Unaudited Condensed Consolidated Interim Financial Statements
(In Canadian dollars)

MORNEAU SHEPELL INC.

Three months ended March 31, 2013 and 2012
(Unaudited)

MORNEAU SHEPELL INC.

Unaudited Condensed Consolidated Interim Statements of Financial Position
(In thousands of Canadian dollars)
March 31, 2013 and December 31, 2012

	March 31, 2013	December 31, 2012 (note 3)	January 1, 2012 (note 3)
Assets			
Current assets:			
Trade and other receivables	$ 64,366	$ 55,576	$ 50,779
Unbilled fees	51,394	44,812	34,862
Prepaid expenses and other	4,667	2,532	3,105
Cash and investments held in trust	9,323	14,174	12,248
Deferred implementation costs	3,353	2,668	2,121
Total current assets	133,103	119,762	103,115
Unbilled fees	1,170	1,649	1,505
Deferred implementation costs	9,562	10,360	7,000
Capital assets	20,825	21,273	23,961
Intangible assets	225,674	228,325	230,716
Goodwill	305,054	304,988	301,792
Total assets	$ 695,388	$ 686,357	$ 668,089
Liabilities and Equity			
Current liabilities:			
Bank indebtedness	$ 4,191	$ 134	$ 807
Trade and other payables	50,537	47,181	47,092
Income taxes payable	2,367	3,949	213
Deferred revenue	3,681	2,786	2,250
Insurance premium liabilities	9,323	14,174	12,248
Future consideration related to acquisitions (note 9)	2,882	2,858	500
Dividends payable	3,116	3,116	3,116
Total current liabilities	76,097	74,198	66,226
Long-term debt (note 4)	162,260	153,073	207,121
Convertible debenture payable	71,333	71,104	–
Interest rate swap (note 4)	2,821	3,101	5,389
Future consideration related to acquisitions (note 9)	–	451	1,653
Other liabilities	8,126	8,526	8,307
Provisions	1,382	1,419	1,887
Deferred tax liability	27,723	27,867	20,391
Total Liabilities	349,742	339,739	310,974
Equity:			
Share capital	473,838	473,838	473,838
Contributed surplus	13,689	12,674	8,721
Equity component of convertible debenture	757	757	–
Accumulated other comprehensive loss	(2,761)	(3,329)	(5,116)
Deficit	(139,877)	(137,322)	(120,328)
Total equity	345,646	346,618	357,115
Total liabilities and equity	$ 695,388	$ 686,357	$ 668,089

Contingencies (note 9)

See accompanying notes to 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, 2013 and 2012

	Three months ended March 31, 2013	Three months ended March 31, 2012 (note 3)
Operating revenue	$ 115,730	$ 103,966
Operating expenses:		
Salary, benefits and contractor	78,405	72,475
Depreciation and amortization	6,607	5,916
Rent and occupancy	5,366	4,477
Office and administration	11,771	10,841
Total operating expenses	102,149	93,709
Finance costs (note 4)	3,430	3,511
Profit from operations before income taxes	10,151	6,746
Income taxes:		
Current	3,493	1,068
Deferred	(293)	1,257
Total income taxes	3,200	2,325
Profit for the period	6,951	4,421
Other comprehensive income:		
Items that may be reclassified subsequently to net income:		
Effective portion of change in interest rate cash flow hedge	280	1,526
Transfer to profit due to termination of interest rate cash flow hedges	–	583
Foreign currency translation differences for foreign operations	153	(150)
Income tax on the above items	(74)	(555)
	359	1,404
Items that will not be reclassified to net income:		
Re-measurements for post-employment benefit plans	284	(81)
Income tax on the above item	(75)	21
	209	(60)
Other comprehensive income, net of tax effect	568	1,344
Comprehensive income for the period	$ 7,519	$ 5,765
Earnings per share (note 6):		
Basic	$ 0.14	$ 0.09
Diluted	$ 0.14	$ 0.09

See accompanying notes to 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, 2013 and 2012

