## MANAGEMENT'S DISCUSSION AND ANALYSIS

Morneau Sobeco Income Fund (the "Fund") was formed on August 22, 2005 and commenced operations on September 30, 2005 when it completed an initial public offering.

This Management's Discussion and Analysis ("MD&A") covers the year ended December 31, 2010 and should be read in conjunction with our accompanying Audited Consolidated Financial Statements and notes thereto for the year ended December 31, 2010.

All financial information is presented in Canadian dollars and in accordance with Canadian generally accepted accounting principles ("GAAP") 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 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-GAAP measures such as Standardized EBITDA, Adjusted Standardized EBITDA, Standardized Distributable Cash, Adjusted Consolidated Distributable Cash, Standardized Distributable Cash Payout Ratio and Adjusted Consolidated Distributable Cash Payout Ratio. Standardized EBITDA is intended to represent an indication of the entity's capacity to generate income 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, Standardized EBITDA comprises revenues less operating costs before interest expense, capital asset amortization and impairment charges, and income taxes, while Adjusted Standardized EBITDA represents Standardized EBITDA before taking into account non-recurring expenditures. We believe both Standardized EBITDA and Adjusted Standardized EBITDA are useful measures in evaluating our performance. We utilize them to monitor compliance with debt covenants and to make decisions related to distributions to Unitholders rather than net income due to the significant amount of amortization expense related to our intangible assets. We also believe that Standardized Distributable Cash, Adjusted Consolidated Distributable Cash, Standardized Distributable Cash Payout Ratio and Adjusted Consolidated Distributable Cash Payout Ratio are useful supplemental measures of performance as they are generally used by Canadian open-ended business income funds as indicators of financial performance. See the footnotes to the "Results of Operations" chart for more details. Non-GAAP measures do not have any standard meaning prescribed by GAAP and therefore may not be comparable to similar measures presented by other issuers.

This MD&A is in all material respects in accordance with the recommendations provided in CICA's publication *Standardized Distributable Cash in Income Trusts and Other Flow-Through Entities: Guidance*

*on Preparation and Disclosure* and the CICA's publication *Improved Communication with Non-GAAP Financial Measures: General Principles and Guidance for Reporting EBITDA and Free Cash Flow.*

## FORMATION AND OWNERSHIP STRUCTURE OF THE FUND

As of December 31, 2010 we were an unincorporated, open-ended, limited purpose trust established under the laws of Ontario. We indirectly own 42,749,215 Class A Limited Partnership units of Morneau Sobeco Group Limited Partnership ("MS Group LP"), which represents a 89.2% ownership interest. MS Group LP owns directly and indirectly 100% of Morneau Sobeco Limited Partnership and Morneau Sobeco, Ltd. (the "Morneau Sobeco Operating Entities"). The 10.8% non-controlling interest in MS Group LP is held through Class B LP units of the limited partnership (the "Class B LP Units") and an equal number of Special Voting Units of the Fund, which together are exchangeable into Units. Management employees and former owners of the predecessors of the Morneau Sobeco Operating Entities ("Management Securityholders") hold this non-controlling interest.

On January 1, 2011 we converted from an income fund structure to a corporation named Morneau Shepell Inc. ("Morneau Shepell") pursuant to a plan of arrangement (the "Reorganization"). In connection with this Reorganization, holders of units of the Fund ("Units") and Class B LP Units received common shares in the capital of Morneau Shepell ("Shares") in exchange for their Units and Class B LP Units, respectively, on a one-to-one basis. As a result, as at March 10, 2011, no Units, MS Group LP Class B LP Units, and Special Voting Units of the Fund remained issued and outstanding. As at March 10, 2011, Morneau Shepell had 47,940,409 Shares issued and outstanding.

## BUSINESS OVERVIEW

Morneau Sobeco Income Fund (Morneau Shepell Inc. as of January 1, 2011) is the largest Canadian-owned 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 2,300 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 work place 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 occupancy costs, technology costs (equipment leases, telecommunications and software), non-recoverable client service costs (such as printing, travel and third-party professional services), training, marketing, office costs, professional services and insurance.

**SUMMARY AND OUTLOOK**

For the year ended December 31, 2010 revenue growth was $3.5 million, or 1.1% compared to the same period in 2009. Net income growth for the year ended was 74.8%, reaching $18.9 million compared to $10.8 million in 2009. Excluding the impact of non-recurring expenditures, Adjusted Standardized EBITDA was $64.0 million, compared to $64.4 million for the same period in 2009. Including the impact of non-recurring expenditures, Standardized EBITDA for the year ended was $56.0 million, compared to $61.3 million in 2009. Adjusted Standardized EBITDA and Standardized EBITDA margin for the year ended December 31, 2010 were 19.1% and 16.7% respectively, compared to 19.4% and 18.5% for the same period in 2009. Adjusted Standardized EBITDA per Unit (basic) and Standardized EBITDA per Unit (basic) for 2010 were $1.34 and $1.17 respectively, compared to $1.40 and $1.33 for the same period in 2009.

We have continued to see growth in our outsourcing and pension and benefits consulting practices for the year, as a result of new business relationships, increased mandates from existing clients, and the commencement of the service component for several large outsourcing projects. The lagging impact of the global recession resulted in moderate declines in the EAP and health management practices. We remain confident that new business relationships secured during the latter part of 2010, coupled with an improving new business pipeline, will yield positive results in 2011.

As noted above, we received all requisite regulatory approvals and consents required to complete the Reorganization from an income trust structure into Morneau Shepell. 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.

Starting in January 2011, the monthly dividend level is $0.065 per share. This dividend level will facilitate the reduction of debt, while providing investors with an attractive yield. The foregoing dividend policy is subject to the discretion of our board of directors and may vary depending on, among other things, our operating cash flow, financial requirements, limitations and restrictions in credit facilities, the satisfaction of solvency tests imposed by the corporate laws for the declaration of dividends and other conditions existing at such future time.

In addition to the above, as part of the Reorganization, Morneau Shepell and our newly-formed operating subsidiary Morneau Shepell Ltd. ("MSL"), entered into an amended and restated credit agreement with our existing lending parties effective January 1, 2011, for a term of four years. The terms of the amended and restated credit facility remain similar to those contained in the previous agreement, with the exception of changes in the distribution of available credit between term and revolving loans, and in financial covenant related to the Debt to EBITDA ratio.

## DISTRIBUTIONS TO UNITHOLDERS

Monthly distributions were declared for Unitholders of record on the last business day of each month and were paid on about the 15th day of the following month, with the exception of distributions declared for the month of December 2010, which was based on Units on record on December 20, 2010 and paid out on December 30, 2010 as a result of the Reorganization.

Monthly distributions were $0.07871 per unit for the year.

The following table presents excess (shortfall) cash flow from operating activities and net income over distributions to Unitholders for the years ended December 31, 2010, 2009 and 2008.

| *(In thousands of dollars)* | **Year ended December 31, 2010** | **Year ended December 31, 2009** | **Year ended December 31, 2008** |
|---|---|---|---|
| Cash flow from operating activities | $ 42,414 | $ 48,955 | $ 35,295 |
| Net income | 18,929 | 10,826 | 8,796 |
| Distributions to Unitholders, including Class B LP Units | 45,110 | 43,902 | 32,718 |
| (Shortfall) Excess of cash flow from operating activities over distributions | (2,696) | 5,053 | 2,577 |
| (Shortfall) of net income over distributions | (26,181) | (33,076) | (23,922) |

We consider the amount of cash generated by the business in determining the amount of distributions payable to Unitholders. 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 net income in setting the level of distributions 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 as well as non-controlling interest related to the Class B LP Units. The shortfall of cash flow from operating activities over distributions is primarily due to the timing of significant supplier payments and other non-recurring payments related to office consolidation projects and Reorganization.

