MANAGEMENT'S DISCUSSION AND ANALYSIS

Morneau Shepell Inc. ("Morneau Shepell") was incorporated pursuant to the laws of the Province of Ontario on October 21, 2010, and as of January 1, 2011, is the successor to Morneau Sobeco Income Fund (the "Fund"). On January 1, 2011, the Fund converted from an income fund structure to a corporation named Morneau Shepell pursuant to a plan of arrangement (the "Reorganization").

Comparative amounts in the MD&A and future MD&A and financial statements are those of the Fund. Morneau Shepell will refer to common shares, shareholders, and dividends, which were formerly referred to as units, unitholders, and distributions under the Fund.

This Management's Discussion and Analysis ("MD&A") covers the year ended December 31, 2011 and should be read in conjunction with the accompanying audited Consolidated Financial Statements of Morneau Shepell and notes thereto for the year ended December 31, 2011.

All financial information is presented in Canadian dollars and in accordance with International Financial Reporting Standards (see "Transition to IFRS" discussion below), 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. 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, Free Cash Flow, Normalized Free Cash Flow, Payout Ratio and Normalized Payout Ratio. EBITDA is not a calculation based on IFRS and does not have a standardized meaning. It is 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 tangible and intangible capital assets, which vary according to their vintage, technological currency, and management's estimate of their useful life. Accordingly, EBITDA comprises revenues less operating costs before finance costs, depreciation, amortization and impairment losses, and income taxes, while Adjusted EBITDA represents EBITDA before taking into account certain non-recurring expenditures. We believe both EBITDA and Adjusted EBITDA are useful measures in evaluating our performance. We utilize them to monitor compliance with debt covenants and to make decisions related to dividends to shareholders rather than profit due to the significant amount of amortization expense related to our intangible assets. We also believe that Free Cash Flow, Normalized Free Cash Flow, Payout Ratio, and Normalized Payout Ratio are useful supplemental measures of performance as they are generally used as indicators of financial performance. 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, as reported in accordance with IFRS, adjusted for capital expenditures. Normalized Free Cash Flow is Free Cash Flow, adjusted for changes in non-cash operating working capital and certain non-recurring 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.

FORMATION AND OWNERSHIP STRUCTURE OF MORNEAU SHEPELL

Effective January 1, 2011, Morneau Shepell completed the Reorganization and became successor to the Fund, pursuant to the laws of the Province of Ontario. The Reorganization, whereby the Fund was converted from an income trust structure into a public corporation, was made in response to the legislative changes enacted by the Federal government that apply a tax at the income trust level on unitholder distributions commencing January 1, 2011.

Pursuant to this Reorganization, units of the Fund ("Units") and all Class B limited partnership units of Morneau Sobeco Group Limited Partnership ("LP Units") were exchanged, on a one-for-one basis for common shares of Morneau Shepell Inc. Holders of Units and LP Units, therefore, became the shareholders of Morneau Shepell Inc. effective January 1, 2011.

The Reorganization was treated as a change in business form rather than a change in control and accounted for as a continuity of interest; as a result, the carrying amounts of assets, liabilities, and unitholders' equity in the consolidated financial statements of the Fund immediately before the conversion was the same as the carrying values of Morneau Shepell immediately after the conversion. Morneau Shepell's conversion from an income trust structure to a corporation had no impact on its strategic and operational objectives.

As at March 7, 2012, Morneau Shepell had 47,940,409 common shares issued and outstanding.

BUSINESS OVERVIEW

Morneau Shepell is the largest Canadian firm providing human resource consulting and outsourcing services. We deliver solutions to assist employers in managing the financial security, health and productivity of their employees. With approximately 2,600 employees in offices across North America, we offer services to over 8,000 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, outsourcing engagements, employee assistance program services and health management services.

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

Our outsourcing business is characterized by fixed contracts, which typically have three-year to five-year terms. Most outsourcing 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 outsourcing contract are usually paid on a fee-for-service basis.

In the billing for Employee Assistance Program ("EAP") services, a portion of the EAP client agreements require payment of a minimum retainer and incremental usage-based fees. The remainder of the EAP agreements are billed based on an actual usage or fixed fees. Most EAP agreements may be terminated by the client upon 30 to 60 days' notice to us, however, it is typical for EAP agreements to continue for multiple years and many automatically renew on an annual basis.

Fees from health management 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. Like most EAP agreements, most workplace health and productivity agreements may be terminated by the client upon 30 to 60 days' notice to us; however, it is typical 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 (such as printing and travel), training, marketing, office costs, professional services and insurance.

TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS ("IFRS")

The Canadian Accounting Standards Board confirmed in February 2008 that publicly accountable entities will be required to adopt International Financial Reporting Standards ("IFRS") for interim and annual financial statements for periods beginning on January 1, 2011.

Our conversion project plan was comprehensive and addressed matters related to changes in accounting policies and disclosures, information systems and business processes, internal control over financial reporting and disclosure controls and procedures, and training and communication requirements. In transitioning to IFRS, no significant changes to our information technology systems, internal controls over financial reporting and disclosure, or business processes were determined to be required. To facilitate the application of and to develop the required level of expertise, training was provided to key accounting personnel throughout 2010. Changes to accounting policies have been adopted, and applied in accordance with IFRS 1, *First-time Adoption of International Financial Reporting Standards*. Our financial statements were previously prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP").

While the adoption of IFRS did not result in changes to our actual revenue or cash flows, certain changes to the consolidated financial position and results of operations were noted. To allow users to better understand these changes, reconciliations between GAAP and IFRS for total assets, liabilities, shareholders' equity, and profit have been provided in note 32 to our audited consolidated financial statements for the year ended December 31, 2011.

