MORNEAU SHEPELL

UNAUDITED CONDENSED INTERIM CONSOLIDATED FINANCIAL STATEMENTS

and

MANAGEMENT'S DISCUSSION AND ANALYSIS

For The Quarter Ended September 30, 2011

MORNEAU SHEPELL INC.
UNAUDITED CONDENSED INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(In thousands of dollars)

	As at September 30, 2011	As at December 31, 2010
Assets		
Current		
Cash	$ -	$ 360
Trade and other receivables	66,606	61,093
Unbilled fees	23,909	16,266
Income taxes recoverable	-	386
Prepaid expenses and other	4,192	1,788
Deferred implementation costs	1,727	659
Total Current Assets	96,434	80,552
Non-Current		
Deferred implementation costs	7,175	2,881
Capital assets	20,395	17,034
Intangible assets	232,880	234,650
Goodwill	300,792	300,792
Total Non-Current Assets	561,242	555,357
Total Assets	**$ 657,676**	**$ 635,909**

See accompanying notes to unaudited condensed interim consolidated financial statements

MORNEAU SHEPELL INC.
UNAUDITED CONDENSED INTERIM CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(In thousands of dollars)

	As at September 30, 2011	**As at December 31, 2010**
Liabilities and Equity		
Current		
Bank indebtedness (note 5)	$ 3,942	$ -
Trade and other payables	42,953	40,023
Income taxes payable	173	453
Deferred revenues	3,710	1,584
Current portion of long-term debt (note 5)	11,500	11,500
Future consideration related to acquisition (note 4(b))	500	4,672
Dividends payable (note 6)	3,116	-
Total Current Liabilities	65,894	58,232
Insurance premium liabilities:		
Payable to insurance companies	10,354	13,946
Less: related cash and investments held	(10,354)	(13,946)
	-	-
Non-Current		
Long-term debt (note 5)	198,505	183,355
Payable to LP unitholders on investment	-	53,729
Interest-rate swaps (note 5)	5,928	4,424
Future consideration related to acquisition (note 4(b))	1,653	-
Other liabilities	6,954	6,685
Provisions	1,499	1,890
Payable to LTIP unitholders	-	5,449
Deferred income taxes	17,589	11,820
Total Non-Current Liabilities	232,128	267,352
Total Liabilities	**298,022**	**325,584**
Equity		
Share capital (note 6)	473,838	420,109
Contributed surplus (note 6)	7,653	-
Deficit	(116,783)	(107,429)
Accumulated other comprehensive loss	(5,054)	(2,355)
Total Shareholders' Equity	**359,654**	**310,325**
Total Liabilities and Equity	**$ 657,676**	**$ 635,909**

Commitments, Contingencies, and Subsequent Events (notes 4, 5, 10)

See accompanying notes to unaudited condensed interim consolidated financial statements

The unaudited condensed interim consolidated financial statements were approved by the Board on and signed on its behalf by:

"Robert Chisholm"
Robert Chisholm
Audit Committee Chair

"Alan Torrie"
Alan Torrie
President & CEO

MORNEAU SHEPELL INC.
UNAUDITED CONDENSED INTERIM CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(In thousands of dollars, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 30, 2011	**September 30, 2010**	**September 30, 2011**	**September 30, 2010**
Revenue				
Fees	$ 86,035	$ 76,863	$ 253,914	$ 233,285
Commissions and other income	5,539	6,220	13,627	14,891
Total Operating Revenue	91,574	83,083	267,541	248,176
Expenses				
Salary, benefit and contractor expenses	58,161	51,966	173,072	159,340
Depreciation, amortization, and impairment losses	5,315	6,710	15,595	21,358
Rent and occupancy	4,184	4,299	12,619	12,623
Office and administration	10,738	9,501	29,757	28,978
Total Operating Expenses	78,398	72,476	231,043	222,299
Profit before Finance Costs and Interest Expense	**13,176**	**10,607**	**36,498**	**25,877**
Finance costs (note 5)	3,847	2,605	11,119	7,878
Interest expense related to LP Units and LTIP awards	-	76	-	98
Contingent consideration related to business acquisitions (note 4(a))	-	-	192	-
Profit from Operations before Income Taxes	**9,329**	**7,926**	**25,187**	**17,901**
Income taxes (recovery)				
Current	213	258	580	703
Deferred	2,729	(1,003)	5,629	(3,647)
	2,942	(745)	6,209	(2,944)
Profit for the period	**6,387**	**8,671**	**18,978**	**20,845**
Other Comprehensive Income				
Net change in interest rate cash flow hedges (note 5)	(3,017)	678	(4,844)	1,574
Ineffective portion of changes in fair value of interest rate cash flow hedges transferred to profit (note 5)	191	(40)	331	78
Net change in previous interest rate cash flow hedges prior to termination (note 5)	-	-	78	-
Reclassification to profit due to termination of cash flow hedges (note 5)	583	-	1,550	-
Foreign currency translation differences for foreign operations	356	(201)	186	(197)
Other comprehensive income (loss) for the period, net of tax effect	(1,887)	437	(2,699)	1,455
Comprehensive Income for the period	**$ 4,500**	**$ 9,108**	**$ 16,279**	**$ 22,300**
Earnings Per Share (note 7)				
Earnings per share (basic)	**$ 0.13**	$ NA	**$ 0.39**	$ NA
Earnings per share (diluted)	**$ 0.13**	$ NA	**$ 0.39**	$ NA

See accompanying notes to unaudited condensed interim consolidated financial statements

MORNEAU SHEPELL INC.
UNAUDITED CONDENSED INTERIM CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
(In thousands of dollars)

For the nine months ended September 30, 2011:

	Share Capital	Contributed Surplus	Deficit	Currency Translation Reserve	Hedging Reserve	Total Equity
Balance, January 1, 2011	$ 420,109	$ -	$ (107,429)	$ (207)	$ (2,148)	$ 310,325
Exchange of LP Units on Reorganization (note 1)	53,729					53,729
Long-term incentive plan – reclassification as equity-based awards (note 11)		5,449				5,449
Long-term incentive plan non-cash expense		1,916				1,916
Long-term incentive plan – DRIP		288	(288)			-
Profit for the period			18,978			18,978
Dividends			(28,044)			(28,044)
Other comprehensive loss for the period			-	186	(2,885)	(2,699)
Balance, September 30, 2011	**$ 473,838**	**$ 7,653**	**$ (116,783)**	**$ (21)**	**$ (5,033)**	**$ 359,654**

For the nine months ended September 30, 2010:

	Share Capital	Contributed Surplus	Deficit	Currency Translation Reserve	Hedging Reserve	Total Equity
Balance, January 1, 2010	$ 415,626	$ -	$ (80,651)	$ -	$ (5,392)	$ 329,583
Exchange of LP Units	2,714	-	-	-	-	2,714
Settlement of LTIP units through treasury	169	-	(49)	-	-	120
LTIP-DRIP			(131)			(131)
Profit for the period	-	-	20,845	-	-	20,845
Distributions	-	-	(30,065)	-	-	(30,065)
Other comprehensive income for the period	-	-	-	(197)	1,652	1,455
Balance, September 30, 2010	**$ 418,509**	**$ -**	**$ (90,051)**	**$(197)**	**$ (3,740)**	**$ 324,521**

See accompanying notes to unaudited condensed interim consolidated financial statements

MORNEAU SHEPELL INC.
UNAUDITED CONDENSED INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands of dollars)

