

Beutel, Goodman

Investment Manager Review

October 28, 2010

EXECUTIVE SUMMARY

- On October 28, 2010 Martin Bélanger met with the following Beutel, Goodman professionals from 9:00 a.m. to 12:00 p.m. at their Toronto office:
 - Peter Clarke, Managing Director, Client Service
 - Mark Thomson, Managing Director, Canadian Equities
 - Steve Arpin, Vice President, Equity Analyst
 - Pat Palozzi, Portfolio Manager, Canadian Equities
- Ranked “Retain” by Russell
- Beutel, Goodman manages 10% of the Diversified Equity Fund and 33 1/3% of the Canadian Equity Fund
- The UWO Retirement Plans had \$55.7 million with Beutel, Goodman as of September 30, 2010 and annualized investment management fees are 0.23% at that asset level; the Operating & Endowment Fund had \$32.7 million
- Beutel, Goodman’s investment style is bottom-up, value
- Beutel, Goodman was hired on August 28, 2009
- The Retirement Plans invest in a separately managed account with Beutel, Goodman
- There have been no changes to Beutel, Goodman’s corporate structure since our last review
- William Ashby retired as President at the end of June 2010 and his successor, Peter Clarke, re-organized the senior management structure by creating a management committee made of five senior managers. I don’t see any issues with the new structure
- The Canadian equity mandate managed by Beutel, Goodman posted a return of 8.14% year-to-date for 2010, outperforming the S&P/TSX Index by 0.68%. Since inception in August 2009 the fund has underperformed the index by 3.67%
- Most of the outperformance/underperformance (depending on the time horizon) came from stock selection
- There have been no changes to key individuals on our portfolio. Mark Thomson is still the lead portfolio manager on the strategy
- Beutel, Goodman’s investment process has not changed since we’ve hired them
- Their research process considers environmental, social or governance factors when they present a financial liability
- The strategy has \$8.2 billion in assets under management and is not closed to new business
- Beutel, Goodman doesn’t have any major compliance issues. The company, its funds or its personnel are not facing any major litigation, no material issue was raised following their most recent regulatory review, the firm is not aware of any conflict of interest involving its personnel. Overall their compliance processes are adequate
- The firm has an adequate code of ethics
- Beutel, Goodman has an adequate business continuity plan

RECOMMENDATION

- Beutel, Goodman has outperformed its benchmark by 0.68% year-to-date in 2010 but has underperformed by 3.67% annualized since inception in August 2009
- There have been no changes to their investment process, which is very thorough and disciplined
- There have been no personnel changes on our mandate
- The firm doesn't have any compliance issues
- Given the above and Russell's "Retain" recommendation, I don't recommend making any changes to our relationship with Beutel, Goodman & Company Ltd.

ORGANIZATION

- The firm had \$22 billion in assets under management as of September 30, 2010, including \$8.2 billion in Canadian equities, the strategy the UWO Retirement Plans invest in
- They feel that they can manage efficiently up to \$12 billion in Canadian equities
- Since the beginning of 2010 Beutel, Goodman has gained 20 new accounts, for a total of \$741 million. They have lost 2 accounts for \$31 million. The firm's annual client retention rate (in assets) has been greater than 97% since 2005. Clients left because of internal restructuring.
- The UWO Retirement Plans had \$55.7 million with Beutel, Goodman as of September 30, 2010 and the Operating & Endowment Fund had \$32.7 million
- The firm is 51% owned by 35 Beutel, Goodman employees and 49% by Affiliated Managers Group. Affiliated Managers Group is a global asset management company with equity investments in boutique investment management firms.
- There have been no changes to Beutel, Goodman ownership structure since we hired them in August 2009
- As previously announced, William Ashby, the President of Beutel, Goodman, retired at the end of June 2010. Peter Clarke took over his responsibilities. Peter re-organized the management structure of the firm by creating a management committee consisting of 5 managing directors:

Managing Director	Group
Greg Latremoille	Private Client
Peter Clarke	Client Service / Marketing
Michael Gibson	Operations
Bruce Corneil	Fixed Income
Mark Thomson	Equity Research

- The management committee makes decisions using a simple majority rule
- Beutel, Goodman had 25 investment professionals as of September 30, 2010
- Since the beginning of the year the only significant personnel changes were the hiring of Craig Auwaerter as Vice President, Client Service / Marketing and the retirement of William Ashby
- Beutel, Goodman has an adequate business continuity plan. The firm has engaged SS&C Technologies of Mississauga to provide dedicated hosting and business continuity. The disaster recovery centre is located in the Toronto core. They regularly test the plan. The last test was conducted on April 20, 2010 and was successful according to Beutel, Goodman.