SUMMARY AND OUTLOOK

For the year ended December 31, 2011, revenue was $365.0 million, compared to $335.2 million in 2010. Adjusted EBITDA for the year ended December 31, 2011 was $70.1 million, compared to $64.3 million in 2010. EBITDA for the year ended December 31, 2011 was $69.3 million, compared to $55.4 million for the same periods in 2010. Adjusted EBITDA margin for the year ended December 31, 2011 remained consistent with 2010, at 19.2%. EBITDA margin for the year ended December 31, 2011 was 19.0%, compared to 16.5% for the same period in 2010. Adjusted EBITDA per Share (basic) for the year ended December 31, 2011 was $1.45, compared to $1.35 for the same period in 2010. EBITDA per Share (basic) for the year ended December 31, 2011 was $1.44, compared to $1.16 for the same period in 2010.

The momentum of 2010 was sustained through 2011, successfully translating into growth in all parts of the business. The consulting practice continued to grow as a result of increased mandates from existing and new clients, while the new business relationships secured during the latter part of 2010 and throughout 2011 drove growth in the outsourcing, EAP, and health management practices. During the year, we also completed the acquisition of Jacques Lamarre & Associates, a company specializing in providing EAP, crisis management, and organizational health and productivity solutions. This acquisition offered accretive benefits, immediately broadening our EAP solutions portfolio, while allowing us to expand our presence within the province of Quebec.

Subsequent to the year, in continuing to strengthen our outsourcing practice, we completed the acquisition of SBC Systems Company Inc. ("SBC Systems"), a business providing employee benefits administration systems in the United States. This acquisition will offer immediate accretive benefits, providing a suite of flexible administration products and a robust technology platform which will allow us to further build our business and expand our presence in the United States.

We are confident that these acquisitions, along with our established business relationships and prospective client base, will continue to yield positive results in 2012.

DIVIDENDS TO SHAREHOLDERS

Monthly dividends were declared for shareholders of record on the last business day of each month and were paid on about the 15th day of the following month. Monthly dividends were $0.065 per share for the year.

The following table presents excess (shortfall) cash provided by operating activities and profit over dividends to shareholders for the years ended December 31, 2011, 2010 and 2009.

(In thousands of dollars)	**Year ended December 31, 2011**	**Year ended December 31, 2010**	**Year ended December 31, 2009** [1]
Cash provided by operating activities	$ 54,863	$ 42,414	$ 48,955
Profit [2]	24,903	21,418	10,826
Dividends to shareholders [3]	37,392	45,110	43,902
Excess (shortfall) of cash provided by operating activities over dividends	17,471	(2,696)	5,053
(Shortfall) of profit over dividends	(12,489)	(23,692)	(33,076)

(1) Morneau Shepell adopted IFRS on January 1, 2011, with a date of transition of January 1, 2010; as such, comparative 2010 figures have been adjusted to conform with IFRS, but comparative 2009 figures presented are as determined in accordance with Canadian GAAP.
(2) The 2010 comparative figures have been adjusted for interest expense related to the change in fair value of LP Units and LTIP awards, to increase comparability with current period results.
(3) The comparative 2010 dividend figure represent distributions paid to holders of Fund Units and LP Units; those paid to LP Units have been classified as interest expense in the comparative 2010 figures per the audited consolidated financial statements under IFRS.

We consider the amount of cash generated by the business in determining the amount of dividends payable to shareholders. In general, we do not take into account quarterly working capital fluctuations as these tend to be temporary in nature. 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 divergence is particularly relevant for us since we have a relatively high level of amortization expense.

Normalized Payout Ratio for the year ended December 31, 2011 was 91.7% respectively compared to 101.1% for the same period in 2010. The improved Normalized Payout Ratio for the year ended December 31, 2011 was primarily due to the increase in cash provided by operating activities before non-cash operating working capital and changes in the amount of dividends declared.

