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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Value Investing in Canadian Equities

MARK D. THOMSON is the Senior Vice President of Canadian Equities at Beutel Goodman & Company Ltd. He joined Beutel Goodman in 1989 and has over 25 years of investment experience. He is the Director of Research, and is responsible for oversight of the global equity research process, and a portfolio manager who leads the Canadian Equity Team. He is also a member of the BG Management Committee and sits on the Board of Directors. Prior to joining BG, Mark was a portfolio manager at Pemberton Securities. Mark is a graduate of Mills College and is a CFA charterholder.

SECTOR – GENERAL INVESTING

TWST: Please begin with an overview of Beutel, Goodman & Company and your investment philosophy there.

Mr. Thomson: We manage approximately CAD19 billion. About a third of that is Canadian equities, both large and small cap. We define small cap as stocks with a market cap of less than 1.5 billion. We are bottom-up value investors. Preservation of capital is paramount to what we do. This holds true right across all of our asset classes, whether it be fixed income or equities. On the equity side, we believe that the value of a business is determined by the present value of future free cash flows. If we can find stocks that are trading at a sufficient discount to this business value such that they provide us with a minimum of a 50% return over the next three years, we buy them. We also believe that if we purchase companies at a significant discount to their business value, not only will there be an adequate return, but we will minimize risk.

Highlights

Mark D. Thomson is a bottom-up value investor who says that preservation of capital is paramount to what he does. He believes the value of a business is determined by the current value of future free cash flows. He will buy such a stock if it is trading at a sufficient discount to this business value and is likely to provide a minimum of 50% return over the next three years. If he buys companies at a significant discount to business value, not only will there be an adequate return but he will also minimize risk. He is currently overweight in consumer discretionary and staples, telecommunications and financials.
Companies include: Quebecor (QBR.B.TSE); CIBC (CM); Molson-Coors (TAP); TD Bank (TD); Cenovus (CVE); Rogers (ROG); TELUS (TU).

TWST: Tell us about the Canadian equity markets, and how they were impacted by the events in the United States on the economy in the markets.

Mr. Thomson: A significant portion of the Canadian market has high economic sensitivity. Materials at 19.5% and Energy at 26.5% account for 46% of the Canadian Index. These cyclicals, by definition, have a significant exposure to the economy and when investors in 2008 were concerned about an economic freefall, the stocks were hit. At the same time, the global banking system was severely stressed. The market extrapolated problems in other banking markets into the domestic domain. This happened despite low exposure to many of the issues that came to the fore in other markets. This low exposure, however, provided scant support for Canadian bank stocks in a market that was looking for themes rather than anomalies. Historically, if you review the bear markets of the 1960s, 1970s and 1980s, Canadian bank stocks declined by approximately 30-35%. This time they dropped more than 50%. By 2009, the declines in the cyclicals and banking sectors provided a price opportunity and the stocks exhibited exceptional performance. As economically sensitive stocks rebounded, many of the names that held up in 2008, with their lower economic sensitivity, lost their lustre and underperformed.

1-Year Daily Chart of Quebecor

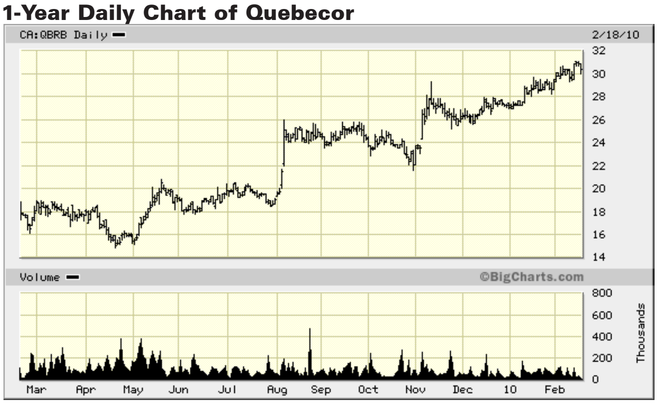

Chart provided by www.BigCharts.com

As far as sector weightings go, we don't have to be in every sector. Unlike the market, which we view as agnostic to risk, the only limitation we have is on the magnitude of the sector overweight. In that case we can only go 10% over a market's sector weight.

