Unaudited Condensed Consolidated Interim Financial Statements
(In thousands of Canadian dollars)

MORNEAU SHEPELL INC.

Three months ended March 31, 2020 and 2019
(Unaudited)

MORNEAU SHEPELL INC.

Unaudited Condensed Consolidated Interim Statements of Financial Position
(In thousands of Canadian dollars)
March 31, 2020, and December 31, 2019

	March 31, 2020	December 31, 2019
Assets		
Current assets:		
Cash	$ 160,774	$ 9,469
Trade and other receivables	128,760	112,484
Unbilled fees	92,623	104,993
Finance lease receivables	1,720	1,641
Prepaid expenses and other	20,229	16,334
Cash and investments held in trust	11,854	11,984
Deferred implementation costs	13,244	13,633
Interest rate and currency swaps (note 5)	9,295	95
Total current assets	438,499	270,633
Non-current assets:		
Deferred implementation costs	56,894	49,145
Finance lease receivables	3,179	3,375
Capital assets	119,740	116,288
Intangible assets	478,202	477,892
Goodwill	607,026	607,151
Investments in joint ventures	6,159	5,734
Total non-current assets	1,271,200	1,259,585
Total assets	$ 1,709,699	$ 1,530,218

MORNEAU SHEPELL INC.

Unaudited Condensed Consolidated Interim Statements of Financial Position
(In thousands of Canadian dollars)
March 31, 2020 and December 31, 2019

	March 31, 2020	December 31, 2019
Liabilities and Equity		
Current liabilities:		
Bank indebtedness	$ –	$ 5,818
Trade and other payables	112,344	101,365
Income taxes payable	7,397	3,927
Deferred revenue	16,799	12,487
Insurance premium liabilities	11,854	11,984
Interest rate and currency swaps (note 5)	2,836	4,683
Future consideration related to acquisitions	18,398	23,611
Dividends payable	4,434	4,325
Convertible debenture payable (note 6)	–	40,699
Lease liabilities	19,939	18,572
Total current liabilities	194,001	227,471
Non-current liabilities:		
Deferred revenue	28,442	25,409
Long-term debt (note 5)	586,244	470,456
Future consideration related to acquisitions	262	255
Interest rate and currency swaps (note 5)	5,256	1,920
Provisions	3,168	2,873
Deferred tax liability	107,463	102,891
Lease liabilities	77,119	80,555
Total non-current liabilities	807,954	684,359
Equity:		
Share capital	913,961	872,981
Contributed surplus	28,234	27,667
Equity component of convertible debentures	–	495
Accumulated other comprehensive income	23,482	796
Deficit	(257,933)	(283,551)
Total equity	707,744	618,388
Total liabilities and equity	$ 1,709,699	$ 1,530,218

Subsequent Event (note 5)

See accompanying notes to the unaudited condensed consolidated interim financial statements.

MORNEAU SHEPELL INC.

Unaudited Condensed Consolidated Interim Statements of Income and Comprehensive Income
(In thousands of Canadian dollars, except per share amounts)
For the three months ended March 31, 2020 and 2019

	Three months ended March 31, 2020	Three months ended March 31, 2019
Operating revenue (note 12)	$ 243,048	$ 204,695
Operating expenses:		
Salaries, benefits and contractors	164,325	132,766
Other operating expenses	37,417	30,919
Depreciation and amortization	26,239	21,920
Total operating expenses	227,981	185,605
Finance costs	7,436	6,962
Gain on business divestiture (note 4)	39,843	–
Share of income of joint ventures	10	277
Profit before income taxes	47,484	12,405
Income taxes:		
Current	5,359	4,576
Deferred	3,220	(830)
Total income taxes	8,579	3,746
Profit for the period	38,905	8,659
Other comprehensive income (loss):		
Items that may be reclassified subsequently to profit:		
Effective portion of change in interest rate cash flow hedges	(5,464)	(2,231)
Foreign currency translation differences for foreign operations	26,530	(6,582)
Income taxes on the above items	1,448	424
	22,514	(8,389)
Items that will not be reclassified to profit:		
Actuarial gain on post-employment benefit plans	234	22
Income taxes on the above item	(62)	(8)
	172	14
Other comprehensive income (loss), net of tax effect	22,686	(8,375)
Comprehensive income for the period	$ 61,591	$ 284
Earnings per share (note 8):		
Basic	$ 0.56	$ 0.13
Diluted	$ 0.56	$ 0.13

See accompanying notes to the unaudited condensed consolidated interim financial statements.