	Nine Months Ended	
	September 30, 2011	September 30, 2010
Operating activities		
Profit for the period	$ 18,978	$ 20,845
Items not involving cash:		
Amortization of capital assets	4,971	3,981
Amortization of intangible assets	10,624	17,377
Finance costs (note 5)	11,119	7,878
Interest related to LP Units and LTIP awards	-	98
Long-term incentive plan	1,916	2,092
Current income taxes	580	703
Deferred income taxes (recovery)	5,629	(3,647)
Fair value of forward exchange contracts	-	396
Changes in sublease loss provisions	(391)	(1,145)
Other	461	(538)
	53,887	48,040
Change in non-cash operating working capital (note 9)	(13,397)	(17,288)
Cash generated from operating activities	40,490	30,752
Finance costs paid	(7,866)	(7,228)
Income taxes paid	(456)	(274)
Cash provided by operating activities	**32,168**	**23,250**
Financing activities		
Payment of credit agreement renewal fees	(1,200)	-
Change in revolving loan	16,000	20,000
Repayment of promissory note	-	(4,500)
Interest paid to LP unitholders	-	(3,756)
Settlement of interest-rate swaps (note 5)	(4,150)	-
Dividends paid	(24,928)	(30,070)
Cash used in financing activities	**(14,278)**	**(18,326)**
Investing activities		
Business acquisition – Leong & Associates (note 4(a))	(4,864)	(2,457)
Business acquisition – Jacques Lamarre & Associates (note 4(b))	(4,250)	-
Additions to intangible assets	(4,912)	(3,394)
Purchase of capital assets	(8,166)	(4,657)
Proceed from sale of capital assets	-	238
Cash used in investing activities	**(22,192)**	**(10,270)**
Net decrease in cash for the period	(4,302)	(5,346)
Cash, beginning of period	360	1,606
Bank indebtedness, end of period	**$ (3,942)**	**$ (3,740)**

See accompanying notes to unaudited condensed interim consolidated financial statements

1. ORGANIZATION AND NATURE OF THE BUSINESS

On December 2, 2010, Morneau Sobeco Income Fund (the "Fund") and Morneau Shepell Inc. (the "Company") entered into a plan of arrangement ("Reorganization"), whereby the Fund was converted from an income trust structure into the public corporation Morneau Shepell Inc., effective January 1, 2011. The Company was incorporated pursuant to the laws of the Province of Ontario on October 21, 2010 for the purposes of participating in the Reorganization.

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.

This Reorganization was treated as a change in business form rather than a change in control and therefore, has been accounted for as a continuity of interest. The carrying amounts of assets, liabilities, and unitholders' equity in the consolidated financial statements of the Fund immediately prior to the Reorganization were the same as the carrying values of the Company immediately following the Reorganization. The Company refers to common shares, shareholders, and dividends which were formerly referred to as units, unitholders, and distributions under the Fund. Comparative amounts in these and future financial statements during 2011 are those of the Fund.

The Company is a Canadian firm providing human resource consulting and outsourcing services, delivering 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 Sobeco 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 around the globe.

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

2. BASIS OF PREPARATION

Statement of compliance

These condensed interim consolidated financial statements for the three and nine months ended September 30, 2011 have been prepared in accordance with International Accounting Standard 34, *Interim Financial Reporting* as issued by the International Accounting Standards Board ("IASB") under International Financial Reporting Standards ("IFRS"). The same accounting policies and methods of computation were followed in the preparation of these unaudited condensed interim consolidated financial statements as were followed in the preparation of the unaudited condensed interim consolidated financial statements for the three months ended March 31, 2011.

The unaudited condensed interim consolidated financial statements for the three months ended March 31, 2011 contain certain incremental annual IFRS disclosures not included in the annual financial statements for the year ended December 31, 2010 prepared in accordance with previous Canadian GAAP. Accordingly, these unaudited condensed interim consolidated financial statements for the three and nine months ended September 30, 2011 should be read in conjunction with the annual consolidated financial statements for the year ended December 31, 2010 prepared in accordance with previous Canadian GAAP, as well as the unaudited condensed interim consolidated financial statements for the three months ended March 31, 2011.

2. BASIS OF PREPARATION (continued)

As IFRS and Canadian GAAP differ in some areas, management has amended certain accounting, measurement, and consolidation methods previously applied under Canadian GAAP financial statements in order to comply with IFRS. An explanation of how the transition to IFRS has affected the reported financial position, financial results and cash flows of the Company is provided in note 11. This note includes reconciliations of equity and total comprehensive income for the comparative periods under previous GAAP to those reported under IFRS.

3. SIGNIFICANT ACCOUNTING POLICIES

Future Accounting Changes

IFRS 9, Financial Instruments

IFRS 9 introduces new requirements for classifying and measuring financial assets and may affect the Company'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, 2013 but is available for early adoption. The Company has not early adopted IFRS 9 for the period ended September 30, 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, 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 measurement date (i.e. an exit price). 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 period ended September 30, 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 on or after July 1, 2012, but is available for early adoption. The Company has not early adopted the amendments to IAS 1, 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

3. SIGNIFICANT ACCOUNTING POLICIES (continued)

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, and the extent of the impact has not been determined.

4. BUSINESS ACQUISITIONS

(a) Leong & Associates Actuaries and Consultants Inc. ("Leong & Associates")

The purchase price requires the Company to pay additional consideration in the acquisition of Leong & Associates contingent on their financial performance. The third and final installment of $4,864 ($4,672 as of December 31, 2010), which was subject to revenue adjustments plus interest calculated at annual rates of 3.87%, was settled in full on August 15, 2011. The additional $192 contingent consideration was recognized through profit and loss during the second quarter of 2011, and presented as such on the face of the consolidated Statements of Income and Comprehensive Income. There have been no changes to the recognized amounts of assets acquired and liabilities assumed at the acquisition date.

(b) Jacques Lamarre & Associates and Parcours d'enfant ("Jacques Lamarre & Associates")

On September 30, 2011, the Company completed the acquisition of the Jacques Lamarre & Associates business, a company specializing in providing employee assistance programs ("EAP"), crisis management, and organizational health and productivity solutions. This acquisition allows the Company to broaden its portfolio of EAP solutions, and to expand its presence in the province of Quebec. The purchase price is contingent on future business results and is expected to approximate $6.8 million payable in two instalments. The first instalment of approximately $4,8 million of which $0.5 million will be released pending finalization of the purchase price in January 2012, was satisfied on closing through cash consideration. The second and final instalment of $2.0 million, is subject to certain revenue adjustments, and will be settled in October 2013. As at September 30, 2011, the contingent consideration has been recognized as an acquisition liability on the statement of financial position at the estimated discounted value.

This acquisition has been accounted for using the purchase method of accounting. The purchase price allocation presented below is preliminary pending finalization of the purchase price in January 2012, and the valuation of the net identifiable assets acquired and liabilities assumed.

Had this acquisition occurred on January 1, 2011, management estimates that fees revenue would have increased by approximately $2.1 million and $6.5 million to $93.7 million and $274.0 million for the three and nine months ended September 30, 2011, respectively. Profit for the period, excluding amortization charge of acquired intangible assets, would have increased by approximately $0.1 million and $0.5 million to $6.5 million and $19.5 million for the same periods. In determining these amounts, management has assumed that the fair values determined provisionally that arose on the date of acquisition would have been the same if the acquisition had occurred on January 1, 2011.

4. BUSINESS ACQUISITIONS (continued)

The preliminary estimated fair values as of the acquisition date of the assets acquired and liabilities assumed are as follows:

Accounts receivable	$ 1,250
Unbilled fees	2,210
Prepaid expenses and deposits	20
Capital assets	160
Intangible assets	3,950
Accounts payable	(1,190)
	$ 6,400

Intangibles assets acquired consist of customer contracts, customer lists, and non-compete agreements; the fair value of each component has not been presented above, as the valuation of the net assets acquired had not been completed as at September 30, 2011. Upon finalization of the valuation of the net assets acquired, including intangibles, during the measurement period, any excess of the purchase price over net assets acquired will be allocated to goodwill.

These consolidated financial statements include the results of Jacques Lamarre & Associates from the date of acquisition September 30, 2011.

5. LONG TERM DEBT

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

	As at September 30, 2011	As at December 31, 2010
Non-revolving term loans	$ 130,000	$ 160,000
Revolving loans	81,500	35,500
	211,500	195,500
Less: current portion of long-term debt	(11,500)	(11,500)
Less: debt issue costs, net of accumulated amortization	(1,495)	(645)
	$ 198,505	$ 183,355

On January 1, 2011, the Company, in connection with the Reorganization (note 1), entered into an amended and restated credit agreement for 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 was increased by $25,000 on March 31, 2011 from the initial $75,000 facility per the amended and restated agreement), which includes a swing line of $7,000. The terms of the amended and restated credit agreement remain similar to those contained in the previous agreement, with the exception of a change in Debt to Adjusted EBITDA financial covenant of 3.25:1.00 effective as at December 30, 2010 and up to December 30, 2011, and 3.00:1.00 on December 31, 2011, and thereafter.

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, the Debt to Adjusted EBITDA ratio as described above, and an EBITDA to interest expense ratio of not less than 3.00:1.00.

EBITDA is defined as net income before interest expense, income taxes (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.