The Standardized Distributable Cash Payout Ratio was 145.4% on a twelve-month rolling basis ending December 31, 2010 compared to 109.6% for the same period in 2009. The Adjusted Consolidated Distributable Cash Payout Ratio for the year ended December 31, 2010 was 101.9% compared to 98.3% for the same period in 2009. The higher Standardized Distributable Cash Payout and Adjusted Consolidated Distributable Cash Payout ratios for 2010 reflect the increased distributions from the issuance of additional Units on March 24, 2009, and increased capital expenditures of $2.5 million, primarily due to software development costs related to the Shepell•fgi business and to office consolidation initiatives undertaken during the year.

## ANALYSIS OF 2010 OPERATING RESULTS

**Results of Operations**

| Selected Unaudited Consolidated Financial Information *(In thousands of dollars except per unit amounts )* | **Three Months Ended December 31 2010** | **Three Months Ended December 31 2009** | **Year Ended December 31 2010** | **Year Ended December 31 2009** |
|---|---|---|---|---|
| **Revenue** | **$ 87,017** | $ 83,316 | **$ 335,194** | $ 331,703 |
| Deduct: | | | | |
| Salary, benefit and contractor expenses | **61,913** | 51,196 | **221,325** | 210,243 |
| Other operating expenses | **18,532** | 17,171 | **60,330** | 61,484 |
| Interest expense | **2,689** | 2,683 | **10,461** | 13,211 |
| Amortization of capital and intangible assets | **5,362** | 10,770 | **26,718** | 45,151 |
| Income taxes (recovery) | **(2,480)** | (3,212) | **(4,910)** | (10,614) |
| Non-controlling interest | **109** | 539 | **2,341** | 1,402 |
| **Net income for the period/year** | **892** | 4,169 | **18,929** | 10,826 |
| Add (deduct): | | | | |
| Interest expense | **2,689** | 2,683 | **10,461** | 13,211 |
| Amortization of capital and intangible assets | **5,362** | 10,770 | **26,718** | 45,151 |
| Income taxes (recovery) | **(2,480)** | (3,212) | **(4,910)** | (10,614) |
| Impairment of leasehold improvements | **-** | 790 | **-** | 1,338 |
| Impairment of proprietary software | **2,417** | - | **2,417** | - |
| Non-controlling interest | **109** | 539 | **2,341** | 1,402 |
| **Standardized EBITDA**[1] | **$ 8,989** | $ 15,739 | **$ 55,956** | $ 61,314 |
| Adjustments: [8] | | | | |
| Sublease loss provision | **-** | 1,822 | **128** | 2,200 |
| Severance related to integration | **-** | 913 | **-** | 913 |
| Severance related to restructuring | **5,967** | - | **5,967** | - |
| Reorganization and strategic planning | **1,508** | - | **1,920** | - |
| **Adjusted Standardized EBITDA** | **$ 16,464** | $ 18,474 | **$ 63,971** | $ 64,427 |
| Standardized EBITDA margin | **10.3%** | 18.9% | **16.7%** | 18.5% |
| Adjusted Standardized EBITDA margin | **18.9%** | 22.2% | **19.1%** | 19.4% |
| **Cash from operating activities** | **$ 19,164** | $ 18,649 | **$ 42,414** | $ 48,955 |
| Deduct: Capital expenditures [7] | **4,011** | 2,399 | **11,424** | 8,912 |
| Consolidated Distributable Cash [2] | **15,153** | 16,250 | **30,990** | 40,043 |
| Deduct: Consolidated Distributable Cash available to non-controlling interest | **1,647** | 1,885 | **3,435** | 4,851 |
| **Standardized Distributable Cash** (available for Unitholders) [3] | **$ 13,506** | $ 14,365 | **$ 27,555** | $ 35,192 |
| Consolidated Distributable Cash [2] | **$ 15,153** | $ 16,250 | **$ 30,990** | $ 40,043 |
| Add/(deduct): | | | | |
| Changes in Non-cash operating working capital | **(12,069)** | (3,854) | **4,719** | 4,610 |
| Adjustments related to non-operating cash items [9] | **7,475** | - | **8,542** | - |
| **Adjusted Consolidated Distributable Cash [4]** | **$ 10,559** | $ 12,396 | **$ 44,251** | $ 44,653 |
| Net income per Unit (basic) | **$ 0.02** | $ 0.10 | **$ 0.45** | $ 0.27 |
| Net income per Unit (diluted) | **$ 0.02** | $ 0.10 | **$ 0.44** | $ 0.26 |
| Standardized EBITDA per Unit (basic) | **$ 0.19** | $ 0.33 | **$ 1.17** | $ 1.33 |
| Adjusted Standardized EBITDA per Unit (basic) | **$ 0.35** | $ 0.39 | **$ 1.34** | $ 1.40 |
| Standardized Distributable Cash per Unit (basic) | **$ 0.32** | $ 0.34 | **$ 0.65** | $ 0.87 |
| Adjusted Consolidated Distributable Cash per Unit (basic) | **$ 0.22** | $ 0.26 | **$ 0.93** | $ 0.97 |
| Standardized Distributions declared per Unit (basic) | **$ 0.24** | $ 0.24 | **$ 0.95** | $ 0.95 |
| Standardized Distributable Cash Payout Ratio [5] | **74.4%** | 69.1% | **145.4%** | 109.6% |
| Adjusted Consolidated Distributable Cash Payout Ratio [6] | **106.9%** | 90.6% | **101.9%** | 98.3% |
| Twelve-month rolling Standardized Distributable Cash Payout Ratio | **145.4%** | 109.6% | **145.4%** | 109.6% |
| Twelve-month rolling Adjusted Consolidated Distributable Cash Payout Ratio | **101.9%** | 98.3% | **101.9%** | 98.3% |

Footnotes:

(1) "Standardized EBITDA" is defined as net income before interest expense, income taxes (recovery), depreciation, amortization, impairment charges, and non-controlling interest.

(2) "Consolidated Distributable Cash" is defined as cash from operating activities adjusted for capital expenditures.

(3) "Standardized Distributable Cash" is defined as cash from operating activities, including the effects of changes in non-cash operating working capital, less capital expenditures and Consolidated Distributable Cash available to non-controlling interest.

(4) "Adjusted Consolidated Distributable Cash" is defined as Consolidated Distributable Cash excluding changes in non-cash operating working capital and adjustments related to non-recurring expendutires.

(5) "Standardized Distributable Cash Payout Ratio" is defined as declared distributions divided by Standardized Distributable Cash.

(6) "Adjusted Consolidated Distributable Cash Payout Ratio" is defined as declared distributions divided by Adjusted Consolidated Distributable Cash.

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

(8) "Adjustments" represents significant non-recurring expenditures related to restructuring, Reorganization and strategic planning, as well as the integration of Shepell•fgi operations and Morneau Sobeco.

