MORNEAU SHEPELL MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE THREE AND NINE MONTHS ENDED SEPTEMBER 30, 2016

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Morneau Shepell Inc. ("Morneau Shepell" or the "Company") was incorporated pursuant to the laws of the Province of Ontario on October 19, 2010, and as of January 1, 2011, is the successor of Morneau Sobeco Income Fund (the "Fund").

This Management's Discussion and Analysis ("MD&A") covers the three and nine months ended September 30, 2016 and should be read in conjunction with the accompanying unaudited condensed consolidated interim financial statements of Morneau Shepell and notes thereto for the three and nine months ended September 30, 2016, and the MD&A and the audited consolidated financial statements and notes thereto for the year ended December 31, 2015.

All financial information is presented in Canadian dollars and in accordance with International Financial Reporting Standards, unless otherwise noted. Certain totals, subtotals and percentages may not reconcile due to rounding.

This MD&A contains "forward-looking statements" within the meaning of applicable securities laws, such as statements concerning anticipated future events, results, circumstances, performance or expectations that are not historical facts. They are based on certain factors and assumptions, including expected growth, results of operations, business prospects and opportunities. Use of words such as "may", "will", "expect", "believe", or other words of similar effect may indicate a "forward-looking" statement. These statements are not guarantees of future performance and are subject to numerous risks and uncertainties, including those described in our publicly filed documents (available on SEDAR at www.sedar.com) and in this MD&A under the heading "Risks and Uncertainties". Those risks and uncertainties include the ability to maintain profitability and manage growth, ability to pay dividends, reliance on information systems and technology, reputational risk, dependence on key clients, reliance on key professionals and general economic conditions. Many of these risks and uncertainties can affect our actual results and could cause our actual results to differ materially from those expressed or implied in any forward-looking statement made by us or on our behalf. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. All forward-looking statements in this MD&A are qualified by these cautionary statements. These statements are made as of the date of this MD&A and, except as required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise. Additionally, we undertake no obligation to comment on analyses, expectations or statements made by third parties in respect of us, our financial or operating results or our securities.

To assist investors in assessing our financial performance, this discussion also makes reference to certain non-IFRS measures such as EBITDA, adjusted EBITDA, EBITDA margin, adjusted EBITDA margin, Free Cash Flow, Normalized Free Cash Flow, twelve-month rolling Normalized Payout Ratio, and twelve-month rolling Normalized Payout Ratio including changes in adjusted non-cash operating working capital. EBITDA and adjusted EBITDA are intended to represent an indication of Morneau Shepell's capacity to generate profit from operations before taking into account management's financing decisions and costs of consuming tangible and intangible capital assets, which vary according to their vintage, technological currency, and management's estimate of their useful life. Accordingly, EBITDA comprises profit before finance costs, income tax expenses, depreciation and amortization, while Adjusted EBITDA represents EBITDA before taking into account certain unusual expenditures. EBITDA margin represents EBITDA as a percentage of revenue, and Adjusted EBITDA margin represents Adjusted EBITDA as a percentage of revenue. We believe both EBITDA and Adjusted EBITDA are useful measures in evaluating our performance and we utilize them to monitor compliance with debt covenants. We also believe that Free Cash Flow, Normalized Free Cash Flow, the twelve-month rolling Normalized Payout Ratio, and the twelve-month rolling Normalized Payout Ratio including changes in adjusted non-cash operating working capital, are useful supplemental measures of Morneau Shepell's ability to

generate cash after deducting capital expenditures required to maintain or expand the business. We also utilize them to make decisions related to dividends to shareholders. These ratios, however, are non-IFRS measures and therefore, should not be seen as a substitute for cash flow from operating activities. Free Cash Flow is defined as cash provided by operating activities adjusted for capital expenditures. Normalized Free Cash Flow is defined as cash provided by operating activities, adjusted for changes in non-cash operating working capital, capital expenditures, current income taxes (net of income taxes paid) and certain unusual expenditures.

Non-IFRS measures do not have any standard meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers. Non-IFRS measures are reconciled to IFRS measures elsewhere in this MD&A.

OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares and 10 million preferred shares. Each common share entitles the holder to one vote at all meetings of shareholders and represents an interest in dividends declared by the Company and an undivided interest in the net assets of the Company. As at November 8, 2016, Morneau Shepell had 53,204,210 common shares, nil preferred shares and $86.0 million aggregate principal amount of 4.75% convertible debentures outstanding. In the event all of the outstanding 4.75% convertible debentures are converted into common shares of the Company by the holders prior to their maturity date, the total number of common shares issuable will be approximately 3,400,000. The number of long-term incentive plan ("LTIP") units, including those that remain unvested, that are outstanding and may be converted to common shares is approximately 2,900,000.

BUSINESS OVERVIEW

Morneau Shepell is the largest Canadian firm providing health and productivity, administrative and retirement solutions. We deliver solutions to assist employers in managing the financial security, health and productivity of their employees. With almost 4,000 employees in offices across North America, we offer services to approximately 20,000 organizations in Canada, the United States and around the globe directly and through our distribution channel partners.

We derive our revenue primarily from fees charged to clients for consulting engagements, outsourcing engagements, employee and family assistance programs and absence management solution services.

