MORNEAU SHEPELL MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2017

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MANAGEMENT'S DISCUSSION AND ANALYSIS

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

This Management's Discussion and Analysis ("MD&A") covers the year ended December 31, 2017 and should be read in conjunction with the consolidated financial statements of Morneau Shepell and notes thereto for the years ended December 31, 2017 and 2016. Unless otherwise noted, all financial information presented has been rounded to the nearest thousand.

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

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

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

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

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

OUTSTANDING SHARE DATA

The Company is authorized to issue an unlimited number of common shares and 10 million preferred shares. Each common share entitles the holder to one vote at all meetings of shareholders and represents an interest in dividends declared by the Company and an undivided interest in the net assets of the Company. As at March 7, 2018, Morneau Shepell had 53,853,225 common shares, nil preferred shares and $86.0 million aggregate principal amount of 4.75% convertible debentures outstanding. In the event all of the outstanding 4.75% convertible debentures are converted into common shares of the Company by the holders prior to their maturity date, the total number of common shares issuable will be approximately 3,400,000. The number of long-term incentive plan ("LTIP") units, including those that remain unvested, that are outstanding and may be converted to common shares is approximately 2,600,000.

BUSINESS OVERVIEW

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

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

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

Our Administrative Solutions practice is characterized by fixed contracts, which typically have three-year to five-year terms. Most Administrative Solutions 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 contract are usually paid on a fee-for-service basis. A small number of contracts contain a large up front customization and implementation fee, with lower ongoing maintenance fees.

In the billing for Employee Support Solutions ("ESS") services, a portion of the ESS client agreements require payment of a minimum retainer and incremental usage-based fees. The remainder of the ESS agreements are billed based on actual usage or fixed fees.

Fees from Absence Management Solutions ("AMS") services, such as attendance support and disability management are generally based on negotiated fees or a formula tied to the nature of the service being provided. Fees for workers' compensation services are charged based on billable hours or on a fee-for-service basis.

Most ESS and AMS agreements may be terminated by the client upon 30 to 60 days' notice to us. It is typical, however, for these agreements to continue for multiple years and many automatically renew on an annual basis.

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

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

2017 SUMMARY AND OUTLOOK

(In thousands of dollars)	**Three months ended December 31, 2017**	**Three months ended December 31, 2016**	**Year ended December 31, 2017**	**Year ended December 31, 2016**
Revenue	$158,722	$149,089	$631,155	$592,057
Organic Revenue [1]	$155,106	$148,101	$618,722	$586,312
Adjusted EBITDA	$29,004	$26,714	$120,820	$112,261
Adjusted EBITDA margin	18.3%	17.9%	19.1%	19.0%
Normalized Free Cash Flow	$20,466	$19,690	$72,331	$70,902
Profit	$4,289	$5,660	$34,582	$26,000

Footnote:

(1) Organic Revenue is defined as revenue excluding acquisitions not in the comparative period and divestitures, and the U.S. Health Exchange outsourcing business which was terminated in the prior year, and is calculated as follows:

(In thousands of dollars)	**Three months ended December 31, 2017**	**Three months ended December 31, 2016**	**Year ended December 31, 2017**	**Year ended December 31, 2016**
Revenue	**$158,722**	**$149,089**	**$631,155**	**$592,057**
Acquisitions	$3,616	–	$12,433	–
U.S. Health Exchange	–	$988	–	$5,745
Organic Revenue	**$155,106**	**$148,101**	**$618,722**	**$586,312**

Fourth quarter:

We had a solid fourth quarter of 2017 and continued to deliver revenue and adjusted EBITDA growth versus the comparative quarter in 2016. Highlights of the fourth quarter include:

- Revenue growth of 6.5% versus the comparative period.

- An increase in Adjusted EBITDA of 8.6%, or $2.3 million, to $29.0 million versus the comparative period, with Adjusted EBITDA margin increasing to 18.3%.

- Profit for the fourth quarter of 2017 was $4.3 million compared to $5.7 million in the comparative period.

Highlights of 2017:

- Revenue grew by 6.6% versus last year from new business wins and continued growth with existing clients from all four lines of our business.

- Adjusted EBITDA increased by $8.6 million to $120.8 million, or 7.6% versus the prior year with Adjusted EBITDA Margin increasing to 19.1% from 19.0%.

- Profit for the year increased by $8.6 million to $34.6 million compared to $26.0 million in the prior year.

- On December 1, 2017, the Company acquired the Chestnut Global Partners Group of Companies ("Chestnut"), an international employee assistance program provider. Chestnut through Chestnut Global Partners, LLC, based in Bloomington, Illinois, has equity interests in joint ventures that have a presence internationally, including the United States, Brazil, China, Eastern Europe, India and Russia, which complements the Company's existing employee support solutions line of business and allows us to expand our presence globally.

- On October 31, 2017, the Company completed the acquisition of Groupe Pro-Santé Inc. ("Pro-Santé"), a health and wellness service provider based in Québec City. This acquisition complements the Company's existing employee support solutions line of business, and further solidifies our position as the leading employee and family assistance program provider in the Quebec region.

We are confident that our continued investment in our business, our established and prospective client base, and our financial flexibility will continue to yield positive results for the Company.

2017 OPERATING RESULTS SUMMARY

Results of Operations	**Three months ended December 31,**		**Year ended December 31,**	
Selected Consolidated Financial Information	**2017**	**2016**	**2017**	**2016**
(In thousands of dollars, except per share amounts)				
Revenue	$158,722	$149,089	$631,155	$592,057
Deduct:				
Salaries, benefits and contractor expenses	111,408	101,702	429,026	404,142
Other operating expenses	28,024	26,305	100,992	98,772
Finance costs	3,277	3,140	13,165	14,889
Depreciation and amortization	9,808	9,112	38,200	35,238
Write-down of deferred implementation costs	–	–	–	935
Income tax expenses	1,916	3,170	15,190	12,081
Profit	**4,289**	**5,660**	**34,582**	**26,000**
Add:				
Finance costs	3,277	3,140	13,165	14,889
Depreciation and amortization	9,808	9,112	38,200	35,238
Income tax expenses	1,916	3,170	15,190	12,081
EBITDA (1)	$19,290	$21,082	$101,137	$88,208
Adjustments:				
Sublease loss provision	1,225	1,800	1,225	2,200
Mercer Canada Outsourcing conversion costs	1,319	1,283	7,157	8,508
Retirement allowance	–	–	4,131	–
Reorganization and operational effectiveness initiatives	6,241	2,549	6,241	12,410
Lease exit costs	929	–	929	–
Write-down of deferred implementation costs	–	–	–	935
Adjusted EBITDA	**$29,004**	**$26,714**	**$120,820**	**$112,261**
EBITDA margin (2)	12.2%	14.1%	16.0%	14.9%
Adjusted EBITDA margin (2)	18.3%	17.9%	19.1%	19.0%
Cash provided by operating activities	$44,005	$27,947	$77,588	$67,039
Deduct: Capital expenditures (3)	(11,677)	(4,507)	(31,415)	(22,507)
Free Cash Flow (4)	**32,328**	**23,440**	**46,173**	**44,532**
Add (deduct):				
Changes in non-cash operating working capital	(20,495)	(7,467)	14,470	9,734
Current income taxes, net of income taxes paid	338	(115)	(4,549)	(3,990)
Adjustments to EBITDA (5)	8,295	3,832	16,237	20,626
Normalized Free Cash Flow (6)	**$20,466**	**$19,690**	**$72,331**	**$70,902**
Earnings per Share (basic and diluted)	$0.08	$0.10	$0.62	$0.49
EBITDA per share (basic)	$0.35	$0.38	$1.83	$1.67
Adjusted EBITDA per Share (basic)	$0.52	$0.49	$2.18	$2.13
Dividends declared	$10,457	$10,374	$41,779	$39,999
Twelve-month rolling Normalized Payout Ratio (7)	57.8%	56.4%	57.8%	56.4%
Twelve-month rolling Normalized Payout Ratio, including changes in adjusted non-cash operating working capital (8)	73.6%	66.4%	73.6%	66.4%