MORNEAU SHEPELL INC.

Unaudited Condensed Consolidated Interim Statements of Changes in Equity
(In thousands of Canadian dollars)
For the three months ended March 31, 2020 and 2019

2020	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive income	Equity component of convertible debentures	Total equity
Balance, January 1, 2020	$ 872,981	$ 27,667	$ (283,551)	$ 796	$ 495	$ 618,388
Long-term incentive plan – issuance	–	1,792	–	–	–	1,792
Long-term incentive plan – redemption, net of taxes	1,308	(1,225)	–	–	–	83
Shares issued upon conversion of Convertible Debentures (note 6)	39,672	–	–	–	(495)	39,177
Profit for the period	–	–	38,905	–	–	38,905
Dividends (note 7)	–	–	(13,287)	–	–	(13,287)
Other comprehensive income	–	–	–	22,686	–	22,686
Balance, March 31, 2020	$ 913,961	$ 28,234	$ (257,933)	$ 23,482	$ –	$ 707,744

2019	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive income (loss)	Equity component of convertible debentures	Total equity
Balance, December 31, 2018	$ 820,792	$ 27,141	$ (252,482)	$ 9,908	$ 1,045	$ 606,404
Adjustment on initial application of IFRS 16	–	–	417	–	–	417
Balance, January 1, 2019, restated	820,792	27,141	(252,065)	9,908	1,045	606,821
Long-term incentive plan- issuance	–	1,307	–	–	–	1,307
Long-term incentive plan – redemption	2,103	(2,103)	–	–	–	–
Profit for the period	–	–	8,659	–	–	8,659
Dividends (note 7)	–	–	(12,533)	–	–	(12,533)
Other comprehensive loss	–	–	–	(8,375)	–	(8,375)
Balance, March 31, 2019	$ 822,895	$ 26,345	$ (255,939)	$ 1,533	$ 1,045	$ 595,879

See accompanying notes to the unaudited condensed consolidated interim financial statements.

MORNEAU SHEPELL INC.

Unaudited Condensed Consolidated Interim Statements of Cash Flows
(In thousands of Canadian dollars)
For the three months ended March 31, 2020 and 2019

	Three months ended March 31, 2020	Three months ended March 31, 2019
Operating activities		
Profit for the period	$ 38,905	$ 8,659
Items not involving cash:		
Depreciation and amortization	26,239	21,920
Finance costs	7,436	6,962
Long-term incentive plan expense	1,792	1,307
Income taxes	8,579	3,746
Gain on business divestiture (note 4)	(39,843)	–
Other	468	(619)
	43,576	41,975
Change in non-cash operating working capital (note 10)	(5,172)	(3,962)
Cash generated from operating activities	38,404	38,013
Finance costs paid	(6,732)	(6,475)
Income taxes paid	(2,027)	(4,412)
Cash provided by operating activities	29,645	27,126
Financing activities:		
Change in revolving loan	102,412	172
Principal payment of lease liabilities	(3,875)	(3,540)
Redemption of convertible debentures (note 6)	(1,521)	–
Dividends paid	(13,179)	(12,521)
Cash provided by (used) in financing activities	83,837	(15,889)
Investing activities:		
Deferred and contingent acquisition payments	(7,851)	(495)
Business divestiture (note 4)	67,535	–
Principal payment received from finance leases	405	382
Additions to intangible assets	(7,672)	(6,597)
Additions to capital assets	(8,776)	(3,572)
Cash provided by (used) in investing activities	43,641	(10,282)
Increase in cash for the period	157,123	955
Cash (Bank indebtedness, net of cash), beginning of period	3,651	(9,141)
Cash (Bank indebtedness, net of cash), end of period (note 10)	$ 160,774	$ (8,186)

See accompanying notes to the unaudited condensed consolidated interim financial statements.

