484    | 429,404                        | 551,570    | 980,974    |
| ULAE          |                                |            | 50,075     |                                |            | 66,339     |
| Total         |                                |            | \$ 806,559 |                                |            | 1,047,313  |

Note: The All Other exposure category consists of a mix of casualty, property, marine, aviation and other miscellaneous long-tailed exposures.

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The following table provides a breakdown of loss and loss adjustment expense reserves (net of reinsurance balances recoverable) by type of exposure as of December 31, 2005 and 2004:

|               | <b>2005</b>                               | <b>2004</b>       |
|---------------|---|-------------------|
|               | <b>(in thousands of<br/>U.S. dollars)</b> |                   |
| Asbestos      | \$ 325,920                                | \$ 411,412        |
| Environmental | 58,037                                    | 67,636            |
| Other         | 209,203                                   | 257,612           |
| <b>Total</b>  | <b>\$ 593,160</b>                         | <b>\$ 736,660</b> |

As of December 31, 2005, the IBNR reserves (net of reinsurance balances receivable) accounted for \$326.3 million, or 55.0%, of Castlewood's total loss reserves. The reserve for IBNR (net of reinsurance balance receivable) accounted for \$409.7 million, or 55.6%, of Castlewood's total loss reserves at December 31, 2004.

*Annual Loss and Loss Adjustment Reviews*

Because a significant amount of time can lapse between the assumption of risk, the occurrence of a loss event, the reporting of the event to an insurance or reinsurance company and the ultimate payment of the claim on the loss event, the liability for unpaid losses and loss adjustment expenses is based largely upon estimates. Castlewood's management must use considerable judgment in the process of developing these estimates. The liability for unpaid losses and loss adjustment expenses for property and casualty business includes amounts determined from loss reports on individual cases and amounts for IBNR reserves. Such reserves are estimated by management based upon loss reports received from ceding companies, supplemented by Castlewood's own estimates of losses for which no ceding company loss reports have yet been received.

In establishing reserves, management also considers independent actuarial estimates of ultimate losses. Castlewood's actuaries employ generally accepted actuarial methodologies to estimate ultimate losses and loss adjustment expenses. A loss reserve study is prepared by an independent actuary annually in order to provide additional insight into the reasonableness of Castlewood's reserves for losses and loss adjustment expenses.

As of December 31, 2005, 1996 was the most recent year in which policies were underwritten by any of Castlewood's insurance and reinsurance subsidiaries. As such, all of Castlewood's unpaid claims liabilities are considered to have a long-tail claims payout. Loss reserves primarily relate to casualty exposures, including latent claims, of which approximately 76% relate to asbestos and environmental exposures.

Within the annual loss reserve studies produced by Castlewood's external actuaries, exposures for each subsidiary are separated into homogeneous reserving categories for the purpose of estimating IBNR. Each reserving category contains either direct insurance or assumed reinsurance reserves and groups relatively similar types of risks and exposures (for example asbestos, environmental, casualty, property) and lines of business written (for example marine, aviation, non-marine). Based on the exposure characteristics and the nature of available data for each individual reserving category, a number of methodologies are applied. Recorded reserves for each category are selected from the indications produced by the various methodologies after consideration of exposure characteristics, data limitations and strengths and weaknesses of each method applied. This approach to estimating IBNR has been consistently adopted in the annual loss reserve studies for each period presented.





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The ranges of gross loss and loss adjustment expense reserves implied by the various methodologies used by each of Castlewood's insurance subsidiaries as of December 31, 2005 are:

|               | <b>Low</b>        | <b>Selected</b>   | <b>High</b>       |
|---------------|-------------------|-------------------|-------------------|
| Asbestos      | \$ 335,122        | \$ 446,830        | \$ 464,703        |
| Environmental | 65,624            | 131,249           | 149,624           |
| All Other     | 148,076           | 178,405           | 239,062           |
| ULAE          | 50,075            | 50,075            | 50,075            |
| <b>Total</b>  | <b>\$ 598,897</b> | <b>\$ 806,559</b> | <b>\$ 903,464</b> |

*Latent Claims.* Castlewood's loss reserves are largely related to casualty exposures including latent exposures primarily relating to asbestos and environmental exposure, or A&E. In establishing the reserves for unpaid claims, management considers facts currently known and the current state of the law and coverage litigation. Liabilities are recognized for known claims (including the cost of related litigation) when sufficient information has been developed to indicate the involvement of a specific insurance policy, and management can reasonably estimate its liability. In addition, reserves are established to cover loss development related to both known and unasserted claims.

The estimation of unpaid claim liabilities is subject to a high degree of uncertainty for a number of reasons. First, unpaid claim liabilities for property and casualty exposures in general are impacted by changes in the legal environment, jury awards, medical cost trends and general inflation. Moreover, for latent exposures in particular, developed case law and adequate claim history do not exist. There is significant coverage litigation related to these exposures, which creates further uncertainty in the estimation of the liabilities. As such, for these types of exposures, it is especially unclear whether past claim experience will be representative of future claim experience. Ultimate values for such claims cannot be estimated using reserving techniques that extrapolate losses to an ultimate basis using loss development factors, and the uncertainties surrounding the estimation of unpaid claim liabilities are not likely to be resolved in the near future. There can be no assurance that the reserves established by Castlewood will be adequate or will not be adversely affected by the development of other latent exposures.

Castlewood's asbestos claims are primarily products liability claims submitted by a variety of insureds who operated in different parts of the asbestos distribution chain. While most such claims arise from asbestos mining and primary asbestos manufacturers, it has also been receiving claims from tertiary defendants such as smaller manufacturers and the industry has seen an emerging trend of non-products claims arising from premises exposures. Unlike products claims, primary policies generally do not contain aggregate policy limits for premises claims, which, accordingly, remain at the primary layer and, thus, rarely impact excess insurance policies. As the vast majority of Castlewood's policies are excess policies, this trend has had only a marginal effect on our asbestos exposures thus far.

Asbestos reform efforts have been underway at both the federal and state level to address the cost and scope of asbestos claims to the American economy. While there is significant opposition to proposals for a federal trust fund that would replace the tort system for asbestos claims and the prospect for passage of such federal level reforms appears remote at present, several states including Texas and Florida have passed reforms based on medical criteria requiring certain levels of medically documented injury before a lawsuit can be filed, resulting in a drop of year-on-year case filings in those states adopting this reform measure.

Asbestos claims fall into two general categories: impaired and unimpaired bodily injury claims. Property damage claims represent only a small fraction of asbestos claims. Impaired claims primarily include individuals suffering from

mesothelioma or a cancer such as lung cancer. Unimpaired claims include asbestosis and those whose lung regions contain pleural plaques. Unimpaired claims are not life threatening and do not cause changes to one's ability to function or to one's lifestyle.

Unlike traditional property and casualty insurers that either have large numbers of individual claims arising from personal lines such as auto, or small numbers of high value claims as in medical malpractice insurance lines, Castlewood's primary exposures arise from asbestos and environmental claims that do not follow a consistent pattern. For instance, Castlewood may encounter a small insured with one large environmental claim due to significant groundwater contamination, while a Fortune 500 company may submit

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numerous claims for relatively small values. Moreover, there is no set pattern for the life of an environmental or asbestos claim. Some of these claims may resolve within two years whereas others have remained unresolved for nearly two decades. Therefore, Castlewood's open and closing claims data do not follow any identifiable or discernible pattern.

Furthermore, because of the reinsurance nature of the claims Castlewood manages, it focuses on the activities at the (re)insured level rather than at the individual claims level. The counterparties with whom Castlewood typically interacts are generally insurers or large industrial concerns and not individual claimants. Claims do not follow any consistent pattern. They arise from many insureds or locations and in a broad range of circumstances. An insured may present one large claim or hundreds or thousands of small claims. Plaintiffs' counsel frequently aggregate thousands of claims within one lawsuit. The deductibles to which claims are subject vary from policy to policy and year to year. Often claims data is only available to reinsurers such as Castlewood on an aggregated basis. Accordingly, Castlewood has not found claim count information or average reserve amounts to be reliable indicators of exposure for its reserve estimation process or for management of its liabilities. Castlewood has found data accumulation and claims management more effective and meaningful at the (re)insured level rather than at the underlying claim level. As such we have designed our reserving methodologies to be independent of claim count information. As the level of exposures to a (re)insured can vary substantially, Castlewood focuses on the aggregate exposures and pursues commutations and policy buy-backs with the larger (re)insureds.

Castlewood employs approximately twenty-nine full time equivalent employees, including a qualified U.S. attorney, actuaries, and experienced claims-handlers to directly administer its asbestos and environmental liabilities. Castlewood has established a provision for future expenses of \$38.6 million, which reflects the total anticipated costs to administer these claims to expiration.

Castlewood's future asbestos loss development may be influenced by many factors including:

Onset of future asbestos-related illness in individuals exposed to asbestos over the past 50 or more years.

Future viability of the practice of resolving asbestos liability for defendant companies through bankruptcy.

Enactment of tort reforms establishing stricter medical criteria for asbestos awards.

Attempts to resolve all U.S.-related asbestos litigation through federal legislation.

The influence of each of these factors is not easily quantifiable and Castlewood's historical asbestos loss development is of limited value in determining future asbestos loss development using traditional actuarial reserving techniques.

Significant trends affecting insurer liabilities and reserves in recent years had little effect on environmental claims, except for claims arising out of damages to natural resources. New Jersey has pioneered the use of natural resources damages to advance further pursuit of funds from potentially responsible parties, or PRPs. A recent successful action against Exxon Mobil has increased the likelihood the use of natural resource damages will expand within New Jersey and perhaps other states. These actions target primary policies and will likely have less effect on excess carriers because damages, when awarded, are typically spread across many PRPs and across many policy years. As such, claims do not generally reach excess insurance layers.

Castlewood's future environmental loss development may also be influenced by other factors including:

Existence of currently undiscovered polluted sites eligible for clean-up under the Comprehensive Environmental Response, Compensation, and Liability Act (CERCLA) and related legislation.

Costs imposed due to joint and several liability if not all PRPs are capable of paying their share.

Success of legal challenges to certain policy terms such as the absolute pollution exclusion.

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Potential future reforms and amendments to CERCLA, particularly as the resources of Superfund – the funding vehicle, established as part of CERCLA, to provide financing for cleanup of polluted sites where no PRP can be identified – become exhausted.

The influence of each of these factors is not easily quantifiable and, as with asbestos-related exposures, Castlewood’s historical environmental loss development is of limited value in determining future environmental loss development using traditional actuarial reserving techniques.

Finally, the issue of lead paint liability represents a potential emerging trend in latent claim activity that could potentially lead to future reserve adjustments. After a series of successful defense efforts by defendant lead pigment manufacturers in lead paint litigation, a Rhode Island court, earlier this year, ruled in favor of the government in a nuisance claim against the defendant manufacturers. Although the damages portion of the case has yet to be decided, the plaintiff could receive a significant award. Further, there are similar pending claims in several jurisdictions including California. As policies do not generally contain exclusions for bodily injury or property damage arising from lead paint or lead pigment, there is the potential for significant impact to excess insurers if plaintiffs prevail in successive nuisance claims pending in other jurisdictions.

Castlewood’s independent, external actuaries use industry benchmarking methodologies to estimate appropriate IBNR reserves for Castlewood’s A&E exposures. These methods are based on comparisons of Castlewood’s loss experience on A&E exposures relative to industry loss experience on A&E exposures. Estimates of IBNR are derived separately for each relevant Castlewood subsidiary and, for some subsidiaries, separately for distinct portfolios of exposure. The discussion that follows describes, in greater detail, the primary actuarial methodologies used by Castlewood’s independent actuaries to estimate IBNR for A&E exposures.

In addition to the specific considerations for each method described below, many general factors are considered in the application of the methods and the interpretation of results for each portfolio of exposures. These factors include the mix of product types (e.g. primary insurance versus reinsurance of primary versus reinsurance of reinsurance), the average attachment point of coverages (e.g. first-dollar primary versus umbrella over primary versus high-excess), payment and reporting lags related to the international domicile of Castlewood subsidiaries, payment and reporting pattern acceleration due to large – wholesale – settlements (e.g. policy buy-backs and commutations) pursued by Castlewood, lists of individual risks remaining and general trends within the legal and tort environments.

1. *Paid Survival Ratio Method.* In this method, Castlewood’s expected annual average payment amount is multiplied by an expected future number of payment years to get an indicated reserve. Castlewood’s historical calendar year payments are examined to determine an expected future annual average payment amount. This amount is multiplied by an expected number of future payment years to estimate a reserve. Trends in calendar year payment activity are considered when selecting an expected future annual average payment amount. Accepted industry benchmarks are used in determining an expected number of future payment years. Each year, annual payments data is updated, trends in payments are re-evaluated and changes to benchmark future payment years are reviewed. This method has advantages of ease of application and simplicity of assumptions. A potential disadvantage of the method is that results could be misleading for portfolios of high excess exposures where significant payment activity has not yet begun.

2. *Paid Market Share Method.* In this method, Castlewood’s estimated market share is applied to the industry estimated unpaid losses. The ratio of Castlewood’s historical calendar year payments to industry historical calendar year payments is examined to estimate Castlewood’s market share. This ratio is then applied to the estimate of industry unpaid losses. Each year, calendar year payment data is updated (for both Castlewood and industry), estimates of industry unpaid losses are reviewed and the selection of Castlewood’s estimated market share is revisited. This method has the advantage that trends in calendar-year market share can be incorporated into the selection of company share of

remaining market payments. A potential disadvantage of this method is that it is particularly sensitive to assumptions regarding the time-lag between industry payments and Castlewood payments.

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3. *Reserve-to-Paid Method.* In this method, the ratio of estimated industry reserves to industry paid-to-date losses is multiplied by Castlewood's paid-to-date losses to estimate Castlewood's reserves. Specific considerations in the application of this method include the completeness of Castlewood's paid-to-date loss information, the potential acceleration or deceleration in Castlewood's payments (relative to the industry) due to Castlewood's claims handling practices, and the impact of large individual settlements. Each year, paid-to-date loss information is updated (for both Castlewood and the industry) and updates to industry estimated reserves are reviewed. This method has the advantage of relying purely on paid loss data and so is not influenced by subjectivity of case reserve loss estimates. A potential disadvantage is that the application to Castlewood portfolios which do not have complete inception-to-date paid loss history could produce misleading results.

4. *IBNR:Case Ratio Method.* In this method, the ratio of estimated industry IBNR reserves to industry case reserves is multiplied by Castlewood's case reserves to estimate Castlewood IBNR reserves. Specific considerations in the application of this method include the presence of policies reserved at policy limits, changes in overall industry case reserve adequacy and recent loss reporting history for Castlewood. Each year, Castlewood case reserves are updated, industry reserves are updated and the applicability of the industry IBNR:case ratio is reviewed. This method has the advantage that it incorporates the most recent estimates of amounts needed to settle open cases included in current case reserves. A potential disadvantage is that results could be misleading where Castlewood case reserve adequacy differs significantly from overall industry case reserve adequacy.

5. *Ultimate-to-Incurred Method.* In this method, the ratio of estimated industry ultimate losses to industry incurred-to-date losses is applied to Castlewood incurred-to-date losses to estimate Castlewood's IBNR reserves. Specific considerations in the application of this method include the completeness of Castlewood's incurred-to-date loss information, the potential acceleration or deceleration in Castlewood's incurred losses (relative to the industry) due to Castlewood's claims handling practices and the impact of large individual settlements. Each year incurred-to-date loss information is updated (for both Castlewood and the industry) and updates to industry estimated ultimate losses are reviewed. This method has the advantage that it incorporates both paid and case reserve information in projecting ultimate losses. A potential disadvantage is that results could be misleading where cumulative paid loss data is incomplete or where Castlewood case reserve adequacy differs significantly from overall industry case reserve adequacy.

Under the Paid Survival Ratio Method, the Paid Market Share Method and the Reserve-to-Paid Method, we first determine the estimated total reserve and then deduct the reported outstanding case reserves to arrive at an estimated IBNR reserve. The IBNR:Case Ratio Method first determines an estimated IBNR reserve which is then added to the advised outstanding case reserves to arrive at an estimated total loss reserve. The Ultimate-to-Incurred Method first determines an estimate of the ultimate losses to be paid and then deducts paid-to-date losses to arrive at an estimated total loss reserve and then deducts outstanding case reserves to arrive at the estimated IBNR reserve.

Within the annual loss reserve studies produced by Castlewood's external actuaries, exposures for each subsidiary are separated into homogeneous reserving categories for the purpose of estimating IBNR. Each reserving category contains either direct insurance or assumed reinsurance reserves and groups relatively similar types of risks and exposures (for example asbestos, environmental, casualty, property) and lines of business written (for example marine, aviation, non-marine). Based on the exposure characteristics and the nature of available data for each individual reserving category, a number of methodologies are applied. Recorded reserves for each category are selected from the indications produced by the various methodologies after consideration of exposure characteristics, data limitations, and strengths and weaknesses of each method applied. This approach to estimating IBNR has been consistently adopted in the annual loss reserve studies for each period presented.

As of December 31, 2005, Castlewood has nine separate insurance and/or reinsurance subsidiaries whose reserves are categorized into approximately 170 reserve categories in total, including 15 distinct asbestos reserving categories and

18 distinct environmental reserving categories.



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The five methodologies discussed above are applied for each of the 15 asbestos reserving categories and each of the 18 environmental reserving categories. As is common in actuarial practice, no one methodology is exclusively or consistently relied upon when selecting a recorded reserve. Consistent reliance on a single methodology to select a recorded reserve would be inappropriate in light of the dynamic nature of both the asbestos and environmental liabilities in general, and the actual Castlewood exposure portfolios in particular.

In selecting a recorded reserve, management considers the range of results produced by the methods, and the strengths and weaknesses of the methods in relation to the data available and the specific characteristics of the portfolio under consideration. Trends in both Castlewood data and industry data are also considered in the reserve selection process. Recent trends or changes in the relevant tort and legal environments are also considered when assessing methodology results and selecting an appropriate recorded reserve amount for each portfolio.

The following key assumptions were used to estimate Asbestos and Environmental reserves at December 31, 2005:

1. \$65 billion Ultimate Industry Asbestos losses this level of industry-wide losses and its comparison to industry-wide paid, incurred and outstanding case reserves is the base benchmarking assumption applied to Paid Market Share, Reserve-to-Paid, IBNR: Case Ratio and the Ultimate-to-Incurred asbestos reserving methodologies.
2. \$35 billion Ultimate Industry Environmental losses this level of industry-wide losses and its comparison to industry-wide paid, incurred and outstanding case reserves is the base benchmarking assumption applied to Paid Market Share, Reserve-to-Paid, IBNR: Case Ratio and the Ultimate-to-Incurred environmental reserving methodologies.
3. Loss reporting lag Castlewood's subsidiaries assumed a mix of insurance and reinsurance exposures generally through the London Market. As the available industry benchmark loss information, as supplied by our independent consulting actuaries, is compiled largely from U.S. direct insurance company experience, Castlewood's loss reporting is expected to lag relative to available industry benchmark information. This time-lag used by each of Castlewood's insurance subsidiaries varies between from 1 to 3 years depending on the relative mix of domicile, percentages of product mix of insurance, reinsurance and retrocessional reinsurance, primary insurance, excess insurance, reinsurance of direct, and reinsurance of reinsurance within any given exposure category. Exposure portfolios written from a non-U.S. domicile are assumed to have a greater time-lag than portfolios written from a U.S. domicile. Portfolios with a larger proportion of reinsurance exposures are assumed to have a greater time-lag than portfolios with a larger proportion of insurance exposures.

With one exception, the above assumptions have generally not changed from the immediately preceding annual review at December 31, 2004. The one material change related to a subsidiary acquired in late 2004. The estimate of loss reserves of such subsidiary at December 31, 2005 assumed a reduction in the loss-reporting lag from 3 years, used at December 31, 2004, to 2.35 years. This change in assumption was made based on additional analysis of the mix of reinsurance of direct versus reinsurance of reinsurance exposures within the portfolio of such subsidiary. While this had the effect of reducing gross reserves of such subsidiary by \$40 million, there was no material effect on net reserves due to an associated decrease in the recorded benefit of reinsurance protections.

The following tables provide a summary of the impact of changes in industry ultimate losses, from the selected \$65 billion for asbestos and \$35 billion for environmental, and changes in the time-lag, from the selected average of 2 years for the company behind industry development that it is assumed relates to the company's insurance and reinsurance companies. Please note that the table below demonstrates sensitivity to changes to key assumptions using methodologies selected for determining loss and ALAE at December 31,



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2005 and differs from the table on page 126 which demonstrates the range of outcomes produced by the various methodologies.

| <b>Sensitivity to Industry Asbestos Ultimate Loss Assumption</b> |                         | <b>Asbestos Gross<br/>Loss Reserves</b> |
|--|-------------------------|---|
| Asbestos   | \$65 billion (selected) | \$ 446,830                              |
| Asbestos   | \$60 billion            | 380,805                                 |

| <b>Sensitivity to Industry Environmental Ultimate Loss Assumption</b> |                         | <b>Environmental<br/>Gross<br/>Loss Reserves</b> |
|---|-------------------------|--|
| Environmental   | \$35 billion (selected) | \$ 131,249                                       |
| Environmental   | \$40 billion            | 162,069  |
| Environmental   | \$30 billion            | 100,429  |

| <b>Sensitivity to time-lag Assumption*</b>                       | <b>Asbestos<br/>Loss Reserves</b> | <b>Environmental<br/>Loss Reserves</b> |
|--|-----------------------------------|--|
| Selected average of 2 years (varies by portfolio from 1-3 years) | \$ 446,830                        | \$ 131,249                             |
| Increase all portfolio lags by six months                        | 478,239                           | 136,797                                |
| Decrease all portfolio lags by six months                        | 417,237                           | 128,557                                |

\* using \$65 billion/\$35 billion Asbestos/Environmental Industry Ultimate Loss assumptions

Industry publications indicate that the range of ultimate industry asbestos losses is estimated to be between \$55 billion and \$65 billion. Based on management's experience of substantial loss development on Castlewood asbestos exposure portfolios, Castlewood has selected the upper end of the range as the basis for its asbestos loss reserving. Although the industry publications suggest a low end of the range of industry ultimate losses of \$55 billion, Castlewood considers that unlikely and believes that it is more reasonable to assume that the lower end of this range of ultimate losses could be \$60 billion.