(9) For the three months and year ended December 31, 2010, this represents payments associated with sublease properties and lease buyout arrangement resulting from the integration of Shepell•fgi and Morneau Sobeco offices, amounts related to restructuring as well as Reorganization and strategic planning.

## ANALYSIS OF 2010 ANNUAL RESULTS

### *Revenue*

Revenue for the year ended December 31, 2010 increased by $3.5 million, or 1.1%, to $335.2 million compared to $331.7 million for the same period in 2009. This increase was primarily driven by growth in the pension and benefits consulting and outsourcing practices, resulting from new business relationships, increased mandates from existing clients, and the commencement of the service component for several large outsourcing projects. The lagging impact of the global recession resulted in moderate declines in the EAP and health management practices. We remain confident that new business secured during the latter part of 2010, coupled with an improving new business pipeline, will yield positive results in 2011.

### *Salary, Benefit and Contractor Expenses*

Salary, benefit and contractor expenses for the year ended December 31, 2010 increased by $11.1 million, or 5.3%, to $221.3 million compared to $210.2 million for the same period in 2009. The increase was primarily attributable to increased severance expenditures of $5.1 million related to restructuring and general increases of $6.0 million due to merit, improved benefits coverage, and headcount changes.

### *Other Operating Expenses*

Other operating expenses for the year ended December 31, 2010 decreased by $1.2 million, or 2.0%, to $60.3 million compared to $61.5 million for the same period in 2009. The decrease was primarily due to decreased occupancy and office costs of $0.5 million and $0.3 million respectively as a result of our office consolidation initiatives. In addition, we had certain 2009 expenses which did not recur including a $1.3 million write-down of leasehold improvements, a $2.2 million provision for future rental loss associated with the sublease of excess office spaces and additional capital tax expense of $0.6 million due to an unfavorable assessment. This was partially offset by an impairment charge of $2.4 million related to proprietary software, and Reorganization and strategic planning expenditures of $1.9 million.

### *Interest Expensen*

Interest expense for the year ended December 31, 2010 decreased by $2.7 million, or 20.5%, to $10.5 million compared to $13.2 million for the same period in 2009. The decrease was primarily due to a decrease in accretion interest of $3.3 million with the repayment of the $75 million promissory note during second quarter of 2009 and of the $4.5 million promissory note during the third quarter of 2010, that was partially

offset by increased interest expense of $0.5 million on our revolving facility to address working capital needs.

***Amortization of Capital and Intangible Assets***

Amortization for the year ended December 31, 2010 decreased by $18.5 million, or 40.9%, to $26.7 million compared to $45.2 million for the same period in 2009. This decrease was primarily attributable to lower amortization expense on intangible assets acquired through the Shepell•fgi acquisition and on proprietary software that became fully amortized during the year of $17.9 million and $2.0 million respectively. This was partially offset by increased amortization expense on purchased software of $0.4 million, newly-acquired customer contracts of $0.2 million, and internally-developed software of $0.2 million.

***Income Tax Recovery***

Income tax recovery for the year ended December 31, 2010 decreased by $5.7 million to a recovery of $4.9 million compared to the $10.6 million recovery for the same period in 2009. The decrease was primarily due to decline in future income tax recovery related to the reversal of temporary differences associated with intangible assets acquired through past share acquisitions.

***Net Income***

As a result of the changes noted above, the net income for the year ended December 31, 2010 was $18.9 million compared to the net income of $10.8 million for the same period in 2009.

***Non-GAAP Financial Measures: Standardized EBITDA, Adjusted Standardized EBITDA, Standardized Distributable Cash and Adjusted Consolidated Distributable Cash***

***Standardized EBITDA and Adjusted Standardized EBITDA***

Removing the impact of non-recurring expenditures during the period, Adjusted Standardized EBITDA remained comparable to the same period of 2009, decreasing by $0.4 million to $64.0 million from $64.4 million. Including non-recurring expenditures related to Reorganization and strategic planning, severance expenditures related to restructuring, and an adjustment to the sublease loss provision due to a lease buyout arrangement, Standardized EBITDA for the year ended December 31, 2010 decreased by $5.3 million to $56.0 million compared to $61.3 million for the same period in 2009. This decrease was due to increased revenue of $3.5 million, which was offset by $8.8 million of increased salary, benefit and contractor expenses and other operating expenses, before impairment charges.

***Standardized Distributable Cash***

Standardized Distributable Cash for the year ended December 31, 2010 decreased by $7.6 million to $27.6 million compared to $35.2 million for the same period in 2009. This decrease was primarily due to decreased cash from operating activities of $6.6 million, and increased capital expenditure spending of $2.5 million. This was partially offset by a decrease in Consolidated Distributable Cash available to non-controlling interest of $1.5 million.

***Adjusted Consolidated Distributable Cash***

Adjusted Consolidated Distributable Cash for the year ended December 31, 2010 decreased by $0.4 million to $44.3 million compared to $44.7 million for the same period in 2009. This decrease was primarily the result of increased capital expenditures of $2.5 million that was partially offset by the change in fair value of foreign exchange contracts of $1.8 million.

## ANALYSIS OF 2010 FOURTH QUARTER RESULTS

### *Revenue*

Revenue for the three months ended December 31, 2010 increased by $3.7 million, or 4.4%, to $87.0 million, compared to $83.3 million for the same period in 2009. Growth in the pension and benefits consulting and outsourcing practices, mainly resulting from new business from a significant client, increased mandates and out-of-scope services from existing clients, and the continuation of the service component for several large outsourcing projects, largely offset modest declines in the EAP and health management practices.

### *Salary, Benefit and Contractor Expenses*

Salary, benefit and contractor expenses for the three months ended December 31, 2010 increased by $10.7 million, or 20.9%, to $61.9 million, compared to $51.2 million for the same period in 2009. This increase was primarily attributable to increased severance expenditures of $5.1 million and a $2.6 million increase related to general merit and improved benefits coverage. The remaining increase is the result of a change in the timing of adjustments to variable compensation accruals and implementation costs related to outsourcing contracts.

### *Other Operating Expenses*

Other operating expenses for the three months ended December 31, 2010 increased by $1.3 million, or 7.6%, to $18.5 million compared to $17.2 million for the same period in 2009. This increase was primarily attributable to a $2.4 million write-down of proprietary software, Reorganization and strategic planning expenditures of $1.5 million in the current year, and increased bad debt expense and contingency provisions of $0.6 million. This was partially offset by a $1.3 write-down of leasehold improvements and $1.8 million of provision for future rental loss associated with the sublease of excess office space in 2009 which did not recur.

### *Interest Expense*

Interest expense for the three months ended December 31, 2010 remained comparable to the same period in 2009, at $2.7 million.

### *Amortization of Capital and Intangible Assets*

Amortization for the three months ended December 31, 2010 decreased by $5.4 million, or 50.0%, to $5.4 million compared to $10.8 million for the same period in 2009. The decrease was primarily attributable to decreased amortization expense on customer contracts acquired as part of the Shepell•fgi acquisition of $4.1 million and on proprietary software of $2.0 million, both of which were fully amortized prior to the fourth quarter of 2010. This was partially offset by increased amortization on purchased software of $0.3 million and on internally-developed software of $0.1 million.

