



Morneau Sobeco Income Fund

2006 First Quarter Results

MORNEAU
SOBECO

May 10, 2006

To Our Unitholders

Morneau Sobeco Income Fund (the “Fund”) is pleased to present its financial results for the period ended March 31, 2006. These results reflect the solid performance of the Fund’s operating business in the quarter.

This is the Fund’s third reporting period since our initial public offering (“IPO”), which closed on September 30, 2005. In order to provide investors with a more meaningful assessment of the Fund’s performance, and for comparison purposes, our 2005 figures include the results for the Fund’s predecessor company, W.F. Morneau Services Inc.

Revenue for the three months ended March 31, 2006 increased by \$1.7 million, or 5.7%, to \$32.1 million compared to \$30.4 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 client increasing revenue by \$1.2 million.

The board and management are very pleased with our results in the first quarter. They reflect our recurring assignments with clients, as well as work on several new consulting assignments and outsourcing implementation projects which were awarded to us at the end of 2005.

Earnings before interest, taxes, depreciation and amortization, adjusted for compensation changes related to the firm’s new public status and for tax credits (Adjusted EBITDA) increased \$0.6 million, or 8.7%, to \$7.2 million for the three months ended March 31, 2006 compared to \$6.6 million for the same period in 2005. The increase in EBITDA is due to increased revenue of \$1.7 million partially offset by increased operating costs of \$0.9 million, in line with management’s expectations. Adjusted EBITDA margins continued to increase, reaching 22.5% in the 2006 period, compared with 21.8% in the corresponding period last year.

Total Distributable Cash increased by \$0.3 million, or 5.4%, to \$6.6 million for the three months ended March 31, 2006 relative to \$6.3 million for the same period in 2005. This

increase is primarily due to increased Adjusted EBITDA of \$0.6 million as discussed earlier and lower taxes of \$0.1 million, partially offset by higher interest of \$0.4 million. The first quarter of 2006 saw solid performance with a Distributable Cash Payout Ratio of 86% (with the Payout Ratio being Declared Distributions divided by Distributable Cash).

After the quarter, the Fund announced that one of our subsidiaries had signed an agreement to acquire all of the issued and outstanding shares of Heath Benefits Consulting Inc. This proposed transaction is expected to close on May 31, 2006. According to the terms of the agreement, the purchase price will be based on revenue from the Heath business going forward. Morneau Sobeco expects the purchase price to be approximately \$15.5 million, to be satisfied through the assumption of the current Heath debt of about \$4.7 million, and the issuance of units of Morneau Sobeco Income Fund or securities exchangeable for such units.

The transaction will be accretive to Morneau Sobeco Income Fund Unitholders. We believe that this acquisition is strategically important for Morneau Sobeco and is an excellent fit for the firm. The proposed transaction provides a platform to enable us to grow in Western Canada. Once it is consolidated with Heath, the new Morneau Sobeco Vancouver office will be the third largest in the organization, after Montréal and Toronto.

Our year-to-date results are in line with management's expectations and we anticipate continued solid results into 2006.

On behalf of the Board of Trustees and management team at Morneau Sobeco, I thank you for your continued support.



WILLIAM MORNEAU
President & Chief Executive Officer

HIGHLIGHTS

POSITIVE START TO THE NEW YEAR

REVENUE INCREASED BY 5.7% OVER 2005

MARGINS CONTINUING TO IMPROVE

FIRST SELECTED ACQUISITION TO BE
ACCRETIVE TO DISTRIBUTABLE CASH

MORNEAU SOBECO INCOME FUND

CONSOLIDATED BALANCE SHEET

As at March 31, 2006

(unaudited)

(In thousands of dollars)

	March 31, 2006	December 31, 2005
Assets		
Current assets:		
Cash	\$ —	\$ 4,348
Accounts receivable	25,812	22,562
Unbilled fees	3,681	4,482
Income taxes recoverable	519	659
Prepaid expenses and other	1,748	1,807
	<u>31,760</u>	<u>33,858</u>
Future income taxes (note 10)	632	600
Capital assets (note 3)	10,933	11,291
Intangible assets (note 4)	127,917	131,458
Goodwill	<u>126,511</u>	<u>126,511</u>
	<u>\$297,753</u>	<u>\$303,718</u>
Liabilities and Unitholders' Equity		
Current liabilities:		
Bank Indebtedness	\$ 719	\$ —
Accounts payable and accrued liabilities	3,843	4,179
Accrued compensation and related benefits	2,393	5,764
Unitholder distributions payable (including non-controlling)	<u>2,452</u>	<u>2,461</u>
	9,407	12,404
Insurance premium liabilities:		
Payable to insurance companies	5,826	5,413
Less related cash and investments held	<u>(5,826)</u>	<u>(5,413)</u>
	—	—
Long-term debt (note 5)	35,000	35,000
Non-controlling Interest (note 7)	53,729	54,322
Unitholders' Equity:		
Fund Units (note 6)	204,476	204,476
Deficit	<u>(4,859)</u>	<u>(2,484)</u>
	<u>199,617</u>	<u>201,992</u>
	<u>\$297,753</u>	<u>\$303,718</u>
Commitments (note 12)		
Contingencies (note 13)		



Robert Chisholm
Trustee,
Audit Committee Chair



William Morneau Jr.
Trustee,
President and CEO

See accompanying notes to consolidated financial statements.