Three months ended March 31, 2013	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Equity component of convertible debentures	Total equity
Balance, January 1, 2013, as previously reported	$ 473,838	$ 12,674	$ (137,322)	$ (2,623)	$ 757	$ 347,324
IAS 19 opening adjustment (note 3)	–	–	–	(706)	–	(706)
Balance, January 1, 2013, restated	$ 473,838	$ 12,674	$ (137,322)	$ (3,329)	$ 757	$ 346,618
Long-term incentive plan - non-cash expense	–	857	–	–	–	857
Long-term incentive plan - DRIP	–	158	(158)	–	–	–
Profit for the period	–	–	6,951	–	–	6,951
Dividends	–	–	(9,348)	–	–	(9,348)
Other comprehensive income	–	–	–	568	–	568
Balance, March 31, 2013	$ 473,838	$ 13,689	$ (139,877)	$ (2,761)	$ 757	$ 345,646

Three months ended March 31, 2012	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Equity component of convertible debentures	Total equity
Balance, January 1, 2012, as previously reported	$ 473,838	$ 8,721	$ (120,328)	$ (4,648)	$ –	$ 357,583
IAS 19 opening adjustment (note 3)	–	–	–	(468)	–	(468)
Balance, January 1, 2012, restated	$ 473,838	$ 8,721	$ (120,328)	$ (5,116)	$ –	$ 357,115
Long-term incentive plan - non-cash expense	–	641	–	–	–	641
Long-term incentive plan - DRIP	–	119	(119)	–	–	–
Profit for the period	–	–	4,421	–	–	4,421
Dividends	–	–	(9,348)	–	–	(9,348)
Other comprehensive income (note 3)	–	–	–	1,344	–	1,344
Equity component of convertible debenture	–	–	–	–	757	757
Balance, March 31, 2012	$ 473,838	$ 9,481	$ (125,374)	$ (3,772)	$ 757	$ 354,930

See accompanying notes to 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, 2013 and 2012

	Three months ended March 31, 2013	2012
Operating activities:		
Profit for the period	$ 6,951	$ 4,421
Items not involving cash:		
Depreciation and amortization	6,607	5,916
Finance costs (note 4)	3,430	3,511
Long-term incentive plan	857	641
Current income taxes	3,493	1,068
Deferred income taxes	(293)	1,257
Change in provisions	(37)	(272)
Other	(97)	77
	20,911	16,619
Change in non-cash operating working capital (note 8)	(12,626)	(8,966)
Cash generated from operating activities	8,285	7,653
Finance costs paid	(3,026)	(2,652)
Income taxes paid	(5,075)	(38)
Cash provided by operating activities	184	4,963
Financing activities:		
Change in revolving loan	9,074	(64,795)
Proceeds from convertible debentures offering	–	75,000
Expenses related to issuance of convertible debentures	–	(3,568)
Dividends paid	(9,348)	(9,348)
Cash used in financing activities	(274)	(2,711)
Investing activities:		
Business acquisition – initial and contingent payment, SBC Systems Company Inc.	(500)	(4,740)
Additions to intangible assets	(1,742)	(2,382)
Additions to capital assets	(1,725)	(1,256)
Cash used in investing activities	(3,967)	(8,378)
Decrease in cash for the period	(4,057)	(6,126)
Bank indebtedness, beginning of period	(134)	(807)
Bank indebtedness, end of period	$ (4,191)	$ (6,933)

See accompanying notes to Unaudited Condensed Consolidated Interim Financial Statements.

1. Organization and nature of the business:

Morneau Shepell Inc. (the "Company") provides health and productivity, administrative and retirement solutions to assist employers in managing the financial security, health and productivity of their employees, whose principal and head office is located at One Morneau Shepell Centre, 895 Don Mills Road, Suite 700, Toronto, Ontario, M3C 1W3. The Company offers its services to organizations that are situated in Canada, in the United States and internationally.

The Company was incorporated pursuant to the laws of the Province of Ontario on October 19, 2010.

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

These Unaudited Condensed Consolidated Interim Financial Statements were approved by the Company's Board of Directors on May 14, 2013.

2. Basis of preparation:

These unaudited condensed consolidated interim financial statements for the three months ended March 31, 2013 and 2012 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, 2012 prepared in accordance with IFRS as issued by the IASB.

3. Significant accounting policies:

Except as described below, the accounting policies applied by the Company in these unaudited condensed consolidated interim financial statements are consistent with those applied by the Company in its consolidated financial statements as at and for the year ended December 31, 2012.

Changes in accounting policies:

The Company has adopted the following new and revised standards, along with any consequential amendments, effective January 1, 2013. These changes were made in accordance with the applicable transitional provisions.

