# Morneau Sobeco Income Fund

*2007 First Quarter Results*

Fresh thinking.
Innovative solutions.

May 15, 2007

To Our Unitholders

Morneau Sobeco Income Fund (the "Fund") is pleased to present its financial results for the period ended March 31, 2007. These results reflect the solid performance of the Fund's operating business in the quarter. Our revenue growth was 12.2% for the period, our EBITDA margin remained strong at 21.8%, and the Distributable Income Payout Ratio for the quarter was 78.8%.

Revenue for the three months ended March 31, 2007 increased by $3.9 million, or 12.2%, to $36.1 million compared to $32.2 million for the same period in 2006. The increase in revenue was a result of additional consulting and outsourcing business from a variety of clients, with one existing client increasing revenue by $1.0 million. Revenue also increased by $2.2 million due to the firm's acquisition of Heath Benefits Consulting in June 2006.

The 2007 first quarter results reflect the firms' recurring assignments with clients, as well as work on a large number of new consulting assignments and outsourcing mandates which were awarded to Morneau Sobeco at the end of 2006 and are currently underway.

Net income for the three months ended March 31, 2007 increased by $0.1 million, or 5.1%, to $2.3 million compared to $2.2 million for the same period in 2006.

Earnings before interest, taxes, depreciation and amortization (EBITDA) for this three-month period increased by 8.8%. Adjusting for the salary component of the Heath acquisition, EBITDA growth was 11.9%, and EBITDA margin was 22.4%. The increase was due to increased revenue of $3.9 million partially offset by increased salaries and benefits expense and operating costs of $3.3 million.

Distributable Income for the three months ended March 31, 2007 increased by $0.9 million. The increase was primarily due to increased EBITDA of $0.8 million after taking into account the salary component of the Heath acquisition in the amount of $0.2 million. Distributable Cash decreased by $1.8 million in the quarter. This decrease was primarily due to decreased cash from operating activities of $1.8 million, which includes the payment of year-end accrued liabilities in the first quarter of 2007. In 2006, some of these liabilities were paid prior to our Initial Public Offering of September 30, 2005.

The Distributable Income Payout Ratio for the quarter was 78.8% compared to 86.3% in the first quarter of 2006. The Distributable Cash Payout Ratio for the quarter was -502.1% which reflects the payment of year-end accrued liabilities in the quarter. On a twelve-month rolling basis, the Distributable Income Payout Ratio and the Distributable Cash Payout Ratio were 83.3% and 83.5% respectively.

In the quarter, the Board of Trustees authorized a 7% increase to the Fund's target monthly distribution from $0.06875 per Unit to $0.07356 per Unit, commencing with the March 2007 distribution that was paid on April 16, 2007.

The Fund is on track for 2007 both in terms of financial performance and business strategy. The firm continues to focus on its core pension and benefits services, and to pursue selected acquisitions.

On that note, the Fund announced that one of its subsidiaries had signed an Asset Purchase agreement to acquire certain assets, liabilities and contracts of the defined benefit pension administration and actuarial consulting practices of Cowan Benefits Consulting Limited. The transaction is expected to close on June 1, 2007. According to the terms of the agreement, the purchase price is expected to be approximately $6 million, subject to adjustments. This acquisition is financially positive for our Unitholders, and confirms our organization's continuing growth potential. This acquisition will be funded by debt and it will be accretive immediately.

Our year-to-date results are in line with management's expectations, and the board and management continue to believe that 2007 will be a solid year for Morneau Sobeco.

On behalf of the Board of Trustees and management team at Morneau Sobeco, I thank you for your continued support.

William Morneau
*President & Chief Executive Officer*

# HIGHLIGHTS

CONSISTENT RESULTS TO BEGIN 2007

REVENUE INCREASED BY 12.2% OVER 2006

EBITDA MARGIN OF 21.8% IN THE QUARTER

DISTRIBUTIONS INCREASED BY 7%

ACCRETIVE ACQUISITION OF PENSION CONSULTANT AND ADMINISTRATOR

## MORNEAU SOBECO INCOME FUND

## CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands of dollars)

| | As at March 31, 2007 | As at December 31, 2006 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash | $ — | $ 5,257 |
| Accounts receivable | 25,632 | 23,315 |
| Unbilled fees | 5,215 | 4,117 |
| Income taxes recoverable | 100 | 774 |
| Prepaid expenses and other | 1,524 | 1,875 |
| | 32,471 | 35,338 |
| Future income taxes (note 11) | 617 | 741 |
| Interest-rate swap (note 6) | 776 | 840 |
| Capital assets (note 4) | 10,446 | 10,833 |
| Intangible assets (note 5) | 121,252 | 125,027 |
| Goodwill | 127,767 | 127,767 |
| | $293,329 | $300,546 |
| **Liabilities and Unitholders' Equity** | | |
| Current liabilities: | | |
| Bank indebtedness (note 6) | $ 1,962 | $ — |
| Accounts payable and accrued liabilities | 5,043 | 5,868 |
| Accrued compensation and related benefits | 1,770 | 7,025 |
| Unitholder distributions payable (including non-controlling) | 2,607 | 2,793 |
| | 11,382 | 15,686 |
| Insurance premium liabilities: | | |
| Payable to insurance companies | 9,116 | 9,108 |
| Less related cash and investments held | (9,116) | (9,108) |
| | — | — |
| Long-term debt (note 6) | 34,876 | 35,000 |
| | 46,258 | 50,686 |
| Non-controlling interest (note 8) | 55,061 | 55,461 |
| Unitholders' equity: | | |
| Fund units (note 7) | 205,549 | 205,549 |
| Deficit | (13,539) | (11,150) |
| | 192,010 | 194,399 |
| | $293,329 | $300,546 |

Commitments and Contingencies (notes 14 and 15)

Robert Chisholm
Trustee,
Audit Committee Chair

William Morneau
Trustee,
President and CEO

*See accompanying notes to consolidated financial statements*

## MORNEAU SOBECO INCOME FUND

## CONSOLIDATED STATEMENTS OF INCOME, OTHER COMPREHENSIVE INCOME AND DEFICIT

For the three months ended

(Unaudited)

(In thousands of dollars, except per unit amounts)

| | March 31, 2007 | March 31, 2006 |
|---|---|---|
| **Revenue** | | |
| Fees | $ 31,178 | $ 29,296 |
| Commissions | 4,776 | 2,761 |
| Other | 137 | 121 |
| | 36,091 | 32,178 |
| **Expenses** | | |
| Salaries and benefits | 21,673 | 18,898 |
| Other operating | 6,553 | 6,052 |
| Amortization of capital assets (note 4) | 523 | 498 |
| Amortization of intangible assets (note 5) | 3,775 | 3,542 |
| Interest (note 6) | 453 | 461 |
| | 32,977 | 29,451 |
| Income before income taxes and non-controlling interest | 3,114 | 2,727 |
| Income taxes (recovery) (note 11) | | |
| Current | 134 | 61 |
| Future | 124 | (32) |
| | 258 | 29 |
| Income before non-controlling interest | 2,856 | 2,698 |
| Non-controlling interest (note 8) | (588) | (540) |
| Net income | 2,268 | 2,158 |
| Other comprehensive income (note 2(l)) | — | |
| Comprehensive income | 2,268 | |
| Deficit, beginning of period | (11,150) | (2,484) |
| Distributions declared (note 9) | (4,657) | (4,533) |
| Deficit, end of period | $ (13,539) | $ (4,859) |
| Net income per Unit (basic and diluted) (note 13) | $0.10279 | $0.09821 |

*See accompanying notes to consolidated financial statements*

## MORNEAU SOBECO INCOME FUND

## CONSOLIDATED STATEMENTS OF CASH FLOWS

For the three months ended
(Unaudited)
(In thousands of dollars)

| | March 31, 2007 | March 31, 2006 |
|---|---|---|
| Cash provided by (used in): | | |
| Operating activities | | |
| Net income | $ 2,268 | $ 2,158 |
| Items not involving cash: | | |
| Amortization of capital assets (note 4) | 523 | 498 |
| Amortization of intangible assets (note 5) | 3,775 | 3,542 |
| Amortization of debt issue costs (note 6) | 13 | — |
| Non-controlling interest of Class B LP Units | 588 | 540 |
| Future income taxes | 124 | (32) |
| Salary component of Heath acquisition (note 3) | 220 | — |
| Fair value of interest-rate swap agreements (note 6) | 64 | — |
| | 7,575 | 6,706 |
| Change in non-cash operating working capital: | | |
| Accounts receivable | (2,317) | (3,250) |
| Unbilled fees | (1,098) | 801 |
| Income taxes recoverable | 674 | 140 |
| Prepaid expenses and other | 214 | 58 |
| Accrued compensation and related benefits | (5,255) | (3,371) |
| Accounts payable and accrued liabilities | (825) | (336) |
| | (1,032) | 748 |
| Financing activities | | |
| Distributions paid | (6,051) | (5,675) |
| Investing activities | | |
| Purchase of capital assets | (136) | (140) |
| Net (decrease) in cash for the period | (7,219) | (5,067) |
| Cash, beginning of period | 5,257 | 4,348 |
| Cash (bank indebtedness), end of period | $ (1,962) | $ (719) |
| Supplemental disclosures: | | |
| *Interest paid* | $ 376 | $ 455 |
| *Income taxes paid (refunded)* | $ (477) | $ 40 |

*See accompanying notes to consolidated financial statements.*

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the three months ended March 31, 2007
(Unaudited)
(In thousands of dollars except per unit amounts)

### 1. ORGANIZATION AND NATURE OF THE BUSINESS

Morneau Sobeco Income Fund (the "Fund") is an unincorporated, open-ended, limited purpose trust established under the laws of the Province of Ontario on August 22, 2005.

The Fund is the largest Canadian-owned pension and benefits consulting and outsourcing firm, providing services to organizations across Canada and in the United States. The Fund focuses on the integrated design and delivery of retirement, employee compensation and benefit programs.

### 2. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of the Fund have been prepared by management in accordance with Canadian generally accepted accounting principles and the significant accounting policies are summarized below:

***(a) Basis of presentation***

These consolidated financial statements include the assets, liabilities, revenue and expenses of the following entities:

| | % Ownership |
|---|---|
| Morneau Sobeco Limited Partnership ("MSLP") | 79.4 |
| Morneau Sobeco Group Limited Partnership ("MS Group LP") | 79.4 |
| Morneau Sobeco, Ltd. ("MSUS") | 79.4 |
| Morneau Sobeco Corporation ("MS Corp") | 79.4 |
| Morneau Sobeco Trust ("Trust") | 100 |
| Morneau Sobeco GP Inc. ("MS GP") | 100 |

***(b) Measurement uncertainties***

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

### *(c) Revenue recognition and unbilled fees*

Fees for administrative, actuarial and consulting services are recognized when the services are rendered.