MORNEAU SOBECO INCOME FUND

CONSOLIDATED STATEMENT OF
INCOME AND DEFICIT

For the quarter ended March 31, 2006
(unaudited)

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

	March 31, <u>2006</u>
Revenue	
Fees	\$ 29,296
Commissions	2,761
Other	<u>121</u>
	32,178
Expenses	
Salaries and benefits	18,898
Other operating	6,052
Amortization of capital assets (note 3)	498
Amortization of intangible assets (note 4)	3,542
Interest	<u>461</u>
	29,451
Income before income taxes	2,727
Income taxes (recovery) (note 10)	
Current	61
Future	<u>(32)</u>
	<u>29</u>
Income before non-controlling interest	2,698
Non-controlling interest	<u>(540)</u>
Net income	2,158
Deficit, beginning of period	(2,484)
Distributions declared (note 8)	<u>(4,533)</u>
Deficit, end of period	<u>\$ (4,859)</u>
Net income per Unit – (basic and diluted)	<u><u>\$0.09821</u></u>

See accompanying notes to consolidated financial statements.

MORNEAU SOBECO INCOME FUND

CONSOLIDATED STATEMENT OF CASH FLOWS

For the quarter ended March 31, 2006

(unaudited)

(In thousands of dollars)

	March 31, 2006
Cash provided by (used in):	
Operating activities	
Net income	\$ 2,158
Items not involving cash:	
Amortization	4,040
Non-controlling interest of Class B LP Units . .	540
Future income taxes	(32)
	<u>6,706</u>
Change in non-cash operating working capital:	
Accounts receivable	(3,250)
Income taxes recoverable	140
Unbilled fees	801
Prepaid expenses and other	58
Accrued compensation and related benefits	(3,371)
Accounts payable and accrued liabilities	(336)
	<u>748</u>
Financing activities	
Distributions paid	(5,675)
Investing activities	
Purchase of capital assets	(140)
Net increase/(decrease) in cash	(5,067)
Cash, beginning of period	<u>4,348</u>
Cash indebtedness, end of period	<u>\$ (719)</u>
Supplemental disclosures:	
Interest paid	\$ 455
Income taxes paid	\$ 42
Income tax refund	\$ (2)

See accompanying notes to consolidated financial statements.

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

(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 ten dollars.

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. 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.

The Fund is a leading 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 and employee compensation and benefit programs.

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:

	<u>% Ownership</u>
Morneau Sobeco Limited Partnership ("MSLP")	80%
Morneau Sobeco Group Limited Partnership ("MS Group LP")	80%
Morneau Sobeco, Ltd. ("MSUS")	80%
Morneau Sobeco Corporation ("MS Corp")	80%
Morneau Sobeco Trust ("Trust")	100%
Morneau Sobeco GP Inc. ("MS GP")	100%

As the Fund was established on August 22, 2005 and had no revenue or expenses until September 30, 2005 when the Fund

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

acquired W.F. Morneau Services Inc., the Consolidated Statement of Income and Deficit and Consolidated Statement of Cash Flows do not reflect any comparable results for 2005.

(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 as an adjustment of interest expenses on the related debt instrument. The related amount payable to, or receivable from, swap counterparties is included as an adjustment to accrued interest.

(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.

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

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.

(f) Capital assets

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

<u>Asset</u>	<u>Basis</u>	<u>Rate</u>
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 consisting principally of customer relationships, proprietary software and customer contracts have been recognized on acquisition, 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 twenty, five and three years respectively.

Goodwill is not amortized and is subject to an 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

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

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 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) 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 9 employees, 3 retirees and 55 deferred vested members as at March 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.

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

(k) Income taxes

The Fund uses the asset and liability method of accounting for income taxes. 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.

3. CAPITAL ASSETS

The Fund's capital assets are comprised of:

	Cost	Accumulated Amortization March 31, 2006	Net Book Value March 31, 2006	Net Book Value December 31, 2005
Computer equipment	\$ 1,553	\$(200)	\$ 1,353	\$ 1,385
Furniture and equipment . .	2,756	(252)	2,504	2,573
Leasehold improvements . .	7,605	(529)	7,076	7,333
	<u>\$11,914</u>	<u>\$(981)</u>	<u>\$10,933</u>	<u>\$11,291</u>

Amortization during the quarter ended March 31, 2006 was \$498.

4. INTANGIBLE ASSETS

The Fund's intangible assets are comprised of:

	Cost	Accumulated Amortization March 31, 2006	Net Book Value March 31, 2006	Net Book Value December 31, 2005
Customer relationships . . .	\$ 90,000	\$(2,250)	\$ 87,750	\$ 88,875
Customer contracts	5,000	(833)	4,167	4,583
Proprietary software	40,000	(4,000)	36,000	38,000
	<u>\$135,000</u>	<u>\$(7,083)</u>	<u>\$127,917</u>	<u>\$131,458</u>

Amortization during the quarter ended March 31, 2006 was \$3,542.

