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

MORNEAU SHEPELL INC.

Three months ended March 31, 2021 and 2020
(Unaudited)

MORNEAU SHEPELL INC.

Unaudited Condensed Consolidated Interim Statements of Financial Position
(In thousands of Canadian dollars)
March 31, 2021 and December 31, 2020

	March 31, 2021	December 31, 2020
Assets		
Current assets:		
Cash (note 8)	$ 6,037	$ 8,736
Trade and other receivables	100,821	98,684
Unbilled fees	102,629	97,823
Finance lease receivables	1,435	1,396
Prepaid expenses and other	16,310	14,429
Cash and investments held in trust	11,770	11,351
Income taxes receivable	1,894	4,753
Deferred implementation costs	15,109	13,273
Total current assets	256,005	250,445
Non-current assets:		
Deferred implementation costs	58,686	60,356
Finance lease receivables	1,143	1,391
Capital assets	159,303	157,503
Intangible assets	456,746	452,538
Goodwill	589,946	585,879
Investments in joint ventures	6,674	6,394
Interest rate and total return swaps (note 9)	256	–
Total non-current assets	1,272,754	1,264,061
Total assets	$ 1,528,759	$ 1,514,506

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

MORNEAU SHEPELL INC.

Unaudited Condensed Consolidated Interim Statements of Financial Position
(In thousands of Canadian dollars)
March 31, 2021 and December 31, 2020

	March 31, 2021	December 31, 2020
Liabilities and Equity		
Current liabilities:		
Bank indebtedness (note 8)	$ –	$ 12,784
Trade and other payables	116,883	93,646
Deferred revenue	18,624	18,258
Insurance premium liabilities	11,770	11,351
Interest rate swaps (note 9)	2,872	2,786
Future consideration related to acquisitions (note 9)	1,860	505
Dividends payable	4,471	4,470
Provisions	5,261	4,100
Lease liabilities	21,914	19,506
Total current liabilities	183,655	167,406
Non-current liabilities:		
Deferred revenue	28,291	26,408
Long-term debt (note 4)	412,425	411,924
Interest rate swaps (note 9)	3,089	4,150
Future consideration related to acquisitions (note 9)	1,902	49
Provisions	7,933	8,964
Deferred tax liability	117,901	116,254
Lease liabilities	121,530	122,644
Total non-current liabilities	693,071	690,393
Equity:		
Share capital	922,189	922,189
Contributed surplus	27,296	25,481
Accumulated other comprehensive loss	(13,228)	(9,977)
Deficit	(284,224)	(280,986)
Total equity	652,033	656,707
Total liabilities and equity	$ 1,528,759	$ 1,514,506

Subsequent Event (note 4)

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, 2021 and 2020

	Three months ended March 31, 2021	Three months ended March 31, 2020
Operating revenue (note 10)	$ 257,140	$ 243,048
Operating expenses:		
Salaries, benefits and contractors	176,862	164,325
Other operating expenses	33,607	37,417
Depreciation and amortization	27,217	26,239
Total operating expenses	237,686	227,981
Finance costs	5,933	7,436
Gain on business divestiture	–	39,843
Share of income of joint ventures	516	10
Profit before income taxes	14,037	47,484
Income taxes:		
Current	4,878	5,359
Deferred	(1,016)	3,220
Total income taxes	3,862	8,579
Profit for the period	10,175	38,905
Other comprehensive (loss) income:		
Items that may be reclassified subsequently to profit:		
Effective portion of change in total return swaps and interest rate cash flow hedges (note 9)	1,203	(5,464)
Foreign currency translation differences for foreign operations	(4,139)	26,530
Income taxes on the above items	(327)	1,448
	(3,263)	22,514
Items that will not be reclassified to profit:		
Actuarial gain on post-employment benefit plans	16	234
Income taxes on the above item	(4)	(62)
	12	172
Other comprehensive (loss) income, net of tax effect	(3,251)	22,686
Comprehensive income for the period	$ 6,924	$ 61,591
Earnings per share (note 6):		
Basic	$ 0.15	$ 0.56
Diluted	$ 0.14	$ 0.56

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, 2021 and 2020

2021	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Total equity
Balance, January 1, 2021	$ 922,189	$ 25,481	$ (280,986)	$ (9,977)	$ 656,707
Long-term incentive plan – issuance	–	1,815	–	–	1,815
Long-term incentive plan – redemption, net of taxes	–	–	–	–	–
Profit for the period	–	–	10,175	–	10,175
Dividends (note 5)	–	–	(13,413)	–	(13,413)
Other comprehensive loss	–	–	–	(3,251)	(3,251)
Balance, March 31, 2021	$ 922,189	$ 27,296	$ (284,224)	$ (13,228)	$ 652,033

2020	Share capital	Contributed surplus	Deficit	Equity component of convertible debentures	Accumulated other comprehensive income	Total equity
Balance, January 1, 2020	$ 872,981	$ 27,667	$ (283,551)	$ 495	$ 796	$ 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	39,672	–	–	(495)	–	39,177
Profit for the period	–	–	38,905	–	–	38,905
Dividends (note 5)	–	–	(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

