MORNEAU SOBECO

Morneau Sobeco Income Fund

It's all about consistency

2006 Annual Report

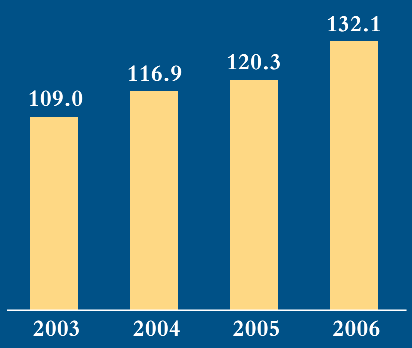
ABOUT MORNEAU SOBECO

Morneau Sobeco is the largest Canadian-owned pension and benefits consulting and outsourcing firm, providing services to organizations across Canada and in the United States. With more than 1,000 employees in offices in 12 cities across North America, Morneau Sobeco has focused on the integrated design and delivery of pension and benefits plans for more than 40 years. Units of Morneau Sobeco Income Fund trade on the Toronto Stock Exchange under the symbol MSI.UN. More information on Morneau Sobeco can be obtained on the firm's Web site at **www.morneausobeco.com.**

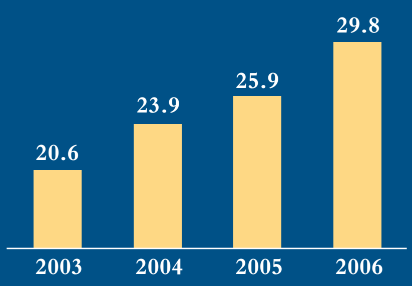
FINANCIAL HIGHLIGHTS

- Revenue grew by 9.8% in 2006 to $132.1 million
- Net income grew to $9.8 million
- EBITDA was $29.8 million and margin on revenue was 22.6%
- Cash from operations was $31.0 million
- Distributable Cash grew to $29.7 million
- Clients representing 96.8% of 2005 revenues remained with Morneau Sobeco in 2006, generating increased revenues of 3.3%
- Clients generating more than $100,000 in annual revenue increased in number from 199 in 2005 to 223 in 2006

Revenue Growth
($ millions)



Adjusted EBITDA
($ millions)



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Design and delivery of pension and benefits programs

As the largest Canadian-owned pension and benefits consulting and outsourcing firm, Morneau Sobeco has been helping employers manage their employees' health and financial security for more than four decades. The firm serves clients from offices in 12 cities across Canada and in the United States with a team of more than 1,000 employees – including a management team of approximately 50 partners.

Morneau Sobeco is distinguished by its fundamental commitment to excellence in service, by its partnership with clients in the development and delivery of innovative pension and benefits solutions, and by the mastery of information technology and systems, which allows the firm to manage a vast quantity of data and transactions and to host sophisticated employee pension and benefits Web sites for employers in Canada and the U.S.

As the business and regulatory environments have become more complex, the design and delivery of pension and benefits programs have become increasingly challenging. With that challenge comes the need for specialized expertise to ensure regulatory compliance, to evaluate and contain employers' program costs and to serve employees' needs effectively.

On the consulting side of our business, our actuaries conduct formal valuations of retirement plans, and our consultants design pension and benefits plans for employers. On the outsourcing side of the business, we take over the time-consuming task of delivering and administering pension and benefits plans and we enable participants to match their employee benefits to their evolving needs, using highly advanced and proprietary systems.

We serve more than 1,000 clients: small and large corporations, trade and professional associations, not-for-profit organizations, as well as governments and their agencies. Due to the lead times and commitments in these assignments, our client relationships are typically long-term. We have served many clients for more than 20 years.

As a result of our ability to attract new clients and our long-term client relationships, Morneau Sobeco has generated consistently growing revenues. This long-term recurrence of revenues provides significant stability to the business and a solid foundation for reliable and growing distributions for Unitholders.

Morneau Sobeco is distinguished by its fundamental commitment to excellence in service, by its partnership with clients in the development and delivery of innovative pension and benefits solutions, and by the mastery of information technology and systems.

Bill Morneau
President and
Chief Executive Officer

PRESIDENT'S MESSAGE TO UNITHOLDERS

Executing the plan, delivering the performance

In 2006, Morneau Sobeco completed its first full year of public ownership and rewarded Unitholders by generating increased revenue and showing evidence of strong financial performance to support consistent cash distributions. This performance also enabled our Board of Trustees to declare an additional, one-time distribution which brought total distributions to $0.8365 per Unit for the year.

Morneau Sobeco's performance in 2006 was ahead of the objectives we set for ourselves for the year. We increased revenues by 9.8%, while maintaining a solid EBITDA margin of 22.6%. With slightly higher Unitholder cash distributions, our Distributable Cash Payout Ratio declined, from 100% at the time of our initial public offering ("IPO") to 78% at the end of 2006, further enhancing the ability of our business to consistently generate cash for Unitholders.

Further, in 2006, the number of Morneau Sobeco clients generating revenues of more than $100,000 increased to 223 from 199 in 2005.

We achieved this solid performance by successfully executing the components of our business plan, which includes an abiding commitment to excellence in client service and a three-part growth strategy.

I have frequently noted that success in our business depends on putting our clients' needs first, maintaining a long-term perspective, and sharing with clients the benefits of many small improvements and savings that eventually pay large rewards. The key to making this strategy successful resides in the creativity and commitment of our actuaries, pension and benefits specialists, and other business professionals. We seek to be the employer of choice in our field. Our goal is to achieve consistent excellence in the service of long-term clients with equally long-tenured employees.

Our three-part growth strategy focuses on expanded mandates with existing clients, mandates from new clients, and the acquisition of complementary businesses that expand our service offering or extend our geographic footprint.

In 2006, we expanded mandates from clients such as Quebec's Commission administrative des régimes de retraite et d'assurance (CARRA), the body that manages 31 pension plans serving 524,000 active public-sector employees and 642,000 deferred members and retirees. We also made use of our leading-edge technology platform to implement new and enhanced benefits plan administration features for the State of Nevada's Public Employees' Benefits Program and its more than 35,000 employees.

On the new business front, among others, we won significant assignments with a large Canadian financial institution, a major Toronto hospital, and a key national oil industry company. These organizations have awarded us mandates to administer their respective pension plans, and these will be important activities for us throughout 2007.

In June 2006, we acted on the third element of our growth plan by acquiring Vancouver-based Heath Benefits Consulting Inc., an employee benefits consulting and administrating firm with an established client base, a solid presence in Western Canada, and a commitment to provide superior client service.

This acquisition increased our team by approximately 90 new employees, and strengthened our presence in Vancouver, Calgary, Winnipeg, Toronto and Ottawa. The acquisition gives former Heath clients access to a broader range of services. Integration of the Heath operations has gone smoothly and achieved the anticipated synergies. As a result, the acquisition has been immediately accretive for Morneau Sobeco Income Fund's Unitholders.

During the year, we also strengthened the ranks of our senior management team with the appointment of Pierre Chamberland as Chief Operating Officer. Pierre has served with Morneau Sobeco for 24 years in a variety of increasingly senior roles in both management and client service. In this new role, he is now responsible for our firm's day-to-day operations in both consulting and outsourcing.

As a result of our consistent growth, the Board of Trustees has authorized a 7% increase to our target monthly distribution from \$0.06875 per Unit to \$0.07356 per Unit, starting with the March 2007 distribution.

Our outlook for 2007 and beyond is positive. Based on our recurring revenue business model and our analysis of clients, assignments and opportunities in the market, we expect that revenues and Distributable Cash will continue to grow.

Although the federal government substantially changed the ground rules for income trusts by announcing its intention to begin taxing previously tax-sheltered Unitholder distributions starting in 2011, we anticipate no significant changes to our business strategy. We plan to continue to invest in technology while we explore acquisition opportunities. Our internal cash needs are low, and we expect to continue to distribute cash to Unitholders monthly. Morneau Sobeco is fundamentally a strong business with an exceptionally strong client base and a proven business model.

I would like to conclude by thanking our employees for their hard work, and our clients for their continuing confidence in us.

As always, we will strive to deliver positive results, to live up to the trust that investors have placed in us, and to increase Unitholder value.

William Morneau
President and Chief Executive Officer

MANAGEMENT ROUNDTABLE

Conversations on Performance. Morneau Sobeco has a solid business, with blue-chip clients and a recurring revenue business model, that has generated growing revenues and provided a foundation for reliable cash distributions for Unitholders. We recently gathered the eight members of the Executive Committee team together for a roundtable to share client experiences and thoughts, and discuss what makes this business work today.

From left to right:

David Haber
Nancy Reid
Fred Vettese
Pierre Chamberland
Julien Ponce
Brian Chan
Randal Phillips
Bill Morneau

Fred Vettese
Executive Vice President and Chief Actuary

Q: Pensions and benefits are in the media nearly every day and a concern to just about every Canadian family. What's happening in the industry? Is there still a need for conventional actuarial consulting services, and how long can you expect this demand to continue?

A: Recent regulatory changes and business failures have given a great deal more visibility to pension funding and accounting issues. The uncertainties and risks have always been there, but now they're much more visible. In turn, this visibility has prompted many organizations to consider a change from defined benefit plans to defined contribution plans.

Let's be clear that this is a very long and complex task. Defined benefit plans won't simply wind up and then disappear. Longer-serving employees are usually "grandfathered" and will continue to have defined benefit pension entitlements for decades to come. As a result, our clients will continue to need our help with the administrative and management burdens.

Our strategy is to provide our clients with professional actuarial advice on funding their plans, and to relieve them of the costly and time-consuming aspects of pension and benefits administration. This really is a field for specialists.

Our approach frees our clients to focus on running their business while we help them ensure that their pension and benefits plans are professionally managed, that they comply with an increasingly complex regulatory environment, and that employees and retirees are being properly served. Morneau Sobeco has always been willing to expand within its business envelope of pensions and benefits, and beyond the basic actuarial requirements, whether that meant setting up an employee call centre or developing and implementing Web-based tools so that employees could make changes to their selection of benefits as their needs change over time. We continue to believe that we can ease the challenges that employers face in managing their plans, and we seek to be innovative in providing solutions to these challenges.

Finally, being focused exclusively on pensions and benefits also confers two important advantages. First, our focus enables us to be faster in responding to the emerging needs of our clients. We're not distracted by multiple issues, or encumbered by conflicting demands. Second, our defined service offering allows us to channel our investment specifically to the people, processes and technology that will enhance our delivery of service in the pension and benefits area. We recognize that continuous improvement only comes by maintaining our focus and investment.

Julien Ponce
Executive Vice President, Quebec

Q: Technology is playing an increasingly important role in the pension and benefits industry and Morneau Sobeco says it has a competitive advantage in technology, compared to other firms. Isn't pension and benefits consulting and outsourcing becoming just another automated service?

A: Although pension and benefits consulting and outsourcing rely extensively on information systems and technology, it is ultimately a people business. At Morneau Sobeco, it's our people – partners, professionals and support teams – who build and maintain our client relationships.

We have deliberately recruited, trained, promoted, continuously developed and retained personnel with a client-service focus and a passion for what they're doing. As a result, it is common for people to have been with this company for 20 years or more. And I think our people really have a sense that they belong to an organization that's different from the competition – we strive to be the employer of choice in our field. In return, we listen, we're flexible, and we encourage our people to continue their professional development.

When your employees are happy and motivated to do a good job, there is definitely a positive impact on service, and our clients feel it in their day-to-day dealings with Morneau Sobeco at every level, from our front-line support people to our senior executives.

Technology is vital to process huge volumes of data and to process equally huge numbers of transactions and reports. It enables our clients to reach employees through online services and to provide decision-making software (such as financial modelling tools) for plan members to make more intelligent choices. Technology is made possible by the design of our proprietary systems and it enhances the human experience of our services. Ultimately, these systems, and the results they deliver, are produced by people dealing with other people – our clients. We never forget that this is a people business.

Q: How does Morneau Sobeco develop new client relationships? Is there really a difference in how you do business, especially with large, complex organizations?

Randal Phillips
Executive Vice President, Administrative Solutions

A: Morneau Sobeco recently won a number of important mandates with private and public sector organizations, including a national financial institution, a large Toronto hospital, and a company in the oil industry. These organizations were seeking to replace their internal pension systems with new, innovative outsourced approaches.

In addition to ensuring technical compliance and being offered an acceptable financial arrangement, potential clients look at every aspect of the project from multiple risk management perspectives: operations, branding, legal, audit, communications, information technology, security, and more – they need to be completely satisfied that our approach and systems would perform as planned and not expose their organizations to risk.

Many organizations arrange follow-up meetings with our team to review proposed business processes in more detail, and perform a hands-on "test drive" of some of the systems that would be used. There is often an interest in our Web-based modelling tools since most employers want to provide an outstanding user experience for their employees – to help them understand their retirement plans and make the best decisions about their financial future.

Large, complex organizations are demanding clients that require extensive management, financial and technical resources. We have a best-in-class technology platform, but I think what ultimately makes the difference is our ability to anticipate the issues and concerns that our clients will face, and demonstrate that we understand these by having solutions ready. Morneau Sobeco seeks to bring the right technology, the right experience and the right client-centered attitude. Ultimately, that's a successful approach for all assignments.

David Haber
Executive Vice President, Western Canada

Q: In June 2006, Morneau Sobeco implemented a growth strategy with the acquisition of Vancouver-based Heath Benefits Consulting. As Heath's CEO, you joined Morneau Sobeco's senior management team. What should clients know about this acquisition?

A: When a provider of professional services is acquired, the first thing clients want to know is, "Will I still be working with you?" and we were able to assure our clients they would. We also told them they would have access to a wider range of services, and be served by a firm with significant depth of managerial, technical and financial resources.

We could say to our clients, unreservedly, that the acquisition of our firm [Heath Benefits Consulting] by Morneau Sobeco was a good thing for all of us. Client relationships were maintained and even enhanced.

Our people gained the added security of becoming part of one of the dominant national players in our industry, with additional and more varied career development paths open to them. Our people didn't need to worry much about the change and how it affected them; they could continue to focus their energies on putting clients first.

At Heath, we had acquired a number of smaller firms, which provided us with experience and an understanding of both sides. This clearly has been helpful, as the integration of the operations has been remarkably uneventful.

Morneau Sobeco's core business complements Heath's, and the client focus is paramount in both corporate cultures. We have successfully expanded Heath's business base by expanding the range of services and extending its geographic footprint. Bigger is not necessarily better; however, we can now serve our clients more effectively than we could have by remaining independent.

Q: The rules for public companies have changed dramatically in recent years. How has Morneau Sobeco had to adapt to being a public company?

Nancy Reid
Chief Financial Officer

A: As a private company under the leadership of the Morneau family, we had always ensured that the firm's corporate governance reflected very high standards. So, when the company became publicly held in September 2005, there were very few and minor changes required to ensure compliance with the governance and internal control requirements of the security regulators. Most of these changes related to recording and documenting our internal control processes and increasing the communication of our policies.

At the time of our IPO, we appointed independent, respected, financially literate and experienced Trustees, and put methodical processes in place to further ensure the integrity of our financial reporting. Among others, we created two formal committees with well-defined mandates: an Audit Committee, and a Compensation, Nomination and Corporate Governance Committee. Consequently, the CEO and I, as CFO, have a great deal of confidence in formally signing off on all of our financial disclosure.

