

STOCK ANALYSIS REPORT**Tower Group Incorporated (TWGP) – Analysis by Nathan Ramos – December 18, 2009**<http://www.betapeg.com>

Industry: **Insurance**
Sector: **Financial**
Recommendation: **STRONG BUY**
Price: **\$23.02 (as of December 18, 2009)**
Target Price: **\$30.76 or 32.47% undervalued**
52 Week Low-High: **\$19.70-31.05**
Fundamentals Grade: **B**
Investment Style: **Small Cap Value**
Consider Buying: **When less than \$23.66**

CORPORATE INFORMATION

Location: 120 Broadway 31st Floor
New York, NY 10271
Phone: 212-6552000
Fax: 212-6552199
Web Site: <http://www.twrgrp.com/>
Employees: 588
Exchange: NASDAQ

BUSINESS SUMMARY

Tower Group, Inc. (Tower), through its subsidiaries, is engaged in offering a range of specialized property and casualty insurance products and services to businesses and to individuals primarily in the Northeast, Florida, Texas and California. The Company provide coverage for many different market segments, including nonstandard risks that do not fit the underwriting criteria of standard risk carriers due to factors, such as type of business, location and premium per policy. It provides on both an admitted and excess and surplus lines basis, commercial lines products comprised of commercial package, general liability, workers' compensation, commercial auto and commercial umbrella policies to businesses such as residential and commercial buildings, retail and wholesale stores, food service and restaurants, artisan contractors and garage automotive services. In November 2009, Tower Group, Inc. completed the acquisition of Specialty Underwriters' Alliance, Inc.

ANALYSIS

Tower Group has been an outperformer in an industry beaten down by the 2007-2009 recession. Tower Group managed to increase shareholders' equity and book value through it all. The Company's strategy is to underwrite insurance in specific market segments often ignored by traditional insurance companies. They often go where no one else is willing to go. This strategy has allowed Tower Group to increase revenues and profit by 350% and 536% since 2004 respectively. Earnings yield and profit margin are above the sector average indicating the company has excellent profitability levels. Tower Group pays a healthy dividend yield of 1.22%. The Company could pay off all its long-term debt in 2.5 years on profit alone. The stock price has not reflected these excellent fundamentals however. The PE, PS, and PB ratios are below the industry average indicating the company is cheap relative to its industry. Tower Group has outperformed 37% of the market in the last 12 months indicating the stock to be substantially undervalued relative to its fundamentals grade of 88%. Tower Group is valued at \$30.72 which is undervalued at a current price of \$23.02 (December 18, 2009). Return on assets is below the sector average. Risks include overwhelming catastrophic losses to policy holders, adverse government regulations, deterioration of capital markets, obsolescence of the current business model, etc. Refer to the 2008 annual report for more.

[2008 Annual Report](#)

KEY STATISTICS

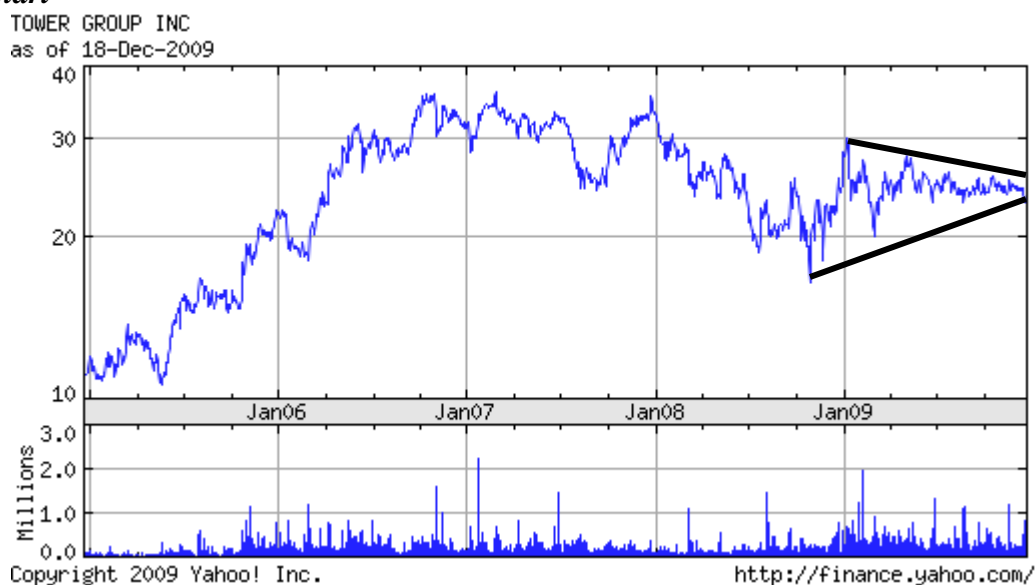
Beta:	0.61
Dividend Rate per Share:	\$0.28
Dividend Yield:	1.22%
Earnings Yield:	10.21%
EPS (past 12-mo.):	\$2.35
Institutional Ownership:	95%
Market Capitalization:	\$920.80 Mil – Mid Cap
Net Income (past 12-mo.):	\$94.30 Mil
Net Profit Margin:	11.08%
Return on Equity:	3.56%
Revenue (past 12-mo.):	\$848 Mil
Total Shares Outstanding:	40.50 Mil