TWST: What about your weightings, where are you most exposed, and where are you underexposed in your weightings?

Mr. Thomson: We are 13.5% underweight Materials. In the case of Consumer Discretionary, however, we are approximately 500 basis points overweight. The overweight is primarily due to **Quebecor** (QBR.B.TSE), which from our perspective should more appropriately be classified in the telecommunications group. We are also very heavily overweight, to the tune of 500 basis points each in Consumer Staples, Telecommunications and Financials. Approximately 94% of our portfolio, by weight, is comprised of free-cash flow generating companies which, from our perspective, provide a high quality skew relative to the S&P/TSX. The portfolio, both in aggregate and in individual names, is valued significantly below the market using standard metrics such as P/Es and price-to-book multiples.

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2009 was also a market where the smaller the market cap and the lower the quality of a company, the higher the return. Large cap, high-quality companies that paid dividends returned on average 24% last year. This is in the context of market returns of 35% for the S&P/TSX. On the other hand, companies under 1.5 billion in market cap that paid no dividends, returned 143%.

TWST: What about the changes or shifts and emphasis in your portfolio that occurred because of this severe market correction?

Mr. Thomson: We didn't have to shift. The portfolio was defensive going into the downturn and performed very well in 2008. In 2009, however, the market emphasis on cyclicals and smaller, poorer quality stocks resulted in the portfolio underperforming on a relative basis.

TWST: Would you take us through your investment decision-making process and the criteria that you look for in potential holdings?

Mr. Thomson: We have a strong research orientation and all the analysts are also members of the portfolio team. On the Canadian large-cap side, we have five members. There are approximately 90-100 names in Canada that are available for investment for a large-cap investor. We have written reports on those names where we have assessed the underlying business value. Once we have determined our minimum 50% hurdle, we purchase stocks at our buy targets. Weights are determined by liquidity and potential returns.

1-Year Daily Chart of TD Bank

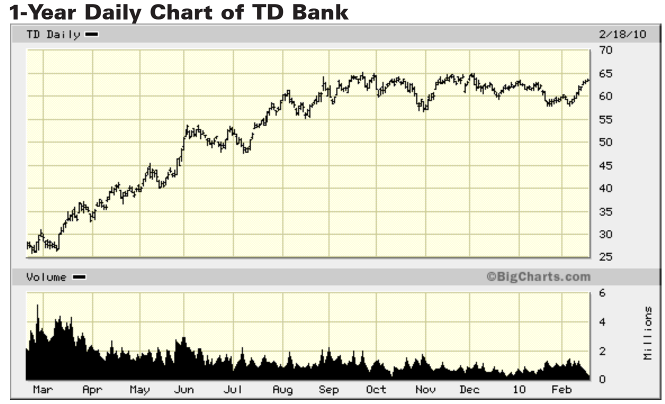


Chart provided by www.BigCharts.com

TWST: Are you underweighted in technology and healthcare?

Mr. Thomson: Very under weight, actually zero. Information technology is primarily **Research in Motion** (RIM), which accounts for 3.5% of the Index, Healthcare is less than a 1% weight. Unlike the U.S. where you have big drug companies and healthcare providers, in Canada, this sector is primarily comprised of businesses with less predictable cash flows.

TWST: What are some of the companies that you can tell us about that you feel are representative of your investment approach, you mentioned Quebecor earlier?

Mr. Thomson: At the time of purchase, **Quebecor** was very much out of favour and the market had questions about management. The company has a very stable cable business, trades at a very low valuation, has a decent balance sheet and the operating outlook over the next three years is positive. If you want to look at our big positions, we have a large weight in **TD Bank** (TD). We like the bank due to its risk averse culture, strong retail focus, and presence in the U.S. The latter position is largely the reason that **TD** has a low valuation. The company has performed very well in the U.S. and if you look at their loan losses relative to peers, they have been very successful. The U.S. has witnessed a significant decline in competition, which from our perspective, is ultimately going to be very profitable for the surviving entities.