5. LONG TERM DEBT (continued)

At September 30, 2011 the Company had available and utilized the following credit facilities:

- $130,000 of term loans. The term loan is repayable in full on January 5, 2015 and bear interest at 2.48% plus an applicable margin of 2.875%.
- $81,500 of $93,000 revolving loans. The revolving loan consists of a $6,000 prime loan and a $75,500 bankers acceptance ("BA") loan. The prime loan bears interest at prime rate plus an applicable margin of 2.875% and the BA loan is renewed on a monthly basis, bearing interest at the one-month BA rate plus an applicable margin of 2.875%.
- $3,265 of the $7,000 swing line available. The swing line carries interest at prime plus an applicable margin of 2.875%.

The Company complied with all the required financial covenants and the ratios as at September 30, 2011 were 3.1 and 5.1 respectively.

Subsequent to September 30, 2011, in connection with the Jacques Lamarre & Associates acquisition (note 4(b)), the credit agreement was amended to increase the Debt to Adjusted EBITDA financial covenant to 3.25:1.00 up to March 30, 2013, and 3.00:1.00 on March 31, 2013, and thereafter.

Cash flow hedges

The Company enters into interest-rate swap agreements to hedge against the variable interest rate component of term loans outstanding.

On January 7, 2011, pursuant to the Reorganization (note 1) and the new and amended credit agreement, the Company terminated its interest-rate swap agreements in the notional amounts of $137,000 and $23,000, previously entered into to fix the variable component of its term loans outstanding at 3.647% and 2.22% (before the applicable margin), respectively. As a result of this transaction, the Company incurred a termination expenditure of $4,150. Since these interest-rate swap agreements were previously designated as cash flow hedges against the term loans outstanding, the designated hedging items from the cash flow hedge relationships were eliminated.

On January 1, 2011, borrowings under the term loan were reduced from $160,000 to $130,000, removing the expectation that the forecasted variable interest payments associated with $30,000 of term loans that was previously hedged would occur. As a result, $778 of the $4,150, representing the cumulative loss on the interest rate swap cash flow hedges recognized through other comprehensive income up to the date of termination on $30,000, and $69 representing the ineffective portion up to that date, were recognized immediately into profit or loss as finance costs. The remaining $3,303 will be amortized into profit or loss as finance costs concurrently with the variable interest payments on the term loan remaining, until June 1, 2012, the maturity date of the original credit facility.

Pursuant to the termination of the previous interest-rate swap agreements (as described above), the Company entered in a new interest-rate swap agreement on January 7, 2011, in the notional amount of $130,000, from February 1, 2011 up to and ending January 5, 2015. This swap was 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 swap at September 30, 2011 was $5,928.

5. LONG TERM DEBT (continued)

Finance costs

The Company's finance costs were comprised of the following:

	Three Months Ended September 30		Nine Months Ended September 30	
	2011	2010	2011	2010
Interest on term loan	$ 1,748	$ 2,197	$ 5,158	$ 6,517
Interest on revolving loan, bank indebtedness, and other charges	839	345	2,150	710
Amortization of debt issuance costs	117	117	351	351
Interest and amortization on terminated interest-rate swap	583	-	2,527	-
Ineffective portion on interest-rate swap cash flow hedge	191	(54)	380	-
Other	369	-	553	300
Total Finance Costs	**$ 3,847**	**$ 2,605**	**$ 11,119**	**$ 7,878**

6. SHARE CAPITAL

Common shares

The Company is authorized to issue an unlimited number of common shares, with no par value. On January 1, 2011, pursuant to the Reorganization (note 1), 47,940,409 common shares were issued in exchange on a one-for-one basis for all outstanding Fund's Units and LP Units.

Preferred shares

The Company is authorized to issue 10 million preferred shares, with no limit on their value. As of September 30, 2011, no preferred shares were issued or outstanding.

Dividends

Dividends are declared in Canadian dollars. The quarterly dividend rate decreased from $0.236 in 2010 (representing distributions declared on Units) to $0.195 in 2011, as a result of legislative changes enacted by the Federal government that resulted in the Company's reorganization from an income trust structure (note 1).

6. SHARE CAPITAL (continued)

The change in Share Capital, including Contributed Surplus was as follows:

	Number of Fund Units	Number of Common Shares	Stated Capital	Contributed Surplus
Balance, January 1, 2010	42,280,489	-	$ 415,626	$ -
Exchange of LP Units for Fund Units	272,132	-	2,713	-
Settlement of LTIP awards through treasury	-	-	169	-
Shares issued under LTIP	196,594	-	1,601	-
Balance December 31, 2010	42,749,215	-	$ 420,109	$ -
Exchange of Fund Units on Reorganization (note 1)	(42,749,215)	42,749,215	-	-
Exchange of LP Units on Reorganization (note 1)	-	5,191,194	53,729	-
LTIP – reclassification as equity-based awards (note 11)	-	-	-	5,449
LTIP expense – current period	-	-	-	2,204
Balance, September 30, 2011	**-**	**47,940,409**	**$ 473,838**	**$ 7,653**

As discussed in note 1, prior to the Reorganization, the Company operated under an income trust structure, where the equity of the Fund was held in the form of Units and LP Units.

On January 1, 2011, all outstanding Units and LP Units were exchanged on a one-for-one basis for common shares of the Company.

Due to the classification of Fund Units and LP Units as financial liabilities for all purposes other than financial statement presentation, transactions related to the Company's LTIP plan and Contributed Surplus were reported through profit or loss for the comparative 2010 period. Pursuant to the Reorganization (note 1), LTIP units were deemed to be equity-based awards in accordance with *IFRS 2, Share-based Payment*, and therefore, the balance payable to LTIP unit holders was reclassified to Contributed Surplus.

7. 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.

7. EARNINGS PER SHARE (continued)

The following details the earnings per share, basic and diluted, calculations for the three and nine months ended September 30, 2011:

Profit attributable to common shares	**Three Months Ended September 2011**	**Nine Months Ended September 2011**
Profit attributable to common shares (basic and diluted)	$ 6,387	$ 18,978
Weighted average number of common shares *(in actual number of shares)*		
Weighted average number of shares	47,940,409	47,940,409
Add: Vested LTIP awards	243,380	243,380
Weighted average number of common shares (basic)	48,183,789	48,183,789
Add: Dilutive effect of unvested LTIP awards	405,983	417,365
Weighted average number of common shares (diluted)	48,589,772	48,601,154
Earnings per share (basic)	**$ 0.13**	**$ 0.39**
Earnings per share (diluted)	**$ 0.13**	**$ 0.39**

Except for financial statement presentation purposes, all Fund and LP Units were classified as financial liabilities under IFRS; as a result, earnings per share has not been presented for the comparative 2010 period.

8. SEGMENTED INFORMATION

The Company offers human resource consulting, outsourcing, employee assistance, and health management services, delivering solutions to assist employers in managing the financial security, health and productivity of their employees. As at September 30, 2011, on the basis of type of services provided and in accordance with *IFRS 8, Operating Segments*, the Company was represented by and had one reportable segment.

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 consolidated financial statements:

	Three Months Ended September 30		**Nine Months Ended September 30**	
	2011	**2010**	**2011**	**2010**
Revenue:				
Canada	$ 87,779	$ 78,367	$ 256,455	$ 233,661
United States	3,795	4,716	11,086	14,515
Consolidated Total	**$ 91,574**	**$ 83,083**	**$ 267,541**	**$ 248,176**

8. SEGMENTED INFORMATION (continued)

	As at September 30, 2011	As at December 31, 2010
Total Assets:		
Canada	$ 650,291	$ 627,950
United States	7,385	7,959
Consolidated Total	**$ 657,676**	**$ 635,909**

9. SUPPLEMENTARY CASH FLOW INFORMATION

Change in non-cash operating working capital was as follows:

	Nine Months Ended September 30	
	2011	**2010**
Trade and other receivables	$ (4,261)	$ (5,367)
Unbilled fees	(5,431)	(795)
Prepaid expense and other	(2,369)	(78)
Deferred implementation costs	(5,363)	(2,046)
Trade and other payables	1,901	(9,666)
Deferred revenue	2,126	664
	$ (13,397)	**$ (17,288)**

10. COMMITMENTS

The Company has lease commitments for office premises and equipment with options for renewal. As at September 30, 2011 the minimum payments not including operating expenses, due in each of the next five years and thereafter, are expected to be as follows for each year ending December 31:

	Gross Commitment	Sublease Income	Net Commitment
2011 (remainder)	$ 2,593	$ (571)	$ 2,022
2012	9,455	(2,157)	7,298
2013	9,334	(2,098)	7,236
2014	9,205	(2,098)	7,107
2015	8,715	(2,098)	6,617
Thereafter	56,278	(10,595)	45,683
Total	**$ 95,580**	**$ (19,617)**	**$ 75,963**

The Company is party to various subleases to which the Company 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. The Company considers the risk of default by the subtenants to be low therefore no accrual has been set up for the guarantee.