1. Organization and nature of the business:

Morneau Shepell Inc. was incorporated pursuant to the laws of the Province of Ontario on October 19, 2010 and is a continuation of Morneau Sobeco Income Fund, which was converted from an income trust structure into Morneau Shepell Inc., effective January 1, 2011.

Morneau Shepell Inc., its subsidiaries, and joint ventures (the "Company") provide an integrated approach to employee well-being through its cloud-based platform. The Company provides services in employee and family assistance, health and wellness, recognition, pension and benefits administration, retirement consulting, actuarial and investment services. The Company's principal and head office is located at One Morneau Shepell Centre, 895 Don Mills Road, Suite 700, Toronto, Ontario, M3C 1W3. The Company offers its services to organizations that are situated in Canada, in the United States and internationally.

References herein to the Company represent the financial position, results of operations, cash flows and disclosures of Morneau Shepell Inc. and its subsidiaries on a consolidated basis.

These unaudited condensed consolidated interim financial statements ("interim financial statements") were approved by the Company's Board of Directors on May 7, 2020.

2. Basis of preparation:

These interim financial statements for the three months ended March 31, 2020 and 2019 have been prepared in accordance with International Accounting Standards 34, Interim Financial Reporting, as issued by the International Accounting Standards Board ("IASB").

These interim financial statements do not include all the disclosures required by International Financial Reporting Standards ("IFRS") for annual consolidated financial statements and accordingly should be read in conjunction with the Company's audited consolidated financial statements for the year ended December 31, 2019 prepared in accordance with IFRS as issued by the IASB.

The uncertainties around the outbreak of the novel coronavirus ("COVID-19") pandemic required the use of judgments and estimates which resulted in no material impacts for the period ended March 31, 2020. The future impact of COVID-19 uncertainties could generate, in future reporting periods, a significant risk of material adjustment to the reported amounts of assets, liabilities, revenue and expenses in the consolidated financial statements. Examples of accounting estimates and judgments that may be impacted by the pandemic include: revenue recognition, impairment of goodwill and intangible assets, allowance for expected credit losses, corporate income taxes, provisions and contingent consideration related to acquisitions.

3. Significant accounting policies:

The accounting policies applied by the Company in these unaudited condensed consolidated interim financial statements are consistent with those applied by the Company in its consolidated financial statements as at and for the year ended December 31, 2019; except for the following new accounting policies:

(a) Definition of a business

In October 2018, the IASB issued amendments to the definition of a business in IFRS 3 – *Business Combinations*. The objective of the amendments is to assist entities in determining whether a transaction should be accounted for as a business combination or as an asset acquisition. The amendments apply prospectively to acquisitions that occur in annual periods beginning on or after January 1, 2020, with earlier application permitted. The adoption of the IFRS 3 amendments did not have a material impact on these unaudited condensed consolidated interim financial statements.

(b) Definition of material

In October 2018, the IASB issued amendments to IAS 1 – *Presentation of Financial Statements* and IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* to align the definition of "material" across the standards and to clarify certain aspects of the definition. The objective of this amendment is to improve disclosure effectiveness in the financial statements by improving the understanding of the existing requirements rather than to significantly impact an entity's materiality judgments. The amendments apply prospectively to annual periods beginning on or after January 1, 2020, with earlier application permitted. The adoption of the IAS 1 amendments did not have a material impact on these unaudited condensed consolidated interim financial statements.

