MORNEAU SHEPELL MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED DECEMBER 31, 2016

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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, 2016 and should be read in conjunction with the consolidated financial statements of Morneau Shepell and notes thereto for the years ended December 31, 2016 and 2015. 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, 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. These ratios, however, are non-IFRS measures and therefore, should not be seen as a substitute for cash flow from operating activities. 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.

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 2, 2017, Morneau Shepell had 53,228,470 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 2,800,000.

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

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 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.

2016 SUMMARY AND OUTLOOK

(In thousands of dollars)	**Three months ended December 31, 2016**	**Three months ended December 31, 2015**	**Year ended December 31, 2016**	**Year ended December 31, 2015**
Revenue	$149,089	$145,696	$592,057	$567,286
Organic Revenue [1]	$146,004	$142,154	$568,281	$548,546
Adjusted EBITDA	$26,714	$25,211	$112,261	$105,801
Adjusted EBITDA margin	17.9%	17.3%	19.0%	18.7%
Normalized Free Cash Flow	$19,690	$18,178	$70,902	$61,584
Profit	$5,660	$2,422	$26,000	$16,418

Footnote:

(1) Organic Revenue is defined as revenue excluding acquisitions not in the comparative period and divestitures, and the Health Republic Insurance of New York (HRINY), who was given a wind-down of business directive by the New York State Department of Financial Services in 2015, and is calculated as follows:

(In thousands of dollars)	**Three months ended December 31, 2016**	**Three months ended December 31, 2015**	**Year ended December 31, 2016**	**Year ended December 31, 2015**
Revenue	**$149,089**	**$145,696**	**$592,057**	**$567,286**
Acquisitions	3,085	–	23,776	–
HRINY	–	3,542	–	18,740
Organic Revenue	**$146,004**	**$142,154**	**$568,281**	**$548,546**

Fourth quarter:

We continued to deliver revenue, profit and adjusted EBITDA growth versus the comparative quarter in 2015:

- Revenue and Organic Revenue growth of 2.3% and 2.7%.
- An increase in profit of $3.2 million to $5.7 million.
- An increase in Adjusted EBITDA of $1.5 million to $26.7 million, with Adjusted EBITDA Margin increasing to 17.9% from 17.3%.

Highlights of 2016:

- Revenue and Organic Revenue grew by 4.4% and 3.6%, respectively, versus last year from new business wins and continued growth with existing clients from all four lines of our business.
- Profit for the year increased by $9.6 million to $26.0 million compared to $16.4 million in the prior year.
- Adjusted EBITDA increased by $6.5 million to $112.3 million, or 6.1% versus the prior year with Adjusted EBITDA Margin increasing to 19.0% from 18.7%.
- On December 20, 2016, the Company completed the acquisitions of Solareh, Société pour L`Avancement Des Ressources Humaines Inc. ("Solareh"), a national health and wellness services company, and Les Consultants Longpré & Associés Inc. ("Longpré"), an employee assistance and wellness program provider. These acquisitions complement the Company's existing employee support solutions line of business, and expand our presence in the Quebec region.
- During 2016, the Company completed several significant financing transactions that provide the Company the financial flexibility to pursue strategic acquisitions and new business initiatives. In June 2016, the Company completed the issuance of $86 million principal amount of 4.75% Convertible Unsecured Subordinated Debentures for net proceeds of $82.0 million. The previously issued and outstanding 5.75% Convertible Unsecured Subordinated Debentures (the "5.75% Convertible Debentures") in the principal amount of $72.4 million were converted by holders to common shares of the Company after the Company issued a notice of redemption, and the $2.5 million principal amount of 5.75% Convertible Debentures that still remained outstanding after the notice of redemption period was over were then redeemed for cash by the Company. In December 2016, the Company also amended the maturity date of the existing credit facility agreement that was set to mature on November 29, 2017 to December 20, 2020. The amended credit agreement includes a revolving facility of $300.0 million plus a $100.0 million accordion feature activated at the Company's discretion.

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.