11. TRANSITION TO IFRS

The Company adopted IFRS in accordance with IFRS 1, *First-time Adoption of International Financial Reporting Standards*, as at January 1, 2010 (“Transition Date”). The same accounting policies and methods of computation were followed in the preparation of the comparative financial statements for the three and nine months ended September 30, 2010 as were for the three

11. TRANSITION TO IFRS (continued)

months ended March 31, 2011. A discussion of the impact of IFRS 1 and those adjustments related to the differences between Canadian GAAP and IFRS on the Company's opening statement of financial position is included in note 15 of the Company's unaudited condensed interim consolidated financial statements for the three months ended March 31, 2011.

Explanation of how the transition from Canadian GAAP to IFRS has impacted the financial position, financial performance, and equity for the current comparative three and nine month periods ended September 30, 2010 is set out in the following reconciliations and the notes that accompany them.

Notes to Reconciliations

(a) Employee Future Benefits

In accordance with IFRS 1, the Company elected not to retrospectively apply IAS 19, and therefore, recognized the cumulative actuarial loss of $369 that existed as at the Transition Date into opening deficit for its defined benefit plan. The recognition of the cumulative actuarial loss as at the Transition Date resulted in the reduction of deficit and trade and other payables of $20 and $71 for the three and nine months ended September 30, 2010 respectively.

(b) Foreign Currency Translation

Since the functional currency of the Company's United States and New Caledonia-based operations were determined to be U.S. dollar and CFP Franc, respectively, the foreign currency translation gains and losses in re-translating to the Company's functional currency, the Canadian dollar, were required to be recognized separately into other comprehensive income. Deficit for the three and nine months ended September 30, 2010 was increased by $(201) and $(197), respectively as a result of this change; other comprehensive loss was increased by a corresponding amount in both periods described.

(c) Income Taxes

The transition to IFRS resulted in an increase to deferred tax liabilities primarily due to the Reorganization (note 1), related to the re-measurement of temporary differences on certain intangible assets that was not required under Canadian GAAP, and the increase in tax rate used to measure temporary differences related to the Fund and its flow-through subsidiaries.

The differences detailed above and the transitional IFRS adjustments discussed in this note resulted in the following tax adjustments in each period:

	Deferred Income Taxes (Liability)	Share Capital	Deficit	Other Comprehensive Income
January 1, 2010	$ 7,153	$ (41)	$ (7,432)	$ 319
Three months ended September 30, 2010	(134)	-	120	14
Nine months ended September 30, 2010	(476)	-	513	(37)

11. TRANSITION TO IFRS (continued)

(d) Hedge Accounting

In accordance with IFRS 1, as at the Transition Date, the Company assessed on a retrospective and prospective basis, the relationship of its cash flow hedges established under Canadian GAAP, and re-designated the hedging relationships in accordance with IFRS. The ineffective portion of the cash flow hedges as at the Transition Date of $234 was recognized to opening deficit as at the Transition Date.

The ineffective portion of the cash flow hedge for the three and nine months ended September 30, 2010 resulted in an increase in deficit of $(54) and $106, and a corresponding change, net of tax effect, of $(40) and $69 in other comprehensive income, respectively.

(e) Financial Instruments – Presentation

The treatment of LP Units as financial liabilities resulted in the following adjustments to the Company's financial statements for the comparative 2010 periods:

- Distributions made on LP Units of $1,231 and $3,756 for the three and nine months ended September 30, 2010, respectively were classified as Interest Expense – fair value of LP Units and LTIP awards, increasing deficit and payable to LP unitholders on investment in the same amounts;
- Reversal of non-controlling interest (under GAAP) of $908 and $2,232 for the three and nine months ended September 30, 2010, respectively related to LP Units' share of profit, resulted in a reduction in deficit and increase in payable to LP unitholders on investment in the same amounts;
- LP Units fair valued and reported as Interest Expense – fair value of LP Units and LTIP awards as at September 30, 2010, based on the fair value of the underlying Fund Units; this change resulted in an increase in deficit and payable to LP unitholders on investment for the three and nine months ended September 30, 2010 of $(1,038) and $(3,437), respectively. On transition to IFRS, the Company had also recognized an increase in deficit and payable to LP unitholders on investments of $7,512;
- Classification of Minority Interest (under GAAP) of $42,708 as at September 30, 2010 as payable to LP unitholders on investment; and
- Change in the fair value applied to the exchange of LP Units for Fund Units, resulting in an increase to Share Capital and Payable to LP unitholders on Investments of $809 for the nine months ended September 30, 2010.

Similarly, since Fund Units were classified as a financial liability for purposes other than financial statement presentation, LTIP awards granted for the comparative 2010 period were also considered cash-settled and thus classified as a liability. The treatment of LTIP units as financial liabilities resulted in the following adjustments to the Company's financial statements for the comparative 2010 period:

- Classification of Contributed Surplus (under GAAP) of $5,989 as at September 30, 2010 as a financial liability, payable to LTIP unitholders; and

11. TRANSITION TO IFRS (continued)

- LTIP awards fair valued and reported as Interest Expense – fair value of LP Units and LTIP awards as at September 30, 2010, based on the fair value of the underlying Fund Units; this change resulted in an increase in deficit and payable to LTIP unit holders for the three and nine months ended September 30, 2010 of $(117) and $(221), respectively. On transition to IFRS, the Company had also recognized an increase in deficit and payable to LTIP unitholders of $121.

The following are reconciliations of the financial statements previously presented under Canadian GAAP to the amended financial statements prepared under IFRS. While the transition from GAAP to IFRS resulted in the movement of finance costs and income taxes paid into the body of the Company's unaudited consolidated statement of cash flows as part of operating activities (disclosed as supplementary information under GAAP), it did not result in any changes to the operating, investing, or financing cash flows of the Company.

Reconciliation of Consolidated Statement of Financial Position as of Sep 30, 2010

Canadian GAAP Account Classifications	Note Reference	Canadian GAAP balance	IFRS 1 Adjustment	Effect of transition to IFRS	IFRS Balance	IFRS Account Classification
Assets						
Current Assets						
Accounts receivable		59,158			59,158	Trade and other receivables
Unbilled fees		18,323			18,323	Unbilled fees
Income taxes recoverable		1,736			1,736	Income taxes recoverable
Prepaid expenses and other	(a)	3,366	(95)	-	3,271	Prepaid expenses and other
Current portion of deferred implementation costs		548			548	Current portion of deferred implementation costs
Total Current Assets		83,131	(95)	-	83,036	Total Current Assets
Non-Current						
Foreign exchange contracts		82			82	Foreign exchange contracts
Deferred implementation costs		2,594			2,594	Deferred implementation costs
Capital Assets		16,471			16,471	Capital Assets
Intangible Assets		238,977			238,977	Intangible Assets
Goodwill		300,792			300,792	Goodwill
Total Non-Current Assets		558,916	-	-	558,916	Total Non-Current Assets
Total Assets		**$ 642,047**	**$ (95)**	**$ -**	**$ 641,952**	
Liabilities						
Current						
Bank Indebtedness		3,740			3,740	Bank indebtedness
Accounts payable and accrued liabilities	(a)	29,858	274	(71)	30,061	Trade and other payables
		-			-	Income taxes payable
Deferred revenues		2,459			2,459	Deferred revenues
Current portion of promissory note		-			-	Current portion of promissory note
Unitholder distributions payable (including non-controlling)		3,759			3,759	Dividends payable and interest payable to LP unitholders
Future consideration related to acquisition		-	3,772		3,772	Future consideration related to acquisition
Current portion of long-term debt		31,500			31,500	Current portion of long-term debt
Total Current Liabilities		71,316	4,046	(71)	75,291	Total Current Liabilities
Insurance premium liabilities						
Payable to insurance companies		9,387			9,387	Payable to insurance companies
Less: related cash and investments held		(9,387)			(9,387)	Less: related cash and investments held
		-	-	-	-	
Non-Current						
Long-term debt		159,238			159,238	Long-term debt
	(e)	-		47,498	47,498	Payable to LP Unit holders on investment
Interest-rate swaps		5,689			5,689	Interest-rate swaps
Other Liabilities		8,720		(2,307)	6,413	Other liabilities
		-		2,307	2,307	Provisions
	(e)			5,889	5,889	Payable to LTIP unit holders
Future Income Taxes	(c)	8,429	7,153	(476)	15,106	Deferred income taxes
Total Non-Current Liabilities		182,076	7,153	52,911	242,140	Total Non-Current Liabilities
Total Liabilities		**253,392**	**11,199**	**52,840**	**317,431**	**Total Liabilities**
Minority Interest	(e)	42,708	-	(42,708)	-	
Equity						
Unitholders' Capital	(e)	417,741	(41)	809	418,509	Share capital
Contributed Surplus	(e)	5,989		(5,989)	-	Contributed Surplus
Accumulated Other Comprehensive Income/(Loss)	(b), (d)	(4,362)	553	(128)	(3,937)	Accumulated Other Comprehensive Income/(Loss)
Deficit	(a), (b), (c), (d), (e)	(73,421)	(11,806)	(4,824)	(90,051)	Deficit
Total Unitholders Capital		345,947	(11,294)	(10,132)	324,521	Total Shareholders' Equity
Total Liabilities and Equity		**$ 642,047**	**$ (95)**	**$ -**	**$ 641,952**	