"We have a large weight in TD Bank. We like the bank due to its risk averse culture, strong retail focus, and presence in the U.S. The latter position is largely the reason that TD has a low valuation. The company has performed very well in the U.S. and if you look at their loan losses relative to peers, they have been very successful."

1-Year Daily Chart of CIBC

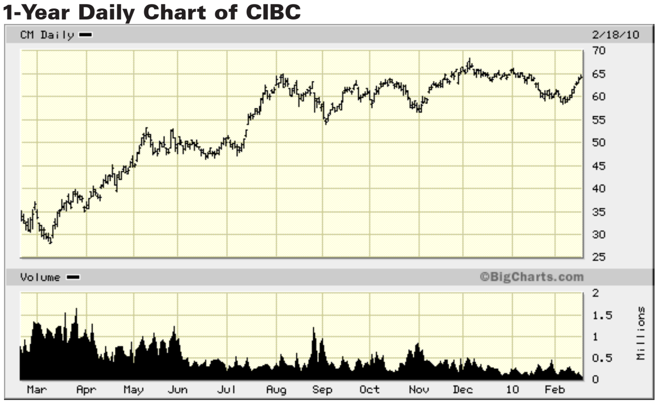
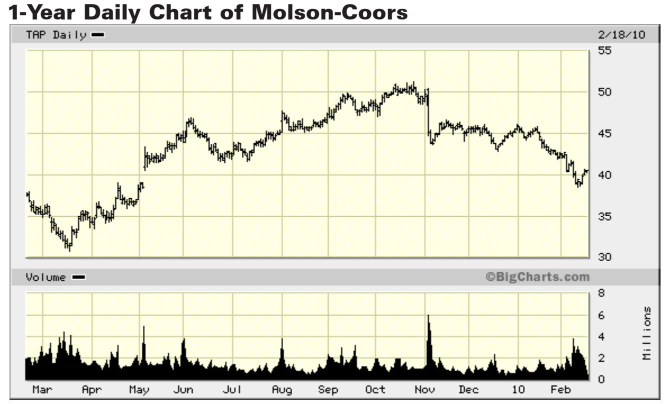


Chart provided by www.BigCharts.com

1-Year Daily Chart of Molson-Coors



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"CIBC has historically tended to exposed themselves to inordinate risk. Despite this, we are attracted to the high percentage that the retail franchise contributes to the bottom line. Our view is that the risks are more than priced into the current stock price, and we think the company is well positioned going forward."

The second name we like on the banking side would be **CIBC** (CM). This is more controversial as **CIBC** has historically tended to exposed themselves to inordinate risk. Despite this, we are attracted to the high percentage that the retail franchise contributes to the bottom line. Our view is that the risks are more than priced into the current stock price, and we think the company is well positioned going forward. We also have a significant exposure to the Canadian insurers, which like their global peers, are trading at close to book value, have very low earnings multiples and, unlike their peers, have decent dividend yields.

Another stock we like is **Molson-Coors** (TAP), which is not technically part of the S&P/TSX Index, but is trading at a very low double-digit multiple of earnings, is a significant free cash flow generating business, and trades very close to book-value. We think it is the type of stock that has been out of favour because investors are looking for earnings momentum and economic sensitivity. We think the company is very interesting, not only on the context of its valuation, but its position in a global industry that is consolidating at a rapid rate.

We like the telecommunication stocks, which are cheap on a global basis. We have two names of significant size in the portfolio; one of these is **Rogers** (ROG), and the other is **TELUS** (TU). Both have high exposures to wireless, which in Canada is a un-penetrated market compared to many foreign countries. Current concerns regarding new competition, which we view as more noise than reality, has taken the stock prices down to levels where they are trading at close to trough EBITDA multiples.

TWST: What about your energy stocks?