Guidance from industry publications is more varied in respect of estimates of ultimate industry environmental losses. Consistent with an industry published estimate, Castlewood believes the reasonable range for ultimate industry environmental losses is between \$30 billion and \$40 billion. Castlewood has selected the midpoint of this range as the basis for its environmental loss reserving based on advice supplied by its independent consulting actuaries. Another industry publication indicates that ultimate industry environmental losses could be \$56 billion. However, based on our own loss experience, including successful settlement activity by the company, the decline in new claims notified in recent years and improvements in environmental clean-up technology, Castlewood does not believe that the \$56 billion estimate would be a reasonable basis for its reserving for environmental losses.

Management's current estimate of the time lag that relates to its insurance and reinsurance subsidiaries compared to the industry is considered reasonable given the analysis performed by its internal and external actuaries to date.

Over time, additional information regarding such exposure characteristics may be developed for any given portfolio. This additional information could cause a shift in the lag assumed. As mentioned above, a change in lag assumption from 3 years to 2.35 years was made for a single asbestos portfolio between December 31, 2004 and December 31, 2005. The change reduced the overall Castlewood average time lag by 0.4 years. It is possible that further information could arise regarding other portfolios which would cause a shift in time-lag assumed, but it is unlikely to cause a shift larger than 6 months for Castlewood as a whole.

*Non-Latent Claims.* Non-latent claims are less significant to Castlewood, both in terms of reserves held and in terms of risk of significant reserve deficiency. For non-latent loss exposure, a range of traditional loss development extrapolation techniques is applied. Incremental paid and incurred loss development methodologies are the most commonly used methods. Traditional cumulative paid and incurred loss development methods are used where inception-to-date, cumulative paid and reported incurred loss development history is available.

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These methods assume that cohorts, or groups, of losses from similar exposures will increase over time in a predictable manner. Historical paid and incurred loss development experience is examined for earlier accident years to make inferences about how later accident years' losses will develop. Where company-specific loss information is not available or not reliable, industry loss development information published by industry sources such as the Reinsurance Association of America is considered. These methods calculate an estimate of ultimate losses and then deduct paid-to-date losses to arrive at an estimated total loss reserve. Outstanding losses are then deducted from estimated total loss reserves to calculate the estimated IBNR reserve. Management does not expect changes in underlying reserving assumptions to have a material impact on net loss and loss adjustment expense reserves as they are primarily sensitive to changes due to loss development.

*Quarterly Reserve Reviews.* In addition to an in-depth annual review, Castlewood also performs quarterly reserve reviews. This is done by examining quarterly paid and incurred loss development to determine whether it is consistent with reserves established during the preceding annual reserve review. Loss development is reviewed separately for each major exposure type (e.g. asbestos, environmental, etc.), for each relevant Castlewood subsidiary, and for large wholesale commutation settlements versus routine paid and advised losses. This process is undertaken to determine whether loss development experience during a quarter warrants any change to held reserves.

Loss development is examined separately by exposure type because different exposures develop differently over time. For example, the expected reporting and payout of losses for a given amount of asbestos reserves can be expected to take place over a different time frame and in a different quarterly pattern from the same amount of environmental reserves.

In addition, loss development is examined separately for each relevant Castlewood subsidiary. While the most significant exposures for most Castlewood subsidiaries are latent asbestos and environmental exposures, there are differing profiles to the exposure across Castlewood's subsidiaries. Companies can differ in their exposure profile due to the mix of insurance versus reinsurance, the mix of primary versus excess insurance, the underwriting years of participation and other criteria. These differing profiles lead to different expectations for quarterly and annual loss development by company.

Castlewood's quarterly paid and incurred loss development is often driven by large, wholesale settlements such as commutations and policy buy-backs which settle many individual claims in a single transaction. This allows for monitoring of the potential profitability of large settlements which, in turn, can provide information about the adequacy of reserves on remaining exposures which have not yet been settled. For example, if it were found that large settlements were consistently leading to large negative, or favorable, incurred losses upon settlement, it might be an indication that reserves on remaining exposures are redundant. Conversely, if it were found that large settlements were consistently leading to large positive, or adverse, incurred losses upon settlement, it might be an indication particularly if the size of the losses were increasing that certain loss reserves on remaining exposures are deficient. Moreover, removing the loss development resulting from large settlements allows for a review of loss development related only to those contracts which remain exposed to losses. Were this not done, it is possible that savings on large wholesale settlements could mask significant underlying development on remaining exposures.

Once the data has been analyzed as described above, an in-depth review is performed on classes of exposure with significant loss development. Discussions are held with appropriate personnel, including individual company managers, claims handlers and attorneys, to better understand the causes. If it is determined that development differs significantly from expectations, reserves would be adjusted.

Quarterly loss development is expected to be fairly erratic for the types of exposure insured and reinsured by Castlewood. Several quarters of low incurred loss development can be followed by spikes of relatively large incurred losses. This is characteristic of latent claims and other insurance losses which are reported and settled many years after

the inception of the policy. Given the high degree of statistical uncertainty, and potential volatility, it would be unusual to adjust reserves on the basis of one, or even several, quarters of loss development activity. As such, unless the incurred loss activity in any one quarter is of such significance that management is able to quantify the impact on the ultimate liability for loss and loss adjustment expenses,

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reductions or increases in loss and loss adjustment expense liabilities are carried out in the fourth quarter based on the annual reserve review described above.

As described above, Castlewood's management regularly reviews and updates reserve estimates using the most current information available and employing various actuarial methods. Adjustments resulting from changes in Castlewood's estimates are recorded in the period when such adjustments are determined. The ultimate liability for loss and loss adjustment expenses is likely to differ from the original estimate due to a number of factors, primarily consisting of the overall claims activity occurring during any period, including the completion of commutations of assumed liabilities and ceded reinsurance receivables, policy buy-backs and general incurred claims activity.

### *Reinsurance Balances Receivable*

Castlewood's acquired reinsurance subsidiaries, prior to acquisition by Castlewood, used retrocessional agreements to reduce their exposure to the risk of insurance and reinsurance they assumed. Loss reserves represent total gross losses, and reinsurance receivable represents anticipated recoveries of a portion of those unpaid losses as well as amounts receivable from reinsurers with respect to claims that have already been paid. While reinsurance arrangements are designed to limit losses and to permit recovery of a portion of direct unpaid losses, reinsurance does not relieve Castlewood of its liabilities to its insureds or reinsureds. Therefore, Castlewood evaluates and monitors concentration of credit risk among its reinsurers, including companies that are insolvent, in run-off or facing financial difficulties. Provisions are made for amounts considered potentially uncollectible.

### *Goodwill*

Castlewood follows FAS No. 142 *Goodwill and Other Intangible Assets* which requires that recorded goodwill be assessed for impairment on at least an annual basis. In determining goodwill, Castlewood must determine the fair value of the assets of an acquired company. The determination of fair value necessarily involves many assumptions. 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 Castlewood's management run-off strategy. Fair value adjustments are based on the estimated timing of loss and loss adjustment expense payments and an assumed interest rate, and are amortized over the estimated payout period, as adjusted for accelerations on commutation settlements, using the constant yield method options. Interest rates used to determine the fair value of gross loss reserves are based upon risk free rates applicable to the average duration of the loss reserves. Interest rates used to determine the fair value of reinsurance receivables are increased to reflect the credit risk associated with the reinsurers from who the receivables are, or will become, due. If the assumptions made in initially valuing the assets change significantly in the future, Castlewood may be required to record impairment charges which could have a material impact on its financial condition and results of operations.

FAS 141 also requires that negative goodwill be recorded in earnings. During 2004 and the first three months of 2006, Castlewood took negative goodwill into earnings upon the completion of the acquisition of certain companies and presented it as an extraordinary gain.

### *New Accounting Pronouncements*

In December 2004, the Financial Accounting Standards Board, or the FASB, issued FAS No. 123(R) *Share Based Payments*, or FAS 123R. FAS 123R requires that compensation costs related to share based payment transactions be recognized in a company's financial statements. The amount of compensation costs will be measured based on the grant date fair value of the awards issued and will be recognized over the period that an employee provides services in exchange for the award or the requisite service or vesting period. Castlewood has adopted FAS 123R using the modified prospective method for the fiscal year beginning January 1, 2006. Castlewood's adoption of FAS 123R had

no material impact on Castlewood's consolidated financial statements. FAS 123R is effective for the first interim or annual reporting period beginning after January 1, 2006. On May 23, 2006, Castlewood entered into a merger agreement and a recapitalization



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agreement. As a result of the execution of these agreements, the accounting treatment for share-based awards issued under Castlewood's employee share plan changed from book value to fair value.

In June 2005, the FASB directed its staff to issue the proposed FASB Staff Proposal, or FSP, Emerging Issues Task Force, or EITF Issue 03-1, as final and retitled it as FSP FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments*, which replaced existing guidance in EITF 03-1 of the same name. FSP FAS 115-1 clarifies that an impairment should be recognized as a loss no later than when the impairment is deemed other-than-temporary, even if the decision to sell the investment has not been made. FSP FAS 115-1 is effective for other-than-temporary impairment analysis conducted in periods beginning after December 15, 2005. Castlewood's previous policy regarding other-than-temporary impairments substantially complies with FSP FAS 115-1, and therefore the adoption of this standard had no material impact on Castlewood's net income or equity.

In July 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*. FIN 48 prescribes detailed guidance for the financial statement recognition, measurement and disclosure of uncertain tax positions recognized in an enterprise's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. Tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. FIN 48 will be effective for fiscal years beginning after December 15, 2006 and the provisions of FIN 48 will be applied to all tax positions upon initial adoption of the Interpretation. The cumulative effect of applying the provisions of this Interpretation will be reported as an adjustment to the opening balance of retained earnings for that fiscal year. The Company is currently evaluating the potential impact of FIN 48 on its financial statements when adopted.

In September 2006, the FASB issued FAS 157, *Fair Value Measurement*. This Statement provides guidance for using fair value to measure assets and liabilities. Under this standard, the definition of fair value focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price). FAS 157 clarifies that fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets and the lowest priority to unobservable data. Further, FAS 157 requires tabular disclosures of the fair value measurements by level within the fair value hierarchy. FAS 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted as of the beginning of a fiscal year. The Company is currently evaluating the potential impact of FAS 157 on its financial statements when adopted.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements* (SAB 108), which provides guidance on the consideration of the effects of prior year misstatements in quantifying current year misstatements for the purpose of a materiality assessment. Two approaches are commonly used to evaluate the materiality of misstatements or errors in financial statements: the rollover, also known as the current-period or income-statement approach, and the iron curtain, also known as the cumulative or balance-sheet approach. The rollover approach quantifies a misstatement based on the amount of the error originating in the current-period income statement. This approach could allow balance sheet items to grow each year by immaterial amounts, until the cumulative error becomes material. The iron curtain approach quantifies a misstatement based on the effects of correcting the misstatement existing in the balance sheet at the end of the current period. This approach does not consider the income statement effects of correcting prior year misstatements in the current year to be errors. The reliance on only one of these approaches, to the exclusion of the other, does not appropriately quantify all misstatements that could be material to financial-statement users. Accordingly, SAB 108 will require quantification of financial statement errors based on the effects of the error on each of a company's financial statements and the related financial statement disclosures. This model is commonly referred to as a dual approach because it essentially requires quantification of errors under both the iron-curtain and the roll-over approaches. From a transition perspective, SAB 108 permits

companies to record the cumulative effect of initially applying the dual approach in the first year ending after November 15, 2006 by recording any necessary correcting adjustments to the carrying values of assets and liabilities as of the beginning of that year with the offsetting adjustment recorded to the opening balance of

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retained earnings. SAB 108 is effective for annual financial statements covering the first fiscal year ending after November 15, 2006. The Company does not expect the adoption of SAB 108 to have a material affect on its results of operations, financial position or liquidity.

**Results of Operations**

The following table sets forth Castlewood's selected consolidated statement of operations data for each of the periods indicated.

|   | <b>Three Months Ended</b> |                      | <b>Nine Months Ended</b> |                      | <b>Year Ended December 31,</b>        |               |                |
|---|---------------------------|----------------------|--------------------------|----------------------|---------------------------------------|---------------|----------------|
|   | <b>September 30,</b>      | <b>September 30,</b> | <b>September 30,</b>     | <b>September 30,</b> | <b>2005</b>                           | <b>2004</b>   | <b>2003</b>    |
|   | <b>2006</b>               | <b>2005</b>          | <b>2006</b>              | <b>2005</b>          | <b>(in thousands of U.S. dollars)</b> |               |                |
| <b>INCOME</b>   |                           |                      |                          |                      |                                       |               |                |
| Consulting Fee Income   | \$ 9,350                  | \$ 5,180             | \$ 20,950                | \$ 13,525            | \$ 22,006                             | \$ 23,703     | \$ 24,746      |
| Net Investment Income   | 12,697                    | 7,410                | 33,502                   | 20,589               | 28,236                                | 11,102        | 8,032          |
| Net Realized Gains/(Losses)                                   | 15                        | 456                  | (64)                     | 560                  | 1,268                                 | (600)         | (960)          |
| <b>TOTAL INCOME</b>   | <b>22,062</b>             | <b>13,046</b>        | <b>54,388</b>            | <b>34,674</b>        | <b>51,510</b>                         | <b>34,205</b> | <b>31,818</b>  |
| <b>EXPENSES</b>   |                           |                      |                          |                      |                                       |               |                |
| Net Reduction in Loss and Loss Adjustment Expense Liabilities | (3,920)                   | (1,043)              | (10,700)                 | (6,466)              | (96,007)                              | (13,706)      | (24,044)       |
| Salaries and Benefits   | 7,996                     | 6,133                | 22,436                   | 18,529               | 40,821                                | 26,290        | 15,661         |
| General and Administrative Expenses                           | 4,154                     | 3,239                | 12,287                   | 9,379                | 10,962                                | 10,677        | 6,993          |
| Interest Expense  | 362                       | 0                    | 894                      | 0                    | 0                                     | 0             | 0              |
| Net Foreign Exchange (Gain)/Loss                              | (947)                     | 223                  | (8,914)                  | 2,418                | 4,602                                 | (3,731)       | (2,362)        |
| <b>TOTAL EXPENSES</b>   | <b>7,645</b>              | <b>8,552</b>         | <b>16,003</b>            | <b>23,860</b>        | <b>(39,622)</b>                       | <b>19,530</b> | <b>(3,752)</b> |
| Net Earnings before Minority Interest                         | 14,417                    | 4,494                | 38,385                   | 10,814               | 91,132                                | 14,675        | 35,570         |
| Share of Net Earnings of Partly-Owned Companies               | 232                       | 63                   | 495                      | 142                  | 192                                   | 6,881         | 1,623          |
| Income Tax Expense  | (1,034)                   | (285)                | (239)                    | (1,612)              | (914)                                 | (1,924)       | (1,490)        |
| Minority Interest   | (2,619)                   | (439)                | (7,805)                  | (1,430)              | (9,700)                               | (3,097)       | (5,111)        |
| Net Earnings before Extraordinary Gain                        | 10,996                    | 3,833                | 30,836                   | 7,914                | 80,710                                | 16,535        | 30,592         |
| Extraordinary Gain -  | 0                         | 0                    | 4,347                    | 0                    | 0                                     | 21,759        | 0              |

Negative Goodwill  
(net of minority  
interest)

|              |           |          |           |          |           |           |           |
|--------------|-----------|----------|-----------|----------|-----------|-----------|-----------|
| NET EARNINGS | \$ 10,996 | \$ 3,833 | \$ 35,183 | \$ 7,914 | \$ 80,710 | \$ 38,294 | \$ 30,592 |
|--------------|-----------|----------|-----------|----------|-----------|-----------|-----------|

**Table of Contents*****Comparison of Three Months Ended September 30, 2006 and 2005***

Castlewood reported consolidated net earnings of approximately \$11.0 million for the three months ended September 30, 2006 compared to approximately \$3.8 million for the same period in 2005. The increase was primarily a result of higher investment income, higher consulting fees and increased foreign exchange gains, partially offset by increased minority interest expense, income tax expense and loan interest expense.

*Consulting Fees:*

|             | <b>Three Months Ended September 30,<br/>2006      2005      Variance<br/>(in thousands of U.S. dollars)</b> |          |          |
|-------------|---|----------|----------|
| Consulting  | \$ 14,265   | \$ 8,956 | \$ 5,309 |
| Reinsurance | (4,915)   | (3,776)  | (1,139)  |
| Total       | \$ 9,350  | \$ 5,180 | \$ 4,170 |

Castlewood earned consulting fees of approximately \$9.4 million and \$5.2 million for the three months ended September 30, 2006 and 2005, respectively. Included in these amounts were approximately \$0.3 million in consulting fees charged to wholly-owned subsidiaries of B.H. Acquisition, a partly-owned company, in both 2006 and 2005. The increase in consulting fees is primarily due to the increase in incentive-based fees earned by its U.S. subsidiary in the period.

Internal management fees of \$4.9 million and \$3.8 million were paid in the three months ended September 30, 2006 and 2005, respectively, by Castlewood's reinsurance companies to its consulting companies. The increase in fees paid by the reinsurance segment was due primarily to the fees paid by Brampton in the quarter. Brampton was acquired by Castlewood on March 30, 2006.

*Net Investment Income and Net Realized Gains/(Losses):*

|             | <b>Three Months Ended September 30,<br/>Net Investment      Net Realized<br/>Income      Gains/(Losses)<br/>2006      2005      Variance      2006      2005      Variance<br/>(in thousands of U.S. dollars)</b> |          |          |       |        |          |
|-------------|---|----------|----------|-------|--------|----------|
| Consulting  | \$ 309  | \$ 143   | \$ 166   | \$ 0  | \$ 0   | \$ 0     |
| Reinsurance | 12,388  | 7,267    | 5,121    | 15    | 456    | (441)    |
| Total       | \$ 12,697   | \$ 7,410 | \$ 5,287 | \$ 15 | \$ 456 | \$ (441) |

Net investment income for the three-month period ended September 30, 2006 increased by \$5.3 million to \$12.7 million, as compared to \$7.4 million for the three-month period ended September 30, 2005. The increase was attributable to the increase in prevailing interest rates quarter on quarter along with an increase in average cash and

investment balances from \$918.9 million to \$1,095.5 million for the quarters ended September 30, 2005 and 2006, respectively. The increase in cash and investment balances was due primarily to the acquisition of Brampton which was completed on March 30, 2006.

The average return on the cash and fixed maturities investments for the three-month period ended September 30, 2006 was 4.64%, as compared to the average return of 3.42% for the three-month period ended September 30, 2005. The increase in yield was primarily the result of increasing interest rates in the last three months of 2005 and the first six months of 2006. The average Standard & Poor's credit rating of Castlewood's fixed income investments at September 30, 2006 was AAA.

Net realized gains/(losses) for the three-month periods ended September 30, 2006 and 2005 were \$15,000 and \$456,000, respectively. Based on Castlewood's current investment strategy, Castlewood does not expect net realized gains and losses to be significant in the foreseeable future.

**Table of Contents***Net Reduction in Loss and Loss Adjustment Expense Liabilities:*

Net reduction in loss and loss adjustment expense liabilities for the three months ended September 30, 2006 and 2005 were \$3.9 million and \$1.0 million, respectively. The net reduction in loss and loss adjustment expense liabilities for both three-month periods was primarily attributable to the reduction in estimates of loss adjustment expense liabilities to reflect 2006 and 2005 run-off activity partially offset by reductions in estimates of reinsurance balances receivable. The following table shows the components of the movement in net reduction in loss and loss adjustment expense liabilities for the three months ended September 30, 2006 and 2005.

|   | <b>Three Months Ended<br/>September 30,<br/>2006                  2005<br/>(in thousands of<br/>U.S. dollars)</b> |              |
|---|---|--------------|
| Net Losses Paid   | \$ (16,315)   | \$ (19,912)  |
| Net Change in Case and LAE Reserves                               | 12,042  | 1,497        |
| Net Change in IBNR  | 8,193   | 19,458       |
| <br>Net Reduction in Loss and Loss Adjustment Expense Liabilities | <br>\$ 3,920  | <br>\$ 1,043 |

The table below provides a reconciliation of the beginning and ending reserves for losses and loss adjustment expenses for the three months ended September 30, 2006 and 2005. Losses incurred and paid are reflected net of reinsurance recoverables.

|  | <b>Three Months Ended<br/>September 30,<br/>2006                  2005<br/>(in thousands of<br/>U.S. dollars)</b> |                |
|--|---|----------------|
| Net Reserves for Losses and Loss Adjustment Expenses, July 1           | \$ 772,010  | \$ 695,292     |
| Incurred Related to Prior Years  | (3,920)   | (1,043)        |
| Paid Related to Prior Years  | (16,315)  | (19,912)       |
| Effect of Exchange Rate Movement                                       | 3,596   | (9,569)        |
| <br>Net Reserves for Losses and Loss Adjustment Expenses, September 30 | <br>\$ 755,371  | <br>\$ 664,768 |

*Salaries and Benefits:*

|  | <b>Three Months Ended<br/>September 30,<br/>2006                  2005                  Variance<br/>(in thousands of U.S. dollars)</b> |  |  |
|--|---|--|--|
|--|---|--|--|

|             |          |          |            |
|-------------|----------|----------|------------|
| Consulting  | \$ 6,812 | \$ 5,634 | \$ (1,178) |
| Reinsurance | 1,184    | 499      | (685)      |
| Total       | \$ 7,996 | \$ 6,133 | \$ (1,863) |

Salaries and benefits, which include expenses relating to Castlewood's discretionary bonus and employee share plans, were \$8.0 million and \$6.1 million for the three-month periods ended September 30, 2006 and 2005, respectively. Salary costs have increased quarter on quarter due primarily to growth in staff numbers from an average of 157 for the three months ended September 30, 2005 to 186 for the three months ended September 30, 2006.

Castlewood expects that staff costs will continue to increase in 2006 and into 2007 as it continues to grow and add staff. Bonus accrual expenses will be variable and dependent on the overall profit of Castlewood.



**Table of Contents***General and Administrative Expenses:*

|             | <b>Three Months Ended<br/>September 30,</b> |             |                 |
|-------------|---|-------------|-----------------|
|             | <b>2006</b>                                 | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>       |             |                 |
| Consulting  | \$ 2,596                                    | \$ 2,260    | \$ (336)        |
| Reinsurance | 1,558                                       | 979         | (579)           |
| Total       | \$ 4,154                                    | \$ 3,239    | \$ (915)        |

General and administrative expenses attributable to the consulting segment increased by \$0.3 million during the three months ended September 30, 2006, as compared to the three months ended September 30, 2005. This increase was due primarily to increases in rent and rent related costs due to an increase in office space along with an increase in professional fees and travel relating to due diligence work on potential acquisition opportunities. Castlewood expects that general and administrative expenses attributable to the consulting segment will increase in 2006 and into 2007 due to growth in its U.S. operations, continued growth in staff resources and additional costs associated with its reporting obligations as a public company if the merger is completed.