CANADIAN EQUITY MANDATE

	3-Mth	YTD	1-Yr	Since Inception
Beutel, Goodman Cdn Equity	9.97%	8.14%	9.50%	11.05%
S&P/TSX	10.26%	7.46%	11.60%	14.72%
Value Added	-0.29%	0.68%	-2.10%	-3.67%

- The fund has 33 names (as of September 30, 2010); the Fund will typically hold between 30 and 50 stocks
- Beutel, Goodman outperformed its benchmark by 68 bps since the beginning of 2010, as of September 30, 2010
- Beutel, Goodman overweight in the Telecommunications and banking sectors have helped
- The main contributors to performance were positions in Telus Corp., TD Bank and Magna International while the main detractors were Manulife, Cameco Corp. and Talisman Energy.
- They invested in Magna because it's a well run business, it generates good cash flows, it has low debt, good relationships and they believe that the company will be one of the winners when the auto industry restructures. The stock appreciated because the company posted good results and the dual share structure was eliminated. Beutel, Goodman voted in favour of the share restructuring, despite the large premium paid to the controlling shareholder.
- Manulife detracted from performance. It has a solid business outside the U.S. according to Beutel, Goodman. 65% of their revenues come from Canada and Asia. They see good prospects for Canada and Asia and Beutel, Goodman believes that the Canadian and Asian components of their company is worth more than the current price of the entire company. The company is well positioned to cater to wealthy individuals and the stock price is attractive. The weak stock price is explained by earnings volatility caused by the absence of hedging on their variable annuity business. In jurisdictions with different accounting rules, their earnings would not be as volatile. The quality of their assets is good and Beutel, Goodman is comfortable with the new CEO.
- Portfolio turnover is typically 20% to 30%
- Their portfolio positioning is currently as follows:
 - Remain fully invested
 - Invest in companies with strong free cash flows and high dividend yield
 - Underweight resource cyclical due to slow growth expectations
 - Overweight sectors sensitive to the improving North American economy, such as industrials and consumers
 - Remain overweight in the Financials sector:
 - Insurers' long-term outlook if favourable and they have high-quality assets
 - The constraints on use of excess bank capital have been removed
 - They recently added to their positions in Royal Bank, Potash and Canadian Oil Sands and trimmed their exposure to Potash (following the announcement of the takeover bid by BHP) and Enbridge

Investment Personnel

- There have been no changes to the lead portfolio manager on our strategy
- Mark Thomson, Managing Director, Canadian Equities is still the lead portfolio manager; he's supported by 4 portfolio managers / equity analysts on the Canadian equity team
- All stocks are covered by their global research platform, except Canadian financials which are covered from a Canadian point of view only

- The average age of investment professionals is about 43
- We reviewed the investment thesis for several companies (Finning International, Manulife Magna International and Intact Financial) and overall the portfolio managers met (Mark Thomson, Steve Arpin and Pat Palozzi) have demonstrated a very good understanding of the companies they cover and were very insightful in their analysis
- Portfolio managers / analysts must prepare a detailed research on each of their investment ideas. The reported is vetted by Mark Thomson and another team member and then presented to the entire team for debate.

Investment Process

- Process hasn't changed: bottom-up value
- Beutel Goodman uses a bottom-up value process to select securities. Its philosophy is based on four principles:
 - Preservation of capital is paramount
 - Business value is determined by the present value of sustainable free cash flow; they define free cash flow as: Net Earnings + Depreciation + Amortization – Maintenance Capital Expenditures
 - Low valuations outperform high valuations
 - Purchase of companies below business value
- Beutel Goodman focuses on a firm's ability to create long-term shareholder value through free cash flow generation. They believe that long-term shareholder value is created by: management skill, competitive advantage, strategic positioning, industry structure, profitability and financial strength.
- For non-cyclical companies they require a 33% discount to intrinsic value in order to purchase the stock. For cyclical companies, the discount must be at least 50%. Furthermore, they believe that a company's ability to generate free cash flow provides the following benefits: independence, financial flexibility, ability to make acquisitions, organic growth, capacity to repurchase shares, capability to pay dividends. They estimate value three years into the future using a discounted cash flow model.
- For non-cyclical companies, their sell discipline involves selling 1/3 of their position when their target price is reached. They then review the business value through additional research. If the business value has increased, they hold on to their position, otherwise they sell the remainder of their position. For cyclical companies, they also sell 1/3 of their position when their target price is reached, but they will sell the rest of their position when the stock price reaches the peak historical multiple.
- They will also sell for the following reasons: change in senior management or corporate strategy, major asset acquisition or disposal, material increase in financial leverage or the business value becomes impossible to determine.
- Environmental, Social and Governance Factors (ESG):
 - Any potential liability is taken into consideration when they analyze a company
 - They include a margin of safety when they value a stock
 - They manage a fund for The Ethical Fund Company and very few companies are screened out of their universe, which indicates that their process tends to select companies with strong ESG characteristics.
- The size of an active position is based on the following considerations:
 - The minimum position size is 1%
 - The position size is based on liquidity and the market capitalization of a company is a good proxy for liquidity