### *Income Tax Recovery*

Income tax recovery for the three months ended December 31, 2010 decreased by $0.7 million to a $2.5 million recovery compared to $3.2 million for the same period in 2009. The decrease was primarily due to decline in future income tax recovery related to the reversal of temporary differences associated with intangible assets acquired through past share acquisitions.

### *Net Income*

As a result of the changes noted above, the net income for the three months ended December 31, 2010 was $0.9 million compared to $4.2 million for the same period in 2009.

***Non-GAAP Financial Measures: Standardized EBITDA, Adjusted Standardized EBITDA, Standardized Distributable Cash and Adjusted Consolidated Distributable Cash***

***Standardized EBITDA and Adjusted Standardized EBITDA***

Standardized EBITDA, adjusted for the impact of the $6.0 million in severance related to restructuring and $1.5 million associated with Reorganization and strategic planning, decreased by $2.0 million to $16.5 million compared to $18.5 million for the same period in 2009.

Inclusive of the above non-recurring adjustments, Standardized EBITDA for the three months ended December 31, 2010 decreased by $6.7 million, or 42.7%, to $9.0 million compared to $15.7 million for the same period in 2009. This decrease was due to increased salary, benefit and contractor expenses and other operating expenses, excluding impairment charges related to proprietary software and leasehold improvements, of $10.4 million, offset by increased revenue of $3.7 million.

***Standardized Distributable Cash***

Standardized Distributable Cash for the three months ended December 31, 2010 decreased by $0.9 million to $13.5 million compared to $14.4 million for the same period in 2009. This decrease was primarily due to increased capital expenditures mainly for technology spending of $1.6 million, partially offset by increase cash from operating activities of $0.5 million and a $0.2 million decrease in Consolidated Distributable Cash available to non-controlling interest.

***Adjusted Consolidated Distributable Cash***

Adjusted Consolidated Distributable Cash for the three months ended December 31, 2010 decreased by $1.8 million to $10.6 million compared to $12.4 million for the same period in 2009. This decrease was primarily attributable to increased capital expenditures of $1.6 million.

## LIQUIDITY AND CAPITAL RESOURCES

***Cash Flows***

The following table provides an overview of our cash flows for the periods indicated:

| **Cash Flow Information**<br>Selected Unaudited Consolidated Financial Information<br>*(In thousands of dollars)* | **Three Months Ended December 31** | | **Year Ended December 31** | |
|---|---|---|---|---|
| | **2010** | **2009** | **2010** | **2009** |
| Cash provided by (used in): | | | | |
| Operating activities | **$ 19,164** | $ 18,649 | **$ 42,414** | $ 48,955 |
| Investing activities | **(4,011)** | (2,399) | **(14,281)** | (9,624) |
| Financing activities | **(11,052)** | (11,845) | **(29,369)** | (37,221) |
| Increase (decrease) in cash | **$ 4,101** | $ 4,405 | **$ (1,236)** | $ 2,110 |

## 2010 Annual Results

Cash from operating activities for the year ended December 31, 2010 decreased by $6.6 million to $42.4 million compared to $49.0 million for the same period in 2009. This decrease was primarily due to an

increase in net income of $8.1 million, that was offset by a decreased add-back of non-cash operating items of $14.5 million. This change in non-cash items is primarily represented by decreased amortization expenses of $18.5 million, decreased accretion interest of $3.3 million, and changes in sublease loss provisions of $2.8 million. This was partially offset by increased future income taxes recovery of $5.7 million, increased add-backs related to the change in fair value of foreign exchange contracts of $1.8 million, of asset impairment charges of $1.1 million, of increased non-controlling interest of $0.9 million, and of long-term incentive plan expenditures of $0.7 million.

Cash used in investing activities for the year ended December 31, 2010 increased by $4.7 million to cash outflows of $14.3 million compared to cash outflows of $9.6 million for the same period in 2009. This increase is primarily due to increased business acquisition-related payments of $1.5 million, and increased capital expenditures of $2.9 million mainly on technology spending and leasehold improvements related to office consolidations.

Cash used in financing activities for the year ended December 31, 2010 decreased by $7.8 million to a use of cash of $29.4 million compared to a use of cash of $37.2 million for the same period in 2009. This decrease was primarily attributable to increased utilization of our revolving facility of $19.5 million to fund various non-recurring payments related to business acquisitions, the Reorganization, and to address working capital needs. This was partially offset by increased distributions of $5.5 million mainly due to the elimination of the income trust structure at January 1, 2011, the repayment of the $4.5 million promissory note related to the Shepell•fgi acquisition, and proceeds from the sale of Units held in Treasury related to the LTIP of $1.9 million in 2009 that did not recur.

**2010 Fourth Quarter Results**

Cash from operating activities for the three months ended December 31, 2010 increased by $0.6 million to $19.2 million compared to $18.6 million for the same period in 2009. This change was primarily attributable to a decrease in net income of $3.3 million, and a decreased add-back from non-cash adjustments of $4.5 million, that was offset by an increased source of cash from non-cash operating working capital of $8.2 million. The change in non-cash items of $4.5 million is primarily represented by decreased amortization expense of $5.4 million, a change in sublease loss provisions of $1.8 million, and decreased non-controlling interest of $0.4 million. This was partially offset by add-backs related increased asset impairment charges of $1.6 million and increased future income taxes recovery of $1.1 million.

Changes in non-cash operating working capital for the three months ended December 31, 2010 increased by $8.2 million to a source of cash of $12.1 million from $3.9 million for the same period in 2009. This change is primarily due to the change in accounts payable of $5.2 million related to severance and reorganization payables, the change in accounts receivables (including unbilled fees) of $1.3 million and the change in prepaids and other receivables of $1.6 million due to the timing of vendor payments and a reduction in the supplies inventory maintained for seminar and workshops held.

Cash used in investing activities for the three months ended December 31, 2010 increased by $1.6 million to cash outflow of $4.0 million compared to cash outflows of $2.4 million for the same period in 2009. This increase was primarily due to increased capital expenditures $1.6 million mainly due to technology spending.

Cash used in financing activities for the three months ended December 31, 2010 decreased by $0.7 million to a use of cash of $11.1 million compared to a use of cash of $11.8 million for the same period in 2009. This decrease was primarily attributable to increased utilization of the revolving facility of $6.5 million to fund non-recurring expenditures and due to working capital needs. This was partially offset by the additional distribution made in December 2010 of $3.8 million due to the elimination of the income trust structure at January 1, 2011, and proceeds from the sale of Units held in Treasury related to the LTIP of $1.9 million in 2009 that did not recur.

### *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 months and year ended December 31 of $1.6 million and $2.5 million, respectively, was the result of increased leasehold improvements on office consolidations and an increase in technology spending.

### *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, a delayed draw facility, a revolving loan and a promissory note 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[1] | $ 160,000 | $ - | $ - | $ 160,000 |
| Revolving loan[1] | 35,500 | 11,500 | - | 24,000 |
| Operating leases, gross | 94,249 | 18,385 | 16,667 | 59,197 |
| Total | $ 289,749 | $ 29,885 | $ 16,667 | $ 243,197 |

[1] Based on terms of amended and restated credit agreement.