2016 OPERATING RESULTS SUMMARY

Results of Operations	**Three months ended December 31,**		**Year ended December 31,**	
Selected Consolidated Financial Information	**2016**	**2015**	**2016**	**2015**
(In thousands of dollars, except per share amounts)				
Revenue	$149,089	$145,696	$592,057	$567,286
Deduct:				
Salaries, benefits and contractor expenses	101,702	105,438	404,142	392,121
Other operating expenses	26,305	23,510	98,772	88,027
Finance costs	3,140	4,178	14,889	15,002
Depreciation and amortization	9,112	8,610	35,238	32,867
Write-down of deferred implementation costs and impairment	–	–	935	15,100
Income tax expenses	3,170	1,538	12,081	7,751
Profit for the period	**5,660**	**2,422**	**26,000**	**16,418**
Add:				
Finance costs	3,140	4,178	14,889	15,002
Depreciation and amortization	9,112	8,610	35,238	32,867
Income tax expenses	3,170	1,538	12,081	7,751
EBITDA (1)	$21,082	$16,748	$88,208	$72,038
Adjustments:				
Sublease loss provision	1,800	–	2,200	700
Reorganization and operational effectiveness initiatives	2,549	4,440	12,410	4,440
Write-down of deferred implementation costs and impairment	–	–	935	15,100
Mercer Canada Outsourcing conversion costs	1,283	4,023	8,508	13,523
Adjusted EBITDA	**$26,714**	**$25,211**	**$112,261**	**$105,801**
EBITDA margin (2)	14.1%	11.5%	14.9%	12.7%
Adjusted EBITDA margin (2)	17.9%	17.3%	19.0%	18.7%
Cash provided by operating activities	$27,947	$38,899	$67,039	$63,898
Deduct: Capital expenditures (3)	(4,507)	(5,788)	(22,507)	(25,913)
Free Cash Flow (4)	**23,440**	**33,111**	**44,532**	**37,985**
Add (deduct):				
Changes in non-cash operating working capital	(7,467)	(24,805)	9,734	(4,988)
Mercer Canada Outsourcing conversion – capital	–	270	–	658
Current income taxes, net of income taxes paid	(115)	1,614	(3,990)	(1,769)
Adjustments to EBITDA (5)	3,832	7,988	20,626	29,698
Normalized Free Cash Flow (6)	**$19,690**	**$18,178**	**$70,902**	**$61,584**
Earnings per Share (basic)	$0.10	$0.05	$0.49	$0.33
Earnings per Share (diluted)	$0.10	$0.05	$0.49	$0.33
Adjusted EBITDA per Share (basic)	$0.49	$0.51	$2.13	$2.14
Dividends declared	$10,374	$9,379	$39,999	$37,467
Twelve-month rolling Normalized Payout Ratio (7)	56.4%	60.8%	56.4%	60.8%
Twelve-month rolling Normalized Payout Ratio, including changes in adjusted non-cash operating working capital (8)	66.4%	66.5%	66.4%	66.5%

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 sublease loss provisions, and for the year ended December 31, 2016, non-cash reorganization and operational effectiveness initiatives costs of $292. For the comparative three month period ended December 31, 2015, adjustments to EBITDA do not include non-cash reorganization and operational effectiveness initiative costs of $475, and for the comparative year then ended, impairment charges for internally developed software of $2,890 recognized as a result of the wind-down of business directive issued to HRINY. 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 year ended December 31, 2016, non-cash working capital was adjusted by $(935) which represents adjustments to working capital for the write-down of HRINJ deferred implementation costs. For the comparative three months ended December 31, 2015, the non-cash working capital was adjusted for by $(4,038), and for the comparative year then ended the non-cash operating working capital was adjusted for by $(10,262), which represents 2014 leasehold inducements receivable related to capital expenditures collected in 2015 and the year over year change in non-cash operating working capital resulting from the HRINY deferred implementation costs write-off.

ANALYSIS OF FOURTH QUARTER 2016 OPERATING RESULTS

Revenue

Revenue for the three months ended December 31, 2016 increased by $3.4 million, or 2.3%, to $149.1 million compared to $145.7 million for the same period in 2015. Excluding revenue from acquisitions not in the comparative period and HRINY in 2015, Organic revenue grew by $3.9 million or 2.7%.

The increase is primarily coming from our Administrative Solutions and ESS lines of business as a result of increased activity with existing clients and new client wins.

Salaries, Benefits and Contractor Expenses

Salaries, benefits and contractor expenses for the three months ended December 31, 2016 decreased by $3.7 million, or 3.5%, to $101.7 million compared to $105.4 million for the same period in 2015. Excluding the net decrease in compensation expense of $0.4 million resulting from acquisitions not in the comparative period net of the wind-down of HRINY in 2015, compensation expense decreased by $3.4 million mainly due to lower compensation costs incurred related to reorganization and operational effectiveness costs of $1.9 million and for Mercer Canada Outsourcing conversion of $2.0 million.