My job is made easier due to the fact that Morneau Sobeco has a stable and predictable recurring revenue stream. For example, clients representing 96.8% of 2005 revenues remained with Morneau Sobeco in 2006, and generated 3.3% more revenue in 2006. Over time, the transparency of our operational and business performance should give all of our stakeholders confidence that we are representing our business results with complete candour, and that they have a fully informed view of their investment in Morneau Sobeco.

Brian Chan
Executive Vice President and Chief Information Officer

Q: One of the competitive advantages claimed by Morneau Sobeco is its leading-edge technology platform. Does the company use or invest in technology differently from others in the pension and benefits consulting and outsourcing industry?

A: Yes, our approach to technology investment is a bit different than that of others in the pension and benefits field. Instead of building a technology-driven platform and hoping that our clients will support it, Morneau Sobeco takes a pragmatic, client-driven approach based on clients' real-world needs, as well as opportunities to deliver enhancements that will be valued and supported by many types of clients. This approach delivers features and functions that do what our clients want, and work the way our clients want – it is really their solution, not one that's imposed on them.

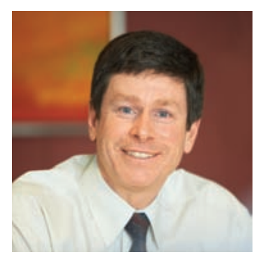
In February 2007, Morneau Sobeco implemented a major upgrade to the State of Nevada's benefits administration system, with new functions and features that enhance its automation and self-service capabilities for more than 35,000 employees and plan members. The upgrade delivers a major improvement in the way users manage their own benefits plans.

In this case, the right solution for the State of Nevada's Public Employees' Benefits Program required an investment in technology by our company. Now, however, we can offer the new features and functions from this system more widely in the marketplace as a major new release of our main system software.

This approach to technology investment avoids the risks in trying to move clients to a "one-size-fits-all" solution, and it makes the features and functions clients truly value in their daily work more widely available, more quickly. That's good for our clients and that's good for Morneau Sobeco.

Q: One of Morneau Sobeco's principal growth strategies has been the expansion of mandates from current clients. How does this benefit clients?

A: In 2005, Morneau Sobeco won a significant mandate from Quebec's Commission administrative des régimes de retraite et d'assurance (CARRA), which administers 31 pension plans for Quebec provincial public servants, including the healthcare and education sectors, as well as provincial government and agency personnel. CARRA serves 524,000 active participants and 642,000 deferred members and retirees. Morneau Sobeco is partnering with IBM Canada to implement a new pension administration solution to replace their internally-developed systems, which had operated for about 30 years. Implementation is to be complete by 2009.



Pierre Chamberland
Chief Operating Officer

Since winning the original tender, our objective has been to become this client's supplier of choice and to win additional mandates. In 2006, for example, we were retained to lead their data preparation project for the data conversion. Beyond the 2009 project completion date, even though the software automatically updates itself, we expect that there will be a stream of changes in legislation, methods and processes which, in turn, will trigger the need for continuing long-term support.

We have been able to increase our involvement with CARRA because we have proven our ability to offer more integrated services by demonstrating the quality of our resources and technology through our core services. In the simplest terms, making more use of Morneau Sobeco's talents and resources enables CARRA to achieve more, sooner, at the best possible price.

CHAIRMAN AND LEAD TRUSTEE LETTERS

Focus on Relationships. Morneau Sobeco is committed to protecting and strengthening its client relationships – one of the most important assets of the firm – and to maintaining and nurturing the faith and confidence of its Unitholders.

W.F. Morneau, Sr.
Chairman

David Day
Lead Trustee

It is not always apparent to outside observers, or those new to the firm, but Morneau Sobeco's greatest asset is its long-term relationships with its clients. In fact, the firm has served many clients for more than 20 years.

Safeguarding assets and investing prudently mean valuing continuity and maintaining a long-term perspective. On a daily basis, that perspective manifests itself by doing – always – what's best for the client, knowing that our diligence will be suitably compensated. The increasingly complex nature of the pension and benefits field also means that clients are more and more dependent on Morneau Sobeco's experience and demonstrated expertise.

Helping clients manage the health and financial security of their employees is a massive responsibility, as decisions made today will continue to have repercussions for decades to come. That's not a duty Morneau Sobeco takes lightly.

Going forward, Unitholders can be assured that Morneau Sobeco's commitment is to protect and strengthen client relationships, and increase their number and value.

W.F. Morneau, Sr.
Chairman

As you will read in the President's Message to Unitholders and our Audited Consolidated Financial Statements, in 2006, Morneau Sobeco Income Fund enjoyed another year of solid operating and financial performance to support reliable cash distributions to Unitholders.

Throughout the course of the last year, we have placed much emphasis on establishing and maintaining standards of financial reporting and disclosure that more than meet regulatory standards, striving to achieve best practices in corporate communications with Unitholders and all other stakeholders. As with all companies, this is not an end state, but rather a journey of constant evaluation and review, comparison and improvement.

We are confident that Morneau Sobeco is a sound business today, with excellent prospects for the future. You can also be assured that Morneau Sobeco is equipped with all the necessary management, financial and systems resources to achieve its full potential and to provide its Unitholders with attractive investment returns.

David Day
Lead Trustee

MANAGEMENT'S DISCUSSION AND ANALYSIS OF 2006 RESULTS

Morneau Sobeco Income Fund (the "Fund") was formed on August 22, 2005 and commenced operations on September 30, 2005 when it completed an initial public offering ("IPO"). Using the proceeds from the IPO, the Fund indirectly acquired a controlling interest in Morneau Sobeco Group Limited Partnership ("MS Group LP"), which in turn acquired Morneau Sobeco Corporation ("Morneau Sobeco"), the successor to W.F. Morneau Services, Inc. ("WFMS").

This Management's Discussion and Analysis ("MD&A") covers the year ended December 31, 2006 and should be read in conjunction with the accompanying Audited Consolidated Financial Statements of the Fund and notes thereto for the year ended December 31, 2006 as well as the MD&A and Audited Consolidated Financial Statements and notes thereto contained in the Fund's Annual Report for the year ended December 31, 2005. Since the Fund formed on August 22, 2005, comparative information for the period from August 22, 2005 to December 31, 2005 is provided in the Fund's Audited Consolidated Statement of Income and Deficit and the Audited Consolidated Statement of Cash Flows. In order to provide meaningful information to the user, this MD&A includes financial data of WFMS, which carried on the Morneau Sobeco business prior to September 30, 2005. WFMS data is used to provide full year operating data for 2005 for comparison to full year operating data of the Fund for 2006.

All financial information is presented in Canadian dollars and in accordance with Canadian generally accepted accounting principles ("GAAP") 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. 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 income tax matters, ability to maintain profitability and manage growth, 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 the Fund, its financial or operating results or its securities.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF 2006 RESULTS

To assist investors in assessing the Fund's financial performance, this discussion also makes reference to certain non-GAAP measures such as EBITDA and Adjusted EBITDA. As a result of adopting the CSA Staff Notice 52-306 (Revised) in the third quarter of 2006, we modified our method of calculating Distributable Cash. Further, as a result of incorporating draft recommendations expected to be implemented in 2007, we have introduced a new non-GAAP performance metric: Distributable Income. Distributable Income is defined as net income for the period adjusted for specific non-cash items, including amortization and future income taxes and adjusted for maintenance capital expenditures. See the footnotes to the "Results of Operations" chart for more details. Non-GAAP measures do not have any standard meaning prescribed by GAAP and therefore may not be comparable to similar measures presented by other issuers.

FORMATION AND OWNERSHIP STRUCTURE OF THE FUND

The Fund is an unincorporated, open-ended, limited purpose trust established under the laws of Ontario. It indirectly owns 22,062,916 Class A Limited Partnership units of MS Group LP, which represents a 79.4% ownership interest. MS Group LP owns directly and indirectly 100% of Morneau Sobeco Limited Partnership and Morneau Sobeco, Ltd. (the "Morneau Sobeco Operating Entities"). The 20.6% non-controlling interest in MS Group LP is held through Class B LP units of the limited partnership (the "Class B LP Units") and an equal number of Special Voting Units of the Fund, which together are exchangeable into Units provided that the Fund achieves certain objectives. Management employees and former owners of the predecessors of the Morneau Sobeco Operating Entities ("Management Securityholders") hold this non-controlling interest.

As at December 31, 2006, 22,062,916 Units and 5,721,444 Special Voting Units of the Fund were issued and outstanding, and 5,721,444 MS Group LP Class B LP Units were issued and outstanding.

BUSINESS OVERVIEW

Morneau Sobeco is the largest Canadian-owned pension and benefits consulting and outsourcing firm, providing services to organizations across Canada and in the United States. We focus on the integrated design and delivery of retirement, employee compensation and benefits programs. We have over 1,000 professionals and support staff with offices in 12 cities across North America. Our clients are primarily large and medium-sized organizations in Canada and the United States, which typically utilize our services on a recurring or contracted basis over a long term.

We derive our revenue primarily from fees charged to clients for pension and benefits consulting and outsourcing engagements. Fees from consulting engagements are charged based on billable hours or 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. In addition, we earn interest income from our cash balances which is included in other revenue. Fees from outsourcing engagements are generally based on negotiated fees or a formula tied to the nature of the service being provided. Our outsourcing business 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.

Our largest operating expense is compensation and related costs. This includes salaries, annual performance-based bonuses, benefits (e.g., pension, health, dental), payroll taxes and temporary staffing services. For the comparable operating results of WFMS contained in this MD&A, compensation expense also includes distributions paid as bonuses to employee-shareholders. Other operating expenses include occupancy costs, technology costs (equipment leases, telecommunications and software), non-recoverable client service costs (such as printing, travel and third-party professional services), training, marketing, office costs, professional services (legal and audit) and insurance.

OVERVIEW AND OUTLOOK

The results for 2006 met our expectations, from both a revenue and profitability standpoint. Revenue growth was 9.8% for the year and EBITDA margin was 22.6% compared to 21.5% for 2005.

On June 1, 2006, the Fund indirectly acquired all of the issued and outstanding shares of Heath Benefits Consulting Inc. ("Heath") through its subsidiary MS Group LP. Heath was a Vancouver-based benefits consulting firm with over 90 employees across Canada. The integration of Heath is proceeding according to plan. The consideration is based on future revenue from the Heath business going forward as well as achieving targeted cost efficiencies. The consideration, which is currently estimated to be approximately $15.4 million, is being paid in three instalments and is satisfied primarily through the assumption and repayment of the Heath debt of $4.6 million and the issuance of Class B LP Units. The first instalment of the purchase price was made on closing. The second and third instalments plus an amount to compensate for foregone distributions payable will be settled in June and December of 2008. These amounts will be recorded at that time except for a portion of the third instalment which is conditional on the continuing employment of certain selling shareholders and is being recorded as salary expense over the required employment period to December 2008.

The salary component of the Heath acquisition recorded for the fourth quarter and for the year were $0.2 million and $0.5 million respectively. Eliminating the effects of this resulted in an EBITDA margin of 23.8% and 23.0% respectively for the quarter and the year.

Distributable Income Payout Ratio and Distributable Cash Payout Ratio for the year were 85.3% and 77.9% respectively (see "Results of Operations" for details). These figures take into account a special one-time cash distribution of $0.0115 per Unit in December 2006, representing the incremental taxable income arising from the Fund's strong financial performance in 2006.

We believe 2007 will be a solid year for Morneau Sobeco. We continue to execute our business strategy which includes focusing on our core services and striving to deliver high-quality services in the most efficient and cost-effective manner. Our strategy for future growth encompasses expanding relationships with current clients, continuing to attract new clients especially in the growing outsourcing market, targeting underserved markets and pursuing selected acquisitions.

As a result of our consistent growth, the Board of Trustees has authorized a 7% increase to our target monthly distribution from $0.06875 per Unit to $0.07356 per Unit, commencing with the March 2007 distribution to be paid April 16, 2007.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF 2006 RESULTS

ANALYSIS OF 2006 OPERATING RESULTS

Results of Operations

Selected Unaudited Consolidated Financial Information *(In thousands of dollars except per unit amounts)*	Quarter ended December 31 **2006**	2005	Year ended December 31 **2006**	2005
Revenue	**$ 34,079**	$ 30,071	**$ 132,087**	$ 120,323
Deduct:				
Salaries and benefits expense	**18,741**	17,024	**76,240**	81,117
Other operating expense	**7,448**	5,901	**26,004**	23,160
Interest	**471**	478	**883**	663
Amortization	**4,251**	4,025	**16,652**	5,920
Partnership distributions	**–**	–	**–**	6,825
Income taxes	**84**	19	**58**	477
Non-controlling interest	**635**	525	**2,490**	525
Net income for the period	**2,449**	2,099	**9,760**	1,636
Add:				
Amortization	**4,251**	4,025	**16,652**	5,920
Income taxes	**84**	19	**58**	477
Interest	**471**	478	**883**	663
Non-controlling interest	**635**	525	**2,490**	525
EBITDA[(1)]	**7,890**	7,146	**29,843**	9,221
Adjustment:				
Executive compensation and employee-shareholder and partner distributions adjustments[(2)]	**–**	–	**–**	16,703
Adjusted EBITDA[(3)]	**$ 7,890**	$ 7,146	**$ 29,843**	$ 25,924
Adjusted EBITDA Margin	**23.2%**	23.8%	**22.6%**	21.5%
Add (deduct):				
Current taxes	**49**	(19)	**(199)**	(477)
Salary component of Heath acquisition	**220**	–	**513**	–
Interest paid	**(401)**	(478)	**(1,723)**	(663)
Capital expenditures[(4)]	**(781)**	(106)	**(1,308)**	(556)
Distributable Income[(5)]	**6,977**	6,543	**27,126**	24,228
EBITDA[(1)]	**7,890**	7,146	**29,843**	9,221
Add (deduct):				
Change in non-cash operating working capital	**2,103**	(291)	**2,589**	(5,548)
Current taxes	**49**	(19)	**(199)**	(477)
Loss on sale of property	**–**	35	**–**	35
Salary component of Heath acquisition	**220**	–	**513**	–
Interest paid	**(401)**	(478)	**(1,723)**	(663)
Cash from operating activities	**9,861**	6,393	**31,023**	2,568
Adjustment:				
Change in employee-shareholder distributions and one-time bonuses paid[(2)]	**–**	–	**–**	17,664
Cash from adjusted operating activities	**9,861**	6,393	**31,023**	20,232
(Deduct):				
Capital expenditures[(4)]	**(781)**	(106)	**(1,308)**	(556)
Distributable Cash[(6)]	**$ 9,080**	$ 6,287	**$ 29,715**	$ 19,676
Distributable Cash available to non-controlling interest	**1,870**	1,257	**6,076**	n/a
Distributable Cash available for Unitholders	**7,210**	5,030	**23,639**	n/a
Net income per Unit (basic and diluted)	**$ 0.11100**	$ 0.09553	**$ 0.44318**	n/a
Distributable Income per Unit (basic and diluted)	**$ 0.25111**	$ 0.23817	**$ 0.98087**	n/a
Distributable Cash per Unit (basic and diluted)	**$ 0.32680**	$ 0.22886	**$ 1.07341**	n/a
Distributions declared per Unit (basic and diluted)	**$ 0.21775**	$ 0.20854	**$ 0.83650**	n/a
Distributable Income Payout Ratio[(7)]	**86.7%**	87.6%	**85.3%**	n/a
Distributable Cash Payout Ratio[(8)]	**66.6%**	91.1%	**77.9%**	n/a

(1) "EBITDA" is defined as earnings (loss) before interest expense, income taxes, depreciation, amortization and non-controlling interest.
(2) Represents the difference between historical executive compensation (including employee-shareholder and partner distributions) and compensation arrangements in place since the acquisition of Morneau Sobeco by the Fund.
(3) "Adjusted EBITDA" is EBITDA adjusted for items that were applicable prior to the acquisition of Morneau Sobeco by the Fund in order to make historical comparisons more meaningful.
(4) Non-maintenance capital expenditures are not shown as a reduction from Distributable Income or Distributable Cash for the periods prior to September 30, 2005 since these expenditures are considered non-recurring.
(5) "Distributable Income" is defined as net income for the period adjusted for specific non-cash items, including amortization, future income taxes and maintenance capital expenditures. In the comparable data for the periods prior to September 30, 2005, Distributable Income has also been adjusted for items that were applicable prior to the acquisition of Morneau Sobeco by the Fund in order to make historical comparisons more meaningful.
(6) "Distributable Cash" is defined as Cash from operating activities adjusted for maintenance capital expenditures. In the comparable data for the periods prior to September 30, 2005, Distributable Cash has also been adjusted for items that were applicable prior to the acquisition of Morneau Sobeco by the Fund in order to make historical comparisons more meaningful.
(7) "Distributable Income Payout Ratio" is defined as declared distributions divided by Distributable Income.
(8) "Distributable Cash Payout Ratio" is defined as declared distributions divided by Distributable Cash.