Footnotes:

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

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

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

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

(5) "Adjustments to EBITDA" do not include the non-cash component of the retirement allowance of $2,027 and lease exit costs of $194, and sublease loss provisions, and for the comparative year ended December 31, 2016, non-cash reorganization and operational effectiveness initiatives costs of $292 and the write-down of deferred implementation costs. These amounts have been excluded as they have already been added back in cash from operating activities before the change in non- cash operating working capital.

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

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

(8) "Twelve-month rolling Normalized Payout Ratio, including changes in adjusted non-cash operating working capital" is defined as dividends declared divided by the Twelve-month rolling Normalized Free Cash Flow, including changes in non-cash operating working capital adjusted for unusual fluctuations. For the twelve-month period ended December 31, 2017, non-cash operating working capital was adjusted by ($1,125), which represents the working capital impact of the retirement allowance. For the comparative twelve-month period ended December 31, 2016, the non-cash operating working capital was adjusted for by ($935), which represents the year over year change in non-cash operating working capital resulting from the write-down of deferred implementation costs for the U.S. Health Exchange business.

ANALYSIS OF FOURTH QUARTER 2017 OPERATING RESULTS

Revenue

Revenue for the three months ended December 31, 2017 increased by $9.6 million, or 6.5%, to $158.7 million compared to $149.1 million for the same period in 2016. Organic revenue grew by $7.0 million, or 4.7%, from the same period in 2016 due to new business wins and continued growth from existing clients in all four of our lines of business, with ESS contributing 2.2% and Administrative Solutions 1.0% of the organic revenue growth.

Salaries, Benefits and Contractor Expenses

Salaries, benefits and contractor expenses for the three months ended December 31, 2017 increased by $9.7 million, or 9.5%, to $111.4 million compared to $101.7 million for the same period in 2016. Excluding the net increase in compensation expense of $2.0 million resulting from acquisitions not in the comparative period net of the U.S. Health Exchange outsourcing service business, compensation expense increased by $7.7 million. The increase is mainly attributable to $4.0 million of general increases to support the Company's continued growth and higher reorganization and operational effectiveness initiative costs of $3.7 million versus the comparative period.

Other Operating Expenses

Other operating expenses for the three months ended December 31, 2017 increased by $1.7 million, or 6.5%, to $28.0 million compared to $26.3 million for the same period in 2016. Excluding the net decrease in other operating expenses of $0.1 million resulting from the U.S. Health Exchange outsourcing service business net of acquisitions not in the comparative period, other operating expenses grew by $1.8 million. The increase is due to lease exit costs of $0.9 million not in the comparative period and $1.5 million of general increases required to support the Company's continued growth, partially offset by a lower sublease loss provision of $0.6 million.

Finance Costs

Finance costs for the three months ended December 31, 2017 increased by $0.1 million, or 4.4%, to $3.3 million compared to $3.1 million for the same period in 2016, due to increased borrowings under the Company's credit facility agreement.

Depreciation and Amortization

Depreciation and amortization for the three months ended December 31, 2017 increased by $0.7 million, or 7.6%, to $9.8 million compared to $9.1 million for the same period in 2016. The increase is due to higher amortization of internally developed software of $0.2 million and higher depreciation on capital assets of $0.4 million.

Income Tax Expenses

Income tax expenses decreased by $1.3 million to $1.9 million compared to $3.2 million for the same period in 2016 due to lower profit from operations before tax.

Profit for the period

As a result of the changes noted above, the profit for the three months ended December 31, 2017 decreased by $1.4 million to $4.3 million compared to $5.7 million for the same period in 2016.

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

Adjusted EBITDA and EBITDA

Adjusted EBITDA increased by $2.3 million, or 8.6%, to $29.0 million compared to $26.7 million for the same period in 2016. The increase is primarily due to growth in revenue of $9.6 million, partially offset by an increase in salaries and other operating expenses of $7.3 million after EBITDA adjustments. These adjusted EBITDA items do not constitute a part of the Company's on-going operating expenses, and are described in the analysis of the year ended December 31, 2017 operating results section below.

EBITDA decreased by $1.8 million to $19.3 million compared to $21.1 million for the same period in 2016.

Free Cash Flow

Free Cash Flow for the three months ended December 31, 2017 increased by $8.9 million to $32.3 million compared to $23.4 million for the same period in 2016. The increase is primarily due to higher cash provided by operating activities of $16.1 million due to more favorable changes in non-cash operating working capital of $13.0 million, partially offset by higher capital expenditures of $7.2 million (see discussion of capital expenditures in Liquidity and Capital Resources section below).

Normalized Free Cash Flow

Normalized Free Cash Flow for the three months ended December 31, 2017 increased by $0.8 million to $20.5 million compared to $19.7 million for the same period in 2016. The increase is due to higher cash generated from operating activities before changes in non-cash operating working capital and EBITDA adjustments of $7.8 million, partially offset by higher capital expenditures of $7.2 million.

ANALYSIS OF YEAR ENDED DECEMBER 31, 2017 OPERATING RESULTS

Revenue

Revenue for the year ended December 31, 2017 increased by $39.1 million, or 6.6%, to $631.2 million compared to $ 592.1 million for 2016. Organic revenue grew by $32.4 million, or 5.5%, from the same period in 2016 due to new business wins and continued growth from existing clients in all four of our lines of business, with Administrative Solutions contributing 2.3% and ESS 1.6% of the organic revenue growth.

Salaries, Benefits and Contractor Expenses

Salaries, benefits and contractor expenses for the year ended December 31, 2017 increased by $24.9 million, or 6.2%, to $ 429.0 million compared to $404.1 million for the same period in 2016. Excluding the net increase in compensation expense of $4.9 million resulting from acquisitions not in the comparative period net of the U.S. Health Exchange outsourcing service business, compensation expense increased by $20.0 million. The increase is mainly attributable to general increases of $24.0 million to support the Company's continued growth and the retirement allowance for our former President and Chief Executive Officer of $4.1 million, partially offset by lower reorganization and operational effectiveness initiatives of $6.2 million, lower compensation costs for Mercer Canada Outsourcing conversion of $1.0 million, and the write-down of deferred implementation costs of $0.9 million in the comparative period.