ANALYSIS OF 2011 OPERATING RESULTS

Results of Operations	**Three months ended December 31**		**Year ended December 31**	
Selected Unaudited Consolidated Financial Information	**2011**	**2010**	**2011**	**2010**
(In thousands of dollars except per share amounts)				
Revenue	**$ 97,447**	$ 87,018	**$ 364,988**	$ 335,194
Deduct:				
Salary, benefit and contractor expenses	**64,072**	61,894	**237,144**	221,235
Other operating expenses	**15,935**	16,105	**58,311**	57,706
Finance costs	**3,095**	2,652	**14,214**	10,530
Interest expense related to LP units and LTIP awards	**-**	7,711	**-**	7,810
Depreciation, amortization and impairment losses	**5,492**	7,778	**21,087**	29,135
Income taxes expenses (recovery)	**2,928**	(2,784)	**9,137**	(5,730)
Contingent consideration related to business acquisitions	**-**	900	**192**	900
Profit for the year	**5,925**	(7,238)	**24,903**	13,608
Add (deduct):				
Finance costs	**3,095**	2,652	**14,214**	10,530
Interest expense related to LP units and LTIP awards	**-**	7,711	**-**	7,810
Depreciation, amortization and impairment losses	**5,492**	7,778	**21,087**	29,135
Income taxes expense (recovery)	**2,928**	(2,784)	**9,137**	(5,730)
EBITDA[1]	**$ 17,440**	$ 8,119	**$ 69,341**	$ 55,353
Adjustments: [8]				
Severance related to restructuring	**-**	5,967	**-**	5,967
Core system technology spending	**230**	-	**230**	-
Contingent consideration related to business acquisitions	**-**	900	**192**	900
Sublease loss provision	**-**	-	**-**	128
Reorganization and strategic planning	**325**	1,508	**325**	1,920
Adjusted EBITDA	**$ 17,995**	$ 16,494	**$ 70,088**	$ 64,268
EBITDA margin	**17.9%**	9.3%	**19.0%**	16.5%
Adjusted EBITDA margin	**18.5%**	19.0%	**19.2%**	19.2%
Cash provided by operating activities	**$ 22,695**	$ 19,164	**$ 54,863**	$ 42,414
Deduct: Capital expenditures [2]	**7,212**	4,011	**20,290**	11,424
Free Cash Flow [3]	**15,483**	15,153	**34,573**	30,990
Add (deduct):				
Changes in Non-cash operating working capital	**(7,205)**	(12,205)	**6,192**	5,083
Other Non-recurring payments	**-**	7,475	**-**	8,542
Normalized Free Cash Flow [4]	**$ 8,278**	$ 10,423	**$ 40,765**	$ 44,615
Earnings per Share (basic)	**$ 0.12**	NA	**$ 0.52**	NA
Earnings per Share (diluted)	**$ 0.12**	NA	**$ 0.51**	NA
EBITDA per Share (basic) [7]	**$ 0.36**	$ 0.17	**$ 1.44**	$ 1.16
Adjusted EBITDA per Share (basic)	**$ 0.37**	$ 0.35	**$ 1.45**	$ 1.35
Payout Ratio [5]	**60.4%**	74.5%	**108.2%**	145.6%
Normalized Payout Ratio [6]	**112.9%**	108.3%	**91.7%**	101.1%
Twelve-month rolling Payout Ratio	**108.2%**	129.4%	**108.2%**	129.4%
Twelve-month rolling Normalized Payout Ratio	**91.7%**	101.1%	**91.7%**	101.1%

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Footnotes:

(1) "EBITDA" is defined as profit before finance costs, income taxes expenses (recovery), depreciation, amortization and impairment losses.

(2) "Capital Expenditures" excludes additions to intangible assets acquired through business acquisition, and is presented net of disposals.

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

(4) "Normalized Free Cash Flow" is defined as cash provided by operating activities, adjusted for changes in non-cash operating working capital, capital expenditures, and non-recurring expenditures.

(5) "Payout Ratio" is defined as dividends declared divided by Free Cash Flow.

(6) "Normalized Payout Ratio" is defined as dividends declared divided by Normalized Free Cash Flow.

(7) "Per Share (basic)" calculation for the comparative 2010 period has been calculated assuming Fund and LP Units as capital, and as a result, was based on the weighted average number of Fund Units outstanding during the period.

(8) Adjustments represent significant expenditures resulting from Reorganization and strategic planning, contingent consideration related to business acquisitions, severances from restructuring and integration of Shepell.fgi and Morneau Sobeco offices and operations.

ANALYSIS OF YEAR ENDED DECEMBER 31, 2011 AND 2010 RESULTS

Revenue

Revenue for the year ended December 31, 2011 increased by $29.8 million, or 8.9%, to $365.0 million compared to $335.2 million for the same period in 2010. The Jacques Lamarre & Associates acquisition contributed $1.9 million to the EAP practice which, along with the outsourcing, consulting, and health management practices all continued to see growth from new business partnerships, and increased mandates from new and existing clients.

Salary, Benefit and Contractor Expenses

Salary, benefit and contractor expenses for the year ended December 31, 2011 increased by $15.9 million, or 7.2%, to $237.1 million compared to $221.2 million for the same period in 2010. This increase was primarily attributable to annual merit increases, increased headcount to support business growth and new business and from the Jacques Lamarre & Associates acquisition, and increased variable compensation expenses; this change was partially offset by decreased severance related to restructuring.

Other Operating Expenses

Other operating expenses for the year ended December 31, 2011 increased by $0.6 million, or 1.0%, to $58.3 million, compared to $57.7 million for the same period in 2010. This is due to increased office and administration expenses of $1.7 million and training and recruiting costs of $0.7 million, necessitated in order to support new business and revenue growth. This was partially offset by reorganization and strategic planning expenditures of $1.9 million that did not recur in 2011.

Finance Costs

Finance costs for the year ended December 31, 2011 increased by $3.7 million or 35.2%, to $14.2 million compared to $10.5 million for the same period in 2010. The increase was primarily due to the termination of the $137 million and $23 million interest-rate swap agreements in January 2011, resulting in the immediate recognition of $0.8 million expense upon settlement and $2.3 million in amortization related to the remaining loss on the interest-rate swaps, $0.3 million in additional interest payable on the final instalment related to the Leong & Associates acquisition, and $0.2 million related to increased borrowing on the credit facility to address working capital needs.

Interest Expenses related to LP Units and LTIP awards

Interest expense related to LP Units and LTIP awards for the year ended December 31, 2011 was $nil, compared to $7.8 million for the same period in 2010. For the comparative 2010 period, in accordance with IFRS, LP Units and LTIP awards were classified as financial liabilities to be fair valued at each reporting period. On January 1, 2011, pursuant to the Reorganization, all Fund and LP Units were exchanged on a one-for-one basis for common shares of Morneau Shepell (equity instruments) and therefore, no corresponding expense was incurred in 2011.

Depreciation, amortization and impairment losses

Depreciation, amortization and impairment losses for the year ended December 31, 2011 decreased by $8.0 million, or 27.6%, to $21.1 million compared to $29.1 million for the same period in 2010. This decrease was primarily attributable to lower amortization expenditure of $6.0 million relating to proprietary software, $2.4 million related to intangible assets acquired through the Shepell-fgi acquisition that became fully amortized in 2010 and impairment charge of $2.4 million that did not recur in 2011. This was partially offset by an increase in amortization on capital assets of $2.2 million and on internally-developed software put into use of $0.5 million.