Other Operating Expenses

Other operating expenses for the three months ended December 31, 2016 increased by $2.8 million, or 11.9%, to $26.3 million compared to $23.5 million for the same period in 2015. Excluding the net decrease in other operating expenses of $0.4 million resulting from acquisitions not in the comparative period net of the wind-down of HRINY in 2015, other operating expenses grew by $3.2 million due to a $1.8 million sublease loss provision and $1.4 million of general increases required to support the Company's continued growth.

Finance Costs

Finance costs for the three months ended December 31, 2016 decreased by $1.0 million, or (24.8)%, to $3.1 million compared to $4.2 million for the same period in 2015, due to reduced borrowings under the Company's credit facility agreement.

Depreciation and Amortization

Depreciation and amortization for the three months ended December 31, 2016 increased by $0.5 million, or 5.8%, to $9.1 million compared to $8.6 million for the same period in 2015. The increase is mainly due to higher amortization related to internally developed software to support the Company's growth, customer requirements and new service offerings.

Income Tax Expenses

Income tax expenses increased by $1.6 million to $3.2 million compared to $1.5 million for the same period in 2015 due to higher profit before tax with the effective tax rate for both periods remaining comparable.

Profit for the Period

As a result of the changes noted above, the profit for the three months ended December 31, 2016 increased by $3.2 million to $5.7 million compared to a $2.4 million for the same period in 2015.

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

Adjusted EBITDA and EBITDA

Adjusted EBITDA increased by $1.5 million, or 6.0%, to $26.7 million compared to $25.2 million for the same period in 2015. The increase is primarily due to growth in revenue of $3.4 million, partially offset by an increase in salaries other operating expenses of $1.9 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, 2016 operating results section below.

EBITDA increased by $4.3 million to $21.1 million compared to $16.7 million for the same period in 2015.

Free Cash Flow

Free Cash Flow for the three months ended December 31, 2016 decreased by $9.7 million to $23.4 million compared to $33.1 million for the same period in 2015. The decrease is primarily due to lower cash provided by operating activities of $11.0 million due to less favorable changes in non-cash operating working capital, partially offset by lower capital expenditures of $1.3 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, 2016 increased by $1.5 million to $19.7 million compared to $18.2 million for the same period in 2015. The increase is due to higher cash generated from operating activities after EBITDA adjustments of $2.2 million, lower capital expenditures of $1.0 million and finance costs paid of $0.7 million, partially offset by higher current tax expense of $2.3 million.

ANALYSIS OF YEAR ENDED DECEMBER 31, 2016 OPERATING RESULTS

Revenue

Revenue for the year ended December 31, 2016 increased by $24.8 million, or 4.4%, to $592.1 million compared to $ 567.3 million for 2015.

Excluding revenue from acquisitions not in the comparative period and HRINY in 2015, organic revenue grew by $19.7 million or 3.6%. The increase is coming from all four of our lines of business as a result of increased activity with existing clients and new client wins.

Salaries, Benefits and Contractor Expenses

Salaries, benefits and contractor expenses for the year ended December 31, 2016 increased by $12.0 million, or 3.1%, to $ 404.1 million compared to $392.1 million for the same period in 2015. Excluding the net increase in compensation expense of $2.1 million resulting from acquisitions not in the comparative period net of the wind down of HRINY in 2015, compensation expense increased by $9.9 million. This increase is mainly attributable to higher reorganization and operational effectiveness initiatives costs of $8.0 million and $5.3 million of general merit increases, partially offset by lower Mercer Canada Outsourcing conversion compensation costs of $3.4 million.

Other Operating Expenses

Other operating expenses for the year ended December 31, 2016 increased by $10.8 million, or 12.2%, to $98.8 million compared to $88.0 million for the same period in 2015. Excluding the net decrease in other operating expenses of $0.5 million resulting from acquisitions not in the comparative period net of the wind-down of HRINY in 2015, other operating expenses grew by $11.3 million. The increase is due to $1.5 million of higher sublease loss provisions, and $9.8 million of general increases required to support the Company's continued growth.