Other Operating Expenses

Other operating expenses for the year ended December 31, 2017 increased by $2.2 million, or 2.2%, to $101.0 million compared to $98.8 million for the same period in 2016. Excluding the net decrease in other operating expenses of $0.6 million resulting from acquisitions not in the comparative period net of the U.S. Health Exchange outsourcing service business, other operating expenses grew by $2.8 million. The increase is due to lease exit costs of $0.9 million not in the comparative period and $2.9 million of general increases required to support the Company's continued growth, partially offset by a lower sublease loss provision of $1.0 million.

Finance Costs

Finance costs for the year ended December 31, 2017 decreased by $1.7 million, or (11.6%) to $13.2 million compared to $14.9 million for the same period in 2016. The decrease in finance costs is due to lower average borrowings during the year under the Company's credit facility agreement and lower non-cash accretion and amortization on the convertible debentures.

Depreciation and Amortization

Depreciation and amortization for the year ended December 31, 2017 increased by $3.0 million, or 8.4%, to $38.2 million compared to $35.2 million for the same period in 2016. The increase is due to higher amortization of internally developed software of $1.4 million and acquired customer relationships of $0.8 million, and higher depreciation of capital assets of $1.4 million, partially offset by lower amortization of purchased software of $0.6 million.

Income Tax Expenses

Income tax expenses for the year ended December 31, 2017 increased by $3.1 million, or 25.7%, to $15.2 million compared to $12.1 million for the same period in 2016 due to higher profit from operations before tax for the year.

Profit for the year

As a result of the changes noted above, the profit for the year ended December 31, 2017 was $34.6 million compared to $26.0 million for the same period in 2016.

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

Adjusted EBITDA and EBITDA

Adjusted EBITDA increased by $8.6 million, or 7.6%, to $120.8 million compared to $112.3 million for the same period in 2016. The increase is primarily due to growth in revenue of $39.1 million, partially offset by an increase in salaries and other operating expenses of $30.5 million after EBITDA adjustments. These adjusted EBITDA items do not constitute a part of the Company's on-going operating expenses. Below is a description of the year ended December 31, 2017 adjustments:

- Mercer Canada Outsourcing conversion costs represent systems and service improvements required to support the clients acquired in November, 2012. The process commenced immediately after the acquisition and as a result of the savings realized from the original conversion, we decided in 2016 to convert the remaining clients acquired which were not included in the original conversion. The Mercer Canada Outsourcing conversion is now complete.

- Retirement allowance costs represent retirement remuneration to the former President and Chief Executive Officer of the Company after his decision to retire after twelve years with the Company, including the past eight as President and CEO.

- Reorganization and operational effectiveness initiatives represents severance costs related to corporate reorganizations, the completion of the Mercer Canada Outsourcing conversion, and employee terminations to achieve post-acquisition planned synergies.

- The sublease loss provision arose as a result of our decision to sublet excess office space now available in one of our U.S. offices as a result of the completion of significant conversion and implementation projects.

- Lease exit costs represents costs for termination penalties paid and write-off of leasehold improvements, net of extinguishment of related liabilities for leasehold inducements and straight-line rent, for early vacating a floor in one of our Montreal offices that was no longer required.

EBITDA increased by $12.9 million to $101.1 million compared to $88.2 million for the same period in 2016.

Free Cash Flow

Free Cash Flow for the year ended December 31, 2017 increased by $1.6 million to $46.2 million compared to $44.5 million for the same period in 2016. The increase is primarily due to higher cash provided by operating activities of $10.5 million due to higher profit for the period, partially offset by lower capital expenditures of $8.9 million (see discussion of capital expenditures in Liquidity and Capital Resources section below).

Normalized Free Cash Flow

Normalized Free Cash Flow for the year ended December 31, 2017 increased by $1.4 million to $72.3 million compared to $70.9 million for the same period in 2016. The increase is due to higher cash generated from

operating activities before changes in non-cash operating working capital and EBITDA adjustments of $15.5 million, partially offset by higher current tax expense of $4.9 million and capital expenditures of $8.9 million.

LIQUIDITY AND CAPITAL RESOURCES

Cash Flows

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

Cash Flow Information

Selected Consolidated Financial Information:

(In thousands of dollars) *Cash provided by (used in):*	**Year ended December 31, 2017**	**Year ended December 31, 2016**
Operating activities	$ 77,588	$ 67,039
Financing activities	(28,716)	(38,554)
Investing activities	(51,232)	(33,441)
Decrease in cash	$ (2,360)	$ (4,956)

Cash provided by operating activities for the year ended December 31, 2017 increased by $10.5 million to $77.6 million compared to $67.0 million for the same period in 2016. The increase is due to higher cash generated from operating activities of $15.1 million due to higher profit for the year and items not involving cash, partially offset by higher income taxes paid of $4.3 million.

Cash used in financing activities for the year ended December 31, 2017 decreased by $9.8 million to $28.7 million compared to $38.6 million for the same period in 2016. This decrease was due to a net increase in borrowings under the credit facility (net of the proceeds received from the $86.0 convertible debentures issued in the comparative period which were used to pay down amounts borrowed under the credit facility and to fund the redemption of the previously issued convertible debentures that remained outstanding) of $8.7 million and the repayment of the $2.5 million promissory notes issued as partial consideration for the acquisition of Group AST (1993) Inc. in the comparative period, partially offset by higher dividends paid of $2.1 million.

Cash used in investing activities for the year ended December 31, 2017 increased by $17.8 million to $51.2 million compared to $33.4 million for the same period in 2016. The increase is due to higher additions to intangible and capital assets of $8.9 million (see discussion of capital expenditures below), and higher acquisition related payments of $8.9 million.

Dividends to Shareholders

Monthly dividends were declared for shareholders of record on the last business day of each month and were paid on approximately the 15th day of the following month. Monthly dividends were $0.065 per share each month for the fourth quarter of 2017. The Company continued to declare the same monthly dividend amount in January and February 2018.

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

The twelve-month rolling Normalized Payout Ratio at December 31, 2017 was 57.8% compared to 56.4% for

the same period in 2016. The increase in the Normalized Payout Ratio is due to higher dividends paid due to shares issued upon the conversion of convertible debentures and on redemption of LTIP. The twelve-month rolling Normalized Payout Ratio, including changes in adjusted non-cash operating working capital at December 31, 2017 was 73.6% compared to 66.4% for the same period in 2016. The increase in the ratio was mainly due to the change in the adjusted non-cash operating working capital.

Capital Expenditures

Our capital expenditures typically include information technology hardware and software (external and internally developed), leasehold improvements, and office furniture. Such amounts are expected to be funded from our operating cash flow. Additional capital expenditure requirements may result from significant business expansion. Capital expenditures for the three months ended December 31, 2017 increased by $7.2 million to $11.7 million compared to $4.5 million for the same period in 2016 and for the year ended December 31, 2017 increased by $8.9 million to $31.4 million from $22.5 million in the comparative period. The increase in capital expenditures for the three months ended December 31, 2017 is due to higher hardware purchases of $0.9 million, and higher internally developed software expenditures of $5.7 million. The increase in capital expenditures for the year ended December 31, 2017 is due to increased leasehold improvements and office furniture expenditures of $1.9 million (net of increased leasehold inducements) primarily due to new office leases and improvements, an increase of $4.7 million in internally developed software expenditures, and an increase of $1.1 million in hardware purchases.