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 related to these premises have been included above. The terms of the subleases extend through July 2022 and the aggregate sublease income on these subleases is $21,365. 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 Leong & Associates is contingent on business results and is expected to be payable in three instalments. The first instalment of $3.0 million was satisfied on closing through cash and equity consideration, and the second instalment of $2.5 million was satisfied in January 2010. The third and final instalment, which is subject to revenue adjustments plus interest calculated at annual rates of 3.87%, will be settled on April 1, 2011.

We have no material contractual obligations other than those described in this MD&A and have no off-balance sheet financing arrangements.

### *Capital Resources*

The following table provides an overview of our capital resources:

| **Capital Resources** *(In thousands of dollars)* | **As at December 31, 2010** | **As at December 31, 2009** |
|---|---|---|
| Revolving loan | $ 11,500 | $ 11,500 |
| Long-term debt, net of unamortized debt issue cost | $ 183,355 | $ 158,887 |
| Promissory notes | $ - | $ 4,306 |
| Non-controlling interests | $ 41,591 | $ 46,137 |
| Unitholders' equity | $ 338,774 | $ 352,345 |

As at December 31, 2010, our working capital (current assets minus current liabilities, excluding future considerations related to acquisition), was approximately $27.3 million compared to $15.2 million as at December 31, 2009.

In 2008, as part of the Shepell•fgi acquisition, we entered into a credit agreement with a syndicate of Canadian chartered banks for a period of four years maturing on June 1, 2012.

Under the agreement, the following credit facilities are available:

- $160 million senior secured term loan ("term loan").
- $40 million senior secured revolving term facility ("revolving loan").
- $5 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 credit agreement. 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.

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 then 3.25:1.0
(ii) Ratio of EBITDA to interest expense of not less than 3.0:1.0

We complied with all the required financial covenants and the ratios as at December 31, 2010 were 3.0:1 and 6.3:1 respectively.

We entered into an amended and restated credit agreement effective January 1, 2011 for a term of four years. The credit facility provides for a term loan of $130 million and a revolving facility of $75 million, which includes a swing line of $7 million. 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 the required Debt to Adjusted EBITDA financial covenant of 3.25:1.00 effective as at December 31, 2010 and up to December 30, 2011, and 3.00:1:00 on December 31, 2011 and thereafter.

### *Promissory notes*

As part of the Shepell•fgi acquisition, we issued two non-interest bearing promissory notes secured by a general assignment of all our assets, which is subordinated to the credit facilities in the amounts of $75.0 million and $4.5 million due on July 2, 2009 and July 2, 2010, respectively. The $75.0 million note was fully satisfied in 2009. On July 1, 2010, the $4.5 million promissory note was fully repaid.

## SELECTED BALANCE SHEET DATA

The following table provides an overview of our selected balance sheet data:

| **Selected Balance Sheet Data** *(in thousands of dollars)* | **As at December 31, 2010** | **As at December 31, 2009** |
|---|---|---|
| Current assets | $ 80,447 | $ 78,174 |
| Other long-term assets | $ 555,357 | $ 571,192 |
| Current liabilities | $ 53,176 | $ 62,956 |
| Long-term financial liabilities [(1)] | $ 183,355 | $ 158,887 |

(1) Comprised of long-term debt and promissory note.

### Current Assets

Current assets as at December 31, 2010 increased by $2.2 million to $80.4 million from $78.2 million as at December 31, 2009. The increase was primarily due to increase in accounts receivable net of unbilled fees of $4.8 million as a result of growth in revenue and the timing of billings and collections. This was partially offset by decreased cash and cash equivalents of $1.2 million flowing from our operational cash flow needs, and decreased prepaids and other receivables of $1.4 million due to the timing of vendor payments and a reduction in the health management supplies inventory maintained for seminars and workshops.

### Other Long-Term Assets

Other long-term assets as at December 31, 2010 decreased by $15.8 million to $555.4 million from $571.2 million as at December 31, 2009. The decrease was primarily due to the amortization of capital and intangible assets of $26.7 million, an impairment charge of $2.4 million related to proprietary software, and the expiration of the foreign exchange contracts during the quarter of $0.5 million. This was partially offset by capital expenditures of $11.8 million, and increased implementation expenditures associated with outsourcing contracts of $2.0 million.

### Current Liabilities

Current liabilities as at December 31, 2010 decreased by $9.8 million to $53.2 million from $63.0 million as at December 31, 2009. The decrease was primarily due to the repayment of the $4.5 million promissory note (discounted value of $4.3 million at December 31, 2009), the payment of December 2010 cash distribution declared of $3.8 million during the month pursuant to the Reorganization, and the payment of $2.5 million related to a previous business acquisition. This was partially offset by an increased in accounts payable and accrued liabilities of $1.0 million due to the timing of suppliers' payments.

### Long-Term Financial Liabilities

Long-term financial liabilities as at December 31, 2010 increased by $24.5 million to $183.4 million from $158.9 million as at December 31, 2009. This increase was the result of the increased utilization of our revolving facility of $24.0 million to fund various non-recurring expenditures and our operational cash flow needs, and $0.5 million related to the amortization of debt financing fees associated with the credit facility acquired as part of the Shepell•fgi acquisition.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements, in accordance with GAAP, 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 earnings in the periods in which they become known. Accordingly, actual results could differ from these estimates. The accounting policies and estimates that are critical to our business relate to the following items:

### *Revenue Recognition*

We earn fee-for-service revenue based on hourly rates and the time spent delivering those services. We also earn contracted revenue based on negotiated fixed amounts or on a formula tied to the nature of the service, rather than the time spent. Revenue is recognized in the period that the service is rendered, irrespective of when it is invoiced. 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 straight-line basis over the term of the contract. Incremental usage is recognized when the minimum usage threshold is exceeded up to a cap where applicable. Unbilled fees are recorded at the lower of unbilled hours worked at standard billing rates and the amount which we estimate can be recovered upon invoicing. Expenses are recognized as incurred. Losses on fixed-fee contracts are recognized during the period in which the loss becomes probable. Billings in excess of revenue are recorded as a deferred revenue liability until services are rendered. Revenue does not include reimbursements for recoverable expenses, such as employee travel expenses, outside printing and third-party professional services. Reimbursements are accounted for as a reduction to expenses. Outsourcing engagements typically involve both an implementation and administration component; unless it can be determined that the implementation phase is independent of the administrative one, revenues (and related expenses) are deferred and recognized over the term of the service contract period.

We also earn commission revenue as payment for the provision of benefits consulting services to clients, as a percentage of insurance premiums paid by our clients. Commission revenue is received annually, semi-annually, quarterly or monthly. Annual fees are typically paid at the beginning of the insurance policy period and are recognized as income at the later of the billing or effective date of the policy, net of a provision for return commissions due to policy cancellations or change of broker.

### *Intangible Assets and Goodwill*

Intangible assets consist of trade names, customer relationships, purchased and internally-developed software, proprietary software, and customer contracts. 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, determined in accordance with Section 3064, *Goodwill and Intangible Assets*. 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, or on a declining balance basis for purchased software. Intangible assets with an indefinite life are not amortized but are tested for impairment annually or more frequently if events or circumstances indicate there may be an impairment by comparing the estimated discounted future net cash flows from the asset to its carrying amount.