(c) Conceptual framework for financial reporting

In March 2018, the IASB issued a comprehensive set of concepts for financial reporting: the revised Conceptual Framework for Financial Reporting ("Conceptual Framework"), which replaces its previous version. It assists companies in developing accounting policies when no IFRS standard applies to a particular transaction and it helps stakeholders more broadly to better understand the standards.

The revised Conceptual Framework's effective date is January 1, 2020, with earlier application permitted. The adoption of this revised Conceptual Framework did not have a material impact on these unaudited condensed consolidated interim financial statements.

(d) Interest rate benchmark reform

In September 2019, the IASB issued amendments to IFRS 9, IAS 39 and IFRS 7 – *Financial Instruments: Disclosures*. The objective of these amendments is to support the provision of useful financial information during the period of uncertainty arising from the phasing out of interest-rate benchmarks such as interbank offered rates. The amendments enable entities to use hedge accounting despite the uncertainties surrounding the use of interbank offered rates and require entities to provide additional information about their hedging relationships which are directly affected by these uncertainties.

(In thousands of Canadian dollars)

The amendments apply retrospectively to annual periods beginning on or after January 1, 2020, with earlier application permitted. The adoption of these amendments did not have a material impact on these unaudited condensed consolidated interim financial statements.

4. Business divestiture:

On March 1, 2020, the Company sold its benefits consulting business to HUB International Limited for a purchase price of $70,000 subject to working capital adjustments and holdback conditions being satisfied. $67,535 was received on closing, $1,275 to be received within 120 days after closing when working capital adjustments have been finalized, and the remaining $1,190 to be received over the following 24 months.

The benefits consulting business represented approximately 3% of the Company's consolidated revenue for the year ended December 31, 2019. The divested business was part of the Health & Productivity Solutions operating segment.

The assets and liabilities disposed of were comprised of the following:

Capital assets	$	114
Intangible assets		5,263
Goodwill		18,047
Net working capital		2,286
Total	$	25,710

Total selling costs (including reserves) for the divestiture were approximately $4,447. The pre-tax gain on business divestiture of $39,843 ($33,436 after tax) was recorded in the unaudited condensed consolidated interim statements of income and comprehensive income.

(In thousands of Canadian dollars)

5. Long-term debt:

The Company's long-term debt obligations can be broken down as follows:

	March 31, 2020	December 31, 2019
Revolving loans	$ 588,787	$ 473,200
Less: debt issuance costs, net of accumulated amortization	(2,543)	(2,744)
	$ 586,244	$ 470,456

As at March 31, 2020 the Company has a revolving facility of $600,000 (including a swing line of $14,000) under its existing Credit Facility Agreement (the "Credit Facility Agreement") which matures on July 27, 2023. The interest rates under the Credit Facility Agreement are floating, based on a margin over certain referenced rates of interest.

As at March 31, 2020, the Company had $301,500 borrowed in Canadian dollars (December 31, 2019 - $235,000), $287,287 (US$ 202,500) borrowed in US dollars (December 31, 2019 - $238,200, US$ 183,400), and had not utilized the swing line available (December 31, 2019 - $2,860 utilized). Borrowings under the Credit Facility Agreement bear interest at CDOR or Canadian Prime plus a specified margin for borrowings in Canadian dollars. Borrowings in US dollars under the Credit Facility Agreement bear interest at US Base Rate or LIBOR plus a specified margin.

As at March 31, 2020, the Company complied with all the required financial covenants.

On April 17, 2020 the Company entered into an amended and restated Credit Facility Agreement (the "Amended and Restated Credit Facility Agreement"). The key changes to the Amended and Restated Credit Facility Agreement include:

- The Company obtained an incremental $100,000 of committed capacity ("Incremental Facility") which matures 364 days from closing. The Incremental Facility bears interest at CDOR or Canadian Prime plus incremental specified margin for borrowings in Canadian dollars or at US Base Rate or LIBOR plus incremental specified margin for borrowings in US dollars.

- The debt to Adjusted EBITDA financial covenant will remain at 4:1 until maturity of the credit agreement.