PRICE RATIOS:

Forward P/E:	6.77
PEG:	0.29
PB:	1.00
PE:	9.80
PS:	1.09

FINANCIAL CONDITION:

Current Ratio:	NA
Debt/Income:	2.50
Debt Ratio:	0.65

PRICE HISTORY**5-Year Price Chart**

The chart indicates a bullish symmetrical triangle pattern as indicated by the bold lines. The stock can be expected to remain flat or go higher short term as indicated by this pattern. For more information on this pattern, go to <http://www.chartpatterns.com/symmetricaltriangles.htm>.

HISTORICAL FINANCIAL PERFORMANCE AND ESTIMATES (in millions)

Date	2004	2005	2006	2007	2008	2009 Est.
<i>Capital Expenditures</i>	\$3.00	\$5.00	\$23.00	\$16.00	\$17.00	\$26.37
<i>Dividend Payout</i>	\$1.00	\$2.00	\$2.00	\$4.00	\$5.00	\$6.54
<i>Dividend Rate</i>	\$0.05	\$0.10	\$0.10	\$0.17	\$0.22	\$0.28
<i>Dividend Yield</i>	0.42%	0.45%	0.32%	0.53%	0.89%	1.04%
<i>EPS</i>	\$0.45	\$1.05	\$1.85	\$1.96	\$2.48	\$3.32
<i>Free Cash Flow/Share</i>	\$3.65	\$6.20	\$5.55	\$2.61	\$1.96	\$1.72
<i>Long-term Debt</i>	\$47.00	\$47.00	\$68.00	\$101.00	\$101.00	\$120.15
<i>Long-term Debt/Share</i>	\$2.35	\$2.35	\$3.40	\$4.39	\$4.39	\$5.09
<i>Net Cash Balance</i>	\$55.00	\$39.00	\$101.00	\$78.00	\$136.00	\$165.35
<i>Net Cash/Share</i>	\$2.75	\$1.95	\$5.05	\$3.39	\$5.91	\$7.06
<i>Net Income</i>	\$9.00	\$21.00	\$37.00	\$45.00	\$57.00	\$77.51
<i>Net Profit Margin</i>	8.33%	9.55%	12.37%	10.92%	11.78%	12.75%
<i>Operating Cash Flow</i>	\$76.00	\$129.00	\$134.00	\$76.00	\$62.00	\$64.48
<i>PB</i>	1.86	3.03	2.77	2.46	1.67	\$1.80
<i>PE</i>	26.67	20.93	16.79	16.90	9.82	\$6.77
<i>PS</i>	2.22	2.00	2.08	1.85	1.16	\$1.02
<i>Revenue/Share</i>	\$5.40	\$11.00	\$14.95	\$17.91	\$21.04	\$26.80
<i>Sales (millions)</i>	\$108.00	\$220.00	\$299.00	\$412.00	\$484.00	\$628.54
<i>Shares Outstanding</i>	20	20	20	23	23	23.84
<i>Stock Price</i>	\$12.00	\$21.98	\$31.07	\$33.07	\$24.33	\$30.72
<i>Total Assets</i>	\$494.00	\$657.00	\$954.00	\$1,356.00	\$1,533.00	\$1,889.63
<i>Total Assets/Share</i>	\$24.70	\$32.85	\$47.70	\$58.96	\$66.65	\$80.34
<i>Total Equity</i>	\$129.00	\$145.00	\$224.00	\$309.00	\$335.00	\$405.85
<i>Total Equity/Share</i>	\$6.45	\$7.25	\$11.20	\$13.43	\$14.57	\$17.24
<i>Total Liabilities</i>	\$365.00	\$513.00	\$730.00	\$1,046.00	\$1,198.00	\$1,485.22
<i>Total Liabilities/Share</i>	\$18.25	\$25.65	\$36.50	\$45.48	\$52.09	\$63.17

RELATIVE STRENGTH

Tower Group has outperformed 37% of the market in the last 12 months indicating the stock to be substantially undervalued relative to its fundamentals grade of 88%.