Contractual Obligations

Commitments

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

We are a party to various subleases to which we would be liable for the rental payment in the case of a default by the subtenants. The minimum payments and the aggregate sublease income related to these premises have been netted against the operating leases amounts reported below. We consider the risk of default by the subtenants to be low and therefore no accrual has been set up. A summary of contractual obligations, which outlines the year the payments are due is as follows:

(In thousands of dollars)	**Total**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023 and thereafter**
Long-term debt	$ 180,445	$ –	$ –	$ 180,445	$ –	$ –	$ –
Convertible debenture	86,000	–	–	–	86,000	–	–
Operating leases, net	125,219	15,263	15,075	14,705	13,741	12,618	53,817
Total	**$ 391,664**	**$ 15,263**	**$ 15,075**	**$ 195,150**	**$ 99,741**	**$ 12,618**	**$ 53,817**

Contingent Consideration

The remaining purchase price for Pro-Santé, Société pour L`Avancement Des Ressources Humaines Inc. ("Solareh"), and Les Consultants Longpré & Associés Inc. ("Longpré") is contingent on future business results and the estimated remaining contingent consideration payable for these acquisitions is $3.5 million due from 2018 thru 2022. These contingent future installments have been recognized as an acquisition liability on the statement of financial position at their estimated discounted amounts as at December 31, 2017.

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

Capital Resources

The following table provides an overview of our capital resources:

(In thousands of dollars)		**As at December 31, 2017**		**As at December 31, 2016**
Bank indebtedness	$	5,416	$	3,056
Long-term debt, net of debt issuance costs		179,669		166,299
Convertible debentures, net of issuance costs and equity component of debenture		82,080		81,096
Shareholders' equity		361,059		361,707

Long-term debt

The long-term debt, net of debt issuance costs, increased by $13.4 million from $166.3 million as at December 31, 2016 to $179.7 million as at December 31, 2017. This increase is the result of an increase in borrowings under the Company's credit facility agreement to finance business growth and acquisition related payments.

The Company has a credit facility agreement (the "Credit Facility Agreement") that matures on December 20, 2020 and provides for a revolving facility of $300.0 million (including a swing line of $14.0 million). As at December 31, 2017, $180.4 million of the Credit Facility, including $7.1 million of the swing line available, had been utilized.

The interest rates for the Credit Facility Agreement are floating, based on a margin over certain referenced rates of interest. The applicable margin may vary up and down depending on the ratio of the Company's consolidated debt to Adjusted EBITDA as defined in the Credit Facility Agreement. In July 2017, the Company entered into a forward-starting interest rate swap agreement to hedge against the variable interest rate component on $50.0 million notional amount borrowed under the Credit Facility Agreement for the period from November 29, 2017 up to and ending December 20, 2020. The notional amount of this swap is $50.0 million and is used to fix the variable component of the interest rate at 1.79%, before the applicable margin, for the duration of this period and has been designated as a cash flow hedge.

The Credit Facility Agreement is secured by a general assignment of all the assets of the Company and requires the Company to maintain, on a consolidated basis, a Debt to Adjusted EBITDA financial covenant of not more than 3.0:1.0 or for the twelve month period immediately following the completion of a permitted acquisition as defined in the Credit Facility Agreement with a purchase price of $25.0 million or more, not more than 3.5:1.0, and an EBITDA to interest expense ratio of not less than 3.0:1.0.

We are in compliance with all of the required financial covenants as at December 31, 2017

Convertible debentures

In June 2016, the Company issued $86.0 million principal amount of 4.75% Convertible Unsecured Subordinated Debentures (the "4.75% Convertible Debentures") for net proceeds of $82.0 million. The

4.75% Convertible Debentures pay interest semi-annually on June 30 and December 31, commencing with the initial interest payment on December 31, 2016 and have a maturity date of June 30, 2021.

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

SELECTED STATEMENT OF FINANCIAL POSITION DATA

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

(in thousands of dollars)	As at December 31, 2017	As at December 31, 2016
Current assets	$ 190,205	$ 160,938
Non-current assets	620,065	612,688
Current liabilities	113,576	97,082
Non-current liabilities	335,635	314,837

Current Assets

Current assets as at December 31, 2017 increased by $29.3 million to $190.2 million from $160.9 million as at December 31, 2016. The increase is primarily attributable to an increase in trade and other receivables and unbilled fees of $26.1 million, including a $10.1 million increase in the trade receivable balance from a U.S. public sector customer, due to growth in the business and billing terms in accordance with contracts, an increase in prepaid expenses of $1.5 million due to timing of vendor payments and renewal cycle, an increase in cash and investments held in trust of $0.9 million, and an increase in the current portion of deferred implementation cost of $0.8 million.

Non-current Assets

Non-current assets as at December 31, 2017 increased by $7.4 million to $620.1 million from $612.7 million as at December 31, 2016. The increase is primarily due to $6.3 million in investments in joint ventures acquired as part of the CGP acquisition, and an increase in the non-current portion of deferred implementation costs of $3.2 million due to increased deferred implementation activities, which was partially offset by a decrease in the non-current portion of unbilled fees of $3.0 million.

Current Liabilities

Current liabilities as at December 31, 2017 increased by $16.5 million to $113.6 million from $97.1 million as at December 31, 2016. This increase is primarily due to higher trade and other payables of $13.4 million due to timing of payments to vendors and timing of compensation related accruals, an increase in insurance premium liabilities of $0.9 million, an increase in bank indebtedness of $2.4 million, and higher income taxes payable of $3.3 million. This was partially offset by a decrease in future consideration related to acquisitions

of $2.4 million primarily as a result of acquisition settlement payments, and the fair value of the interest rate swaps being in a liability position of $1.6 million at comparative period end.

Non-current Liabilities

Non-current liabilities as at December 31, 2017 increased by $20.8 million to $335.6 million from $314.8 million as at December 31, 2016. The increase is mainly due to an increase in the long-term debt of $13.4 million due to higher amounts borrowed under the Credit Facility Agreement, an increase of $1.0 million in the Convertible Debentures due to non-cash accretion and amortization of issuance costs, an increase in the deferred tax liability of $2.0 million, and an increase in other liabilities of $5.4 million primarily due to leasehold inducements received, which was partially offset by a decrease of $1.5 million in the non-current portion of future consideration related to acquisitions.

As a result of the changes in current assets and current liabilities discussed above, working capital increased by $12.7 million from $63.9 million as at December 31, 2016 to $76.6 million as at December 31, 2017.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements requires us to make estimates and assumptions that affect the reported values of assets and liabilities as well as disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period.

These estimates are reviewed periodically and, as adjustments become necessary, they are reported in profit or loss in the periods in which they become known. Accordingly, actual results could differ from these estimates. The Company's significant accounting policies are presented in Note 3 of the audited consolidated financial statements and notes thereto for the years ended December 31, 2017 and 2016. The accounting policies and estimates that are critical to our business relate to the following items:

Revenue Recognition

Revenue includes fees generated from consulting engagements, Administrative Solutions engagements, ESS and AMS services.