Finance Costs

Finance costs for the year ended December 31, 2016 decreased by $0.1 million, or (0.8)% to $14.9 million compared to $15.0 million for the same period in 2015. The decrease in finance costs is due to reduced borrowings under the Company's credit facility agreement, partially offset by higher non-cash interest expense related to the 5.75% Convertible Debentures converted and redeemed during the year.

Depreciation and Amortization

Depreciation and amortization for the year ended December 31, 2016 increased by $2.4 million, or 7.2%, to $35.2 million compared to $32.9 million for the same period in 2015. The increase is mainly due to higher amortization related to internally developed software to support the Company's growth, customer requirements and new service offerings.

Write-down of Deferred Implementation Costs and Impairment

For the year ended December 31, 2016, as detailed in the discussion of Adjusted EBITDA items below, the Company determined that deferred implementation costs specifically related to HRINJ were no longer recoverable and recorded a pre-tax write-down in the amount of $0.9 million ($0.6 million after tax).

For the year ended December 31, 2015, as detailed in the discussion of Adjusted EBITDA items below, we determined that deferred implementation costs related to HRINY were no longer recoverable and recorded

a pre-tax write-down of $12.2 million ($8.6 million after tax). In addition, we also recognized impairment charges on internally developed software related to U.S. Health Exchange Outsourcing services in the pre-tax amount of $2.9 million ($2.1 million after tax).

Income Tax Expenses

Income tax expenses for the year ended December 31, 2016 increased by $4.3 million, or 55.9%, to $12.1 million compared to $7.8 million for the same period in 2015 due to higher profit for the year with the effective tax rates for both years remaining comparable.

Profit for the Year

As a result of the changes noted above, the profit for the year ended December 31, 2016 was $26.0 million compared to $16.4 million for the same period in 2015.

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

Adjusted EBITDA and EBITDA

Adjusted EBITDA increased by $6.5 million, or 6.1%, to $112.3 million compared to $105.8 million for the same period in 2015. The increase is primarily due to growth in revenue of $24.8 million, partially offset by an increase in salaries and other operating expenses of $18.3 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, 2016 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 we have substantially completed the original planned conversion. As a result of the savings we realized from the original conversion, we decided to convert the remaining clients acquired which were not included in the original conversion. Based on our project plan this additional conversion is expected to finish in the third quarter of 2017.

- The write-down of deferred implementation costs related to HRINJ arose as a result of an Order of Rehabilitation entered by the Superior Court of New Jersey. The comparative write-down of deferred implementation costs and impairment losses on internally developed software in 2015 was triggered by the sudden wind-down of HRINY. In both cases the events were triggered by business directives issued by regulatory authorities in the United States due to the volatility of the Health Exchange program. It is not typical for our Administrative Solutions contracts to be terminated shortly after the commencement of their first outsourcing term.

- Reorganization and operational effectiveness initiatives represents severance, professional fees and exit costs incurred as a result of the loss of the Health Exchange Clients, corporate reorganizations and employee terminations to achieve post-acquisition planned synergies.

- The sublease loss provisions arose as a result of our decision to sublet excess office space now available in Montreal with the acquisitions of Longpré and Solareh to achieve planned post-acquisition synergies, and to sublet excess space in our U.S. office used to service our U.S. Health Exchange business.

EBITDA increased by $16.2 million to $88.2 million compared to $72.0 million for the same period in 2015.

Free Cash Flow

Free Cash Flow for the year ended December 31, 2016 increased by $6.5 million to $44.5 million compared to $38.0 million for the same period in 2015. The increase is primarily due to higher cash provided by operating activities of $3.1 million due to higher profit for the period and lower capital expenditures of $3.4 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, 2016 increased by $9.3 million to $70.9 million compared to $61.6 million for the same period in 2015. The increase was mainly due to higher cash generating from operating activities before changes in non-cash operating working capital and EBITDA adjustments of $5.2 million, lower capital expenditures adjusted for Mercer Outsourcing Conversion capital of $2.7 million and lower finance costs paid of $2.3 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, 2016**	**Year ended December 31, 2015**
Operating activities	$ 67,039	$ 63,898
Financing activities	(38,554)	(20,859)
Investing activities	(33,441)	(35,968)
Increase (decrease) in cash	$ (4,956)	$ 7,071

Cash provided by operating activities for the year ended December 31, 2016 increased by $3.1 million to $67.0 million compared to $63.9 million for the same period in 2015. The increase is due to lower finance costs of $2.3 million primarily due to timing on when the first semi-annual convertible debenture interest payment was due and lower income taxes paid of $1.3 million.