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

5. BANK INDEBTEDNESS AND LONG-TERM DEBT

At March 31, 2006, the Fund has 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 has entered into interest rate swap agreements in order to fix the interest rate at 4.4% for the duration of the loan. The fair value of the interest rate swap at March 31, 2006 is \$730.

The Fund also has available a secured operating line of credit for \$15,000 with \$719 drawn at March 31, 2006. The line of credit bears interest at the bankers' acceptance rate plus 1% and the undrawn portion incurs a stand-by fee of 0.20%. The bank indebtedness and term loan are secured by a general assignment of the assets of the Fund.

6. FUND UNITS

The Fund is authorized to issue an unlimited number of Units. The Fund is also authorized to issue 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. The following voting units were issued and outstanding:

	<u>March 31, 2006</u>		<u>December 31, 2005</u>	
	Units		Units	
	<u>Issued</u>	<u>Amount</u>	<u>Issued</u>	<u>Amount</u>
Units	21,977,212	\$204,476	21,977,212	\$204,476
Special Voting Units	5,494,303	—	5,494,303	—
	<u>27,471,515</u>	<u>\$204,476</u>	<u>27,471,515</u>	<u>\$204,476</u>

7. NON-CONTROLLING INTEREST

The former shareholders of Morneau Sobeco retained 5,494,303 Class B LP Units of MS Group LP after over-allotment. The LP Units are fully exchangeable for equal Units in the Fund, subject to certain restrictions and provide the former shareholders of Morneau Sobeco with a non-controlling interest of 20% in the Fund. Some of the

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

Class B LP Units are subordinated in their rights to receive distributions.

	<u>March 31, 2006</u>		<u>December 31, 2005</u>	
	<u>Units Issued</u>	<u>Amount</u>	<u>Units Issued</u>	<u>Amount</u>
Subordinated Class B				
LP Units	4,095,060	\$40,951	4,095,060	\$40,951
Non-subordinated				
Class B LP Units . . .	<u>1,399,243</u>	<u>13,992</u>	<u>1,399,243</u>	<u>13,992</u>
	5,494,303	54,943	5,494,303	54,943
Net deficit from prior period		<u>(621)</u>		<u>—</u>
Balance, beginning of period		54,322		54,943
Share of net income for the quarter/period . .		540		525
Distributions for the quarter/period (note 8)		<u>(1,133)</u>		<u>(1,146)</u>
Balance, end of quarter/period		<u>\$53,729</u>		<u>\$54,322</u>

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

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

12 month period. "EBITDA" is defined as earnings before interest, income taxes, depreciation and amortization.

8. DISTRIBUTIONS TO UNITHOLDERS

The Board of Trustees determines the amount of distributions. Distributions announced during the quarter ended March 31, 2006 were as follows:

Trust Units			
<u>Unitholder record date</u>	<u>Total</u>	<u>Per Unit</u>	<u>Paid or payable</u>
January 31, 2006	\$1,511	\$0.06875	February 15, 2006
February 28, 2006	1,511	0.06875	March 15, 2006
March 31, 2006	<u>1,511</u>	<u>0.06875</u>	April 17, 2006
	<u>\$4,533</u>	<u>\$0.20625</u>	

Class B LP Units			
<u>Unitholder record date</u>	<u>Total</u>	<u>Per Unit</u>	<u>Paid or payable</u>
<i>Non-subordinated</i>			
January 31, 2006	\$ 96	\$0.06875	February 15, 2006
February 28, 2006	96	0.06875	March 15, 2006
March 31, 2006	<u>96</u>	<u>0.06875</u>	April 17, 2006
	<u>288</u>		
<i>Subordinated</i>			
March 31, 2006	<u>845</u>	<u>0.20625</u>	April 17, 2006
	<u>\$1,133</u>	<u>\$0.20625</u>	

9. 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.

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

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:

<u>Percentage by which Distributable Cash per Unit Exceeds Base Threshold⁽¹⁾</u>	<u>Maximum Proportion of Excess Distributable Cash Available for LTIP Payments</u>
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%

Note:

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

The base distribution threshold will be subject to review by the Committee at least annually.

The Committee decided that the initial LTIP awards will be determined following the completion of the first complete fiscal year to December 31, 2006. At that time, the Committee will consider performance for the past fifteen months in order to determine an allocation for the LTIP.

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

10. 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.