General and administrative expenses attributable to the reinsurance segment increased by \$0.6 million during the three months ended September 30, 2006, as compared to the three months ended September 30, 2005. The increased costs for the current quarter relate primarily to general and administrative expenses incurred in relation to the legal costs associated with arranging a loan facility with a London-based Bank. Castlewood does not expect a significant level of costs in the reinsurance segment as the majority of costs incurred are covered by the management agreements in place with the consulting segment, including those related to new acquisitions.

*Foreign Exchange Gain/(Loss):*

|             | <b>Three Months Ended<br/>September 30,</b> |             |                 |
|-------------|---|-------------|-----------------|
|             | <b>2006</b>                                 | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>       |             |                 |
| Consulting  | \$ 61                                       | \$ 80       | \$ (19)         |
| Reinsurance | 886   | (303)       | 1,189           |
| Total       | \$ 947                                      | \$ (223)    | \$ 1,170        |

Castlewood recorded a foreign exchange gain of \$0.9 million for the three-month period ended September 30, 2006, as compared to a foreign exchange loss of \$(0.2) million for the same period in 2005. The gain for the three-month period ended September 30, 2006 arose as a result of having surplus British Pounds at a time when the British Pound strengthened against the U.S. Dollar. For the three months ended September 30, 2005, the foreign exchange loss arose primarily as a result of the holding of surplus net Euros in one of the reinsurance subsidiaries along with the weakening of the Euro against the U.S. Dollar.

*Share of Income of Partly-Owned Companies:*

|             | <b>Three Months Ended<br/>September 30,</b> |             |                 |
|-------------|---|-------------|-----------------|
|             | <b>2006</b>                                 | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>       |             |                 |
| Consulting  | \$ 0  | \$ 0        | \$ 0            |
| Reinsurance | 232   | 63          | 169             |
| Total       | \$ 232                                      | \$ 63       | \$ 169          |

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Castlewood's share of equity in earnings of partly-owned companies for the three-month periods ended September 30, 2006 and 2005, was \$0.2 million and \$0.1 million, respectively. These amounts represent Castlewood's proportionate share of equity in the earnings of B.H. Acquisition.

On consummation of the merger, B.H. Acquisition will become a wholly-owned subsidiary of Castlewood and, as a result, Castlewood will consolidate the results of B.H. Acquisition rather than report its proportionate share of B.H. Acquisition's income.

*Income Tax Expense:*

|             | <b>Three Months Ended September 30,</b> |             |                 |
|-------------|---|-------------|-----------------|
|             | <b>2006</b>                             | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>   |             |                 |
| Consulting  | \$ 935                                  | \$ 279      | \$ (656)        |
| Reinsurance | 99                                      | 6           | (93)            |
| Total       | \$ 1,034                                | \$ 285      | \$ (749)        |

The consulting segment incurred \$0.9 million of income tax expense in the three-months ended September 30, 2006, as compared to a \$0.3 million tax expense for the same period in 2005.

The variance between the two periods arose primarily as a result of Castlewood booking an increased tax expense relating to income earned in the quarter from its U.S. subsidiaries.

*Minority Interest:*

|             | <b>Three Months Ended September 30,</b> |             |                 |
|-------------|---|-------------|-----------------|
|             | <b>2006</b>                             | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>   |             |                 |
| Consulting  | \$                                      | \$          | \$              |
| Reinsurance | (2,619)                                 | (439)       | (2,180)         |
| Total       | \$ (2,619)                              | \$ (439)    | \$ (2,180)      |

Castlewood recorded a minority interest in earnings of \$2.6 million and \$0.4 million for the three-month periods ended September 30, 2006 and 2005, respectively, reflecting the 49.9% minority economic interest held by a third party in the earnings from Hillcot and Brampton. The large increase in 2006 over 2005 is attributable to the net earnings of Brampton which was acquired on March 30, 2006.

*Interest Expense:*

|             | <b>Three Months Ended<br/>September 30,</b> |             |                 |
|-------------|---|-------------|-----------------|
|             | <b>2006</b>                                 | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>       |             |                 |
| Consulting  | \$  | \$          | \$              |
| Reinsurance | 362   |             | (362)           |
| Total       | \$ 362                                      | \$          | \$ (362)        |

Interest expense of \$0.4 million was recorded for the quarter ended September 30, 2006. This amount relates to the interest on the funds that were borrowed from a London-based bank to partially assist with the financing of the Brampton acquisition.

**Table of Contents*****Comparison of Nine Months Ended September 30, 2006 and 2005***

Castlewood reported consolidated net earnings of approximately \$35.2 million for the nine months ended September 30, 2006 compared to approximately \$7.9 million for the same period in 2005. The increase was primarily a result of higher investment income, higher consulting fees, increased foreign exchange gains and the recording of \$4.4 million in negative goodwill, partially offset by higher salaries and benefits costs, minority interest expense and loan interest expense.

***Consulting Fees:***

|             | <b>Nine Months Ended September 30,<br/>2006                      2005                      Variance<br/>(in thousands of U.S. dollars)</b> |           |          |
|-------------|--|-----------|----------|
| Consulting  | \$ 34,687  | \$ 25,364 | \$ 9,323 |
| Reinsurance | (13,737)   | (11,839)  | (1,898)  |
| Total       | \$ 20,950  | \$ 13,525 | \$ 7,425 |

Castlewood earned consulting fees of approximately \$21.0 million and \$13.5 million for the nine months ended September 30, 2006 and 2005, respectively. Included in these amounts were approximately \$0.9 million in consulting fees charged to wholly-owned subsidiaries of B.H. Acquisition, a partly-owned company, in both 2006 and 2005. The increase in consulting fees is primarily due to the increased fees generated by the consulting companies from both new internal and external clients along with increases in incentive-based fees for the period. In particular, Castlewood (US) Inc., which commenced operations on April 1, 2005, had fee and incentive income for the nine months ended September 30, 2006 that was \$7.0 million higher than for the same period in 2005.

Internal management fees of \$13.7 million and \$11.8 million were paid in the nine months ended September 30, 2006 and 2005, respectively, by Castlewood's reinsurance companies to its consulting companies. The increase in fees paid by the reinsurance segment for the nine months ended September 30, 2006 was due primarily to the management fees paid by Brampton in the period offset by a reduction in fees paid by Hillcot Re. Brampton was acquired by Castlewood on March 30, 2006.

***Net Investment Income and Net Realized Gains/(Losses):***

|             | <b>Nine Months Ended September 30,<br/>Net Investment                      Net Realized<br/>Income                      Gains/(Losses)<br/>2006                      2005                      Variance                      2006                      2005                      Variance<br/>(in thousands of U.S. dollars)</b> |           |           |         |        |          |
|-------------|--|-----------|-----------|---------|--------|----------|
| Consulting  | \$ 886   | \$ 386    | \$ 500    | \$ 0    | \$ 0   | \$ 0     |
| Reinsurance | 32,616   | 20,203    | 12,413    | (64)    | 560    | (624)    |
| Total       | \$ 33,502  | \$ 20,589 | \$ 12,913 | \$ (64) | \$ 560 | \$ (624) |

Net investment income for the nine-month period ended September 30, 2006 increased by \$12.9 million to \$33.5 million, as compared to \$20.6 million for the nine-month period ended September 30, 2005. The increase was attributable to the combination of an increase in prevailing interest rates between September 30, 2005 and September 30, 2006 as well as an increase in average cash and investment balances from \$925.8 million to \$1,018.8 million for the nine months ended September 30, 2005 and 2006, respectively. The increase in cash and investment balances was due primarily to the acquisition of Brampton which was completed on March 30, 2006.

The average return on the cash and fixed maturities investments for the nine-month period ended September 30, 2006 was 4.38%, as compared to the average return of 3.05% for the nine-month period ended September 30, 2005. The increase in yield was primarily the result of increasing interest rates in the last three

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months of 2005 and the first six months of 2006. The average Standard & Poor's credit rating of Castlewood's fixed income investments at September 30, 2006 was AAA.

Net realized gains/(losses) for the nine months ended September 30, 2006 and 2005 were \$(0.1) and \$0.6 million, respectively. Based on Castlewood's current investment strategy, Castlewood does not expect net realized gains and losses to be significant in the foreseeable future.

*Net Reduction in Loss and Loss Adjustment Expense Liabilities:*

Net reduction in loss and loss adjustment expense liabilities for the nine months ended September 30, 2006 and 2005 were \$10.7 million and \$6.5 million, respectively. The net reduction in loss and loss adjustment expense liabilities for both nine month periods was primarily attributable to the reduction in estimates of loss adjustment expense liabilities to reflect 2006 and 2005 run-off activity partially offset by reductions in estimates of reinsurance balances receivable. The following table shows the components of the movement in net reduction in loss and loss adjustment expense liabilities for the nine months ended September 30, 2006 and 2005.

|   | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|--|-------------|
|   | <b>2006</b>                                | <b>2005</b> |
|   | <b>(in thousands of U.S. dollars)</b>      |             |
| Net Losses Paid   | \$ (43,771)                                | \$ (59,963) |
| Net Change in Case and LAE Reserves                           | 28,163                                     | 36,775      |
| Net Change in IBNR  | 26,308                                     | 29,654      |
| Net Reduction in Loss and Loss Adjustment Expense Liabilities | \$ 10,700                                  | \$ 6,466    |

The table below provides a reconciliation of the beginning and ending reserves for losses and loss adjustment expenses for the nine months ended September 30, 2006 and 2005. Losses incurred and paid are reflected net of reinsurance recoverables.

|  | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|--|-------------|
|  | <b>2006</b>                                | <b>2005</b> |
|  | <b>(in thousands of U.S. dollars)</b>      |             |
| Net Reserves for Losses and Loss Adjustment Expenses, January 1    | \$ 593,160                                 | \$ 736,660  |
| Incurred Related to Prior Years                                    | (10,700)                                   | (6,466)     |
| Paid Related to Prior Years  | (43,771)                                   | (59,963)    |
| Effect of Exchange Rate Movement                                   | 8,434                                      | (23,325)    |
| Acquired on Acquisition of Subsidiaries                            | 208,248                                    | 17,862      |
| Net Reserves for Losses and Loss Adjustment Expenses, September 30 | \$ 755,371                                 | \$ 664,768  |

*Salaries and Benefits:*

|             | <b>Nine Months Ended September 30,</b><br><b>(in thousands of U.S. dollars)</b> |             |                 |
|-------------|---|-------------|-----------------|
|             | <b>2006</b>   | <b>2005</b> | <b>Variance</b> |
| Consulting  | \$ 17,633   | \$ 17,178   | \$ (455)        |
| Reinsurance | 4,803   | 1,351       | (3,452)         |
| Total       | \$ 22,436   | \$ 18,529   | \$ (3,907)      |

Salaries and benefits, which include expenses relating to Castlewood's discretionary bonus and employee share plans, were \$22.4 million and \$18.5 million for the nine months ended September 30, 2006 and 2005, respectively. On May 23, 2006, Castlewood entered into a merger agreement and a recapitalization agreement,



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which agreements provide for the cancellation of the current incentive compensation plan and replaces it with a new incentive compensation plan. As a result of the execution of these agreements, the accounting treatment for share-based awards under Castlewood's employee share plan changed from book value to fair value. As a result of this modification, Castlewood recognized additional stock-based compensation of \$15.6 million in the three months ended June 30, 2006. As a result of the cancellation of the current annual incentive compensation plan, \$21.2 million of prior years' unpaid bonus accrual was reversed during the three months ended June 30, 2006. The expense associated with the new annual incentive compensation plan was \$6.2 million for the nine months ended September 30, 2006 as compared to an expense of \$1.4 million relating to the prior plan for the nine months ended September 30, 2005.

Castlewood expects that staff costs will continue to increase in 2006 and into 2007 as it continues to grow and add staff. Bonus accrual expenses will be variable and dependent on the overall profit of Castlewood as they will, in accordance with the annual incentive plan, be equal to 15% of after tax earnings of Castlewood.

*General and Administrative Expenses:*

|             | <b>Nine Months Ended September 30,</b> |             |                 |
|-------------|--|-------------|-----------------|
|             | <b>2006</b>                            | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>  |             |                 |
| Consulting  | \$ 8,600                               | \$ 7,138    | \$ (1,462)      |
| Reinsurance | 3,687                                  | 2,241       | (1,446)         |
| Total       | \$ 12,287                              | \$ 9,379    | \$ (2,908)      |

General and administrative expenses attributable to the consulting segment increased by \$1.5 million during the nine months ended September 30, 2006, as compared to the nine months ended September 30, 2005. This increase was due primarily to increases in rent and rent related costs due to an increase in office space, increased computer related costs and an increase in professional fees and travel relating to due diligence work on potential acquisition opportunities. Castlewood expects that general and administrative expenses attributable to the consulting segment will increase in 2006 and into 2007 due to growth in its U.S. operations, continued growth in staff resources and additional costs associated with its reporting obligations as a public company if the merger is completed.

General and administrative expenses attributable to the reinsurance segment increased by \$1.5 million during the nine months ended September 30, 2006, as compared to the nine months ended September 30, 2005. The increased costs for the current year relate primarily to general and administrative expenses in relation to the integration of Brampton into Castlewood as well as legal costs associated with arranging the loan facility with a London-based bank. On an ongoing basis, Castlewood does not expect a significant level of costs in the reinsurance segment as the majority of costs incurred are covered by the management agreements in place with the consulting segment, including those related to new acquisitions.

*Foreign Exchange Gain/(Loss):*

|  | <b>Nine Months Ended September 30,</b> |             |                 |
|--|--|-------------|-----------------|
|  | <b>2006</b>                            | <b>2005</b> | <b>Variance</b> |
|  | <b>(in thousands of U.S. dollars)</b>  |             |                 |

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|             |            |            |            |
|-------------|------------|------------|------------|
| Consulting  | \$ (1,188) | \$ 43      | \$ (1,231) |
| Reinsurance | 10,102     | (2,461)    | 12,563     |
| Total       | \$ 8,914   | \$ (2,418) | \$ 11,332  |

Castlewood recorded a foreign exchange gain of \$8.9 million for the nine months ended September 30, 2006, as compared to a foreign exchange loss of \$2.4 million for the same period in 2005. The gain for the nine-month period ended September 30, 2006 arose primarily as a result of having surplus British Pounds as a result of Castlewood's acquisition of Brampton at a time when the British Pound strengthened against the U.S. Dollar. On May 8, 2006 Brampton converted its surplus British Pounds to U.S. Dollars. For the nine

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months ended September 30, 2005, the foreign exchange loss arose primarily as a result of the holding of surplus net Euros in one of the reinsurance subsidiaries along with the weakening of the Euro against the U.S. Dollar.

*Share of Income of Partly-Owned Companies:*

|             | <b>Nine Months Ended<br/>September 30,</b> |             |                 |
|-------------|--|-------------|-----------------|
|             | <b>2006</b>                                | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>      |             |                 |
| Consulting  | \$ 0                                       | \$ 0        | \$ 0            |
| Reinsurance | 495  | 142         | 353             |
| Total       | \$ 495                                     | \$ 142      | \$ 353          |

Castlewood's share of equity in earnings of partly-owned companies for the nine months ended September 30, 2006 and 2005, were \$0.5 million and \$0.1 million, respectively. These amounts represent Castlewood's proportionate share of equity in the earnings of B.H. Acquisition as well as, for the nine months ended September 30, 2005, Castlewood's proportionate share of equity in the earnings of Cassandra, a twenty-seven percent owned equity investment that was disposed of in March 2005.

On consummation of the merger, B.H. Acquisition will become a wholly-owned subsidiary of Castlewood and, as a result, Castlewood will consolidate the results of B.H. Acquisition rather than report its proportionate share of B.H. Acquisition's income.

*Income Tax Expense:*

|             | <b>Nine Months Ended<br/>September 30,</b> |             |                 |
|-------------|--|-------------|-----------------|
|             | <b>2006</b>                                | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>      |             |                 |
| Consulting  | \$ 184                                     | \$ 1,134    | \$ 950          |
| Reinsurance | 55   | 478         | 423             |
| Total       | \$ 239                                     | \$ 1,612    | \$ 1,373        |

The consulting segment incurred a tax expense of \$0.2 million for the nine months ended September 30, 2006, as compared to a \$1.1 million tax expense for the same period in 2005. The variance between the two periods arose as a result of Castlewood booking an increased tax expense relating to income earned in the 2006 period from its U.S. subsidiaries.

The reinsurance segment incurred \$0.1 of tax expense in the nine months ended September 30, 2006, as compared to a \$0.5 million tax expense for the same period in 2005. The tax expense for the nine months ended September 30, 2005 was an adjustment of prior year taxes.

*Minority Interest:*

|             | <b>Nine Months Ended September 30,</b> |             |                 |
|-------------|--|-------------|-----------------|
|             | <b>2006</b>                            | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>  |             |                 |
| Consulting  | \$                                     | \$          | \$              |
| Reinsurance | (7,805)                                | (1,430)     | (6,375)         |
| Total       | \$ (7,805)                             | \$ (1,430)  | \$ (6,375)      |

Castlewood recorded a minority interest in earnings of \$7.8 million and \$1.4 million for the nine months ended September 30, 2006 and 2005, respectively, reflecting the 49.9% minority economic interest held by a third party in the earnings from Hillcot and Brampton. The large increase in 2006 over 2005 is attributable to the net earnings of Brampton which was acquired on March 30, 2006.

**Table of Contents***Interest Expense:*

|             | <b>Nine Months Ended<br/>September 30,</b> |             |                 |
|-------------|--|-------------|-----------------|
|             | <b>2006</b>                                | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>      |             |                 |
| Consulting  | \$   | \$          | \$              |
| Reinsurance | 894  |             | (894)           |
| Total       | \$ 894                                     | \$          | \$ (894)        |

Interest expense of \$0.9 million was recorded for the nine months ended September 30, 2006. This amount relates to the interest on the funds that were borrowed from an international bank to partially assist with the financing of the Brampton acquisition as well as interest on the promissory note that formed part of the acquisition cost for Brampton. Prior to September 30, 2006 the promissory note was repaid in full and the bank loan was reduced.

*Negative Goodwill:*

|             | <b>Nine Months Ended<br/>September 30,</b> |             |                 |
|-------------|--|-------------|-----------------|
|             | <b>2006</b>                                | <b>2005</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b>      |             |                 |
| Consulting  | \$   | \$          | \$              |
| Reinsurance | 4,347                                      |             | 4,347           |
| Total       | \$ 4,347                                   | \$          | \$ 4,347        |

Negative goodwill of \$4.3 million, net of minority interest of \$4.3 million, was recorded for the nine months ended September 30, 2006 in connection with Castlewood's acquisition of Brampton. This amount represents the excess of the fair value of net assets acquired of \$117.9 million over the cost of \$109.2 million. This excess has, in accordance with SFAS 141 Business Combinations, been recognized as an extraordinary gain in 2006. The negative goodwill arose primarily as a result of the income earned by Brampton between the date of the balance sheet on which the agreed purchase price was based, December 31, 2004, and the date the acquisition closed, March 30, 2006.

***Comparison of the Year Ended December 31, 2005 and 2004***

Castlewood reported consolidated net earnings of approximately \$80.7 million in 2005 compared to approximately \$38.3 million in 2004. The increase was primarily a result of higher income arising from the net reduction in loss and loss adjustment expense liabilities and higher investment income, partially offset by higher salaries and benefits expenses and foreign exchange losses. Net income for 2004 also included an extraordinary gain of \$21.8 million for negative goodwill.

*Consulting Fees:*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2005</b>                           | <b>2004</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ 38,046                             | \$ 32,992   | \$ 5,054        |
| Reinsurance | (16,040)                              | (9,289)     | (6,751)         |
| Total       | \$ 22,006                             | \$ 23,703   | \$ (1,697)      |

Castlewood earned consulting fees of approximately \$22.0 million and \$23.7 million for the years ended December 31, 2005 and 2004, respectively. Included in these amounts were approximately \$1.3 million in consulting fees charged to B.H. Acquisition, a partly-owned company, in both 2005 and 2004. The reduction

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in consulting fees during 2005 of \$1.7 million was primarily due to a reduction in incentive-based fee engagements partially offset by an increase in fees from new fixed fee recurring engagements.

Internal management fees of \$16.0 million and \$9.3 million were paid in 2005 and 2004, respectively, by Castlewood's reinsurance companies to its consulting companies. The increase in fees paid in 2005 by the reinsurance segment to the consulting segment was due primarily to the acquisition of new reinsurance entities by Castlewood in 2005 and late 2004.

*Net Investment Income and Net Realized Gains/(Losses):*

|             | Net Investment Income          |           | Year Ended December 31,<br>Net Realized Gains/(Losses) |          |          |          |
|-------------|--------------------------------|-----------|--|----------|----------|----------|
|             | 2005                           | 2004      | Variance   | 2005     | 2004     | Variance |
|             | (in thousands of U.S. dollars) |           |  |          |          |          |
| Consulting  | \$ 576                         | \$ 460    | \$ 116   | \$ 0     | \$ 0     | \$ 0     |
| Reinsurance | 27,660                         | 10,642    | 17,018   | 1,268    | (600)    | 1,868    |
| Total       | \$ 28,236                      | \$ 11,102 | \$ 17,134  | \$ 1,268 | \$ (600) | \$ 1,868 |

Net investment income for the year ended December 31, 2005 increased \$17.1 million to \$28.2 million, as compared to \$11.1 million for the year ended December 31, 2004. The increase was primarily attributable to having a larger average cash and investment balance in 2005 (\$913.5 million) versus 2004 (\$497.1 million) along with an increase in prevailing interest rates period on period.

The average return on the cash and fixed maturities investments for the year ended December 31, 2005 was 3.2%, as compared to the average return of 2.1% for the year ended December 31, 2004. The increase in yield was primarily the result of increasing interest rates in 2005. The weighted average Standard & Poor's credit rating of Castlewood's fixed income investments at December 31, 2005 was AAA.