- The conviction in the stock will also influence the size of the position

Risk Management

- Beutel Goodman controls portfolio risk by doing a thorough analysis of each stock
- Risk control guidelines are broad; there's no minimum for any sector and the maximum is equal to the S&P/TSX weight plus 10%
- The minimum number of stocks is 30 and the maximum per stock is 10%

Capacity

- They currently manage \$8.2 billion in Canadian equity mandates
- They feel that they can handle up to \$12 billion in Canadian equities
- They feel at above 1% of total market capitalization it becomes harder for a portfolio to add value

Trading

- Trading was discussed with Peter Clarke and Mark Thomson
- They look for best execution when they select brokers
- Everyone on the team has a say on brokers' evaluation, including portfolio managers, analysts and traders
- Their 2 equity traders have extensive industry experience
- Regarding trading venues, Beutel, Goodman uses algorithm for transitions because they can be done at low cost and because they provide additional data that some clients request
- Approximately 25% of their transactions involve soft dollars; they follow the CFA Institute guidelines regarding the use of soft dollars; they use brokers for industry specific knowledge and historical data, not for company valuation
- They use traditional brokers for the rest of their transactions
- Overall Beutel, Goodman has adequate trading capabilities, especially given their low turnover

COMPLIANCE

- Compliance was reviewed with Peter Clarke
- Michael Gibson, Managing Director of Operations is the Chief Compliance Officer; he is assisted by Cynthia Rogers, the firm's legal counsel
- We reviewed some of Beutel, Goodman compliance processes, including: client mandate monitoring, soft dollar practices, personal trading policy and code of ethics
- Beutel, Goodman, its funds or its personnel are not facing any other litigation
- No material issue was raised following their most recent regulatory review
- Beutel, Goodman is not aware of any conflict of interest involving its personnel
- The firm has an adequate code of ethics
- Everyone has to pre-clear personal transactions
- The funds managed on behalf of UWO are in compliance with the letter of appointment dated August 18, 2009
- Overall Beutel, Goodman has adequate compliance processes in place.

**THE UNIVERSITY OF WESTERN ONTARIO
RETIREMENT PLANS and OPERATING & ENDOWMENT FUND
Beutel, Goodman & Company Ltd.
Meeting Agenda**

Date: October 28, 2010

Meeting time: 9:00 AM to 12:00 PM

Location: 20, Eglinton Ave West, Suite 2000, Toronto, Ontario

UWO Attendee:

Martin Bélanger, Director, Investments

ORGANIZATION:

- Introduction – relationship review
- Discuss any meaningful change to your corporate structure over the past 12 months
- Review changes in assets under management
- Discuss clients gained and lost
- Overview of new products
- Overview of your business continuity plan

INVESTMENT PERSONNEL:

- Introduction to key personnel on our mandates
- Discuss personnel turnover

REVIEW OF UWO PORTFOLIOS (Retirement Plans and Operating & Endowment Fund):

- Performance overview
- Attribution analysis
- Detractors/contributors to performance
- Portfolio characteristics
- Overview of investment process and changes to investment philosophy, if any; please provide examples of stocks added that meet your investment criteria
- Discuss changes made to the portfolios
- Describe how you measure and control portfolio investment risk
- Report how you integrate environmental, social and governance factors in your investment process and the impact on your portfolio and investment strategy
- Discuss portfolio positioning

INVESTMENT RESEARCH:

- Review global research platform
- Review approach to research
- Discuss research reports with portfolio managers/analysts

TRADING:

- Overview of trading systems and methodology
- Execution analysis
- Discuss total trading costs analysis
- Discuss soft dollar allocation
- Discuss broker/dealer selection
- Discuss stock exchange selection

COMPLIANCE:

- Provide an overview of your compliance processes
- Confirm that all investments managed by Beutel, Goodman & Company on behalf of UWO are in compliance with the terms and conditions of the Letter of Appointment and the Investment Manager Mandate and Performance Standards and in compliance with all applicable laws
- Describe any material litigation to which your firm, key personnel or the funds have been party over the past year
- Describe any material issue raised as a result of recent regulatory reviews
- Confirm that your key investment personnel complies with an appropriate code of ethics
- Confirm that any conflict of interest or potential conflict of interest involving Beutel, Goodman & Company or key investment personnel has been disclosed

OTHER:

- Office tour