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:

	March 31, <u>2006</u>	December 31, <u>2005</u>
Income taxes at statutory rates:		
Federal	22.12%	22.12%
Provincial	<u>11.84%</u>	<u>11.98%</u>
	<u>33.96%</u>	<u>34.10%</u>
Income tax provision applied to earnings before income taxes:		
Combined basic federal and provincial income taxes at statutory rates applied to earnings from continuing operations	\$ 794	\$ 955
Earnings taxed in the hands of the unitholders	(1,623)	(1,774)
Non-deductible expenses	27	38
Non-deductible intangibles	1,041	1,045
Financing cost deductible for tax purposes	(248)	(252)
Effect of higher tax rates in non-Canadian jurisdictions	3	26
Non-capital loss carried forward	—	(79)
Other	<u>35</u>	<u>60</u>
	<u>\$ 29</u>	<u>\$ 19</u>

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

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 taxes are as follows:

	March 31, <u>2006</u>	December 31, <u>2005</u>
Future income tax assets:		
Excess of tax bases of capital assets and intangibles over their carrying values	\$632	\$589
Non-capital losses	<u>—</u>	<u>11</u>
Net future income tax asset	<u>\$632</u>	<u>\$600</u>

11. 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.

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

Information about the pension plan's defined benefit option is as follows:

	March 31, 2006	December 31, 2005
Fair value of plan assets	\$2,344	\$2,954
Accrued benefit obligation	3,000	3,896
Funded status – deficit	<u>\$ (656)</u>	<u>\$ (942)</u>
Accrued benefit obligation:		
Balance, beginning of period	\$3,896	\$3,897
Current service cost	23	18
Interest cost	42	47
Benefits paid	(845)	(7)
Actuarial (losses)/gains	<u>(116)</u>	<u>151</u>
Balance, end of period	<u>\$3,000</u>	<u>\$3,896</u>
Plan assets:		
Fair value, beginning of period	\$2,954	\$2,854
Actual return on plan assets	80	65
Employer contributions	155	42
Benefits paid	<u>(845)</u>	<u>(7)</u>
Fair value, end of period	<u>\$2,344</u>	<u>\$2,954</u>
Reconciliation of accrued benefit obligation to accrued benefit asset, end of period:		
Plan assets at fair value	\$2,344	\$2,954
Accrued benefit obligation	<u>3,000</u>	<u>3,896</u>
Funding status – plan deficit	(656)	(942)
Unamortized net actuarial loss	258	410
Unamortized transitional obligation	<u>516</u>	<u>539</u>
Accrued benefit asset:	<u>\$ 118</u>	<u>\$ 7</u>
End of period allocation of fair value of plan assets (%)		
Pooled balanced fund (60% equities, 40% bonds)	90%	90%
Pooled bond fund	<u>10%</u>	<u>10%</u>
	<u>100%</u>	<u>100%</u>

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

	March 31, <u>2006</u>	December 31, <u>2005</u>
Pension plan cost		
Current service cost	\$ 23	\$ 18
Interest cost on accrued benefit obligation	42	47
Return on plan assets	(80)	(65)
Actuarial (losses)/gains during the period on accrued benefit obligation	<u>(116)</u>	<u>151</u>
	(131)	151
Other adjustments to allocate cost to period in which service is rendered, specifically indicating:		
Difference between actual and expected return on plan assets . . .	35	19
Amortization of actuarial gains/(losses)	117	(151)
Transitional amounts	<u>23</u>	<u>22</u>
Net pension plan expense	<u>\$ 44</u>	<u>\$ 41</u>

Other information about the Fund's defined benefit option is as follows:

Employer contributions	\$ 155	\$ 42
Benefits paid	845	7

The net expense for the Fund's defined benefit option for the period ended March 31, 2006 is \$44 and for the defined contribution option is \$389.

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.

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

Weighted average assumptions:

	March 31, 2006	December 31, 2005
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 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%

12. COMMITMENTS

The Fund has lease commitments for office premises and equipment with options for renewal. 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 or period ending December 31:

	March 31, 2006	December 31, 2005
2006	\$ 3,351	\$ 4,445
2007	4,173	4,057
2008	3,967	3,824
2009	3,469	3,328
2010	2,944	2,796
Thereafter	<u>5,852</u>	<u>5,754</u>
Total	<u>\$23,756</u>	<u>\$24,204</u>

13. 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

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

material adverse effect on the financial position or results of operations of the Fund.

14. ECONOMIC DEPENDENCE

The Fund's largest client accounts for approximately 11% of the Fund's revenue and its top 10 clients, in aggregate, account for approximately 34% of revenue. 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.

15. 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:

	<u>Canada</u>	<u>United States</u>
Revenue	<u>\$30,605</u>	<u>\$1,573</u>

Assets held in the United States consist of cash, accounts receivable, prepaids, computer equipment, furniture and office equipment and liabilities includes miscellaneous payables, accrued compensations, and income tax payable, had a book value as follows:

	<u>March 31, 2006</u>	<u>December 31, 2005</u>
Assets	\$ 1,836	\$1,962
Liabilities	\$ 190	\$ 325

MORNEAU SOBECO INCOME FUND

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the quarter ended March 31, 2006

(unaudited)

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

16. SUBSEQUENT EVENT

On April 24, 2006, The Fund's signed an agreement to acquire all of the issued and outstanding shares of Heath Benefits Consulting Inc. ("Heath"), a Vancouver-based benefits consulting firm with 93 employees across Canada. The transaction is expected to close on May 31, 2006, and is subject to the fulfilment of a number of conditions, including the completion of final due diligence by Morneau Sobeco, completion of definitive documentation and approval of the Toronto Stock Exchange and other regulatory authorities.