Unbilled fees are recorded at the lower of unbilled hours worked at normal billing rates and the amount which is estimated to be recoverable upon invoicing.

Commissions are recognized when earned which is at the later of the billing or effective date of the policy, net of a provision for return commissions due to policy cancellation.

Investment income is recorded on the accrual basis.

### *(d) Foreign currency translation*

Monetary assets and liabilities denominated in foreign currencies have been translated into Canadian dollars at the exchange rate prevailing at the consolidated balance sheet dates. Non-monetary items have been translated into Canadian dollars at the exchange rate prevailing when the assets were acquired or obligations incurred. Revenue and expenses have been translated at rates in effect on the transaction dates. Exchange gains or losses are reflected in income for the period.

### *(e) Capital assets*

Capital assets are stated at their initial capital cost less accumulated amortization. Amortization is recognized over the assets' estimated useful lives as follows:

| Asset | Basis | Rate |
|---|---|---|
| Computer equipment . . . . . . . . . . | Declining balance | 30% |
| Furniture and equipment . . . . . . . . | Declining balance | 20% |
| Leasehold improvements . . . . . . . . | Straight-line | Over term of the lease |

### *(f) Intangible assets and goodwill*

Intangible assets consist principally of customer relationships, proprietary software and customer contracts, based on management's best estimate of the relative fair values. These intangible assets are being amortized on a straight-line basis over their estimated useful lives of 15 to 20, 5 and 3 years respectively.

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 the Fund and the carrying value of its net assets including goodwill. An impairment loss will be recognized if the carrying amount of the Fund's net assets exceeds its estimated fair value.

***(g) Impairment of long-lived assets***

The Fund periodically reviews the useful lives and the carrying values of its long-lived assets for continued appropriateness. The Fund reviews long-lived assets for impairment annually or whenever events or changes in circumstances indicate that the carrying amount of the assets may not be recoverable. An impairment loss is measured at the amount by which the carrying amount of the long-lived asset exceeds its fair value.

***(h) Insurance premium liabilities and related cash and investments***

In its capacity as consultants, the Fund collects premiums from insureds and remits premiums, net of agreed deductions, such as taxes, administrative fees and commissions, to insurance underwriters. These are considered flow-through items for the Fund and, as such, the cash and investment balances relating to these liabilities are deducted from the related liability in the consolidated balance sheet.

***(i) Long-term incentive plan***

The Fund has a long-term incentive plan under which participants are eligible to receive Units. The amount awarded under this plan is recorded as salaries and benefits expense on a straight-line basis over the three-year vesting period.

### *(j) Employee future benefits*

The Fund offers a pension benefit plan for its employees, which includes a defined benefit option and a defined contribution option.

The defined benefit option was closed effective January 1, 1998 and included 8 employees, 5 retirees and 54 deferred vested members as at March 31, 2007. All other employees are covered by the defined contribution option of the plan.

The Fund accrues its obligations under the defined benefit option of the plan as the employees render the services necessary to earn the pension. For the defined contribution option, the Fund matches member contributions and may be required to make additional contributions at the option of the member, up to the limits defined in the plan text.

### *(k) Income taxes*

The Fund is a mutual fund trust for income tax purposes. As such, the Fund is only taxable on any amount not distributed to Unitholders. As substantially all taxable income will be distributed to the Unitholders, no provision for income taxes on earnings has been made in these consolidated financial statements. Income tax liabilities relating to the Fund are taxed in the hands of the Unitholders.

The Fund uses the asset and liability method of accounting for income taxes of its subsidiaries. Under this method of tax allocation, future tax assets and liabilities are recognized on the basis of future tax consequences attributable to differences between the carrying amounts of assets and liabilities as recorded in the consolidated financial statements and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period in which the date of enactment or substantive enactment occurs.

***(l) Financial instruments***

Effective January 1, 2007, the Fund adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) Handbook Section 1530, Comprehensive Income; Section 3855, Financial Instruments – Recognition and Measurement; and, Section 3865, Hedges, retroactively without restatement. These new Handbook Sections provide requirements for the recognition and measurement of financial instruments and the use of hedge accounting. Section 1530 establishes standards for reporting and presenting comprehensive income, which is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with generally accepted accounting principles.

Under Section 3855, financial instruments must be classified into one of these five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net income; and financial assets held-to-maturity, loan and receivables and other financial liabilities are measured at amortized cost using the effective interest method of amortization. Transaction costs are expensed as incurred for financial instruments classified or designated as held–for-trading. For other financial instruments, transaction costs are capitalized on initial recognition.

Upon adoption of these new standards, the Fund designated its cash and short-term investments as held-for-trading, which are measured at fair value. Accounts receivable is classified as loans and receivables, which are measured at amortized cost. Bank indebtedness, Accounts payable and accrued liabilities, Accrued compensation and related benefits, Unitholder distributions payable and Long-term debt, are classified as other financial liabilities. The Fund had neither available for sale, nor held-to-maturity instruments during the three months ended March 31, 2007.

Interest-rate swap agreements are used as part of the Fund's program to manage the fixed and floating interest rate mix of the Fund's total debt outstanding and related overall cost of borrowing. The interest-rate swap agreements involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based. The interest-rate swap agreements are classified as held-for-trading and are recorded at their fair value with a corresponding adjustment to interest expense.

The adoption of these Handbook Sections had no impact on opening deficit. The Fund had no "other comprehensive income or loss" transactions during the three months ended March 31, 2007 and no opening or closing balances for accumulated other comprehensive income or loss.

## 3. BUSINESS ACQUISITION

***Heath Benefits Consulting Inc. ("Heath")***

On June 1, 2006, the Fund indirectly acquired all of the issued and outstanding shares of Heath, a Vancouver-based benefits consulting firm with over 90 employees across Canada.

The consideration is based on future revenue from the Heath business with a minimum purchase price of $9,014. The consideration, which is currently estimated to be approximately $15,400, is being paid in three instalments and is satisfied primarily through the assumption and repayment of the Heath debt of $4,648 on closing and the issuance of Class B LP Units of MS Group LP.

The first instalment of the purchase price was made on closing. The purchase price is conditional upon the success in retaining and growing revenue from specified Heath clients, as well as achieving targeted cost efficiencies. The second and third instalments, which represent contingent consideration, will be settled on June 30 and December 1 of 2008 and are currently estimated to be approximately $6,400. These instalments will be settled by issuing a number of Class B LP Units of MS Group LP based on a pre-determined value of $12.52 per unit. In addition to the estimate of $15,400, contingent consideration will include amounts to compensate for foregone distributions payable on its second and third instalments during the period June 1, 2006 to December 1, 2008, which amounted to approximately $361 to the end of March 31, 2007.

These contingent consideration elements will be recorded when the final purchase price has been established except for a portion of the third instalment which is conditional on the continuing employment of certain selling shareholders and is being recorded as salary expense over the required employment period to December, 2008. The estimated payable amount as at March 31, 2007 is $733 and the expense for the three months ended March 31, 2007 was $220.

The acquisition has been accounted for by the purchase method based on management's best estimate of the relative fair value of the identifiable assets and liabilities assumed. The first instalment of the purchase price has been accounted for as follows:

(In thousands of dollars except per unit amounts)

| | |
|---|---|
| Assets and liabilities acquired: | |
| Cash | $ 827 |
| Accounts receivable | 1,530 |
| Income taxes recoverable | 106 |
| Prepaid expenses and other | 101 |
| Capital assets | 365 |
| Intangible assets | 8,090 |
| Goodwill | 1,256 |
| Bank indebtedness | (1,734) |
| Accounts payable and accrued liabilities | (1,527) |
| Payable to insurance companies | (3,156) |
| Related cash balances held | 3,156 |
| | $ 9,014 |
| Consideration: | |
| Cash | $ 449 |
| Debt assumed and repaid | 4,648 |
| Exchangeable Units (first instalment paid on June 20, 2006) | 3,917 |
| | $ 9,014 |

These consolidated financial statements include the results of Heath from the date of acquisition.

## 4. CAPITAL ASSETS

The Fund's capital assets are comprised of:

| | Cost | Accumulated Amortization March 31, 2007 | Net Book Value March 31, 2007 | Net Book Value December 31, 2006 |
|---|---|---|---|---|
| Computer equipment | $ 2,020 | $ (687) | $ 1,333 | $ 1,401 |
| Furniture and equipment | 3,426 | (827) | 2,599 | 2,675 |
| Leasehold improvements | 8,137 | (1,623) | 6,514 | 6,757 |
| | $13,583 | $(3,137) | $10,446 | $10,833 |

Amortization for the three months ended March 31, 2007 and March 31, 2006 were $523 and $498 respectively.

(In thousands of dollars except per unit amounts)

## 5. INTANGIBLE ASSETS

The Fund's intangible assets are comprised of:

| | Cost | Accumulated Amortization March 31, 2007 | Net Book Value March 31, 2007 | Net Book Value December 31, 2006 |
|---|---|---|---|---|
| Customer relationships | $ 98,090 | $ (7,240) | $ 90,850 | $ 92,110 |
| Customer contracts | 5,000 | (2,598) | 2,402 | 2,917 |
| Proprietary software | 40,000 | (12,000) | 28,000 | 30,000 |
| | $143,090 | $(21,838) | $121,252 | $125,027 |

Amortization for the three months ended March 31, 2007 and March 31, 2006 were $3,775 and $3,542 respectively.

## 6. BANK INDEBTEDNESS AND LONG-TERM DEBT

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| Secured term loan | $35,000 | $35,000 |
| Debt issue costs, net of accumulated amortization | (124) | — |
| | $34,876 | $35,000 |

At March 31, 2007, the Fund had a secured term loan of $35,000 with two Canadian chartered banks repayable in full on September 30, 2009. The term loan bears interest at the bankers' acceptance rate plus 1%.

As a result of adopting the new financial instruments standard in 2007, Debt issue costs incurred on the secured term loan have been reclassified from Prepaid expenses and other, to Long-term debt. The corresponding amortization of $13 for the three months period ended March 31, 2007 has been removed from Other operating expenses and is now reflected as Interest expense. The debt issue costs, net of accumulated amortization as at December 31, 2006 were $137 and have not been restated.

The Fund entered into interest-rate swap agreements on September 30, 2005 in order to fix the interest rate at 4.4% for the duration of the loan. These interest-rate swap agreements have been recorded at their fair value with the corresponding adjustment to interest expense. As at March 31, 2007 the fair value of the swap was $776 (December 31, 2006 – $840) and the adjustment to interest expense for the period was $64 (March 31, 2006 – $nil).