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, 2021 and 2020

	Three months ended March 31, 2021	Three months ended March 31, 2020
Operating activities		
Profit for the period	$ 10,175	$ 38,905
Items not involving cash:		
Depreciation and amortization	27,217	26,239
Finance costs	5,933	7,436
Long-term incentive plan expense	1,997	1,792
Income taxes	3,862	8,579
Change in provisions	130	–
Gain on business divestiture	–	(39,843)
Other	(398)	468
	48,916	43,576
Change in operating working capital (note 8)	15,898	(5,172)
Cash generated from operating activities	64,814	38,404
Finance costs paid	(4,813)	(6,732)
Income taxes paid	(2,176)	(2,027)
Cash provided by operating activities	57,825	29,645
Financing activities:		
Change in revolving loan	201	102,412
Principal payment of lease liabilities	(3,733)	(3,875)
Redemption of convertible debentures	–	(1,521)
Dividends paid	(13,413)	(13,179)
Cash (used in) provided by financing activities	(16,945)	83,837
Investing activities:		
Deferred and contingent acquisition payments	(71)	(7,851)
Business acquisition	(9,840)	–
Business divestiture	–	67,535
Principal payment received from finance leases	337	405
Additions to intangible assets	(12,059)	(7,672)
Additions to capital assets	(9,162)	(8,776)
Cash (used in) provided by investing activities	(30,795)	43,641
Increase in cash for the period	10,085	157,123
(Bank indebtedness, net of cash) Cash, beginning of period	(4,048)	3,651
Cash net of bank indebtedness, end of period	$ 6,037	$ 160,774

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 wellbeing 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, 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 13, 2021.

2. Basis of preparation:

These interim financial statements for the three months ended March 31, 2021 and 2020 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, 2020 (“annual financial statements”) prepared in accordance with IFRS as issued by the IASB. Certain comparative figures have been reclassified to conform to current presentation.

The preparation of the interim financial statements requires Management to make judgments, estimates and assumptions that affect the application of accounting policies and reported assets, liabilities, revenue and expenses, consistent with those described in the Company’s annual financial statements and as described in these interim financial statements. Estimates and underlying assumptions are reviewed on an ongoing basis. Estimates are based on historical experience and other assumptions that are considered reasonable in the circumstances. The actual amount or values may vary in certain instances from the assumptions and estimates made. Changes will be recorded, with corresponding effect in profit or loss, when, and if, better information is obtained. The future impact of uncertainties around the outbreak of the novel coronavirus (“COVID-19”) pandemic could generate, in future reporting periods, a significant risk of material adjustment to the reported amounts of assets, liabilities, revenue and expenses in the interim 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 payable related to acquisitions.

(In thousands of Canadian dollars)

3. Significant accounting policies:

The accounting policies applied by the Company in these interim financial statements are consistent with those applied by the Company in its annual financial statements; except for the following changes in accounting policies:

Interest Rate Benchmark Reform – Phase 2:

In August 2020, the IASB issued additional amendments to IFRS 9 *Financial Instruments*, IFRS 7 *Financial Instruments: Disclosures*, IFRS 4 *Insurance Contracts* and IFRS 16 *Leases.* The objective of these amendments is to address issues that might affect financial reporting as a result of the reform of an interest rate benchmark, including the effects of changes to contractual cash flows or hedging relationships arising from the replacement of an interest rate benchmark with an alternative benchmark rate. The amendments provide practical relief from certain requirements in IFRS 9, IFRS 7, IFRS 4 and IFRS 16. The Company adopted these amendments on January 1, 2021, which did not have a material impact on the Company's interim financial statements.

4. Long-term debt:

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

	March 31, 2021	December 31, 2020
Revolving loans	$ 414,168	$ 413,967
Less: debt issuance costs, net of accumulated amortization	(1,743)	(2,043)
	$ 412,425	$ 411,924

As at March 31, 2021, under the Credit Facility Agreement, the Company had a revolving facility of $600,000 (including a swing line of $14,000), which matures on July 27, 2023, and a $100,000 Incremental Facility that matures on April 16, 2021.

On April 15, 2021, the Company extended the $100,000 Incremental Facility for an additional 364 days and changed the Incremental Facility from a revolving credit facility to a term loan facility. The Company drew from the term loan facility, which charges a lower applicable margin, and used the proceeds to pay down an equivalent amount of the revolving credit facility. There are no material changes to the other terms of the Credit Facility Agreement.

As at March 31, 2021, the Company had borrowed $328,658 (December 31, 2020 – $314,657) and $85,510 (US$ 68,000) (December 31, 2020 – $99,310, US$ 78,000), and had not utilized the swing line available (December 31, 2020 - $6,613 utilized, which is included in the bank indebtedness). Borrowings in Canadian dollars bear interest at CDOR or Canadian Prime plus the applicable margin. Borrowings in US dollars bear interest at US Base Rate or LIBOR plus the applicable margin.

As at March 31, 2021, the Company complied with all the required financial covenants.

5. Dividends:

The monthly dividend rate, approved by the Board of Directors, was $0.065 for the three months ended March 31, 2021 (2020 - $0.065). Dividends declared for the three months ended March 31, 2021 were $13,413 (2020 - $13,287).