Net realized gains for the year ended December 31, 2005 increased \$1.9 million to \$1.3 million, as compared to a net realized loss of \$0.6 million for the year ended December 31, 2004. Based on Castlewood's current investment strategy, Castlewood does not expect net realized gains and losses to be significant in the foreseeable future.

*Net Reduction in Loss and Loss Adjustment Expense Liabilities:*

Net reduction in loss and loss adjustment expense liabilities for the years ended December 31, 2005 and 2004 were \$96.0 million and \$13.7 million, respectively. The net reduction in loss and loss adjustment expense liabilities for 2005 was primarily attributable to a reduction in estimates of ultimate losses of \$65.3 million that arose from the completion of approximately 68 commutations of assumed and ceded exposures, the settlement of losses in the year below carried reserves, lower than expected incurred adverse loss development and the resulting reductions in actuarial estimates of IBNR losses. In 2004, the estimate of net ultimate losses increased by \$1.0 million primarily as a result of adverse development of incurred asbestos and environmental losses partially offset by the completion of approximately 36 commutations of assumed and ceded exposures and settlement of losses below carried reserves. As a result of the collection of certain reinsurance receivables, against which bad debt provisions had been provided in earlier periods, Castlewood reduced its aggregate provisions for bad debt by \$20.2 million in 2005. There was no

change to the provisions for bad debts in 2004. During 2005, Castlewood reduced its estimate of loss adjustment expense liabilities to reflect 2005 run-off activity by \$10.5 million compared to a reduction of \$14.7 million in 2004. The lower reduction in 2005 was due to an increase in the ultimate length of time, and therefore cost, by which management expects to conclude the run-off of certain liabilities.



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The following table shows the components of the movement in net reduction in loss and loss adjustment expense liabilities for the years ended December 31, 2005 and 2004.

|   | <b>Year Ended<br/>December 31,<br/>2005                  2004</b> |             |
|---|---|-------------|
|   | <b>(in thousands of<br/>U.S. dollars)</b>                         |             |
| Net Losses Paid   | \$ (69,007)   | \$ (19,019) |
| Net Change in Case and LAE Reserves                           | 95,156  | 33,745      |
| Net Change in IBNR  | 69,858  | (1,020)     |
| Net Reduction in Loss and Loss Adjustment Expense Liabilities | \$ 96,007   | \$ 13,706   |

Net change in case and LAE reserves comprises the movement during the year in specific case reserve liabilities as a result of claims settlements or changes advised to Castlewood by its policyholders and attorneys, less changes in case reserves recoverable advised by Castlewood to its reinsurers as a result of the settlement or movement of assumed claims. Net change in IBNR represents the change in Castlewood's actuarial estimates of losses incurred but not reported.

The table below provides a reconciliation of the beginning and ending reserves for losses and loss adjustment expenses for the years ended December 31, 2005 and 2004. Losses incurred and paid are reflected net of reinsurance receivables.

|   | <b>Year Ended December 31,<br/>2005                  2004</b> |            |
|---|---|------------|
|   | <b>(in thousands of<br/>U.S. dollars)</b>                     |            |
| Net Reserves for Losses and Loss Adjustment Expenses, January 1   | \$ 736,660  | \$ 230,155 |
| Incurred Related to Prior Years                                   | (96,007)  | (13,706)   |
| Paid Related to Prior Years                                       | (69,007)  | (19,019)   |
| Effect of Exchange Rate Movement                                  | 3,652   | 4,124      |
| Acquired on Acquisition of Subsidiaries                           | 17,862  | 535,106    |
| Net Reserves for Losses and Loss Adjustment Expenses, December 31 | \$ 593,160  | \$ 736,660 |

*Salaries and Benefits:*

|  | <b>Year Ended December 31,<br/>2005                  2004                  Variance</b> |  |
|--|---|--|
|  | <b>(in thousands of U.S. dollars)</b>   |  |

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|             |           |           |             |
|-------------|-----------|-----------|-------------|
| Consulting  | \$ 26,864 | \$ 20,312 | \$ (6,552)  |
| Reinsurance | 13,957    | 5,978     | (7,979)     |
| Total       | \$ 40,821 | \$ 26,290 | \$ (14,531) |

Salaries and benefits, which include accrued bonuses, were \$40.8 million and \$26.3 million for the years ended December 31, 2005 and 2004, respectively. This increase was due to the combination of increased staff costs of \$4.8 million due to an increase in employee headcount from 124 to 166 from December 31, 2004 to December 31, 2005, and \$9.7 million of expense relating to Castlewood's discretionary bonus and employee share plans. The employee share plan was implemented in August 2004 and the associated compensation expense was accounted for using the intrinsic value method under APB Opinion No. 25. In 2005 and 2004, the total costs associated with both plans were \$19.8 million and \$10.1 million, respectively. The salary costs for the reinsurance segment relate to the discretionary bonus plan and equal 15% of after-tax income earned by the reinsurance segment.

Castlewood expects that staff costs will continue to increase in 2006 as Castlewood continues to grow and add staff. Bonus accrual expenses will be variable and dependent on the overall profit of the Company.

**Table of Contents***General and Administrative Expenses:*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2005</b>                           | <b>2004</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ 9,246                              | \$ 6,874    | \$ (2,372)      |
| Reinsurance | 1,716                                 | 3,803       | 2,087           |
| Total       | \$ 10,962                             | \$ 10,677   | \$ (285)        |

General and administrative expenses attributable to the consulting segment increased by approximately \$2.4 million during 2005, as compared to 2004. This increase was due primarily to an increase in professional fees of \$1.0 million and rent and rent-related costs of \$0.8 million due to Castlewood's continued growth in the United Kingdom. Castlewood expects that general and administrative expenses attributable to the consulting segment will continue to increase in 2006 due to growth in its U.S. operations, continued growth in staff resources and additional costs associated with its reporting obligations as a public company if the merger is consummated.

General and administrative expenses attributable to the reinsurance segment decreased by approximately \$2.1 million in 2005, as compared to 2004. This decrease was due primarily to a decrease in provisions for rent and rent related costs of \$1.8 million relating to property based in London leased by River Thames. The provision was established based on the difference between the rent River Thames pays under its lease and what it was receiving for the sublease to a third party of the property. During 2005, the property, after expiration of the third-party sub-lease, was sublet to a related party for a higher rent which enabled River Thames to reduce its provision.

*Foreign Exchange Gain/(Loss):*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2005</b>                           | <b>2004</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ (10)                               | \$ 89       | \$ (99)         |
| Reinsurance | (4,592)                               | 3,642       | (8,234)         |
| Total       | \$ (4,602)                            | \$ 3,731    | \$ (8,333)      |

Castlewood recorded a foreign exchange loss of \$4.6 million for 2005, as compared to a foreign exchange gain of \$3.7 million for 2004. The loss in the current year arose as a result of having surplus British Pounds and Euros at various points in the year. For 2004, the foreign exchange gain arose primarily as a result of surplus Swiss Franc cash balances that were acquired as a result of an acquisition. The 2005 and 2004 currency mismatches were addressed and corrected by converting the surplus foreign currency to U.S. Dollars at the time the mismatch was identified. As Castlewood's functional currency is the U.S. Dollar, it seeks to manage its exposure to foreign currency exchange by broadly matching foreign currency assets against foreign currency liabilities.

*Share of Income of Partly-Owned Companies:*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2005</b>                           | <b>2004</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ 0                                  | \$ 0        | \$ 0            |
| Reinsurance | 192                                   | 6,881       | (6,689)         |
| Total       | \$ 192                                | \$ 6,881    | \$ (6,689)      |

Castlewood's share of equity in earnings of partly-owned companies for the years ended December 31, 2005 and 2004, was \$0.2 million and \$6.9 million, respectively. For 2005, this amount represents Castlewood's

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proportionate share of equity in the earnings of B.H. Acquisition and Cassandra. Included in 2004, in addition to earnings relating to B.H. Acquisition and Cassandra, is Castlewood's proportionate share of earnings of the JCF CFN Entities, a forty-percent owned equity investment that was disposed of in 2004.

*Income Tax (Expense)/Recovery:*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2005</b>                           | <b>2004</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ (883)                              | \$ (1,939)  | \$ 1,056        |
| Reinsurance | (31)                                  | 15          | (46)            |
| Total       | \$ (914)                              | \$ (1,924)  | \$ 1,010        |

Income taxes of \$0.9 million and \$1.9 million were recorded for the years ended December 31, 2005 and 2004, respectively. The income tax expense was incurred primarily on earnings of Castlewood's U.K. and U.S. subsidiaries.

*Minority Interest:*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2005</b>                           | <b>2004</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ 0                                  | \$ 0        | \$ 0            |
| Reinsurance | 9,700                                 | 3,097       | 6,603           |
| Total       | \$ 9,700                              | \$ 3,097    | \$ 6,603        |

Castlewood recorded a minority interest in earnings of \$9.7 million and \$3.1 million in 2005 and 2004, respectively, reflecting the 49.9% minority economic interest held by a third party in the earnings from Hillcot.

*Negative Goodwill:*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2005</b>                           | <b>2004</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ 0                                  | \$ 0        | \$ 0            |
| Reinsurance | 0                                     | 21,759      | (21,759)        |
| Total       | \$ 0                                  | \$ 21,759   | \$ (21,759)     |

Negative goodwill of \$21.8 million was recorded for the year ended December 31, 2004. This amount represents the excess of the fair value of net assets acquired of \$26.2 million over the cost of \$4.4 million in relation to Castlewood's acquisition of Mercantile Indemnity Company Ltd., Harper Insurance Limited and Longmynd Insurance Company Ltd. The negative goodwill arose primarily as the result of a negotiated discount between the cost of acquisition and the fair value of net assets acquired for an acquisition where indemnities for aggregate adverse loss development were received. The aggregate adverse loss development indemnities provide coverage capped at the worst plausible loss and loss adjustment expense reserve levels. This excess has, in accordance with FAS 141 Business Combinations, been recognized as an extraordinary gain in 2004.

***Comparison of the Year Ended December 31, 2004 and 2003***

Castlewood reported consolidated net earnings of approximately \$38.3 million in 2004 compared to approximately \$30.6 million in 2003. The increase was primarily a result of an extraordinary gain of \$21.8 million and higher investment income in 2004, partially offset by a substantial decrease in the change in

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net reduction in loss and loss adjustment expense liabilities and a substantial increase in salaries and benefit expense and general and administrative expenses.

*Consulting Fees:*

|                                       | <b>Year Ended December 31,</b> |                  |                   |
|---------------------------------------|--------------------------------|------------------|-------------------|
|                                       | <b>2004</b>                    | <b>2003</b>      | <b>Variance</b>   |
| <b>(in thousands of U.S. dollars)</b> |                                |                  |                   |
| Consulting                            | \$ 32,992                      | \$ 31,112        | \$ 1,880          |
| Reinsurance                           | (9,289)                        | (6,366)          | (2,923)           |
| <b>Total</b>                          | <b>\$ 23,703</b>               | <b>\$ 24,746</b> | <b>\$ (1,043)</b> |

Castlewood earned consulting fees of approximately \$23.7 million and \$24.7 million for the years ended December 31, 2004 and 2003, respectively. Included in these amounts were approximately \$1.3 million in consulting fees charged to B.H. Acquisition, a partly-owned company, in both 2004 and 2003. The reduction in consulting fees during 2004 of \$1.0 million was primarily due to the reduction of fixed fee engagements and the sale, in 2003, of Castlewood's captive management subsidiary, partially offset by an increase in incentive-based fee engagements.

Internal management fees of \$9.3 million and \$6.4 million were paid in 2004 and 2003, respectively, by Castlewood's reinsurance companies to its consulting companies. The increase in fees paid in 2004 by the reinsurance segment to the consulting segment was due to the acquisition of Harper Insurance Limited, or Harper, by Castlewood in 2004 and an increase in incentive-based fees.

*Net Investment Income and Net Realized Gains/(Losses):*

|                                       | <b>Year Ended December 31,</b> |                       |                 | <b>Year Ended December 31,</b> |                 |                 |
|---------------------------------------|--------------------------------|-----------------------|-----------------|--------------------------------|-----------------|-----------------|
|                                       | <b>Net Investment</b>          |                       | <b>Variance</b> | <b>Net Realized</b>            |                 | <b>Variance</b> |
| <b>Income</b>                         |                                | <b>Gains/(Losses)</b> |                 |                                |                 |                 |
|                                       | <b>2004</b>                    | <b>2003</b>           |                 | <b>2004</b>                    | <b>2003</b>     |                 |
| <b>(in thousands of U.S. dollars)</b> |                                |                       |                 |                                |                 |                 |
| Consulting                            | \$ 460                         | \$ 265                | \$ 195          | \$ 0                           | \$ (862)        | \$ 862          |
| Reinsurance                           | 10,642                         | 7,767                 | 2,875           | (600)                          | (98)            | (502)           |
| <b>Total</b>                          | <b>\$ 11,102</b>               | <b>\$ 8,032</b>       | <b>\$ 3,070</b> | <b>\$ (600)</b>                | <b>\$ (960)</b> | <b>\$ 360</b>   |

Net investment income, for the years ended December 31, 2004 increased \$3.1 million to \$11.1 million, as compared to \$8.0 million for the year ended December 31, 2003. The increase was attributable to the combination of the acquisition of Harper's investment portfolio of \$526.6 million in October 2004 and the increase in the investment yield during 2004.

The average return on the cash and fixed maturities investments for the year ended December 31, 2004 was 2.1%, as compared to the average return of 1.9% for the year ended December 31, 2003. The increase in yield was primarily

the result of increasing interest rates in 2004. The weighted average Standard & Poor's credit rating of Castlewood's fixed income investments at December 31, 2004 was AAA-.

Net realized losses for the year ended December 31, 2004 decreased by \$0.4 million to \$0.6 million, as compared to a net realized loss of \$1.0 million for the year ended December 31, 2003. Based on Castlewood's current investment strategy, Castlewood does not expect net realized gains and losses to be significant in the foreseeable future.

*Net Reduction in Loss and Loss Adjustment Expense Liabilities:*

Net reduction in loss and loss adjustment expense liabilities for the years ended December 31, 2004 and 2003 were \$13.7 million and \$24.0 million, respectively. In 2004, the estimate of net ultimate losses increased by \$1.0 million primarily as a result of adverse development of incurred asbestos and environmental losses partially offset by completing approximately 36 commutations of assumed and ceded exposures and settlement



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of losses below carried reserves. In 2003, the estimate of net ultimate losses reduced by \$13.6 million as a result of the completion of 13 commutations of assumed and ceded exposures, the settlement of losses below carried reserves and the resulting reductions in actuarial estimates of IBNR losses. During 2004, Castlewood reduced its estimate of loss adjustment expense liabilities by \$14.7 million to reflect 2004 run-off activity compared to a reduction of \$10.4 million in 2003. The higher reduction in 2004 was due to the re-estimate of the ultimate cost and length of time by which management expects to conclude the run-off of liabilities of Hillcot, which was acquired by Castlewood in March 2003.

The following table shows the components of the movement in net reduction in loss and loss adjustment expense liabilities for the years ended December 31, 2004 and 2003.

|   | <b>Year Ended December 31,</b>        |               |
|---|---------------------------------------|---------------|
|   | <b>2004</b>                           | <b>2003</b>   |
|   | <b>(in thousands of U.S. dollars)</b> |               |
| Net Losses Paid   | \$ (19,019)                           | \$ (4,094)    |
| Net Change in Case and LAE Reserves                                 | 33,745                                | 9,946         |
| Net Change in IBNR  | (1,020)                               | 18,192        |
| <br>Net Reduction in Losses and Loss Adjustment Expense Liabilities | <br>\$ 13,706                         | <br>\$ 24,044 |

The table below provides a reconciliation of the beginning and ending reserves for losses and loss adjustment expenses for the years ended December 31, 2004 and 2003. Losses incurred and paid are reflected net of reinsurance receivables.

|   | <b>Year Ended December 31,</b>        |                |
|---|---------------------------------------|----------------|
|   | <b>2004</b>                           | <b>2003</b>    |
|   | <b>(in thousands of U.S. dollars)</b> |                |
| Net Reserves for Losses and Loss Adjustment Expenses, January 1       | \$ 230,155                            | \$ 184,518     |
| Incurred Related to Prior Years                                       | (13,706)                              | (24,044)       |
| Paid Related to Prior Years   | (19,019)                              | (4,094)        |
| Effect of Exchange Rate Movement                                      | 4,124                                 | 10,575         |
| Acquired on Acquisition of Subsidiaries                               | 535,106                               | 63,200         |
| <br>Net Reserves for Losses and Loss Adjustment Expenses, December 31 | <br>\$ 736,660                        | <br>\$ 230,155 |

*Salaries and Benefits:*

|  | <b>Year Ended December 31,</b>        |             |                 |
|--|---------------------------------------|-------------|-----------------|
|  | <b>2004</b>                           | <b>2003</b> | <b>Variance</b> |
|  | <b>(in thousands of U.S. dollars)</b> |             |                 |

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|             |           |           |             |
|-------------|-----------|-----------|-------------|
| Consulting  | \$ 20,312 | \$ 12,234 | \$ (8,078)  |
| Reinsurance | 5,978     | 3,427     | (2,551)     |
| Total       | \$ 26,290 | \$ 15,661 | \$ (10,629) |

Salaries and benefits, which include accrued bonuses, were \$26.3 million and \$15.7 million for the years ended December 31, 2004 and 2003, respectively. This increase was due to the combination of increased staff costs of \$3.6 million due to an increase in employee headcount from 106 to 124 from December 31, 2003 to December 31, 2004, and \$7.0 million of expense relating to Castlewood's discretionary bonus and employee share plans. The employee share plan was implemented in August 2004 with a portion of the awards being vested at the date of the grant and the associated employee compensation expense was accounted for using the intrinsic value method under APB Opinion No. 25. In 2004 and 2003, the total costs associated with both plans were \$10.1 million and \$3.1 million, respectively. The salary costs for the reinsurance segment relate to the discretionary bonus plan and equal 15% of after-tax income earned by the reinsurance segment.

**Table of Contents***General and Administrative Expenses:*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2004</b>                           | <b>2003</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ 6,874                              | \$ 6,821    | \$ (53)         |
| Reinsurance | 3,803                                 | 172         | (3,631)         |
| Total       | \$ 10,677                             | \$ 6,993    | \$ (3,684)      |

General and administrative expenses attributable to the consulting segment decreased by approximately \$0.1 million during 2004, as compared to 2003.

General and administrative expenses attributable to the reinsurance segment increased by approximately \$3.6 million in 2004, as compared to 2003. The 2003 general and administrative expenses included the release of an accrued pension liability of \$3.1 million. This provision was established prior to Castlewood completing the acquisition of the company. In late 2003, Castlewood received confirmation from the pension actuary that the pension was fully funded and that there would not be any future shortfall that would have to be funded by Castlewood.

*Foreign Exchange Gain/(Loss):*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2004</b>                           | <b>2003</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ 89                                 | \$ 219      | \$ (130)        |
| Reinsurance | 3,642                                 | 2,143       | 1,499           |
| Total       | \$ 3,731                              | \$ 2,362    | \$ 1,369        |

Castlewood recorded foreign exchange gains of \$3.7 million and \$2.4 million for the years ended December 31, 2004 and 2003, respectively. The foreign exchange gain in 2004 arose primarily as a result of surplus Swiss Franc cash balances that were acquired as a result of an acquisition. For 2003, the gain was attributable to Castlewood's British Pound denominated available-for-sale investment portfolio. The 2004 and 2003 currency mismatches were addressed and corrected by converting the surplus Swiss Franc and British Pounds to U.S. Dollars at the time the mismatch was identified. As Castlewood's functional currency is the U.S. Dollar, it seeks to manage its exposure to foreign currency exchange by broadly matching currency assets against foreign currency liabilities.

*Share of Income of Partly-Owned Companies:*

|  | <b>Year Ended December 31,</b>        |             |                 |
|--|---------------------------------------|-------------|-----------------|
|  | <b>2004</b>                           | <b>2003</b> | <b>Variance</b> |
|  | <b>(in thousands of U.S. dollars)</b> |             |                 |

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|             |          |          |          |
|-------------|----------|----------|----------|
| Consulting  | \$ 0     | \$ 0     | \$ 0     |
| Reinsurance | 6,881    | 1,623    | 5,258    |
| Total       | \$ 6,881 | \$ 1,623 | \$ 5,258 |

Castlewood's share of equity in earnings of partly-owned companies for the years ended December 31, 2004 and 2003, was \$6.9 million and \$1.6 million, respectively. For 2004 and 2003, this amount represents Castlewood's proportionate share of equity in the earnings of B.H. Acquisition and the JCF CFN Entities.

**Table of Contents***Income Tax (Expense)/Recovery:*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2004</b>                           | <b>2003</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ (1,939)                            | \$ (1,490)  | \$ (449)        |
| Reinsurance | 15                                    | 0           | 15              |
| Total       | \$ (1,924)                            | \$ (1,490)  | \$ (434)        |

Income taxes of \$1.9 million and \$1.5 million were recorded for the years ended December 31, 2004 and 2003, respectively. This income tax expense was incurred on earnings of Castlewood's U.K. and U.S. subsidiaries.

*Minority Interest:*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2004</b>                           | <b>2003</b> | <b>Variance</b> |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ 0                                  | \$ 0        | \$ 0            |
| Reinsurance | 3,097                                 | 5,111       | (2,014)         |
| Total       | \$ 3,097                              | \$ 5,111    | \$ (2,014)      |

Castlewood recorded a minority interest in earnings of \$3.1 million and \$5.1 million in 2004 and 2003, respectively, reflecting the 49.9% minority economic interest held by a third party in the earnings from Hillcot.

*Negative Goodwill:*

|             | <b>Year Ended December 31,</b>        |             |                 |
|-------------|---------------------------------------|-------------|-----------------|
|             | <b>2004</b>                           | <b>2003</b> | <b>Variance</b> |
|             | <b>(Unaudited)</b>                    |             |                 |
|             | <b>(in thousands of U.S. dollars)</b> |             |                 |
| Consulting  | \$ 0                                  | \$ 0        | \$ 0            |
| Reinsurance | 21,759                                | 0           | 21,759          |
| Total       | \$ 21,759                             | \$ 0        | \$ 21,759       |

Negative goodwill of \$21.8 million was recorded for the year ended December 31, 2004. This amount represents the excess of the fair value of net assets acquired of \$26.2 million over the cost of \$4.4 million in relation to Castlewood's acquisition of Mercantile Indemnity Company Ltd., Harper Insurance Limited and Longmynd Insurance Company

Ltd. The negative goodwill arose primarily as the result of a negotiated discount between the cost of acquisition and the fair value of net assets acquired for an acquisition where indemnities for aggregate adverse loss development were received. The aggregate loss development indemnities provide coverage capped at worst possible loss and loss adjustment expenses reserve levels. This excess has, in accordance with FAS 141 Business Combinations, been recognized as an extraordinary gain in 2004.