(In thousands of dollars except per unit amounts)

The Fund also has available a secured operating line of credit for $15,000 with $1,962 drawn at March 31, 2007. The line of credit bears interest at the bankers' acceptance rate plus 1% and the undrawn portion incurs a standby fee of 0.2%. The bank indebtedness and term loan are secured by a general assignment of the assets of the Fund.

## 7. FUND UNITS

The Fund is authorized to issue an unlimited number of Units and an unlimited number of special voting units ("Special Voting Units"). Special Voting Units are not entitled to any beneficial interest in any distribution from the Fund.

Units are redeemable at any time on demand by the Unitholders up to an aggregate maximum monthly amount of $50. Trustees may, in their sole discretion, waive this limitation. The redemption price is calculated based on the lesser of:

(i) 90% of the "market price", as defined in the prospectus, as of the date on which the Units were surrendered for redemption; and

(ii) 100% of the "closing market price", as defined in the prospectus, on the redemption date.

The following details the issued and outstanding Units and Special Voting Units:

| | March 31, 2007 | | December 31, 2006 | |
|---|---|---|---|---|
| | Units Issued | Amount | Units Issued | Amount |
| Units | 22,062,916 | $205,549 | 22,062,916 | $205,549 |
| Special Voting Units | 5,721,444 | — | 5,721,444 | — |
| | 27,784,360 | $205,549 | 27,784,360 | $205,549 |

(In thousands of dollars except per unit amounts)

## 8. NON-CONTROLLING INTEREST

The former shareholders of Morneau Sobeco and Heath own 5,721,444 Class B LP Units of MS Group LP. The Class B LP Units are fully exchangeable for equal Units in the Fund, subject to certain restrictions, and provide the former shareholders of Morneau Sobeco and Heath with a non-controlling interest of 20.6% in the Fund. Some of the Class B LP Units are subordinated in their rights to receive distributions.

| | March 31, 2007 | | December 31, 2006 | |
|---|---|---|---|---|
| | Units Issued | Amount | Units Issued | Amount |
| Subordinated Class B LP Units | 4,095,060 | $40,951 | 4,095,060 | $40,951 |
| Non-subordinated Class B LP Units | 1,626,384 | 16,836 | 1,626,384 | 16,836 |
| | 5,721,444 | $57,787 | 5,721,444 | $57,787 |

| | Three Months ended March 31, 2007 | | Three Months ended March 31, 2006 | |
|---|---|---|---|---|
| | Units Issued | Amount | Units Issued | Amount |
| Balance, beginning of period | 5,721,444 | $55,461 | 5,494,303 | $54,322 |
| Salary component of Heath acquisition (note 3) | — | 220 | — | — |
| Share of net income for the period | — | 588 | — | 540 |
| Distributions for the period | — | (1,208) | — | (1,133) |
| Balance, end of year/period | 5,721,444 | $55,061 | 5,494,303 | $53,729 |

Distributions on the Subordinated Class B LP Units are subordinated in favour of the Fund Units and the Non-subordinated Class B LP Units. These distributions are paid at the end of a fiscal quarter to the extent that an average monthly distribution of at least $0.06875 per Unit and

(In thousands of dollars except per unit amounts)

Non-subordinated Class B LP Unit in respect of that quarter has been paid, and any deficiency in such distributions to holders of Units and Non-subordinated Class B LP Units during the subordination period has been satisfied.

The subordination provisions of the Subordinated Class B LP Units apply until the date on which both of the following conditions have been satisfied: (i) for four consecutive fiscal quarters of the Fund beginning on December 31, 2006, the Fund has earned EBITDA of at least $25,169 during such period; and (ii) commencing with the 12-month period ending September 30, 2007, the Fund and MS Group LP have respectively paid an average distribution of at least $0.06875 per Unit and per Class B LP Unit per month for the preceding 12-month period. "EBITDA" is defined as earnings before interest, income taxes, depreciation and amortization.

## 9. DISTRIBUTIONS TO UNITHOLDERS

The Board of Trustees determines the amount of distributions. The Fund's Declaration of Trust provides that distributions must be made to ensure that the Fund will not be liable for ordinary income taxes under the *Income Tax Act* (*Canada*). Any taxable income of the Fund that is unavailable for cash distribution will be distributed to Unitholders in the form of additional Units.

Commencing on March 2007, the monthly distribution has increased from $0.06875 per Unit to $0.07356 per Unit. Distributions announced during the three months ended March 31, 2007 and 2006 were as follows:

| Unitholder record date | Total | Per Unit | Paid or payable for the three months ended March 31, 2007 |
|---|---|---|---|
| **Trust Units** | | | |
| January 31, 2007 | $1,517 | $0.06875 | February 15, 2007 |
| February 28, 2007 | 1,517 | 0.06875 | March 15, 2007 |
| March 30, 2007 | 1,623 | 0.07356 | April 16, 2007 |
| | $4,657 | $0.21106 | |

(In thousands of dollars except per unit amounts)

| Unitholder record date | Total | Per Unit | Paid or payable for the three months ended March 31, 2007 |
|---|---|---|---|
| **Class B LP Units** | | | |
| *Non-subordinated* | | | |
| January 31, 2007 . . . . . | $112 | $0.06875 | February 15, 2007 |
| February 28, 2007 . . . . | 112 | 0.06875 | March 15, 2007 |
| March 30, 2007 . . . . . . | 120 | 0.07356 | April 16, 2007 |
| | $344 | $0.21106 | |
| *Subordinated* | | | |
| March 30, 2007 . . . . . . | $864 | $0.21106 | April 16, 2007 |

| Unitholder record date | Total | Per Unit | Paid or payable for the three months ended March 31, 2006 |
|---|---|---|---|
| **Trust Units** | | | |
| January 31, 2006 . . . . | $1,511 | $0.06875 | February 15, 2006 |
| February 28, 2006 . . . | 1,511 | 0.06875 | March 15, 2006 |
| March 31, 2006 . . . . . | 1,511 | 0.06875 | April 17, 2006 |
| | $4,533 | $0.20625 | |
| **Class B LP Units** | | | |
| *Non-subordinated* | | | |
| January 31, 2006 . . . . | $ 96 | $0.06875 | February 15, 2006 |
| February 28, 2006 . . . | 96 | 0.06875 | March 15, 2006 |
| March 31, 2006 . . . . . | 96 | 0.06875 | April 17, 2006 |
| | $ 288 | $0.20625 | |
| *Subordinated* | | | |
| March 31, 2006 . . . . . | $ 845 | $0.20625 | April 17, 2006 |

## 10. LONG-TERM INCENTIVE PLAN

Executives are eligible to participate in Morneau Sobeco's Long-Term Incentive Plan ("LTIP"), which is designed to align compensation with distributable cash earned by the Fund's subsidiaries. The LTIP provides compensation opportunities for performance resulting in the Fund exceeding its distributable cash targets. The Fund's Compensation, Nominating and Corporate Governance Committee of the Board of Trustees (the "Committee") determines (i) who will participate in the LTIP; (ii) the level of participation; and (iii) the time or times when LTIP awards will vest or be paid to each participant.

(In thousands of dollars except per unit amounts)

Pursuant to the LTIP, Morneau Sobeco sets aside a pool of funds based upon the amount, by which the distributable cash per Unit (fully diluted) exceeds defined threshold amounts. Morneau Sobeco or a trustee purchases Units in the market with this pool of funds and holds the Units until such time as ownership vests to each participant. Generally, one-third of these Units vest equally over the three years following the grant of the awards. LTIP participants are entitled to receive distributions on all Units held for their account prior to the applicable vesting date. Unvested Units held by the trustee for an LTIP participant will be forfeited if the participant resigns or is terminated prior to the applicable vesting date and those Units will be sold and the proceeds returned to Morneau Sobeco.

In 2006, the LTIP provided for awards based on the amount by which distributable cash per Unit exceeded a base distribution threshold of $0.825 per Unit per annum. The percentage amount of that excess, which formed the LTIP incentive pool, was determined in accordance with the table below:

| Percentage by which Distributable Cash per Unit Exceeds Base Threshold | Maximum Proportion of Excess Distributable Cash Available for LTIP Payments |
|---|---|
| 5% or less | 10% |
| Over 5% to 10% | 15% of any excess over 5% to 10% |
| Greater than 10% | 20% of any excess over 10% |

The base distribution threshold is subject to review by the Committee at least annually. The Committee awarded a payment under the terms of the LTIP of $386 for the year ended December 31, 2006. This amount is recorded as salary expense over the three-year vesting period of 2007 to 2009. The expense recognized for the three months ended March 31, 2007 was $32 (March 31, 2006 – nil).

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the three months ended March 31, 2007
(Unaudited)
(In thousands of dollars except per unit amounts)

## 11. INCOME TAXES

Income tax obligations relating to distributions from the Fund are obligations of the Unitholders and, accordingly, no provision for income taxes has been made in respect of income of the Fund. A provision for income taxes was recognized for the Fund's subsidiaries that are subject to tax.

The difference between income taxes calculated using the Fund's effective income tax rates and the amounts that would result from the application of the statutory income tax rates arises from the following:

| | Three Months ended March 31 | |
|---|---|---|
| | 2007 | 2006 |
| Income taxes at statutory rates: | | |
| Federal | 22.12% | 22.12% |
| Provincial | 12.13% | 11.84% |
| | 34.25% | 33.96% |
| Income tax provision applied to income before income taxes: | | |
| Combined basic federal and provincial income taxes at statutory rates applied to income from continuing operations | $ 1,070 | $ 794 |
| Income taxed in the hands of the Unitholders | (1,868) | (1,623) |
| Non-deductible expenses | 36 | 27 |
| Non-deductible intangibles | 1,117 | 1,041 |
| Financing cost deductible for tax purposes | (251) | (248) |
| Effect of higher tax rates in non-Canadian jurisdictions | 3 | 3 |
| Non-deductible salary | 67 | — |
| Other | 84 | 35 |
| | $ 258 | $ 29 |

(In thousands of dollars except per unit amounts)

Future income tax assets and liabilities are provided for temporary differences between the financial statement carrying values of existing assets and liabilities and their respective tax bases. The significant components of future income tax assets and liabilities related to continuing operations are as follows:

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| Future income tax assets comprised of : | | |
| Excess of tax bases of capital assets and intangibles over their carrying values | $617 | $741 |

On October 31, 2006, the Department of Finance (Canada) announced the "Tax Fairness Plan" whereby the income tax rules applicable to publicly traded trusts and partnerships will be significantly modified. In particular, certain income of (and distributions made by) these entities will be taxed in a manner similar to income earned by (and distributions made by) a corporation. These proposals will be effective for the 2007 taxation year with respect to trusts which commence public trading after October 31, 2006, but the application of the rules will be delayed to the 2011 taxation year with respect to trusts which were publicly traded prior to November 1, 2006 (although the announcement suggested that this transitional relief could be lost under certain circumstances, including the "undue expansion" of an income trust). On December 21, 2006, the Department of Finance (Canada) issued for public comment the draft legislation to implement these proposals.