Cash used in financing activities for the year ended December 31, 2016 increased by $17.7 million to $38.6 million compared to $20.9 million for the same period in 2015. The net proceeds raised from the issuance of the new $86.0 million 4.75% convertible debentures were used primarily to pay down amounts borrowed under the credit facility and to fund the redemption of the previously issued 5.75% convertible debentures that remained outstanding. As a result, the change is primarily due to repayment of amounts borrowed under the credit facility in 2016.

Cash used in investing activities for the year ended December 31, 2016 decreased by $2.5 million to $33.4 million compared to $36.0 million for the same period in 2015. The decrease is due to lower additions to intangible and capital assets of $3.4 million (see discussion of capital expenditures below), partially offset by higher acquisition related payments of $0.8 million.

Dividends to Shareholders

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

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, 2016 was 56.4% compared to 60.8% for the same period in 2015. The decrease in the Normalized Payout Ratio is primarily due to higher Normalized Free Cash Flow during the past twelve months.

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, 2016 decreased by $1.3 million to $4.5 million compared to $5.8 million for the same period in 2015 and the decrease for the year ended December 31, 2016 was $3.4 million to $22.5 million from $25.9 million in the comparative period. The decrease in capital expenditures for the three months ended December 31, 2016 is due to reduced hardware and software purchases of $0.5 million, and lower internally developed software expenditures of $0.7 million. The decrease in capital expenditures for the year ended December 31, 2016 is due to reduced leasehold improvements and office furniture expenditures of $2.0 million (net of leasehold inducements) primarily due to the completion of the offices consolidation in various regions in the comparative year, and lower internally developed software expenditures of $0.6 million.

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 section "Capital Resources."

We are 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 above. We consider the risk of default by the subtenants to be low 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**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022 and thereafter**
Long-term debt	$ 167,385	$ –	$ –	$ –	$ 167,385	$ –	$ –
Convertible debenture	86,000	–	–	–	–	86,000	–
Operating leases, net	100,173	15,500	14,488	13,636	13,391	12,741	30,417
Total	**$ 353,558**	**$ 15,500**	**$ 14,488**	**$ 13,636**	**$180,776**	**$ 98,741**	**$ 30,417**

Contingent Consideration

The purchase price for Solareh, Longpré, Bensigner Du Pont & Associates, Inc. ("BDA"), and the U.S. health and welfare benefits administration business of Ceridian are contingent on future business results and the estimated remaining contingent consideration payable of $7.5 million is due from 2017 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, 2016.

In addition there is $0.2 million of contingent consideration for other smaller acquisitions that is due in 2018.

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, 2016**	**As at December 31, 2015**
Cash	$ –	$ 1,900
Bank indebtedness	3,056	–
Long-term debt, net of debt issuance costs	166,299	241,846
Convertible debenture, net of issuance costs and equity component of debenture	81,096	73,760
Shareholders' equity	361,707	296,424

Long-term debt

Long-term debt, net of debt issuance costs, decreased by $75.5 million from $241.8 million as at December 31, 2015 to $166.3 million as at December 31, 2016 due to repayments of amounts borrowed under the Company's credit facility agreement from the proceeds received from the issuance of convertible debentures (see discussion on the issuance of convertible debentures under the convertible debentures section below).

The Company had a credit facility agreement (the "Credit Facility Agreement") maturing on November 29, 2017 which provided for a revolving facility of $300.0 million (including a swing line of $7.0 million).

During the fourth quarter of 2016, the Credit Facility Agreement was amended to form the amended credit facility agreement (the "Amended Credit Facility Agreement"). The Amended Credit Facility Agreement matures on December 20, 2020 and provides for a revolving facility of $300.0 million (including a swing line of $14.0 million).

The interest rates for the Amended 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 our consolidated debt to Adjusted EBITDA as defined in the Amended Credit Facility agreement.

The Amended 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 Amended Credit Facility Agreement with a purchase price of $25,000 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, 2016.

Interest-rate Swap

In February 2014, the Company entered into a forward starting interest-rate swap agreement to hedge against the variable interest rate component on $160.0 million notional amount borrowed under the Credit Facility Agreement for the period from January 5, 2015 up to and ending November 29, 2017. The notional amount of this swap is $160.0 million and is used to fix the variable component of the interest rate at 1.98%, before the applicable margin, for the duration of this period and has been designated as a cash flow hedge.