Non-GAAP Financial Measures: EBITDA, Adjusted EBITDA, Distributable Income, Distributable Cash, Distributable Income Payout Ratio and Distributable Cash Payout Ratio

We believe that EBITDA is a useful measure in evaluating performance of the Fund. It is used to monitor compliance with debt covenants and to make decisions related to distributions to Unitholders. Adjusted EBITDA is a useful measure in evaluating the performance for comparison purposes with prior periods as certain previous arrangements are non-recurring and will differ materially from ongoing arrangements as a public entity. We also believe that Distributable Income, Distributable Cash, Distributable Income Payout Ratio and Distributable Cash Payout Ratio are useful supplemental measures of performance as they are generally used by Canadian open-ended business income funds as indicators of financial performance.

In order to make historical data of WFMS more comparable to the ongoing performance data of the Fund, we have made the following two adjustments to EBITDA and to Distributable Cash:

(i) As a private company, WFMS historically paid out substantial amounts of pre-tax income as distributions to its shareholders and partners each year. Distributions to employee-shareholders were reflected as salary expenses. Distributions to partners were reflected as partnership earnings. Since the practice of paying such distributions has been discontinued effective September 30, 2005, we believe that an adjustment to historical EBITDA to account for such distributions should be made to arrive at an adjusted amount of EBITDA.

(ii) As the new executive compensation arrangements effective October 1, 2005 differ materially from the previous arrangements, we believe that adjustments relating to the new executive compensation arrangements are a more useful reflection of the results of operations for WFMS. To provide consistency, adjustments have been made to executive compensation arrangements as if the new compensation arrangements had been in place for all of 2005.

As a result of adopting the CSA Staff Notice 52-306 (Revised), the Distributable Cash calculation in this MD&A has been revised from previous MD&As to incorporate the changes in non-cash operating working capital. This change enables the Distributable Cash to reconcile back to the Cash from operating activities which is a GAAP measure.

Distributions to Unitholders

Monthly distributions are declared by the Fund for Unitholders of record on the last business day of each month and are paid on about the 15th day of the following month.

To reduce Unitholder risk, approximately 72% of the Class B LP Units are subordinated in their rights to distributions until Unitholders of the Fund receive their target distributions. This subordination is in place until September 30, 2007, or later if the Fund has not made its target distributions or met specified EBITDA targets.

ANALYSIS OF 2006 ANNUAL RESULTS

Revenue

Revenue for the year ended December 31, 2006 increased by $11.8 million, or 9.8%, to $132.1 million compared to $120.3 million for the same period in 2005. The increase in revenue was a result of additional consulting and outsourcing business from a variety of new and existing clients, with one existing client increasing our revenue by $3.1 million and a new client contributing $1.1 million. Revenue also increased by $5.4 million due to the Heath acquisition. The increase in revenue was partially offset by reduced volumes and special projects of $1.1 million for a large outsourcing client, and a $2.5 million reduction in outsourcing fees related to two contracts in the U.S. which ended in 2005.

Salaries and Benefits

Salaries and benefits for the year ended December 31, 2006 decreased by $4.9 million, or 6.0%, to $76.2 million compared to $81.1 million for the same period in 2005. The decrease was attributable to the elimination of employee-shareholder distributions and reduced executive compensation of $11.2 million and a non-recurring tax credit of $0.7 million related to employees carrying out e-commerce activities in the province of Quebec. This was partially offset by salary increases of $3.7 million, or 5.3%, salary and benefits of $2.8 million for Heath and the salary component of the Heath acquisition of $0.5 million.

Other Operating Expenses

Other operating expenses for the year ended December 31, 2006 increased by $2.8 million, or 12.3%, to $26.0 million compared to $23.2 million for the same period in 2005. The increase was primarily attributable to Heath operating expenses of $1.0 million, increased technology spending of $0.5 million, increased professional fees including legal, audit and public company costs of $0.6 million, and increased general expenses of $0.7 million.

Interest Expense

Interest expense for the year ended December 31, 2006 increased by $0.2 million to $0.9 million compared to $0.7 million for the same period in 2005. Interest expense for 2006 consists of $1.7 million in interest charges as a result of the $35 million of debt restructuring in connection with the change in ownership of the business on September 30, 2005 and the formation of the Fund, $0.05 million of interest on the $5.1 million incremental debt for 90 days related to the acquisition of Heath on June 1, 2006 offset by the recognition of the fair value of our swap agreements of $0.8 million. This compares to interest charges of $0.7 million on an average debt of $13.3 million for the year ended December 31, 2005.

Amortization

Amortization for the year ended December 31, 2006 increased by $10.7 million, or 181.3%, to $16.7 million compared to $5.9 million for the same period in 2005. The increase was attributable to the increase in intangible assets as a result of the purchase of WFMS by the Fund and acquisition of Heath on June 1, 2006.

Partnership Distributions

Distributions from WFMS's limited partnership subsidiary for the year ended December 31, 2006 was $nil compared to $6.8 million for the same period in 2005.

Income Tax Expense

Income tax expense for the year ended December 31, 2006 decreased by $0.4 million to $0.1 million compared to $0.5 million income tax expense for the same period in 2005. The changes in income tax expense are primarily attributable to changes in the corporate structure.

Net Income

As a result of the changes in revenue and expenses described above, net income for the year ended December 31, 2006 increased by $8.2 million to $9.8 million compared to net income of $1.6 million for the same period in 2005.

Changes in Non-Cash Operating Working Capital

Changes in non-cash operating working capital for the year ended December 31, 2006 increased by $8.1 million to $2.6 million compared to a use of $5.5 million for the same period in 2005. The increase was attributable to the change in accrued compensation and related benefits due to the elimination of the employee-shareholder distribution of $9.8 million in 2005, partially offset by a decrease in income tax recoverable of $1.7 million.

Cash from Operating Activities

Cash from operating activities for the year ended December 31, 2006 increased by $10.8 million to $31.0 million compared to cash from adjusted operating activities of $20.2 million for the same period in 2005. This increase was primarily due to improved Adjusted EBITDA of $4.4 million after taking into account the salary component of the Heath acquisition of $0.5 million, a decrease in current taxes of $0.3 million and an increase in non-cash operating working capital of $7.1 million after adjusting for executive compensation as well as employee-shareholders and partner distributions. This was partially offset by an increase in interest paid of $1.0 million.

Non-GAAP Financial Measures: Adjusted EBITDA, Distributable Income and Distributable Cash

Adjusted EBITDA

EBITDA for the year ended December 31, 2006 increased $3.9 million, or 15.1%, to $29.8 million compared to Adjusted EBITDA of $25.9 million for the same period in 2005. The increase was due to increased revenue of $11.8 million, partially offset by increased salaries and benefits of $5.1 million and increased operating costs of $2.8 million.

Distributable Income

Distributable Income for the year ended December 31, 2006 increased by $2.9 million, or 12.0%, to $27.1 million relative to $24.2 million for the same period in 2005. The increase was due to increased Adjusted EBITDA of $4.4 million after taking into account the salary component of the Heath acquisition of $0.5 million and a decrease in current taxes of $0.3 million. This was partially offset by higher interest payments of $1.0 million as a result of the new financing structure on September 30, 2005 and increased capital expenditures of $0.8 million which included leasehold improvements of $0.4 million related to the integration of the Heath locations.

Distributable Cash

Distributable Cash for the year ended December 31, 2006 increased by $10.0 million, or 51.0%, to $29.7 million relative to $19.7 million for the same period in 2005. This increase was primarily due to increased cash from adjusted operating activities of $10.8 million, partially offset by higher capital expenditures of $0.8 million.

ANALYSIS OF 2006 FOURTH QUARTER RESULTS

Revenue

Revenue for the three months ended December 31, 2006 increased by $4.0 million, or 13.3%, to $34.1 million compared to $30.1 million for the same period in 2005. The increase in revenue was a result of additional consulting and outsourcing business from a variety of clients, with one existing client increasing our revenue by $0.6 million. Revenue also increased by $2.0 million due to the Heath acquisition. The increase in revenue was partially offset by a $0.3 million reduction in outsourcing fees related to one contract in the U.S. which ended in late 2005.

Salaries and Benefits

Salaries and benefits for the three months ended December 31, 2006 increased by $1.7 million, or 10.1%, to $18.7 million compared to $17.0 million for the same period in 2005. The increase was attributable to salary and benefits of $1.0 million for Heath, the salary component of the Heath acquisition of $0.2 million and increases in salaries and bonuses of $1.2 million. This was partially offset by a non-recurring tax credit of $0.7 million related to employees carrying out e-commerce activities in the province of Quebec.

Other Operating Expenses

Other operating expenses for the three months ended December 31, 2006 increased by $1.6 million, or 26.2%, to $7.4 million compared to $5.9 million for the same period in 2005. The increase was primarily attributable to Heath operating expenses of $0.4 million, increased technology spending of $0.4 million and increased general expenses of $0.8 million.

Interest Expense

Interest expense for the three months ended December 31, 2006 remains unchanged at $0.5 million compared to the same period in 2005. The 2006 interest expense consisted of $0.4 million in interest charges on $35 million of debt and $0.1 million due to the recognition of the fair value of our swap agreements. This compares to interest charges of $0.5 million on an average debt of $36.1 million for the three months ended December 31, 2005.

Amortization

Amortization for the three months ended December 31, 2006 increased by $0.2 million, or 5.7%, to $4.2 million compared to $4.0 million for the same period in 2005. The increase was mainly attributable to the increase in intangible assets as a result of the acquisition of Heath on June 1, 2006.

Income Tax Expense

Income tax expense for the three months ended December 31, 2006 was $0.1 million compared to a $19 thousand tax expense for the same period in 2005. The changes in tax expense are primarily attributable to minor changes in taxable income.

Net Income

As a result of the changes in revenue and expenses described above, net income for the three months ended December 31, 2006 increased by $0.3 million compared to $2.1 million for the same period in 2005.

Changes in Non-Cash Operating Working Capital

Changes in non-cash operating working capital for the three months ended December 31, 2006 increased by $2.4 million to $2.1 million compared to a use of $0.3 million for the same period in 2005. The increase was primarily attributable to increased accrued compensation and related benefits and payable and accrued liabilities of $6.9 million as one-time IPO related expenses were paid in the fourth quarter of 2005. This was partially offset by the change in receivables, net of unbilled fees of $1.9 million and the change in income tax recoverable of $2.6 million relating to the acquisition of W.F. Morneau Service Inc. during the fourth quarter of 2005.

Cash from Operating Activities

Cash from operating activities for the three months ended December 31, 2006 increased by $3.5 million to $9.9 million compared to $6.4 million for the same period in 2005. This increase was primarily due to improved EBITDA of $1.0 million after taking into account the salary component of the Heath acquisition of $0.2 million, an increase in changes in non-cash operating working capital of $2.4 million and lower current taxes of $0.1 million.

Non-GAAP Financial Measures: EBITDA, Distributable Income and Distributable Cash

EBITDA

EBITDA for the three months ended December 31, 2006 increased $0.8 million, or 10.4%, to $7.9 million compared to $7.1 million for the same period in 2005. The increase was due to increased revenue of $4.0 million partially offset by increased salaries and benefits expense and operating costs of $3.2 million.

Distributable Income

Distributable Income for the three months ended December 31, 2006 increased by $0.4 million to $6.9 million compared to $6.5 million for the same period in 2005. The increase was due to increased EBITDA of $1.0 million after taking into account the salary component of the Heath acquisition in the amount of $0.2 million and lower current taxes of $0.1 million. This was partially offset by increased capital expenditures of $0.7 million which included leasehold improvements of $0.4 million related to the integration of the Heath locations.

Distributable Cash

Distributable Cash for the three months ended December 31, 2006 increased by $2.8 million, or 44.4%, to $9.1 million compared to $6.3 million for the same period in 2005. This increase was primarily due to improved cash from adjusted operating activities of $3.5 million partially offset by higher capital expenditures of $0.7 million.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

The following table provides an overview of the Fund's cash flows for the periods indicated.

Cash Flow Information

Selected Unaudited Consolidated Financial Information *(In thousands of dollars)*	Quarter ended December 31 **2006**	2005	Year ended December 31 **2006**	2005
Operating Activities	**$ 9,861**	$ 6,393	**$ 31,023**	$ 2,568
Less employee-shareholder distributions and one-time bonuses[1]	**–**	–	**–**	(17,664)
Adjusted Operating Activities	**9,861**	6,393	**31,023**	20,232
Investing Activities	**(781)**	(106)	**(7,312)**	(212,421)
Financing Activities	**(5,731)**	(8,628)	**(22,802)**	209,729
Less partner distributions	**–**	–	**–**	(2,500)
Adjusted Financing Activities	**(5,731)**	(8,628)	**(22,802)**	212,229
Increase (decrease) in cash before employee-shareholder and partner distributions and one-time bonuses[1]	**3,349**	(2,341)	**909**	20,040
Employee-shareholder and partner distributions and one-time bonuses[1]	**–**	–	**–**	(20,164)
Increase (decrease) in cash after employee-shareholder and partner distributions and one-time bonuses	**$ 3,349**	$ (2,341)	**$ 909**	$ (124)

(1) Represents the sum of the aggregate employee-shareholder and partner distributions and one-time bonuses deducted from Operating Activities and Financing Activities.

2006 Annual Results

Cash inflows from operating activities for the year ended December 31, 2006 increased by $10.8 million to $31.0 million compared to cash from adjusted operating activities of $20.2 million for the same period in 2005. This increase was primarily due to improved Adjusted EBITDA of $4.4 million after taking into account the salary component of the Heath acquisition in the amount of $0.5 million, a decrease in current taxes of $0.3 million and an increase in non-cash operating working capital after adjustments related to executive compensation as well as employee-shareholder and partner distributions of $7.1 million. This was partially offset by an increase in interest paid of $1.0 million.