Goodwill is not amortized and is subject to an annual impairment test. Goodwill impairment is assessed based on a comparison of the estimated fair value of each of our reporting units and the carrying value of the reporting unit's net assets including goodwill. An impairment loss will be recognized if the carrying amount of our net assets exceeds its estimated fair value.

***Allowance for Doubtful Accounts***

A provision for accounts receivable resulting from the potential risk that the accounts receivable will not be collected has been recorded. We continually monitor past due accounts to assess the likelihood of collection to estimate the required provision.

***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.

***Future Income Taxes***

We use the asset and liability method of accounting for income taxes. Future income taxes are recognized for the temporary differences between the financial statement carrying amounts of assets and liabilities and their respective tax bases. Future income tax assets and liabilities are measured using enacted or substantively enacted tax rates and laws that are expected to apply to taxable income in the years in which those temporary differences are expected to be reversed or settled. A valuation allowance is recorded against a future income tax asset if it is not anticipated that the asset will be realized in the foreseeable future. The effect on future income tax assets and liabilities of a change in tax rate is recognized in income in the period that includes the date of enactment or substantive enactment.

***Financial Instruments***

Financial assets and financial liabilities are initially measured at fair value, defined as the amount of consideration that could be agreed upon in an arm's length transaction between knowledgeable, willing parties who are under no compulsion to act. In certain circumstances, however, the initial fair value may be based on other observable current market transactions in the same instrument, without modification or on a valuation technique using market based inputs. Subsequent measurement of our financial assets and liabilities is dependent on their classification as held for trading, loans and receivables, other financial liabilities, or derivative instruments.

Held for trading financial assets and liabilities are measured at fair value as at the date of the consolidated balance sheet, and any unrealized gains or losses from market fluctuations are included in the consolidated statement of income.

Loans and receivables and other financial liabilities are measured at amortized cost using the effective interest method of amortization.

Derivative financial instruments are used by us in the management of our interest rate risk exposure on debt financing and foreign exchange risk arising due to fluctuations in the United States dollar.

Derivatives that have been designated and function effectively as a hedge are accounted for using hedge accounting principles. The effective portions of changes in fair value of derivatives that qualify for hedge accounting are recorded in other comprehensive income. Any ineffective portions of changes in the fair value are recognized in net income in the period in which the change occurred. If the hedging relationship ceases to be effective, the cumulative change in the fair value of the interest-rate swap are recognized into income beginning in the period in which the change occurs. Derivatives that do not qualify for hedge accounting are recorded on the consolidated balance sheet at fair value with changes in fair value recorded as income or expense in the consolidated statement of income.

Fair value measurements recognized in the balance sheet are categorized using a fair value hierarchy that reflects the significant inputs used in determining the fair values, in accordance with the amendment to CICA Handbook Section 3862 in June 2009:

(i) Level 1 - Inputs unadjusted quoted prices of identical instruments in active markets

(ii) Level 2 - Inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly

(iii) Level 3 – One or more significant inputs used in a valuation technique are unobservable in determining fair values of the instruments

Each type of fair value is categorized based on the lowest level input that is significant to the fair value measurement.

We do not use derivative financial instruments for trading or speculative purposes.

***New Accounting Policies***

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

***Future Accounting Changes***

**International Financial Reporting Standards**

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 established project plan for implementing IFRS consists of four phases (initial scoping and planning, detailed assessment, design, and implementation) and is designed to address:

- Changes to accounting policies and disclosure requirements;
- Changes to information systems and business processes;
- Changes to internal control over financial reporting and disclosure controls and procedures; and
- Training requirements and communications.

As at December 31, 2010, we have substantially completed the first three phases of our project plan, and expect to be ready to report all required IFRS financial statement information and reconciliations for the quarter ending March 31, 2011 by the required date. Conclusions drawn in each phase, however, have not yet been reviewed by our external advisors, and therefore remain subject to change.

The initial scoping and planning phase of the project plan, which involved the identification of the key differences between IFRS and Canadian GAAP, and an assessment of the exemptions and elections available upon transition under IFRS 1, *First-time Adoption of International Reporting Standards*. While the full impact of this transition on our consolidated financial statements have not yet been completely

quantified, our progress-to-date in the detailed assessment phase of the project plan has identified the following key differences between current accounting policies and those required or expected to be required in preparing IFRS-compliance financial statements. The expectations below represent the our assessments and should not be construed to be final, as they are subject to change following review by the our external advisors.

First-Time Adoption of IFRS (IFRS 1)

IFRS 1 provides the framework for the first-time adoption of IFRS and outlines the mandatory and option exemptions and elections available, to the general requirement for full retrospective application of IFRS.

The most significant mandatory and optional exemptions and elections relevant to us, and their anticipated impact are:

| **Area of IFRS** | **Summary of Exemption Available** | **Anticipated Impact**<br>*(in thousands of dollars where applicable)* |
|---|---|---|
| Business Combinations | We may elect, on transition to IFRS, not to retrospectively apply IFRS 3 "Business Combinations" to past business combinations.<br><br>We, however, would remain privy to retrospectively apply certain guidelines within IFRS 3, to exclude from the purchase equation acquisition-related costs and to include contingent consideration. | We will elect to apply this exemption and will not restate any business combinations prior to January 1, 2010.<br><br>The transitional adjustment expected to result from the inclusion of contingent consideration will result in a charge to opening deficit as at January 1, 2010 ranging between $3,500 and $4,000. |
| Employee Benefits | We may elect, on transition to IFRS, not to retrospectively apply IAS 19 "Employee Benefits" such that we would be required to split the cumulative actuarial gains and losses from the inception of the benefits plan until January 1, 2010 into a recognized and unrecognized portion. | We will elect not to retrospectively apply IAS 19, and will recognize the cumulative actuarial gain on the benefits plan as at January 1, 2010.<br><br>This election is expected to result in an increase to opening deficit as at January 1, 2010 ranging between $300 and $400. |
| Designation of previously recognized financial instruments | We are required to re-designate and assess effectiveness of hedging relationships that were established prior to transition to IFRS on January 1, 2010. The ineffective portion as at the date of transition is recognized as the transitional adjustment. | We have completed the documentation required and re-affirmed the hedging relationships existing as at the transition date January 1, 2010. A transitional charge to opening deficit, representing the ineffective portion of the hedge at that date, is expected to range between $200 and $300. |

The following electives, while applicable to us, are expected to have minimal or no financial reporting impact on us:

| Area of IFRS | Summary of Exemption Available |
| --- | --- |
| Non-Controlling Interests | We are required to prospectively apply certain requirements of IAS 27 "Consolidated and Separate Financial Statements" from the date of transition January 1, 2010, including the pro-rata allocation of total comprehensive income to the partners and the non-controlling interests.<br><br>We do not expect any impact on our financial results as a result of the application of this standard, but will result in the classification of non-controlling interest as Unitholder Equity per the comparative 2010 financial statements. |
| Property Plant and Equipment | We may elect, on transition to IFRS, to revalue, as its new cost basis for property, plant, and equipment, its fair value as at January 1, 2010. This exemption can be applied on an asset by asset basis.<br><br>We do not plan to revalue any of its capital and intangible assets at January 1, 2010, thereby resulting in no financial impact to us. |