Income Tax Expenses (Recovery)

Income tax expenses (recovery) for the year ended December 31, 2011 increased by $14.8 million to an expense of $9.1 million, compared to a $5.7 million recovery for the same period in 2010. This increase was primarily attributable to the Company's conversion from an income trust structure to a corporation and increased taxable earnings. This is offset by the re-measurement of certain deferred tax balances previously residing in the Fund's flow through entities using the corporate tax rate.

Profit for the Year

As a result of the changes noted above, profit for the year ended December 31, 2011 was $24.9 million compared to $13.6 million (after IFRS-related adjustments) for the same period in 2010.

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

Adjusted EBITDA and EBITDA

Adjusted EBITDA remained strong, increasing by $5.8 million to $70.1 million, compared to $64.3 million for the same period in 2010. This increase was primarily due to increased revenue of $29.8 million, which was offset by increased salary, benefit and contractor expenses, other operating expenses, adjustments for severance related to restructuring, and reorganization and strategic planning expenses of $24.1 million. EBITDA for the year ended December 31, 2011, increased by $13.9 million to $69.3 million, compared to $55.4 million for the same period in 2010.

Free Cash Flow

Free Cash Flow for the year ended December 31, 2011 increased by $3.6 million to $34.6 million compared to $31.0 million for the same period in 2010. This increase was primarily due to increased cash provided by operating activities of $12.4 million, which was partially offset by an increased capital expenditure (related to software technology development and office consolidation and expansion initiatives, and excluding those assets acquired through business acquisitions) of $8.9 million.

Normalized Free Cash Flow

Normalized Free Cash Flow for the year ended December 31, 2011 decreased by $3.8 million to $40.8 million compared to $44.6 million for the same period in 2010. The decrease was primarily the result of increased capital expenditures spending (excluding those acquired through business acquisitions) of $8.9 million and non-operating cash payments of $8.5 million in 2010 that did not recur; this was partially offset by an increase in cash provided by operating activities, before non-cash operating working capital of $13.6 million.

ANALYSIS OF 2011 FOURTH QUARTER RESULTS

Revenue

Revenue for the three months ended December 31, 2011 increased by $10.4 million, or 12.0%, to $97.4 million from $87.0 million for the same period in 2010. The increase was driven by growth across our outsourcing, EAP, and health management practices. Our outsourcing practice saw growth from increased mandates from new and existing clients, and the commencement of the service component of a significant outsourcing contract, while our EAP and health management practices continued to realize the benefits of new business relationships secured during the latter part of 2011 and 2010, and from the Jacques Lamarre & Associates business acquisition of $1.9 million. Our consulting practice remained consistently strong with the same period in 2010.

Salary, Benefit and Contractor Expenses

Salary, benefit and contractor expenses for the three months ended December 31, 2011 increased by $2.2 million, or 3.6%, to $64.1 million compared to $61.9 million for the same period in 2010. This increase was primarily attributable to annual merit increases, increased headcount to support business growth and new business and from the Jacques Lamarre & Associates acquisition, and increases in variable compensation expense; this change was partially offset by decreased severance related to restructuring.

Other Operating Expenses

Other operating expenses for the three months ended December 31, 2011 decreased by $0.2 million, or 1.3%, to $15.9 million compared to $16.1 million for the same period in 2010. This decrease is primarily attributable to reorganization and strategic planning expenditures of $1.5 million that did not recur in 2011. This was partially offset by increased office and administration expenses of $1.0 million to support new business and revenue growth, and expenditures related to the corporate branding initiative of $0.3 million.

Finance Costs

Finance costs for the three months ended December 31, 2011 increased by $0.4 million, or 14.8%, to $3.1 million compared to $2.7 million for the same period in 2010. This increase is primarily due to $0.6 million in amortization related to the remaining loss on the previous $137 million and $23 million interest-rate swap agreements terminated in the first quarter of 2011.

Interest Expenses related to LP Units and LTIP awards

Interest expense related to LP Units and LTIP awards for the three months ended December 31, 2011 was $nil, compared to $7.7 million for the same period in 2010. In accordance with IFRS, for the comparative 2010 period, LP Units and LTIP awards were classified as financial liabilities to be fair valued at each reporting period. On January 1, 2011, pursuant to the Reorganization, all Fund and LP Units were exchanged on a one-for-one basis for common shares of Morneau Shepell (equity instruments) and therefore, no corresponding expense was incurred in 2011.

Depreciation, amortization and impairment losses

Depreciation, amortization and impairment losses for the three months ended December 31, 2011 decreased $2.3 million, or 29.5%, to $5.5 million compared to $7.8 million. The decrease is primarily due to a $2.4 million write-down of proprietary software in 2010.

Income Tax Expenses (Recovery)

Income tax expenses (recovery) for the three months ended December 31, 2011 increased by $5.7 million to an expense of $2.9 million, compared to a $2.8 million recovery for the same period in 2010. This increase was primarily attributable to the Company's conversion from an income trust to a corporation and increased taxable earnings.

Profit for the Period

As a result of the changes noted above, profit for the three months ended December 31, 2011 was $5.9 million compared to a loss of $7.2 million (after IFRS-related adjustments) for the same period in 2010.

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 to $18.0 million, compared to $16.5 million for the same period in 2010. This increase was due to increased revenue of $10.4 million, which was offset primarily by $8.7 million of increased salary, benefit and contractor expenses, other operating expenses, adjustments for severance related to restructuring, and reorganization and strategic planning expenses. EBITDA increased by $9.3 million to $17.4 million, compared to $8.1 million in the same period of 2010.