Cash outflows from investing activities for the year ended December 31, 2006 decreased by $205.1 million to $7.3 million for the year ended December 31, 2006 from $212.4 million for the same period in 2005. Cash outflows for 2005 consisted of the purchase of WFMS for $209.8 million on September 30, 2005 and the payment of $1.2 million of dividends compared to cash outflows of $6.0 million related to the purchase of Heath on June 1, 2006.

Cash outflows from adjusted financing activities for the year ended December 31, 2006 were $22.8 million for the year ended December 31, 2006 compared to net cash inflows of $212.2 million for the same period in 2005. The cash outflows in 2006 consisted of Unitholder distribution payments of $22.8 million. The net cash inflows in 2005 consisted of net proceeds of the IPO in the amount of $184.6 million plus $31.0 million in additional term loans partially offset by distribution payments of $3.3 million.

2006 Fourth Quarter Results

Cash inflows from operating activities for the three months ended December 31, 2006 increased by $3.5 million to $9.9 million compared to cash from operating activities of $6.4 million for the same period in 2005. This increase was primarily due to improved EBITDA of $1.0 million after taking into account the salary component of the Heath acquisition in the amount of $0.2 million plus an increase in changes in non-cash operating working capital of $2.4 million.

Cash outflow from investing activities for the three months ended December 31, 2006 increased by $0.7 million to $0.8 million for the three months ended December 31, 2006 from $0.1 million for the same period in 2005. This increase was primarily due to higher capital expenditures as a result of additional leasehold improvements of $0.4 million related to the integration of the Heath locations and the timing of technology spending.

Cash outflows from financing activities for the three months ended December 31, 2006 decreased by $2.9 million to $5.7 million compared to cash outflows of $8.6 million for the same period in 2005. The decrease was attributed to the one-time repayment of $5.0 million from the Fund's line of credit which was initially drawn down in order to facilitate cash transfers at the IPO closing as well as additional IPO related costs of $0.3 million in the fourth quarter of 2005. This is partially offset by higher Unitholder distribution payments of $2.4 million in the quarter.

Capital Expenditures

Pension and benefits consulting and outsourcing is not a capital intensive business. Historically, capital expenditures have included office furniture, facility improvements, and information technology software and hardware. In 2005, our capital expenditures relating to buildings, office furniture, facility improvements and information technology software and hardware were $0.6 million. In 2006, our capital expenditures were $1.3 million, of which $0.4 million related to leasehold improvements for the integration of the Heath locations. Going forward, we expect that the capital expenditures required to maintain our current platform will be principally related to information technology hardware and telecommunications equipment. Additional capital expenditure requirements may result from significant business expansion. Such amounts are expected to be funded from our operating cash flow.

Contractual Obligations

We lease office space and selected equipment under operating lease agreements with terms ranging from one to seven years. We also have a term loan described under "Capital Resources". Future expected payments are as follows:

Summary of Contractual Obligations

(In thousands of dollars)	Total	2007 to 2009	2010 to 2011	Beyond 2011
Term loan	$ 35,000	$ 35,000	$ –	$ –
Operating leases	21,273	12,649	5,619	3,005
Total	$ 56,273	$ 47,649	$ 5,619	$ 3,005

In addition, the Fund has entered into a sublease agreement to sublet one of Heath's office premises. According to the agreement, the Fund is liable for the rent in case of a default by the subtenant. The average annual rent for the lease is $190 thousand and the lease expires on October 30, 2011.

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

Capital Resources

The following table provides an overview of the Fund's capital resources:

Capital Resources

(In thousands of dollars)	As at December 31 **2006**	2005
Cash	**$ 5,257**	$ 4,348
Long-term debt	**$ 35,000**	$ 35,000
Working capital	**$ 19,652**	$ 21,454
Unitholders' equity	**$ 194,399**	$ 201,992

We have historically utilized cash from operations to finance working capital requirements and fund growth. As at December 31, 2006, the Fund's working capital (current assets minus current liabilities) was approximately $19.7 million. Liabilities consist mainly of accounts payable and accrued liabilities of $5.9 million, accrued compensation and related benefits of $7.0 million and Unitholder distributions payable of $2.8 million.

We have also maintained credit facilities to manage working capital requirements throughout the year. The Fund's credit facilities include a secured term loan of $35 million repayable in full on September 30, 2009. The term loan bears interest at bankers' acceptance rates plus 1%, which have been fixed at 4.4% using an interest-rate swap. This secured term loan requires the Fund to maintain certain financial covenants on a consolidated basis as follows:

(i) Ratio of Debt to EBITDA not to exceed 2.5 to 1.0

(ii) Ratio of EBITDA to interest expense of not less than 3.0 to 1.0

The Fund complied with all the required financial covenants and the ratios at year end were 1.2 and 17.3 respectively.

The credit facilities also include a secured operating line of credit of up to $15 million bearing interest at bankers' acceptance rates plus 1% and a standby fee of 0.2% on the undrawn portion. As at December 31, 2006, the operating line was undrawn and the Fund had excess cash of $5.3 million.

SELECTED BALANCE SHEET DATA

The following table provides an overview of the Fund's selected balance sheet data:

Selected Balance Sheet Data

(In thousands of dollars)	As at December 31 **2006**	2005
Current assets	**$ 35,338**	$ 33,858
Other long-term assets	**$ 265,208**	$ 269,860
Current liabilities	**$ 15,686**	$ 12,404

Current Assets

Current assets for the year ended December 31, 2006 increased by $1.5 million to $35.3 million from $33.8 million in 2005. The increase was primarily due to increased cash of $0.9 million, increased accounts receivables net of unbilled fees of $0.4 million and increased income tax recoverable and prepaid of $0.2 million.

Other Long-Term Assets

Other long-term assets for the year ended December 31, 2006 decreased by $4.6 million to $265.2 million from $269.8 million in 2005. The decrease was as a result of amortization expense of $16.7 million partially offset by intangible assets and goodwill acquired through the Heath acquisition of $9.3 million, capital asset additions of $1.3 million and the interest-rate swap fair value of $0.8 million.

Current Liabilities

Current liabilities for the year ended December 31, 2006 increased by $3.3 million to $15.7 million from $12.4 million in 2005. The increase was primarily due to increased accounts payable and accrued liabilities of $1.7 million due to the timing of suppliers' payments, an increase in accrued compensation and related benefits of $1.2 million due to changes in the timing of payment of certain bonuses and increased Unitholder distributions of $0.3 million due to a special one-time cash distribution which represented the incremental taxable income arising from the Fund's strong financial performance in 2006.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements, in accordance with GAAP, requires us to make estimates and assumptions that affect the reported values of assets and liabilities as well as disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the periods in which they become known. Accordingly, actual results could differ from these estimates. The accounting policies and estimates that are critical to the Fund's business relate to the following items:

Revenue Recognition

We earn fee-for-service revenue based on hourly rates and the time spent delivering those services. We also earn contracted revenue based on negotiated fixed amounts or on a formula tied to the nature of the service, rather than the time spent. Revenue is recognized in the period that the service is rendered, irrespective of when it is invoiced. Unbilled fees are recorded at the lower of unbilled hours worked at standard billing rates and the amount which we estimate can be recovered upon invoicing. Expenses are recognized as incurred. Losses on fixed-fee contracts are recognized during the period in which the loss becomes probable. Billings in excess of revenue are recorded as a deferred revenue liability, included with accounts payable and accrued liabilities, until services are rendered. Revenue does not include reimbursements for recoverable expenses, such as employee travel expenses, outside printing and third-party professional services. Reimbursements are accounted for as a reduction to expenses.

We also earn commission revenue as payment for the provision of benefits consulting services to clients, as a percentage of insurance premiums paid by our clients. Commission revenue is received annually, semi-annually, quarterly or monthly. Annual fees are typically paid at the beginning of the insurance policy period and are recognized as income at the later of the billing or effective date of the policy, net of a provision for return commissions due to policy cancellations or change of broker.

Amortization of Finite-Life Intangible Assets

We have accounted for our acquisition of WFMS and Heath using the purchase method of accounting. Intangible assets consisting principally of customer relationships, proprietary software and customer contracts have been recognized on acquisition based on our best estimate of the relative fair values. These finite-life intangible assets are being amortized over their estimated useful lives of 15 to 20, 5 and 3 years respectively. Impairment is assessed annually, or when events or changes in circumstances indicate the carrying amount of assets may not be recoverable.

Goodwill is not amortized and is subject to an impairment test at least annually or when it is more likely than not that the carrying amount of the Fund's net assets exceeds its fair value. Goodwill impairment is assessed based on a comparison of the fair value of the Fund and its net assets including goodwill.

Allowance for Doubtful Accounts

A provision for accounts receivable resulting from the potential risk that the receivable will not be collected has been recorded. We continually monitor past due accounts to assess the likelihood of collection to estimate the required provision.

Litigation and Claims

We are involved in litigation and other claims arising in the normal course of business. We must use judgment to determine whether or not a claim has any merit, the amount of the claim and whether to record a provision, which is dependent upon the potential success of the claim. We believe that none of the current claims will have a material adverse impact on the financial position of the Fund.

Future Income Tax

We use the asset and liability method of accounting for income taxes. Future income tax assets are recognized only to the extent that we determine it is more likely than not that the future income tax assets will be realized. In 2006, Morneau Sobeco was approved for a tax credit for e-commerce activities performed prior to the IPO. These credits are no longer available.

Future Accounting Changes

The CICA has issued three new accounting standards:

1. Section 3855, *Financial Instruments – Recognition and Measurement*, effective for fiscal years beginning on or after October 1, 2006. This section describes the standards for recognizing and measuring financial instruments in the balance sheet and the standards for reporting gains and losses in the financial instrument. Financial assets available for sale, assets and liabilities held for trading and derivative financial instruments, part of a hedging relationship or not, have to be measured at fair value. The impact of remeasuring our financial assets and liabilities at fair value will be recognized in opening deficit and opening accumulated other comprehensive income as appropriate.

2. Section 1530, *Comprehensive Income*, effective for fiscal years beginning on or after October 1, 2006. It describes reporting and disclosure recommendations with respect to comprehensive income and its components. Comprehensive income is the change in Unitholders' equity, which results from transactions other than those resulting from investments by Unitholders and distributions to Unitholders. These transactions and events include unrealized gains and losses resulting from changes in the fair value of certain financial instruments.

3. Section 3865, *Hedges*, effective for fiscal years beginning on or after October 1, 2006. The recommendations expand the guidelines outlined in Accounting Guideline 13 ("AcG-13"), *Hedging Relationships.* This section describes when and how hedge accounting can be applied as well as the disclosure requirements. Hedge accounting enables the recording of gains and losses, revenues and expenses from the derivative financial instruments in the same period as for those related to the hedged item.

These standards will be effective for the Fund as of January 1, 2007. Any adjustment of the previous carrying amounts will be recognized as an adjustment to either accumulated other comprehensive income or retained earnings at January 1, 2007 and prior period consolidated statements will not be restated. The impact of the adoption of these new standards on the Fund's financial statements is not expected to be material.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The Fund's financial instruments consist of cash, accounts receivable, accounts payable and accrued liabilities, Unitholder distributions payable, interest-rate swaps and a term loan.

We have a secured term loan of $35 million with two Canadian chartered banks repayable on September 30, 2009. We have entered into interest-rate swap agreements to fix the interest rate at 4.4% for the four-year term. We also have available a secured operating line of credit for $15 million. The line of credit bears interest at the bankers' acceptance rate plus 1% and the undrawn portion incurs a standby fee of 0.2%.

The carrying value of the financial instruments approximates their fair values due to their short-term nature with the exception of the interest-rate swap agreements in place on the term loan, which have been recorded at the current market rate.

We are not engaged in currency hedging activities and do not own other instruments that may be settled by the delivery of non-financial assets. We realize a portion of our sales in U.S. dollars and are thus exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar. The net revenue exposure after accounting for related expenses denominated in U.S. dollars was approximately US$1.0 million for the three months ended December 31, 2006 and US$3.0 million for the year ended December 31, 2006.

In our view, the Fund is not exposed to significant interest, currency or credit risks arising from financial instruments.

RISKS AND UNCERTAINTIES

The results of operations, business prospects and financial condition of the Fund are subject to a number of risks and uncertainties and are affected by a number of factors outside our control.

Risk Related to the Business of Morneau Sobeco

Ability to Maintain Profitability and Manage Growth

There can be no assurance that Morneau Sobeco will be able to sustain profitability in future periods. Morneau Sobeco's future operating results will depend on a number of factors, including its ability to continue to successfully execute its strategic initiatives.

There can be no assurance that Morneau Sobeco will be successful in achieving its strategic plan or that its strategic plan will enable the firm to maintain its historical revenue growth rates or to sustain profitability. Failure to successfully execute any material part of Morneau Sobeco's strategic plan could have a material adverse effect on its business, financial condition and operating results, and the ability of the Fund to make distributions on the Units.

There can be no assurance that Morneau Sobeco will be able to effectively manage its growth, and any failure to do so could have a material adverse effect on the firm's and the Fund's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Information systems are an integral part of Morneau Sobeco's business and the products and services offered to its clients. Morneau Sobeco relies on systems to maintain accurate records and to carry out required administrative functions in accordance with the terms of its contractual obligations to its clients. Morneau Sobeco relies on the Internet as a key mechanism for delivering services to clients and achieving efficiencies in its service model. The Internet has experienced, and is expected to continue to experience, significant growth in the number of users and volume of traffic. As a result, its performance and reliability may decline. In order to maintain the level of security, service and reliability that clients require, Morneau Sobeco may be required to make significant investments in the online means of delivering consulting and outsourcing services. In addition, Web sites and proprietary online services have experienced service interruptions and other delays. If these outages or delays occur frequently in the future, Internet usage as a medium of exchange of information could decline and the Internet might not adequately support the firm's Web-based tools. The adoption of additional laws or regulations with respect to the Internet may impede the efficiency of the Internet as a medium of exchange of information and decrease the demand for Morneau Sobeco's services.

Any disruptions in Morneau Sobeco's systems, the failure of the systems to operate as expected or the firm's ability to use the Internet effectively to deliver services could, depending on the magnitude of the problem, result in a loss of current or future business and/or potential claims against Morneau Sobeco, all of which could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Reputational Risk

Morneau Sobeco depends, to a large extent, on its relationships with its clients and its reputation for high-quality outsourcing and consulting services. As a result, the impact of a client not being satisfied with Morneau Sobeco's services or products may be more damaging in Morneau Sobeco's business than in other businesses. Moreover, if the firm fails to meet its contractual obligations, Morneau Sobeco could be subject to legal liability and a loss of client relationships.

Dependence on Key Clients

For the year ended December 31, 2006, Morneau Sobeco's largest client accounted for approximately 12% of revenue and its top 10 clients, in the aggregate, accounted for approximately 34% of revenue. As clients may terminate engagements with minimal notice, there can be no assurance that Morneau Sobeco will be able to retain relationships with its largest clients. Moreover, there can be no assurance that such clients will continue to use Morneau Sobeco's services in the future. Any negative change involving any of Morneau Sobeco's largest clients, including but not limited to a client's financial condition or desire to continue using the firm's services, could result in a significant reduction in revenue which could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Risk of Future Legal Proceedings

Morneau Sobeco may be threatened with, or may be named as a defendant in, or may become subject to, various legal proceedings in the ordinary course of conducting its business, including lawsuits based upon professional errors and omissions. Morneau Sobeco's business involves assumptions and estimates concerning future events, the actual outcome of which cannot be known with certainty in advance. In addition, computational, software programming or data management errors could occur. For example, possible legal proceedings could result from:

(i) a client's assertion that actuarial assumptions used in a pension plan were unreasonable, leading to plan underfunding;

(ii) a claim that inaccurate data was used, which could lead to an underestimation of plan liabilities; or

(iii) a claim that employee benefits plan documents were misinterpreted or plan amendments were misstated in plan documents, which could lead to overpayments to beneficiaries.