(a) IAS 1 Amendment, Presentation of Items of Other Comprehensive Income ("IAS 1"):

The Company has adopted the amendments to IAS 1 effective January 1, 2013. These amendments required the Company to group other comprehensive income items by those that will be reclassified subsequently to profit or loss and those that will not be reclassified. The Company has reclassified comprehensive items of the comparative period. These changes did not result in any adjustments to other comprehensive income or comprehensive income.

(b) IFRS 10, Consolidated Financial Statements ("IFRS 10"):

IFRS 10 replaces International Accounting Standard ("IAS") 27, Consolidated and Separate Financial Statements, and SIC-12, Consolidation - Special Purpose Entities. This new standard contains a single consolidation model that identifies control as the basis for consolidation for all types of entities, sets forth factors to consider in assessing control, and requires control to be assessed on a continuous basis. The Company has assessed its consolidation conclusions on January 1, 2013 and determined that the adoption of IFRS 10 did not result in any change in the consolidation status of any of its subsidiaries and investees.

(c) IAS 19, Employee Benefits ("IAS 19")

IAS 19, Employee Benefits (amended in 2011), amends certain accounting requirements for defined benefit plans.

IAS 19 (revised 2011) requires the net defined benefit liability (asset) to be recognized on the balance sheet without any deferral of actuarial gains and losses and past service costs as previously allowed. Past service costs are recognized in net income when incurred. Expected returns on plan assets are no longer included in post- employment benefits' expense. Instead, post-employment benefits' expense includes market yields on high quality bonds. Re-measurements consisting of actuarial gains and losses, the actual return on plan assets (excluding the net interest component) and any change in the asset ceiling are recognized in other comprehensive income. The Company continues to immediately recognize in retained earnings all pension adjustments recognized in other comprehensive income.

The Company adopted these amendments retrospectively and adjusted its opening equity as at January 1, 2012 to recognize previously unrecognized past service costs and adjustments to the asset ceiling for post-employment plans. The adjustments for each financial statement line item affected are presented in the tables below.

(In thousands of Canadian dollars)

Adjustments to the unaudited condensed consolidated interim statements of financial position

	Deferred tax liability	Other liabilities	Trade and other payables	Accumulated other comprehensive income
Balance at January 1, 2012 as previously reported	$ 20,560	$ 7,670	$ 47,092	$ (4,648)
Re-measurements for post-employment benefit plans	(169)	637	–	(468)
Balance at January 1, 2012 after accounting change	$ 20,391	$ 8,307	$ 47,092	$ (5,116)

	Deferred tax liability	Other liabilities	Trade and other payables	Accumulated other comprehensive income
Balance at December 31, 2012 as previously reported	$ 28,122	$ 7,656	$ 47,090	$ (2,623)
Re-measurements for post-employment benefit plans	(255)	870	91	(706)
Balance at December 31, 2012 after accounting change	$ 27,867	$ 8,526	$ 47,181	$ (3,329)

Adjustments to the unaudited condensed consolidated interim statements of income and comprehensive income

	Three months ended March 31, 2012
Other comprehensive income, net of tax effect as previously reported	$ 1,404
Re-measurements for post-employment benefit plans	(81)
Income tax on the above item	21
Other comprehensive income, net of tax effect after accounting change	$ 1,344

There was no impact on earnings per share or the Unaudited Condensed Consolidated Interim Statements of Cash Flows as a result of the Company's adoption of these new and revised accounting standards. The total impact on other comprehensive income for the year ended December 31, 2012 as a result of the adoption of these new and revised accounting standards is $(238).

(In thousands of Canadian dollars)

(d) IFRS 13, Fair Value Measurement ("IFRS 13")

IFRS 13 provides a single framework for measuring fair value. The measurement of the fair value of an asset or liability is based on assumptions that market participants would use when pricing the asset or liability under current market conditions, including assumptions about risk. The Company adopted IFRS 13 on January 1, 2013 on a prospective basis. The adoption of IFRS 13 did not require any adjustments to the valuation techniques used by the Company to measure fair value and did not result in any measurement adjustments as at January 1, 2013.

4. Long- term debt:

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

	March 31, 2013	December 31, 2012
Non-revolving loans	$ 130,000	$ 130,000
Revolving loans	33,059	23,985
	163,059	153,985
Less: debt issuance costs, net of accumulated amortization	799	912
	$ 162,260	$ 153,073

The Company has a credit facility agreement with a term of four years, maturing on January 5, 2015. The credit facility provides for a term loan of $130,000 and a revolving facility of $100,000 (which includes a swing line of $7,000).