Fees from consulting engagements are charged based on billable hours or on a fee-for-service basis. In some cases, consulting engagements may be billed on a fixed-fee basis, although these engagements are typically much smaller and the services are delivered over a shorter period of time. For some benefits consulting assignments which involve the purchase of an insurance policy underwritten by an insurance company, we may be paid commissions (in lieu of fees) by the client's insurance company, which is a common practice in the industry. These commissions are based on a percentage of the premiums paid by the client to the insurance company and our policy is to disclose them to our client. We assume no underwriting risk as the insurance policy is underwritten by the insurance company.

Our Administrative Solutions practice is characterized by fixed contracts, which typically have three-year to five-year terms. Most outsourcing contracts contain an upfront implementation fee and an ongoing monthly service fee. Implementations usually take three to twelve months and involve transferring the administration of a client's pension and/or benefits plans onto our systems, tailoring our systems and training our employees. Additional services provided that are outside the scope of the outsourcing contract are usually paid on a fee-for-service basis. A small number of contracts contain a large up front customization and implementation fee, with lower ongoing maintenance fees.

In the billing for Employee Support Solutions ("ESS") services, a portion of the ESS client agreements require payment of a minimum retainer and incremental usage-based fees. The remainder of the ESS agreements are billed based on an actual usage or fixed fees. Most ESS agreements may be terminated by the client upon 30 to 60 days' notice to us, however, it is typical for ESS agreements to continue for multiple years and many automatically renew on an annual basis.

Fees from Absence Management Solutions ("AMS") services, such as attendance support and disability management are generally based on negotiated fees or a formula tied to the nature of the service being provided. Like most ESS agreements, most workplace health and productivity agreements may be terminated by the client upon 30 to 60 days' notice to us; however, it is typical for these agreements to continue for multiple years and many automatically renew on an annual basis. Fees for workers compensation services are charged based on billable hours or on a fee-for-service basis.

Our largest operating expense is compensation and related costs. This includes salaries, annual performance-based bonuses, benefits, payroll taxes, independent service providers and temporary staffing services.

The remaining operating expenses include rent and occupancy costs, technology costs (including equipment leases, telecommunications, and software licenses and maintenance), non-recoverable client service costs, training, marketing, office costs, professional services and insurance.

2016 THIRD QUARTER SUMMARY AND OUTLOOK

(In thousands of dollars)	**Three months ended September 30, 2016**	**Three months ended September 30, 2015**	**Nine months ended September 30, 2016**	**Nine months ended September 30, 2015**
Revenue	$144,594	$140,778	$442,967	$421,590
Organic Revenue[1]	$139,040	$135,483	$422,277	$406,390
Adjusted EBITDA	$27,187	$25,886	$85,548	$80,590
Adjusted EBITDA margin	18.8%	18.4%	19.3%	19.1%
Normalized Free Cash Flow	$17,323	$13,177	$51,214	$43,406
Profit (loss)	$5,210	($3,487)	$20,340	$13,996

Footnote:

(1) Organic Revenue is defined as revenue excluding acquisitions not in the comparative period and divestitures, and the Health Republic Insurance of New York (HRINY), who was given a wind down of business directive by the New York State Department of Financial Services in 2015, and is calculated as follows:

(In thousands of dollars)	**Three months ended September 30, 2016**	**Three months ended September 30, 2015**	**Nine months ended September 30, 2016**	**Nine months ended September 30, 2015**
Revenue	**$144,594**	**$140,778**	**$442,967**	**$421,590**
Acquisitions	(5,554)	–	(20,690)	–
HRINY	–	(5,295)	–	(15,200)
Organic Revenue	**$139,040**	**$135,483**	**$422,277**	**$406,390**

Third quarter:

We continued to deliver revenue and adjusted EBITDA growth versus the comparative quarter in 2015. Highlights of the third quarter include:

- Revenue and Organic Revenue growth of 2.7% and 2.6%, respectively, versus the comparative quarter with year-over-year growth of 5.1% (Organic Revenue – 3.9%) over the comparative nine months.

- An increase in adjusted EBITDA of $1.3 million to $27.2 million, or 5% versus the comparative period.

We expect our Revenue growth to be slightly lower than our longer term historical performance in the short term, but more in line with our year to date performance due to timing of new client wins. We expect our continued investments in our business and our established and prospective client base will continue to yield positive results for the Company in the longer term.