Defending lawsuits of this nature could require much management attention, which could divert its focus from operations. Such claims could produce negative publicity that could hurt Morneau Sobeco's reputation and business. A significant judgment against Morneau Sobeco, or the imposition of a significant fine or penalty as a result of a finding that Morneau Sobeco failed to comply with laws or regulations, could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Reliance on Key Professionals

Morneau Sobeco's operations are dependent on the abilities, experiences and efforts of its professionals, many of whom have excellent reputations and a significant number of contacts in the industry in which Morneau Sobeco operates. Morneau Sobeco's business depends, in part, on its professionals' ability to develop and maintain alliances with businesses such as brokerage firms, financial services companies, healthcare organizations, insurance companies, business process outsourcing organizations and other companies, in order to develop, market and deliver its services. If Morneau Sobeco's strategic alliances are discontinued due to the loss of professional staff, or if the firm has difficulty developing new alliances, profitability could be negatively impacted. Should any member of its professional staff be unable or unwilling to continue his or her relationship with Morneau Sobeco, this change could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Competition

Morneau Sobeco operates in a highly competitive North American market. As a result, Morneau Sobeco competes with many domestic and international firms. Some of its competitors have achieved substantially more market penetration in certain of the areas in which Morneau Sobeco competes. In addition, some of Morneau Sobeco's competitors have substantially more financial resources and/or financial flexibility than Morneau Sobeco. Competitive forces could result in reduced market share and thus have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Legislative and Regulatory Changes

The business of pension and benefits consulting and outsourcing is highly regulated and laws are constantly evolving. Any changes to laws, rules, regulations or policies could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Changes in Business Conditions

Morneau Sobeco's future success depends, in part, on its ability to develop and implement technology solutions that anticipate and keep pace with rapid and continuing changes in technology, industry standards and client preferences. The firm may not be successful in anticipating or responding to these developments on a timely basis and its ideas may not be accepted in the marketplace. The effort to gain technological expertise and develop new technologies in its business requires Morneau Sobeco to incur significant expenses. If Morneau Sobeco cannot offer new technologies as quickly as its competitors, or if the competition develops more cost-effective technologies, Morneau Sobeco could lose market share. Also, products and technologies developed by Morneau Sobeco's competitors may make the firm's service or product offerings non-competitive or obsolete. Any one of these circumstances could have a material adverse effect on Morneau Sobeco's ability to obtain and fulfill important client engagements, and thus could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Timely Completion of Projects and Performance of Obligations

In its contracts with clients, Morneau Sobeco is sometimes committed to complete a project by a scheduled date. If the project is not completed by the scheduled date, Morneau Sobeco may either incur significant additional costs or be held responsible for the costs incurred by the client to rectify damages due to the late completion. Morneau Sobeco's success depends in large part on whether it fulfills these and other contractual obligations with clients and maintains client satisfaction. If Morneau Sobeco fails to satisfactorily perform its contractual obligations, its clients could terminate contracts and/or take legal action against Morneau Sobeco. Such occurrences could result in a loss of its professional reputation and extra costs needed to defend or rectify the situation and thus have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Implications of Fixed-Price Contracts

A portion of Morneau Sobeco's revenue comes from fixed-price contracts. A fixed-price contract requires Morneau Sobeco to perform either all or a specified portion of work under the contract for a fixed price. Fixed-price contracts expose Morneau Sobeco to a number of risks, including underestimation of costs, ambiguities in specifications, unforeseen costs or difficulties, problems with new technologies, delays beyond the control of Morneau Sobeco, failures of subcontractors to perform, and economic or other changes that may occur during the contract period. Increasing use of fixed-price contracts and/or increasing the size of such contracts would increase Morneau Sobeco's exposure to these risks. Losses under fixed-price contracts could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Interest Rate Fluctuations

Morneau Sobeco may be exposed to fluctuations in interest rates under its borrowings. Increases in interest rates may have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Protection of Intellectual Property

Morneau Sobeco continually develops and improves its proprietary technology solutions for clients. No assurance can be given that Morneau Sobeco's competitors will not develop substantially similar technology. Morneau Sobeco relies on one or more of the following to protect its proprietary rights: trademarks, copyrights, trade secrets, confidentiality procedures and contractual provisions. Despite Morneau Sobeco's efforts to protect its proprietary rights, unauthorized parties may attempt to obtain and use information that Morneau Sobeco regards as proprietary. Stopping unauthorized use of Morneau Sobeco's proprietary rights may be difficult, time-consuming and costly. There can be no assurance that Morneau Sobeco will be successful in protecting its proprietary rights and, if it is not, this could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Rising Insurance Costs

The cost of maintaining professional errors and omissions insurance as well as director and officer liability insurance is significant. Morneau Sobeco could experience higher insurance premiums as a result of adverse claims experience or because of general increases in premiums by insurance carriers for reasons unrelated to its own claims experience. Generally, Morneau Sobeco's insurance policies must be renewed annually. Its ability to continue to obtain insurance at affordable premiums depends upon its ability to continue to operate with an acceptable claims record. A significant increase in the number of claims, the existence of one or more claims in excess of its policy limits or the inability to obtain adequate insurance coverage at acceptable rates, or at all, could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Absence of Operating History as a Public Entity

Although management has significant experience in the pension and benefits consulting and outsourcing industry, it does not have experience operating Morneau Sobeco as a public company. To operate effectively as a public company, it will be required to continue to implement changes in certain aspects of its business, and its management and other employees will need to learn how to comply with ongoing public company requirements. Failure to take such actions, or delay in the implementation thereof, could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

Risk Related to the Structure of the Fund

Income Tax Matters

There can be no assurance that Canadian federal income tax laws and administrative policies respecting the treatment of mutual fund trusts will not be changed in a manner which may adversely affect the Unitholders.

The Fund Declaration of Trust provides that a sufficient amount of the Fund's net income and net realized capital gains shall be distributed each year to Unitholders in order to eliminate the Fund's liability for tax under Part 1 of the *Income Tax Act (Canada)*. Where such amount of net income and net realized capital gains of the Fund in a taxation year exceeds the cash available for distribution in the year, such excess net income and net realized capital gains will be distributed to Unitholders in the form of additional Units. Unitholders are generally required to include an amount equal to the fair market value of those Units in their taxable income, in circumstances when they do not directly receive a cash distribution.

On October 31, 2006, the Department of Finance (Canada) announced the "Tax Fairness Plan" whereby the income tax rules applicable to publicly traded trusts and partnerships will be significantly modified. In particular, certain income of (and distributions made by) these entities will be taxed in a manner similar to income earned by (and distributions made by) a corporation. These proposals will be effective for the 2007 taxation year with respect to trusts which commence public trading after October 31, 2006, but the application of the rules will be delayed to the 2011 taxation year with respect to trusts which were publicly traded prior to November 1, 2006 (although the announcement suggested that this transitional relief could be lost under certain circumstances, including the "undue expansion" of an income trust). On December 21, 2006, the Department of Finance (Canada) issued for public comment the draft legislation to implement these proposals. There is no assurance that the draft legislation will be enacted in the manner proposed or at all.

On December 15, 2006, the Department of Finance (Canada) released guidance for income trusts and other flow-through entities that qualify for the four-year transitional relief. The guidance establishes objective tests with respect to how much an income trust is permitted to grow without jeopardizing its transitional relief. In general, the Fund will be permitted to issue new equity over the next four years equal to its market capitalization as of the end of trading on October 31, 2006 (subject to certain annual limits). Market capitalization, for these purposes, is to be measured in terms of the value of the Fund's issued and outstanding publicly traded units. If these limits are exceeded, the Fund may lose its transitional relief and thereby become immediately subject to the proposed rules.

The Fund is considering these announcements and the possible impact of the proposed rules on the Fund. The impact of the proposed rules (including the guidance released on December 15, 2006) may adversely affect the marketability of the Fund's Units and the ability of the Fund to undertake financings and acquisitions, and, at such time as the proposed rules apply to the Fund, the distributable cash of the Fund may be materially reduced.

Dependence on Morneau Sobeco Group LP and Its Subsidiaries

The Fund is an unincorporated open-ended, limited purpose trust that is entirely dependent on the operations and assets of the Trust. Cash distributions to Unitholders will be dependent on, among other things, the ability of the Trust to pay interest on the Trust Notes and to make cash distributions in respect of the Trust Units, which, in turn, is dependent on MS Group LP making cash distributions. MS Group LP's ability to make cash distributions is dependent on the ability of its subsidiaries to make cash distributions or other payments or advances. This will be subject to applicable laws and regulations and contractual restrictions contained in the instruments governing any indebtedness of those entities, including restrictive covenants in the credit facilities.

Cash Distributions Are Not Guaranteed and Will Fluctuate With the Business Performance

Although the Fund intends to distribute the interest received in respect of the Trust Notes and the cash distributions received in respect of the Trust Units, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Units, there can be no assurance regarding the amounts of income to be generated by MS Group LP's businesses or ultimately distributed to the Fund. The ability of the Fund to make cash distributions, and the actual amount distributed, will be entirely dependent on the operations and assets of MS Group LP (and its subsidiaries), and will be subject to various factors including each of its financial performance, its obligations under applicable credit facilities, fluctuations in its working capital, the sustainability of its margins and its capital expenditure requirements. The market value of the Units may deteriorate if the Fund is unable to meet its distribution targets in the future, and that deterioration may be significant. In addition, the composition of cash distributions for tax purposes may change over time and may affect the after-tax return for investors.

Restrictions on Potential Growth

The payout by Morneau Sobeco of substantially all of its operating cash flow will make additional capital and operating expenditures dependent on increased cash flow or additional financing in the future. Lack of those funds could limit the future growth of Morneau Sobeco and its cash flow.

Nature of Units

The Units share certain attributes common to both equity securities and debt instruments. The Units do not represent a direct investment in the businesses of Morneau Sobeco and should not be viewed by investors as direct securities of MS Corp or its subsidiaries. As holders of Units, Unitholders will not have the statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring "oppression" or "derivative" actions or rights of dissent. The Units represent a fractional interest in the Fund. The Fund's primary assets are Trust Units and Trust Notes.

The Units are not "deposits" within the meaning of the *Canada Deposit Insurance Corporations Act (Canada)* and are not insured under the provisions of that Act or any other legislation. Furthermore, the Fund is not a trust company and, accordingly, is not registered under any trust and loan company legislation as it does not carry on or intend to carry on the business of a trust company.

Market Price of Units

Publicly traded investment trusts such as the Fund do not necessarily trade at prices determined solely by reference to the underlying value of their investments. Increases in market rates of interest may lead purchasers to demand a higher yield on the Units, which may adversely affect their price. In addition, the market price for the Units may be affected by changes in general market conditions, fluctuations in the markets for equity securities and other factors beyond the Fund's control.

The market value of the Units may deteriorate if the Fund is unable to meet its distribution targets in the future, and that deterioration may be material. In addition, the composition of cash distributions for tax purposes may change over time and may affect the after-tax return for investors.

Leverage and Restrictive Covenants in Agreements Relating to Indebtedness of Morneau Sobeco

The ability of the Trust and its subsidiaries to make distributions or make other payments or advances will be subject to applicable laws and contractual restrictions contained in the instruments governing any indebtedness of those entities. The degree to which MS Group LP or Morneau Sobeco is leveraged could have important consequences to the Unitholders including: Morneau Sobeco's ability to obtain additional financing for working capital, capital expenditures or acquisitions in the future may be limited; a significant portion of Morneau Sobeco's cash flow from operations may be dedicated to the payment of the principal of and interest on its indebtedness, thereby reducing funds available for future operations; certain borrowings will be at variable rates of interests, which exposes Morneau Sobeco to the risk of increased interest rates; and, Morneau Sobeco may be more vulnerable to economic downturns and be limited in its ability to withstand competitive pressures. These factors may increase the sensitivity of Distributable Cash to interest rate variations.

Distribution of Securities on Redemption or Termination of the Fund

It is anticipated that the redemption right will not be the primary mechanism for Unitholders to liquidate their investments. Upon redemption of Units or termination of the Fund, the Trustees may distribute the Trust Notes and Trust Units directly to the Unitholders, subject to obtaining all required regulatory approvals. Trust Units and Trust Notes so distributed may not be qualified investments for registered plans[1] depending upon the circumstances at the time. There is currently no market for the Trust Notes and the Trust Units.

Dilution of Existing Unitholders and MS Group LP Unitholders

The Fund Declaration of Trust authorizes the Fund to issue an unlimited number of Units for that consideration and on those terms and conditions as shall be established by the Trustees without the approval of any Unitholders. The Unitholders will have no pre-emptive rights in connection with such further issues. Additional Units will be issued by the Fund in connection with the indirect exchange of the Class B MS Group LP Units. In addition, MS Group LP is permitted to issue additional MS Group LP Units for any consideration and on any terms and conditions.

Future Sales of Units by the Management Securityholders

The Management Securityholders hold all of the Class B LP Units, representing in aggregate 20.6% of the outstanding MS Group LP Units, which, pursuant to the Exchange Agreement, can be exchanged for Units at any time, subject to certain conditions. Certain of the Management Securityholders have also been granted certain registration rights by the Fund. If the Management Securityholders sell a substantial number of Units in the public market, the market price of the Units could fall. The perception among the public that these sales will occur could also contribute to a decline in the market price of the Units.

Restrictions on Certain Unitholders and Liquidity of Units

The Fund Declaration of Trust imposes various restrictions on Unitholders. Non-resident Unitholders are prohibited from beneficially owning either more than 40% of Units and/or the Special Voting Units (on non-diluted and fully diluted bases). These restrictions may limit (or inhibit the exercise of) the rights of certain persons, including non-residents of Canada and U.S. persons, to acquire Units, to exercise their rights as Unitholders and to initiate and complete takeover bids in respect of the Units. As a result, these restrictions may limit the demand for Units from certain Unitholders and thereby adversely affect the liquidity and market value of the Units held by the public.

Statutory Remedies

The Fund is not a legally recognized entity within the relevant definitions of the *Bankruptcy and Insolvency Act*, the *Companies' Creditors Arrangement Act* and in some cases, the *Winding-up and Restructuring Act*. As a result, in the event that a restructuring of the Fund is necessary, the Fund and its stakeholders may not be able to access the remedies and procedures available thereunder.

(1) Trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education savings plans, each as defined in the *Income Tax Act (Canada)*.