On December 15, 2006, the Department of Finance (Canada) released guidance for income trusts and other flow-through entities that qualify for the four-year transitional relief. The guidance establishes objective tests with respect to how much an income trust is permitted to grow without jeopardizing its transitional relief. In general, the Fund will be permitted to issue new equity over the next four years equal to its market capitalization as of the end of trading on October 31, 2006 (subject to certain annual limits). Market capitalization, for these purposes, is to be measured in terms of the value of the Fund's issued and outstanding publicly traded units. If these limits are exceeded, the Fund may lose its transitional relief and thereby become immediately subject to the proposed rules.

On March 29, 2007, the Ministry introduced Bill C-52 in the House of Commons to implement these proposals. Currently, the Fund is only taxable on amounts that are not distributed to Unitholders. If enacted in its current form, the proposed legislation will result in a change in which certain earnings of the Fund will be subject to income tax regardless of whether amounts are distributed to the Unitholders or not. There is no assurance that the draft legislation will be enacted in the manner proposed or at all.

The Fund is considering these announcements and the possible impact of the proposed rules to the Fund. The impact of the proposed rules may adversely affect the marketability of the Fund's Units and the ability of the Fund to undertake financings and acquisitions, and, at such time as the proposed rules apply to the Fund, the distributable cash of the Fund may be materially reduced.

## 12. EMPLOYEE FUTURE BENEFITS

The Fund offers a pension benefit plan for its employees, which includes a defined benefit option and a defined contribution option. The defined benefit option was closed to new members effective January 1, 1998.

As of January 1, 1998, all new members participate in a defined contribution option, whereby the Fund matches member contributions and may be required to make additional contributions at the option of the members up to a limit prescribed under the *Income Tax Act (Canada)*. Under the defined contribution option, each member is required to contribute a specific dollar amount based on the member's job level classification. Each member may elect to make an optional contribution of between 50% and 300% of the member's required contribution. The Fund matches required contributions. For employees with less than 10 years of service, the Fund contributes 50% of optional contributions and for members with 10 or more years, 75% of optional contributions.

(In thousands of dollars except per unit amounts)

The pension fund assets and obligations were measured as at March 31, 2007. Information about the pension plan's defined benefit option is as follows:

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| Fair value of plan assets | $2,609 | $2,562 |
| Accrued benefit obligation | 3,212 | 3,164 |
| Funded status – deficit | $ (603) | $ (602) |
| Plan assets: | | |
| Fair value, beginning of period | $2,562 | $2,954 |
| Actual return on plan assets | 23 | 217 |
| Employer contributions | 39 | 260 |
| Benefits paid | (15) | (869) |
| Fair value, end of period | $2,609 | $2,562 |
| Accrued benefit obligation: | | |
| Balance, beginning of period | $3,164 | $3,896 |
| Current service cost | 23 | 90 |
| Interest cost | 40 | 169 |
| Benefits paid | (15) | (869) |
| Actuarial losses (gains) | — | (122) |
| Balance, end of period | $3,212 | $3,164 |
| Reconciliation of plan assets to accrued benefit obligation, end of period: | | |
| Fair value of plan assets | $2,609 | $2,562 |
| Accrued benefit obligation | 3,212 | 3,164 |
| Funded status – deficit | (603) | (602) |
| Unamortized net actuarial loss | 177 | 155 |
| Unamortized transitional obligation | 426 | 449 |
| Accrued benefit asset | $ — | $ 2 |
| End of period allocation of fair value of plan assets (%) | | |
| Pooled Equities Fund | 45% | 45% |
| Pooled Bond Fund | 55% | 55% |
| | 100% | 100% |

(In thousands of dollars except per unit amounts)

| | March 31, 2007 | March 31, 2006 |
|---|---|---|
| Pension plan cost | | |
| Current service cost | $ 23 | $ 23 |
| Interest cost on accrued benefit obligation | 40 | 42 |
| Return on plan assets | (23) | (80) |
| Actuarial losses (gains) during the period on accrued benefit obligation | — | (116) |
| | $ 40 | $(131) |
| Other adjustments: | | |
| Difference between actual and expected return on plan assets | (22) | 35 |
| Amortization of actuarial losses (gains) | — | 117 |
| Transitional amounts | 23 | 23 |
| Net pension plan expense | $ 41 | $ 44 |

Other information about the Fund's defined benefit option is as follows:

| | | |
|---|---|---|
| Employer contributions | $ 39 | $ 155 |
| Benefits paid | $ 15 | $ 845 |

Actuarial valuation for the Fund's pension plan is generally required every three years. The most recent actuarial valuation of the Fund's pension plan will be conducted in 2007.

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| Weighted average assumptions: | | |
| Discount rate at the end of the current fiscal period used to determine the accrued benefit obligation | 5.00% | 5.00% |
| Discount rate at the end of preceding period used to determine the benefit cost | 5.00% | 4.75% |
| Rate of compensation increase used to determine the accrued benefit obligation | 2.50% | 2.50% |
| Rate of compensation increase used to determine the benefit cost | 2.50% | 2.50% |
| Expected long-term rate of return on plan assets | 7.00% | 7.00% |

(In thousands of dollars except per unit amounts)

The net expense for the Fund's defined contribution option for the three months ended March 31, 2007 and March 31, 2006 were $466 and $389 respectively.

## 13. NET INCOME PER UNIT

Net income per Unit is calculated by dividing Net income by the weighted average number of Units outstanding during the period. The following table reconciles the weighted average number of Units outstanding used in computing basic Net income per Unit to weighted average number of Units in computing diluted Net income per Unit:

| | For the three months ended March 31 | |
|---|---|---|
| | 2007 | 2006 |
| Basic: | | |
| Net income | $ 2,268 | $ 2,158 |
| Weighted average number of Units outstanding | 22,062,916 | 21,977,212 |
| Diluted: | | |
| Net income | $ 2,268 | $ 2,158 |
| Non-controlling interest | 588 | 540 |
| Net income available to Unitholders and Class B LP Unitholders | $ 2,856 | $ 2,698 |
| Weighted average number of Units outstanding – Basic | 22,062,916 | 21,977,212 |
| Weighted average exchangeable Class B LP Units outstanding | 5,721,444 | 5,494,303 |
| Total weighted average number of diluted Units | 27,784,360 | 27,471,515 |
| Net income per Unit – basic and diluted | $ 0.10279 | $ 0.09821 |

## 14. COMMITMENTS

The Fund has lease commitments for office premises and equipment with options for renewal. As at March 31, 2007 the minimum payments not including operating expenses, due in each of the next five years and thereafter, are expected to be as follows for each year ending December 31:

(In thousands of dollars except per unit amounts)

| | |
|---|---|
| 2007 | $ 3,762 |
| 2008 | 4,554 |
| 2009 | 3,934 |
| 2010 | 3,106 |
| 2011 | 2,726 |
| Thereafter | 3,026 |
| Total | $21,108 |

In addition, the Fund entered into a sublease agreement in 2006 to sublet one of the former Heath office premises. According to the agreement, the Fund is liable for the rent in case of a default by the subtenant. The average annual rent for the lease is $190 and the lease expires on October 30, 2011. The fair value of the total future lease payments as at March 31, 2007 was $791. The Fund considers the risk of default by the subtenant to be low therefore no accrual has been set up for the guarantee.

## 15. CONTINGENCIES

From time to time, the Fund is involved in routine litigation incidental to the Fund's business. Management believes that adequate provisions have been made where required and the ultimate resolution with respect to any claim will not have a material adverse effect on the financial position or results of operations of the Fund.

## 16. ECONOMIC DEPENDENCE

Revenue from the Fund's largest client was approximately 10% of total revenue for the three months ended March 31, 2007 (March 31, 2006 – 11%). Its top 10 clients accounted for approximately 33% of total revenue for the three months ended March 31, 2007 (March 31, 2006 – 34%).

The Fund, in its normal course of business, is exposed to credit risk from its clients. Risk associated with concentration of credit risk with respect to accounts receivables are limited due to the credit rating of our top 10 clients. The Fund has over

(In thousands of dollars except per unit amounts)

1,000 clients with no client consisting of greater than 1% of total revenue with the exception of the top ten clients.

## 17. SEGMENTED INFORMATION

The Fund's operations consist of one reporting segment, which provides employee pension and benefits consulting and outsourcing services. Geographic data were as follows:

| | For the three months ended March 31 | |
|---|---|---|
| | 2007 | 2006 |
| Revenue | | |
| Canada | $34,043 | $30,605 |
| United States | 2,048 | 1,573 |

Assets held in Canada and the United States mainly consist of Cash, Accounts receivable, Unbilled fees, Income taxes recoverable, Prepaid expenses and other, Interest-rate swap, Capital assets, Intangibles assets and Goodwill, and liabilities include Bank indebtedness, Accounts payable and accrued liabilities, Accrued compensation and related compensation, Unitholder distributions payable, Long-term debt and Non-controlling interest. The book values are as follows:

| | March 31, 2007 | December 31, 2006 |
|---|---|---|
| Assets | | |
| Canada | $291,436 | $298,497 |
| United States | 1,893 | 2,049 |
| Liabilities | | |
| Canada | $101,213 | $105,861 |
| United States | 106 | 286 |

The Fund is not engaged in currency hedging activities and does not own other instruments that may be settled by the delivery of non-financial assets. The Fund realizes a portion of sales in U.S. dollars and is thus exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar. The net revenue exposure after accounting for related expenses denominated in U.S. dollars was approximately US$0.9 million for the three months ended March 31, 2007.

## 18. SUBSEQUENT EVENT

On May 15, 2007, a subsidiary of the Fund signed an Asset Purchase agreement to acquire certain assets, liabilities and contracts of the defined benefit pension administration and actuarial consulting practices of Cowan Benefits Consulting Limited ("Cowan"), a benefits consulting firm based in the Waterloo region, in Ontario. The purchase price is subject to the final pension administration and actuarial consulting services revenue and certain other integration conditions and is expected to be approximately $6 million. The acquisition will be funded by debt and is expected to close on June 1, 2007.