2016 THIRD QUARTER OPERATING RESULTS SUMMARY

Results of Operations	**Three months ended September 30,**		**Nine Months ended September 30,**	
Selected Unaudited Consolidated Financial Information	**2016**	**2015**	**2016**	**2015**
(In thousands of dollars except per share amounts)				
Revenue	$144,594	$140,778	$442,967	$421,590
Deduct:				
Salaries, benefits and contractor expenses	100,903	96,408	302,439	286,683
Other operating expenses	23,658	21,879	72,467	64,517
Finance costs	3,250	3,638	11,749	10,824
Depreciation and amortization	8,778	8,167	26,126	24,257
Write-down of deferred implementation costs and impairment	935	15,100	935	15,100
Income tax expenses (recovery)	1,860	(927)	8,911	6,213
Profit (loss) for the period	**5,210**	**(3,487)**	**20,340**	**13,996**
Add:				
Finance costs	3,250	3,638	11,749	10,824
Depreciation and amortization	8,778	8,167	26,126	24,257
Income tax expenses (recovery)	1,860	(927)	8,911	6,213
EBITDA (1)	$19,098	$7,391	$67,126	$55,290
Adjustments:				
Sublease loss provision	400	–	400	700
Reorganization and operational effectiveness initiatives	4,843	–	9,861	–
Write-down of deferred implementation costs and impairment	935	15,100	935	15,100
Mercer Canada Outsourcing conversion costs	1,911	3,395	7,226	9,500
Adjusted EBITDA	**$27,187**	**$25,886**	**$85,548**	**$80,590**
EBITDA margin (2)	13.2%	5.3%	15.2%	13.1%
Adjusted EBITDA margin (2)	18.8%	18.4%	19.3%	19.1%
Cash provided by operating activities	$30,197	$18,018	$39,092	$24,999
Deduct: Capital expenditures (3)	(5,686)	(7,289)	(18,000)	(20,125)
Free Cash Flow (4)	**24,511**	**10,729**	**21,092**	**4,874**
Add (deduct):				
Changes in non-cash operating working capital	(12,019)	(13,373)	17,201	19,817
Mercer Canada Outsourcing conversion – capital	–	197	–	388
Current income taxes, net of income taxes paid	(1,634)	19	(3,875)	(3,383)
Adjustments to EBITDA (5)	6,465	15,605	16,796	21,710
Normalized Free Cash Flow (6)	**$17,323**	**$13,177**	**$51,214**	**$43,406**
Earnings (loss) per Share (basic)	$0.09	($0.07)	$0.39	$0.28
Earnings (loss) per Share (diluted)	$0.09	($0.07)	$0.39	$0.28
Adjusted EBITDA per Share (basic)	$0.49	$0.52	$1.64	$1.63
Dividends declared	$10,355	$9,365	$29,625	$28,088
Twelve-month rolling Normalized Payout Ratio (7)	56.2%	65.9%	56.2%	65.9%
Twelve-month rolling Normalized Payout Ratio, including changes in adjusted non-cash operating working capital (8)	54.2%	89.0%	54.2%	89.0%

Footnotes:

(1) "EBITDA" is defined as profit before finance costs, income tax expenses, depreciation and amortization.

(2) "EBITDA margin" represents EBITDA as a percentage of revenue, and "Adjusted EBITDA margin" represents Adjusted EBITDA as a percentage of revenue.

(3) "Capital Expenditures" includes additions to capital assets and intangible assets but excludes additions to capital assets and intangible assets acquired through business acquisitions, and is presented net of disposals.

(4) "Free Cash Flow" is defined as cash provided by operating activities adjusted for capital expenditures.

(5) Adjustments to EBITDA do not include the sublease loss provision of $400 (2015- $700), non-cash reorganization and operational effectiveness initiatives costs of $291 ($2015- $nil), and for the comparative three months and nine months ended September 30, 2015, the impairment charges for internally developed software of $2,890 recognized as a result of the wind down of business directive issued to HRINY. These amounts have been excluded as they have already been added back in cash from operating activities before the change in non- cash operating working capital.

(6) "Normalized Free Cash Flow" is defined as cash provided by operating activities, adjusted for changes in non-cash operating working capital, capital expenditures, current income taxes (net of income taxes paid) and certain unusual expenditures.

(7) "Twelve-month rolling Normalized Payout Ratio" is defined as dividends declared divided by Normalized Free Cash Flow for the rolling twelve-month period.

(8) "Twelve-month rolling Normalized Payout Ratio, including changes in adjusted non-cash operating working capital" is defined as dividends declared divided by the Twelve-month rolling Normalized Free Cash Flow, including changes in non-cash operating working capital adjusted for unusual fluctuations. For the twelve-month period ended September 30, 2016 and September 30, 2015 the non-cash working capital was adjusted by $(935) and $(2,196), respectively, which represents adjustments to working capital for write-off of deferred implementation costs and the change in the leasehold inducement receivable related to capital expenditures.

ANALYSIS OF THIRD QUARTER 2016 OPERATING RESULTS

Revenue

Revenue for the three months ended September 30, 2016 increased by $3.8 million, or 2.7%, to $144.6 million compared to $140.8 million for the same period in 2015. Excluding revenue from acquisitions not in the comparative period and HRINY in 2015, Organic revenue grew by $3.6 million or 2.6%.

The increase is primarily coming from our Administrative Solutions and ESS lines of business as a result of increased activity with existing clients and new client wins.

Salaries, Benefits and Contractor Expenses

Salaries, benefits and contractor expenses for the three months ended September 30, 2016 increased by $4.5 million, or 4.7%, to $100.9 million compared to $96.4 million for the same period in 2015. Excluding the net decrease in compensation expense of $0.5 million resulting from acquisitions not in the comparative period net of the wind down of HRINY in 2015, compensation expense increased by $5.0 million. The increase is mainly attributable to higher reorganization and operational effectiveness initiatives costs of $4.8 million.