Reconciliation of Consolidated Income and Comprehensive Income for the three months ended Sep 30, 2010

Canadian GAAP Account Classifications	Note Reference	Canadian GAAP balance	IFRS Changes in Accounting Policy	IFRS Reclassification	IFRS Balance	IFRS Account Classification
Revenue						
Fees		76,863			76,863	Fees
Commissions		6,169			6,169	Commissions
Other		51			51	Finance Income
Total Revenue		**83,083**	**-**	**-**	**83,083**	**Total Operating Revenue**
Expenses						
Salary, benefit, and contractor expenses	(a)	51,986	(20)	-	51,966	Salary, benefit, and contractor expenses
Other operating expenses	(b)	14,001	(201)	(13,800)	-	Other operating expenses
Amortization of capital assets		1,155	-	5,555	6,710	Depreciation, amortization, and impairment Charges
Amortization of intangible assets		5,555	-	(5,555)	-	
				4,299	4,299	Rent and occupancy
				9,501	9,501	Office and administration
		72,697	(221)	-	72,476	
Income before income taxes and non-controlling interest		**10,386**	**221**	**-**	**10,607**	**Profit before finance costs and interest expense**
Interest expense	(d)	2,659	(54)		2,605	Finance Costs
	(e)		76		76	Interest Expense related to LP Units and LTIP awards
		7,727	**199**	**-**	**7,926**	**Profit from Operations Before Income Taxes**
Income taxes (recovery)						Income taxes (recovery)
Current		258	-	-	258	Current
Future	(c)	(883)	(120)	-	(1,003)	Deferred
		(625)	(120)	-	(745)	
Income before non-controlling interest		**8,352**	**319**	**-**	**8,671**	
Non-controlling interest	(e)	908	-	(908)	-	
Net Income		**7,444**	**319**	**908**	**8,671**	**Profit for the period**
Other comprehensive income						
Unrealized gain on interest rate swap hedges, net of tax effect	(d)	678	-	-	678	Net change in interest rate cash flow hedges, net of tax effect
	(c), (d)	-	(40)	-	(40)	Ineffective portion of changes in fair value of interest rate cash flow hedges transferred to income
	(b)	-	(201)	-	(201)	Foreign currency translation differences for foreign operations
Comprehensive Income for the period		**$ 8,122**	**$ 78**	**$ 908**	**$ 9,108**	**Comprehensive Income for the period**

Reconciliation of Consolidated Income and Comprehensive Income for the nine months ended Sep 30, 2010

Canadian GAAP Account Classifications	Note Reference	Canadian GAAP balance	Effect of transition to IFRS	IFRS Reclassification	IFRS Balance	IFRS Account Classification
Revenue						
Fees		233,285			233,285	Fees
Commissions and other income		14,891			14,891	Commissions and other income
Total Revenue		**248,176**	**-**	**-**	**248,176**	**Total Operating Revenue**
Expenses						
Salary, benefit, and contractor expenses	(a)	159,411	(71)		159,340	Salary, benefit, and contractor expenses
Other operating expenses	(b)	41,798	(197)	(41,601)	-	Other operating expenses
Amortization of capital assets		3,283		18,075	21,358	Depreciation, amortization, and impairment losses
Amortization of intangible assets		18,075		(18,075)	-	
				12,623	12,623	Rent and occupancy
				28,978	28,978	Office and administration
		222,567	(268)	-	222,299	
		25,609	**268**	**-**	**25,877**	**Profit before finance costs and interest expense**
Interest expense	(d)	7,772	106		7,878	Finance Costs
	(e)		98		98	Interest Expense related to LP Units and LTIP awards
Income before income taxes and non-controlling interest		**17,837**	**64**	**-**	**17,901**	**Profit from Operations Before Income Taxes**
Income taxes (recovery)						Income taxes (recovery)
Current		703			703	Current
Future	(c)	(3,134)	(513)		(3,647)	Deferred
		(2,431)	(513)	-	(2,944)	
Income before non-controlling interest		**20,268**	**577**	**-**	**20,845**	
Non-controlling interest	(e)	2,232		(2,232)	-	
Net Income		**18,036**	**577**	**2,232**	**20,845**	**Profit for the period**
Other comprehensive income						
Unrealized gain on interest rate swap hedges, net of tax effect	(d)	1,583	(9)		1,574	Net change in interest rate cash flow hedges
	(c), (d)		78		78	Ineffective portion of changes in fair value of interest rate cash flow hedges transferred to income
	(b)		(197)		(197)	Foreign currency translation differences for foreign operations
Other comprehensive income for the period, net of tax effect		1,583	(128)	-	1,455	Other comprehensive income for the period, net of tax effect
Comprehensive Income for the period		**$ 19,619**	**$ 449**	**$ 2,232**	**$ 22,300**	**Comprehensive Income for the period**

On January 1, 2011, Morneau Sobeco Income Fund (the "Fund") converted from an income fund structure to a corporation named Morneau Shepell Inc. ("Morneau Shepell") pursuant to a plan of arrangement (the "Reorganization"). 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 the Fund.

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 three and nine months ended September 30, 2011 and should be read in conjunction with the accompanying unaudited condensed interim Consolidated Financial Statements of Morneau Shepell and notes thereto for the three and nine months ended September 30, 2011, as well as the unaudited condensed interim Consolidated Financial Statements of Morneau Shepell and notes thereto for the three months ended March 31, 2011, and the MD&A and the Audited Consolidated Financial Statements and notes thereto contained in the Fund's Annual Report for the year ended December 31, 2010.

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

On December 2, 2010, the Fund and Morneau Shepell entered into a plan of arrangement ("Reorganization"), whereby the Fund was converted from an income trust structure into the public corporation Morneau Shepell Inc., effective January 1, 2011, pursuant to the laws of the Province of Ontario. The conversion 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 November 7, 2011, 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 workplace health and productivity solutions. 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.

Fees from outsourcing engagements are generally based on negotiated fees or a formula tied to the nature of the service being provided.

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 a 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.

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 11 to our unaudited condensed interim consolidated financial statements for the three and nine months ended September 30, 2011. Additional disclosure related to the mandatory and optional elections and exemptions adopted by the Company under IFRS 1 upon transition to IFRS on January 1, 2010, are provided in note 15 to our unaudited condensed interim consolidated financial statements for the three months ended March 31, 2011.

SUMMARY AND OUTLOOK

For the three and nine months ended September 30, 2011, revenue was $91.6 million and $267.5 million, respectively, compared to $83.1 million and $248.2 million in the same periods of 2010. Adjusted EBITDA for the three and nine months ended September 30, 2011 was $18.5 million and $52.1 million respectively, compared to $17.9 million and $47.8 million for the same periods in 2010.