The purchase price will be based on revenue from the Heath business going forward. Morneau Sobeco expects the purchase price to be approximately \$15.5 million. The purchase price is expected to be satisfied through the assumption of the current Heath debt of about \$4.7 million, and the issuance of units of Morneau Sobeco Income Fund or securities exchangeable for such units. The purchase price will be paid in three installments, the first on closing and the second and third installments conditional upon the success in retaining and growing revenue from current Heath clients, as well as achieving targeted cost efficiencies.

MANAGEMENT'S DISCUSSION AND ANALYSIS

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") and accompanying consolidated financial statements of the Fund and notes thereto, cover the Fund for the first quarter ended March 31, 2006. Since the Fund formed on August 22, 2005, no comparative information is provided in the Fund's unaudited consolidated statement of income and deficit and unaudited consolidated statement of cash flows. In order to provide meaningful information to the user, the following MD&A includes financial data of WFMS, which carried on the Morneau Sobeco business prior to September 30, 2005. WFMS data was used to provide operating data for the quarter ended March 31, 2005 for comparison to quarter ended March 31, 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 that involve risks and uncertainties. Actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed under "Risk and Uncertainties". This discussion also makes reference to certain non-GAAP measures such as EBITDA, Adjusted EBITDA and Distributable Cash to assist investors in assessing the Fund's financial performance. (See footnotes to the "Results of Operations" chart and the section entitled "Non-GAAP financial measures: EBITDA, Adjusted EBITDA and Distributable Cash" for definitions.) 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

On September 30, 2005, the Fund completed an IPO of 19,979,284 trust units (“Units”) at a price of \$10.00 per Unit, for total net proceeds of \$184,496,842. The proceeds were used to indirectly acquire a 72.7% interest in Morneau Sobeco with the previous shareholders retaining the balance of the interest. 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. These proceeds were used to reduce the non-controlling interest in Morneau Sobeco to 20%. No additional Units have been issued since that date and thus, there remains a total of 21,977,212 Units issued and outstanding.

The previous owners of Morneau Sobeco own the non-controlling interest in Morneau Sobeco through a combination of 5,494,303 Class B Limited Partnership units (“Class B LP Units”) of MS Group LP and an equal number of special voting units of the Fund, which together are exchangeable into Units provided that the Fund achieves certain objectives.

To reduce Unitholder risk, approximately 75% 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.

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 benefit programs. We have approximately 950 professionals and support staff with offices in 11 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. For some benefit consulting assignments which involve insurance, 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 typically disclosed to the client and are based on a percentage of the premiums paid by the client to the insurance company. 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 consulting engagements are charged based on billable hours or a fee-for-service basis. In some cases, consulting engagements can also 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. 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 usually have three 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 first quarter of 2006 saw solid performance with revenue growth of 5.7%, an EBITDA margin of 22.5% and Distributable Cash Payout Ratio⁽¹⁾ of 86%.

We are continuing 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.

On April 24, 2006, we signed an agreement to purchase Heath Benefits Consulting Inc. This acquisition is strategically important for Morneau Sobeco. Combining our operations provides a platform to enable us to grow in Western Canada. Through this transaction, the new Morneau Sobeco Vancouver office will be the third largest in our organization, after Montréal and Toronto.

Note:

(1) Payout Ratio is defined as declared distributions divided by Distributable Cash (see definition on page 3).

ANALYSIS OF 2006 QUARTERLY OPERATING RESULTS

Results of Operations

Selected Unaudited Consolidated Financial Information

	Quarter ended March 31	
	<u>2006</u>	<u>2005</u>
	(In thousands of dollars)	
Revenue	\$ 32,178	\$30,440
Salaries and benefits expense	18,898	20,253
Other operating expense	6,052	5,105
Partnership distributions	—	5,119
Net income/(loss) before non-controlling interest for the period	2,698	(818)
Add (Deduct):		
Amortization	4,040	589
Taxes	29	155
Interest	461	37
EBITDA⁽¹⁾	7,228	(37)
Adjustments:		
Executive compensation and employee- shareholder and partner distributions adjustments ⁽²⁾	—	6,688
Adjusted EBITDA⁽³⁾	7,228	6,651
<i>Adjusted EBITDA Margin</i>	22.5%	21.8%
Deduct:		
Interest	\$ 461	\$ 37
Current Taxes	29	155
Capital expenditures ⁽⁴⁾	140	199
Total Distributable Cash⁽⁵⁾	\$ 6,598	\$ 6,260
Distributable Cash available to non- controlling interest	\$ 1,320	n/a
Distributable Cash available for Unitholders ..	\$ 5,278	n/a
Net income per Unit (basic and diluted)	\$0.09821	n/a
Distributable Cash per Unit (basic and diluted)	\$0.24016	n/a
Distributions declared per Unit (basic and diluted)	\$0.20625	n/a
Payout ratio	86%	n/a

Notes:

- (1) "EBITDA" is defined as earnings 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 Cash for the periods prior to

September 30, 2005 since these expenditures are considered non-recurring. The amounts shown for periods prior to September 30, 2005 reflect estimated capital expenditure requirements as a public company or \$600,000 per year.