SUPPLEMENTAL SUMMARY OF QUARTERLY RESULTS

Operating results, distribution summary and condensed balance sheet history are as follows:

Operating Results, Distribution and Condensed Balance Sheets

Selected Unaudited Consolidated Financial Information Three Months Ended *(In thousands of dollars except per unit amounts)*	**December 31 2006**	September 30 2006	June 30 2006	March 31 2006	December 31 2005
Revenue	**$ 34,079**	$ 33,037	$ 32,793	$ 32,178	$ 30,071
Net Income	**2,449**	1,798	3,355	2,158	2,099
EBITDA	**7,890**	7,053	7,672	7,228	7,146
EBITDA Margin	**23.2%**	21.3%	23.4%	22.5%	23.8%
Distributable Income	**6,977**	6,753	6,830	6,566	6,543
Distributable Cash(1)	**9,080**	10,988	9,039	608	6,287
Distributions declared	**6,050**	5,731	5,688	5,666	5,729
Net income per Unit (basic and diluted)	**$ 0.11100**	$ 0.08148	$ 0.15245	$ 0.09821	$ 0.09553
Distributable Income per Unit (basic and diluted)	**$ 0.25111**	$ 0.24305	$ 0.24769	$ 0.23902	$ 0.23817
Distributable Cash per Unit (basic and diluted)	**$ 0.32680**	$ 0.39559	$ 0.32777	$ 0.02212	$ 0.22886
Distributions declared per Unit (basic and diluted)	**$ 0.21775**	$ 0.20625	$ 0.20625	$ 0.20625	$ 0.20854
Distributable Income Payout Ratio	**86.7%**	84.9%	83.3%	86.3%	87.6%
Distributable Cash Payout Ratio(1)	**66.6%**	52.1%	63.0%	932.0%	91.1%
Twelve-month rolling Distributable Income Payout Ratio	**85.3%**	85.5%	n/a	n/a	n/a
Twelve-month rolling Distributable Cash Payout Ratio	**77.9%**	85.2%	n/a	n/a	n/a
Total Assets	**$ 300,546**	$ 299,723	$ 307,188	$ 297,753	$ 303,718
Total Long-term debt	**$ 35,000**	$ 35,000	$ 35,000	$ 35,000	$ 35,000

(1) Distributable Cash has been restated for the quarters ended December 31, 2005, March 31, 2006 and June 30, 2006 to include changes in non-cash operating working capital. The Distributable Cash for the three months ended March 31, 2006 is significantly lower than the Distributions declared as the company pays its employees their annual bonuses in that quarter.

DISCLOSURE CONTROLS AND PROCEDURES

The Fund's disclosure controls and procedures have been designed to provide reasonable assurance that all relevant information is identified to its 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 operating effectively based on the evaluation of these controls and procedures conducted at December 31, 2006.

ADDITIONAL INFORMATION

The Fund's Units trade on the Toronto Stock Exchange under the symbol MSI.UN. Additional information relating to the Fund, including all public filings, is available on the SEDAR Web site (www.sedar.com) and on our own Web site at www.morneausobeco.com.

The content of this MD&A reflects information known as of March 15, 2007.

MANAGEMENT STATEMENT OF RESPONSIBILITY FOR FINANCIAL REPORTING

The accompanying consolidated financial statements for Morneau Sobeco Income Fund (the "Fund") have been prepared by management and approved by the Board of Trustees of the Fund. Management is responsible for the preparation and presentation of these financial statements and all the financial information contained in the Annual Report within reasonable limits of materiality. The Fund's consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles. In the preparation of these financial statements, estimates are necessary because a precise determination of certain assets and liabilities is dependent on future events. Management believes such estimates have been based on careful judgments and have been properly reflected in the accompanying consolidated financial statements.

To assist management in discharging these responsibilities, the Fund maintains a system of internal controls, which is designed to provide reasonable assurance that the Fund's assets are safeguarded, that transactions are executed in accordance with management's authorization and that the financial records form a reliable base for the preparation of accurate and timely financial information.

Management recognizes its responsibilities for conducting the Fund's affairs in compliance with established financial reporting standards and applicable laws, and for the maintenance of proper standards of conduct in its activities.

KPMG LLP, Chartered Accountants, were appointed as external auditors by the Trustees of the Fund and have audited the consolidated financial statements of the Fund in accordance with Canadian generally accepted auditing standards. Their report outlines the nature of their audit and expresses their opinion on the consolidated financial statements of the Fund.

The Board of Trustees of the Fund has appointed an Audit Committee composed of three Trustees who are not members of management. The Audit Committee meets periodically with management and the external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues. The Audit Committee is responsible for reviewing the Fund's annual and interim consolidated financial statements and the report of the external auditors. The Audit Committee reports the results of such reviews to the Board of Trustees of the Fund and makes recommendations with respect to the appointment of the Fund's external auditors. In addition, the Board of Trustees may refer to the Audit Committee on other matters and questions relating to the financial position of the Fund and its subsidiaries.

The Board of Trustees of the Fund is responsible for ensuring that management fulfills its responsibilities for financial reporting and is responsible for approving the consolidated financial statements of the Fund.

William Morneau
President and CEO

Nancy Reid
Chief Financial Officer

KPMG

KPMG LLP
Chartered Accountants
Suite 3300 Commerce Court West
PO Box 31 Stn Commerce Court
Toronto ON M5L 1B2
Canada

Telephone (416) 777-8500
Fax (416) 777-8818
Internet www.kpmg.ca

AUDITORS' REPORT

To the Unitholders of Morneau Sobeco Income Fund

We have audited the consolidated balance sheets of Morneau Sobeco Income Fund (the "Fund") as at December 31, 2006 and 2005 and the consolidated statements of income and deficit and cash flows for the year ended December 31, 2006 and for the period from August 22, 2005 to December 31, 2005. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Fund as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the year ended December 31, 2006 and for the period ended December 31, 2005 in accordance with Canadian generally accepted accounting principles.

KPMG LLP

Chartered Accountants

Toronto, Canada

March 2, 2007

MORNEAU SOBECO INCOME FUND
CONSOLIDATED BALANCE SHEETS

(In thousands of dollars)	As at December 31 **2006**	2005
Assets		
Current assets:		
Cash	**$ 5,257**	$ 4,348
Accounts receivable	**23,315**	22,562
Unbilled fees	**4,117**	4,482
Income taxes recoverable	**774**	659
Prepaid expenses and other	**1,875**	1,807
	35,338	33,858
Future income taxes (note 12)	**741**	600
Interest-rate swap (note 7)	**840**	–
Capital assets (note 4)	**10,833**	11,291
Intangible assets (note 5)	**125,027**	131,458
Goodwill (note 6)	**127,767**	126,511
	$ 300,546	$ 303,718
Liabilities and Unitholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	**$ 5,868**	$ 4,179
Accrued compensation and related benefits	**7,025**	5,764
Unitholder distributions payable (including non-controlling)	**2,793**	2,461
	15,686	12,404
Insurance premium liabilities:		
Payable to insurance companies	**9,108**	5,413
Less related cash and investments held	**(9,108)**	(5,413)
	–	–
Long-term debt (note 7)	**35,000**	35,000
	50,686	47,404
Non-controlling interest (note 9)	**55,461**	54,322
Unitholders' equity:		
Fund units (note 8)	**205,549**	204,476
Deficit	**(11,150)**	(2,484)
	194,399	201,992
	$ 300,546	$ 303,718

Commitments and Contingencies (notes 15 and 16)

See accompanying notes to consolidated financial statements

Robert Chisholm
Trustee, Audit Committee Chair

William Morneau
Trustee, President and CEO

MORNEAU SOBECO INCOME FUND
CONSOLIDATED STATEMENTS OF INCOME AND DEFICIT

(In thousands of dollars except per unit amounts)	**Year ended December 31, 2006**	Period ended December 31, 2005 (note 2(a))
Revenue		
Fees	**$ 113,942**	$ 26,658
Commissions	**17,669**	3,337
Other	**476**	76
	132,087	30,071
Expenses		
Salaries and benefits (note 12)	**76,240**	17,024
Other operating	**26,004**	5,866
Loss on disposal of capital assets	**–**	35
Amortization of capital assets (note 4)	**2,131**	483
Amortization of intangible assets (note 5)	**14,521**	3,542
Interest (note 7)	**883**	478
	119,779	27,428
Income before income taxes and non-controlling interest	**12,308**	2,643
Income taxes (recovery) (note 12)		
Current	**199**	83
Future	**(141)**	(64)
	58	19
Income before non-controlling interest	**12,250**	2,624
Non-controlling interest (note 9)	**(2,490)**	(525)
Net income	**9,760**	2,099
Deficit, beginning of year/period	**(2,484)**	–
Distributions declared (note 10)	**(18,426)**	(4,583)
Deficit, end of year/period	**$ (11,150)**	$ (2,484)
Net income per Unit (basic and diluted) (note 14)	**$ 0.44318**	$ 0.09553

See accompanying notes to consolidated financial statements

MORNEAU SOBECO INCOME FUND
CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands of dollars)	**Year ended December 31, 2006**	Period ended December 31, 2005 (note 2(a))
Cash provided by (used in):		
Operating activities		
Net income	**$ 9,760**	$ 2,099
Items not involving cash:		
Amortization	**16,652**	4,025
Loss on disposal of capital assets	**–**	35
Non-controlling interest of Class B LP Units	**2,490**	525
Future income taxes	**(141)**	–
Salary component of Heath acquisition (note 3)	**513**	–
Fair value of interest-rate swap agreements (note 7)	**(840)**	–
	28,434	6,684
Change in non-cash operating working capital:		
Accounts receivable	**777**	2,790
Income taxes recoverable	**(9)**	1,601
Unbilled fees	**365**	(394)
Prepaid expenses and other	**33**	(464)
Accrued compensation and related benefits	**1,261**	(2,411)
Accounts payable and accrued liabilities	**162**	(1,477)
	31,023	6,329
Financing activities		
Issuance of Units (note 1)	**–**	199,793
Expenses related to issuance of Units (note 1)	**–**	(15,296)
Proceeds from long-term debt (note 7)	**–**	35,000
Issuance of over-allotment Units (note 1)	**–**	19,979
Repayment of term loan	**–**	(10,000)
Distributions paid	**(22,802)**	(3,268)
	(22,802)	226,208
Investing activities		
Business acquisition (note 3)	**(5,097)**	(208,104)
Additional acquisition through over-allotment (note 1)	**–**	(19,979)
Cash and bank indebtedness assumed (note 3)	**(907)**	–
Purchase of capital assets	**(1,308)**	(106)
	(7,312)	(228,189)
Net increase in cash for the year/period	**909**	4,348
Cash, beginning of year/period	**4,348**	–
Cash, end of year/period	**$ 5,257**	$ 4,348
Supplemental disclosures:		
Interest paid	**$ 1,723**	$ 314
Income taxes refunded	**$ (100)**	$ (1,461)

See accompanying notes to consolidated financial statements

For the years ended December 31, 2006 and 2005
(In thousands of dollars except unit and per unit amounts)

1. ORGANIZATION AND NATURE OF THE BUSINESS

Morneau Sobeco Income Fund (the "Fund") is an unincorporated, open-ended, limited purpose trust established under the laws of the Province of Ontario by a Declaration of Trust made as of August 22, 2005. The Fund was established through the issuance of one unit for $10.00.

The Fund is the largest Canadian-owned pension and benefits consulting and outsourcing firm, providing services to organizations across Canada and in the United States. The Fund focuses on the integrated design and delivery of retirement, employee compensation and benefits programs.

On September 30, 2005, the Fund completed an initial public offering ("IPO") and the sale of 19,979,284 trust units ("Units") for $10.00 per Unit, for total gross proceeds of $199,793 before issuance costs of $15,296. On October 18, 2005, the over-allotment option of the Fund's IPO was exercised resulting in the issuance of an additional 1,997,928 Units, for gross proceeds of $19,979.

On June 1, 2006, the Fund indirectly acquired all of the issued and outstanding shares of Heath Benefits Consulting Inc. ("Heath") through Morneau Sobeco Group Limited Partnership ("MS Group LP") in exchange for 312,845 Class B LP Units, $449 in cash, the assumption of debt of $4,648 and two additional instalments that will be made in 2008 subject to certain conditions (see note 3).

On June 22, 2006, the Fund issued 85,704 Units in exchange for Class B LP Units of MS Group LP and Special Voting Units.

2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Fund have been prepared by management in accordance with Canadian generally accepted accounting principles and the significant accounting policies are summarized below:

(a) Basis of presentation

These consolidated financial statements include the assets, liabilities, revenue and expenses of the following entities:

	% Ownership
Morneau Sobeco Limited Partnership ("MSLP")	79.4
Morneau Sobeco Group Limited Partnership ("MS Group LP")	79.4
Morneau Sobeco, Ltd. ("MSUS")	79.4
Morneau Sobeco Corporation ("MS Corp")	79.4
Morneau Sobeco Trust ("Trust")	100
Morneau Sobeco GP Inc. ("MS GP")	100

The Fund was established on August 22, 2005 and had no revenue or expenses until September 30, 2005 when the Fund acquired W.F. Morneau Services Inc. The comparative amounts reflect results for the period from August 22, 2005 to December 31, 2005.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

On July 1, 2006, Heath Benefits Consulting Inc. ("Heath"), Heath Benefits Consulting AB Inc., Norfolk Living Benefits Inc., Morneau Heath Acquisition Inc. and Morneau Sobeco Corporation were amalgamated and continue to operate as MS Corp.

(b) Financial instruments

The fair value of the Fund's financial assets and liabilities approximate carrying values due to their short-term nature or with respect to the long-term debt instruments, because they bear interest at market rates. The Fund does not enter into financial instruments for trading or speculative purposes.

Interest-rate swap agreements are used as part of the Fund's program to manage the fixed and floating interest rate mix of the Fund's total debt outstanding and related overall cost of borrowing. The interest-rate swap agreements involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based and are recorded at their fair value with a corresponding adjustment to interest expense.

(c) Measurement uncertainties

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(d) Revenue recognition and unbilled fees

Fees for administrative, actuarial and consulting services are recognized when the services are rendered.

Unbilled fees are recorded at the lower of unbilled hours worked at normal billing rates and the amount which is estimated to be recoverable upon invoicing.

Commissions are recognized when earned which is at the later of the billing or effective date of the policy, net of a provision for return commissions due to policy cancellation.

Investment income is recorded on the accrual basis.

(e) Foreign currency translation

Monetary assets and liabilities denominated in foreign currencies have been translated into Canadian dollars at the exchange rate prevailing at the consolidated balance sheet dates. Non-monetary items have been translated into Canadian dollars at the exchange rate prevailing when the assets were acquired or obligations incurred. Revenue and expenses have been translated at rates in effect on the transaction dates. Exchange gains or losses are reflected in income for the period.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(f) Capital assets

Capital assets are stated at their initial capital cost less accumulated amortization. Amortization is recognized over the assets' estimated useful lives as follows:

Asset	Basis	Rate
Computer equipment	Declining balance	30%
Furniture and equipment	Declining balance	20%
Leasehold improvements	Straight-line	Over term of the lease

(g) Intangible assets and goodwill

Intangible assets consist principally of customer relationships, proprietary software and customer contracts, based on management's best estimate of the relative fair values. These intangible assets are being amortized on a straight-line basis over their estimated useful lives of 15 to 20, 5 and 3 years respectively.

Goodwill is not amortized and is subject to an annual impairment test. Goodwill impairment is assessed based on a comparison of the estimated fair value of the Fund and the carrying value of its net assets including goodwill. An impairment loss will be recognized if the carrying amount of the Fund's net assets exceeds its estimated fair value.

(h) Impairment of long-lived assets

The Fund periodically reviews the useful lives and the carrying values of its long-lived assets for continued appropriateness. The Fund reviews long-lived assets for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. An impairment loss is measured at the amount by which the carrying amount of the long-lived asset exceeds its fair value.