Generally, revenue from the rendering of services is recognized when the following criteria are met:

- The amount of revenue can be reliably measured;
- The stage of completion can be reliably measured;
- The receipt of economic benefits is probable; and
- Costs incurred and to be incurred can be reliably measured.

Concurrently with the above general principles, Morneau Shepell applies the following specific revenue recognition policies:

Fees for actuarial and consulting services are billed either on a time-and-material basis or on a fixed-fee basis. Revenue is recognized as services are rendered and expenditures are incurred.

ESS revenue is recognized through a combination of the minimum contracted amount and incremental usage above the minimum thresholds. The minimum contracted amount is recognized on a basis consistent with the provision of ESS services. Incremental usage is recognized when the minimum usage threshold is exceeded.

AMS revenue is recognized on a fixed-fee or time-and-material basis. On fixed-fee basis arrangements, where the provision of service is characterized by an indeterminate number of acts, revenue is recognized on a straight-line basis over the term of the contract. On time-and-material basis arrangements, revenue is recognized as services are rendered and expenditures are incurred.

Administrative Solutions engagements typically involve both an implementation and administration component. Where a singular contract requires the delivery of multiple components, revenue recognition criteria are applied to determine whether each component of the contract qualifies for treatment as a separate unit of accounting. Multiple deliverable arrangements are determined to exist if all of the following criteria are met:

- The delivered item has value to the customer on a stand-alone basis; and
- The fair value of the undelivered item can be reliably measured.

If these criteria are not met, deliverables (components) included in an arrangement are accounted for as a single unit of accounting and revenue is deferred and recognized on a basis consistent with elements of the service contract.

Unbilled fees represent fees earned for services rendered but not yet invoiced as at the reporting date; upon billing, this balance will be transferred to trade receivables. 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 Shepell maintains a provision for amounts expected to be unrecoverable.

Other sources of operating revenue include the following:

(i) Investment income earned in the course of normal business operations, and is recorded on the accrual basis.

(ii) Commissions income are recognized when earned, net of a provision for return commissions due to policy cancellations or change of brokers.

Intangible Assets

Intangible assets consist of customer relationships, customer contracts, proprietary software, and trade names acquired through acquisitions or business combinations, internally-developed software and purchased software.

Internally-developed software is recognized at the cost of all eligible development costs, when all the following criteria are met:

- It is technically feasible to complete the software so that it will be available for use;
- Management intends to complete the software and use or sell it;
- Morneau Shepell is able to use or sell the software;
- Future benefits associated with the software can be demonstrated;
- Adequate technical, financial, and other resources to complete the development and to use or sell the software are available; and
- The expenditures attributable to the software during its development can be reliably measured.

Eligible expenditures capitalized as part of internally-developed software include external direct costs of materials and services consumed in development, and payroll and payroll-related costs for employees who

are directly associated with and who devote time to the development of the software. All costs incurred in the preliminary research stage of the projects are expensed as incurred.

Intangible assets with a finite life are amortized on a straight-line basis over their estimated useful lives. Intangible assets with an indefinite life are not amortized, but are tested for impairment annually or whenever impairment indicators are identified. Trade names have been determined to have an indefinite life based on their strength, history, and expected future use.

Amortization expense has been presented in profit or loss as depreciation and amortization. Assets are removed from asset and accumulated amortization balances once they become fully amortized. Proceeds from disposals are netted against the related assets and accumulated amortization, and resulting gains and losses are included in profit or loss.

Amortization on internally-developed software does not commence until the asset is ready for use as management intended.

Goodwill

Goodwill represents the excess of the cost of business acquisitions over the fair value of our share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill is carried at cost less accumulated impairment charges and is subject to an impairment test annually or whenever impairment indicators are identified.

Deferred implementation costs and deferred outsourcing revenues

Implementation costs incurred in connection with Administrative Solutions contracts, relate to those costs necessary to set up clients and their human resource or benefit programs onto the Company's systems and operating processes. Such costs may include internal and external costs for coding and customizing systems, client data conversion costs, and contract negotiation costs. For Administrative Solutions contracts that are accounted for as a combined unit of accounting, specific, incremental, and direct costs, net of any revenue received from the implementation component, are deferred and amortized over the term of the service contract.

If a client terminates a contract prior to its end, a loss on the contract may be recorded (if necessary), and any remaining deferred implementation revenues and costs would be recognized into income over the remaining implementation period through to the date of termination.

Deferred income tax assets and liabilities (utilization of tax losses)

Deferred income tax assets are recognized for all unused tax losses and deductible temporary differences to the extent that it is probable that taxable profit will be available against which the losses and deductible temporary differences can be utilized. Significant management judgment is required to determine the amount of deferred income tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

Future consideration related to acquisitions

The Company may pay future consideration related to acquisitions based upon performance measures contractually agreed at the time of purchase. Management estimates the future consideration payable based on underlying contract terms, and best estimates of the future performance of the acquiree.

Depending on the future performance of the acquiree, management estimates of the amounts payable for future consideration related to acquisitions may materially differ from the consideration ultimately paid.

Impairment of Non-financial Assets

The Company's identifiable tangible and intangible assets with finite useful lives are reviewed for indications of impairment at each statement of financial position date and when events or changes in circumstances indicate that they may be impaired. Impairments are recorded when the recoverable amount of assets are less than their carrying amounts. The recoverable amount is the higher of an asset's fair value less cost to sell or its value in use.

Similarly, intangible assets with indefinite useful lives and goodwill are tested for impairment annually or whenever impairment indicators are identified, by estimating their recoverable amounts and comparing it to their carrying amounts. Where individual assets cannot be tested individually, they are grouped together into cash-generating units ("CGUs"), the smallest group of assets that are capable of generating cash inflows from continuing use largely independent of other groups of assets, and tested on this basis. Goodwill acquired through business combinations is allocated to each CGU or groups of CGU's but not larger than an operating segment that is expected to benefit from the synergies of the combination.

An impairment loss is recognized if the carrying amount of the CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss, and those impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the unit, and then to reduce the carrying amount of the other assets in the unit on a pro rata basis.

Impairment losses in respect of goodwill are not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, and only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization had no impairment charge been recorded.

Goodwill and intangible assets impairment review involves significant estimates and assumptions regarding cash flow projections, growth projections, economic risk, and weighted cost of capital. If future events or results differ adversely from these estimates and assumptions, the Company could incur impairment charges in future periods.

Allowance for Doubtful Accounts

We are required to assess whether accounts receivable are collectible from customers. Accordingly, management establishes an allowance for estimated losses arising from non-payment and delinquent accounts, taking into consideration customer creditworthiness, current economic trends, and past experience. If future collections differ from estimates, future earnings could be adversely affected.

Litigation and Claims

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

Related party transactions

The Company's related parties include key management personnel, unconsolidated structured entities, and joint ventures. Details of these related parties, as well as the Company's related party transactions can be found in note 23 'Related Parties' of the Company's consolidated financial statements for the year ended December 31, 2017.