Free Cash Flow

Free Cash Flow for the three months ended December 31, 2011 increased by $0.3 million to $15.5 million, compared to $15.2 million for the same period in 2010. This increase was primarily due to increased cash provided by operating activities of $3.5 million which was partially offset by increased capital expenditure spending of $3.2 million.

Normalized Free Cash Flow

Normalized Free Cash Flow for the three months ended December 31, 2011 decreased by $2.1 million to $8.3 million compared to $10.4 million for the same period in 2010. The decrease was primarily the result of increased capital expenditures of $3.2 million and non-recurring payments of $7.5 million in 2010, that was partially offset by an increase in cash provided by operating activities, before non-cash operating working capital of $8.5 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 Audited Consolidated Financial Information *(In thousands of dollars)*	**Year ended December 31**	
	2011	**2010**
Cash provided by (used in):		
Operating activities	**$ 54,863**	**$ 42,414**
Investing activities	**(29,404)**	**(14,281)**
Financing activities	**(26,626)**	**(29,369)**
Decrease in cash	**$ (1,167)**	**$ (1,236)**

Cash provided by operating activities for the year ended December 31, 2011 increased by $12.4 million to $54.8 million compared to $42.4 million for the same period in 2010. This change was primarily attributable to increased cash provided by operating activities before change in non-cash operating working capital of $14.3 million, that was partially offset by an increase in non-cash operating working capital of $1.1 million, and increased finance costs and income taxes paid of $0.7 million.

Cash used in investing activities for the year ended December 31, 2011 increased by $15.1 million to $29.4 million compared to $14.3 million for the same period in 2010. This increase was primarily attributable to increased business acquisition-related payments of $6.7 million on the Jacques Lamarre & Associates and Leong & Associates acquisitions, and increased net capital expenditures of $8.4 million.

Cash used in financing activities for the year ended December 31, 2011 decreased by $2.8 million to $26.6 million compared to $29.4 million for the same period in 2010. This decrease was primarily attributable to decreased dividends paid on common shares of $9.6 million, the full repayment of the $4.5 million promissory note issued in connection with the Shepell.fgi acquisition in 2010, and decreased distribution paid to LP unitholders recorded under IFRS as interest of $5.0 million. This was partially offset by a decreased utilization of the revolving term facility of $11.0 million, the payment of $4.2 million on settlement of the previous interest-rate swap agreements terminated in January 2011, and the payment of $1.2 million in renewal fees related to the new and amended credit agreement pursuant to the Reorganization.

Capital Expenditures

Our capital expenditures typically include information technology hardware and software (external and internally developed), facility expansion and improvements, and office furniture. Additional capital expenditure requirements may result from significant business expansion. Such amounts are expected to be funded from our operating cash flow. The increase in capital expenditures (excluding those acquired through business acquisitions) for the year ended December 31, 2011 of $8.9 million were primarily the result of increased leasehold improvements on office consolidations and expansions, and an increase in software technology development. While the increase in technology spending was necessary to support the growth of the business, we anticipate leasehold improvement expenditures to return to normal levels upon the completion of certain office consolidation and expansion initiatives in early 2012.

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 a term loan and revolving loan described under "Capital Resources". Future expected payments are as follows:

Summary of Contractual Obligations
(In thousands of dollars)

	Total	2012 to 2013	2014 to 2015	Beyond 2015
Term loan	$ 130,000	$ -	$ 130,000	$ -
Revolving loans	78,500	-	78,500	-
Operating leases, net	74,471	14,765	13,928	45,778
Total	$ 282,971	$ 14,765	$ 222,428	$ 45,778

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 minimal payments and the aggregate sublease income related to these premises have been included above. We consider the risk of default by the subtenants to be low therefore no accrual has been set up.

Contingent Consideration

The purchase price for Jacques Lamarre & Associates is contingent on business results and is expected to be payable in two instalments. The first instalment of $4.8 million, of which $0.5 million is currently being held for release pending finalization of the purchase price in first half of 2012, was satisfied on closing through cash considerations. The second and final instalment of $2.0 million is subject to certain revenue adjustments, and will be settled in October 2013. As at December 31, 2011, $1.7 million, representing the discounted value of the $2.0 million remaining to be settled, has been recognized as acquisition liability in the statement of financial position.

During the year, we settled the third and final instalment related to the Leong & Associates business acquisition through cash considerations of $4.9 million, and therefore, no additional contingent consideration exists.

Subsequent to the year-end, on January 31, 2012, we completed the acquisition of SBC Systems Company Inc. ("SBC Systems"), a business providing employee benefits administration system in the United States. The purchase price is contingent on business results and is expected to be payable in three instalments. The first instalment of $5.0 million was satisfied on closing through cash considerations on January 31, 2012. The second and final instalments of $0.5 million each, are subject to revenue adjustments, and will be settled in March 2013 and 2014, respectively. As at December 31, 2011, this business acquisition has been disclosed as a subsequent event to the notes to the audited consolidated financial statements of the Company.

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:

Capital Resources *(In thousands of dollars)*	**As at December 31, 2011**	**As at December 31, 2010**
Bank indebtedness	$ 807	$ -
Long-term debt, net of unamortized debt issue cost	$ 207,121	$ 194,855
Payable to LP Unit holders on investment (1)	$ -	$ 53,729
Shareholders' equity	$ 357,583	$ 310,325

(1) This balance represents Minority Interest (under previous Canadian GAAP) related to the LP Units classified under IFRS as a financial liability. The LP units were exchanged, on a one-for-one basis for common shares of Morneau Shepell on January 1, 2011.