Convertible debentures

On March 27, 2012, the Company issued $75.0 million principal amount of 5.75% Convertible Unsecured Subordinated Debentures (the “5.75% Convertible Debentures”) for net proceeds of $71.4 million with a maturity date of March 31, 2017. The 5.75% Convertible Debentures were convertible at the option of the holder to common shares at a conversion price of $15.0 per common share, and the Company had the option to redeem the 5.75% Convertible Debentures after March 31, 2016 at a redemption price equal to 100% of their principal amount plus accrued and unpaid interest. In May 2016, the Company issued a notice of redemption for the remaining outstanding 5.75% Convertible Debentures. During the six months ended June 30, 2016, 5.75% Convertible Debentures in the principal amount of $72.4 million were converted by holders to common shares. In June 2016, the Company exercised its option to redeem all the $2.5 million principal amount of 5.75% Convertible Debentures that still remained issued and outstanding for cash.

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 will be 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, 2016	As at December 31, 2015
Current assets	$ 160,938	$ 156,410
Non-current assets	612,688	599,238
Current liabilities	97,082	77,761
Non-current liabilities	314,837	381,463

Current Assets

Current assets as at December 31, 2016 increased by $4.5 million to $160.9 million from $156.4 million as at December 31, 2015. The increase is primarily attributable to an increase in prepaid expenses and other assets of $2.0 million, an increase in cash and investments held in trust of $4.8 million, and an increase in the current portion of deferred implementation costs of $1.7 million. This was partially offset by a bank indebtedness balance as at December 31, 2016 compared to a cash balance of $1.9 million at December 31, 2015 year end, and lower trade and other receivables and unbilled fees of $1.4 million due to improved collection cycle.

Non-current Assets

Non-current assets as at December 31, 2016 increased by $13.5 million to $612.7 million from $599.2 million at December 31, 2015. The increase was primarily due to an increase in the non-current portion of deferred implementation costs of $8.6 million from increased deferred implementation activities in the U.S. for outsourcing contracts that commenced services in the fourth quarter of 2016, an increase in the non-current portion of unbilled fees $5.1 million due to contract billing terms, and goodwill acquired of $3.1 million from the acquisition of Solareh. This was partially offset by a decrease in capital and intangible assets of $3.9 million due to depreciation and amortization in excess of capital expenditures and capital, and intangible assets acquired via acquisitions for the year.

Current Liabilities

Current liabilities as at December 31, 2016 increased by $19.3 million to $97.1 million from $77.8 million as at December 31, 2015. The increase is mainly due to an increase in deferred revenue of $2.6 million due to timing of consideration received from clients, an increase in the current portion of future consideration related to acquisitions of $4.2 million, higher insurance premium liabilities of $4.8 million, higher trade and other payables of $4.9 million due to timing of payments to vendors and change in compensation related accruals, bank indebtedness of $3.1 million and income taxes payable of $2.2 million compared to an income taxes receivable balance as at December 31, 2015. This was partially offset by the repayment of the $2.5 million promissory note issued as partial consideration for the acquisition of Groupe AST (1993) Inc.

Non-current Liabilities

Non-current liabilities as at December 31, 2016 decreased by $66.6 million to $314.8 million from $381.5 million at December 31, 2015. The decrease is mainly due to the repayment of $75.1 million of the long-term debt from proceeds received from the issuance of the 4.75% Convertible Debentures. This was partially offset by an increase in the convertible debentures balance of $7.3 million due to the issuance of the 4.75% Convertible Debentures net of the conversion and redemption of all of the remaining 5.75% Convertible Debentures outstanding.

As a result of the changes in current assets and current liabilities discussed above, our working capital decreased by $14.7 million from $78.6 million as at December 31, 2015 to $63.9 million as at December 31, 2016.

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, 2016 and 2015. 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, which is at the later of the billing or the effective date of the policy, 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 depreciated. 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 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 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.

Changes in Accounting Policies

The Company has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2016.