(a) Interest rate swaps:

The Company uses interest rate swap agreements to hedge against the variable interest rate component on amounts borrowed under the Credit Facility Agreement. These swaps have been designated as cash flow hedges for hedge accounting treatment under IFRS 9 and they were considered effective as at March 31, 2020 and December 31 2019.

The company did not enter into any new interest rate swaps during the quarter. The fair value of the existing interest rate swaps at March 31, 2020 was a liability of $8,092 (December 31, 2019 net liability - $2,629).

(b) Cross currency interest rate swap:

The Company periodically enters into short term cross-currency interest rate swap agreements with one of the syndicated banks under the Credit Facility Agreement to help manage interest costs. Under this agreement, the Company would borrow in US$ and swap the amount for Canadian borrowings for approximately one month enabling the Company to reduce interest costs while protecting the Company from any foreign exchange exposure on settlement. As at March 31, 2020 the Company had US $130,500 of debt under this arrangement (December 31, 2019 – US $131,400). The fair value of the swap was an asset of $9,295 at March 31, 2020 (December 31, 2019 – liability of $3,879). The swap was settled on April 3, 2020 with no net foreign exchange gain or loss.

6. Convertible Debentures:

On January 9, 2020, the Company converted all of the remaining convertible debentures being $39,178, at the holders' request, into 1.6 million common shares of the Company at a conversion price of $25.10 per common share. The Company recorded $495 of the equity component of convertible debentures in share capital. The remaining $1,521 principal amount was redeemed for cash at a price of one thousand dollars per debenture, plus accrued and unpaid interest.

7. Dividends:

The monthly dividend rate, approved by the Board of Directors, was $0.065 for the three months ended March 31, 2020 (2019 - $0.065). Dividends declared for the three months ended March 31, 2020 were $13,287 (2019 - $12,533).

8. Earnings per share:

Basic earnings per share was calculated by dividing profit attributable to common shareholders by the sum of the weighted average number of common shares outstanding during the period, plus vested LTIP awards.

Diluted earnings per share was calculated using the basic calculation described above, and adjusting for the potentially dilutive effect of total number of additional common shares that would have been issued by the Company on unvested LTIP awards and the conversion of the convertible debentures.

The following details the earnings per share, basic and diluted, calculations for the three months ended March 31, 2020 and 2019:

(In thousands of Canadian dollars)

	Three months ended March 31, 2020	2019
Profit attributable to common shareholders (basic and diluted)	$ 38,905	$ 8,659
Weighted average number of common shares (in number of shares):		
Outstanding beginning of period	66,542,725	64,205,330
Issued on redemption of LTIP [1]	12,747	19,331
Issued on conversion of convertible debentures [1] (note 6)	1,410,924	–
Vested LTIP awards	1,614,266	1,637,373
Outstanding end of period – Basic	69,580,662	65,862,034
Dilutive effect of unvested LTIP awards	410,727	484,684
Diluted	69,991,389	66,346,718
Earnings per share:		
Basic	$ 0.56	$ 0.13
Diluted	$ 0.56	$ 0.13

[1] During the three months ended March 31, 2020, 105,387 shares (2019 – 205,052 shares) were issued on redemption of LTIP units and 1,560,874 shares (2019 – nil shares) were issued on upon conversion of convertible debentures.

9. Segmented information:

The Company provides health and productivity, administrative and retirement solutions to assist employers in managing the financial security, health and productivity of their employees. The Company has four operating segments, consistent with the Company's four lines of business, that have been aggregated under IFRS 8, to determine that the Company had only one reportable segment.