As at December 31, 2011, our working capital (current assets minus current liabilities, excluding future consideration related to acquisition), was approximately $37.4 million compared to $27.5 million as at December 31, 2010.

In 2008, as part of the Shepell•fgi acquisition, the Fund entered into a credit agreement with a syndicate of Canadian chartered banks for a period of four years maturing on September 1, 2012. On January 1, 2011, Morneau Shepell, in connection with the Reorganization, entered into an amended and restated credit agreement for a term of four years, maturing on January 5, 2015.

Under the amended and restated agreement, the following credit facilities are available:

- $130 million senior secured term loan (“term loan”).
- $93 million senior secured revolving term facility (“revolving loan”) (increased by $25 million on March 31, 2011 from $75 million provided under the January 1, 2011 agreement).
- $7 million swing line.

The interest rates for the facilities are floating, based on a margin over certain reference rates of interest. The applicable margin may vary up and down depending on the ratio of our consolidated debt to Adjusted EBITDA as calculated in the new credit agreement. EBITDA is defined as net income before interest expense, income taxes expenses (recovery), depreciation, amortization, non-controlling interest and non-recurring expenditures. Adjusted EBITDA is defined as EBITDA plus the pro-forma EBITDA from Permitted Acquisitions’ entities.

The credit facilities are secured by a general assignment of all our assets. The credit agreement also requires us to maintain the following financial covenants on a consolidated basis:

(i) Ratio of debt to Adjusted EBITDA not greater than 3.25:1.0 effective as at December 30, 2010 and up to December 30, 2011, and 3.0:1.0 on December 31, 2011 and thereafter;
(ii) Ratio of EBITDA to interest expense of not less than 3.0:1.0

On October 7, 2011, in connection with the Jacques Lamarre & Associates acquisition, the required Debt to Adjusted EBITDA financial covenant was amended to remain 3.25:1.0 up to March 30, 2013, and 3.0:1.0 on March 31, 2013, and thereafter.

We are in compliance with all the required financial covenants, and the ratios as at December 31, 2011 were 2.9 and 5.0 respectively.

SELECTED STATEMENT OF FINANCIAL POSITION DATA

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

Selected Statement of Financial Position Data *(in thousands of dollars)*	**As at December 31, 2011**	**As at December 31, 2010**
Current assets	$ 103,115	$ 94,498
Non-Current assets	$ 564,974	$ 555,357
Current liabilities	$ 66,226	$ 71,678
Non-Current liabilities	$ 244,280	$ 267,852

Current Assets

Current assets as at December 31, 2011 increased by $8.6 million to $103.1 million from $94.5 million as at December 31, 2010. The increase was primarily due to an increase in accounts receivable and unbilled fees of $8.3 million as a result of growth in revenue, the timing of billings and collections, and in acquired assets through the Jacques Lamarre & Associates acquisition, increased deferred implementation costs of $1.5 million with the commencement of the service component of significant outsourcing contracts during the year, and increased prepaid expenses of $1.3 million due to the timing of employee benefits and vendor payments. This was partially offset by decreased cash of $0.4 million, decreased cash and investments held for insurance premiums of $1.7 million and income taxes receivable of $0.4 million.

Non-Current Assets

Non-current assets as at December 31, 2011 increased by $9.6 million to $565.0 million from $555.4 million as at December 31, 2010. The increase was primarily due to capital expenditures of $20.3 million, increased deferred implementation costs associated with outsourcing contracts of $4.1 million, $4.1 million in acquired capital and intangible assets related to the Jacques Lamarre & Associates business acquisition, and $1.5 million in unbilled fees to be invoiced subsequent to 2012. This was partially offset by the amortization of capital and intangible assets of $21.1 million.

Current Liabilities

Current liabilities as at December 31, 2011 decreased by $5.5 million to $66.2 million from $71.7 million as at December 31, 2010. This decrease was primarily the result of a decrease in the current portion of long-term debt of $11.5 million, a decrease in insurance premium liabilities of $1.7 million and the payment of the final instalment related to Leong & Associates business acquisition of $4.9 million, of which $4.7 million was accrued for as of December 31, 2010. This was partially offset by increased trade and other payables of $7.6 million due to the timing of suppliers' payments and in assumed liabilities from the Jacques Lamarre & Associates acquisition, increased dividends payable of $3.1 million due to the payment of the December 2010 distribution in 2010 pursuant to the Reorganization, increased deferred revenue of $0.7 million due to the timing of customer billings, increased bank indebtedness of $0.8 million, and contingent consideration related to the Jacques Lamarre & Associates business acquisition of $0.5 million.

Non-Current Liabilities

Non-current liabilities as at December 31, 2011 decreased by $23.6 million to $244.3 million from $267.9 million as at December 31, 2010. This decrease was primarily the result of the exchange of the Fund and LP Units (classified as financial liabilities under IFRS) into shares of Morneau Shepell of $53.7 million, and the classification of LTIP as equity-based awards of $5.4 million pursuant to the Reorganization. This was further decreased by the payment of $4.2 million on settlement of the previous $137 million and $23 million interest-rate swap agreements in January 2011, and $0.5 million in provisional accruals. This was partially offset by increased utilization of the revolving facility of $13.0 million, an increase in the non-current portion of long-term debt of $11.5 million due to reclassification from current, increased deferred income taxes of $8.7 million, $5.4 million related to the fair value of the new $130 million interest-rate swap agreement, and $1.7 million related to contingent consideration payable on the Jacques Lamarre & Associates business acquisition.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements, in accordance with IFRS, 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 for the year ended December 31, 2011. The accounting policies and estimates that are critical to our business relate to the following items:

Revenue Recognition

Revenues include fees generated from administrative, actuarial, and consulting services, EAP, health management, and outsourcing contracts.