***Liquidity and Capital Resources***

As Castlewood is a holding company and has no substantial operations of its own, its assets consist primarily of its investments in subsidiaries. The potential sources of the cash flows to the holding company consist of dividends, advances and loans from its subsidiary companies.

Castlewood's future cash flows depend upon the availability of dividends or other statutorily permissible payments from Castlewood's subsidiaries. The ability to pay dividends and make other distributions is limited by the applicable laws and regulations of the jurisdictions in which Castlewood's insurance and reinsurance subsidiaries operate, including Bermuda, The United Kingdom, Belgium, Luxembourg and Switzerland, which subject these subsidiaries to significant regulatory restrictions. These laws and regulations require, among other

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things, some of Castlewood's insurance and reinsurance subsidiaries to maintain minimum solvency requirements and limit the amount of dividends and other payments that these subsidiaries can pay to Castlewood, which in turn may limit Castlewood's ability to pay dividends and make other payments. As of December 31, 2005 and 2004, the insurance and reinsurance subsidiaries' solvency and liquidity were in excess of the minimum levels required. Retained earnings of Castlewood's insurance and reinsurance subsidiaries are not currently restricted as minimum capital solvency margins are covered by share capital and additional paid-in-capital. However, as of both December 31, 2005 and 2004, retained earnings of \$8.5 million of one of B.H. Acquisition's subsidiaries requires regulatory approval prior to distribution. B.H. Acquisition will become a wholly-owned subsidiary of Castlewood following the recapitalization and the merger.

Castlewood's capital management strategy is to preserve sufficient capital to enable it to make future acquisitions while maintaining a conservative investment strategy. Castlewood believes that restrictions on liquidity resulting from restrictions on the payments of dividends by Castlewood's subsidiary companies will not have a material impact on Castlewood's ability to meet its cash obligations.

Castlewood's sources of funds primarily consist of the cash and investment portfolios acquired on the completion of the acquisition of an insurance or reinsurance company in run-off. These acquired cash and investment balances are classified as cash provided by investing activities. Castlewood will use these funds acquired, together with collections from reinsurance debtors, consulting income, investment income and proceeds from sales and redemption of investments, to pay losses and loss expenses, salaries and benefits and general and administrative expenses, with the remainder used for acquisitions, additional investments and, in the past, for dividend payments to shareholders. Castlewood expects that its reinsurance segment will have a net use of cash from operations as total net claim settlements and operating expenses will generally be in excess of investment income earned. Castlewood expects that its consulting segment operating cash flows will generally be breakeven. Castlewood expects its operating cash flows, together with its existing capital base and cash and investments acquired on the acquisition of its insurance and reinsurance subsidiaries, to be sufficient to meet cash requirements and to operate its business going forward. Castlewood does not intend to pay cash dividends on its ordinary shares following the merger.

Castlewood maintains a short duration conservative investment strategy whereby 74.6% of its invested assets are held with a maturity of less than one year and 97.1% have maturities of less than five years. Excluding the impact of commutations, Castlewood expects that approximately 11% of the net reserves are expected to be settled within one year and approximately 41% of the reserves settled within five years. However, Castlewood's strategy of commuting its liabilities has the potential to accelerate the natural payout of losses to less than five years. Therefore, the relatively short-duration investment portfolio is maintained in order to provide liquidity for commutation opportunities and preclude Castlewood from having to liquidate longer dated securities thereby allowing Castlewood to maintain its fixed income securities on a held-to-maturity basis. As such, Castlewood does not anticipate having to sell longer dated investments in order to meet future policyholder liabilities. However, if Castlewood had to sell a portion of its held-to-maturity portfolio to meet policyholder liabilities it would, at that point, amend the classification of the held-to-maturity portfolio to that of an available-for-sale portfolio. This reclassification would require the investment portfolio to be recorded at market value as opposed to amortized cost. As at September 30, 2006 such a reclassification would result in a reduction in the value of Castlewood's cash and investments of \$4.5 million, reflecting the unrealized loss position of the held to maturity portfolio as at September 30, 2006.

At December 31, 2005, total cash and investments were \$884.9 million, compared to \$942.1 million at December 31, 2004. The decrease of \$57.2 million was primarily due to an increase of paid losses of \$69.5 million relating to Harper Insurance Limited, or Harper, one of Castlewood's reinsurance subsidiaries. Harper was acquired on October 29, 2004 and the 2005 loss payments reflect a full year of Castlewood owning Harper. This was offset by the combination of investment income earned of \$28.2 million and cash acquired on acquisition of a subsidiary of \$18.0 million less a payment of \$22 million in final settlement of distribution rights from certain acquired companies.





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At December 31, 2004, total cash and investments were \$942.1 million, compared to \$395.6 million at December 31, 2003. The increase of \$546.5 million was primarily due to the acquisition by Castlewood of Harper's cash and investments of \$526.6 million.

### ***Source of Funds***

Castlewood primarily generates its cash from the acquisitions it completes. These acquired cash and investment balances are classified as cash provided by investing activities.

Castlewood expects that for the reinsurance segment there will be a net use of cash from operations, due to total claim settlements and operating expenses being in excess of investment income earned, and that for the consulting segment operating cash flows will be breakeven. As a result, the net operating cash flows for Castlewood are expected to be negative as it pays out cash in claims settlements and expenses in excess of cash generated via investment income and consulting fees.

### ***Operating***

Net cash provided by operating activities for the nine-month period ended September 30, 2006 was \$23.7 million compared to \$19.6 million for the nine-month period ended September 30, 2005. This increase in cash flows is attributable to higher investment and consulting income and lower paid losses for the nine months ended September 30, 2006 as compared to the same period in 2005.

Net cash (used in) provided by operating activities for the year ended December 31, 2005 was \$(6.3) million compared to \$0.9 million for the year ended December 31, 2004. An increase in net losses paid of \$50.0 million offset by the funds realized on the sale of trading securities was the main source for the year over year decrease. Net loss payments made in the year ended December 31, 2005 were \$69.0 million compared to \$19.0 million for the year ended December 31, 2004.

During 2004 Castlewood, through a subsidiary, acquired Harper (formerly Turegum Insurance Company). As part of the acquisition, Castlewood acquired Harper's fixed income portfolio. Upon completion of the acquisition, Harper's fixed income investment portfolio was reviewed by management, taking into account Castlewood's run-off strategy for Harper's liabilities. Fixed income maturities were selected to provide, together with the short-term cash investments, sufficient cash flow to fund expected claims payments, while maximizing interest income. As a result of this analysis, Castlewood classified certain fixed income securities as held to maturity. Fixed income securities that were not part of Castlewood's run-off strategy were classified as trading as management intended to sell these securities in the near term. The securities designated as trading were completely sold in the first quarter of 2005.

### ***Investing***

Investing cash flows consist primarily of cash acquired and used on acquisitions and proceeds on the sale of investments and payments for investments acquired. Net cash provided by investing activities was \$153.2 million during the nine months ended September 30, 2006 compared to \$52.1 million during the nine months ended September 30, 2005. The increase in the current period was due to an increase in cash balances acquired on the purchase of subsidiaries along with proceeds from the sale and maturity of investments held by Castlewood.

Net cash (used) provided by investing activities during the year ended December 31, 2005 was \$(14.1) million as compared to \$197.0 million during the year ended December 31, 2004. The decrease for 2005 was attributable to the decrease in cash available to be invested due to increase in cash requirements to pay losses along with a reduction in cash acquired on acquisitions in 2005 as compared to 2004. Net cash provided by investing activities during the year

ended December 31, 2004 was \$197.0 million as compared to \$40.8 million during 2003.

**Table of Contents***Financing*

Net cash used in financing activities was \$54.9 million during the nine months ended September 30, 2006 compared to \$0.8 million during the nine months ended September 30, 2005. The increase in cash used in financing activities for Castlewood was primarily attributable to the combination of redemption of shares, dividends paid and repayment of bank and vendor loans offset by capital contributions by the minority interest shareholder of a subsidiary.

Net cash used in financing activities was \$0.8 million during the year ended December 31, 2005 compared to \$12.4 million for the year ended December 31, 2004. The cash used for both years was exclusively for distributions to shareholders. Net cash used by financing activities was \$12.4 million during the year ended December 31, 2004 compared to \$29.3 million for the year ended December 31, 2003. For 2003 cash of \$66.8 million was returned to shareholders and \$37.5 million was contributed by shareholders and minority interests.

*Investments*

At December 31, 2005, Castlewood's investments included \$296.6 million in a fixed income portfolio that is classified as held-to-maturity, compared to \$228.2 million at December 31, 2004. The maturity distribution of this portfolio as of December 31, 2005 and 2004 was as follows:

|                          | 2005              |            | 2004              |            |
|--------------------------|-------------------|------------|-------------------|------------|
|                          | Amortized<br>Cost | Fair Value | Amortized<br>Cost | Fair Value |
| Due within 1 year        | \$ 81,552         | \$ 80,886  | \$ 59,250         | \$ 59,069  |
| After 1 through 5 years  | 181,826           | 178,152    | 121,213           | 120,222    |
| After 5 through 10 years | 15,170            | 14,887     | 7,323             | 7,262      |
| After 10 years           | 18,036            | 17,345     | 40,446            | 40,118     |
|                          | \$ 296,584        | \$ 291,270 | \$ 228,232        | \$ 226,671 |

*Long-Term Debt*

On April 12, 2006, Castlewood, through Hillcot, entered into a facility loan agreement for \$44.4 million with an international bank. On April 13, 2006, Hillcot drew down \$44.4 million from the facility, the proceeds of which were used to repay shareholder funds advanced for the acquisition of Aioi Europe. The interest rate on the facility is LIBOR plus 2% and the facility is repayable within 4 years. The facility is secured by a first charge over Hillcot's shares in Aioi Europe together with a floating charge over Hillcot's assets. On May 5, 2006, Hillcot repaid \$25.2 million of the principal, plus accumulated interest, leaving \$19.2 million of the facility outstanding.

On October 3, 2006, a subsidiary of Castlewood, Virginia Holdings Ltd., or Virginia, entered into a facility loan agreement for \$24.5 million with a London-based bank. On October 4, 2006, Virginia drew down \$24.5 million from the facility, the proceeds of which were used to partially fund the acquisition of Cavell Holdings Limited (U.K.), a U.K. company. The interest rate on the loan is LIBOR plus 2% and the loan is repayable within 4 years.

**Table of Contents*****Aggregate Contractual Obligations***

The following table shows Castlewood's aggregate contractual obligations by time period remaining to due date as of December 31, 2005:

***Payments due by period***

|   | <b>Total</b>                 | <b>&lt; 1 year</b> | <b>1-3 Years</b> | <b>3-5 Years</b> | <b>&gt; 5 Years</b> |
|---|------------------------------|--------------------|------------------|------------------|---------------------|
|   | <b>(Dollars in millions)</b> |                    |                  |                  |                     |
| <b>Contractual Obligations</b>              |                              |                    |                  |                  |                     |
| Investment commitments                      | \$ 83.2                      | \$ 15.8            | \$ 57.4          | \$ 9.2           | \$ 0.8              |
| Operating lease obligations                 | 4.7                          | 1.4                | 1.6              | 0.7              | 1.0                 |
| Gross reserves for losses and loss expenses | 806.6                        | 86.8               | 137.8            | 108.2            | 473.8               |
|   | \$ 894.5                     | \$ 104.0           | \$ 196.8         | \$ 118.1         | \$ 475.6            |

The amounts included for net reserve for losses and loss adjustment expenses reflect the estimated timing of expected loss payments on known claims and anticipated future claims. Both the amount and timing of cash flows are uncertain and do not have contractual payout terms. For a discussion of these uncertainties, see Critical Accounting Policies Loss and Loss Adjustment Expenses beginning on page 124. Due to the inherent uncertainty in the process of estimating the timing of these payments, there is a risk that the amounts paid in any period will differ significantly from those disclosed. Total estimated obligations are expected to be funded by existing cash and investments.

***Off-Balance Sheet Arrangements***

As of September 30, 2006, Castlewood did not have any off-balance sheet arrangements.

***Commitments***

In 2005, Castlewood made a capital commitment of up to \$10 million in GSC European Mezzanine Fund II, L.P., or the GCS Fund. The GSC Fund invests in mezzanine securities of middle and large market companies throughout Western Europe. As of December 31, 2005, the capital contributed to the GSC Fund was \$1.8 million with the remaining of the commitment being \$8.2 million.

In June 2006, the commitment of Castlewood to invest up to \$75.0 million in J.C. Flowers II, L.P., or the Flowers Fund, was accepted by the Flowers Fund. Castlewood intends to use cash on hand to fund this commitment. The Flowers Fund is a private investment fund for which JCF Associates II L.P. is the general partner and J.C. Flowers & Co. LLC is the investment advisor. JCF Associates II L.P. and J.C. Flowers & Co. LLC are controlled by Mr. Flowers. No fees or other compensation will be payable by Castlewood to the Flowers Fund, JCF Associates II L.P., J.C. Flowers & Co. LLC, or Mr. Flowers in connection with this investment. John J. Oros, who will be New Enstar's Executive Chairman and a member of its board of directors, is a managing director of J.C. Flowers & Co. LLC. Mr. Oros will split his time between J.C. Flowers & Co. LLC and New Enstar. As of November 28, 2006, the Flowers Fund has drawn down a total of \$19.0 million of Castlewood's \$75.0 million commitment.

**Quantitative and Qualitative Information about Market Risk**

***Interest Rate Risk***

Castlewood has calculated the effect that an immediate parallel shift in the U.S. interest rate yield curve would have on its cash and investments at September 30, 2006. The modeling of this effect was performed on Castlewood's mutual funds as a shift in the yield curve would not have an impact on its fixed income

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investments classified as held to maturity as they are carried at purchase cost adjusted for amortization of premiums and discounts. The results of this analysis are summarized in the table below.

**Interest Rate Movement Analysis on Market Value of Mutual Funds**

|                               | <b>Interest Rate Shift in Basis Points</b> |            |            |            |             |
|-------------------------------|--|------------|------------|------------|-------------|
|                               | <b>-100</b>                                | <b>-50</b> | <b>0</b>   | <b>+50</b> | <b>+100</b> |
|                               | <b>(in thousands of U.S. dollars)</b>      |            |            |            |             |
| Total Market Value            | \$ 211,577                                 | \$ 210,920 | \$ 210,275 | \$ 209,639 | \$ 209,014  |
| Market Value Change from Base | 0.63%                                      | 0.31%      | 0.0%       | (0.31)%    | (0.60)%     |
| Change in Unrealized Value    | \$ 1,302                                   | \$ 645     | \$ 0       | \$ (636)   | \$ (1,261)  |

As a holder of fixed income securities and mutual funds, Castlewood also has exposure to credit risk. In an effort to minimize this risk, its investment guidelines have been defined to ensure that the fixed income held to maturity portfolio is invested in high-quality securities. At September 30, 2006, approximately 90.2% of Castlewood's fixed income held to maturity portfolio was rated AA-or better by Standard & Poor's.

At September 30, 2006, reinsurance receivables of \$167.2 million were associated with a single reinsurer which represented 53.0% of reinsurance balances receivable. This reinsurer is rated A+ by Standard & Poor's. In the event that all or any of the reinsuring companies are unable to meet their obligations under existing reinsurance agreements, Castlewood will be liable for such defaulted amounts.

***Effects of Inflation***

Castlewood does not believe that inflation has had a material effect on its consolidated results of operations. Loss reserves are established to recognize likely loss settlements at the date payment is made. Those reserves inherently recognize the anticipated effects of inflation. The actual effects of inflation on Castlewood's results cannot be accurately known, however, until claims are ultimately resolved.

***Foreign Currency Risk***

Through its subsidiaries, Castlewood conducts business in a variety of non-U.S. currencies, the principal exposures being in Euros and British pounds. Assets and liabilities denominated in foreign currencies are exposed to changes in currency exchange rates. As Castlewood's functional currency is the U.S. Dollar, exchange rate fluctuations may materially impact Castlewood's results of operations and financial position. Castlewood currently does not use foreign currency hedges to manage its foreign currency exchange risk. With the exception of its 20.7 million Euro denominated investment in New NIB Partners LP, Castlewood manages its exposure to foreign currency exchange risk by broadly matching its non-U.S. Dollar denominated assets against its non-U.S. Dollar denominated liabilities. This matching process is done quarterly in arrears and therefore any mismatches occurring in the period may give rise to foreign exchange gains and losses, which could adversely affect its operating results.

The table below summarizes Castlewood's gross and net exposure as at September 30, 2006 to foreign currencies (in millions of U.S. dollars):

| <b>GBP</b> | <b>Euro</b> | <b>AUD</b> | <b>NOK</b> | <b>Other</b> | <b>Total</b> |
|------------|-------------|------------|------------|--------------|--------------|
|------------|-------------|------------|------------|--------------|--------------|

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|                               |          |         |         |         |         |          |
|-------------------------------|----------|---------|---------|---------|---------|----------|
| Total Assets                  | \$ 263.3 | \$ 76.6 | \$ 19.0 | \$ 17.2 | \$ 10.9 | \$ 387.0 |
| Total Liabilities             | 221.3    | 62.0    | 18.8    | 8.5     | 9.4     | 320.0    |
| Net Foreign Currency Exposure | \$ 42.0  | \$ 14.6 | \$ 0.2  | \$ 8.7  | \$ 1.5  | \$ 67.0  |

Excluding any tax effects, as of September 30, 2006, a 10% change in the U.S. Dollar relative to the other currencies held by Castlewood would have resulted in a \$6.7 million change in the net assets held by Castlewood. Subsequent to September 30, 2006, the above Net Foreign Currency exposures were eliminated with the exception of Castlewood's 20.7 million Euro denominated investment in New NIB Partners LP as Castlewood has decided to retain the currency exposure with respect to this investment.

**Table of Contents****INFORMATION ABOUT ENSTAR**

Enstar is a publicly traded Georgia corporation engaged in the operation of several partially-owned affiliates in financial services businesses. Enstar also continues its active search for one or more additional operating businesses which meet its acquisition criteria. Through the operations of its partially-owned affiliates, Castlewood and B.H. Acquisition, and their subsidiaries, Enstar acquires and manages insurance and reinsurance companies in run-off. The management of these businesses includes claims administration, adjustment and settlement together with the collection of reinsurance recoveries.

**Enstar Executive Officers**

Certain information concerning the executive officers of Enstar is set forth below:

| <b>Name</b>      | <b>Age</b> | <b>Position</b>  | <b>Executive Officer Since</b> |
|------------------|------------|--|--------------------------------|
| Nimrod T. Frazer | 77         | Director, Chairman of the Board and Chief Executive Officer              | 1990                           |
| John J. Oros     | 59         | Director, President and Chief Operating Officer                          | 2000                           |
| Cheryl D. Davis  | 47         | Chief Financial Officer, Vice President of Corporate Taxes and Secretary | 1991                           |
| Amy M. Dunaway   | 49         | Treasurer and Controller   | 1991                           |

*Mr. Frazer* is Chairman of the Board and Chief Executive Officer of Enstar. Mr. Frazer was named Chairman of the Board, Acting President and Chief Executive Officer on October 26, 1990 and served as President from May 26, 1992 to June 6, 2001. Mr. Frazer has served on the board of directors of Affirmative Insurance Holdings, Inc. since November 2005.

*Mr. Oros* was named Executive Vice President of Enstar in March of 2000, and on June 6, 2001, Mr. Oros was named President and Chief Operating Officer of Enstar. Before joining Enstar, Mr. Oros was an investment banker at Goldman, Sachs & Co. in the Financial Institutions Group. Mr. Oros joined Goldman, Sachs & Co. in 1980, and was made a General Partner in 1986. Mr. Oros resigned from Goldman Sachs & Co. in March 2000 to join Enstar. In February 2006, Mr. Oros became a Managing Director of J.C. Flowers & Co. LLC, which serves as investment advisor to J.C. Flowers II L.P., a newly-formed private equity fund affiliated with J. Christopher Flowers. Mr. Oros splits his time between J.C. Flowers & Co. LLC and Enstar.

*Ms. Davis* was named Chief Financial Officer and Secretary of Enstar in April of 1991 and Vice President of Corporate Taxes of Enstar in 1989. Ms. Davis has been employed with Enstar since April of 1988.

*Ms. Dunaway* was named Treasurer and Controller of Enstar in April of 1991. Ms. Dunaway has been employed with Enstar since September of 1990.



**Table of Contents****Executive Compensation Enstar Executive Officers**

The following sets forth summary information concerning the compensation paid by Enstar to Messrs. Frazer and Oros and Milles. Davis and Dunaway during the last three fiscal years.

***Summary Compensation Table***

| Name and Principal Position  | Year            | Annual Compensation |            | Long-Term Compensation Awards  |                               | All Other Compensation (\$) |
|--|-----------------|---------------------|------------|--------------------------------|-------------------------------|-----------------------------|
|  |                 | Salary (\$)(1)      | Bonus (\$) | Other Annual Compensation (\$) | Securities Underlying Options |                             |
| Nimrod T. Frazer   | 2005            | \$ 350,000          |            |                                |                               | \$ 2,892(2)                 |
| Chairman of the Board and Chief Executive Officer                    | 2004            | \$ 363,462          |            |                                |                               | \$ 2,655(2)                 |
|  | 2003            | \$ 347,308          |            |                                | 60,000                        | \$ 2,632(2)                 |
|  | John J. Oros    | 2005                | \$ 350,000 |                                |                               | \$ 51,350(3)                |
| President and Chief Operating Officer                                | 2004            | \$ 363,462          |            |                                |                               | \$ 50,373(3)                |
|  | 2003            | \$ 347,308          |            |                                | 100,000                       | \$ 9,201(3)                 |
|  | Cheryl D. Davis | 2005                | \$ 175,000 |                                |                               | \$ 12,358(4)                |
| Chief Financial Officer, Vice-President of Corp. Taxes and Secretary | 2004            | \$ 181,731          |            |                                |                               | \$ 11,125(4)                |
|  | 2003            | \$ 174,665          |            |                                |                               | \$ 10,297(4)                |
|  | Amy M. Dunaway  | 2005                | \$ 103,000 |                                |                               | \$ 11,856(4)                |
| Treasurer and Controller   | 2004            | \$ 106,962          |            |                                |                               | \$ 10,942(4)                |
|  | 2003            | \$ 102,796          |            |                                |                               | \$ 10,114(4)                |

- (1) Base salaries for executive officers have not changed since 2003. However, the amounts paid vary based upon the number of pay periods during the year.
- (2) Amount shown represents premiums paid by Enstar for health and dental insurance for Mr. Frazer.
- (3) Amount shown represents premiums paid by Enstar for health and dental insurance for Mr. Oros, and for 2004 and 2005, excess of expense allowance over actual expenses paid to Mr. Oros.
- (4) Amounts shown for Milles. Davis and Dunaway are for premiums paid by Enstar for term life insurance and health and dental insurance.