Other Operating Expenses

Other operating expenses for the three months ended September 30, 2016 increased by $1.8 million, or 8.1%, to $23.7 million compared to $21.9 million for the same period in 2015. Excluding the net decrease in other operating expenses of $0.5 million resulting from acquisitions not in the comparative period net of the wind down of HRINY in 2015, other operating expenses grew by $2.3 million due to general increases required to support the Company's continued growth.

Finance Costs

Finance costs for the three months ended September 30, 2016 decreased by $0.4 million, or 10.7%, to $3.3 million compared to $3.6 million for the same period in 2015, due to reduced borrowings under the Company's credit facility agreement (see discussion of the Company's credit facility agreement under the 'Capital Resources' section below).

Depreciation and Amortization

Depreciation and amortization for the three months ended September 30, 2016 increased by $0.6 million, or 7.5%, to $8.8 million compared to $8.2 million for the same period in 2015. The increase is mainly due to higher amortization of internally developed software to support the Company's growth, customer requirements and new service offerings.

Write-down of Deferred Implementation Costs and Impairment

For the three months ended September 30, 2016, as a result of an Order of Rehabilitation entered by the Superior Court of New Jersey for Health Republic Insurance of New Jersey, the Company determined that deferred implementation costs specifically related to this client were no longer recoverable and recorded a pre-tax write-down in the amount of $0.9 million ($0.6 million after tax).

For the same period in 2015, as a result of the wind down of business directive issued by the New York State Department of Financial Services, the Centers for Medicare and Medicaid Services, and the New York State of Health to Health Republic Insurance of New York (HRINY), one of our US Health Exchange outsourcing clients, we determined that the deferred implementation costs related to HRINY were no longer recoverable and recorded a pre-tax write-down of $12.2 million ($8.6 million after tax). In addition, we also recognized impairment charges on internally developed software related to US Health Exchange Outsourcing services in the pre-tax amount of $2.9 million ($2.1 million after tax).

Income Tax Expenses

Income tax expenses increased by $2.8 million to $1.9 million compared to a recovery of $0.9 million for the same period in 2015 primarily due to the deferred income tax recovery related to the write-down of the deferred implementation costs and impairment loss on internally developed software in the comparative period.

Profit for the Period

As a result of the changes noted above, the profit for the three months ended September 30, 2016 increased by $8.7 million to $5.2 million compared to a $3.5 million loss for the same period in 2015.

Key Financial Measures: EBITDA, Adjusted EBITDA, Free Cash Flow and Normalized Free Cash Flow

Adjusted EBITDA and EBITDA

Adjusted EBITDA increased by $1.3 million, or 5.0%, to $27.2 million compared to $25.9 million for the same period in 2015. The increase is primarily due to growth in revenue of $3.8 million, partially offset by an increase in salaries and other operating expenses of $2.5 million after EBITDA adjustments. These adjusted EBITDA items do not constitute a part of the Company's on-going operating expenses, and are described in the analysis of the nine months ended September 30, 2016 operating results section below.

EBITDA increased by $11.7 million to $19.1 million compared to $7.4 million for the same period in 2015 primarily due to the write-down of deferred implementation costs and impairment related to HRINY in the comparative period.

Free Cash Flow

Free Cash Flow for the three months ended September 30, 2016 increased by $13.8 million to $24.5 million compared to $10.7 million for the same period in 2015. The increase is primarily due to higher cash provided by operating activities of $12.2 million and lower capital expenditures of $1.6 million (see discussion of capital expenditures in Liquidity and Capital Resources section below).

Normalized Free Cash Flow

Normalized Free Cash Flow for the three months ended September 30, 2016 increased by $4.1 million to $17.3 million compared to $13.2 million for the same period in 2015. The increase was mainly due to lower finance costs paid of $2.6 million as a result of the change in timing of interest payments on convertible debentures and lower capital expenditures (adjusted for Mercer Conversion Outsourcing conversion capital) of $1.4 million.

ANALYSIS OF NINE MONTHS ENDED SEPTEMBER 30, 2016 OPERATING RESULTS

Revenue

Revenue for the nine months ended September 30, 2016 increased by $21.4 million, or 5.1%, to $443.0 million compared to $ 421.6 million for the same period in 2015.

Excluding revenue from acquisitions not in the comparative period and HRINY in 2015, organic revenue grew by $15.9 million or 3.9%. The increase is primarily coming from our Administrative Solutions and ESS lines of business as a result of increased activity with existing clients and new client wins.

Salaries, Benefits and Contractor Expenses

Salaries, benefits and contractor expenses for the nine months ended September 30, 2016 increased by $15.8 million, or 5.5%, to $302.4 million compared to $286.7 million for the same period in 2015. Excluding the net increase in compensation expense of $2.5 million resulting from acquisitions not in the comparative period net of the wind down of HRINY in 2015, compensation expense increased by $13.3 million. This increase is mainly attributable to higher reorganization and operational effectiveness initiatives costs of $9.9 million and $4.8 million of general increases to support the Company’s continued growth net of adjustment to variable compensation expenses, partially offset by lower Mercer Canada Outsourcing Conversation compensation costs of $1.4 million.