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 administrative, actuarial and consulting services are billed either on a time-and-material basis or on a fixed-fee basis. On time-and-material engagements, revenue is recognized as services are rendered and expenditures are incurred. On fixed-fee engagements, revenue is recognized in the period in which the services are rendered.

EAP 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 provision of EAP services. Incremental usage is recognized when the minimum usage threshold is exceeded.

Health management 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.

Outsourcing 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 outsourcing contract qualifies for treatment as a separate unit of account. 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 based on the terms of the agreement.

Commissions 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. Other income includes investment income earned in the course of normal business operations, and are recorded on the accrual basis.

Intangible Assets and Goodwill

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.

Intangible assets acquired through acquisitions or business combinations are initially recognized at fair value based on an allocation of the purchase price.

Internally-developed software is recognized at the aggregate fair value 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 developed use 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 internal-use computer software project (to the extent that their time was spent directly on the project). 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. Intangible assets are measured at cost less accumulated amortization and accumulated impairment losses.

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 or equity method investee at the date of acquisition. Goodwill is not amortized and is subject to an annual impairment test, and is carried at cost less accumulated impairment charges.

Income Taxes

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill and trademark.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

Allowance for Doubtful Accounts

We are required to assess whether accounts receivables 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.

New Accounting Policies

No new accounting policies were adopted by the Company during the year.

Future Accounting Changes

IFRS 9, Financial Instruments
IFRS 9 introduces new requirements for classifying and measuring financial assets and may affect Morneau Shepell's accounting for its financial assets. Specifically, IFRS 9 requires financial assets to be classified into two measurement categories, those measured at fair value and those measured at amortized cost. The standard is not applicable until January 1, 2015 but is available for early adoption. The Company has not early adopted IFRS 9 for year ended December 31, 2011, and the extent of the impact has not been determined.

IFRS 10, Consolidated Financial Statements
IFRS 10 replaces 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 standard is not applicable until January 1, 2013, but is available for early adoption. The Company has not early adopted IFRS 10 for the year ended December 31, 2011, and the extent of the impact has not been determined.

IFRS 13, Fair Value Measurement
IFRS 13 defines and provides a framework for measuring "fair value" and sets forth related disclosure requirements. Specifically, IFRS 13 defines fair value to be the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measure date. The standard is applicable prospectively for annual periods beginning on or after January 1, 2013, but is available for early adoption. The Company has not early adopted IFRS 13 for the year ended

December 31, 2011, and the extent of the impact has not been determined.

IAS 1, Presentation of Financial Statements
IAS 1 was amended to require an entity to present separately the items of Other Comprehensive Income that may be reclassified to profit or loss in the future from those that would never be reclassified to profit or loss. The standard is applicable retrospectively for annual periods beginning or after July 1, 2012, but is available for early adoption. The Company has not early adopted the amendments to IAS 1 for the year ended December 31, 2011, and the extent of the impact has not been determined.

IAS 19, Employee Benefits
IAS 19 was amended to improve and provide clarity on the recognition, presentation, and disclosure requirements of defined benefit plans. Specifically, the amendments will require the recognition of changes in the net defined benefit liability (asset), modify the accounting for termination benefits, and enhance disclosures. The standard is applicable retrospectively for annual periods beginning on or after January 1, 2013, but is available for early adoption. The Company has not early adopted the amendments to IAS 19 for the year ended December 31, 2011, and the extent of the impact has not been determined.

RISKS AND UNCERTAINTIES

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

Risks Related to the Business of Morneau Shepell

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, and the ability of Morneau Shepell to pay dividends.

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, and on the ability of Morneau Shepell to pay dividends.

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.

Reliance on Information Systems and Technology

Information systems are an integral part of Morneau Shepell’s business and the products and services offered to its clients. Morneau Shepell relies on systems to maintain accurate records and to carry out required administrative functions in accordance with the terms of its contractual obligations to its clients.

In order to maintain the level of security, service and reliability that clients require, Morneau Shepell may be required to make significant investments in the online means of delivering services. The adoption of additional laws or regulations with respect to the internet may impede the efficiency of the internet as a medium of exchange of information and decrease the demand for Morneau Shepell's services.

Any disruptions in Morneau Shepell's systems, the failure of the systems to operate as expected, or the firm's ability to use the internet effectively to deliver services could, depending on the magnitude of the problem, result in a loss of current or future business 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, and on the ability of Morneau Shepell to pay dividends.

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 industry 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, and on the ability of Morneau Shepell to pay dividends.

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 or delay services or projects, or defer contracts currently underway. This situation could also lead to greater delays and defaults in payments or debt collection, resulting in lower operating results. Because of lower revenue during an economic slowdown, competition may increase and prices may be reduced by certain competitors to maintain or expand their market share. Pricing and profitability could be adversely affected as a result.

Dependence on Key Clients

For the year ended December 31, 2011, Morneau Shepell's largest client accounted for approximately 5% of revenue and its top 10 clients, in the aggregate, accounted for approximately 22% of revenue. 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 the firm'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, and on the ability of Morneau Shepell to pay dividends. No one Morneau Shepell client makes up more than 10% of Morneau Shepell's total revenue for the years ended December 31, 2011 and 2010.

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.

The pension and benefits consulting and outsourcing service 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, and on the ability of Morneau Shepell to pay dividends.

Insurance

Morneau Shepell believes that its professional errors and omissions 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.