*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 ("IPO").*

This Management's Discussion and Analysis ("MD&A") covers the three months ended March 31, 2007 and should be read in conjunction with the accompanying unaudited interim Consolidated Financial Statements of the Fund and notes thereto for the period ended March 31, 2007 as well as the MD&A and Audited Consolidated Financial Statements and notes thereto contained in the Fund's Annual Report for the year ended December 31, 2006.

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 income tax matters, ability to maintain profitability and manage growth, 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 the Fund, its financial or operating results or its securities.

To assist investors in assessing the Fund's financial performance, this discussion also makes reference to certain non-GAAP measures such as EBITDA, Distributable Income, Distributable Cash, Distributable Income Payout Ratio and Distributable Cash Payout Ratio. We believe that EBITDA is a useful measure in evaluating performance of the Fund. It is used to monitor compliance with debt covenants and to make decisions related to distributions to Unitholders. We also believe that Distributable Income, Distributable Cash, Distributable Income Payout Ratio and 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.

## FORMATION AND OWNERSHIP STRUCTURE OF THE FUND

The Fund is an unincorporated, open-ended, limited purpose trust established under the laws of Ontario. It indirectly owns 22,062,916 Class A Limited Partnership units of Morneau Sobeco Group Limited Partnership ("MS Group LP"), which represents a 79.4% 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 20.6% 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 provided that the Fund achieves certain objectives. Management employees and former owners of the predecessors of the Morneau Sobeco Operating Entities ("Management Securityholders") hold this non-controlling interest.

As at March 31, 2007, 22,062,916 Units and 5,721,444 Special Voting Units of the Fund were issued and outstanding, and 5,721,444 MS Group LP Class B LP Units were issued and outstanding.

## BUSINESS OVERVIEW

Morneau Sobeco is the largest Canadian-owned pension and benefits consulting and outsourcing firm, providing services to organizations across Canada and in the United States. We focus on the integrated design and delivery of retirement, employee compensation and benefits programs. We have over 1,000 professionals and support staff with offices in 12 cities across North America. Our clients are primarily large and medium-sized organizations in Canada and the United States, which typically utilize our services on a recurring or contracted basis over a long term.

We derive our revenue primarily from fees charged to clients for pension and benefits consulting and outsourcing engagements. Fees from consulting engagements are charged based on billable hours or 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.

Our largest operating expense is compensation and related costs. This includes salaries, annual performance-based bonuses, benefits (e.g., pension, health, dental), payroll taxes and temporary staffing services. Other 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 (legal and audit) and insurance.

## OVERVIEW AND OUTLOOK

The results for the first quarter of 2007 met our expectations, from both a revenue and profitability standpoint. Revenue growth was 12.2% for the period. Net income and EBITDA growth were 5.1% and 8.8% respectively. Adjusting for the salary component of the Heath acquisition of $0.2 million (see footnote (2) to the "Result of Operations") the EBITDA growth was 11.9%. Our EBITDA margin remained strong at 21.8% or 22.4% adjusting for the Heath acquisition accounting.

The Distributable Income Payout Ratio for the quarter was 78.8% compared to 86.3% in the first quarter of 2006. The Distributable Cash Payout Ratio for the quarter was (502.1)% which reflects the payment of our year-end accrued liabilities in the quarter. On a twelve-month rolling basis, the Distributable Income Payout Ratio and the Distributable Cash Payout Ratio were 83.3% and 83.5% respectively.

As a result of our consistent growth, the Board of Trustees authorized a 7% increase to our target monthly distribution from $0.06875 per Unit to $0.07356 per Unit, commencing with the March 2007 distribution paid April 16, 2007.

On May 15, 2007, a subsidiary of the Fund signed an Asset Purchase agreement to acquire certain assets, liabilities and contracts of the defined benefit pension administration and actuarial consulting practices of Cowan Benefits Consulting Limited ("Cowan"), a benefits consulting firm based in the Waterloo region, in Ontario. The purchase price is subject to the final pension administration and actuarial consulting services revenue and certain other integration conditions and is expected to be approximately $6 million. The acquisition will be funded by debt and is expected to close on June 1, 2007. It will be accretive immediately.

We are on track for 2007 both in terms of our financial performance and executing our business strategy. We continue to focus on our core services and strive to deliver high-quality services in the most efficient and cost-effective manner. Our strategy for future growth encompasses expanding relationships with current clients, continuing to attract new clients especially in the growing outsourcing market, targeting underserved markets and pursuing selected acquisitions.

## DISTRIBUTION TO UNITHOLDERS

Monthly distributions are declared by the Fund for Unitholders of record on the last business day of each month and are paid on about the 15th day of the following month.

To reduce Unitholder risk, approximately 72% of the Class B LP Units are subordinated in their rights to distributions until Unitholders of the Fund receive their target distributions. This subordination is in place until September 30, 2007, or later if the Fund has not made its target distributions.

## ANALYSIS OF 2007 FIRST QUARTER OPERATING RESULTS

### Results of Operations

Selected Unaudited Consolidated Financial Information

| | Three months ended March 31 | |
|---|---|---|
| | 2007 | 2006 |
| | (In thousands of dollars except per unit amounts ) | |
| Revenue | $ 36,091 | $ 32,178 |
| Deduct: | | |
| Salaries and benefits expense | 21,673 | 18,898 |
| Other operating expense | 6,553 | 6,052 |
| Interest | 453 | 461 |
| Amortization of capital and intangible assets | 4,298 | 4,040 |
| Income taxes | 258 | 29 |
| Non-controlling interest | 588 | 540 |
| Net income for the period | 2,268 | 2,158 |
| Add: | | |
| Amortization of capital and intangible assets | 4,298 | 4,040 |
| Income taxes | 258 | 29 |
| Interest | 453 | 461 |
| Non-controlling interest | 588 | 540 |
| EBITDA[(1)] | 7,865 | 7,228 |
| *EBITDA Margin* | *21.8%* | *22.5%* |
| Add (deduct): | | |
| Current taxes | (134) | (61) |
| Salary component of Heath acquisition[(2)] | 220 | — |
| Interest paid | (376) | (461) |
| Capital expenditures | (136) | (140) |
| Distributable Income[(3)] | $ 7,439 | $ 6,566 |
| EBITDA[(1)] | $ 7,865 | $ 7,228 |
| Add (deduct): | | |
| Change in non-cash operating working capital | (8,607) | (5,958) |
| Current taxes | (134) | (61) |
| Salary component of Heath acquisition[(2)] | 220 | — |
| Interest paid | (376) | (461) |
| Cash from operating activities | (1,032) | 748 |
| (Deduct): | | |
| Capital expenditures | (136) | (140) |
| Distributable Cash[(4)] | $ (1,168) | $ 608 |
| Distributable Cash available to non-controlling interest | (241) | 122 |
| Distributable Cash available for Unitholders | (927) | 486 |
| Net income per Unit (basic and diluted) | $ 0.10279 | $0.09821 |
| Distributable Income per Unit (basic and diluted) | $ 0.26774 | $0.23902 |
| Distributable Cash per Unit (basic and diluted) | $(0.04204) | $0.02212 |
| Distributions declared per Unit (basic and diluted) | $ 0.21106 | $0.20625 |
| Distributable Income Payout Ratio[(5)] | 78.8% | 86.3% |
| Distributable Cash Payout Ratio[(6)] | (502.1)% | 932.0% |
| Twelve-month rolling Distributable Income Payout Ratio | 83.3% | n/a |
| Twelve-month rolling Distributable Cash Payout Ratio | 83.5% | n/a |

Footnotes:

(1) "EBITDA" is defined as earnings (loss) before interest expense, income taxes, depreciation, amortization and non-controlling interest.

(2) On June 1, 2006, the Fund indirectly acquired all of the issued and outstanding shares of Heath Benefits Consulting Inc. ("Heath"). Heath was a Vancouver-based benefits consulting firm with over 90 employees across Canada. The purchase price is based on future revenue from the Heath business going forward as well as achieving targeted cost efficiencies. The consideration, which is currently estimated to be approximately $15.4 million, is being paid in three instalments and is satisfied primarily through the assumption and repayment of the Heath debt of $4.6 million and the issuance of Class B LP Units. The first instalment of the purchase price was made on closing. The second and third instalments plus an amount to compensate for foregone distributions payable will be settled in June and December of 2008. These amounts will be recorded at that time except for a portion of the third instalment which is conditional on the continuing employment of certain selling shareholders and is being recorded as salary expense over the required employment period to December 2008.

(3) "Distributable Income" is defined as net income for the period adjusted for specific non-cash items, including amortization, future income taxes and maintenance capital expenditures.

(4) "Distributable Cash" is defined as Cash from operating activities adjusted for maintenance capital expenditures. As a result of adopting the CSA Staff Notice 52-306 (Revised) in the third quarter of 2006, the Distributable Cash calculation in this MD&A has been revised from previous MD&As to incorporate the changes in non-cash operating working capital.

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

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

## ANALYSIS OF 2007 FIRST QUARTER RESULTS

### *Revenue*

Revenue for the three months ended March 31, 2007 increased by $3.9 million, or 12.2%, to $36.1 million compared to $32.2 million for the same period in 2006. The increase in revenue was a result of additional consulting and outsourcing business from a variety of clients, with one existing client increasing our revenue by $1.0 million. Revenue also increased by $2.2 million due to the Heath acquisition.

*Salaries and Benefits*

Salaries and benefits for the three months ended March 31, 2007 increased by $2.8 million, or 14.7%, to $21.7 million compared to $18.9 million for the same period in 2006. The increase was attributable to salary and benefits of $1.3 million for Heath, the salary component of the Heath acquisition of $0.2 million and general increases of $1.3 million.

*Other Operating Expenses*

Other operating expenses for the three months ended March 31, 2007 increased by $0.5 million, or 8.5%, to $6.6 million compared to $6.1 million for the same period in 2006. The increase was primarily attributable to Heath operating expenses of $0.5 million.

*Interest Expense*

Interest expense for the three months ended March 31, 2007 remained unchanged at $0.5 million compared to the same period in 2006.

*Amortization of Capital and Intangible Assets*

Amortization for the three months ended March 31, 2007 increased by $0.3 million, or 6.4%, to $4.3 million compared to $4.0 million for the same period in 2006. The increase was primarily attributable to the increase in intangible assets as a result of the acquisition of Heath.

*Income Tax Expense*

Income tax expense for the three months ended March 31, 2007 was $0.3 million compared to $19 thousand for the same period in 2006. The changes in tax expense are primarily attributable to increased taxable income due to growth.

*Net Income*

As a result of the changes in revenue and expenses described above, net income for the three months ended March 31, 2007 increased by $0.1 million to $2.3 million compared to $2.2 million for the same period in 2006.