***Aggregated Option/SAR Exercises in Last Fiscal Year and Fiscal Year-End Option Values***

None of the executive officers of Enstar exercised any stock options during 2005. The table below shows the number of shares of Enstar common stock covered by both exercisable and unexercisable stock options held by the executive officers of Enstar as of December 31, 2005. The table also reflects the values for in-the-money options based on the

positive spread between the exercise price of such options and the last reported sale price of the Enstar common stock on December 31, 2005 of \$66.25 per share.

| Name             | Shares<br>Acquired<br>on<br>Exercise<br>(#) | Value<br>Realized<br>(\$) | Number of Securities<br>Underlying Unexercised<br>Options at<br>December 31, 2005 (#) |               | Value of Unexercised<br>In-The-Money Options at<br>December 31, 2005 (\$) |               |
|------------------|---|---------------------------|---|---------------|---|---------------|
|                  |   |                           | Exercisable   | Unexercisable | Exercisable   | Unexercisable |
| Nimrod T. Frazer |   |                           | 280,000   | 30,000        | \$ 13,912,500   | \$ 787,500    |
| John J. Oros     |   |                           | 250,000   | 50,000        | \$ 11,425,000   | \$ 1,312,500  |
| Cheryl D. Davis  |   |                           |   |               |   |               |
| Amy M. Dunaway   |   |                           |   |               |   |               |

**Table of Contents*****Equity Compensation Plan Information***

The following summarizes Enstar's equity compensation plans as of December 31, 2005.

| <b>Plan Category</b>                                      | <b>Number of Securities<br/>to<br/>be Issued Upon<br/>Exercise<br/>of Outstanding<br/>Options,<br/>Warrants and Rights</b> | <b>Weighted Average<br/>Exercise Price of<br/>Outstanding<br/>Options,<br/>Warrants and<br/>Rights</b> | <b>Number of<br/>Securities<br/>Remaining<br/>Available<br/>for Future<br/>Issuance</b> |
|---|--|--|---|
| Equity compensation plans approved by shareholders(1)     | 725,000  | \$ 20.47   | 52,500  |
| Equity compensation plans not approved by shareholders(2) | N/A(3)   | N/A(3)   | 27,908  |
| Total   | 725,000  | \$ 20.47   | 80,408  |

- (1) Equity compensation plans approved by Enstar shareholders are the 2001 Outside Directors' Stock Plan, the 1997 Amended Outside Directors' Stock Option Plan, the 1997 Amended CEO Stock Option Plan, and the 1997 Amended Omnibus Incentive Plan.
- (2) Equity compensation plans not approved by Enstar shareholders are the Deferred Compensation and Stock Plan for Non-Employee Directors and two stock purchase agreements entered into by Enstar with Messrs. Frazer and Oros in June 2001 to sell a total of 200,000 shares (100,000 per individual) of Enstar common stock to Messrs. Frazer and Oros.
- (3) Excludes a total of 34,936 stock units granted to non-employee directors under the Deferred Compensation and Stock Plan for Non-Employee Directors and the 200,000 shares of Enstar common stock purchased by Messrs. Frazer and Oros pursuant to the stock purchase agreements referenced in note 2 above.

***Enstar Compensation Committee Interlocks***

Mr. Flowers served on Enstar's Compensation Committee until June 2005. As described in the section "Certain Relationships and Related Transactions" beginning on page 182, Mr. Flowers and Enstar have entered into numerous transactions, directly and indirectly. Enstar believes that the terms of such transactions are no less favorable to Enstar than would have been the case had such transactions been consummated with unrelated parties.

No member of the compensation committee of Enstar's board of directors is or was during 2005 an employee, or is or ever has been an officer, of Enstar or its subsidiaries, except for Mr. Flowers who served as Enstar's Chairman from October 2001 to June 2003. No executive officer of Enstar served as a director or a member of the compensation committee of another company, one of whose executive officers serves as a member of Enstar's board of directors or compensation committee.

**Report of Enstar Compensation Committee**

The Compensation Committee of Enstar's board of directors, or the Compensation Committee, was created in 1996 and currently consists of Messrs. Davis, Armstrong and Curl. The Compensation Committee is responsible for (i) establishing the compensation of the executive officers of Enstar, upon the recommendation of the Chief Executive Officer (with the exception of the compensation of the Chief Executive Officer) and (ii) considering the issuance of stock options for executive officers and directors. Mr. Frazer, Enstar's Chief Executive Officer, is responsible for recommending to the Compensation Committee the compensation for the other executive officers of Enstar. The Compensation Committee has reviewed the applicability of section 162(m) of the Code. Section 162(m) may in certain circumstances deny a federal income tax deduction for compensation to an executive officer that is in excess of \$1 million per year. Because the Compensation Committee has determined that the compensation for all executive officers for 2006 will remain the same as for 2005, it is not anticipated that compensation to any executive officer of Enstar during 2006 will exceed the \$1 million threshold.

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*Compensation Policy and Overall Objectives.* Enstar's executive compensation policy is designed to attract, retain and motivate executive officers needed to achieve Enstar's strategic objectives and to maximize Enstar's performance and shareholder value.

Enstar supports these goals through a compensation strategy principally involving competitive salaries and long-term incentive opportunities. Compensation consists of both fixed pay elements (base salary and benefits) and long-term incentives to encourage and reward distinctive contributions to the success of the organization. Salary and benefit levels reflect position responsibilities and strategic importance and are targeted at market median base salary levels. Total cash compensation has been below market median levels because Enstar has not paid annual bonuses. Long-term incentive opportunities reward key executives for financial and non-financial performance that enhances shareholder value. Long-term incentive opportunities have been at or above market median levels.

In 1997, Enstar retained an independent compensation consulting firm to assist it in analyzing its executive compensation program. The consulting firm recommended that Enstar adopt a policy of providing a significant percentage of certain executive officers' total compensation based on Enstar's performance. In addition, the consultant provided the Compensation Committee with an analysis of senior executive compensation using published survey data for the financial services industry. In 2003, the Compensation Committee again retained an independent compensation consulting firm, which provided it with an updated analysis of senior executive compensation using published industry data. The Compensation Committee considered these recommendations and the compensation analyses in establishing the base salaries for Enstar's Chief Executive Officer, the Chief Operating Officer and the other executive officers for 2005. The base salaries for Enstar's Chief Executive Officer, Chief Operating Officer and other executive officers have not changed since 2003.

*Base Salary.* Each executive officer's base salary, including Mr. Frazer's base salary, is determined based upon a number of factors including the executive officer's responsibilities, contribution to the achievement of Enstar's business plan goals, demonstrated leadership skills and overall effectiveness and length of service. Base salaries are also designed to be competitive with those offered in the various markets in which Enstar competes for executive talent and are analyzed with a view towards desired base salary levels over a three-year to five-year time period. Although these and other factors are considered in setting base salaries, no specific weight is given to any one factor.

*Cash Bonuses.* Enstar did not pay any cash bonuses to its executive officers during 2005.

*Long-Term Incentives.* Long-term incentives are provided pursuant to the 2001 Outside Directors' Stock Plan, the 1997 Amended Outside Directors' Stock Option Plan, the 1997 Amended CEO Stock Option Plan, the 1997 Amended Omnibus Incentive Plan and the Deferred Compensation and Stock Plan for Non-Employee Directors. Stock option plans are designed to encourage and reward distinctive contributions to Enstar's success and to align executives' and shareholders' interest in the enhancement of shareholder value. Stock options are used by Enstar to encourage long-term service by executives. No stock options were granted to the executive officers of Enstar in 2005.

*Severance and Employment Agreements.* The Compensation Committee approved severance agreements for Nimrod T. Frazer, Cheryl D. Davis and Amy M. Dunaway in March 1998, or the Severance Agreements. The Severance Agreements provide that Nimrod T. Frazer, Cheryl D. Davis and Amy M. Dunaway will receive their base salary for a period of twelve months following a termination of employment, other than for cause, as defined in the Severance Agreements, or a voluntary termination.

The Compensation Committee also approved an employment agreement with John J. Oros in March 2000, or the Employment Agreement. The Employment Agreement provides for an initial one-year term and automatic renewal for successive one-year terms thereafter, subject to earlier termination as provided in the Employment Agreement. The Employment Agreement provides an annual base salary to Mr. Oros to be determined by the board of directors and

reimbursement of up to \$50,000 annually for office-related expenses incurred by Mr. Oros in connection with the performance of his duties with Enstar. The Employment Agreement also provides that the board of directors may award to Mr. Oros such bonuses, and in such amounts, as the board of directors shall determine in its sole discretion. In fiscal 2005, Mr. Oros received an

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annual base salary of \$350,000. In determining Mr. Oros' compensation for 2006, the Compensation Committee specifically considered that, beginning in February 2006, Mr. Oros was employed by, and devoting time to, J.C. Flowers & Co. LLC. Nevertheless, given that his priorities remain with Enstar, the overlapping nature of his duties, and the significant value that Mr. Oros brings to Enstar, the Compensation Committee determined that Mr. Oros' compensation should remain unchanged.

*Chief Executive Officer Compensation.* Mr. Frazer does not have an employment agreement with Enstar. The Compensation Committee is responsible for determining Mr. Frazer's compensation annually. In fiscal 2005, Mr. Frazer received an annual base salary of \$350,000. Mr. Frazer's base salary was based on, among other things, his responsibilities, his length of service, his contributions to the business and his overall leadership skills.

Enstar's Compensation Committee:

T. Wayne Davis, Chairman

T. Whit Armstrong

Gregory L. Curl

**The foregoing report should not be deemed incorporated by reference by any general statement incorporating by reference this proxy statement/prospectus into any filing under the Securities Act or the Exchange Act, except to the extent that Enstar specifically incorporates this information by reference, and shall not otherwise be deemed filed under such acts.**

## **Enstar Audit Committee Report**

Enstar's Audit Committee is responsible for, among other things, appointing (subject to shareholder ratification) the accounting firm that will serve as independent auditors for Enstar and reviewing and pre-approving all audit and non-audit services provided to Enstar by its independent auditors. Enstar's Audit Committee is also responsible for overseeing Enstar's financial reporting and accounting practices and monitoring the adequacy of internal accounting, compliance and control systems. Management is responsible for Enstar's system of internal controls, the financial reporting process and the assessment of the effectiveness of internal controls over financial reporting. The independent auditors are responsible for reviewing Enstar's quarterly financial statements, for expressing an opinion on the conformity of the audited financial statements with accounting principles generally accepted in the United States and for issuing reports and opinions on the operating effectiveness of Enstar's internal controls over financial reporting and management's assessment of the effectiveness of Enstar's internal controls over financial reporting.

Members of Enstar's Audit Committee rely, without independent verification, on the information provided to them and on the representations made by management and the opinions and communications of Enstar's independent auditors. Accordingly, the Audit Committee's review does not provide an independent basis to determine that management has maintained appropriate accounting and financial reporting principles or appropriate internal controls and procedures designed to ensure compliance with accounting standards and applicable laws and regulations. Furthermore, the Audit Committee's activities do not ensure that the audit of Enstar's financial statements has been carried out in accordance with generally accepted auditing standards, that the financial statements are presented in accordance with accounting principles generally accepted in the United States or that Enstar's independent auditors are in fact independent.

In fulfilling its responsibilities:

Enstar's Audit Committee reviewed and discussed the audited financial statements, including management's report on internal controls over financial reporting, contained in the 2005 Annual Report on Form 10-K with Enstar's management and the independent auditors prior to the filing of the Form 10-K with the Commission.





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Enstar's Audit Committee reviewed and discussed the unaudited financial statements contained in Enstar's Quarterly Reports on Form 10-Q for each of the quarters ended in 2005 with Enstar's management and the independent auditors prior to the filing thereof with the Commission.

Enstar's Audit Committee discussed with the independent auditors the matters required to be discussed by Statement on Auditing Standards No. 61 (Communications with Audit Committees) and Rule 2-07 of Regulation S-X.

Enstar's Audit Committee received from the independent auditors written disclosures regarding the auditors independence, as required by Independence Standards Board Standard No. 1 (Independence Discussions with Audit Committees), and discussed with the auditors their independence from Enstar and its management.

In reliance on the reviews and discussions noted above and subject to the limitations set forth above, Enstar's Audit Committee approved the inclusion of the audited financial statements and management's report on internal controls over financial reporting in Enstar's Annual Report on Form 10-K for the year ended December 31, 2005, for filing with the Commission.

Enstar's Audit Committee:

T. Whit Armstrong, Chairman  
T. Wayne Davis  
Gregory L. Curl  
Paul J. Collins

**The foregoing report should not be deemed incorporated by reference by any general statement incorporating by reference this proxy statement/prospectus into any filing under the Securities Act or the Exchange Act, except to the extent that Enstar specifically incorporates this information by reference, and shall not otherwise be deemed filed under such acts.**

**Table of Contents****Enstar Stock Performance Graph**

The graph below reflects the cumulative shareholder return (assuming the reinvestment of dividends) on Enstar common stock compared to the return on the Center for Research in Security Prices Total Return Index for the Nasdaq Stock Market (U.S. Companies), or the Nasdaq Composite, U.S., and Enstar's peer group index, or the Peer Group Index, for the periods indicated. The graph reflects the investment of \$100.00 on December 31, 2000 in Enstar common stock, the Nasdaq Composite, U.S., and the Peer Group Index. The Peer Group Index consists of Annuity and Life Re Holdings, Berkshire Hathaway Inc. (Class A), ESG Re Ltd., Everest Re Group Ltd., IPC Holdings Ltd., Max Re Capital Ltd., Odyssey Re Holdings Corp., PXRE Group Ltd., RenaissanceRe Holdings Ltd. and Transatlantic Holdings, Inc., which are publicly traded companies selected by Enstar, as they were identified by Bloomberg L.P. in 2003 as comparable to Enstar based on certain similarities in their principal lines of business with Enstar's reinsurance operations.

|                              | <b>Dec-00</b> | <b>Dec-01</b> | <b>Dec-02</b> | <b>Dec-03</b> | <b>Dec-04</b> | <b>Dec-05</b> |
|------------------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Enstar Group Inc.            | \$ 100        | \$ 158        | \$ 198        | \$ 312        | \$ 415        | \$ 440        |
| NASDAQ US                    | \$ 100        | \$ 79         | \$ 55         | \$ 82         | \$ 89         | \$ 91         |
| Peer Group Index (10 Stocks) | \$ 100        | \$ 107        | \$ 102        | \$ 120        | \$ 125        | \$ 126        |

*Source:* Georgeson Shareholder Communications Inc.

**The performance graph shall not be deemed incorporated by reference by any general statement incorporating by reference this proxy statement/prospectus into any filing under the Securities Act or the Exchange Act, except to the extent that Enstar specifically incorporates this information by reference, and shall not otherwise be deemed filed under such acts.**

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**Other Matters Related to Enstar**

***Section 16(a) Beneficial Ownership Reporting Compliance***

Section 16(a) of the Exchange Act requires officers and directors of Enstar and persons who beneficially own more than ten percent of Enstar's common stock to file with the Commission certain reports, with respect to each such person's beneficial ownership of Enstar's equity securities. In 2005, based solely upon a review of copies of reports and certain representations of Enstar's executive officers and directors, all of Enstar's reporting persons filed their Section 16(a) reports on a timely basis.

***Annual Report on Form 10-K/A***

Enstar has provided herewith to each shareholder as of the Record Date a copy of Enstar's Annual Report on Form 10-K/A for the year ended December 31, 2005, or the 2005 10-K/A, including the financial statements and financial statement schedules, as filed with the Commission, except exhibits thereto. The 2005 10-K/A and the exhibits filed with it are available through Enstar's website at [www.enstargroup.com](http://www.enstargroup.com). Upon request by an eligible shareholder to the following address, Enstar will furnish a copy of the 2005 10-K/A, without exhibits, without charge, and a copy of any or all of the exhibits to the 2005 10-K/A will be furnished for a reasonable fee:

The Enstar Group, Inc.  
401 Madison Avenue  
Montgomery, Alabama 36104  
Attention: Amy M. Dunaway  
Treasurer and Controller

***Shareholder Nominations for Election of Directors***

Under Enstar's articles of incorporation and bylaws, only persons nominated in accordance with the procedures set forth therein will be eligible for election as directors. Shareholders are entitled to nominate persons for election to the board of directors only if the shareholder is otherwise entitled to vote generally in the election of directors and only if timely notice in writing is sent to the Secretary of Enstar. To be timely, a shareholder's notice must be received at the principal executive offices of Enstar at least 60 days but not more than 90 days prior to the Annual Meeting. Such shareholder's notice should set forth (1) the qualifications of the nominee and the other information that would be required to be disclosed in connection with the solicitation of proxies for the election of directors pursuant to Regulation 14(a) under the Exchange Act and (2) with respect to such shareholder giving such notice, (a) the name and address of such shareholder and (b) the number of shares of common stock beneficially owned by such shareholder. Enstar may require any proposed nominee to furnish such other information as may reasonably be required by Enstar to determine the eligibility of such proposed nominee to serve as a director of Enstar.

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**UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION**

You should read the following unaudited pro forma condensed combined financial information below together with Castlewood's and Enstar's historical financial statements and related notes included in or incorporated by reference into this proxy statement/prospectus and the information set forth under "Information about Castlewood Management's Discussion and Analysis of Financial Condition and Results of Operations" beginning on page 119 and the information set forth under "Management's Discussion and Analysis of Financial Condition and Results of Operations" in Enstar's Quarterly Report on Form 10-Q for the nine months ended September 30, 2006 and Annual Report on Form 10-K/A for the year ended December 31, 2005, which are incorporated by reference in this proxy statement/prospectus.

The unaudited pro forma condensed combined balance sheet as of September 30, 2006 combines the historical consolidated balance sheets of Castlewood and Enstar, giving effect to the merger as if it had been consummated on September 30, 2006. The unaudited pro forma condensed combined income statements for the year ended December 31, 2005 and for the nine months ended September 30, 2006 combine the historical consolidated statements of income of Castlewood and Enstar giving effect to the merger as if it had occurred on January 1, 2005.

The unaudited pro forma condensed combined financial information is presented for informational purposes only and is not necessarily indicative of what New Enstar's actual financial position or results of operations would have been had the merger and the recapitalization been consummated on the dates indicated above, nor is it necessarily indicative of the future financial position or results of operations of New Enstar. The unaudited pro forma adjustments are based on estimates and assumptions, which are preliminary and have been made solely for the purpose of developing such pro forma information. The purchase accounting allocations made by management in connection with the unaudited pro forma condensed combined financial information are based on the assumptions and estimates of management and are subject to reallocation when the final purchase accounting takes place after consummation of the merger.

The following unaudited pro forma condensed combined financial information includes the following adjustments for the merger and the recapitalization of Castlewood:

the purchase by Castlewood of the 22% ownership interest of B.H. Acquisition beneficially owned by an affiliate of Trident II, L.P.;

the consolidation of B.H. Acquisition and the elimination of Castlewood and Enstar's investment in B.H. Acquisition previously recorded using the equity method of accounting;

the exchange of Enstar's 6,000 Class A Castlewood shares for 2,972,892 newly issued non-voting convertible New Enstar shares;

the repurchase by Castlewood of 1,797,555 of Trident's Class B Castlewood shares for \$20.0 million;

the exchange of all remaining Class B, C and D Castlewood shares for 6,139,425 newly issued ordinary shares of New Enstar;

the payment by Enstar to Castlewood, and by Castlewood to certain key employees of Castlewood, of \$5.1 million;

the payment of a dividend by Enstar to its shareholders immediately prior to consummation of the merger; and

the acquisition of Enstar's net assets by Castlewood in return for the issuance to Enstar shareholders of 5,775,654 newly issued ordinary shares of Castlewood.