Changes in Accounting Policies

The accounting policies applied by the Company in its consolidated financial statements as at and for the year ended December 31, 2017 are consistent with those applied by the Company in its comparative consolidated financial statements as at and for the year ended December 31, 2016.

Future Accounting Changes

IFRS 15, Revenue from Contracts with Customers ("IFRS 15")

In May, 2014, the IASB issued IFRS 15. The new standard is effective for fiscal years beginning on or after January 1, 2018 and is available for early adoption. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized.

The Company will adopt IFRS 15 in its financial statements using the full retrospective method for the annual period beginning on January 1, 2018 and will apply the following practical expedients on the date of transition:

- Paragraph C5(a) of IFRS 15, under which the Company does not restate contracts that begin and end within the same annual reporting period, or are completed contracts at the beginning of the earliest period presented.

- Paragraph C5(c) of IFRS 15, under which the Company does not disclose the amount of consideration allocated to remaining performance obligations or an explanation of when the Company expects to recognize that amount as revenue for all reporting periods presented before the initial date of application of January 1, 2018.

The Company has also substantially completed its assessment of the impact of adopting this standard on its financial statements.

Under IFRS 15 for Administrative Solutions application service provider ("ASP") and software as a service ("SaaS") contracts that provide the customer with a right to access license to the Company's proprietary pension and benefits software over the term of the contract, the implementation component and ongoing services will be considered a single performance obligation. Currently, the Company considers the implementation component to be a separate unit of accounting, resulting in the recognition of implementation fees as revenue upon the commencement of the implementation.

Furthermore, implementation costs incurred in connection with Administrative Solutions contracts where the implementation component is not considered a separate performance obligation are currently deferred and amortized over the initial term of the service contract. Under IFRS 15, the Company will consider the

renewal period as permitted in the contract in addition to the initial term of the contract, in determining the amortization period for these deferred costs.

As a result of the changes noted above, the Company estimates that the Company's deficit will increase by $4,785 on the date of adoption of January 1, 2018 and by $3,230 on January 1, 2017, with the profit of the Company for the year ended December 31, 2017 decreasing by $1,556.

IFRS 9, Financial Instruments ("IFRS 9")

In July 2014 the IASB finalized IFRS 9. The standard is effective for fiscal years beginning on or after January 1, 2018 and is available for early adoption. The new standard includes revised guidance on the classification and measurement of financial assets, a new 'expected loss' impairment model and introduces a substantially-reformed approach to hedge accounting. The Company intends to adopt IFRS 9 in its financial statements for the annual period beginning on January 1, 2018. The impact of adoption of this standard is not significant.

IFRS 16, Leases ("IFRS 16")

In January 2016, the IASB issued IFRS 16. The standard is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted for those entities that have also adopted IFRS 15. The new standard provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements. IFRS 16 supersedes IAS 17, Leases, and its associated interpretative guidance. IFRS 16 applies a control model to the identification of leases, differentiating between leases and service contracts on the basis of whether there is an identified asset controlled by the customer. Among other significant changes, the distinction between operating and finance leases is removed and assets and liabilities are recognized in respect of all leases. Furthermore, IFRS 16 requires a front-loaded pattern for the recognition of lease expense over the life of the lease. The Company intends to adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the standard has not yet been determined.

RISKS AND UNCERTAINTIES

The results of operations, business prospects and financial considerations of Morneau Shepell remain subject to a number of risks and uncertainties and are affected by a number of factors outside of our control.

Ability to Maintain Profitability and Manage Growth

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

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

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

Competition

Morneau Shepell operates in a highly competitive North American market. As a result, Morneau Shepell competes with many domestic and international firms. Some of its competitors have achieved substantially more market penetration in certain of the areas in which Morneau Shepell competes. In addition, some of Morneau Shepell's competitors have substantially more financial resources and/or financial flexibility than Morneau Shepell. Furthermore, Morneau Shepell's business relies, in part, upon its ability to develop and implement technology solutions, in a cost effective manner that anticipates and keeps pace with rapid and continuing changes in technology, industry standards and client preferences.

Morneau Shepell's competitors may offer new technologies more efficiently or cost effectively than Morneau Shepell. Competitive forces could result in reduced market share and thus have a material adverse effect on Morneau Shepell's business, financial condition and operating results.

Reliance on Information Systems and Technology and Confidentiality of Client Information

Information systems are an integral part of Morneau Shepell's business and the products and services offered to its clients. Morneau Shepell relies on these systems to maintain accurate, accessible and secure records.

In the course of delivering its products and services, Morneau Shepell collects and uses sensitive personal and financial information pertaining to its corporate, institutional and government clients as well as individual users. This information includes personal identification such as date of birth, social insurance numbers and driver's license numbers as well as health, benefits and financial information.

Due to the nature of the information involved in its products and services, Morneau Shepell may be subject to greater cybersecurity risks and consequences of disclosure than other companies. These risks can range from internal human error to uncoordinated individual attempts to gain unauthorized access to its information technology systems, to sophisticated and targeted measures directed at Morneau Shepell and its systems, clients or service providers. Any such disruptions in Morneau Shepell's systems or the failure of

the systems to operate as expected could, depending on the magnitude of the problem, result in the loss of client information (including personal information), a loss of current or future business, reputational harm and/or potential claims against Morneau Shepell, all of which could have a material adverse effect on Morneau Shepell's business, financial condition and operating results.

Morneau Shepell continues to enhance its efforts to mitigate these risks.

It invests in technology security initiatives to better identify and address any vulnerabilities. This includes measures such as annual third party internal and external vulnerability assessments and third party code reviews, data monitoring and assessments. Morneau Shepell has also improved the security testing capabilities of its internal teams. In addition, Morneau Shepell continues to increase the awareness its employees have of security policies and procedures through ongoing communications and privacy and security training. Morneau Shepell ensures that its service providers adopt similar measures through the use of security agreements.

From a systems and infrastructure perspective, Morneau Shepell uses a third party co-location site for data storage to decrease the probability of loss in the event of a business interruption or disaster. Internally, it maintains a complete inventory of all servers and infrastructure components and uses data loss prevention features to reduce the likelihood of improper disclosure of personal and confidential information.

Morneau Shepell’s Chief Information Officer and Chief Security Officer are responsible for establishing, monitoring and maintaining the enterprise technology and security processes and policies with support from third party consultants and the Company’s internal information technology, legal and audit departments.

The Company maintains privacy and network liability insurance coverage in the event of a loss arising from a network security failure, privacy event or social engineering fraud commonly referred to a “phishing attack”.

The above referenced insurance policy, technology security initiatives and employee awareness measures are assessed on an annual basis as part of Morneau Shepell’s comprehensive enterprise risk management process.

While Morneau Shepell has invested and continues to invest in technology security initiatives, information technology risk management and disaster recovery plans, these measures cannot fully insulate it from cybersecurity incidents, technology disruptions or data loss, which could adversely impact its competitiveness and result of operations.