- (5) "Distributable Cash" 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 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.

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

We believe that Adjusted EBITDA is a useful measure in evaluating the performance of the Fund as certain previous arrangements are non-recurring and will differ materially from ongoing arrangements as a public entity. We also believe that Distributable Cash is a useful supplemental measure of performance as it is generally used by Canadian open-ended business income funds as an indicator 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. 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 of 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.
- (ii) We have also adjusted EBITDA in comparable WFMS data to remove the impact of a tax credit in relation to

certain 'e-commerce' activities for which Morneau Sobeco is no longer eligible. This credit was historically recorded as a reduction to salaries and benefits expense.

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.

ANALYSIS OF 2006 FIRST QUARTER RESULTS

Revenue

Revenue for the three months ended March 31, 2006 increased by \$1.7 million, or 5.7%, to \$32.1 million compared to \$30.4 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 client increasing our revenue by \$1.2 million. This was partially offset by reduced outsourcing fees of \$1.1 million for one large client due to a special project being completed in 2005, a change in fee structure for another large outsourcing client resulting in a shift in the timing of fees of \$0.6 million, and a \$1.1 million reduction in outsourcing fees related to the termination of two contracts in the U.S. in 2005.

Salaries and Benefits

Salaries and benefits for the three months ended March 31, 2006 decreased by \$1.3 million, or 6.7%, to \$18.9 million compared to \$20.2 million for the same period in 2005. The decrease was attributable to the elimination of employee-shareholder distributions and reduced executive compensation of \$2.0 million partially offset by salary increases of \$0.7 million or 3.6%.

Other Operating Expenses

Other operating expenses for the three months ended March 31, 2006 increased by \$0.9 million, or 18.6%, to \$6.0 million compared to \$5.1 million for the same period in 2005. The increase is primarily attributable to increased technology spending of \$0.2 million, increased legal and public company costs of \$0.2 million, increased outsourcing audit fees of \$0.2 million, and increased travel costs of \$0.1 million.

Interest Expense

Interest expense for the three months ended March 31, 2006 increased by \$0.4 million to \$0.5 million as a result of the debt restructuring in connection with the change in ownership of the business on September 30, 2005 and the formation of the Fund. On September 30, 2005, the Fund entered into a new term credit facility of \$35 million. The operating line was also drawn to \$0.4 million for 3 days during the quarter. This compares to an average debt of \$4.0 million for the three months ended March 31, 2005.

Amortization

Amortization for the three months ended March 31, 2006 increased by \$3.4 million, or 586%, to \$4.0 million compared to \$0.6 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.

Partnership Distributions

Distributions from WFMS's limited partnership subsidiary for the three months ended March 31, 2006 was \$nil compared to \$5.1 million for the same period in 2005.

Income Tax Expense

Income tax expense for the three months ended March 31, 2006 decreased by \$125 thousand, to \$29 thousand compared to \$155 thousand for the same period in 2005. The changes in tax expense are primarily attributable to changes in partner and trust distributions.

Net Income Before Non-controlling Interest

As a result of the changes in revenue and expenses described above, net income for the three months ended March 31, 2006 increased by \$3.5 million to \$2.7 million compared to a loss of \$0.8 million for the same period in 2005.

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

Adjusted EBITDA

Adjusted EBITDA increased \$0.6 million, or 8.7%, to \$7.2 million for the three months ended March 31, 2006

compared to \$6.6 million for the same period in 2005. The increase is due to increased revenue of \$1.7 million partially offset by increased operating cost of \$0.9 million.

Total Distributable Cash

Total Distributable Cash increased by \$0.3 million, or 5.4% to \$6.6 million for the three months ended March 31, 2006 relative to \$6.3 million for the same period in 2005. This increase is primarily due to increased Adjusted EBITDA of \$0.6 million as discussed above and lower taxes of \$0.1 million, partially offset by higher interest of \$0.4 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

	Quarter Ended March 31	
	<u>2006</u>	<u>2005</u>
	(In thousands of dollars)	
Operating Activities	\$ 748	\$(4,943)
Less employee-shareholder distributions and one-time bonuses	<u>—</u>	<u>(5,979)</u>
Adjusted Operating Activities	<u>748</u>	<u>1,036</u>
Investing Activities	(140)	(199)
Financing Activities	(5,675)	5,119
Less partner distributions	<u>—</u>	<u>2,619</u>
Adjusted Financing Activities	<u>(5,675)</u>	<u>2,500</u>
(Decrease) increase in cash before employee- shareholder and partner distributions and one-time bonuses	(5,067)	3,337
Employee-shareholder and partner distributions and one-time bonuses ⁽¹⁾	<u>—</u>	<u>(3,360)</u>
(Decrease) increase in cash after employee- shareholder and partner distributions and one-time bonuses	<u><u>\$(5,067)</u></u>	<u><u>\$ (23)</u></u>

Note:

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

2006 First Quarter Results

Cash inflows from adjusted operating activities decreased by \$0.3 million, or 27.8%, to \$0.7 million for the three months ended March 31, 2006 from \$1.0 million for the same period in 2005. This decrease was primarily due to increased receivable and unbilled balances of \$3.1 million partially offset by improved profits of \$0.6 million, increased payables of \$1.5 million, and tax recoveries of \$0.6 million.