6. 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.

(In thousands of Canadian dollars)

The following details the earnings per share, basic and diluted, calculations for the three months ended March 31, 2021 and 2020:

	Three months ended March 31, 2021	2020
Profit attributable to common shareholders (basic and diluted)	$ 10,175	$ 38,905
Weighted average number of Common Shares (in number of shares):		
Outstanding beginning of period	68,784,513	66,542,725
Issued on redemption of LTIP[1]	–	12,747
Issued on conversion of convertible debenture[2]	–	1,410,924
Vested LTIP awards	1,328,987	1,614,266
Outstanding end of period – Basic	70,113,500	69,580,662
Dilutive effect of unvested LTIP awards	370,027	410,727
Diluted	70,483,527	69,991,389
Earnings per share:		
Basic	$ 0.15	$ 0.56
Diluted	$ 0.14	$ 0.56

[1] During the three months ended March 31, 2021, nil shares (2020 – 105,387 shares) were issued on redemption of LTIP units.
[2] During the three months ended March 31, 2021, nil shares (2020 – 1,560,874 shares) were issued on conversion of convertible debentures.

7. Segmented information:

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 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 interim financial statements:

	Three months ended March 31, 2021	2020
Revenue:		
Canada	$ 152,880	$ 143,282
United States	88,250	87,932
International	16,010	11,834
Consolidated total	$ 257,140	$ 243,048

(In thousands of Canadian dollars)

	March 31, 2021	December 31, 2020
Total assets:		
Canada	$ 894,303	$ 900,439
United States	489,121	488,771
International	145,335	125,296
Consolidated total	$ 1,528,759	$ 1,514,506

8. Supplementary cash flow information:

Change in operating working capital for the three months ended March 31, 2021 and 2020 was as follows:

	March 31, 2021	March 31, 2020
Trade and other receivables	$ (1,265)	$ (18,023)
Unbilled fees	(4,697)	12,174
Prepaid expenses and other	(1,766)	(3,895)
Deferred implementation costs	(831)	(3,117)
Trade and other payables	23,049	1,981
Deferred revenue	1,408	5,708
	$ 15,898	$ (5,172)

Cash, net of bank indebtedness reconciliation as at March 31, 2021 and December 31, 2020 was as follows:

	March 31, 2021	December 31, 2020
Bank indebtedness	$ –	$ (12,784)
Cash	6,037	8,736
Cash (Bank indebtedness, net of cash)	$ 6,037	$ (4,048)

9. 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 long-term debt, approximate their carrying values due to their short-term nature.

(In thousands of Canadian dollars)

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, 2021	Carrying Value and Fair Value December 31, 2020	Level
Assets carried at fair value:			
Interest rate and total return swaps	$ 256	$ –	2
	$ 256	$ –	
Liabilities carried at fair value:			
Interest rate swaps	$ 5,961	$ 6,936	2
Future consideration related to acquisitions (contingent portion)	2,887	554	3
	$ 8,848	$ 7,490	

During the three months ended March 31, 2021, there were no transfers between any levels.

(a) Interest rate and total return swaps:

The Company utilizes derivatives to manage interest rate risk related to the Company's Credit Facility Agreement and equity price risk exposure related to share-based compensation plans that are accounted for as liabilities. The fair value of the interest rate and total return swaps is 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. The fair value reflects the credit risk of the instruments and includes adjustments to account for the credit risk of the Company and the derivative counterparties, when appropriate. The Company applies hedge accounting to derivatives that meet the criteria for hedge accounting in IFRS 9 *Financial Instruments*. For an effective cash flow hedge, the change in value of the hedging instrument is recognized in other comprehensive (loss) income.

During the quarter, the Company entered into the following swap arrangements:

- Interest rate swap to hedge against the variable rate component on $50,000 borrowed under the Credit Facility Agreement for the period from February 8, 2021 to July 27, 2023. The notional amount of this swap is $50,000 and is used to fix the variable component of the interest rate at 0.59%, before the applicable margin, for the duration of the period.

- Total return swap to hedge its exposure to changes in future cash flows due to changes in the Company's stock price in forecasted obligations related to future payments under its Phantom Plan. The notional amount of the swap is $4,219 with a one-year term that is extendable to match the vesting period of the corresponding awards.

(In thousands of Canadian dollars)

(b) Future consideration related to acquisitions (contingent portion):

The future consideration related to acquisitions is a financial instrument carried at fair value through profit or loss. Contingent consideration arose on past acquisitions 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).

Financial instruments carried at amortized cost:

Cash, trade and other receivables, cash and investments held in trust, bank indebtedness, trade and other payables, insurance premium liabilities, dividends payable and long-term debt are carried at amortized cost, which approximates their fair value.

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 trade and other receivables recognized at the reporting date.

10. Revenue:

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

	Three months ended March 31, 2021	2020
Wellbeing Solutions	$ 100,395	$ 90,333
Administrative Solutions	100,073	98,048
Retirement Solutions	31,689	30,063
Health and Productivity Solutions	24,983	24,604
	$ 257,140	$ 243,048