The interest rates for the credit facilities are floating, based on a margin over certain referenced rates of interest. The applicable margin may vary up or down depending on the ratio of the Company's consolidated Debt to Adjusted EBITDA as calculated in the credit facility agreement.

The credit facilities are secured by a general assignment of all the assets of the Company and require the Company to maintain, on a consolidated basis, Debt to Adjusted EBITDA financial covenant of not more than 3.25:1.00 up to March 30, 2013, and 3.00:1.00 on March 31, 2013, and thereafter and an EBITDA to interest expense ratio of not less than 3.00:1.00.

EBITDA in the amended and restated credit agreement is defined as profit before finance costs, income taxes, depreciation, amortization, non-controlling interest, and non-recurring expenditures. Adjusted EBITDA is defined as EBITDA plus the pro-forma EBITDA from permitted acquisitions' entities.

At March 31, 2013, the Company had utilized the following credit facilities:

- $130,000 of term loans. The term loan is repayable in full on January 5, 2015 and bears interest at the one-month BA rate plus an applicable margin of 2.125%.

- $23,500 of BA loans under the revolving loan. The BA loan is renewed on a monthly basis, bearing interest at the one-month BA rate plus an applicable margin of 2.125%.

- $6,000 of prime loans under the revolving loan. The prime loan bears interest at the prime rate plus an applicable margin of 1.125%.

- $3,500 USD of Libor loans under the revolving loan. The Libor loan is renewed on a monthly basis, bearing interest at the one- month Libor rate plus an applicable margin of 2.125%.

- $1,890 of the swing line available. The swing line carries interest at prime plus an applicable margin of 1.125%.

As at March 31, 2013, the Company complied with all the required financial covenants. At March 31, 2013, the Debt to Adjusted EBITDA ratio was 2.0:1.0 and the EBITDA to interest expense ratio was 5.8:1.0.

(a) Interest rate swaps:

The Company entered into an interest-rate swap agreement to hedge against the variable interest rate component of the term loans outstanding. The notional amount of the swap is $130,000, for the period from February 1, 2011 up to and ending January 5, 2015. This swap is used to fix the variable component of the interest rate at 2.48%, before the applicable margin, for the duration of the term and has been designated as a cash flow hedge. The fair value of the interest rate swap at March 31, 2013 was a liability of $2,821 (December 31, 2012 - $3,101).

(In thousands of Canadian dollars)

(b) Finance costs:

The Company's finance costs comprise the following:

	Three months ended March 31, 2013	2012
Interest on term loan	$ 1,562	$ 1,736
Interest on revolving loan, bank indebtedness and other charges	386	903
Interest on convertible debenture	1,117	59
Amortization of debt issuance costs	289	126
Immediate recognition and amortization of terminated interest rate swap	–	583
Other	76	104
	$ 3,430	$ 3,511

5. Dividends:

Dividends are declared in Canadian dollars. The monthly dividend rate, approved by the Board of Directors, was $0.065 for the three months ended March 31, 2013 (2012 - $0.065). The Company continued to declare the same monthly dividend amount in April 2013.

6. Earnings per share:

Basic earnings per share was calculated by dividing profit attributable to common shares 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 redemption of the convertible debenture.

(In thousands of Canadian dollars)

The following details the earnings per share, basic and diluted, calculations for the three months ended March 31, 2013 and 2012:

	Three months ended March 31, 2013	Three months ended March 31, 2012
Profit attributable to common shares (basic and diluted)	$ 6,951	$ 4,421
Weighted average number of common shares (in actual number of shares):		
January 1	47,940,409	47,940,409
Vested LTIP awards	572,735	519,920
Basic	48,513,144	48,460,329
Dilutive effect of unvested LTIP awards	605,097	316,618
Diluted	49,118,241	48,776,947
Earnings per share:		
Basic	$ 0.14	$ 0.09
Diluted	$ 0.14	$ 0.09

Due to its anti-dilutive effect, the potential issuance related to the convertible debenture has been excluded from the earnings per share calculation.

7. Segmented information:

The Company provides health and productivity, administrative and retirement solutions to assist employers in managing the financial security, health and productivity of their employees. As at March 31, 2013, on the basis of the type of services provided and in accordance with IFRS 8, Operating Segments, the Company was represented by and had one reportable segment.