*Changes in Non-Cash Operating Working Capital*

Changes in non-cash operating working capital for the three months ended March 31, 2007 decreased by $2.6 million to a use of $8.6 million compared to a use of $6.0 million for the same period in 2006. The primary use of funds in the first quarter of every year is the payment of our annual bonuses. The amount paid in 2007 for 2006 bonuses was $6.3 million compared to $5.4 million in 2006 as a portion of 2005 bonuses were paid prior to the IPO. The decrease in non-cash operating working capital was also attributed to increased receivables and unbilled fees of $ 1.0 million due to our growth in revenue and decreased payables due to the timing of supplier payments of $0.5 million.

***Cash from Operating Activities***

Cash from operating activities for the three months ended March 31, 2007 decreased by $1.8 million to an outflow of $1.0 million compared to cash inflow of $0.8 million for the same period in 2006. This decrease was primarily due to decreased changes in non-cash operating working capital of $2.6 million offset by improved EBITDA of $0.8 million after taking into account the salary component of the Heath acquisition of $0.2 million.

## *Non-GAAP Financial Measures: EBITDA, Distributable Income and Distributable Cash*

***EBITDA***

EBITDA for the three months ended March 31, 2007 increased $0.6 million, or 8.8%, to $7.8 million compared to $7.2 million for the same period in 2006. The increase was due to increased revenue of $3.9 million partially offset by increased salaries and benefits expense and operating costs of $3.3 million.

***Distributable Income***

Distributable Income for the three months ended March 31, 2007 increased by $0.9 million or 13.3%, to $7.4 million compared to $6.5 million for the same period in 2006. The increase was primarily due to increased EBITDA of $0.8 million after taking into account the salary component of the Heath acquisition in the amount of $0.2 million.

***Distributable Cash***

Distributable Cash for the three months ended March 31, 2007 decreased by $1.8 million, or 292.2%, to a use of $1.2 million compared to a source of $0.6 million for the same period in

2006. This decrease was primarily due to decreased cash from operating activities of $1.8 million.

## LIQUIDITY AND CAPITAL RESOURCES

### *Cash Flows*

The following table provides an overview of the Fund's cash flows for the periods indicated:

**Cash Flow Information**
Selected Unaudited Consolidated Financial Information

| | Three Months Ended March 31 | |
|---|---|---|
| | 2007 | 2006 |
| | (In thousands of dollars) | |
| Cash provided by (used in) | | |
| Operating Activities | $(1,032) | $ 748 |
| Investing Activities | (136) | (140) |
| Financing Activities | (6,051) | (5,675) |
| (Decrease) in cash | $(7,219) | $(5,067) |

Cash from operating activities for the three months ended March 31, 2007 decreased by $1.8 million to an outflow of $1.0 million compared to cash inflow of $0.8 million for the same period in 2006. This decrease was primarily due to increased use in non-cash operating working capital of $2.6 million partially offset by improved EBITDA of $0.8 million after taking into account the salary component of the Heath acquisition of $0.2 million.

Cash outflow from investing activities for the three months ended March 31, 2007 remained unchanged at $0.1 million compared to the same period in 2006. This consisted of capital assets expenditures of $0.1 million during each quarter.

Cash outflows from financing activities for the three months ended March 31, 2007 increased by $0.4 million to $6.1 million compared to cash outflows of $5.7 million for the same period in 2006. The increase was attributed to the 2006 special one-time cash distribution of $0.3 million and the additional cash distribution of $0.1 million related to Units issued as part of the Heath acquisition paid in the first quarter of 2007.

### *Capital Expenditures*

Pension and benefits consulting and outsourcing is not a capital intensive business. Our capital expenditures typically include office furniture, facility improvements, and information technology software and hardware. Additional capital expenditure requirements may result from significant business expansion. Such amounts are expected to be funded from our operating cash flow.

***Contractual Obligations***

We lease office space and selected equipment under operating lease agreements with terms ranging from one to seven years. We also have a term loan described under "Capital Resources". Future expected payments are as follows:

**Summary of Contractual Obligations**

| | Total | 2007 to 2009 | 2010 to 2011 | Beyond 2011 |
|---|---|---|---|---|
| | (In thousands of dollars) | | | |
| Term loan | $35,000 | $35,000 | $ — | $ — |
| Operating leases | 21,108 | 12,250 | 5,832 | 3,026 |
| Total | $56,108 | $47,250 | $5,832 | $3,026 |

In addition, the Fund has entered into a sublease agreement to sublet one of Heath's office premises. According to the agreement, the Fund is liable for the rent in case of a default by the subtenant. The average annual rent for the lease is $190 thousand and the lease expires on October 30, 2011.

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

***Capital Resources***

The following table provides an overview of the Fund's capital resources:

**Capital Resources**

| | As at March 31, 2007 | As at December 31, 2006 |
|---|---|---|
| | (In thousands of dollars) | |
| Cash | $ — | $ 5,257 |
| Bank Indebtedness | 1,962 | — |
| Working capital | 21,089 | 19,652 |
| Long-term debt, net of unamortized debt issue cost | 34,876 | 35,000 |
| Unitholders' equity | 192,010 | 194,399 |

We have historically utilized cash from operations to finance working capital requirements and fund growth. As at

March 31, 2007, the Fund's working capital (current assets minus current liabilities) was approximately $21.1 million.

We have also maintained credit facilities to manage working capital requirements throughout the year. The Fund's credit facilities include a secured term loan of $35 million repayable in full on September 30, 2009. The term loan bears interest at bankers' acceptance rates plus 1%, which have been fixed at 4.4% using an interest-rate swap. This secured term loan requires the Fund to maintain certain financial covenants on a consolidated basis as follows:

(i) Ratio of Debt to EBITDA not to exceed 2.5 to 1.0

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

The Fund complied with all the required financial covenants and the ratios at March 31, 2007 were 1.2 and 27.0 respectively.

The credit facilities also include a secured operating line of credit of up to $15 million bearing interest at bankers' acceptance rates plus 1% and a standby fee of 0.2% on the undrawn portion. As at March 31, 2007, the Fund had drawn $2.0 million from the secured operating line of credit. This represents the remaining debt from the Heath acquisition of $5.1 million which we have been managing through excess operating cash.

## SELECTED BALANCE SHEET DATA

The following table provides an overview of the Fund's selected balance sheet data:

**Selected Balance Sheet Data**

| | As at March 31, 2007 | As at December 31, 2006 |
|---|---|---|
| | (in thousands of dollars) | |
| Current assets | $ 32,471 | $ 35,338 |
| Other long-term assets | 260,858 | 265,208 |
| Current liabilities | 11,382 | 15,686 |

***Current Assets***

Current assets as at March 31, 2007 decreased by $2.8 million to $32.5 million from $35.3 million as at December 31, 2006. The decrease was primarily due to decreased cash of

$5.2 million as a result of the payment of our annual bonuses and decreased Income tax recoverable and Prepaid expenses of $1.0 million. This was partially offset by increased Accounts receivables and unbilled fees of $3.4 million.

### *Other Long-Term Assets*

Other long-term assets as at March 31, 2007 decreased by $4.4 million to $260.8 million from $265.2 million as at December 31, 2006. The decrease was as a result of the amortization expense of $4.3 million offset by capital asset expenditures of $0.1 million.

### *Current Liabilities*

Current liabilities as at March 31, 2007 decreased by $4.3 million to $11.4 million from $15.7 million as at December 31, 2006. The decrease was primarily due to decreased Accounts payable and accrued liabilities of $0.8 million due to the timing of suppliers' payments, decreased Accrued compensation and related benefits of $5.3 million due to of the payment of annual bonuses in the first quarter of 2007 and decreased Unitholder distributions of $0.2 million due to the payment of the 2006 special one-time cash distribution which represented the incremental taxable income arising from the Fund's strong financial performance in 2006. This was partially offset by Bank indebtedness of $2.0 million as at March 31, 2007.

## 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 the Fund's 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. 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, included with accounts payable and accrued liabilities, 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.

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.

### *Amortization of Finite-Life Intangible Assets*

Intangible assets consist of customer relationships, proprietary software and customer contracts. These finite-life intangible assets are being amortized over their estimated useful lives of 15 to 20, 5 and 3 years respectively. Impairment is assessed annually, or when events or changes in circumstances indicate the carrying amount of assets may not be recoverable.

Goodwill is not amortized and is subject to an impairment test at least annually or when it is more likely than not that the carrying amount of the Fund's net assets exceeds its fair value. Goodwill impairment is assessed based on a comparison of the fair value of the Fund and its net assets including goodwill.

### *Allowance for Doubtful Accounts*

A provision for accounts receivable resulting from the potential risk that the 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 the financial position of the Fund.

### *Future Income Taxes*

We use the asset and liability method of accounting for income taxes. Future income tax assets are recognized only to the extent that we determine it is more likely than not that the future income tax assets will be realized.

### *Financial Instruments*

Effective January 1, 2007, the Fund adopted the new recommendations of the Canadian Institute of Chartered Accountants (CICA) Handbook Section 1530, Comprehensive Income; Section 3855, Financial Instruments – Recognition and Measurement; and, Section 3865, Hedges, retroactively without restatement. These new Handbook Sections provide requirements for the recognition and measurement of financial instruments and the use of hedge accounting. Section 1530 establishes standards for reporting and presenting comprehensive income, which is defined as the change in equity from transactions and other events from non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with generally accepted accounting principles.

Under Section 3855, financial instruments must be classified into one of these five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net income; and financial assets held-to-maturity, loan and receivables and other financial liabilities are measured at amortized cost using the effective interest method of amortization. Transaction costs are expensed as incurred for financial instruments classified or designated as held–for-trading. For other financial instruments, transaction costs are capitalized on initial recognition.

Upon adoption of these new standards, the Fund designated its cash and short-term investments as held-for-trading, which are measured at fair value. Accounts receivable is classified as loans and receivables, which are measured at amortized cost. Bank indebtedness, Accounts payable and accrued liabilities, Accrued compensation and related benefits, Unitholder distributions payable and Long-term debt, are classified as other financial liabilities. The Fund had neither available for sale, nor held-to-maturity instruments during the three months ended March 31, 2007.

Interest-rate swap agreements are used as part of the Fund's program to manage the fixed and floating interest rate mix of the Fund's total debt outstanding and related overall cost of borrowing. The interest-rate swap agreements involve the periodic exchange of payments without the exchange of the notional principal amount upon which the payments are based. The interest-rate swap agreements are classified as held-for-trading and are recorded at their fair value with a corresponding adjustment to interest expense.

The adoption of these Handbook Sections had no impact on opening deficit. The Fund had no "other comprehensive income or loss" transactions during the three months ended March 31, 2007 and no opening or closing balances for accumulated other comprehensive income or loss.