(i) Insurance premium liabilities and related cash and investments

In its capacity as consultants, the Fund collects premiums from insureds and remits premiums, net of agreed deductions, such as taxes, administrative fees and commissions, to insurance underwriters. These are considered flow-through items for the Fund and, as such, the cash and investment balances relating to these liabilities are deducted from the related liability in the consolidated balance sheet.

(j) Long-term incentive plan

The Fund has a long-term incentive plan under which participants are eligible to receive Units. The amount awarded under the plan is recorded as salaries and benefits expense on a straight-line basis over the three-year vesting period.

(k) Employee future benefits

The Fund has a pension benefit plan covering its employees, which includes a defined benefit option and a defined contribution option.

The defined benefit option was closed effective January 1, 1998 and includes 8 employees, 5 retirees and 54 deferred vested members as at December 31, 2006. All other employees are covered by the defined contribution option of the plan.

The Fund accrues its obligations under the defined benefit option of the plan as the employees render the services necessary to earn the pension. For the defined contribution option, the Fund matches member contributions and may be required to make additional contributions at the option of the member, up to the limits defined in the plan text.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(l) Income taxes

The Fund is a mutual fund trust for income tax purposes. As such, the Fund is only taxable on any amount not distributed to Unitholders. As substantially all taxable income will be distributed to the Unitholders, no provision for income taxes on earnings has been made in these consolidated financial statements. Income tax liabilities relating to the Fund are taxed in the hands of the Unitholders.

The Fund uses the asset and liability method of accounting for income taxes of its subsidiaries. Under this method of tax allocation, future tax assets and liabilities are recognized on the basis of future tax consequences attributable to differences between the carrying amounts of assets and liabilities as recorded in the consolidated financial statements and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period in which the date of enactment or substantive enactment occurs.

(m) Proposed Canadian income tax rule changes

On October 31, 2006, the Department of Finance (Canada) announced the "Tax Fairness Plan" whereby the income tax rules applicable to publicly traded trusts and partnerships will be significantly modified. In particular, certain income of (and distributions made by) these entities will be taxed in a manner similar to income earned by (and distributions made by) a corporation. These proposals will be effective for the 2007 taxation year with respect to trusts which commence public trading after October 31, 2006, but the application of the rules will be delayed to the 2011 taxation year with respect to trusts which were publicly traded prior to November 1, 2006 (although the announcement suggested that this transitional relief could be lost under certain circumstances, including the "undue expansion" of an income trust). On December 21, 2006, the Department of Finance (Canada) issued for public comment the draft legislation to implement these proposals. There is no assurance that the draft legislation will be enacted in the manner proposed or at all.

On December 15, 2006, the Department of Finance (Canada) released guidance for income trusts and other flow-through entities that qualify for the four-year transitional relief. The guidance establishes objective tests with respect to how much an income trust is permitted to grow without jeopardizing its transitional relief. In general, the Fund will be permitted to issue new equity over the next four years equal to its market capitalization as of the end of trading on October 31, 2006 (subject to certain annual limits). Market capitalization, for these purposes, is to be measured in terms of the value of the Fund's issued and outstanding publicly traded units. If these limits are exceeded, the Fund may lose its transitional relief and thereby become immediately subject to the proposed rules.

Currently the Fund is only taxable on amounts that are not distributed to Unitholders. If enacted in its current form, the proposed legislation will result in a change in which the earnings of the Fund will be subject to income tax regardless of whether amounts are distributed to the Unitholders or not.

The Fund is considering these announcements and the possible impact of the proposed rules on the Fund. The impact of the proposed rules (including the guidance released on December 15, 2006) may adversely affect the marketability of the Fund's Units and the ability of the Fund to undertake financings and acquisitions, and, at such time as the proposed rules apply to the Fund, the Distributable Cash of the Fund may be materially reduced.

2. SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

(n) Future accounting changes

The CICA has issued three new accounting standards:

(i) Section 3855, *Financial Instruments – Recognition and Measurement*, effective for fiscal years beginning on or after October 1, 2006. This section describes the standards for recognizing and measuring financial instruments in the balance sheet and the standards for reporting gains and losses in the financial instrument. Financial assets available for sale, assets and liabilities held for trading and derivative financial instruments, part of a hedging relationship or not, have to be measured at fair value. The impact of remeasuring our financial assets and liabilities at fair value will be recognized in opening deficit and opening accumulated other comprehensive income as appropriate.

(ii) Section 1530, *Comprehensive Income*, effective for fiscal years beginning on or after October 1, 2006. It describes reporting and disclosure recommendations with respect to comprehensive income and its components. Comprehensive income is the change in Unitholders' equity, which results from transactions other than those resulting from investments by Unitholders and distributions to Unitholders. These transactions and events include unrealized gains and losses resulting from changes in the fair value of certain financial instruments.

(iii) Section 3865, *Hedges*, effective for fiscal years beginning on or after October 1, 2006. The recommendations expand the guidelines outlined in Accounting Guideline 13 ("AcG-13"), *Hedging Relationships*. This section describes when and how hedge accounting can be applied as well as the disclosure requirements. Hedge accounting enables the recording of gains and losses, revenues and expenses from the derivative financial instruments in the same period as for those related to the hedged item.

These standards will be effective for the Fund as of January 1, 2007. Any adjustment of the previous carrying amounts will be recognized as an adjustment to either accumulated other comprehensive income or retained earnings at January 1, 2007 and prior period consolidated statements will not be restated. The impact of the adoption of these new standards on the Fund's financial statements is not expected to be material.

3. BUSINESS ACQUISITIONS

(a) W.F. Morneau Services Inc.

On September 30, 2005, through a series of transactions subsequent to the IPO, the Fund indirectly acquired common shares of W.F. Morneau Services Inc. ("Morneau Sobeco") with the former shareholders of Morneau Sobeco (comprised of the senior management of Morneau Sobeco and Morneau family members) retaining an approximate 27.3% interest in Morneau Sobeco. This interest was reduced to 20% when the over-allotment option of the IPO was exercised.

3. BUSINESS ACQUISITIONS (CONTINUED)

The acquisition has been accounted for by the purchase method. The allocation of the purchase price is summarized as follows:

Assets and liabilities acquired:	
Cash	$ 1,689
Accounts receivable	25,352
Income taxes recoverable	2,325
Unbilled fees	4,087
Prepaid expenses and other	1,343
Future income taxes	536
Capital assets	11,703
Intangible assets	135,000
Goodwill	126,511
Accrued compensation and related benefits	(8,175)
Accounts payable and accrued liabilities	(5,656)
Payable to insurance companies	(5,964)
Related cash balances held	5,964
Term loan	(10,000)
	$ 284,715
Consideration:	
Cash	$ 209,793
Class B LP Units	74,922
	$ 284,715

(b) Heath

On June 1, 2006, the Fund indirectly acquired all of the issued and outstanding shares of Heath, a Vancouver-based benefits consulting firm with over 90 employees across Canada.

The consideration is based on future revenue from the Heath business with a minimum purchase price of $9,014. The consideration, which is currently estimated to be approximately $15,400, is being paid in three instalments and is satisfied primarily through the assumption and repayment of the Heath debt of $4,648 on closing and the issuance of Class B LP Units of MS Group LP.

The first instalment of the purchase price was made on closing. The purchase price is conditional upon the success in retaining and growing revenue from specified Heath clients, as well as achieving targeted cost efficiencies. The second and third instalments, which represent contingent consideration, will be settled on June 30 and December 1 of 2008 and are currently estimated to be approximately $6,400. These instalments will be settled by issuing a number of Class B LP Units of MS Group LP based on a pre-determined value of $12.52 per unit. In addition to the estimate of $15,400, contingent consideration will

(In thousands of dollars except unit and per unit amounts)

3. BUSINESS ACQUISITIONS (CONTINUED)

include amounts to compensate for foregone distributions payable on the second and third instalments during the period June 1, 2006 to December 1, 2008, which amounted to approximately $250 to the end of December 31, 2006.

These contingent consideration elements will be recorded when the final purchase price has been established except for a portion of the third instalment which is conditional on the continuing employment of certain selling shareholders and is being recorded as salary expense over the required employment period to December 2008. The estimated payable amount as at December 31, 2006 is $513.

The acquisition has been accounted for by the purchase method based on management's best estimate of the relative fair value of the identifiable assets and liabilities assumed. The actual calculation and allocation of the purchase price will be based on the assets purchased and liabilities assumed at the effective date of the acquisition transaction and other information available. The first instalment of the purchase price has been accounted for as follows:

Assets and liabilities acquired:	
Cash	$ 827
Accounts receivable	1,530
Income taxes recoverable	106
Prepaid expenses and other	101
Capital assets	365
Intangible assets	8,090
Goodwill	1,256
Bank indebtedness	(1,734)
Accounts payable and accrued liabilities	(1,527)
Payable to insurance companies	(3,156)
Related cash balances held	3,156
	$ 9,014
Consideration:	
Cash	$ 449
Debt assumed and repaid	4,648
Exchangeable Units (first instalment paid on June 20, 2006)	3,917
	$ 9,014

These consolidated financial statements include the results of Heath from the date of acquisition. On July 1, 2006, Heath and its subsidiaries were amalgamated with MS Corp.

As part of the exit activities, two office premises were closed which resulted in exit costs related to occupancy lease terminations and severance of $429.

4. CAPITAL ASSETS

The Fund's capital assets are comprised of:

	Cost	Accumulated amortization 2006	Net book value 2006	Net book value 2005
Computer equipment	$ 1,982	$ (581)	$ 1,401	$ 1,385
Furniture and equipment	3,368	(693)	2,675	2,573
Leasehold improvements	8,097	(1,340)	6,757	7,333
	$ 13,447	$ (2,614)	$ 10,833	$ 11,291

Amortization for the year ended December 31, 2006 and period ended December 31, 2005 were $2,131 and $483 respectively.

5. INTANGIBLE ASSETS

The Fund's intangible assets are comprised of:

	Cost	Accumulated amortization 2006	Net book value 2006	Net book value 2005
Customer relationships	$ 98,090	$ (5,980)	$ 92,110	$ 88,875
Customer contracts	5,000	(2,083)	2,917	4,583
Proprietary software	40,000	(10,000)	30,000	38,000
	$ 143,090	$ (18,063)	$ 125,027	$ 131,458

Amortization for the year ended December 31, 2006 and period ended December 31, 2005 were $14,521 and $3,542 respectively.

6. GOODWILL

	2006	2005
Balance at beginning of year	$ 126,511	$ –
Acquisitions (note 3)	1,256	126,511
	$ 127,767	$ 126,511

(In thousands of dollars except unit and per unit amounts)

7. BANK INDEBTEDNESS AND LONG-TERM DEBT

At December 31, 2006 and 2005, the Fund had a secured term loan of $35,000 with two Canadian chartered banks repayable in full on September 30, 2009. The term loan bears interest at the bankers' acceptance rate plus 1%. The Fund entered into interest-rate swap agreements on September 30, 2005 in order to fix the interest rate at 4.4% for the duration of the loan. These interest-rate swap agreements have been recorded at their fair value with the corresponding adjustment to interest expense. As at December 31, 2006 the fair value of the swap was $840 and the adjustment to interest expense for the year was $840.

The Fund also has available a secured operating line of credit for $15,000 with no amount drawn at December 31, 2006 and 2005. The line of credit bears interest at the bankers' acceptance rate plus 1% and the undrawn portion incurs a standby fee of 0.2%. The bank indebtedness and term loan are secured by a general assignment of the assets of the Fund.

8. FUND UNITS

The Fund is authorized to issue an unlimited number of Units and an unlimited number of special voting units ("Special Voting Units"). Special Voting Units are not entitled to any beneficial interest in any distribution from the Fund.

Units are redeemable at any time on demand by the Unitholders. The redemption price is calculated based on the lesser of:

(i) 90% of the "market price", as defined in the prospectus, as of the date on which the Units were surrendered for redemption; and

(ii) 100% of the "closing market price", as defined in the prospectus, on the redemption date.

The following details the issued and outstanding Units and Special Voting Units:

	December 31, 2006		December 31, 2005	
	Units issued	**Amount**	Units issued	Amount
Units	**22,062,916**	**$ 205,549**	21,977,212	$ 204,476
Special Voting Units	**5,721,444**	**–**	5,494,303	–
	27,784,360	**$ 205,549**	27,471,515	$ 204,476

As part of the Heath acquisition, on June 1, 2006, the Fund issued 312,845 Special Voting Units.

On June 22, 2006, the Fund issued 85,704 Units in exchange for Class B LP Units of MS Group LP and Special Voting Units.

9. NON-CONTROLLING INTEREST

The former shareholders of Morneau Sobeco retained 5,494,303 Class B LP Units of MS Group LP after over-allotment and former shareholders of Heath retained 227,141 Class B LP Units of MS Group LP, as part of the Heath acquisition. The Class B LP Units are fully exchangeable for equal Units in the Fund, subject to certain restrictions, and provide the former shareholders of Morneau Sobeco and Heath with a non-controlling interest of 20.59% in the Fund. Some of the Class B LP Units are subordinated in their rights to receive distributions.

	2006			2005		
	Units issued		**Amount**	Units issued		Amount
Subordinated Class B LP Units	**4,095,060**	**$**	**40,951**	4,095,060	$	40,951
Non-subordinated Class B LP Units	**1,626,384**		**16,836**	1,399,243		13,992
	5,721,444		**57,787**	5,494,303		54,943
Balance, beginning of year/period	**5,494,303**		**54,322**	5,494,303		54,943
Non-subordinated units issued (note 3)	**312,845**		**3,917**	–		–
Exchanged units (note 8)	**(85,704)**		**(1,073)**	–		–
Salary component of Heath acquisition (note 3)	**–**		**513**	–		–
Share of net income for the year/period	**–**		**2,490**	–		525
Distributions for the year/period	**–**		**(4,708)**	–		(1,146)
Balance, end of year/period	**5,721,444**	**$**	**55,461**	5,494,303	$	54,322

Distributions on the Subordinated Class B LP Units will be subordinated in favour of the Fund Units and the Non-subordinated Class B LP Units. These distributions will be paid at the end of a fiscal quarter to the extent that an average monthly distribution of at least $0.06875 per Unit and Non-subordinated Class B LP Unit in respect of that quarter has been paid, and any deficiency in such distributions to holders of Units and Non-subordinated Class B LP Units during the subordination period has been satisfied.

The subordination provisions of the Subordinated Class B LP Units apply until the date on which both of the following conditions have been satisfied: (i) for four consecutive fiscal quarters of the Fund beginning on December 31, 2006, the Fund has earned EBITDA of at least $25,169 during such period; and (ii) commencing with the 12-month period ending September 30, 2007, the Fund and MS Group LP have respectively paid an average distribution of at least $0.06875 per Unit and per Class B LP Unit per month for the preceding 12-month period. "EBITDA" is defined as earnings before interest, income taxes, depreciation and amortization.