Table of Contents**Enstar Group Limited****Pro Forma Condensed Combined Balance Sheet as of September 30, 2006**

|  | <b>Castlewood<br/>Historical(a)</b>   | <b>Enstar<br/>Historical(b)</b> | <b>Pro Forma<br/>Adjustments<br/>(Unaudited)</b> |     | <b>Enstar<br/>Group<br/>Limited<br/>Pro Forma as<br/>Adjusted</b> |
|--|---------------------------------------|---------------------------------|--|-----|---|
|  |                                       |                                 |  |     |   |
|  | <b>(in thousands of U.S. dollars)</b> |                                 |  |     |   |
| <b>ASSETS</b>  |                                       |                                 |  |     |   |
| Total investments  | \$ 618,001                            | \$ 5,382                        | \$ 67,051  | (f) | \$ 690,434  |
| Cash and cash equivalents                                | 402,548                               | 94,675                          | (24,997)   | (c) | 472,226   |
| Restricted cash and cash equivalents                     | 64,155                                |                                 | 8,321  | (f) | 72,476  |
| Reinsurance balances receivable                          | 315,223                               |                                 | 3,618  | (f) | 318,841   |
| Investment in partly-owned companies                     | 17,975                                | 99,678                          | (108,815)  | (j) | 8,838   |
| Other assets   | 48,744                                | 544                             | 1,736  | (f) | 51,024  |
| <b>TOTAL ASSETS</b>                                      | <b>\$ 1,466,646</b>                   | <b>\$ 200,279</b>               | <b>\$ (53,086)</b>                               |     | <b>\$ 1,613,839</b>   |
| <b>LIABILITIES</b>                                       |                                       |                                 |  |     |   |
| Losses and loss adjustment expenses                      | \$ 1,003,825                          | \$                              | \$ 58,207  | (f) | \$ 1,062,032  |
| Reinsurance balances payable                             | 83,451                                |                                 | 5,057  | (f) | 88,508  |
| Accounts payable and accrued liabilities                 | 15,354                                | 2,673                           | 6,172  | (g) | 24,199  |
| Bank loan payable  | 19,766                                |                                 |  |     | 19,766  |
| Income taxes payable and deferred income tax liabilities |                                       | 16,670                          | (10,099)   | (m) | 6,571   |
| Other liabilities  | 26,686                                | 1,468                           |  |     | 28,154  |
| <b>TOTAL LIABILITIES</b>                                 | <b>1,149,082</b>                      | <b>20,811</b>                   | <b>59,337</b>                                    |     | <b>1,229,230</b>  |
| <b>MINORITY INTEREST</b>                                 | <b>50,116</b>                         |                                 |  |     | <b>50,116</b>   |
| <b>SHAREHOLDERS EQUITY</b>                               |                                       |                                 |  |     |   |
| Ordinary shares  | 19                                    | 62                              | 11,742   | (k) | 11,823  |
| Additional paid-in capital                               | 109,634                               | 198,248                         | 234,103  | (l) | 541,985   |
| Accumulated other comprehensive income                   | 2,303                                 | 465                             | (465)  | (o) | 2,303   |
| Retained earnings  | 155,492                               | (13,227)                        | 7,997  | (p) | 150,262   |
| Treasury stock   |                                       | (6,080)                         | (365,800)  | (r) | (371,880)   |
| <b>TOTAL SHAREHOLDERS EQUITY</b>                         | <b>267,448</b>                        | <b>179,468</b>                  | <b>(112,423)</b>                                 |     | <b>334,493</b>  |

|  |              |            |             |              |
|--|--------------|------------|-------------|--------------|
| TOTAL LIABILITIES AND<br>SHAREHOLDERS EQUITY | \$ 1,466,646 | \$ 200,279 | \$ (53,086) | \$ 1,613,839 |
|--|--------------|------------|-------------|--------------|

*See accompanying Notes to the Unaudited Pro Forma Condensed Combined Financial Statements.*

**Table of Contents****Enstar Group Limited****Pro Forma Condensed Combined Income Statement for the Year Ended December 31, 2005**

|   | <b>Castlewood<br/>Historical(a)</b>                          | <b>Enstar<br/>Historical(b)</b> | <b>Pro Forma<br/>Adjustments<br/>(Unaudited)</b> |     | <b>Enstar Group<br/>Limited<br/>Pro Forma</b> |
|---|--|---------------------------------|--|-----|---|
|   | <b>(in thousands of U.S. dollars, except per share data)</b> |                                 |  |     |   |
| <b>INCOME</b>   |  |                                 |  |     |   |
| Consulting fees   | \$ 22,006  | \$                              | \$ (1,250)                                       | (d) | \$ 20,756                                     |
| Net investment income   | 28,236   | 4,559                           | 2,006  | (e) | 34,801  |
| Net realized gains (losses)   | 1,268  |                                 |  |     | 1,268   |
|   | 51,510   | 4,559                           | 756  |     | 56,825  |
| <b>EXPENSES</b>   |  |                                 |  |     |   |
| Net reduction in loss and loss<br>adjustment expense liabilities  | (96,007)   |                                 | 552  | (c) | (95,455)                                      |
| Salaries and benefits   | 40,821   |                                 |  |     | 40,821  |
| General and administrative expenses   | 10,962   | 3,110                           | (42)   | (f) | 14,030  |
| Net foreign exchange loss   | 4,602  |                                 | 67   | (c) | 4,669   |
|   | (39,622)   | 3,110                           | 577  |     | (35,935)                                      |
| Earnings before income taxes,<br>minority interest and share of net<br>earnings of partly-owned companies | 91,132   | 1,449                           | 179  |     | 92,760  |
| Income taxes  | (914)  | (8,917)                         | 8,398  | (g) | (1,433)                                       |
| Minority interest   | (9,700)  |                                 |  |     | (9,700)                                       |
| Share of net earnings of partly-owned<br>companies  | 192  | 26,513                          | (26,473)   | (h) | 232   |
| <b>NET EARNINGS</b>   | <b>\$ 80,710</b>   | <b>\$ 19,045</b>                | <b>\$ (17,896)</b>                               |     | <b>\$ 81,859</b>                              |
| Basic Earnings Per Share  | \$ 4,397.89  |                                 |  |     | \$ 6.95                                       |
| Diluted Earnings Per Share  | \$ 4,304.30  |                                 |  |     | \$ 6.59                                       |
| Weighted average shares outstanding<br>basic  | 18,352   |                                 | 11,768,163                                       |     | 11,786,515                                    |
| Weighted average shares outstanding<br>diluted  | 18,751   |                                 | 12,396,328                                       |     | 12,415,079                                    |

*See accompanying Notes to the Unaudited Pro Forma Condensed Combined Financial Statements.*





**Table of Contents****Enstar Group Limited****Pro Forma Condensed Combined Income Statement for the Nine Month Period Ended September 30, 2006**

|   | <b>Castlewood<br/>Historical(a)</b> | <b>Enstar<br/>Historical(b)</b> | <b>Pro Forma<br/>Adjustments<br/>(Unaudited)</b> |     | <b>Enstar Group<br/>Limited<br/>Pro Forma</b> |
|---|-------------------------------------|---------------------------------|--|-----|---|
| <b>(in thousands of U.S. dollars, except per share data)</b>  |                                     |                                 |  |     |   |
| <b>INCOME</b>   |                                     |                                 |  |     |   |
| Consulting fees   | \$ 20,950                           | \$                              | \$ (938)   | (f) | \$ 20,012                                     |
| Net investment income   | 33,438                              | 3,615                           | 2,791  | (e) | 39,844  |
|   | 54,388                              | 3,615                           | 1,853  |     | 59,856  |
| <b>EXPENSES</b>   |                                     |                                 |  |     |   |
| Net reduction in loss and loss<br>adjustment expense liabilities  | (10,700)                            |                                 | 1,010  | (c) | (9,690)                                       |
| Salaries and benefits   | 22,436                              |                                 |  |     | 22,436  |
| General and administrative expenses   | 12,287                              | 4,245                           | (177)  | (f) | 16,355  |
| Interest expense  | 894                                 |                                 |  |     | 894   |
| Net foreign exchange (gain)   | (8,914)                             |                                 | (80)   | (c) | (8,994)                                       |
|   | 16,003                              | 4,245                           | 753  |     | 21,001  |
| Earnings before income taxes, minority<br>interest and share of net earnings of<br>partly-owned companies | 38,385                              | (630)                           | 1,100  |     | 38,855  |
| Income taxes  | (239)                               | (4,812)                         | 4,768  | (g) | (283)   |
| Minority interest   | (7,805)                             |                                 |  |     | (7,805)                                       |
| Share of net earnings of partly-owned<br>companies  | 495                                 | 10,645                          | (10,782)   | (h) | 358   |
| <b>NET EARNINGS BEFORE<br/>EXTRAORDINARY ITEM</b>   | <b>\$ 30,836</b>                    | <b>\$ 5,203</b>                 | <b>\$ (4,914)</b>                                |     | <b>\$ 31,125</b>                              |
| Basic earnings per share  | \$ 1,660.33                         |                                 |  |     | \$ 2.64                                       |
| Diluted earnings per share  | \$ 1,637.54                         |                                 |  |     | \$ 2.51                                       |
| Weighted average shares outstanding<br>basic  | 18,572                              |                                 | 11,767,943                                       |     | 11,786,515                                    |
| Weighted average shares outstanding<br>diluted  | 18,831                              |                                 | 12,396,248                                       |     | 12,415,079                                    |

*See accompanying Notes to the Unaudited Pro Forma Condensed Combined Financial Statements.*



**Table of Contents****Enstar Group Limited****Notes to Pro Forma Condensed Combined Financial Statements (Unaudited)***(in thousands of U.S. dollars, except share amounts)***1. Adjustment to the Pro Forma Condensed Combined Balance Sheet**

- a. Reflects Castlewood's unaudited historical consolidated balance sheet as of September 30, 2006.
- b. Reflects Enstar's unaudited historical consolidated balance sheet as of September 30, 2006. Certain amounts were reclassified to conform to Castlewood's balance sheet presentation.
- c. Reflects adjustments for cash and cash equivalents (outflows) inflows summarized as follows:

|   |             |              |
|---|-------------|--------------|
| Consolidation of B.H. Acquisition cash and cash equivalents   | 23,606      | (see note f) |
| Proposed \$3.00 per share dividend to be paid by Enstar immediately prior to merger   | (17,327)    | (see note h) |
| Payment to be made to certain key employees of Castlewood on completion of the recapitalization                                 | (5,076)     | (see note i) |
| Repurchase of 1,797.555 Castlewood Class B shares from Trident  | (20,000)    | (see note d) |
| Purchase by Castlewood of the 22% ownership interest of B.H. Acquisition beneficially owned by an affiliate of Trident II, L.P. | (6,200)     | (see note e) |
| Total pro forma cash and cash equivalents adjustments   | \$ (24,997) |              |

- d. In accordance with the recapitalization agreement, Castlewood will, immediately prior to the consummation of the merger, purchase 1,797.555 Castlewood Class B shares from Trident for \$20,000.
- e. In accordance with the recapitalization agreement, an affiliate of Trident, L.P. will, immediately prior to the closing of the merger, sell its 22% ownership interest in B.H. Acquisition to Castlewood for \$6,200.
- f. Immediately upon completion of the purchase of the 22% ownership interest in B.H. Acquisition and the consummation of the merger, Castlewood will own 100% of B.H. Acquisition. As a result, Castlewood will consolidate the assets and liabilities of B.H. Acquisition and will eliminate Castlewood's and Enstar's respective equity investments in B.H. Acquisition of \$17,975 and \$13,271 at September 30, 2006. (See note j below.) The assets and liabilities of B.H. Acquisition that are incorporated into Castlewood's pro forma condensed combined balance sheet as of September 30, 2006 are as follows:

|                                      |  |                   |
|--------------------------------------|--|-------------------|
| <b>ASSETS</b>                        |  |                   |
| Cash and cash equivalents            |  | \$ 23,606         |
| Total investments                    |  | 67,051            |
| Restricted cash and cash equivalents |  | 8,321             |
| Reinsurance balances receivable      |  | 3,618             |
| Other assets                         |  | 1,736             |
| <b>TOTAL ASSETS</b>                  |  | <b>\$ 104,332</b> |

|   |            |
|---|------------|
| LIABILITIES                               |            |
| Losses and loss adjustment expenses       | \$ 58,207  |
| Reinsurance balances payable              | 5,057      |
| Accounts payable and accrued liabilities  | 1,122      |
| TOTAL LIABILITIES                         | 64,386     |
| SHAREHOLDERS EQUITY                       | 39,946     |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | \$ 104,332 |

**Table of Contents****Enstar Group Limited****Notes to Pro Forma Condensed Combined Financial Statements (Unaudited) (Continued)**

g. Reflects the following pro forma adjustments to accounts payable and accrued liabilities:

|  |          |              |
|--|----------|--------------|
| Accounts payable and accrued liabilities acquired in connection with the consolidation of B.H. Acquisition | \$ 1,122 | (see note f) |
| Estimated transaction costs of Castlewood (\$1,700) and Enstar (\$3,000)                                   | 4,700    |              |
| Severance costs relating to certain Enstar employee  | 350      |              |
|  | \$ 6,172 |              |

h. Enstar has announced that it expects to pay a special dividend of \$3.00 per share, or approximately \$17,327 in the aggregate, immediately prior to the merger.

i. In accordance with the recapitalization agreement, Enstar will pay, at the closing of the recapitalization, \$5,076 to Castlewood, and Castlewood, in turn, will pay \$5,076 to certain key employees of Castlewood. The payment of this amount by Enstar will be treated as a charge to income.

j. Reflects the elimination on consolidation of Castlewood's and Enstar's equity investment in B.H. Acquisition (see note f above) and the elimination of Enstar's equity investment in Castlewood as of September 30, 2006 as follows:

|  |            |
|--|------------|
| Castlewood's equity investment in B.H. Acquisition | \$ 17,975  |
| Enstar's equity investment in B.H. Acquisition     | 13,271     |
| Enstar's equity investment in Castlewood           | 77,569     |
| Total elimination of equity investments            | \$ 108,815 |

k. Reflects the share exchange in accordance with the merger agreement and recapitalization agreement.

As of September 30, 2006, the total number of issued and outstanding shares, par value \$1.00, of Castlewood were as follows:

|  |        |
|--|--------|
| Class A  | 6,000  |
| Class B  | 6,000  |
| Class C  | 6,000  |
| Class D (excluding 205.802 unvested shares)    | 732    |
| Total Castlewood shares issued and outstanding | 18,732 |

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Under the recapitalization agreement, Enstar's Class A shares of Castlewood will be exchanged for 2,972,892 non-voting convertible ordinary shares, par value \$1.00, of New Enstar.

Under the recapitalization agreement, 1,797.555 of Trident's Class B shares of Castlewood will be repurchased by Castlewood (see note d above). The remaining 4,202.445 Class B shares will be exchanged for 2,082,236 ordinary shares, par value \$1.00, of New Enstar.

The 6,000 Class C shares of Castlewood will be exchanged for 3,636,612 ordinary shares, par value \$1.00, of New Enstar.

The total number of Class D shares of Castlewood awarded to certain key employees as of September 30, 2006 amounted to 937.827, of which 732.025 had vested as of that date. The 937.827 Class D shares will be exchanged for 420,577 ordinary shares, par value \$1.00, of New Enstar, of which 328,283 will be fully vested and 92,294 shares will vest in installments between April 2007 and April 2010.

Under the merger agreement, each share of Enstar common stock issued and outstanding immediately prior to the consummation of the merger will be converted into the right to receive one ordinary share,

**Table of Contents****Enstar Group Limited****Notes to Pro Forma Condensed Combined Financial Statements (Unaudited) (Continued)**

par value \$1.00, of New Enstar. As of May 23, 2006, the total number of issued and outstanding shares of Enstar common stock, par value \$0.01, was 5,739,384 and the total number of restricted stock units outstanding in respect of Enstar common stock was 36,270. Therefore, the total number of shares, par value \$1.00, and restricted stock units of Castlewood that Enstar shareholders will receive will amount to 5,775,654 which, together with the 2,082,236, 3,636,612 and 328,283 ordinary shares that the Class B, C and D shareholders will receive, respectively, will result in a total of 11,822,785 ordinary shares as issued and outstanding upon the consummation of the merger and recapitalization.

1. Reflects the following increases (decreases) to additional paid-in capital:

Castlewood Additional paid-in capital:

|   |             |              |
|---|-------------|--------------|
| Excess of Class B shares repurchase price, of \$20,000, over par value \$2  | \$ (19,998) | (see note d) |
| Excess of fair value of Enstar net assets acquired on consummation of the merger over par value of shares issued to Enstar shareholders | 452,349     | (see note m) |
| Elimination of Enstar historical additional paid-in capital as of September 30, 2006  | (198,248)   | (see note n) |
| Adjustment to additional paid-in capital  | \$ 234,103  |              |

- m. Based on the average market value of Enstar stock three days before and after the announcement of the merger on May 23, 2006 of \$79.32 per share and the total number of outstanding shares of Enstar common stock and restricted stock units as of May 23, 2006 of 5,775,654, the fair value of the net assets of Enstar as of May 23, 2006 is estimated to be \$458,125. In accordance with the merger agreement, Enstar shareholders will receive one \$1.00 par value ordinary share of New Enstar for each \$0.01 par value share held in Enstar. The excess of the fair value of the net assets of Enstar over the par value of the shares issued to Enstar shareholders is \$452,349 and is credited to additional paid-in capital.

|  |            |              |
|--|------------|--------------|
| Fair value of Enstar                           | \$ 458,125 |              |
| Plus estimated acquisition costs of Castlewood | 1,700      | (see note g) |
| Total purchase price                           | \$ 459,825 |              |



**Table of Contents****Enstar Group Limited****Notes to Pro Forma Condensed Combined Financial Statements (Unaudited) (Continued)**

The purchase price allocation is as follows:

|  | <b>Enstar<br/>Historical (b)</b> | <b>Adjustments</b> | <b>As<br/>Adjusted</b> |
|--|----------------------------------|--------------------|------------------------|
| <b>Assets</b>                                    |                                  |                    |                        |
| Total investments                                | \$ 5,382                         | \$                 | \$ 5,382               |
| Cash and cash equivalents                        | 94,675                           | (25,753)           | 68,922                 |
| Other assets                                     | 544                              |                    | 544                    |
| Investment in other partly owned companies       | 99,678                           | 296,011            | 395,689                |
| <b>Total Assets</b>                              | <b>\$ 200,279</b>                | <b>\$ 270,258</b>  | <b>\$ 470,537</b>      |
| <b>Liabilities</b>                               |                                  |                    |                        |
| Accounts payable and accrued liabilities         | \$ (2,673)                       | \$                 | \$ (2,673)             |
| Income taxes and deferred income tax liabilities | (16,670)                         | 10,099             | (6,571)                |
| Other liabilities                                | (1,468)                          |                    | (1,468)                |
| <b>Total liabilities</b>                         | <b>\$ (20,811)</b>               | <b>\$ 10,099</b>   | <b>\$ (10,712)</b>     |
| <b>Net Assets acquired</b>                       | <b>\$ 179,468</b>                | <b>\$ 280,357</b>  | <b>\$ 459,825</b>      |

With the exception of Enstar's investment in Castlewood, the recorded book value of all of Enstar's recorded historical assets and liabilities as of September 30, 2006 approximates fair value.

Castlewood's management has performed an initial fair value calculation with respect to Enstar's investment in Castlewood, which indicated an estimated fair value of Enstar's investment in Castlewood of \$378,688. When added to the fair value of Enstar's other assets and liabilities, this yields an estimated fair value of net assets acquired by Castlewood of \$466,633, which results in \$6,808 of excess of the fair value of net assets acquired over the purchase price of \$459,825. In accordance with Financial Accounting Standard No. 141 Business Combinations (FAS 141), the amount allocated to Enstar's investments in partly-owned companies has been reduced by \$6,808 from \$402,497 to \$395,689. Upon consummation of the merger, the valuation of Enstar's investment in Castlewood will be finalized by Castlewood's management. If the final valuation of Enstar's investment in Castlewood is less than \$378,688, Castlewood expects to restore the reduction in the allocation to Enstar's investment in partly-owned companies to the extent of \$6,808, and thereafter to record goodwill in its financial statements. If the final valuation of Enstar's investment in Castlewood is greater than \$378,688, the excess over \$378,688 will be treated as an additional reduction in the amounts allocated to Enstar's investment in partly owned companies in accordance with FAS 141. This valuation involves significant assumptions and estimates by Castlewood's management which are subject to reallocation when the final purchase accounting takes place after the consummation of the merger. Castlewood does not expect to record any other intangible assets or goodwill as a result of the merger other than as discussed above.



**Table of Contents****Enstar Group Limited****Notes to Pro Forma Condensed Combined Financial Statements (Unaudited) (Continued)**

The adjustment to cash and cash equivalents is comprised of the following:

|   |            |              |
|---|------------|--------------|
| Proposed \$3.00 per share dividend to be paid by Enstar immediately prior to merger             | 17,327     | (see note h) |
| Payment to be made to certain key employees of Castlewood on completion of its recapitalization | 5,076      | (see note i) |
| Enstar's estimated transaction and severance costs  | 3,350      | (see note g) |
|   | \$ 25,753  |              |
| Reconciliation of purchase price adjustments to note r  |            |              |
| Fair value adjustment as a result of purchase price allocation per above                        | \$ 296,011 |              |
| Estimated Castlewood costs of acquisition   | (1,700)    | (see note g) |
|   | \$ 294,311 | (see note r) |

The adjustments to income taxes and deferred income tax liabilities of \$10,099 reflects the elimination of Enstar's deferred tax liability on Enstar's share of the undistributed earnings of Castlewood.

Bermuda law requires that the excess of the value of the shares issued over the par value of those shares be credited to an equity account called share premium. Section 40(1) of the Bermuda Companies Act (1981) states: Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount or value of the premiums on those shares shall be transferred to an account, to be called the share premium account.... U.S. GAAP nomenclature for share premium is additional paid-in capital.

Accounting Principles Board Opinion 6, Status of Accounting Research Bulletins, paragraph 12(a) contemplates the allocation of any excess of the purchase price of retired stock over the par of stated value of that stock to additional paid-in capital to the extent, inter alia, of additional paid-in capital on the same issue, which would seem to contemplate that any excess of issue price over par of stated value would be credited to additional paid-in capital.

- n. On consummation of the merger, Enstar's historical additional paid-in capital as of September 30, 2006 of \$198,248 will be eliminated on consolidation.
- o. On consummation of the merger, Enstar's historical accumulated other comprehensive income as of September 30, 2006 of \$465 will be eliminated on consolidation.
- p. Reflects the following adjustments to retained earnings:

|  |          |              |
|--|----------|--------------|
| Gain on purchase of the 22% ownership interest of B.H. Acquisition                 | \$ 2,498 | (see note q) |
| Accrued transaction costs of Castlewood  | (1,700)  |              |
| Difference in par value of Class B, C & D shares exchanged for new ordinary shares | (6,028)  |              |
| Elimination of Enstar deficit on consolidation                                     | 13,227   |              |

\$ 7,997

- q. Reflects the difference of \$2,498 between the purchase price of \$6,200 to be paid by Castlewood for the 22% ownership interest of B.H. Acquisition and a 22% share of the net book value of B.H. Acquisition of \$8,698 as of September 30, 2006, based on its unaudited financial statements as of that date. The fair value of B.H. Acquisition is estimated to be approximately equal to its net book value.
- r. Reflects the recording of treasury stock on the balance sheet of New Enstar to eliminate the fair value of Enstar's equity investment in Castlewood.

**Table of Contents****Enstar Group Limited****Notes to Pro Forma Condensed Combined Financial Statements (Unaudited) (Continued)**

Immediately prior to consummation of the merger, Enstar's pro forma net book value as of September 30, 2006 will amount to \$163,814 determined as follows:

|  |                |              |
|--|----------------|--------------|
| Enstar historical net book value as of September 30, 2006            | \$ 179,468     |              |
| Pro forma adjustments to Enstar's September 30, 2006 balance sheet:  |                |              |
| Proposed dividend to be paid by Enstar on consummation of the merger | (17,327)       | (see note h) |
| Payment to Castlewood key employees                                  | (5,076)        | (see note i) |
| Accrued transaction and severance costs                              | (3,350)        | (see note g) |
| Deferred tax liability adjustment                                    | 10,099         | (see note m) |
| <br>Pro forma net book value as of September 30, 2006                | <br>\$ 163,814 |              |

The estimated fair value of Enstar's net assets as of September 30, 2006 is \$458,125 (see note m above). The fair value adjustment of \$294,311 relates to Enstar's equity investment in Castlewood and provides an estimated fair value of this equity investment of \$371,880 (book value of \$77,569 plus fair value adjustment of \$294,311).