Cash outflows from investing activities remained flat for the three months ended March 31, 2006 from the same period in 2005. Cash outflows from adjusted financing activities increased by \$8.1 million for the three months ended March 31, 2006 due to distribution payments of \$5.7 million in the quarter and postponed payments to partners in 2005 for \$2.6 million.

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. Over the two-year period ended December 31, 2005, we undertook non-recurring capital expenditures relating to buildings, office furniture, facility improvements and information technology software totaling \$2.7 million. Going forward, we expect that the capital expenditures required to maintain our current platform will be approximately \$600,000 per year, principally related to information technology hardware and telecommunications equipment, which over the last three years have averaged less than \$450,000 per year. 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 nine years. We also have a term loan described under “Capital Resources”. Future expected payments are as follows:

Summary of Contractual Obligations

Selected Unaudited Consolidated Financial Information

	<u>Total</u>	<u>2006 to 2008</u>	<u>2009 to 2010</u>	<u>Beyond 2010</u>
	(In thousands of dollars)			
Term Loan	\$35,000	\$ —	\$35,000	\$ —
Operating Leases	<u>23,756</u>	<u>11,491</u>	<u>6,413</u>	<u>5,852</u>
Total	<u>\$58,756</u>	<u>\$11,491</u>	<u>\$41,413</u>	<u>\$5,852</u>

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

We have historically utilized cash from operations to finance working capital requirements and fund growth. As at March 31, 2006, the Fund’s working capital (current assets minus current liabilities) was approximately \$22.4 million. Liabilities consist mainly of accounts payable and accrued liabilities of \$3.8 million, accrued compensation and related benefits of \$2.4 million, and Unitholder distributions payable of \$2.5 million.

We have also maintained credit facilities to manage working capital requirements throughout the year. The Fund’s credit facilities include a 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. 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 stand-by fee of 0.2% on the undrawn portion.

As at March 31, 2006, the operating line was drawn and the Fund had bank indebtedness of \$0.7 million.

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

Capital Resources

Selected Unaudited Consolidated Financial Information

	As at March 31, 2006	As at December 31, 2005
	(In thousands of dollars)	
Cash	\$ —	\$ 4,348
Bank indebtedness	719	—
Long-term debt	35,000	35,000
Working capital	22,354	21,454
Unitholders' equity	199,617	201,992

SELECTED BALANCE SHEET DATA

The balance sheet is not comparable to periods prior to the IPO because, at that time, financing was restructured and long-term assets were revalued to market value. Total Assets at March 31, 2006 were \$297.8 million.

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 and 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:

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.

Amortization of Finite-life Intangible Assets

We have accounted for our acquisition of WFMS 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 twenty, five and three 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. Goodwill impairment is assessed based on a comparison of the fair value of the Fund and its net assets including goodwill. An impairment loss will be recognized if the carrying amount of the Fund's net assets exceeds its fair value.

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 claims 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. Prior to the legal restructuring of the Morneau Sobeco business in connection with the IPO, income taxes recoverable related to a tax credit for “e-commerce” activities which is no longer available.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

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

We have a 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 4-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%. There was \$0.7 million drawn on the line of credit at March 31, 2006.

The carrying value of the financial instruments approximates their fair values due to their short-term nature or, in the case of the term loan, due to the interest rate swap agreements in place.

We are not engaged in currency hedging activities and does 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\$0.6 million for the three months ended March 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 result 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.

Ability to Maintain Profitability and Manage Growth

There can be no assurance that we will be able to sustain profitability in future periods. Our future operating results will depend on a number of factors, including our ability to continue to execute our strategy successfully.

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

There can be no assurance that we will be able to manage our growth effectively, and any failure to do so could have a material adverse effect on our business, financial condition and results of operations and the ability of the Fund to make distributions on the Units.

Reliance on Information Systems and Technology

Information systems are an integral part of our business and the products and services offered to our clients. We rely on systems to maintain accurate records and to carry out required administrative functions in accordance with the terms of our contractual obligations to our clients. We rely on the Internet as a key mechanism for delivering our services to our clients and achieving efficiencies in our service model. Any disruptions in our systems, the failure of our systems to operate as expected or our ability to use the Internet effectively to deliver our services could, depending on the magnitude of the problem, result in a loss of current or future business and/or potential claims against the Fund, all of which could materially adversely affect our business, financial condition and results of operations and the ability of the Fund to make distributions on the Units.