(In thousands of Canadian dollars)

The Company operates primarily within two geographical areas: Canada and the United States. The following details the revenues and total assets by geographical area, reconciled to the Company's Unaudited Condensed Consolidated Interim Financial Statements:

	Three months ended March 31, 2013	2012
Revenue:		
Canada	$ 108,990	$ 99,055
United States	6,740	4,911
Consolidated total	$ 115,730	$ 103,966

	March 31, 2013	December 31, 2012
Total assets:		
Canada	$ 682,397	$ 674,038
United States	12,991	12,319
Consolidated total	$ 695,388	$ 686,357

8. Supplementary cash flow information:

Change in non-cash operating working capital for the three months ended March 31, 2013 and 2012 was as follows:

	2013	2012
Trade and other receivables	$ (8,790)	$ (2,256)
Unbilled fees, current and non-current	(6,103)	(8,864)
Prepaid expenses and other	(2,135)	(763)
Deferred implementation costs, current and non-current	113	124
Trade and other payables	3,394	2,464
Deferred revenue	895	329
	$ (12,626)	$ (8,966)

(In thousands of Canadian dollars)

9. Financial instruments:

Fair values:

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

The following table summarizes information regarding the carrying and fair value of the Company's financial assets and liabilities:

	March 31, 2013	December 31, 2012
Assets carried at fair value:		
Cash and investments held in trust	$ 9,323	$ 14,174
Assets carried at amortized cost:		
Trade and other receivables	64,366	55,576
	$ 73,689	$ 69,750
Liabilities carried at fair value:		
Cash flow hedges - interest rate swaps	$ 2,821	$ 3,101
Bank indebtedness	4,191	134
Future consideration related to acquisitions	2,882	3,309
Insurance premium liabilities	9,323	14,174
Liabilities at amortized cost:		
Trade and other payables	50,537	47,181
Long-term debt (note 4)	162,260	153,073
Convertible debentures	71,333	71,104
Dividends payable	3,116	3,116
	$ 306,463	$ 295,192

The fair value of the convertible debentures as at March 31, 2013 is $78,563 (December 31, 2012 - $79,875).

Fair value hierarchy:

Below is a discussion of the Company's determination of fair value for financial instruments carried at fair value. The three levels of fair value hierarchy are defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3: unobservable inputs for the asset or liability

The interest rate swap is a financial instrument carried at fair value. The liability is measured at fair value through other comprehensive income. For the period ending March 31, 2013, the liability was $2,821 (December 31, 2012 - $3,101) and level 2 (December 31, 2012 – level 2) was used to determine the fair value measurement of the interest rate swap. The convertible debentures are a financial instrument carried at amortized cost. For the period ending March 31, 2013, the estimated fair value of the convertible debentures was $71,333 which was based on the market trading prices of the convertible debenture (level 1).

The future consideration related to acquisition is a financial instrument carried at fair value. The liability is measured at fair value through the statement of income. For the period ending March 31, 2013, the liability was $2,882 (December 31, 2012 - $3,309) and level 3 (December 31, 2012 – Level 3) was used to determine the fair value measurement of the future consideration related to acquisition. Contingent consideration arose on the acquisition of Jacques Lamarre & Associates and SBC Systems Company Inc. ("SBC Systems Company").

In the acquisition of Jacques Lamarre & Associates and SBC Systems Company, there is a clause that entitles the seller to an amount based on exceeding revenue targets.

The fair value is determined considering the estimated payment, discounted to present value. The estimated payment is calculated considering different scenarios of projected revenue and the amount to be paid under each scenario, weighted by the probability of each scenario. The key unobservable inputs included anticipated revenue and the discount rate. The estimated fair value increases the higher the annual revenue and the lower the discount rate.

Management considers that changing the above mentioned unobservable inputs to reflect other reasonably possible alternative assumptions would not result in a significant change in the estimated fair value.

During the period ended March 31, 2013, there were no transfers between any levels.

The following table indicates the changes in the future consideration related to acquisition during the period ended March 31, 2013:

	Future consideration related to acquisition
Balance at January 1, 2013	$ 3,309
First instalment contingent payment to SBC Systems Company	(500)
Accretion on future consideration related to acquisition	61
Foreign exchange on future consideration related to acquisition	12
	$ 2,882