STOCK PRICE VALUATION**Stock Price Estimates (FY2009)**

Methodologies	Intrinsic Values	Discount Rates
<i>PE</i>	\$22.43	-2.55%
<i>PEII</i>	\$45.16	96.18%
<i>PS</i>	\$27.36	18.86%
<i>PSII</i>	\$26.92	16.94%
<i>PSIII</i>	\$39.15	70.05%
<i>PB</i>	\$30.73	33.47%
<i>PBII</i>	\$34.37	49.30%
<i>Market Ratio</i>	\$24.33	5.69%
<i>FS</i>	\$36.82	59.95%
<i>Gamma</i>	\$55.25	140.00%
<i>Inverse</i>		
<i>Gamma</i>	\$36.45	58.33%
<i>52 Week</i>	\$32.15	39.64%
<i>Yield</i>	\$26.58	15.48%
<i>Stock Price I</i>	\$27.41	19.08%
<i>Stock Price II</i>	\$35.22	52.98%
<i>Stock Price III</i>	\$30.69	33.31%
<i>Cash Flow</i>	\$31.07	34.97%
<i>Dividend</i>		
<i>Growth</i>	\$29.38	27.63%
<i>Free Cash</i>		
<i>Flow</i>	\$21.44	-6.86%
<i>Revenue</i>	\$30.98	34.59%
<i>Long-term</i>		
<i>Debt</i>	\$20.46	-11.11%
<i>Total Equity</i>	\$28.80	25.10%
<i>Earnings</i>	\$32.55	41.38%
<i>Cash</i>	\$29.04	26.14%
<i>Profit Margin</i>	\$26.34	14.43%
<i>Total Assets</i>	\$29.33	27.40%
<i>Total</i>		
<i>Liabilities</i>	\$19.15	-16.79%
Target Price	\$30.72	33.47%

Tower Group is valued at \$30.72 which is undervalued at a current price of \$23.02 (December 18, 2009).

COMPETITION

Growth Rates %	Company	Industry	S&P 500
Sales (Qtr vs year ago qtr)	96.1	98.8	-5.2
Net Income (YTD vs YTD)	88.3	26.9	-8
Net Income (Qtr vs year ago qtr)	79.3	259.7	24.8
Sales (5-Year Annual Avg.)	45.35	3.71	12.92
Net Income (5-Year Annual Avg.)	56.5	-1.03	12.24
Dividends (5-Year Annual Avg.)		7.36	11.95
Price Ratios	Company	Industry	S&P 500
Current P/E Ratio	8.5	15.5	26.4
P/E Ratio 5-Year High	46.4	6.3	15.8
P/E Ratio 5-Year Low	8.2	0.8	2.5
Price/Sales Ratio	1.1	1.11	2.14
Price/Book Value	1.01	1.11	3.45
Price/Cash Flow Ratio	8.4	12.9	13.3
Profit Margins %	Company	Industry	S&P 500
Gross Margin		0	38.5
Pre-Tax Margin	17.1	7.5	9.9
Net Profit Margin	11.1	6	6.9
5Yr Gross Margin (5-Year Avg.)		0.7	38.3
5Yr PreTax Margin (5-Year Avg.)	17.3	12.3	16.6
5Yr Net Profit Margin (5-Year Avg.)	11.1	9	11.5
Financial Condition	Company	Industry	S&P 500
Debt/Equity Ratio	0.26	0.33	1.11
Current Ratio		0	1.5
Quick Ratio		0	1.2
Interest Coverage		0.8	24
Leverage Ratio	2.9	5.9	3.5
Book Value/Share	22.72	25,438.09	21.54
Investment Returns %	Company	Industry	S&P 500
Return On Equity	15.2	4.3	14.6
Return On Assets	4.7	1.8	5.6
Return On Capital		0.1	7.9
Return On Equity (5-Year Avg.)	17.9	10.2	19.4
Return On Assets (5-Year Avg.)	3.9	2.6	8
Return On Capital (5-Year Avg.)		0	10.8

INSIDER ACTIVITY

The following corporate insiders or major shareholders have recently filed transaction reports with the SEC.