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 anticipate and keep 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, and on the ability of Morneau Shepell to pay dividends.

Relationship with Channel Partners

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, and on the ability of Morneau Shepell to pay dividends.

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, and on the ability of Morneau Shepell to pay dividends.

Implications of Fixed-Price Contracts

A portion of Morneau Shepell's revenue comes from fixed-price contracts. A fixed-price contract requires Morneau Shepell to perform either all or a specified portion of work under the contract for a fixed price. Fixed-price contracts expose Morneau Shepell to a number of risks, including underestimation of costs, ambiguities in specifications, unforeseen costs or difficulties, problems with new technologies, delays beyond the control of Morneau Shepell, failures of subcontractors to perform, and economic or other changes that may occur during the contract period. Losses under fixed-price contracts could have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

Confidentiality of Client Information

Morneau Shepell depends to a large extent on its relationships with its customers and its ability to properly maintain confidential client information. Morneau Shepell maintains rigorous controls to protect confidential information from unauthorized use or disclosure, however the failure of Morneau Shepell to maintain client confidentiality could, depending on the magnitude of the problem, result in a loss of future business and/or potential claims against Morneau Shepell. This could have a material adverse effect on Morneau Shepell's business, financial condition and operating results, and on the ability of Morneau Shepell to pay dividends.

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, and on the ability of Morneau Shepell to pay dividends.

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 was 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.

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 those entities. 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 total debt outstanding and related overall cost of borrowing.

The advance of the Credit Facilities has significantly increased the amount of Morneau Shepell's debt compared to historical levels. The Credit Facilities contain 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 Facilities contain a number of 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 Facilities 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 Facilities 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 Facilities mature on January 5, 2015. 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.

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 $29.1 million for the year ended December 31, 2011. 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, and on the ability of Morneau Shepell to pay dividends.

Risk Related to the Structure of Morneau Shepell

Market Price 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.

Dilution of Common Shares

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 as are 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.

SELECTED ANNUAL INFORMATION

(In thousands of dollars except per share amounts)	**Year ended December 31, 2011**	**Year ended December 31, 2010**	**Year ended December 31, 2009**[1]
Revenue	$ 364,988	$ 335,194	$ 331,703
Profit	24,903	13,608	10,826
Earnings per share (basic)	0.52	NA	0.27
Earnings per share (diluted)	0.51	NA	0.26
Dividends declared per share [2]	0.78	0.95	0.95
Total Assets	668,089	649,855	658,241
Total long-term debt	207,121	183,355	158,887

(1) Morneau Shepell adopted IFRS on January 1, 2011, with a date of transition of January 1, 2010; as such, comparative 2010 figures have been adjusted to conform with IFRS, but comparative 2009 figures presented are as determined in accordance with Canadian GAAP.

(2) The comparative 2010 dividend figure represent distributions paid to holders of Fund Units and LP Units; those paid to LP Units have been classified as interest expense in the comparative 2010 figures per the audited consolidated financial statements under IFRS.

SUPPLEMENTARY SUMMARY OF QUARTERLY RESULTS

Operating results and condensed statement of financial position history are as follows:

Operating Results, Dividend and Condensed Statement of Financial Positions
Selected Unaudited Consolidated Financial Information (In thousands of dollars except per share amounts)

Quarter ended	December 31 2011	September 30 2011	June 30 2011	March 31 2011	December 31 2010	September 30 2010	June 30 2010	March 31 2010
Revenue	$97,447	$91,574	$90,565	$85,402	$87,017	$83,083	$83,669	$81,425
Profit (loss)	5,925	6,387	6,133	6,458	(7,238)	8,671	12,345	(170)
EBITDA	17,440	18,491	17,801	15,609	8,119	17,317	15,848	14,070
Adjusted EBITDA	17,995	18,491	17,993	15,609	16,494	17,857	15,848	14,070
EBITDA margin	17.9%	20.2%	19.7%	18.3%	9.3%	20.8%	18.9%	17.3%
Adjusted EBITDA margin	18.5%	20.2%	19.9%	18.3%	19.0%	21.5%	18.9%	17.3%
Earnings per Share (basic) (2)	0.12	0.13	0.13	0.13	NA	NA	NA	NA
Earnings per Share (diluted) (2)	0.12	0.13	0.13	0.13	NA	NA	NA	NA
Twelve-month rolling Normalized Payout Ratio	91.7%	91.7%	94.1%	95.9%	101.1%	96.7%	97.6%	98.5%
Total assets (3)	$668,089	$668,030	$659,721	$656,059	$649,855	$651,339	$660,673	$653,332
Total long-term debt	$207,121	$198,505	$193,388	$184,772	$183,355	$159,238	$159,121	$159,004

(1) Morneau Shepell adopted IFRS on January 1, 2011, with a date of transition of January 1, 2010; as such, comparative 2010 figures presented have been adjusted to conform with IFRS.

(2) This calculation has not been presented for the comparative 2010 period given the classification of Fund and LP Units as financial liabilities in accordance with IFRS.

(3) Total assets quarterly figures have changed to reflect a reclassification of insurance premium liabilities from being presented as a net figure to separately being presented as a gross asset and liability in accordance with IFRS.

Disclosure Controls and Procedures

Our disclosure controls and procedures have been designed to provide reasonable assurance that all relevant information is identified to its 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, 2011.

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 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 at December 31, 2011.

No changes were made in our internal controls over financial reporting during the fourth quarter ended December 31, 2011, 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, is available on the SEDAR Web site (www.sedar.com) and on our own Web site at www.morneaushepell.com.

The content of this MD&A reflects information known as of March 7, 2012.