The carrying value of the financial instruments approximates their fair values due to their short-term nature with the exception of the interest-rate swap agreements in place on the term loan, which have been recorded at the current market rate.

We are not engaged in currency hedging activities and do not own other instruments that may be settled by the delivery of non-financial assets. We realize a portion of our sales in U.S. dollars and are thus exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar. The net revenue exposure after accounting for related expenses denominated in U.S. dollars was approximately US$0.9 million for the three months ended March 31, 2007.

In our normal course of business, we are exposed to credit risk from our clients. Risk associated with concentrations of credit risk with respect to Accounts receivables are limited due to the credit rating of our top 10 clients. We have over 1,000 clients with no client consisting of greater than 1% of total revenue with the exception of our top ten clients.

In our view, we are not exposed to significant interest, currency or credit risks arising from financial instruments.

## RISKS AND UNCERTAINTIES

The results of operations, business prospects and financial condition of the Fund are 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 Sobeco*

#### *Ability to Maintain Profitability and Manage Growth*

There can be no assurance that Morneau Sobeco will be able to sustain profitability in future periods. Morneau Sobeco'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 Sobeco 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 Sobeco's strategic plan could have a material adverse effect on its business, financial condition and operating results, and the ability of the Fund to make distributions on the Units.

There can be no assurance that Morneau Sobeco will be able to effectively manage its growth, and any failure to do so could have a material adverse effect on the firm's and the Fund's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

#### *Reliance on Information Systems and Technology*

Information systems are an integral part of Morneau Sobeco's business and the products and services offered to its clients.

Morneau Sobeco 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. Morneau Sobeco relies on the Internet as a key mechanism for delivering services to clients and achieving efficiencies in its service model. The Internet has experienced, and is expected to continue to experience, significant growth in the number of users and volume of traffic. As a result, its performance and reliability may decline. In order to maintain the level of security, service and reliability that clients require, Morneau Sobeco may be required to make significant investments in the online means of delivering consulting and outsourcing services. In addition, Web sites and proprietary online services have experienced service interruptions and other delays. If these outages or delays occur frequently in the future, Internet usage as a medium of exchange of information could decline and the Internet might not adequately support the firm's Web-based tools. 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 Sobeco's services.

Any disruptions in Morneau Sobeco'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 Sobeco, all of which could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

***Reputational Risk***

Morneau Sobeco depends, to a large extent, on its relationships with its clients and its reputation for high-quality outsourcing and consulting services. As a result, the impact of a client not being satisfied with Morneau Sobeco's services or products may be more damaging in Morneau Sobeco's business than in other businesses. Moreover, if the firm fails to meet its contractual obligations, Morneau Sobeco could be subject to legal liability and a loss of client relationships.

***Dependence on Key Clients***

For the quarter ended March 31, 2007, Morneau Sobeco's largest client accounted for approximately 10% of revenue (quarter ended March 31, 2006 – 11%) and its top 10 clients, in the aggregate, accounted for approximately 33% of revenue (quarter ended March 31, 2006 – 34%). As clients may terminate engagements with minimal notice, there can be no assurance that Morneau Sobeco will be able to retain relationships with its largest clients. Moreover, there can be no assurance that such clients will continue to use Morneau Sobeco's services in the future. Any negative change involving any of Morneau Sobeco'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 Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

***Risk of Future Legal Proceedings***

Morneau Sobeco 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. Morneau Sobeco's business 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:

(i) a client's assertion that actuarial assumptions used in a pension plan were unreasonable, leading to plan underfunding;

(ii) a claim that inaccurate data was used, which could lead to an underestimation of plan liabilities; or

(iii) a claim that employee benefits plan documents were misinterpreted or plan amendments were misstated in plan documents, which could lead to overpayments to beneficiaries.

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 hurt Morneau Sobeco's reputation and business. A significant judgment against Morneau Sobeco, or the imposition of a significant fine or penalty as a result of a finding that Morneau Sobeco failed to comply with laws or regulations, could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

***Reliance on Key Professionals***

Morneau Sobeco's operations are dependent on the abilities, experiences and efforts of its professionals, many of whom have excellent reputations and a significant number of contacts in the industry in which Morneau Sobeco operates. Morneau Sobeco's business depends, in part, on its professionals' ability to develop and maintain alliances with businesses such as brokerage firms, financial services companies, healthcare organizations, insurance companies, business process outsourcing organizations and other companies, in order to develop, market and deliver its services. If Morneau Sobeco's strategic alliances are discontinued due to the loss of professional staff or if the firm has difficulty developing new alliances, profitability could be negatively impacted. Should any member of its professional staff be unable or unwilling to continue his or her relationship with Morneau Sobeco, this change could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

***Competition***

Morneau Sobeco operates in a highly competitive North American market. As a result, Morneau Sobeco 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 Sobeco competes. In addition, some of Morneau Sobeco's competitors have substantially more financial resources and/or financial flexibility than Morneau Sobeco. Competitive forces could result in reduced market share and thus have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

***Legislative and Regulatory Changes***

The business of pension and benefits consulting and outsourcing is highly regulated and laws are constantly evolving. Any changes to laws, rules, regulations or policies could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

### *Changes in Business Conditions*

Morneau Sobeco's future success depends, in part, on its ability to develop and implement technology solutions that anticipate and keep pace with rapid and continuing changes in technology, industry standards and client preferences. The firm may not be successful in anticipating or responding to these developments on a timely basis and its ideas may not be accepted in the marketplace. The effort to gain technological expertise and develop new technologies in its business requires Morneau Sobeco to incur significant expenses. If Morneau Sobeco cannot offer new technologies as quickly as its competitors, or if the competition develops more cost-effective technologies, Morneau Sobeco could lose market share. Also, products and technologies developed by Morneau Sobeco's competitors may make the firm's service or product offerings non-competitive or obsolete. Any one of these circumstances could have a material adverse effect on Morneau Sobeco's ability to obtain and fulfill important client engagements, and thus could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

### *Timely Completion of Projects and Performance of Obligations*

In its contracts with clients, Morneau Sobeco is sometimes committed to complete a project by a scheduled date. If the project is not completed by the scheduled date, Morneau Sobeco may either incur significant additional costs or be held responsible for the costs incurred by the client to rectify damages due to the late completion. Morneau Sobeco's success depends in large part on whether it fulfills these and other contractual obligations with clients and maintains client satisfaction. If Morneau Sobeco fails to satisfactorily perform its contractual obligations, its clients could terminate contracts and/or take legal action against Morneau Sobeco. Such occurrences could result in a loss of its professional reputation and extra costs needed to defend or rectify the situation and thus have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

### *Implications of Fixed-Price Contracts*

A portion of Morneau Sobeco's revenue comes from fixed-price contracts. A fixed-price contract requires Morneau Sobeco to perform either all or a specified portion of work under the contract for a fixed price. Fixed-price contracts expose Morneau Sobeco 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 Sobeco, failures of subcontractors to perform, and economic or other changes that may occur during the contract period. Increasing use of fixed-price contracts and/or increasing the size of such contracts would increase Morneau Sobeco's exposure to these risks. Losses under fixed-price contracts could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

***Interest Rate Fluctuations***

Morneau Sobeco may be exposed to fluctuations in interest rates under its borrowings. Increases in interest rates may have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

***Protection of Intellectual Property***

Morneau Sobeco continually develops and improves its proprietary technology solutions for clients. No assurance can be given that Morneau Sobeco's competitors will not develop substantially similar technology. Morneau Sobeco relies on one or more of the following to protect its proprietary rights: trademarks, copyrights, trade secrets, confidentiality procedures and contractual provisions. Despite Morneau Sobeco's efforts to protect its proprietary rights, unauthorized parties may attempt to obtain and use information that Morneau Sobeco regards as proprietary. Stopping unauthorized use of Morneau Sobeco's proprietary rights may be difficult, time-consuming and costly. There can be no assurance that Morneau Sobeco will be successful in protecting its proprietary rights and, if it is not, this could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

***Rising Insurance Costs***

The cost of maintaining professional errors and omissions insurance as well as director and officer liability insurance is significant. Morneau Sobeco could experience higher insurance premiums as a result of adverse claims experience or because of general increases in premiums by insurance carriers for reasons unrelated to its own claims experience. Generally, Morneau Sobeco's insurance policies must be renewed annually. Its ability to continue to obtain insurance at affordable premiums depends upon its ability to continue to operate with an acceptable claims record. A significant increase in the number of claims, the existence of one or more claims in excess of its policy limits or the inability to obtain adequate insurance coverage at acceptable rates, or at all, could have a material adverse effect on Morneau Sobeco's business, financial condition and operating results, and on the ability of the Fund to make distributions on the Units.

## *Risk Related to the Structure of the Fund*

### *Income Tax Matters*

There can be no assurance that Canadian federal income tax laws and administrative policies respecting the treatment of mutual fund trusts will not be changed in a manner which may adversely affect the Unitholders.

The Fund Declaration of Trust provides that a sufficient amount of the Fund's net income and net realized capital gains shall be distributed each year to Unitholders in order to eliminate the Fund's liability for tax under Part 1 of the *Income Tax Act (Canada)*. Where such amount of net income and net realized capital gains of the Fund in a taxation year exceeds the cash available for distribution in the year, such excess net income and net realized capital gains will be distributed to Unitholders in the form of additional Units. Unitholders are generally required to include an amount equal to the fair market value of those Units in their taxable income, in circumstances when they do not directly receive a cash distribution.

On October 31, 2006, the Department of Finance (Canada) announced the "Tax Fairness Plan" whereby the income tax rules applicable to publicly traded trusts and partnerships will be significantly modified. In particular, certain income of (and distributions made by) these entities will be taxed in a manner similar to income earned by (and distributions made by) a corporation. These proposals will be effective for the 2007 taxation year with respect to trusts which commence public trading after October 31, 2006, but the application of the rules will be delayed to the 2011 taxation year with respect to trusts which were publicly traded prior to November 1, 2006 (although the announcement suggested that this transitional relief could be lost under certain circumstances, including the "undue expansion" of an income trust). On December 21, 2006, the Department of Finance (Canada) issued for public comment the draft legislation to implement these proposals.

On December 15, 2006, the Department of Finance (Canada) released guidance for income trusts and other flow-through entities that qualify for the four-year transitional relief. The guidance establishes objective tests with respect to how much an income trust is permitted to grow without jeopardizing its transitional relief. In general, the Fund will be permitted to issue new equity over the next four years equal to its market capitalization as of the end of trading on October 31, 2006 (subject to certain annual limits). Market capitalization, for these purposes, is to be measured in terms of the value of the Fund's issued and outstanding publicly traded units. If these limits are exceeded, the Fund may lose its transitional relief and thereby become immediately subject to the proposed rules.