Recent Insider Trading Activity: Tower Group Inc

Date	Name	Transaction	Num Shares	Price(s)	Value
11/23/09	BRYAN CHARLES A	Grant	1,000	\$24.59	24,591.00
11/23/09	SMITH COURTNEY C	Exercise	21,840	NA	NA
11/20/09	RANEGAR LAURIE A	Gift	204	\$24.19	4,934.76
11/19/09	RANEGAR LAURIE A	Sold	808	\$24.57	19,852.56
05/29/09	FOX WILLIAM W JR	Purchase	1,000	\$23.45	23,450.00
05/18/09	VAN GORDER JAN R	Purchase	1,000	\$24.50	24,500.00
04/02/09	BRYAN CHARLES A	Grant	1,830	NA	NA
04/02/09	FOX WILLIAM W JR	Grant	1,830	NA	NA
04/02/09	ROBBIE WILLIAM ALEXANDER	Grant	1,830	NA	NA
04/02/09	SCHUSTER STEVEN W	Grant	1,830	NA	NA
04/02/09	SMITH ROBERT S	Grant	1,830	NA	NA
04/02/09	SMITH ROBERT S	Grant	1,830	NA	NA
04/02/09	VAN GORDER JAN R	Grant	1,830	NA	NA
04/02/09	YOUNG AUSTIN P III	Grant	1,830	NA	NA
03/26/09	SCHUSTER STEVEN W	Sold	2,000	\$24.14	48,270.00
03/19/09	LEE MICHAEL H	Exercise	6,300	\$2.78	17,514.00
03/13/09	LEE MICHAEL H	Grant	24,270	NA	NA
03/10/09	RANEGAR LAURIE A	Grant	7,570	NA	NA
03/10/09	ABANO SALVATORE VINCENT	Grant	3,664	NA	NA

MAJOR HOLDERS**BREAKDOWN**

% of Shares Held by All Insider and 5% Owners:	8%
% of Shares Held by Institutional & Mutual Fund Owners:	84%
% of Float Held by Institutional & Mutual Fund Owners:	90%
Number of Institutions Holding Shares:	179

TOP INSTITUTIONAL HOLDERS

Holder	Shares	% Out	Value*	Reported
Barclays Global Investors UK Holdings Ltd	2,963,581	7.32	\$72,281,740	30-Sep-09
NWQ INVESTMENT MANAGEMENT COMPANY, LLC	2,367,308	5.85	\$57,738,642	30-Sep-09
WELLS FARGO & COMPANY	1,888,997	4.67	\$46,072,636	30-Sep-09
Bank of New York Mellon Corporation	1,748,404	4.32	\$42,643,573	30-Sep-09
VANGUARD GROUP, INC. (THE)	1,613,302	3.99	\$39,348,435	30-Sep-09
TCW GROUP, INC. (THE)	1,260,502	3.11	\$30,743,643	30-Sep-09
COLUMBIA WANGER ASSET MANAGEMENT, L.P.	1,176,500	2.91	\$28,694,835	30-Sep-09
WESTFIELD CAPITAL MANAGEMENT COMPANY	1,106,125	2.73	\$26,978,388	30-Sep-09
LORD ABBETT & CO	1,050,983	2.60	\$25,633,475	30-Sep-09
BANK OF AMERICA CORPORATION	967,710	2.39	\$23,602,446	30-Sep-09

TOP MUTUAL FUND HOLDERS

Holder	Shares	% Out	Value*	Reported
Columbia Fds Ser Tr I-Columbia Value & Restructuring Fd	1,200,000	2.96	\$29,736,000	30-Jun-09
RAINIER SMALL/MIDCAP EQUITY PORTFOLIO	984,835	2.43	\$24,404,211	30-Jun-09
COLUMBIA ACORN FD	900,000	2.22	\$22,302,000	30-Jun-09
ISHARES RUSSELL 2000 INDEX FD	594,487	1.47	\$14,499,537	30-Sep-09

OFFICERS AND DIRECTORS

Michael H. Lee	Chairman of the Board, President, Chief Executive Officer
William E. Hitzelberger	Chief Financial Officer, Senior Vice President
Richard Mark Barrow	Senior Vice President, Chief Accounting Officer
Salvatore Vincent Abano	Senior Vice President, Chief Information Officer
Elliot S. Orol	Senior Vice President, General Counsel, Secretary
Christian K. Pechmann	Senior Vice President - Marketing and Distribution
Joel S. Weiner	Senior Vice President - Strategic Planning, Chief Actuarial Officer
Gary S. Maier	Senior Vice President, Chief Underwriting Officer
Laurie Ranegar	Senior Vice President - Operations
Steven W. Schuster Esq.	Director

GLOSSARY

Bear Market: Market dominated by sellers.