Preliminary Key Accounting Differences

Set out below are selected key areas of accounting differences where changes in accounting policies upon conversion to IFRS may impact our consolidated financial statements. This does not represent a comprehensive list of changes that will result from the transition to IFRS; rather, this list highlights those areas of accounting differences we currently believe to be most significant. Notwithstanding, the below analysis of changes where choices related to accounting policies are available remain to be finalized and assessed by our external advisors.

| Relevant IFRS | Summary of Difference, and Anticipated Financial Statements Impact |
| --- | --- |
| IAS 1: Presentation of Financial Statements | IFRS requires significantly more extensive disclosure than existing Canadian GAAP. Amongst those differences include, but are not limited to, the classification of expenditures by function or nature and the presentation of non-controlling interest as a component of Unitholders' Equity.<br><br>We will address these presentation differences as we prepare our first interim IFRS financial statements in 2011. |
| IFRS 3: Business Combinations | While both IFRS and GAAP follow a similar method of accounting (i.e. acquisition method), the most significant differences as they relate to us include:<br>• Exclusion of acquisition-related costs (including legal, tax advisory and third party valuation fees) from the purchase equation which would correspond to a decrease in goodwill values;<br>• Inclusion of contingent consideration at its fair value on the date of acquisition, with subsequent changes recognized through comprehensive income or through profit or loss, depending on its classification as equity or liability;<br>• On transactions which include the issuance of Units as consideration, the fair value of those Units will be determined on the date of acquisition under IFRS. |

| | |
|---|---|
| | As detailed above, the application of this Standard will result in an opening adjustment to deficit as at January 1, 2010. As of the date of this MD&A, there have been no business acquisitions subsequent to January 1, 2010; therefore, no impact on our financial results has been noted. We will address these differences on subsequent acquisitions as appropriate. |
| IAS 36: Impairment of Assets | IFRS requires a one-step approach to testing for and measurement impairment of all assets at the cash generating unit ("CGU") level. A CGU is the smallest identifiable group of assets that generate cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Impairment is determined by comparing asset carrying values directly to the higher of fair value less costs to sell and value in use. Any impairment is first applied to goodwill and then prorated to other assets in the CGU. Impairment charges can be reversed in subsequent periods if there is a change in estimates that resulted in the initial impairment charge.<br><br>We are currently in the process of finalizing our definition of the CGU for impairment testing purposes, and anticipate that any potential differences resulting from an analysis at this level may result in impairment charge to net income in future periods. |
| IAS 21: Foreign Currency Translation | IFRS refers to functional currency of the foreign operation, which should reflect the underlying transactions, events, and the economic conditions in which it operates. Primary factors to consider include the currency that mainly influences sales price, the currency of the country whose competitive forces drive the sales price, and the currency that mainly influences labour, materials, and other costs of providing the goods or services. If it is determined that the functional currency is not the same as the parent, the translation of the foreign operation at each reporting date requires assets and liabilities to be translated at the closing rate as of that date, income and expense items to be translated as at the transaction date, with all gains and losses to be recognized as a separate component of equity. These foreign exchange translation differences are brought into profit or loss at the point where the foreign operation is disposed of.<br><br>We have determined our functional currency for our U.S.-based operations to be the U.S. Dollar, and for our New Caledonia-based operations to be the CFP Franc. As a result, we anticipate that all foreign currency translation gains and losses associated with these two operations will be recognized as a separate component of equity commencing in 2011, thereby decreasing the foreign exchange gains and losses recognized in net income. |
| IAS 32: Financial Instruments – Presentation | IFRS requires that financial instruments which give the holder the right to put the instrument back to the issuer for cash should be classified as a financial liability, unless certain criteria are met to allow for classification as equity.<br><br>Given our Units are redeemable at the option of the holder and that there is a mandatory requirement to distribute taxable income under the Declaration of Trust in cash where available, we will be required to present its equity as liability for the 2010 comparative period under IFRS. Consequently, distributions paid and payable will be reclassified as interest expense and payable, and transactions related to our LTIP plan will be reclassified from Contributed Surplus to non-current liability.<br><br>This standard, however, is not anticipated to have a material impact going forward in light of the conversion of all our Units and Class B LP Units into common shares of Morneau Shepell effective January 1, 2011. |

| | |
|---|---|
| IAS 16: Property, Plant, and Equipment | IFRS requires the componentization of assets, where all significant components are recognized and depreciated separately. Where the revaluation method is used, this standard also allows for the periodic revaluation of property, equipment, and leaseholds.<br><br>We anticipate that no further segregation of its assets into smaller components is required and the cost method will continue to be used to value our assets; therefore, the impact of this standard (i.e. depreciation expense) is expected to be minimal. |
| IAS 37: Provisions, Contingent Liabilities and Contingent Assets | IFRS requires the recognition of a provision in instances where a liability is "more likely than not" to exist, which can be dictated by the past and confirmed in the future.<br><br>As this is a lower threshold than GAAP, liabilities may increase as provisions may be recorded earlier or where they may not have been recorded at all. We have continued to analyze the impact of this standard on our financial statements and to date, have not identified any circumstances for which a material impact is expected. Should any additional liabilities arise, this would result in an increase in operating expenses, reducing net income. |
| IAS 12: Income Taxes | Any material adjustments to balances resulting from the adoption of IFRS would have a corresponding effect on future income tax balances.<br><br>While we will continue to monitor the tax implications of the transition to IFRS, it is anticipated that any material adjustments identified will result in a corresponding change to future income taxes expense. |

Concurrently with the finalization of the analyses in the second phase, we completed the design phase of our project plan, which involved a compatibility assessment of both our current internal controls over financial reporting and disclosure, and business and accounting processes against IFRS. While we are still finalizing our assessment, we do not anticipate any material changes to our information technology systems or internal controls over financial reporting and disclosure to result, nor do we anticipate that significant changes to our accounting processes will be required in order to facilitate the timely and accurate collection of data. Further, it is anticipated that the implementation of IFRS will not result in any changes to our business functions or activities.

To facilitate the transition to IFRS, training has been provided to date to key accounting personnel in order to develop the required level of expertise; it is anticipated that such training will continue to be provided on an ongoing basis to key personnel and stakeholders, until complete adoption of IFRS in 2011. We are also in the process of reviewing the IFRS impact on the Fund's key performance measures, such as EBITDA and the Cash Payout Ratio. At this time, however, no material impact is expected.

The fourth and final phase, implementation, will commence on January 1, 2011 with the adoption of IFRS. All new policies, processes, and controls will be implemented and monitored to ensure efficient and effective delivery.

At December 31, 2010, we cannot reasonably determine the full impact that adopting IFRS would have on its financial statements, as the current status of the project reflects our most recent assumptions and expectations. Circumstances may arise, such as changes in existing IFRS, or changes in the regulatory or economic environment, which could alter our above assumptions and expectations. These disclosures reflect our expectations based on information available at December 31, 2010. Changes in IFRS standards or circumstances relating to us may cause us to revise our expectations, project plan, and potential IFRS accounting policy choices prior to the conversion date. In tracking our progress against our project plan, we expect to be ready to report all required IFRS financial statement information and reconciliations for the quarter ending March 31, 2011, despite the changing IFRS environment.

## RISKS AND UNCERTAINTIES

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

***Risk 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.

**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 the economic slowdowns and could therefore potentially have an impact on Morneau Shepell's operating results. During an economic downturn, Morneau Shepell clients and potential clients may reduce or delay services or projects, or defer contracts currently underway. This situation could also lead to greater delays and defaults in payments or debt collection, resulting in lower operating results. Because of lower revenue during an economic slowdown, competition may increase and prices may be reduced by certain competitors to maintain or expand their market share. Pricing and profitability could be adversely affected as a result.