Other Operating Expenses

Other operating expenses for the nine months ended September 30, 2016 increased by $8.0 million, or 12.3%, to $72.5 million compared to $64.5 million for the same period in 2015. Excluding the net decrease in other operating expenses of $0.1 million resulting from acquisitions not in the comparative period net of the wind down of HRINY in 2015, other operating expenses grew by $8.1 million due to general increases required to support the Company’s continued growth.

Finance Costs

Finance costs for the nine months ended September 30, 2016 increased by $0.9 million, or 8.5% to $11.7 million compared to $10.8 million for the same period in 2015, due to higher non-cash interest expense related to the 5.75% convertible debentures converted and redeemed during the second quarter, partially

offset by reduced borrowings under the Company's credit facility agreement (see discussion of the Company's credit facility agreement under the 'Capital Resources' section below).

Depreciation and Amortization

Depreciation and amortization for the nine months ended September 30, 2016 increased by $1.9 million, or 7.7%, to $26.1 million compared to $24.3 million for the same period in 2015. The increase is mainly due to higher amortization of internally developed software to support the Company's growth, customer requirements and new service offerings.

Write-down of Deferred Implementation Costs and Impairment

For the nine months ended September 30, 2016, as detailed in the "Analysis of Third Quarter 2016 Operating Results", the Company determined that deferred implementation costs specifically related to HRINJ were no longer recoverable and recorded a pre-tax write-down in the amount of $0.9 million ($0.6 million after tax).

For the same period in 2015, as detailed in the "Analysis of Third Quarter 2016 Operating Results", we determined that deferred implementation costs related to HRINY were no longer recoverable and recorded a pre-tax write-down of $12.2 million ($8.6 million after tax). In addition, we also recognized impairment charges on internally developed software related to US Health Exchange Outsourcing services in the pre-tax amount of $2.9 million ($2.1 million after tax).

Income Tax Expenses

Income tax expenses for the nine months ended September 30, 2016 increased by $2.7 million, or 43.4%, to $8.9 million compared to $6.2 million for the same period in 2015 due to the deferred income tax recovery related to the write-down of the deferred implementation costs and impairment loss on internally developed software in the comparative period.

Profit for the Period

As a result of the changes noted above, the profit for the nine months ended September 30, 2016 was $20.3 million compared to $14.0 million for the same period in 2015.

Key Financial Measures: EBITDA, Adjusted EBITDA, Free Cash Flow and Normalized Free Cash Flow

Adjusted EBITDA and EBITDA

Adjusted EBITDA increased by $5.0 million, or 6.1%, to $85.5 million compared to $80.6 million for the same period in 2015. The increase is primarily due to growth in revenue of $21.4 million, partially offset by an increase in salaries and other operating expenses of $16.4 million after EBITDA adjustments. These adjusted EBITDA items do not constitute a part of the Company's on-going operating expenses. Below is a description of the nine months ended September 30, 2016 adjustments:

- Mercer Canada Outsourcing conversion costs represent systems and service improvements required to support the clients acquired in November, 2012. The process commenced immediately after the acquisition and we have substantially completed the original planned conversion. As a result of the savings we realized from the original conversion, we decided to convert the remaining clients acquired which were not included in the original conversion. Based on our project plan this additional

conversion is expected to finish in the third quarter of 2017.

- The write-down of deferred implementation costs related to HRINJ arose as a result of an Order of Rehabilitation entered by the Superior Court of New Jersey. The comparative write-down of deferred implementation costs and impairment losses on internally developed software in 2015 was triggered by the sudden wind-down of HRINY. In both cases the events were triggered by business directives issued by regulatory authorities in the United States due to the volatility of the Health Exchange program. It is not typical for our Administrative Solutions contracts to be terminated shortly after the commencement of their first outsourcing term.

- Reorganization and operational effectiveness initiatives represents severance and professional fees incurred as a result of the loss of the Health Exchange Clients, corporate reorganizations and employee terminations to achieve post-acquisition planned synergies.

- The 2016 sublease loss provision arose as a result of the plan to sublet the excess space in our US office used to service our US Health Exchange business.

EBITDA increased by $11.8 million to $67.1 million compared to $55.3 million for the same period in 2015.

Free Cash Flow

Free Cash Flow for the nine months ended September 30, 2016 increased by $16.2 million to $21.1 million compared to $4.9 million for the same period in 2015. The increase is primarily due to higher cash provided by operating activities of $14.1 million due to higher profit for the period, a more favorable change in non-cash working capital, lower income taxes paid, and lower capital expenditures of $2.1 million (see discussion of capital expenditures in Liquidity and Capital Resources section below).

Normalized Free Cash Flow

Normalized Free Cash Flow for the nine months ended September 30, 2016 increased by $7.8 million to $51.2 million compared to $43.4 million for the same period in 2015. The increase was mainly due to higher cash generating from operating activities before changes in non-cash operating working capital and EBITDA adjustments of $3.0 million, lower finance costs and current taxes of $3.0 million, and lower capital expenditures (adjusted for Mercer Conversion Outsourcing conversion capital) of $1.7 million.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

The following table provides an overview of the Company's cash flows for the periods indicated:

Cash Flow Information

Selected Consolidated Financial Information:

Cash provided by (used in): *(In thousands of dollars)*	**Nine months ended September 30, 2016**	**Nine months ended September 30, 2015**
Operating activities	**$39,092**	$ 24,999
Financing activities	**(21,975)**	(1,091)
Investing activities	**(19,033)**	(20,413)
Increase (decrease) in cash	**$ (1,916)**	$ 3,495

Cash provided by operating activities for the nine months ended September 30, 2016 increased by $14.1 million to $39.1 million compared to $25.0 million for the same period in 2015. The increase is due to higher cash generating from operating activities of $10.6 million due to increased profit for the period and a more favorable change in non-cash operating working capital, and lower finance costs and income taxes paid of $3.5 million.