Beta: A measure of stock price history relative to the market price history which indicates volatility. A company with a beta of 1 would be as volatile as the market. A beta less than one indicate less volatility to the market. The higher the beta, the more volatile a stock price is.

Bull Market: Market dominated by buyers.

Dividend Rate per Share: The amount of dividends paid per share.

Dividend Yield: The dividend return as a percentage of the stock price.

Earnings: The amount of profits that a company produces during a specific period.

Earnings per Share (EPS): Total earnings divided by all shares outstanding.

Fair Value: The price at which a stock is intrinsically valued.

Fiscal Year: Any 12-month period that a company uses for accounting purposes.

Forward P/E: Same as the traditional P/E except the estimated future EPS is used. If earnings are expected to grow in the future, the estimated P/E will be lower than the current P/E.

Fundamental Analysis: Method of stock analysis in which the company data is used to place an *intrinsic value* of the stock. This value is compared to the current market price. If the *intrinsic value* is less than the market price, the stock is undervalued, indicating a potential buy position.

Fundamental Grade: A grading system used to evaluate the quality of a company based on fundamental analysis.

Industry: A category used to describe a company's primary business activity.

Insider Activity: Corporate insiders (i.e. CEOs, executives, etc.) and major shareholders transactions of stock.

Institutional Investor: A non-bank investor who trades stocks in such large amounts that they require special treatment and lower commissions.

Institutional Ownership: The percentage of institutional investors who have a position in stock.

Intrinsic Value: The actual value of a stock based on tangible and intangible aspects of the company.

Investment Style: A classification used to indicate what kind of investors the stock is most attractive too. There are nine categories and they include:

- Large value
- Large blend
- Large growth
- Medium value
- Medium blend
- Medium growth
- Small value
- Small blend
- Small growth

Market Capitalization: The market value of a company is the value of its outstanding shares. This figure is found by taking the stock price and multiplying it by the total number of shares outstanding.

Outstanding Shares: Stock currently held by investors.

Price/Earnings (PE) Ratio: A valuation ratio of a company's current share price compared to its per-share earnings.

Calculated as:

$$= \frac{\text{Market Value per Share}}{\text{Earnings per Share (EPS)}}$$

The P/E ratio is a comparison of the stock price and earning. The lower the P/E, the better valued the company relative to earnings.

Price/Sales (P/S) Ratio: A ratio for valuing a stock relative to its own past performance. Price to sales is calculated by dividing a stock's current price by its revenue per share for the trailing 12 months:

$$\text{PSR} = \frac{\text{Share Price}}{\text{Revenue Per Share}}$$

Revenue: The income that comes directly from business operations.

Sector: A group of stocks in the same industry or market.

Target Price: An analyst's estimated stock price for a given period of time.

Technical Analysis: Method of stock analysis in which stock price data is used to determine trends. Charting the stock price history indicates up trends (buy), down trends (sell), and flat trends (even). Support lines drawn along lows and resistance lines drawn along highs indicate the time to buy and sell.

Trailing Twelve Months (ttm): A sum of a metric over the last twelve months. EPS (ttm) is earnings per share over the last twelve months.

Volatility: A measure of the fluctuations in stock price. The higher the volatility, the more you can win and lose. *Betas* higher than 1 are more volatile than the market. If the market goes up 1%, a stock with a beta = 3 would likely go up 3%. Likewise, the same the can be true for declines.

SOURCES OF INFORMATION

1. <http://www.investopedia.com>
 2. <http://www.moneycentral.msn.com>
 3. <http://www.finance.yahoo.com>
 4. <http://www.finance.google.com>
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ANALYTICAL METHODOLOGY

This stock report is based on the financial models developed by Nathan Ramos and available to the public at www.betapeg.com. Ratings are based on a ratio of fundamentals to valuation. Highly rated stocks have excellent fundamentals and high valuation relative to market value while low rated stocks have weak fundamentals and low valuation relative to market value.

DISCLAIMER

This document was prepared by Nathan Ramos, a non-certified stock analyst. The material contained is based upon information considered to be accurate but is not warranted by its source. Any opinions expressed are in good faith and are only correct as of the stated date of the report. This report serves as a guide to researching a particular company and does not serve any professional advisory function whatsoever.