EBITDA for the three and nine months ended September 30, 2011 was $18.5 million and $51.9 million respectively, compared to $17.3 million and $47.2 million for the same periods in 2010. Adjusted EBITDA margin for the three and nine months ended September 30, 2011 was 20.2% and 19.5% respectively, compared to 21.5% and 19.3% for the same periods in 2010. EBITDA margin for the three and nine months ended September 30, 2011 was 20.2% and 19.4%, compared to 20.8% and 19.0% for the same periods in 2010. Adjusted EBITDA per Share (basic) for the three and nine months ended September 30, 2011 was $0.38 and $1.08 respectively, compared to $0.37 and $1.00 for the same periods in 2010. EBITDA per Share (basic) for the three and nine months ended September 30, 2011 was $0.38 and $1.08 respectively, compared to $0.36 and $0.99 for the same periods in 2010.

On September 30, 2011, we completed our acquisition of Jacques Lamarre & Associates, a company specializing in providing EAP, crisis management, and organizational health and productivity solutions. This acquisition offers accretive benefits, immediately broadening our EAP solutions portfolio, while allowing us to expand our presence within the province of Quebec. The purchase price is contingent on business results and is expected to approximate $6.8 million, payable in two instalments. The first instalment of $4.8 million, of which $0.5 million will be released pending finalization of the purchase price in January 2012, was settled on closing for cash considerations. The second and final instalment of $2.0 million, is subject to revenue adjustments, and will be settled in October 2013. In connection with this acquisition, subsequent to September 30, 2011, the required Debt to Adjusted EBITDA financial covenant was amended to remain at 3.25:1.00 up to March 30, 2013, and 3.0:1.0 on March 31, 2013, and thereafter.

The momentum of the second quarter carried through into the third, as all parts of the business continued to experience growth. The consulting practice continued to grow as a result of increased mandates from existing and new clients. The new business relationships secured during the latter part of 2010 continued to drive growth in the outsourcing, EAP, and health management practices. We are confident that the opportunities from our established business relationships and prospective client base will continue to yield positive results in the fourth quarter of 2011, and onwards.

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 period.

The following table presents excess (shortfall) cash provided by operating activities and profit over dividends to shareholders for the three and nine months ended September 30, 2011 and 2010, and for the years ended December 31, 2010 and 2009.

(In thousands of dollars)	Three months ended September 30, 2011	Three months ended September 30, 2010	Nine months ended September 30, 2011	Nine months ended September 30, 2010	Year ended December 31, 2010	Year ended December 31, 2009 [(1)]
Cash provided by operating activities	$ 19,968	$ 15,757	$ 32,168	$ 23,250	$ 42,424	$ 48,955
Profit [(2)]	6,387	8,747	18,978	20,943	21,418	10,826
Dividends to shareholders [(3)]	9,348	10,042	28,044	30,065	45,110	43,902
Excess (shortfall) of cash provided by operating activities over dividends	10,620	5,715	4,124	(6,815)	(2,686)	5,053
(Shortfall) of profit over dividends	(2,961)	(1,295)	(9,066)	(9,122)	(23,692)	(33,076)

Footnotes:

(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 2010 interim 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 three and nine months ended September 30, 2011 was 83.5% and 86.3% respectively compared to 92.8% and 98.9% for the same periods in 2010. On a twelve-month rolling basis for the three and nine months ended September 30, 2011, the Normalized Payout Ratio was 91.7% compared to 96.7% for the same period in 2010. The improved Normalized Payout Ratios for the three and nine months ended September 30, 2011 was primarily due to the increase in cash generated from operating activities before non-cash operating working capital and changes in the amount of dividends declared.

ANALYSIS OF 2011 THIRD QUARTER OPERATING RESULTS

Results of Operations

Selected Unaudited Consolidated Financial Information *(In thousands of dollars except per share amounts)*	Three months ended September 30 2011	Three months ended September 30 2010	Nine months ended September 30 2011	Nine months ended September 30 2010
Revenue	**$ 91,574**	$ 83,083	**$ 267,541**	$ 248,176
Deduct:				
Salary, benefit and contractor expenses	**58,161**	51,966	**173,072**	159,340
Other operating expenses	**14,922**	13,800	**42,376**	41,601
Finance costs	**3,847**	2,605	**11,119**	7,878
Interest expense related to LP units and LTIP awards	**-**	76	**-**	98
Amortization of capital and intangible assets	**5,315**	6,710	**15,595**	21,358
Income taxes expenses (recovery)	**2,942**	(745)	**6,209**	(2,944)
Contingent consideration related to business acquisitions[8]	**-**	-	**192**	-
Profit for the period	**6,387**	8,671	**18,978**	20,845
Add (deduct):				
Finance costs	**3,847**	2,605	**11,119**	7,878
Interest expense related to LP units and LTIP awards	**-**	76	**-**	98
Amortization of capital and intangible assets	**5,315**	6,710	**15,595**	21,358
Income taxes expenses (recovery)	**2,942**	(745)	**6,209**	(2,944)
EBITDA[1]	**$ 18,491**	$ 17,317	**$ 51,901**	$ 47,235
Adjustments: [8]				
Contingent consideration related to business acquisitions	**-**	-	**192**	-
Sublease loss provision	**-**	128	**-**	128
Conversion and strategic planning	**-**	412	**-**	412
Adjusted EBITDA	**$ 18,491**	$ 17,857	**$ 52,093**	$ 47,775
EBITDA margin	**20.2%**	20.8%	**19.4%**	19.0%
Adjusted EBITDA margin	**20.2%**	21.5%	**19.5%**	19.3%
Cash provided by operating activities	**$ 19,968**	$ 15,747	**$ 32,168**	$ 23,250
Deduct: Capital expenditures [2]	**4,853**	3,344	**13,078**	7,413
Free Cash Flow [3]	**15,115**	12,403	**19,090**	15,837
Add (deduct):				
Changes in Non-cash operating working capital	**3,926**	1,323	**(13,397)**	(17,288)
Other Non-recurring payments	**-**	(1,067)	**-**	(1,067)
Normalized Free Cash Flow [4]	**$ 11,189**	$ 12,147	**$ 32,487**	$ 34,192
Earnings per Share (basic)	**$ 0.13**	NA	**$ 0.39**	NA
Earnings per Share (diluted)	**$ 0.13**	NA	**$ 0.39**	NA
EBITDA per Share (basic) [7]	**$ 0.38**	$ 0.36	**$ 1.08**	$ 0.99
Adjusted EBITDA per Share (basic)	**$ 0.38**	$ 0.37	**$ 1.08**	$ 1.00
Payout Ratio [5]	**61.8%**	90.9%	**146.9%**	189.8%
Normalized Payout Ratio [6]	**83.5%**	92.8%	**86.3%**	98.9%
Twelve-month rolling Payout Ratio	**114.9%**	140.4%	**114.9%**	140.4%
Twelve-month rolling Normalized Payout Ratio	**91.7%**	96.7%	**91.7%**	96.7%

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 from operating activities adjusted for capital expenditures.

(4) "Normalized Free Cash Flow" is defined as cash from 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 non-recurring expenditures related to business acquisitions, integration of Shepell.fgi and Morneau Sobeco, and conversion and strategic planning expenses.

ANALYSIS OF 2011 THIRD QUARTER RESULTS

Revenue

Revenue for the three months ended September 30, 2011 increased by $8.5 million, or 10.2%, to $91.6 million from $83.1 million for the same period in 2010. The increase was driven by growth across all 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. Our consulting practice continued to see growth from the acquisition of new business from regulatory clients and increased mandates from existing clients, as did our EAP and health management practices compared to same quarter last year, which continued to realize the benefits from new business relationships secured during the latter part of 2010.

Salary, Benefit and Contractor Expenses

Salary, benefit and contractor expenses for the three months ended September 30, 2011 increased by $6.2 million, or 11.9%, to $58.2 million compared to $52.0 million for the same period in 2010. This increase was primarily attributable to annual merit increases, general increases to support business growth, and favorable variable compensation expense adjustments in the same period of 2010 that did not recur in the current period.

Other Operating Expenses

Other operating expenses for the three months ended September 30, 2011 increased by $1.1 million, or 8.0%, to $14.9 million compared to $13.8 million for the same period in 2010. This increase is primarily attributable to increased office and administration expenses of $0.7 million, and increased foreign exchange loss of $0.3 million.