On March 29, 2007, the Ministry introduced Bill C-52 in the House of Commons to implement these proposals. Currently, the Fund is only taxable on amounts that are not distributed to Unitholders. If enacted in its current form, the proposed legislation will result in a change in which certain earnings of the Fund will be subject to income tax regardless of whether amounts are distributed to the Unitholders or not. There is no assurance that the draft legislation will be enacted in the manner proposed or at all.

The Fund is considering these announcements and the possible impact of the proposed rules to the Fund. The impact of the proposed rules may adversely affect the marketability of the Fund's Units and the ability of the Fund to undertake financings and acquisitions, and, at such time as the proposed rules apply to the Fund, the distributable cash of the Fund may be materially reduced.

***Dependence on Morneau Sobeco Group LP and Its Subsidiaries***

The Fund is an unincorporated open-ended, limited purpose trust that is entirely dependent on the operations and assets of the Trust. Cash distributions to Unitholders will be dependent on, among other things, the ability of the Trust to pay interest on the Trust Notes and to make cash distributions in respect of the Trust Units, which, in turn, are dependent on MS Group LP making cash distributions. MS Group LP's ability to make cash distributions is dependent on the ability of its subsidiaries to make cash distributions or other payments or advances. This will be subject to applicable laws and regulations and contractual restrictions contained in the instruments governing any indebtedness of those entities, including restrictive covenants in the credit facilities.

### *Cash Distributions Are Not Guaranteed and Will Fluctuate With the Business Performance*

Although the Fund intends to distribute the interest received in respect of the Trust Notes and the cash distributions received in respect of the Trust Units, less expenses and amounts, if any, paid by the Fund in connection with the redemption of Units, there can be no assurance regarding the amounts of income to be generated by MS Group LP's businesses or ultimately distributed to the Fund. The ability of the Fund to make cash distributions, and the actual amount distributed, will be entirely dependent on the operations and assets of MS Group LP (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. The market value of the Units may deteriorate if the Fund is unable to meet its distribution targets in the future, and that deterioration may be significant. In addition, the composition of cash distributions for tax purposes may change over time and may affect the after-tax return for investors.

### *Restrictions on Potential Growth*

The payout by Morneau Sobeco of substantially all of its operating cash flow will make additional capital and operating expenditures dependent on increased cash flow or additional financing in the future. Lack of those funds could limit the future growth of Morneau Sobeco and its cash flow.

### *Nature of Units*

The Units share certain attributes common to both equity securities and debt instruments. The Units do not represent a direct investment in the businesses of Morneau Sobeco and should not be viewed by investors as direct securities of MS Corp or its subsidiaries. As holders of Units, Unitholders will not have the statutory rights normally associated with ownership of shares of a corporation including, for example, the right to bring "oppression" or "derivative" actions or rights of dissent. The Units represent a fractional interest in the Fund. The Fund's primary assets are Trust Units and Trust Notes.

The Units are not "deposits" within the meaning of the *Canada Deposit Insurance Corporations Act (Canada)* and are not insured under the provisions of that Act or any other legislation. Furthermore, the Fund is not a trust company and, accordingly, is not registered under any trust and loan company legislation as it does not carry on or intend to carry on the business of a trust company.

***Market Price of Units***

Publicly traded investment trusts such as the Fund do not necessarily trade at prices determined solely by reference to the underlying value of their investments. Increases in market rates of interest may lead purchasers to demand a higher yield on the Units, which may adversely affect their price. In addition, the market price for the Units may be affected by changes in general market conditions, fluctuations in the markets for equity securities and other factors beyond the Fund's control.

The market value of the Units may deteriorate if the Fund is unable to meet its distribution targets in the future, and that deterioration may be material. In addition, the composition of cash distributions for tax purposes may change over time and may affect the after-tax return for investors.

***Leverage and Restrictive Covenants in Agreements Relating to Indebtedness of Morneau Sobeco***

The ability of the Trust and its subsidiaries to make distributions 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 MS Group LP or Morneau Sobeco is leveraged could have important consequences to the Unitholders including: Morneau Sobeco's ability to obtain additional financing for working capital, capital expenditures or acquisitions in the future may be limited; a significant portion of Morneau Sobeco'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 interests, which exposes Morneau Sobeco to the risk of increased interest rates; and, Morneau Sobeco 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.

### *Distribution of Securities on Redemption or Termination of the Fund*

It is anticipated that the redemption right will not be the primary mechanism for Unitholders to liquidate their investments. Upon redemption of Units or termination of the Fund, the Trustees may distribute the Trust Notes and Trust Units directly to the Unitholders, subject to obtaining all required regulatory approvals. Trust Units and Trust Notes so distributed may not be qualified investments for registered plans[1] depending upon the circumstances at the time. There is currently no market for the Trust Notes and the Trust Units.

### *Dilution of Existing Unitholders and MS Group LP Unitholders*

The Fund Declaration of Trust authorizes the Fund to issue an unlimited number of Units for that consideration and on those terms and conditions as shall be established by the Trustees without the approval of any Unitholders. The Unitholders will have no pre-emptive rights in connection with such further issues. Additional Units will be issued by the Fund in connection with the indirect exchange of the Class B MS Group LP Units. In addition, MS Group LP is permitted to issue additional MS Group LP Units for any consideration and on any terms and conditions.

### *Future Sales of Units by the Management Securityholders*

The Management Securityholders hold all of the Class B LP Units, representing in aggregate 20.6% of the outstanding MS Group LP Units, which, pursuant to the Exchange Agreement, can be exchanged for Units at any time, subject to certain conditions. Certain of the Management Securityholders have also been granted certain registration rights by the Fund. If the Management Securityholders sell a substantial number of Units in the public market, the market price of the Units could fall. The perception among the public that these sales will occur could also contribute to a decline in the market price of the Units.

### *Restrictions on Certain Unitholders and Liquidity of Units*

The Fund Declaration of Trust imposes various restrictions on Unitholders. Non-resident Unitholders are prohibited from beneficially owning either more than 40% of Units and/or the

[1] Trusts governed by registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and registered education savings plans, each as defined in the *Income Tax Act (Canada)*.

Special Voting Units (on non-diluted and fully diluted base). These restrictions may limit (or inhibit the exercise of) the rights of certain persons, including non-residents of Canada and U.S. persons, to acquire Units, to exercise their rights as Unitholders and to initiate and complete takeover bids in respect of the Units. As a result, these restrictions may limit the demand for Units from certain Unitholders and thereby adversely affect the liquidity and market value of the Units held by the public.

### *Statutory Remedies*

The Fund is not a legally recognized entity within the relevant definitions of the *Bankruptcy and Insolvency Act*, the *Companies' Creditors Arrangement Act* and in some cases, the *Winding- up and Restructuring Act*. As a result, in the event that a restructuring of the Fund is necessary, the Fund and its stakeholders may not be able to access the remedies and procedures available thereunder.

## 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

| | Three months ended | | | | | |
|---|---|---|---|---|---|---|
| | March 31 2007 | December 31 2006 | September 30 2006 | June 30 2006 | March 31 2006 | December 31 2005 |
| | (in thousands of dollars except per unit amounts) | | | | | |
| Revenue | $ 36,091 | $ 34,079 | $ 33,037 | $ 32,793 | $ 32,178 | $ 30,071 |
| Net Income | 2,268 | 2,449 | 1,798 | 3,355 | 2,158 | 2,099 |
| EBITDA | 7,865 | 7,890 | 7,053 | 7,672 | 7,228 | 7,146 |
| EBITDA Margin | 21.8% | 23.2% | 21.3% | 23.4% | 22.5% | 23.8% |
| Distributable Income | 7,439 | 6,977 | 6,753 | 6,830 | 6,566 | 6,543 |
| Distributable Cash(1) | (1,168) | 9,080 | 10,988 | 9,039 | 608 | 6,287 |
| Distributions declared | 5,865 | 6,050 | 5,731 | 5,688 | 5,666 | 5,729 |
| Net income per Unit (basic and diluted) | $ 0.10279 | $0.11100 | $0.08148 | $0.15245 | $0.09821 | $0.09553 |
| Distributable Income per Unit (basic and diluted) | $ 0.26774 | $0.25111 | $0.24305 | $0.24769 | $0.23902 | $0.23817 |
| Distributable Cash per Unit (basic and diluted) | $(0.04204) | $0.32680 | $0.39559 | $0.32777 | $0.02212 | $0.22886 |
| Distributions declared per Unit (basic and diluted) | $ 0.21106 | $0.21775 | $0.20625 | $0.20625 | $0.20625 | $0.20854 |
| Distributable Income Payout Ratio | 78.8% | 86.7% | 84.9% | 83.3% | 86.3% | 87.6% |
| Distributable Cash Payout Ratio(1) | (502.1)% | 66.6% | 52.1% | 63.0% | 932.0% | 91.1% |
| Twelve-month rolling Distributable Income Payout Ratio | 83.3% | 85.3% | 85.5% | n/a | n/a | n/a |
| Twelve-month rolling Distributable Cash Payout Ratio | 83.5% | 77.9% | 85.2% | n/a | n/a | n/a |
| Total Assets | $ 293,329 | $300,546 | $299,723 | $307,188 | $297,753 | $303,718 |
| Total Long-term debt | $ 34,876 | $ 35,000 | $ 35,000 | $ 35,000 | $ 35,000 | $ 35,000 |

(1) Distributable Cash has been restated for the quarters ended March 31, 2006 and June 30, 2006 to include changes in non-cash operating working capital. The Distributable Cash for the three months ended March 31, 2007 and 2006 are significantly lower than the Distributions declared as the company pays its employees their annual bonuses in the first quarter of each year.

## DISCLOSURE CONTROLS AND PROCEDURES

The Fund's 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 operating effectively based on the evaluation of these controls and procedures conducted at March 31, 2007.

## ADDITIONAL INFORMATION

The Fund's Units trade on the Toronto Stock Exchange under the symbol MSI.UN. Additional information relating to the Fund, including all public filings, is available on the SEDAR Web site (*www.sedar.com*) and on our own Web site at *www.morneausobeco.com*.

The content of this MD&A reflects information known as of May 15, 2007.

Human Resource Consulting and Administrative Solutions

*Morneau Sobeco is an industry leader in helping organizations deliver their human resource programs. For more than four decades, we have teamed up with North American companies to help them conceive and implement effective business solutions. The size and diversity of our client base gives our consultants a unique, forward-looking perspective on all compensation, retirement, and employee benefits issues.*

INFO@MORNEAUSOBECO.COM

WWW.MORNEAUSOBECO.COM