Reputational Risk

Morneau Shepell depends to a large extent upon its relationships with its clients and its reputation for high-quality services. As a result, the impact of client dissatisfaction with Morneau Shepell’s services or products may be more damaging in Morneau Shepell’s business than in other businesses. Moreover, if the firm fails to meet its contractual or regulatory obligations, Morneau Shepell could be subject to legal liability and a loss of client relationships.

Satisfactory Performance of Obligations

In its contracts with clients, Morneau Shepell is sometimes committed to meeting identified service levels and/or timelines. If the service levels/timelines are not met, Morneau Shepell may experience reduced revenues, incur significant additional costs or be held responsible for the costs incurred by the client for

failure to meet the service level/timeline. Morneau Shepell's success depends in large part upon whether it fulfills these and other contractual obligations with clients and maintains client satisfaction. If Morneau Shepell fails to satisfactorily perform its contractual obligations, its clients could terminate contracts and/or take legal action against Morneau Shepell. Such occurrences could result in a loss of its professional reputation and in extra costs needed to defend or rectify the situation and thus have a material adverse effect on Morneau Shepell's business, financial condition and operating results.

Economic Conditions

An economic slowdown could cause a decline in demand for Morneau Shepell’s services. Growth in its clients’ businesses may be affected by economic slowdowns and could therefore potentially have an impact on Morneau Shepell’s operating results. During an economic downturn, Morneau Shepell clients and potential clients may reduce their employee populations, delay services or projects, or defer contracts currently underway. This situation could also lead to greater delays and defaults in payments or debt collection, resulting in lower operating results. Because of lower revenue during an economic slowdown, competition may increase and prices may be reduced by certain competitors to maintain or expand their market share. Pricing and profitability could be adversely affected as a result.

Dependence on Key Clients and Key Channel Partners

As clients may terminate engagements with minimum notice, there can be no assurance that Morneau Shepell will be able to retain relationships with its largest clients. Moreover, there can be no assurance that such clients will continue to use Morneau Shepell’s services in the future. Any negative change involving any of Morneau Shepell’s largest clients, including but not limited to a client's financial condition or desire to continue using Morneau Shepell’s services, could result in a significant reduction in revenue which could have a material adverse effect on Morneau Shepell’s business, financial condition and operating results. No one Morneau Shepell client makes up more than 10% of Morneau Shepell’s total revenue for the years ended December 31, 2017 and 2016.

Morneau Shepell markets its services directly to end-user employers as well as through certain channel partners, primarily insurance companies (many of which compete amongst themselves directly). There can be no assurance that Morneau Shepell will be able to maintain its existing relationships with all these channel partners, which could have a material adverse effect on Morneau Shepell’s business, financial condition and operating results.

Reliance on Key Professionals

Morneau Shepell's operations are dependent upon the abilities, experience and efforts of its professionals, many of whom have excellent reputations and a significant number of contacts in the industries in which Morneau Shepell operates. Morneau Shepell's business depends, in part, on its professionals’ abilities to develop and maintain client relationships and alliances with businesses such as financial services companies, healthcare organizations, insurance companies, business process outsourcing organizations and other companies, in order to develop, market and deliver its services. Profitability could be negatively impacted if Morneau Shepell’s client relationships or business alliances are discontinued due to the loss of professional staff or if the firm has difficulty developing new alliances.

Should any member of its professional staff be unable or unwilling to continue his or her relationship with Morneau Shepell, this change could have a material adverse effect on Morneau Shepell’s business, financial condition and operating results.

Risk of Future Legal Proceedings

Morneau Shepell may be threatened with, or may be named as a defendant in, or may become subject to, various legal proceedings in the ordinary course of conducting its business, including lawsuits based upon professional errors and omissions.

Consulting services involves assumptions and estimates concerning future events, the actual outcome of which cannot be known with certainty in advance. In addition, computational, software programming or data management errors could occur. For example, possible legal proceedings could result from a client's assertion that actuarial assumptions used in a pension plan were unreasonable, leading to plan underfunding; a claim that inaccurate data was used, which could lead to an underestimation of plan liabilities; or a claim that employee benefits plan documents were misinterpreted or plan amendments were misstated in plan documents, which could lead to overpayments to beneficiaries. The employee health and productivity services involve confidential counseling, occupational health activities and disability case management. Each of these activities could potentially put Morneau Shepell in conflict with its customers, their employees, or both. Possible legal proceedings could also result from matters such as an employee claiming for breach of confidence, failure to provide adequate counsel, or denial of benefits or employment as a result of Morneau Shepell's actions.

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

Protection of Intellectual Property

Morneau Shepell continually develops and improves its proprietary technology solutions for the delivery of its services. No assurance can be given that Morneau Shepell's competitors will not develop substantially similar technology.

Morneau Shepell relies on one or more of the following to protect its proprietary rights: trademarks, copyrights, trade secrets, confidentiality procedures and contractual provisions. Despite Morneau Shepell's efforts to protect its proprietary rights, unauthorized parties may attempt to obtain and use information that Morneau Shepell regards as proprietary. Stopping unauthorized use of Morneau Shepell's intellectual property may be difficult, time-consuming and costly. There can be no assurance that Morneau Shepell will be successful in protecting its proprietary rights and, if it is not, this could have a material adverse effect on Morneau Shepell's business, financial condition and operating results.

Potential Undisclosed Liabilities Associated with Acquisition/Limited Indemnification

In connection with acquisitions completed by Morneau Shepell, there may be liabilities and contingencies that Morneau Shepell failed to discover or were unable to quantify in its due diligence which it conducted prior to the execution of an acquisition, and Morneau Shepell may not be indemnified for some or all of these liabilities and contingencies. The existence of any material liabilities or contingencies could have a material adverse effect on Morneau Shepell's business, financial condition, liquidity and results of operations.

Insurance

Morneau Shepell believes that its insurance coverage, including professional errors and omissions insurance, cyber liability insurance, crime insurance, director and officer liability insurance, and commercial general liability insurance coverage address all material insurable risks, provides coverage that is similar to that which would be maintained by a prudent operator of a similar business and is subject to deductibles, limits and exclusions which are customary or reasonable given the cost of procuring insurance and current operating conditions.

However, there can be no assurance that such insurance will continue to be offered on economically feasible terms, that all events that could give rise to a loss or liability are insurable, or that the amounts of insurance will at all times be sufficient to cover each and every loss or claim that may occur involving Morneau Shepell's assets or operations.

Foreign Exchange Risk

A portion of Morneau Shepell's sales are in U.S. dollars and thus Morneau Shepell is exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar.

The net revenue exposure denominated in U.S. dollars was $22.0 million for the year ended December 31, 2017. An increase in foreign revenues would expose Morneau Shepell to fluctuations in exchange rates which may have a material adverse effect on Morneau Shepell's business, financial condition, and operating results.

Indebtedness and Interest Rates

The ability of Morneau Shepell to pay dividends or make other payments or advances will be subject to applicable laws and contractual restrictions contained in the instruments governing any indebtedness of Morneau Shepell.