Reputational Risk

We depend to a large extent on our relationships with our clients and our reputation for high-quality outsourcing and consulting services. As a result, if a client is not satisfied with our services or products, it may be more damaging to our business than to other businesses. Moreover, if we fail to meet our contractual obligations, we could be subject to legal liability or loss of client relationships.

Dependence on Key Clients

For the three months ended March 31, 2006, our largest client accounted for approximately 11% of revenue and our 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 we will be able to retain our relationships with our largest clients. Moreover, there can be no assurance that such clients will continue to use our services in the future. Any negative change involving any of our largest clients, including but not limited to a client's financial condition or desire to continue using our services, could result in a significant reduction in revenue, which could have a material adverse effect on our business, results of operations and financial condition and the ability of the Fund to make distributions on the Units.

Risk of Future Legal Proceedings

We 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 our business, including lawsuits based upon professional errors and omissions. The nature of our business involves assumptions and estimates concerning future events, the actual outcome of which we cannot know with certainty in advance. In addition, we could make computational, software programming or data management errors. Our exposure to liability on a particular project may be greater than the profit opportunity of the project. For example, possible claims may include, without limitation: (i) a client's assertion that actuarial assumptions used in a pension plan were unreasonable, leading to plan underfunding; (ii) a claim arising out of the use of inaccurate data, which could lead to an underestimation of plan liabilities; and (iii) a claim that employee benefits plan documents were misinterpreted or plan amendments were misstated in plan documents, leading to overpayments to beneficiaries. Defending lawsuits of this nature or arising out of any of the services that we provide could

require substantial amounts of management attention, which could divert their focus from operations and could materially adversely affect our financial condition. Any such claims may produce negative publicity that could hurt our reputation and business. A significant judgment against us or the imposition of a significant fine or penalty as a result of a finding that we failed to comply with laws or regulations could have a significant adverse impact on our business, financial condition and results of operations and the ability of the Fund to make distributions on the Units.

Reliance on Key Professionals

Our operations are dependent on the abilities, experience and efforts of our professionals, many of whom have significant reputations and contacts in the industry in which we operate. Our business depends, in part, on our professionals' ability to develop and maintain alliances with businesses such as brokerage firms, financial services companies, health care organizations, insurance companies, business process outsourcing organizations and other companies in order to develop, market and deliver our services. If our strategic alliances are discontinued, due to the loss of professional staff or otherwise, or if we have difficulty developing new alliances, profitability could be negatively impacted. Should any members of our professional staff be unable or unwilling to continue their relationship with us, our business, financial condition and operating results and the ability of the Fund to make distributions on the Units could be materially adversely impacted.

Competition

We operate in a highly competitive North American market in our service areas. As a result, we compete with many domestic and international firms. Some of our competitors have achieved substantially more market penetration in certain of the areas in which we compete. In addition, some of our competitors have substantially more financial resources and/or financial flexibility than us. These competitive forces could have a material adverse effect on our business, financial condition and results of operations and the ability of the Fund to make distributions on the Units by reducing our current market share in the area we serve.

Further details are provided in the "Risk Factors" section of the Annual Information Form available on the SEDAR Web site (www.sedar.com).

SUPPLEMENTAL SUMMARY OF
QUARTERLY RESULTS

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

**Operating Results, Distribution and
Condensed Balance Sheet**

Selected Unaudited Consolidated Financial Information

	Quarter ended March 31, 2006	Quarter ended December 31, 2005
	(In thousands of dollars)	
Revenue	\$ 32,178	\$ 30,071
Net Income	2,698	2,624
EBITDA	7,228	7,146
EBITDA Margin	22.5%	23.8%
Distributable cash	6,598	6,543
Distributions declared	5,666	5,729
Net income per Unit (basic and diluted)	\$0.09821	\$0.09553
Distributable Cash per Unit (basic and diluted)	\$0.24016	\$0.23817
Distributions declared per Unit (basic and diluted)	\$0.20625	\$0.20854
Payout ratio	86%	88%
Total Assets	\$297,753	\$303,718
Total Long-term debt	\$ 35,000	\$ 35,000

DISCLOSURE CONTROLS

As of March 31, 2006, an evaluation of the effectiveness of disclosure controls and procedures (as defined under *Multilateral Instrument 52-109*) was carried out by our management team under the supervision of the Chief Executive Officer and the Chief Financial Officer. Based on the evaluation, the Chief Executive Officer and the Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

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 May 10, 2006.



HUMAN RESOURCE CONSULTING AND
ADMINISTRATIVE SOLUTIONS

Morneau Sobeco is an industry leader in helping organizations deliver their human resource programs. For more than four decades, we have teamed up with North American companies to help them conceive and implement effective business solutions. The size and diversity of our client base gives our consultants a unique, forward-looking perspective on all compensation, retirement, and employee benefits issues.

INFO@MORNEAUSOBECO.COM

WWW.MORNEAUSOBECO.COM