Finance Costs

Finance costs for the three months ended September 30, 2011 increased by $1.2 million, or 46.2%, to $3.8 million compared to $2.6 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, $0.3 million in additional interest payable on the final instalment related to the Leong & Associates acquisition, and $0.2 million ineffectiveness related to the $130 million cash flow hedge.

Interest Expenses related to LP Units and LTIP awards

Interest expense for the three months ended September 30, 2011 was $nil, compared to $0.1 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.

Amortization of Capital and Intangible Assets

Amortization for the three months ended September 30, 2011 decreased by $1.4 million, or 20.9%, to $5.3 million compared to $6.7 million for the same period in 2010. This decrease was primarily attributable to lower amortization expenditure of $2.0 million relating to proprietary software which became fully amortized during 2010, and $0.3 million related to proprietary software acquired through the Shepell.fgi acquisition that was partially written down in the fourth quarter of 2010. This was partially offset by increased depreciation on capital assets of $1.0 million.

Income Tax Expenses (Recovery)

Income tax expenses (recovery) for the three months ended September 30, 2011 increased by $3.7 million to an expense of $2.9 million, compared to a $0.8 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.

Profit for the Period

As a result of the changes noted above, profit for the three months ended September 30, 2011 was $6.4 million compared to $8.7 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

EBITDA and Adjusted EBITDA

EBITDA increased by $1.2 million to $18.5 million, compared to $17.3 million in the same period of 2010. This increase was due to increased revenue of $8.5 million, which was offset by $7.3 million of increased salary, benefit and contractor expenses and other operating expenses.

Removing the impact of non-recurring expenditures related to the sublease loss provision and conversion and strategic planning in 2010, Adjusted EBITDA increased by $0.6 million to $18.5 million, compared to $17.9 million for the same period in 2010.

Free Cash Flow

Free Cash Flow for the three months ended September 30, 2011 increased by $2.7 million to $15.1 million, compared to $12.4 million for the same period in 2010. This increase was primarily due to increased cash provided by operating activities of $4.2 million which was partially offset by increased capital expenditure spending of $1.5 million.

Normalized Free Cash Flow

Normalized Free Cash Flow for the three months ended September 30, 2011 decreased by $0.9 million to $11.2 million compared to $12.1 million for the same period in 2010. The decrease was primarily the result of increased capital expenditures spending of $1.5 million, that was partially offset by an increase in cash provided by operating activities, before non-cash operating working capital of $0.6 million.

ANALYSIS OF NINE MONTHS ENDED SEPTEMBER 30, 2011 AND 2010 RESULTS

Revenue

Revenue for the nine months ended September 30, 2011 increased by $19.3 million, or 7.8%, to $267.5 million compared to $248.2 million for the same period in 2010. The outsourcing, consulting, EAP, and health management practices 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 nine months ended September 30, 2011 increased by $13.8 million, or 8.7%, to $173.1 million compared to $159.3 million for the same period in 2010. This increase was primarily attributable to annual merit increases, general increases to support business growth, and favorable variable compensation expense adjustments in the same period of 2010 that did not recur in the current period.

Other Operating Expenses

Other operating expenses for the nine months ended September 30, 2011 increased by $0.8 million, or 1.9%, to $42.4 million, compared to $41.6 million for the same period in 2010. This increase was primarily attributable to increased office and administration expenses of $0.7 million.

Finance Costs

Finance costs for the nine months ended September 30, 2011 increased by $3.2 million or 40.5%, to $11.1 million compared to $7.9 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 upon settlement and $1.7 million in amortization related to the remaining loss on the interest-rate swaps, increased ineffectiveness related to the $130 million cash flow hedge of $0.4 million, and $0.3 million in additional interest payable on the final instalment related to the Leong & Associates acquisition.

Interest Expenses related to LP Units and LTIP awards

Interest expense for the nine months ended September 30, 2011 was $nil, compared to $0.1 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.

Amortization of Capital and Intangible Assets

Amortization for the nine months ended September 30, 2011 decreased by $5.8 million, or 27.1%, to $15.6 million compared to $21.4 million for the same period in 2010. This decrease was primarily attributable to lower amortization expenditure of $6.0 million relating to proprietary software and $1.4 million related to intangible assets acquired through the Shepell-fgi acquisition that became fully amortized in 2010. This was partially offset by an increase in amortization on capital assets of $1.6 million.

Income Tax Expenses (Recovery)

Income tax expenses (recovery) for the nine months ended September 30, 2011 increased by $9.1 million to an expense of $6.2 million, compared to a $2.9 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. 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 Period

As a result of the changes noted above, profit for the nine months ended September 30, 2011 was $19.0 million compared to $20.8 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

EBITDA and Adjusted EBITDA

EBITDA for the nine months ended September 30, 2011, increased by $4.7 million to $51.9 million, compared to $47.2 million for the same period in 2010. This increase was primarily due to

increased revenue of $19.3 million, which was offset by an increase of $14.5 million of salary, benefit and contractor expenses and other operating expenses.

Removing the impact of non-recurring expenditures related to the contingent consideration payable on the Leong & Associates business acquisition in 2011, and the sublease loss provision and conversion and strategic planning expenditures in 2010, Adjusted EBITDA remained strong, increasing by $4.3 million to $52.1 million, compared to $47.8 million for the same period in 2010.

Free Cash Flow

Free Cash Flow for the nine months ended September 30, 2011 increased by $3.3 million to $19.1 million compared to $15.8 million for the same period in 2010. This increase was primarily due to increased cash provided by operating activities of $8.9 million, which was partially offset by an increased capital expenditure spending (excluding those acquired through business acquisitions) of $5.7 million.

Normalized Free Cash Flow

Normalized Free Cash Flow for the nine months ended September 30, 2011 decreased by $1.7 million to $32.5 million compared to $34.2 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 $5.7 million, that was partially offset by an increase in cash provided by operating activities, before non-cash operating working capital of $4.0 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 Unaudited Consolidated Financial Information *(In thousands of dollars)*	**Nine months ended September 30**	
	2011	**2010**
Cash provided by (used in):		
Operating activities	**$ 32,168**	**$ 23,250**
Investing activities	**(22,192)**	**(10,270)**
Financing activities	**(14,278)**	**(18,326)**
Decrease in cash	**$ (4,302)**	**$ (5,346)**

Cash provided by operating activities for the nine months ended September 30, 2011 increased by $8.9 million to $32.2 million compared to $23.3 million for the same period in 2010. This change was primarily attributable to increased cash provided by operating activities before non-cash operating working capital of $5.8 million and an improvement in non-cash operating working capital of $3.9 million, that was partially offset by increased finance costs and income taxes paid of $0.8 million.

Cash used in investing activities for the nine months ended September 30, 2011 increased by $11.9 million to $22.2 million compared to $10.3 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 $5.3 million.

Cash used in financing activities for the nine months ended September 30, 2011 decreased by $4.0 million to $14.3 million compared to $18.3 million for the same period in 2010. This decrease was primarily attributable to decreased dividends paid on common shares of $5.1 million, the full repayment of the $4.5 million promissory note issued in connection with the Shepell.fgi acquisition that did not recur in 2011, and decreased interest paid to LP unitholders of $3.8 million. This was partially offset by the payment of $4.2 million on settlement of the previous $137 million and $23 million interest-rate swap agreements terminated in January 2011, decreased utilization of the revolving term facility of $4.0 million, 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 improvement 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 three and nine months ended September 30, 2011 of $1.5 million and $5.7 million respectively 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	2011 to 2012	2013 to 2014	Beyond 2014
Term loan	$ 130,000	$ -	$ -	$ 130,000
Revolving loans	81,500	11,500	-	70,000
Operating leases, net	75,963	9,320	14,343	52,300
Total	$ 287,463	$ 20,820	$ 14,343	$ 252,300

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 for the guarantee.

Contingent Consideration

The purchase price for Jacques Lamarre & Associates is contingent on business results and is expected to be payable in three instalments. The first instalment of $4.8 million, of which $0.5 million is currently being held for release in February 2012 upon finalization of the purchase price in January 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 September 30, 2011, $2.2 million, representing the discounted value of the $2.5 million remaining to be settled, has been recognized as acquisition liability in the statement of financial position.

During the period, the Company 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.