Cash used in financing activities for the nine months ended September 30, 2016 increased by $20.9 million to $22.0 million compared to $1.1 million for the same period in 2015. The net proceeds raised from the issuance of the new $86.0 million convertible debentures were used primarily to pay down amounts borrowed under the credit facility and to fund the redemption of the previously issued convertible debentures that remained outstanding. As a result, the change is primarily due to repayment of amounts borrowed under the credit facility in 2016.

Cash used in investing activities for the nine months ended September 30, 2016 decreased by $1.4 million to $19.0 million compared to $20.4 million for the same period in 2015. The decrease is due to lower additions to intangible and capital assets of $2.1 million (see discussion of capital expenditures below), partially offset by higher acquisition related payments of $0.7 compared to the same period in 2015.

Dividends to Shareholders

Monthly dividends were declared for shareholders of record on the last business day of each month and were paid approximately on the 15th day of the following month. Monthly dividends were $0.065 per share for the quarter. The Company continued to declare the same monthly dividend amount in October 2016.

We consider the amount of cash generated by the business in determining the amount of dividends to pay to shareholders. We do not generally consider profit or loss in setting the level of dividends as this is a non-cash metric and is not reflective of the level of cash flow that we generate.

The twelve-month rolling Normalized Payout Ratio at September 30, 2016 was 56.2% compared to 65.9% for the same period in 2015. The decrease in the Normalized Payout Ratio is primarily due to higher Normalized Free Cash Flow during the past twelve months.

Capital Expenditures

Our capital expenditures typically include information technology hardware and software (external and internally developed), leasehold improvements, and office furniture. Such amounts are expected to be funded from our operating cash flow. Additional capital expenditure requirements may result from significant business expansion. Capital expenditures for the three months ended September 30, 2016 decreased by $1.6 million to $5.7 million compared to $7.3 million for the same period in 2015 and the decrease for the nine months ended September 30, 2016 was $2.1 million to $18.0 million from $20.1 million in the comparative period. The decrease in capital expenditures for the three months ended September 30, 2016 is due to reduced hardware and software purchases of $0.6 million, and lower internally developed software expenditures of $0.6 million. The decrease in capital expenditures for the nine months ended September 30, 2016 is due to reduced leasehold improvements and office furniture expenditures of $2.1 million (net of leasehold inducements) primarily due to the completion of the offices consolidation in various regions in the comparative period.

Contractual Obligations

Commitments

We lease office space and selected equipment under operating lease agreements with terms ranging from one to fifteen years. We also have revolving loans under the credit facility arrangement and convertible debentures described under the section “Capital Resources”.

A summary of contractual obligations, which outlines the year the payments are due is as follows:

(In thousands of dollars)	**Total**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021 and thereafter**
Long-term debt	$ 172,805	$ -	$ 172,805	$ -	$ -	$ -	$ -
Convertible debenture	86,000	-	-	-	-	-	86,000
Operating leases, net	98,330	4,014	14,918	13,549	12,687	12,429	40,733
Total	**$ 357,135**	**$ 4,014**	**$ 187,723**	**$ 13,549**	**$ 12,687**	**$ 12,429**	**$ 126,733**

We are party to various subleases to which we would be liable for the rental payment in the case of a default by the subtenants. The minimum payments and the aggregate sublease income related to these premises have been netted against the operating leases amounts reported above. We consider the risk of default by the subtenants to be low therefore no accrual has been set up.

Contingent Consideration

The purchase price for Bensigner Du Pont & Associates, Inc. (“BDA”), and the U.S. health and welfare benefits administration business of Ceridian are contingent on future business results and the estimated remaining installments of $2.6 million ($2.0 million U.S.), and $1.6 million ($1.2 million U.S.), respectively, are due in 2017. These contingent future installments have been recognized as an acquisition liability on the statement of financial position at their estimated discounted amounts as at September 30, 2016.

In addition there is $0.2 million of contingent consideration due from 2016 through 2018 for other smaller acquisitions.

We have no material contractual obligations other than those described in this MD&A and have no off-balance sheet financing arrangements.

Capital Resources

The following table provides an overview of our capital resources:

(In thousands of dollars)	**As at September 30, 2016**	**As at December 31, 2015**
Cash	$ –	$ 1,900
Bank indebtedness	16	–
Long- term debt, net of debt issuance costs	172,434	241,846
Convertible debenture, net of issuance costs and equity component of debenture	80,859	73,760
Shareholders’ equity	368,404	301,114

As at September 30, 2016, our working capital increased by $3.1 million from $78.6 million as at December 31, 2015 to $81.7 million as at September 30, 2016. The increase is primarily attributable to the timing of payment to vendors and changes in compensation related accruals. Additional details related to the changes in working capital from year end are included under the selected statement of financial position data section below.