Mr. Thomson: We focus on the names that are relatively low cost providers in an industry that is high cost on a global basis. As such we would focus on names like **Cenovus** (CVE), which may not have exceptional leverage to the upside if oil prices spike, but has significant upside in a robust price environment and at the same time provides protection on the downside if prices decline.

TWST: You mentioned your sell side. Tell us what triggers an exit.

Mr. Thomson: We have definitive sell target prices, which are based on business values. We do not believe that stocks can trade on a sustainable basis above what their business is worth. Our thinking is that, when we are buying the stock and it is out of favour, there are many reasons to keep investors away; fundamentals are unknown, management is questionable, analysts don't like the company etc. Fortunately, the stock at this time is priced cheaply and we are buyers. When a stock is in favour, street analysts love the company, investors are buyers and the outlook is positive. At this point, the stock is customarily expensive and we are sellers at unsustainable prices.

As investors we need a mechanism to run counter to the tendency to continue owning a stock that's trading above its business value. We do this by selling a minimum of one-third of our position when a stock hits our target. We go back at that point and review the value of the business. If the business value has gone up, we continue to hold it. If it hasn't, we sell the position in its entirety.

TWST: What is the average turnover?

Mr. Thomson: It is under 20%.

TWST: Did you sell off any stocks the last year, or do you mostly trim position?

Mr. Thomson: In the case of some of the energy names, we have been sellers. In the case of **Nexen** (NXY), for instance, our entire position was liquidated. In other cases, as stocks reached their targets, we trimmed them back.

TWST: How do you try to control risk in your portfolio, on a portfolio level, and at an individual security level?

Mr. Thomson: Our perspective is centred on controlling risk at the individual security level. If we do our work, the balance sheets are good, the cash flows are sustainable, and the prices of the securities are right. As such, we view our portfolio as being low risk. We have no concerns about the deviation of performance relative to the market, as we believe prices in excess of business value are not sustainable. Over time we believe our portfolios can provide strong risk adjusted returns.

TWST: What is the top-down look at Beutel Goodman and for Canadian equities in 2010?

Mr. Thomson: We don't make top-down calls. Everybody has an opinion, but from our perspective a correct top down call is more luck than prescience. Our view is that there are so many variables at play in any outlook that even the most likely scenario has less than a 50% probability of occurring.

We like businesses that are sustainable in most economic environments, and if the prices are right, we're confident that the portfolio should have reasonable prospects.

TWST: I was then really trying to get some idea about some tailwinds or headwinds that in the Canadian markets that investors should be wary of now?

Mr. Thomson: The pricing of materials and energy stocks could be an issue. The exposure to economically sensitive stocks is much higher in Canada than it is in some other markets. The S&P/TSX relative to the S&P 500 has weights in Energy and Materials which are significantly higher. Currently the S&P/TSX weight in Materials and Energy combined is 46% and is a sharp contrast to the 14% in the S&P 500. This disparity could be a risk for the Canadian market in a slow growth environment. If the high expectations and rich pricing of cyclical stocks aren't justified empirically, these sectors of the index may be vulnerable.

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TWST: What do you think is distinctive about Beutel, Goodman's investment approach to Canadian equities? What do you bring to the table that other peer companies might not?

Mr. Thomson: First, I would say the quality of our research has few peers. We don't follow the street and as such we make our own decisions. Second, our sell discipline is well defined and adhered to in all markets. This limits downside risk. The third factor would be the low turnover of the investment team. Three of the five members have in excess of 16 years experience working together at the firm.

In addition, I think the fact that our primary business is managing large pension funds provides stability for investors with concerns about preservation of capital.

TWST: Mark is there anything that we didn't touch on that you wish to add?

Mr. Thomson: In this type of market, you have to remember the stock market is a market of stocks. In this context, we see good opportunities on the upside and limited risks on the downside in a portfolio of high quality stocks.

TWST: Thank you. (PS)

MARK D. THOMSON
Beutel, Goodman & Company, Ltd.
20 Eglinton Avenue West
Suite 2000
Toronto, ON M4R 1K8
416-485-1010