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 September 30, 2011**	**As at December 31, 2010**
Bank indebtedness	$ 3,942	$ -
Long-term debt, net of unamortized debt issue cost	$ 210,005	$ 194,855
Payable to LP Unit holders on investment (1)	$ -	$ 53,729
Shareholders' equity	$ 359,654	$ 310,325

(1) This balance represents Minority Interest (under 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 September 30, 2011, our working capital (current assets minus current liabilities, excluding future consideration related to acquisition), was approximately $31.0 million compared to $27.0 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

We are in compliance with all the required financial covenants, and the ratios as at September 30, 2011 were 3.1 and 5.1 respectively.

Despite increased utilization of the revolving facility by $4.2 million to fund the business acquisition of Jacques Lamarre & Associates on September 30, 2011, the Company's debt to Adjusted EBITDA ratio remained comparable to the previous quarter at 3.1:1.0. Including the dilutive effect of the acquisition, with all things being held equal, the ratio of debt to Adjusted EBITDA remained comparable at 3.1 as of September 30, 2011.

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

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 September 30, 2011**	**As at December 31, 2010**
Current assets	$ 96,434	$ 80,552
Non-Current assets	$ 561,242	$ 555,357
Current liabilities	$ 65,894	$ 58,232
Non-Current liabilities	$ 232,128	$ 267,352

Current Assets

Current assets as at September 30, 2011 increased by $15.8 million to $96.4 million from $80.6 million as at December 31, 2010. The increase was primarily due to an increase in accounts receivable and unbilled fees of $13.2 million as a result of growth in revenue, the timing of billings and collections, and in acquired assets through the Jacques Lamarre & Associates acquisition. In addition, prepaid expenses increased by $2.4 million due to the timing of employee benefits and vendor payments.

Non-Current Assets

Non-current assets as at September 30, 2011 increased by $5.8 million to $561.2 million from $555.4 million as at December 31, 2010. The increase was primarily due to capital expenditures of $13.1 million, increased deferred implementation costs associated with outsourcing contracts of $4.3 million, and $4.1 million in acquired capital and intangible assets related to the Jacques Lamarre & Associates business acquisition. This was partially offset by the amortization of capital and intangible assets of $15.6 million.

Current Liabilities

Current liabilities as at September 30, 2011 increased by $7.7 million to $65.9 million from $58.2 million as at December 31, 2010. The increase was primarily the result of increased bank indebtedness of $3.9 million, increased trade and other payables of $3.0 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 $2.1 million due to the timing of customer billings, and contingent consideration related to the Jacques Lamarre & Associates business acquisition of $0.5 million. This was partially offset by the payment of the final instalment related Leong & Associates business acquisition of $4.9 million, of which $4.7 million was accrued for as of December 31, 2010.

Non-Current Liabilities

Non-current liabilities as at September 30, 2011 decreased by $35.3 million to $232.1 million from $267.4 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, that was partially offset by an increase in long-term debt of $15.2 million from the utilization of the revolving facility, $5.9 million related to the fair value of the new $130 million interest-rate

swap agreement, increased deferred income taxes of $5.8 million, 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 2 of the unaudited condensed interim consolidated financial statements for the three months ended March 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 for internal use, 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 proprietary software for internal use 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 proprietary software developed for internal 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 quarter.

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, 2013 but is available for early adoption. We have not early adopted IFRS 9 for the period ended September 30, 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, 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 period ended September 30, 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, 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, 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.

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.

General 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

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 three and nine months ended September 30, 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 and director and officer 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. 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 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.

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 consolidated 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 $7.2 million and $21.4 million for the three and nine months ended September 30, 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.

Income Tax Matters

In the normal course of Morneau Shepell's activities, the tax authorities carry out ongoing reviews. In that respect, Morneau Shepell is of the view that all expenses claimed are reasonable, deductible, and correctly determined. There is no assurance that the tax authorities will not challenge these positions. Such challenge, if successful, may have an adverse effect on our earnings and return on Common Shares.

Risk Related to the Structure of Morneau Shepell

Dependence on Morneau Shepell Ltd. and Its Subsidiaries

Although Morneau Shepell intends to pay dividends on its Common Shares, there can be no assurance regarding amounts of income to be generated by its operating subsidiaries or ultimately distributed to Morneau Shepell from these subsidiaries. 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 including their financial performance, obligations under credit facilities, fluctuations in working capital, the sustainability of their margin and capital expenditure requirements and applicable laws and regulations.

Cash Dividends Are Not Guaranteed and Will Fluctuate With the Business Performance

As a corporation, Morneau Shepell's dividend policy will be at the discretion of its Board of Directors. Future dividends, if any, will depend on the operations and assets of Morneau Shepell (and its subsidiaries), and will be subject to various factors including each of its financial performance, its obligations under applicable credit facilities, fluctuations in its working capital, the sustainability of its margins and its capital expenditure requirements.

Market Price of 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.

SUPPLEMENTARY SUMMARY OF QUARTERLY RESULTS

Operating results, dividends summary 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	September 30 2011	June 30 2011	March 31 2011	December 31 2010	September 30 2010	June 30 2010	March 31 2010	December 31 2009[1]
Revenue	$91,574	$90,565	$85,402	$87,017	$83,083	$83,669	$81,425	$83,316
Profit (loss)	6,387	6,133	6,458	(7,238)	8,671	12,345	(170)	4,169
EBITDA	18,491	17,801	15,609	9,019	17,317	15,848	14,070	15,739
Adjusted EBITDA	18,491	17,993	15,609	16,494	17,857	15,848	14,070	18,474
EBITDA margin	20.2%	19.7%	18.3%	10.4%	20.8%	18.9%	17.3%	18.9%
Adjusted EBITDA margin	20.2%	19.9%	18.3%	19.0%	21.5%	18.9%	17.3%	22.2%
Free Cash Flow	15,115	(1,977)	5,952	15,153	12,403	(1,237)	4,671	14,365
Normalized Free Cash Flow	11,189	10,720	10,578	10,413	12,147	11,901	10,144	12,396
Dividends declared [4]	9,348	9,348	9,348	11,288	11,274	11,274	11,274	11,230
Earnings per Share (basic) [3]	0.13	0.13	0.13	NA	NA	NA	NA	0.10
Earnings per Share (diluted) [3]	0.13	0.13	0.13	NA	NA	NA	NA	0.10
EBITDA per Share (basic)	0.38	0.37	0.32	0.19	0.36	0.33	0. 30	0.33
Adjusted EBITDA per Share (basic)	0.38	0.37	0.32	0.35	0.37	0.33	0.30	0.39
Payout Ratio (basic) [2]	61.8%	NM	157.1%	74.5%	90.9%	NM	241.4%	69.1%
Normalized Payout Ratio	83.5%	87.2%	88.4%	108.4%	92.8%	94.7%	111.1%	90.6%
Twelve-month rolling Payout Ratio	114.9%	130.8%	133.8%	145.5%	140.4%	122.2%	117.9%	109.6%
Twelve-month rolling Normalized Flow Payout Ratio	91.7%	94.1%	95.9%	101.1%	96.7%	97.6%	98.5%	98.3%
Total assets	$657,676	$649,844	$640,365	$635,909	$641,952	$644,885	$644,585	$649,366
Total long-term debt	$198,505	$193,388	$184,772	$183,355	$159,238	$159,121	$159,004	$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 presented have been adjusted to conform with IFRS, but comparative 2009 figures presented are based on Canadian GAAP and have not been restated to IFRS.

(2) This ratio is not presented for the quarter ended June 30, 2011 and June 30, 2010, since it is not a meaningful % when the Payout Ratio per share is a negative figure or close to break even.

(3) 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.

(4) The comparative 2010 and 2009 dividend figures presented represent distributions paid to holders of Fund and LP Units.

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 September 30, 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.

The Chief Executive Officer and the Chief Financial Officer have concluded that the internal controls over financial reporting are appropriately designed as at September 30, 2011.

No changes were made in our internal controls over financial reporting during the third quarter ended September 30, 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 November 7, 2011.

HUMAN RESOURCE CONSULTING AND
ADMINISTRATIVE SOLUTIONS

Morneau Shepell Inc. is the largest Canadian-owned firm providing human resource consulting and outsourcing services. Through Morneau Shepell and Shepell·fgi, the firm delivers solutions to assist employers in managing the financial security, health and productivity of their employees. With over 2,500 employees in offices across North America, Morneau Shepell offers its services to organizations that are situated in Canada, in the United States and around the globe.

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