(In thousands of dollars except unit and per unit amounts)

10. DISTRIBUTIONS TO UNITHOLDERS

The Board of Trustees determines the amount of distributions. Distributions announced during the year ended December 31, 2006 and period ended December 31, 2005 were as follows:

Unitholder record date	Total	Per Unit	Paid or payable for the year ended December 31, 2006
Trust Units			
January 31, 2006	$ 1,511	$ 0.06875	February 15, 2006
February 28, 2006	1,511	0.06875	March 15, 2006
March 31, 2006	1,511	0.06875	April 17, 2006
April 28, 2006	1,511	0.06875	May 15, 2006
May 31, 2006	1,511	0.06875	June 15, 2006
June 30, 2006	1,517	0.06875	July 17, 2006
July 31, 2006	1,517	0.06875	August 15, 2006
August 31, 2006	1,517	0.06875	September 15, 2006
September 29, 2006	1,516	0.06875	October 16, 2006
October 31, 2006	1,516	0.06875	November 15, 2006
November 30, 2006	1,517	0.06875	December 15, 2006
December 29, 2006	1,517	0.06875	January 15, 2007
December 29, 2006	254	0.01150	January 15, 2007
	$ 18,426	$ 0.83650	
Class B LP Units			
Non-subordinated			
January 31, 2006	$ 96	$ 0.06875	February 15, 2006
February 28, 2006	96	0.06875	March 15, 2006
March 31, 2006	96	0.06875	April 17, 2006
April 28, 2006	96	0.06875	May 15, 2006
May 31, 2006	96	0.06875	June 15, 2006
June 30, 2006	112	0.06875	July 17, 2006
July 31, 2006	112	0.06875	August 15, 2006
August 31, 2006	112	0.06875	September 15, 2006
September 29, 2006	112	0.06875	October 16, 2006
October 31, 2006	112	0.06875	November 15, 2006
November 30, 2006	112	0.06875	December 15, 2006
December 29, 2006	112	0.06875	January 15, 2007
December 29, 2006	19	0.01150	January 15, 2007
	$ 1,283	$ 0.83650	

10. DISTRIBUTIONS TO UNITHOLDERS (CONTINUED)

Unitholder record date		Total		Per Unit	Paid or payable for the year ended December 31, 2006
Class B LP Units					
Subordinated					
March 31, 2006	$	845	$	0.20625	April 17, 2006
June 30, 2006		845		0.20625	July 17, 2006
September 29, 2006		844		0.20625	October 16, 2006
December 29, 2006		844		0.20625	January 15, 2007
December 29, 2006		47		0.01150	January 15, 2007
	$	3,425	$	0.83650	

Unitholder record date		Total		Per Unit	Paid or payable for the period ended December 31, 2005
Trust Units					
October 31, 2005	$	1,561	$	0.07104	November 15, 2005
November 30, 2005		1,511		0.06875	December 15, 2005
December 31, 2005		1,511		0.06875	January 16, 2006
	$	4,583	$	0.20854	
Class B LP Units					
Non-subordinated					
October 31, 2005	$	100	$	0.07104	November 15, 2005
November 30, 2005		96		0.06875	December 15, 2005
December 31, 2005		96		0.06875	January 16, 2006
	$	292	$	0.20854	
Subordinated					
December 31, 2005		854		0.20854	January 31, 2006
	$	854	$	0.20854	

11. LONG-TERM INCENTIVE PLAN

Executives are eligible to participate in Morneau Sobeco's Long-Term Incentive Plan (LTIP), which is designed to align compensation with distributable cash earned by the Fund's subsidiaries. The LTIP provides compensation opportunities for performance resulting in the Fund exceeding its distributable cash targets. The Fund's Compensation, Nominating and Corporate Governance Committee of the Board of Trustees (the "Committee") will determine (i) who will participate in the LTIP; (ii) the level of participation; and (iii) the time or times when LTIP awards will vest or be paid to each participant.

For the years ended December 31, 2006 and 2005
(In thousands of dollars except unit and per unit amounts)

11. LONG-TERM INCENTIVE PLAN (CONTINUED)

Pursuant to the LTIP, Morneau Sobeco will set aside a pool of funds based upon the amount, if any, by which the distributable cash per Unit (fully diluted) exceeds certain defined threshold amounts. Morneau Sobeco or a Trustee will purchase Units in the market with this pool of funds and will hold the Units until such time as ownership vests to each participant. Generally, one-third of these Units will vest equally over the three years following the grant of the awards. LTIP participants will be entitled to receive distributions on all Units held for their account prior to the applicable vesting date. Unvested Units held by the Trustee for an LTIP participant will be forfeited if the participant resigns or is terminated prior to the applicable vesting date and those Units will be sold and the proceeds returned to Morneau Sobeco.

Initially, the LTIP provides for awards that may be earned based on the amount by which distributable cash per Unit exceeds a base distribution threshold of $0.825 per Unit per annum. The percentage amount of that excess, which forms the LTIP incentive pool, will be determined in accordance with the table below:

Percentage by which distributable cash per Unit exceeds base threshold[1]	Maximum proportion of excess distributable cash available for LTIP payments
5% or less	10%
Over 5% to 10%	15% of any excess over 5% to 10%
Greater than 10%	20% of any excess over 10%

(1) Annualized for fiscal periods of less than 12 months.

The base distribution threshold is subject to review by the Committee at least annually. The Committee awarded a payment under the terms of the LTIP of $386 for the year ended December 31, 2006 (period ended December 2005 – $nil). This amount will be recorded as salary expense over the three-year vesting period of 2007 to 2009.

12. INCOME TAXES

Income tax obligations relating to distributions from the Fund are obligations of the Unitholders and, accordingly, no provision for income taxes has been made in respect of income of the Fund. A provision for income taxes is recognized for the Fund's subsidiaries that are subject to tax, including Large Corporations Tax.

12. INCOME TAXES (CONTINUED)

The difference between income taxes calculated using the Fund's effective income tax rates and the amounts that would result from the application of the statutory income tax rates arises from the following:

		Year ended December 31, 2006		Period ended December 31, 2005 (note 2(a))
Income taxes at statutory rates:				
Federal		**22.12%**		22.12%
Provincial		**12.18%**		11.98%
		34.30%		34.10%
Income tax provision applied to income before income taxes:				
Combined basic federal and provincial income taxes at statutory rates applied to income from continuing operations	**$**	**3,952**	$	955
Income taxed in the hands of the Unitholders		**(7,399)**		(1,774)
Non-deductible expenses		**141**		38
Non-deductible intangible asset amortization		**4,233**		1,045
Financing costs deductible for tax purposes		**(974)**		(252)
Effect of higher tax rates in non-Canadian jurisdictions		**12**		26
Non-capital loss carried forward		**(51)**		(79)
Non-deductible salary expense		**154**		–
Other		**(10)**		60
	$	**58**	$	19

Future income tax assets and liabilities are provided for temporary differences between the financial statement carrying values of existing assets and liabilities and their respective tax bases. The significant components of future income tax assets and liabilities related to continuing operations are as follows:

		2006		2005
Future income tax assets:				
Excess of tax bases of capital assets and intangibles over their carrying values	**$**	**741**	$	589
Non-capital losses		**–**		11
	$	**741**	$	600

The Fund received an income tax credit related to salary costs regarding employees carrying out e-business activities in the province of Quebec of $743. This credit has been recorded as a reduction in salaries and benefits expense for the year ended December 31, 2006.

(In thousands of dollars except unit and per unit amounts)

13. EMPLOYEE FUTURE BENEFITS

The Fund has a pension benefit plan covering its employees, which includes a defined benefit option and a defined contribution option. The defined benefit option was closed to new members effective January 1, 1998.

As of January 1, 1998, all new members participate in a defined contribution option, whereby the Fund matches member contributions and may be required to make additional contributions at the option of the members up to a limit prescribed under the *Income Tax Act (Canada)*. Under the defined contribution option, each member is required to contribute a specific dollar amount based on the member's job level classification. Each member may elect to make an optional contribution of between 50% and 300% of the member's required contribution. The Fund matches required contributions. For employees with less than 10 years of service, the Fund contributes 50% of optional contributions and for members with 10 or more years, 75% of optional contributions.

The pension fund assets and obligations are measured as at December 31, 2006 and 2005. Information about the pension plan's defined benefit option is as follows:

	Year ended December 31, 2006	Period ended December 31, 2005 (note 2(a))
Fair value of plan assets	**$ 2,562**	$ 2,954
Accrued benefit obligation	**3,164**	3,896
Funded status – deficit	**$ (602)**	$ (942)
Plan assets:		
Fair value, beginning of period	**$ 2,954**	$ 2,854
Actual return on plan assets	**217**	65
Employer contributions	**260**	42
Benefits paid	**(869)**	(7)
Fair value, end of period	**$ 2,562**	$ 2,954
Accrued benefit obligation:		
Balance, beginning of period	**$ 3,896**	$ 3,687
Current service cost	**90**	18
Interest cost	**169**	47
Benefits paid	**(869)**	(7)
Actuarial losses (gains)	**(122)**	151
Balance, end of period	**$ 3,164**	$ 3,896
Reconciliation of plan assets to accrued benefit obligation, end of period:		
Fair value of plan assets	**$ 2,562**	$ 2,954
Accrued benefit obligation	**3,164**	3,896
Funded status – deficit	**(602)**	(942)
Unamortized net actuarial loss	**155**	410
Unamortized transitional obligation	**449**	539
Accrued benefit asset	**$ 2**	$ 7

13. EMPLOYEE FUTURE BENEFITS (CONTINUED)

		Year ended December 31, 2006		Period ended December 31, 2005 (note 2(a))
End of period allocation of fair value of plan assets (%)				
Pooled Equities Fund		**45%**		0%
Pooled Balanced Fund (60% equities, 40% bonds)		**0%**		90%
Pooled Bond Fund		**55%**		10%
		100%		100%
Pension plan cost				
Current service cost	**$**	**90**	$	18
Interest cost on accrued benefit obligation		**169**		47
Return on plan assets		**(217)**		(65)
Actuarial losses (gains) during the period on accrued benefit obligation		**(122)**		151
	$	**(80)**	$	151
Other adjustments:				
Difference between actual and expected return on plan assets	**$**	**32**	$	19
Amortization of actuarial losses (gains)		**223**		(151)
Transitional amounts		**90**		22
Net pension plan expense	**$**	**265**	$	41
Other information about the Fund's defined benefit option is as follows:				
Employer contributions	**$**	**260**	$	42
Benefits paid		**869**		7

The net expense for the year ended December 31, 2006 for the Fund's defined benefit option is $265 (period ended December 2005 – $41). The net expense for the Fund's defined contribution option is $1,623 (period ended December 2005 – $368).

Actuarial valuations:

Actuarial valuation for the Fund's pension plan is generally required every three years. The most recent actuarial valuation of the Fund's pension plan was conducted as of December 31, 2003 and the next valuation is scheduled for completion in 2007.

For the years ended December 31, 2006 and 2005
(In thousands of dollars except unit and per unit amounts)

13. EMPLOYEE FUTURE BENEFITS (CONTINUED)

Weighted average assumptions:

	Year ended December 31, 2006	Period ended December 31, 2005 (note 2(a))
Weighted average of the amounts assumed in accounting for the plan:		
Discount rate at the end of the current fiscal period used to determine the accrued benefit obligation	**5.00%**	4.75%
Discount rate at the end of the preceding period used to determine the benefit cost	**4.75%**	5.75%
Rate of compensation increase used to determine the accrued benefit obligation	**2.50%**	2.50%
Rate of compensation increase used to determine the benefit cost	**2.50%**	2.50%
Expected long-term rate of return on plan assets	**7.00%**	7.00%

14. NET INCOME PER UNIT

Net income per unit is calculated by dividing net income by the weighted average number of units outstanding during the year. The weighted average number of units outstanding used in computing basic net income per unit for the year ended December 31, 2006 is 22,022,529 (period ended December 31, 2005 – 21,977,212).

15. COMMITMENTS

The Fund has lease commitments for office premises and equipment with options for renewal. As at December 31, 2006, the minimum payments not including operating expenses, due in each of the next five years and thereafter, are expected to be as follows for each year ending December 31:

2007	$ 4,745
2008	4,255
2009	3,649
2010	2,993
2011	2,626
Thereafter	3,005
Total	$ 21,273

In addition, the Fund has entered into a sublease agreement to sublet one of the former Heath office premises. According to the agreement, the Fund is liable for the rent in case of a default by the subtenant. The average annual rent for the lease is $190 and the lease expires on October 30, 2011.

16. CONTINGENCIES

From time to time, the Fund is involved in routine litigation incidental to the Fund's business. Management believes that adequate provisions have been made where required and the ultimate resolution with respect to any claim will not have a material adverse effect on the financial position or results of operations of the Fund.

17. ECONOMIC DEPENDENCE

The Fund's largest client for the year ended December 31, 2006 accounted for approximately 12% (period ended December 2005 – 14%) of revenue and its top 10 clients, in the aggregate, accounted for approximately 34% of revenue for the year ended December 31, 2006 (period ended December 2005 – 37%). As clients may terminate engagements on minimal notice, there can be no assurance that the Fund will be able to retain its relationships with its largest clients. Moreover, there can be no assurance that such clients will continue to use the services of the Fund in the future. Any negative change involving any of the Fund's largest clients, including but not limited to a client's financial condition or desire to continue using the Fund's services, could result in a significant reduction in business, which could have a material adverse effect on the Fund's business, results of operations and financial condition and the ability of the Fund to make distributions on the Units.

18. SEGMENTED INFORMATION

The Fund's operations consist of one reporting segment, which provides employee pension and benefits consulting and outsourcing services. Geographic data are as follows:

	Year ended December 31, 2006	Period ended December 31, 2005 (note 2(a))
Revenue		
Canada	**$ 125,156**	$ 27,959
United States	**6,931**	2,112

Assets held in Canada and the United States mainly consist of cash, accounts receivable, prepaid expenses, income tax recoverable, capital assets, intangibles and goodwill, and liabilities include accounts payable, accrued compensation, income tax payable, Unitholder distributions, long-term debt and non-controlling interest. The book values are as follows:

	2006	2005
Assets		
Canada	**$ 298,497**	$ 301,756
United States	**2,049**	1,962
Liabilities		
Canada	**$ 105,861**	$ 101,401
United States	**286**	325

GENERAL INFORMATION

Executive Committee

William Morneau
President & Chief Executive Officer

Pierre Chamberland
Chief Operating Officer

Brian Chan
Executive Vice President &
Chief Information Officer

David Haber
Executive Vice President,
Western Canada

Randal Phillips
Executive Vice President,
Administrative Solutions

Julien Ponce
Executive Vice President, Quebec

Nancy Reid
Chief Financial Officer

Fred Vettese
Executive Vice President & Chief Actuary

Other Officer

Lynn Korbak
General Counsel

Audit Committee

Robert Chisholm (Chair)
David Day
Alan Torrie

Compensation, Nomination and Corporate Governance Committee

Robert Chisholm
David Day
Alan Torrie (Chair)

Lead Trustee

David Day

Head Office

895 Don Mills Road
Suite 700
One Morneau Sobeco Centre
Toronto, Ontario
M3C 1W3
Phone: 416-445-2700
Facsimile: 416-445-4688
E-mail: info@morneausobeco.com
Web site: www.morneausobeco.com

Annual Meeting

Tuesday, May 15, 2007
4:00 p.m.
The Toronto Board of Trade
1 First Canadian Place
(Adelaide Street Entrance)
East Dining Room, 4th Floor
Toronto, Ontario
M5X 1C1

Transfer Agent

CIBC Mellon Trust Company
320 Bay Street
Toronto, Ontario
M5H 4A6

Exchange and Symbol

Toronto Stock Exchange (TSX): MSI.UN

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MORNEAU SOBECO

Morneau Sobeco Income Fund