The degree to which Morneau Shepell is leveraged could have important consequences including: Morneau Shepell's ability to obtain additional financing for working capital, capital expenditures or acquisitions in the future may be limited; a significant portion of Morneau Shepell's cash flow from operations may be dedicated to the payment of the principal of and interest on its indebtedness, thereby reducing funds available for future operations; certain borrowings will be at variable rates of interest, which exposes Morneau Shepell to the risk of increased interest rates; and Morneau Shepell may be more vulnerable to economic downturns and be limited in its ability to withstand competitive pressures.

These factors may increase the sensitivity of free cash flow to interest rate variations. Interest rate swap agreements are used as part of Morneau Shepell's program to manage the floating interest rate of Morneau Shepell's Credit Facility.

The Credit Facility contains numerous restrictive covenants that limit the discretion of management with respect to certain business matters. These covenants place significant restrictions on, among other things, the ability of Morneau Shepell to create liens or other encumbrances, to pay dividends or make certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity.

In addition, the Credit Facility contains financial covenants that require Morneau Shepell to meet certain financial ratios and financial condition tests. A failure to comply with the obligations in the Credit Facility could result in a default which, if not cured or waived, could result in a reduction or termination of dividends by Morneau Shepell and permit acceleration of the relevant indebtedness. If the indebtedness under the Credit Facility was to be accelerated, there can be no assurance that the assets of Morneau Shepell would be sufficient to repay in full that indebtedness. In addition, the Credit Facility matures on December 20, 2020. There can be no assurance that future borrowings or equity financing will be available to Morneau Shepell or available on acceptable terms, in an amount sufficient to fund Morneau Shepell's needs.

Credit risk

If a counterparty to a financial instrument held by Morneau Shepell fails to discharge their obligation, this could lead to a financial loss for the Company. As at December 31, 2017, the Company's credit risk was limited to the carrying amount of the cash and accounts receivable as at this date, with one U.S. public sector customer comprising $14.1 million of the accounts receivables balance, $10.6 million of which was greater than ninety days past due. The Company believes that the credit risk of accounts receivable, including the customer noted above, is limited for the following reasons:

(a) Risk associated with concentration of credit risk with respect to accounts receivable is limited due to the credit rating of the Company's top 10 clients.

(b) Management regularly reviews and assesses customer accounts and credit risk. Historically, bad debt as a percentage of revenue has been minimal.

The credit risk on cash and investments held in trust is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

Cash Dividends are not Guaranteed and will Fluctuate with the Business Performance

As a corporation, Morneau Shepell's dividend policy is at the discretion of its Board of Directors. The ability of Morneau Shepell to make dividend payments, and the actual amount paid is entirely dependent on the operations and assets of its subsidiaries and is subject to various factors applicable to Morneau Shepell and its subsidiaries including financial performance, obligations under credit facilities, fluctuations in working capital, the sustainability of margin and capital expenditure requirements, and applicable laws and regulations.

Market Price and Dilution of Common Shares

The market price of Morneau Shepell's common shares may be subject to wide fluctuations in response to many factors, including variations in operating results of Morneau Shepell, divergence in financial results from expectations, changes in business prospects for Morneau Shepell, general economic conditions, legislative changes, and other events and factors outside Morneau Shepell's control.

Sales of a substantial number of common shares by a significant shareholder in the public market or otherwise could adversely affect the prevailing market prices of the common shares and could impair the Company's ability to raise additional capital through an offering of common shares. The possible perception among the public that these sales will occur could also produce the same effect.

Pursuant to its articles of incorporation, Morneau Shepell is authorized to issue an unlimited number of common shares and 10 million preferred shares for the consideration and on such terms established by the

Board of Directors without the approval of any shareholders. Any further issuance of common shares may dilute the interests of existing shareholders. Furthermore, Morneau Shepell may make future acquisitions or enter into financings or other transactions involving the issuance of securities of Morneau Shepell which may be dilutive. In addition, Morneau Shepell may issue shares upon the conversion, redemption or maturity of payment of interest on its convertible debentures. Accordingly, if the debentures are converted this may have a dilutive impact on the Company's earnings per share.

SELECTED ANNUAL INFORMATION

(In thousands of dollars, except per share amounts)	Year ended December 31, 2017	Year ended December 31, 2016	Year ended December 31, 2015
Revenue	$631,155	$592,057	$567,286
Profit for the year [1]	34,582	26,000	16,418
Earnings per share (basic and diluted)	0.62	0.49	0.33
Dividends declared per share	0.78	0.78	0.78
Total assets	810,270	773,626	755,648
Total long-term debt [2]	261,749	247,395	315,606

Footnotes:

(1) The profit for the year ended December 31, 2015 includes the write-down of deferred implementation costs and impairment charges totaling $15,100 related to HRINY.

(2) Includes convertible debentures.

SUPPLEMENTARY SUMMARY OF QUARTERLY RESULTS

Selected Unaudited Consolidated Financial information:

(in thousands of dollars except per share amounts)

Quarter ended	December 31, 2017	September 30, 2017	June 30, 2017	March 31, 2017	December 31, 2016	September 30, 2016	June 30, 2016	March 31, 2016
Revenue	158,722	153,782	160,814	157,837	149,089	144,594	149,251	149,123
Profit	4,289	9,654	12,475	8,164	5,660	5,210	8,081	7,049
EBITDA	19,290	26,960	29,585	25,302	21,082	19,098	25,449	22,579
Adjusted EBITDA	29,004	28,968	31,823	31,025	26,714	27,187	29,533	28,828
EBITDA margin	12.2%	17.5%	18.4%	16.0%	14.1%	13.2%	17.1%	15.1%
Adjusted EBITDA margin	18.3%	18.8%	19.8%	19.7%	17.9%	18.8%	19.8%	19.3%
Earnings per share (basic)	0.08	0.17	0.23	0.15	0.10	0.09	0.16	0.14
Earnings per share (diluted)	0.08	0.17	0.22	0.15	0.10	0.09	0.16	0.14
Normalized Free Cash Flow	20,466	17,862	15,913	18,090	19,690	17,323	18,585	15,308
Dividends declared	10,457	10,525	10,417	10,380	10,374	10,355	9,857	9,413
Twelve-month rolling normalized payout ratio	57.8%	58.3%	58.5%	55.6%	56.4%	56.2%	58.3%	59.8%
Twelve-month rolling normalized payout ratio, including changes in adjusted non-cash operating working capital	73.6%	97.5%	70.7%	72.4%	66.4%	54.2%	60.1%	58.7%
Total assets	810,270	785,712	793,315	777,627	773,626	760,402	768,256	757,357
Total long-term debt [1]	261,749	266,082	267,277	247,638	247,395	253,293	262,031	316,292

Footnotes:

(1) Includes convertible debentures.

Disclosure Controls and Procedures

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

The Chief Executive Officer and the Chief Financial Officer have concluded that the disclosure controls and procedures are appropriately designed and operating effectively as at December 31, 2017.

Internal Control over Financial Reporting

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

The Chief Executive Officer and the Chief Financial Officer have concluded that the internal controls over financial reporting are appropriately designed and operating effectively to provide this assurance based on the evaluation of these controls conducted as of December 31, 2017. No changes were made in our internal controls over financial reporting during the fourth quarter ended December 31, 2017, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Additional Information

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

The content of this MD&A reflects information known as of March 7, 2018.