Long-term debt

Long-term debt, net of debt issuance costs, decreased by $69.4 million from $241.8 million as at December 31, 2015 to $172.4 million as at September 30, 2016 due to repayments of amounts borrowed under the Company's credit facility agreement from the proceeds received from the issuance of convertible debentures in Q2 (see discussion on the issuance of convertible debentures under the convertible debentures section below).

The Company has a credit facility agreement maturing on November 29, 2017 which provides for a revolving facility of $300.0 million (including a swing line of $7.0 million).

The interest rates for the credit facility agreement are floating, based on a margin over certain referenced rates of interest. The applicable margin may vary up and down depending on the ratio of our consolidated debt to Adjusted EBITDA as defined in the credit facility agreement.

We are in compliance with all of the required financial covenants.

Interest-rate Swap

In February 2014, the Company entered into a forward starting interest-rate swap agreement to hedge against the variable interest rate component on $160.0 million notional amount borrowed under the credit facility agreement for the period from January 5, 2015 up to and ending November 29, 2017. The notional amount of this swap is $160.0 million and is used to fix the variable component of the interest rate at 1.98%, before the applicable margin, for the duration of this period and has been designated as a cash flow hedge.

Convertible debentures

On March 27, 2012, the Company issued $75.0 million principal amount of 5.75% Convertible Unsecured Subordinated Debentures (the "5.75% Convertible Debentures") for net proceeds of $71.4 million with a maturity date of March 31, 2017. The 5.75% Convertible Debentures were convertible at the option of the holder to common shares at a conversion price of $15.00 per common share, and the Company had the option to redeem the 5.75% Convertible Debentures after March 31, 2016 at a redemption price equal to 100% of their principal amount plus accrued and unpaid interest. In May 2016, the Company issued a notice of redemption for the remaining outstanding 5.75% Convertible Debentures. During the six months ended June 30, 2016, 5.75% Convertible Debentures in the principal amount of $72.4 million were converted by holders to common shares. In June 2016, the Company exercised its option to redeem all the $2.5 million principal amount of 5.75% Convertible Debentures that still remained issued and outstanding for cash.

In June, 2016, the Company issued $86.0 million principal amount of 4.75% Convertible Unsecured Subordinated Debentures (the "4.75% Convertible Debentures") for net proceeds of $82.0 million. The 4.75% Convertible Debentures pay interest semi-annually on June 30 and December 31, commencing with the initial interest payment on December 31, 2016 and have a maturity date of June 30, 2021.

These debentures are convertible at the option of the holder to common shares at a conversion price of $25.10 per common share. The Company has the option to redeem the 4.75% Convertible Debentures on

and after June 30, 2019 and at any time prior to June 30, 2020 at a redemption price equal to 100% of their principal plus accrued and unpaid interest provided that the weighted average trading price for the 20 consecutive trading days ending five days preceding the date on which the notice of redemption is given is at least 125% of the conversion price of $25.10. On and after June 30, 2020, but prior to the maturity date, the 4.75% Convertible Debentures will be redeemable at a redemption price equal to 100% of their principal amount plus accrued and unpaid interest. On redemption or maturity the Company may elect to repay the principal and satisfy its interest obligations by issuing common shares.

SELECTED STATEMENT OF FINANCIAL POSITION DATA

The following table provides an overview of our selected statement of financial position data:

(in thousands of dollars)	**As at September 30, 2016**	**As at December 31, 2015**
Current assets	$160,959	$ 156,410
Non-current assets	599,443	599,238
Current liabilities	79,217	77,761
Non-current liabilities	312,781	376,773

Current Assets

Current assets as at September 30, 2016 increased by $4.6 million to $161.0 million from $156.4 million as at December 31, 2015. The increase is primarily attributable to an increase in trade and other receivables and unbilled fees of $1.8 million due to growth in revenue, an increase in prepaid expenses and other assets of $3.0 million due to timing of vendor payments, and an increase in cash and investments held in trust of $1.7 million. This was partially offset by a bank indebtedness balance as at September 30, 2016 compared to a cash balance of $1.9 million at December 31, 2015 year end.

Non-current Assets

Non-current assets as at September 30, 2016 increased by $0.2 million to $599.4 million from $599.2 million at December 31, 2015. The increase was primarily due to an increase in the non-current portion of deferred implementation costs of $5.3 million from increased deferred implementation activities in the U.S. for outsourcing contracts that will commence services in the fourth quarter of 2016 and early 2017, an increase in the non-current portion of unbilled fees $1.3 million due to contract billing terms, and an increase in the deferred tax asset of $1.3 million. This was partially offset by a decrease in capital and intangible assets of $8.2 million due to depreciation and amortization in excess of capital expenditures during the period.

Current Liabilities

Current liabilities as at September 30, 2016 increased by $1.5 million to $79.2 million from $77.8 million as at December 31, 2015. The increase is mainly due to an increase in deferred revenue of $3.7 million due to timing of consideration received from customers, an increase in the current portion of future consideration related to acquisition of $3.3 million, higher insurance premium liabilities of $1.7 million and an income taxes payable of $2.2 million compared to income taxes receivable of $0.7 million as at December 31, 2015. This was partially offset by a decrease in trade and other payables of $7.2 million due to the timing of payment to vendors as well as change in compensation related accruals and the repayment of the $2.5 million promissory note issued as partial consideration for the acquisition of Groupe AST (1993) Inc.