IAS 12, Income Taxes ("IAS 12")

Following the November 2016 publication of the IFRS Interpretations Committee's agenda decision addressing the expected manner of recovery of intangible assets with indefinite useful lives for the purposes of measuring deferred tax, we have retrospectively changed our related accounting policy. The Interpretations Committee noted that, in applying IAS 12, an entity determines its expected manner of

recovery of the carrying amount of the intangible asset with an indefinite useful life, and reflects the tax consequences that follow from that expected manner of recovery. Previously, we measured deferred taxes on temporary differences arising from indefinite-life intangible assets based upon the tax that would result solely from sales of the assets. Consequently, we have adopted an accounting policy to measure deferred taxes on temporary differences arising from indefinite-life intangible assets based upon the tax consequences that follow from the expected manner of recovery of the assets.

As a result of the retrospective adoption of this accounting policy, certain amounts previously reported in the consolidated financial statements as at and for the year ended December 31, 2015 were amended. The effect of the change in accounting policy was a decrease in shareholders' equity of $4,690 and an increase in deferred tax liabilities of $4,690 as at January 1, 2015 and December 31, 2015.

Future Accounting Changes

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

On May 28, 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 intends to adopt IFRS 15 in its financial statements for the annual period beginning on January 1, 2018.

We expect the application of IFRS 15 will impact our financial statements in respect of timing of revenue recognition and the accounting for deferred implementation costs related to certain groups of clients within our Administrative Solutions line of business. We have made progress in our implementation of IFRS 15, but it is not yet possible to make a final determination of the impact of the new standard on our financial statements. We expect to report more detailed information in our 2017 financial statements.

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 extent of the impact of adoption of the standard is not expected to be 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 results in 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.

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 external auditors and 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.

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.

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. Further, 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.

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.

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, 2016 and 2015.

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 $13.9 million for the year ended December 31, 2016. 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 fixed and floating interest rate of Morneau Shepell's credit facility related overall cost of borrowing.

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.

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 the 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 Corporation’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, 2016**	**Year ended December 31, 2015**	**Year ended December 31, 2014**
Revenue	$592,057	$567,286	$535,866
Profit [(1)]	26,000	16,418	25,140
Earnings per share (basic)	0.49	0.33	0.51
Earnings per share (diluted)	0.49	0.33	0.51
Dividends declared per share	0.78	0.78	0.78
Total assets	773,626	755,648	756,655
Total long-term debt [(2)]	247,395	315,606	295,310

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, 2016**	**September 30, 2016**	**June 30, 2016**	**March 31, 2016**	**December 31, 2015**	**September 30, 2015**	**June 30, 2015**	**March 31, 2015**
Revenue	149,089	144,594	149,251	149,123	145,696	140,778	142,420	138,392
Profit (loss) [(1)]	5,660	5,210	8,081	7,049	2,422	(3,487)	9,272	8,211
EBITDA	21,082	19,098	25,449	22,579	16,748	7,391	24,653	23,246
Adjusted EBITDA	26,714	27,187	29,533	28,828	25,211	25,886	28,060	26,644
EBITDA margin	14.1%	13.2%	17.1%	15.1%	11.5%	5.3%	17.3%	16.8%
Adjusted EBITDA margin	17.9%	18.8%	19.8%	19.3%	17.3%	18.4%	19.7%	19.3%
Earnings (loss) per share (basic)	0.10	0.09	0.16	0.14	0.05	(0.07)	0.19	0.17
Earnings (loss) per share (diluted)	0.10	0.09	0.16	0.14	0.05	(0.07)	0.19	0.16
Normalized Free Cash Flow	19,690	17,323	18,585	15,308	18,178	13,177	16,054	14,175
Dividends declared	10,374	10,355	9,857	9,413	9,379	9,365	9,363	9,360
Twelve-month rolling normalized payout ratio	56.4%	56.2%	58.3%	59.8%	60.8%	65.9%	70.6%	74.8%
Twelve-month rolling normalized payout ratio, including changes in adjusted non-cash operating working capital	66.4%	54.2%	60.1%	58.7%	66.5%	89.0%	114.5%	107.5%
Total assets	773,626	760,402	768,256	757,357	755,648	762,021	775,921	772,449
Total long-term debt [(2)]	247,395	253,293	262,031	316,292	315,606	325,686	323,923	303,904

Footnotes:

(1) The profit for the quarter ended September 30, 2015 included the write-down of deferred implementation costs and impairment charges totaling $15,100 related to HRINY.

(2) 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, 2016.

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, 2016. No changes were made in our internal controls over financial reporting during the fourth quarter ended December 31, 2016, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Additional Information

Morneau Shepell's shares currently trade on the Toronto Stock Exchange under the symbol MSI. 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 2, 2017.