The Company operates primarily within two geographical areas: Canada and the United States. The following details the revenue and total assets by geographical area, reconciled to the Company's unaudited condensed consolidated interim financial statements:

	Three months ended March 31, 2020	2019
Revenue:		
Canada	$ 143,282	$ 148,405
United States	87,932	46,093
International	11,834	10,197
Consolidated Total	$ 243,048	$ 204,695

(In thousands of Canadian dollars)

	March 31, 2020	December 31, 2019
Total assets:		
Canada	$ 940,159	$ 857,455
United States	645,632	565,701
International	123,908	107,062
Consolidated Total	$ 1,709,699	$ 1,530,218

10. Supplementary cash flow information:

Change in non-cash operating working capital for the three months ended March 31, 2020 and 2019 was as follows:

	2020	2019
Trade and other receivables	$ (18,023)	$ 7,378
Unbilled fees, current and non-current	12,174	(1,557)
Prepaid expenses and other	(3,895)	(4,469)
Deferred implementation costs, current and non-current	(3,117)	(833)
Trade and other payables	1,981	(8,574)
Deferred revenue, current and non-current	5,708	4,093
	$ (5,172)	$ (3,962)

Cash (net of bank indebtedness) reconciliation as at March 31, 2020 and December 31, 2019 was as follows:

	March 31, 2020	December 31, 2019
Bank indebtedness	$ –	$ (5,818)
Cash	160,774	9,469
Cash (net of bank indebtedness)	$ 160,774	$ 3,651

(In thousands of Canadian dollars)

11. Financial instruments:

Financial instruments carried at fair value:

Fair value represents management's estimates at a given point in time. The fair value of the Company's financial assets and liabilities, with the exception of convertible debentures and long-term debt, approximate their carrying values due to their short-term nature.

The following table summarizes information regarding the carrying value, fair value and level used to determine the fair value measurement of the Company's financial assets and liabilities carried at fair value:

	Carrying Value and Fair Value		
	March 31, 2020	December 31, 2019	Level
Assets carried at fair value:			
Interest rate and currency swaps	$ 9,295	$ 95	2
	$ 9,295	$ 95	
Liabilities carried at fair value:			
Interest rate and currency swaps	$ 8,092	$ 6,603	2
Future consideration related to acquisitions (contingent portion)	16,678	14,912	3
	$ 24,770	$ 21,515	

During the three months ended March 31, 2020, there were no transfers between any levels.

The interest rate swaps are financial instruments designated as cash flow hedges. The cross currency swaps are financial instruments. The fair values of the interest rate swaps and currency swaps are based on valuations received from the derivative counterparties, which management evaluates for reasonability. The Company maximizes the use of observable inputs within the valuation model, and the valuation is classified as Level 2. Fair values reflect the credit risks of the instruments and include adjustments to take account of the credit risk of the Company and the derivative counterparties when appropriate.

The future consideration related to acquisitions is a financial instrument carried at fair value through profit or loss. Contingent consideration arose on the acquisitions of Pro-Santé, Longpré, Mercer and MorningStar as a result of a clause that entitles the seller to an additional amount that is contingent on future business results. The fair value is determined considering the estimated payment, discounted to present value (Level 3).

(In thousands of Canadian dollars)

Financial instruments carried at amortized cost:

Trade and other receivables, cash and investments held in trust, bank indebtedness, trade and other payables, insurance premium liabilities, and dividends payable are carried at amortized cost and approximate their fair value because of their short-term nature.

The long-term debt are financial instruments carried at amortized cost whose carrying values do not equal their fair market values. The long-term debt has a carrying value of $586,244 (December 31, 2019 - $470,456) and a fair value of $588,787 (December 31, 2019 - $473,200). The fair value is determined based on the cost of borrowing for a company with a similar risk profile (Level 2).

Credit Risk:

The Company's exposure to credit risk is limited to the carrying amount of cash, investments held in trust, unbilled fees (which are contract assets), and accounts receivable recognized at the reporting date.

12. Revenue:

The following shows the disaggregation of revenue by the Company’s lines of business:

	Three months ended March 31, 2020	2019
Well-Being Solutions	$ 90,333	$ 88,718
Administrative Solutions	98,048	60,968
Retirement Solutions	29,476	29,435
Health and Productivity Solutions	25,191	25,574
	$ 243,048	$ 204,695