In order to eliminate Enstar's equity investment in Castlewood, New Enstar will record treasury stock based on the estimated fair value of Enstar's investment in Castlewood of \$371,880.

The pro forma adjustment to treasury stock is summarized as follows:

|   |                |
|---|----------------|
| Enstar's equity investment in Castlewood at fair value  | \$ 371,880     |
| Elimination of Enstar's treasury stock on consolidation | (6,080)        |
| <br>Pro forma adjustment to Treasury Stock              | <br>\$ 365,800 |

## **2. Adjustments to the Pro Forma Condensed Combined Income Statement for the year ended December 31, 2005**

- a. Reflects Castlewood's historical consolidated income statement for the year ended December 31, 2005.
- b. Reflects Enstar's historical consolidated income statement for the year ended December 31, 2005. Certain amounts were reclassified to conform to Castlewood's income statement presentation.
- c. Represents the consolidation of the B.H. Acquisition.
- d. Represents elimination of management fees paid by B.H. Acquisition to Castlewood.
- e. Represents the consolidation of the B.H. Acquisition net investment income of \$2,406 and the elimination of \$400 of investment management fees paid by Castlewood and B.H. Acquisition to Enstar.

- f. Represents the consolidation of the B.H. Acquisition general and administrative expenses of \$1,608; the elimination of \$400 of investment management fees paid by Castlewood and B.H. Acquisition to Enstar (see note e above); and the elimination of management fees paid by B.H. Acquisition to Castlewood of \$1,250 (see note d above).
- g. Reflects the elimination of Enstar's tax expense on Enstar's share of Castlewood's earnings. After the merger Castlewood does not intend to pay any dividends and certain of its subsidiaries will not be considered controlled foreign corporations for U.S. tax purposes. Therefore, Enstar does not expect to record U.S. tax on its share of Castlewood's earnings.

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**Enstar Group Limited**

**Notes to Pro Forma Condensed Combined Financial Statements (Unaudited) (Continued)**

- h. Represents the elimination of Enstar's and Castlewood's share of net earnings in B.H. Acquisition of \$139 and the elimination of Enstar's share of net earnings in Castlewood of \$26,334.
- 3. Adjustments to the Pro Forma Condensed Combined Income Statement for the nine month period ended September 30, 2006**
- a. Reflects Castlewood's unaudited historical consolidated income statement for the nine month period ended September 30, 2006.
- b. Reflects Enstar's unaudited historical consolidated income statement for the nine month period ended September 30, 2006. Certain amounts were reclassified to conform to Castlewood's income statement presentation.
- c. Represents the consolidation of the balances for B.H. Acquisition.
- d. Represents elimination of management fees paid by B.H. Acquisition to Castlewood.
- e. Represents the consolidation of the B.H. Acquisition net investment income of \$3,091 and the elimination of \$300 of investment management fees paid by Castlewood and B.H. Acquisition to Enstar.
- f. Represents the consolidation of the B.H. Acquisition general and administrative expenses of \$1,061; the elimination of \$300 of investment management fees paid by Castlewood and B.H. Acquisition to Enstar (see note e above); and the elimination of management fees paid by B.H. Acquisition to Castlewood of \$938 (see note d above).
- g. Reflects the elimination of Enstar's tax expense on Enstar's share of Castlewood's earnings. After the merger, Castlewood does not intend to pay any dividends and certain of its subsidiaries will not be considered controlled foreign corporations for U.S. tax purposes. Therefore, Enstar does not expect to record U.S. tax on its share of Castlewood's earnings.
- h. Represents the elimination of Enstar's and Castlewood's share of net earnings in B.H. Acquisition of \$858 and the elimination of Enstar's share of net earnings in Castlewood of \$9,924.

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**MANAGEMENT OF NEW ENSTAR  
FOLLOWING THE MERGER AND OTHER INFORMATION**

**Directors and Executive Officers of New Enstar***Directors of New Enstar*

Pursuant to the recapitalization agreement, Castlewood, Enstar, Trident and certain other shareholders of Castlewood have agreed that New Enstar's board of directors will consist of ten members following the merger. Four of these individuals—Messrs. T. Whit Armstrong, Paul J. Collins, Gregory L. Curl and T. Wayne Davis—are current directors of Enstar, three of these individuals—Messrs. J. Christopher Flowers, Nimrod T. Frazer and John J. Oros—are current directors of both Enstar and Castlewood, and the other three individuals—Messrs. Nicholas A. Packer, Paul J. O'Shea and Dominic F. Silvester—are current directors and/or executive officers of Castlewood. In the event any director is unable to serve as a director, a replacement director will be appointed by a majority of the remaining directors.

Following the merger, New Enstar will have a classified board of directors. Directors will be designated as Class I, Class II or Class III directors. Class I, II and III directors will serve until the 2007, 2008 and 2009 annual meetings of shareholders, respectively. Each year thereafter, directors will be elected for a full term of three years to succeed the directors of the class whose terms expire at that annual meeting.

The names, ages and positions of the directors of New Enstar following the merger are set forth below.

| Name                   | Age | Position(s) with New Enstar           |
|------------------------|-----|---------------------------------------|
| Dominic F. Silvester   | 46  | Chief Executive Officer and Director  |
| John J. Oros           | 59  | Executive Chairman and Director       |
| Paul J. O'Shea         | 49  | Executive Vice President and Director |
| Nicholas A. Packer     | 44  | Executive Vice President and Director |
| T. Whit Armstrong      | 59  | Director                              |
| Paul J. Collins        | 70  | Director                              |
| Gregory L. Curl        | 58  | Director                              |
| T. Wayne Davis         | 60  | Director                              |
| Nimrod T. Frazer       | 77  | Director                              |
| J. Christopher Flowers | 49  | Director                              |

Each of these individuals has consented to serve as a director of New Enstar if the merger is consummated.

The following is a brief summary of the background of the persons expected to serve as directors of New Enstar following the merger:

*Dominic F. Silvester* has served as a director and the Chief Executive Officer of Castlewood since its formation in 2001. In 1993, Mr. Silvester began a business venture in Bermuda to provide run-off services to the insurance and reinsurance industry. In 1995, the business was assumed by Castlewood Limited. Mr. Silvester was engaged as Chief Executive Officer of Castlewood Limited. From 1988 until 1993, Mr. Silvester served as the Chief Financial Officer of Anchor Underwriting Managers Limited. Prior to joining Anchor, he was a Vice President at Adams and Porter (Bermuda) Limited and was a senior auditor in the Bermuda office of Deloitte & Touche. Mr. Silvester will serve as a



Class III director of New Enstar.

*John J. Oros* has served as a director of Enstar since March of 2000. Mr. Oros was named to the position of Executive Vice President of Enstar in March of 2000 and on June 6, 2001, Mr. Oros was named President and Chief Operating Officer. Before joining Enstar, Mr. Oros was an investment banker at Goldman, Sachs & Co. in the Financial Institutions Group. Mr. Oros joined Goldman, Sachs & Co. in 1980 and was made a General Partner in 1986. Mr. Oros resigned from Goldman, Sachs & Co. in March 2000 to join Enstar. In February 2006, Mr. Oros became a Managing Director of J.C. Flowers & Co. LLC, which serves as investment advisor to J.C. Flowers II L.P., a newly-formed private equity fund

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affiliated with J. Christopher Flowers. Mr. Oros will split his time between J.C. Flowers & Co. LLC and New Enstar. Mr. Oros will serve as a Class II director of New Enstar.

*Paul J. O Shea* has served as a director, Executive Vice President and joint Chief Operating Officer of Castlewood since its formation in 2001. Mr. O Shea served as a director and Executive Vice President of Castlewood Limited from 1995 until 2001. In 1994, Mr. O Shea joined Messrs. Silvester and Packer in their run-off business venture in Bermuda. From 1985 until 1994, he served as the Executive Vice President, Chief Operating Officer and a director of Belvedere Group/Caliban Group. Prior to 1985, Mr. O Shea was an accounts manager at Mentor Insurance Company Limited and a senior auditor in the Bermuda office of KPMG Peat Marwick. Mr. O Shea will serve as a Class I director of New Enstar.

*Nicholas A. Packer* has served as Executive Vice President and the joint Chief Operating Officer of Castlewood since its formation in 2001. From 1996 to 2001, Mr. Packer was Chief Operating Officer of Castlewood (EU) Ltd., a wholly-owned subsidiary of Castlewood Limited. Mr. Packer served as Castlewood Limited's Chief Operating Officer from 1995 until 1996. From 1993 to 1995, Mr. Packer joined Mr. Silvester in forming a run-off business venture in Bermuda. Mr. Packer served as Vice President of Anchor Underwriting Managers Limited from 1991 until 1993. Prior to joining Anchor, he was a joint deputy underwriter at CH Bohling & Others, an affiliate of Lloyd's of London. Mr. Packer will serve as a Class II director of New Enstar.

*T. Whit Armstrong* was elected to the position of director of Enstar in June of 1990. Mr. Armstrong has been President, Chief Executive Officer and Chairman of the Board of The Citizens Bank, Enterprise, Alabama, and its holding company, Enterprise Capital Corporation, Inc. for more than five years. Mr. Armstrong is also a director of Alabama Power Company of Birmingham, Alabama. Mr. Armstrong will serve as a Class II director of New Enstar.

*Paul J. Collins* was elected to the position of director of Enstar in May of 2004. Mr. Collins retired as a Vice Chairman and member of the Management Committee of Citigroup Inc. in September 2000. From 1985 to 2000, Mr. Collins served as a director of Citicorp and its principal subsidiary, Citibank; from 1988 to 1998, he also served as Vice Chairman of such entities. Mr. Collins currently serves as a director of Nokia Corporation and BG Group, as a member of the supervisory board of Actis Capital LLP and as a trustee of the University of Wisconsin Foundation and the Glyndebourne Arts Trust. He is also a member of the Advisory Board of Welsh, Carson, Anderson & Stowe, a private equity firm. Mr. Collins will serve as a Class III director of New Enstar.

*Gregory L. Curl* was elected to the position of director of Enstar in July of 2003. Mr. Curl has been Director of Corporate Planning and Strategy for Bank of America since December 1998. Previously, Mr. Curl was Vice Chairman of Corporate Development and President of Specialized Lending for Bank of America from 1997 to 1998. Mr. Curl will serve as a Class I director of New Enstar.

*T. Wayne Davis* was elected to the position of director of Enstar in June of 1990. Mr. Davis was Chairman of the Board of General Parcel Service, Inc., a parcel delivery service, from January of 1989 to September of 1997 and was Chairman of the Board of Momentum Logistics, Inc. from September of 1997 to March of 2003. He also is a director of Winn-Dixie Stores, Inc. and MPS Group, Inc. Mr. Davis will serve as a Class III director of New Enstar.

*Nimrod T. Frazer* was elected to the position of director of Enstar in August of 1990. Mr. Frazer was named Chairman of the Board, Acting President and Chief Executive Officer of Enstar on October 26, 1990 and served as President of Enstar from May 26, 1992 to June 6, 2001. Mr. Frazer has served on the board of directors of Affirmative Insurance Holdings, Inc. since November 2005. Mr. Frazer will serve as a Class I director of New Enstar.

*J. Christopher Flowers* was elected to the position of director of Enstar in October of 1996. Mr. Flowers became a General Partner of Goldman, Sachs & Co. in 1988 and a Managing Director in 1996. He resigned from Goldman,

Sachs & Co. in November 1998 in order to pursue his own business interests. Mr. Flowers was named Vice Chairman of the Board of Enstar in December 1998; Mr. Flowers resigned from such position in July 2003 but remains a member of its board. Mr. Flowers has been a

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Managing Director of J.C. Flowers & Co., LLC, a financial services investment advisory firm since 2002. Mr. Flowers is director of Shinsei Bank, Ltd. (since 2000), NIBC Bank N.V. (since 2005), Fox-Pitt, Kelton (2006) and HSH-Nordbank AG (2006). Mr. Flowers will serve as a Class III director of New Enstar.

***Executive Officers of New Enstar***

The names, ages and positions of the proposed executive officers of New Enstar following the merger are set forth below:

| <b>Name</b>          | <b>Age</b> | <b>Position(s) with New Enstar</b>    |
|----------------------|------------|---------------------------------------|
| Dominic F. Silvester | 46         | Chief Executive Officer and Director  |
| John J. Oros         | 59         | Executive Chairman and Director       |
| Paul J. O Shea       | 49         | Executive Vice President and Director |
| Nicholas A. Packer   | 44         | Executive Vice President and Director |
| Richard J. Harris    | 45         | Chief Financial Officer               |

Richard J. Harris has served as the Chief Financial Officer of Castlewood since May 2003. From 2000 until April 2003, Mr. Harris served as Managing Director of RiverStone Holdings Limited & Subsidiary Companies, the European run-off operations of Fairfax Financial Holdings Limited. As Managing Director, he was responsible for all operational activities, including claims oversight, reinsurance collections, commutations and litigation. Previously, he served as the Chief Financial Officer of Sphere Drake Group and in the auditing group of the Bermuda office of Deloitte & Touche.

**Compensation of Directors**

Directors who are not employees of New Enstar will receive a quarterly retainer fee of \$6,250 and per meeting fees as follows: (1) \$2,500 for each board meeting attended other than a telephone board meeting; (2) \$1,000 for each telephone board meeting attended; (3) \$1,000 for each committee meeting attended; and (4) \$1,500 for each committee meeting attended by a committee chairperson. In addition, the Audit Committee chairperson will receive a quarterly retainer fee of \$500.

**Board Committees**

Following the merger, New Enstar will establish an Audit Committee and a Compensation Committee. New Enstar's board of directors may from time to time establish other committees to facilitate the management of New Enstar.

***Audit Committee***

In accordance with the charter of the audit committee, the audit committee of New Enstar will consist of at least three members appointed by the board of directors on the recommendation of a majority of the independent directors. All members of the audit committee will be independent directors, as required under rules enacted by the Commission and as required by the rules of Nasdaq. The audit committee will report regularly to the board and review with the board any issues with respect to the:

quality or integrity of New Enstar's financial statements;

performance and independence of New Enstar's registered independent accounting firm; and

New Enstar's compliance with legal and regulatory requirements.

At least one member of the audit committee will qualify as an audit committee financial expert, as such qualification is interpreted by the board in its business judgment.

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### ***Compensation Committee***

In accordance with the charter of the compensation committee, the compensation committee of New Enstar will consist of at least three members as appointed by the board of directors on the recommendation of a majority of the independent directors. All members of the compensation committee will be independent directors, as required by the Nasdaq listing standards. All members of the compensation committee will also be Non-Employee Directors for the purposes of Rule 16b-3 under the Exchange Act, and outside directors for the purposes of section 162(m) of the Code. The compensation committee will report regularly to the board of directors of New Enstar and be responsible for:

reviewing, determining and establishing, in consultation with New Enstar's Chief Executive Officer, salaries, bonuses and other compensation for New Enstar's executive officers other than the Chief Executive Officer;

reviewing the performance of New Enstar's Chief Executive Officer and reviewing, determining and establishing salary, bonus and other compensation for the Chief Executive Officer;

reviewing compensation of New Enstar's directors and making recommendations with regard to director compensation to New Enstar's board of directors;

overseeing New Enstar's regulatory compliance with respect to compensation matters; and

preparing an annual report regarding executive compensation for inclusion in New Enstar's annual proxy statement.

### **Employment Agreements**

On May 23, 2006, Castlewood entered into a new employment agreement with Mr. O Shea and amended its employment agreements with Messrs. Packer and Silvester. Mr. O Shea's employment agreement, which will become effective when the merger is consummated, supersedes the employment agreement between Castlewood and Mr. O Shea dated November 29, 2001. Messrs. Packer's and Silvester's amended and restated employment agreements, which also will become effective when the merger is consummated, amend and restate their employment agreements dated as of April 1, 2006. Castlewood also expects that New Enstar and Castlewood (US) Inc. will enter into a new employment agreement with John J. Oros, to become effective when the merger is consummated. Each employment agreement (as amended) has (or is expected to have, in the case of Mr. Oros) an initial five-year term and, after the initial term ends, renews for additional one-year periods unless either party gives prior written notice to terminate the agreement.

Following the merger, Messrs. O Shea and Packer will serve as Executive Vice Presidents of New Enstar, Mr. Silvester will serve as New Enstar's Chief Executive Officer and Mr. Oros will serve as New Enstar's Executive Chairman. As compensation for their services, each executive officer will (1) receive a base salary (Mr. Silvester's salary will be \$565,000 and Messrs. O Shea's and Packer's salary will each be \$440,000, and Mr. Oros's salary is expected to be \$282,500), (2) be eligible for incentive compensation under New Enstar's incentive compensation programs and (3) will be entitled to certain employee benefits, including, for Messrs. Silvester, O Shea and Packer, a housing allowance, a life insurance policy in the amount of five times his base salary, medical, dental and long-term disability insurance, payment of an amount equal to 10% of his base salary each year to his retirement savings plan and, for Messrs. Packer and Silvester, the executive will be reimbursed for one trip for his family to/from Bermuda each calendar year.

The employment agreements also provide (or is expected to provide, in the case of Mr. Oros) that if the executive's employment is terminated during the term of the agreement by New Enstar without cause or by the executive for good

reason (in addition to accrued but unpaid compensation), (1) the executive would be entitled to receive a lump sum amount equal to three times the base salary payable to him and medical benefits for the executive and his spouse and dependents for three years; (2) each outstanding equity incentive award granted to the executive before, on or within three years after the merger will become immediately vested and exercisable on the date of termination and (3) if, for the year in which the executive's employment is terminated, New Enstar achieves the performance goals established in accordance with any incentive plan in

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which he participates, New Enstar will pay an amount equal to the bonus that he would have received had he been employed by New Enstar for the full year. If there is a change of control of New Enstar during the term of the employment agreement and the executive's employment is terminated within one year after such change of control by New Enstar without cause or by the executive for good reason, the executive will be entitled to the compensation described in the preceding sentence and each outstanding equity incentive award granted to the executive after the merger (regardless of whether granted within three years after the merger) will become immediately vested and exercisable on the date of termination.

For purposes of these employment agreements (including the agreement with Mr. Oros), cause generally means:

fraud or dishonesty in connection with the executive's employment that results in a material injury to New Enstar;

conviction of any felony or crime involving fraud or misrepresentation;

the executive's failure to perform his employment-related duties; or

material and continuing failure to follow reasonable instructions of New Enstar's board of directors.

For purposes of these employment agreements, good reason means:

material breach of New Enstar's obligations under the agreements;

relocation of the executive officer's principal business office in Bermuda without the executive officer's prior agreement; or

any material reduction in the executive officer's duties or authority.

Under the terms of their respective employment agreements, each of Messrs. O'Shea, Packer and Silvester agree (and Mr. Oros is expected to agree) to not compete with New Enstar for the term of the employment agreement and, if his employment with Castlewood is terminated before the end of the initial five-year term, for a period of eighteen months after his termination of employment.



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**CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

**Castlewood**

Castlewood and certain of its subsidiaries have entered into transactions with companies and partnerships that are affiliated with Messrs. Flowers and/or Oros, and an entity of which Mr. Flowers is a director and the largest shareholder owns a minority interest in a subsidiary of Castlewood. Messrs. Flowers and Oros are members of Castlewood's board of directors and, following the merger will be members of the New Enstar board of directors. Mr. Flowers also will be one of New Enstar's largest shareholders.

In June 2006, the commitment of Castlewood to invest up to \$75.0 million in J.C. Flowers II, L.P., or the Flowers Fund, was accepted by the Flowers Fund. Castlewood intends to use cash on hand to fund this commitment. The Flowers Fund is a private investment fund for which JCF Associates II L.P. is the general partner and J.C. Flowers & Co. LLC is the investment advisor. JCF Associates II L.P. and J.C. Flowers & Co. LLC are controlled by Mr. Flowers. No fees or other compensation will be payable by Castlewood to the Flowers Fund, JCF Associates II L.P., J.C. Flowers & Co. LLC, or Mr. Flowers in connection with this investment. John J. Oros, who will be New Enstar's Executive Chairman and a member of its board of directors, is a managing director of J.C. Flowers & Co. LLC. Mr. Oros will split his time between J.C. Flowers & Co. LLC and New Enstar.

In June 2006, the commitments of James D. Carey, Dominic F. Silvester, Paul J. O'Shea, Nicholas A. Packer, and Richard J. Harris, directors and/or officers of Castlewood, to invest in the Flowers Fund were accepted by the Flowers Fund. Each of such directors and/or officers is subject to the same fees and expenses charged by the Flowers Fund to its limited partners other than Castlewood and Enstar.

In March 2006, Castlewood and Shinsei Bank Limited, or Shinsei completed the acquisition of Aioi Insurance Company of Europe Limited, or Aioi Europe, a London-based subsidiary of Aioi Insurance Company, Limited. The acquisition was effected through Hillcot Holdings Ltd., or Hillcot, in which Castlewood holds a 50.1% economic interest and Shinsei holds the remaining 49.9%. Castlewood and Shinsei made capital contributions to Hillcot to fund the acquisition in proportion to their economic interests. Aioi Europe has underwritten general insurance and reinsurance business in Europe for its own account from 1982 until 2002 when it generally ceased underwriting, and placed its general insurance and reinsurance business into run-off. The aggregate purchase price paid for Aioi Europe was £62 million (approximately \$108.9 million), with £50 million in cash paid upon the closing of the transaction and £12 million in the form of a promissory note, payable twelve months from the date of the closing. Upon completion of the transaction, Aioi Europe changed its name to Brampton Insurance Company Limited. Mr. Flowers, a member of the Castlewood's board of directors and, following the merger, a director of New Enstar and one of New Enstar's largest shareholders, is a director and the largest shareholder of Shinsei.

In January 2006, Castlewood (EU) Limited, a wholly-owned subsidiary of Castlewood, entered into a six month contract with Mrs. Ashley Holmes, sister-in-law to Mr. Dominic Silvester, to provide human resources consultancy services. Pursuant to the agreement with Mrs. Holmes, Castlewood (EU)