**Dependence on Key Clients**

For the year ended December 31, 2010, Morneau Shepell's largest client accounted for approximately 5% of total revenue (for the year ended December 31, 2009 - 5%) and the top 10 clients accounted for approximately 22% of the Morneau Shepell's total revenue for the year ended December 31, 2010 (for the year ended December 31, 2009 – 22%). 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.

**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 distributions.

**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 distributable cash 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. Morneau Shepell had entered into a currency hedge swap agreement. The net revenue exposure after accounting for the hedge and related expenses denominated in U.S. dollars was $1,136 for the year ended December 31, 2010. 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.

## SELECTED ANNUAL INFORMATION

| *(In thousands of dollars except per unit amounts)* | **Year ended December 31, 2010** | **Year ended December 31, 2009** | **Year ended December 31, 2008** |
|---|---|---|---|
| Revenue | $ 335,194 | $ 331,703 | $ 249,713 |
| Net Income | 18,929 | 10,826 | 8,796 |
| Net income per Unit (basic) | 0.45 | 0.27 | 0.30 |
| Net income per Unit (diluted) | 0.44 | 0. 26 | 0.30 |
| Distributions declared per Unit | 0.95 | 0.95 | 0.92 |
| Total Assets | 635,804 | 649,366 | 689,865 |
| Total long-term financial liabilities | 183,355 | 158,887 | 179,335 |

## SUPPLEMENTARY SUMMARY OF QUARTERLY RESULTS

Operating results, distribution summary and condensed balance sheet history are as follows:

**Operating Results, Distribution and Condensed Balance Sheets**
Selected Unaudited Consolidated Financial Information (In thousands of dollars except per unit amounts)

| **Quarter ended** | **December 31 2010** | **September 30 2010** | **June 30 2010** | **March 31 2010** | **December 31 2009** | **September 30 2009** | **June 30 2009** | **March 31 2009** |
|---|---|---|---|---|---|---|---|---|
| Revenue | $87,017 | $83,083 | $83,669 | $81,425 | $83,316 | $81,728 | $84,903 | $81,756 |
| Net income (loss) | 892 | 7,444 | 6,517 | 4, 076 | 4,169 | 3,900 | 3,288 | (531) |
| Standardized EBITDA | 8,989 | 17,096 | 16,023 | 13,848 | 15,739 | 17,253 | 15,987 | 12,335 |
| Adjusted Standardized EBITDA | 16,464 | 17,636 | 16,023 | 13,848 | 18,474 | 17,631 | 15,987 | 12,335 |
| Standardized EBITDA margin | 10.3% | 20.6% | 19.2% | 17.0% | 18.9% | 21.1% | 18.8% | 15.1% |
| Adjusted Standardized EBITDA margin | 18.9% | 21.2% | 19.2% | 17.0% | 22.2% | 21.6% | 18.8% | 15.1% |
| Standardized Distributable Cash (1) | 13,506 | 11,053 | NM | 4,128 | 14,365 | 15,154 | 45 | 5,697 |
| Adjusted Consolidated Distributable Cash | 10,559 | 11,962 | 11,738 | 9,992 | 12,396 | 11,662 | 11,416 | 9,179 |
| Distributions declared | 11,288 | 11,274 | 11,274 | 11,274 | 11,230 | 11,214 | 11,234 | 10,224 |
| Net income (loss) per Unit (basic) | 0.02 | 0.18 | 0.15 | 0.10 | 0.10 | 0.09 | 0.08 | (0.02) |
| Net income (loss) per Unit (diluted) | 0.02 | 0.17 | 0.15 | 0.10 | 0.10 | 0.09 | 0.08 | (0.02) |
| Standardized EBITDA per Unit (basic) | 0.19 | 0.36 | 0.34 | 0. 29 | 0.33 | 0.36 | 0.34 | 0.30 |
| Adjusted Standardized EBITDA per Unit (basic) | 0.35 | 0.37 | 0.34 | 0.29 | 0.39 | 0.37 | 0.34 | 0.30 |
| Standardized Distributable Cash per Unit (basic) (1) | 0.32 | 0.26 | (0.03) | 0.10 | 0.34 | 0.36 | 0.00 | 0.16 |
| Adjusted Consolidated Distributable Cash per Unit (basic) | 0.22 | 0.25 | 0.25 | 0.21 | 0.26 | 0.25 | 0.24 | 0.22 |
| Distributions declared per Unit (basic) | 0.24 | 0.24 | 0.24 | 0.24 | 0.24 | 0.24 | 0.24 | 0.24 |
| Standardized Distributable Cash Payout Ratio (basic) (2) | 74.4% | 90.9% | NM | 242.0% | 69.1% | 65.4% | NM | 156.0% |
| Adjusted Consolidated Distributable Cash Payout Ratio | 106.9% | 94.2% | 96.0% | 112.8% | 90.6% | 96.2% | 98.4% | 111.4% |
| Twelve-month rolling Standardized Distributable Cash Payout Ratio | 145.4% | 140.6% | 122.5% | 117.9% | 109.6% | 100.2% | 140.9% | 94.9% |
| Twelve-month rolling Adjusted Consolidated Distributable Cash Payout Ratio | 101.9% | 97.7% | 98.3% | 98.9% | 98.3% | 89.7% | 87.3% | 81.8% |
| Total assets | $635,804 | $642,047 | $644,980 | $644,776 | $649,366 | $667,708 | $677,847 | $682,664 |
| Total long-term debt | $183,355 | $159,238 | $159,121 | $159,004 | $158,887 | $158,769 | $158,652 | $135,535 |

(1) The Standardized Distributable Cash for the three months ended June 30, 2010, March 31, 2010, June 30, 2009 and March 31, 2009 were low primarily due to the payment of annual bonuses in the quarters.

(2) This ratio is not presented for the quarter ended June 30, 2010 and June 30, 2009 since it is not a meaningful % when the Standard Distributable Cash per unit is a negative figure or close to break even.

**Disclosure Controls and Procedures**

Our disclosure controls and procedures have been designed to provide reasonable assurance that all relevant information is identified to its Disclosure Committee to ensure appropriate and timely decisions are made regarding public disclosure.

The Chief Executive Officer and the Chief Financial Officer have concluded that the disclosure controls and procedures are appropriately designed and operating effectively as at December 31, 2010.

**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 GAAP. In designing these controls, Management used the *Internal Control – Integrated Framework* (COSO Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission.

The Chief Executive Officer and the Chief Financial Officer have concluded that the internal controls over financial reporting are appropriately designed and operating effectively to provide this assurance based on the evaluation of these controls conducted as at December 31, 2010.

No changes were made in our internal controls over financial reporting during the fourth quarter ended December 31, 2010, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

**Additional Information**

Subsequent to the Reorganization, Morneau Shepell's shares currently trade on the Toronto Stock Exchange under the symbol MSI. Additional information relating to us, including all public filings, is available on the SEDAR Web site (www.sedar.com) and on our own Web site at www.morneaushepell.com.

The content of this MD&A reflects information known as of March 10, 2011.