Non-current Liabilities

Non-current liabilities as at September 30, 2016 decreased by $64.0 million to $312.8 million from $376.8 million at December 31, 2015. The decrease is mainly due to repayment of $69.7 million of the long-term debt from proceeds received from the issuance of the 4.75% Convertible Debentures and a decrease in the non-current portion of future consideration related to acquisition of $3.4 million. This was partially offset by an increase in the convertible debentures balance of $7.1 million due to issuance of the 4.75% Convertible Debentures net of the conversion and redemption of all of the remaining 5.75% Convertible Debentures outstanding, and an increase in the deferred tax liability of $3.4 million.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

In our year ended December 31, 2015 audited consolidated financial statements and accompanying notes, and in our 2015 annual MD&A, we have identified the accounting policies and estimates that are critical to the understanding of our business operations and our results from operations. The unaudited condensed consolidated interim financial statements for the three and nine months ended September 30, 2016 have been prepared using the same accounting policies consistent with those applied in the audited consolidated financial statements for the year ended December 31, 2015. Our critical accounting estimates and assumptions remain substantially unchanged.

Future Accounting Changes

We have reviewed new and revised accounting standards that have been issued, but are not yet effective. See note 3 of the unaudited condensed consolidated interim financial statements for the three and nine months ended September 30, 2016 for further information.

RISKS AND UNCERTAINTIES

The results of operations, business prospects and financial considerations of Morneau Shepell remain subject to a number of risks and uncertainties and are affected by a number of factors outside of our control. For more information about our risks and uncertainties, please refer to our 2015 annual MD&A. The risk and uncertainties remain substantially unchanged from those disclosed in our 2015 annual and fourth quarter MD&A.

SUPPLEMENTARY SUMMARY OF QUARTERLY RESULTS

Selected Unaudited Consolidated Financial information (in thousands of dollars except per share amounts)

Quarter ended	September 30, 2016	June 30, 2016	March 31, 2016	December 31, 2015	September 30, 2015	June 30, 2015	March 31, 2015	December 31, 2014
Revenue	144,594	149,251	149,123	145,696	140,778	142,420	138,392	131,195
Profit (loss) (1)	5,210	8,081	7,049	2,422	(3,487)	9,272	8,211	461
EBITDA	19,098	25,449	22,579	16,748	7,391	24,653	23,246	15,819
Adjusted EBITDA	27,187	29,533	28,828	25,211	25,886	28,060	26,644	22,581
EBITDA margin	13.2%	17.1%	15.1%	11.5%	5.3%	17.3%	16.8%	12.1%
Adjusted EBITDA margin	18.8%	19.8%	19.3%	17.3%	18.4%	19.7%	19.3%	17.2%
Earnings (loss) per share (basic)	0.09	0.16	0.14	0.05	(0.07)	0.19	0.17	0.01
Earnings (loss) per share (diluted)	0.09	0.16	0.14	0.05	(0.07)	0.19	0.16	0.01
Normalized Free Cash Flow	17,323	18,585	15,308	18,178	13,177	16,054	14,175	13,446
Dividends declared	10,355	9,857	9,413	9,379	9,365	9,363	9,360	9,358
Twelve-month rolling normalized payout ratio	56.2%	58.3%	59.8%	60.8%	65.9%	70.6%	74.8%	74.1%
Twelve-month rolling normalized payout ratio, including changes in adjusted non-cash operating working capital	54.2%	60.1%	58.7%	66.5%	89.0%	114.5%	107.5%	98.1%
Total assets	760,402	768,256	757,357	755,648	762,021	775,921	772,449	756,655
Total long-term debt (2)	253,293	262,031	316,292	315,606	325,686	323,923	303,904	295,310

Footnotes:

(1) The profit for the quarter ended September 30, 2015 included the write-down of deferred implementation costs and impairment charges totaling $15,100 related to HRINY.

(2) Includes convertible debentures.

Disclosure Controls and Procedures

Our disclosure controls and procedures have been designed to provide reasonable assurance that all relevant information is identified to our Disclosure Committee to ensure appropriate and timely decisions are made regarding public disclosure.

The Chief Executive Officer and the Chief Financial Officer have concluded that the disclosure controls and procedures are appropriately designed as at September 30, 2016.

Internal Control over Financial Reporting

Management is responsible for designing internal controls over financial reporting, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. In designing these controls, Management used the *Internal Control – Integrated Framework* (COSO 2013 Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission.

The Chief Executive Officer and the Chief Financial Officer have concluded that the internal controls over financial reporting are appropriately designed as at September 30, 2016. No changes were made in our internal controls over financial reporting during the third quarter ended September 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Additional Information

Morneau Shepell's shares currently trade on the Toronto Stock Exchange under the symbol MSI. Additional information relating to us, including all public filings and our Annual Information Form, is available on the SEDAR website (sedar.com) and on our own website at morneaushepell.com.

The content of this MD&A reflects information known as of November 8, 2016.