MORNEAU SHEPELL

2017 Annual Report

Improving business. Improving lives.

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Chair's Message to Shareholders

On behalf of the Board of Directors, I want to extend my appreciation to all our employees for delivering yet another good year for Morneau Shepell. The year 2017 involved a transition to our new CEO, Stephen Liptrap, under whose leadership the Company evolved its strategy for taking the business forward. The Board supports the Company's direction and especially its renewed emphasis on continuing to deliver solid business results while pursuing growth entrepreneurially in a dynamic HR sector.

Entrepreneurial innovation has long been a Company strength going back to its inception in 1966 and the visionary leadership of our Founder, Frank Morneau. Frank retires this year from the Board at the Annual Meeting of Shareholders in May, most recently serving as its Honorary Chair since 2008. As a distinguished businessman, community leader, and active supporter of many charitable causes, Frank has been a driving force in the Company's growth into the strong competitor we are today.

When Frank started the company in 1966 as an actuarial and benefits consulting firm, he initially focused on innovative marketing strategies to build a client base in an under-served market segment: trade and industry associations. Over several decades, Frank has been involved as CEO or board member as the Company grew organically and made many strategic acquisitions including Sobeco and Shepell.fgi and Bensinger DuPont and Associates. From the Company's strong base and from its strategic acquisitions Morneau Shepell has emerged as a North American leader in the human resource sector, with a growing worldwide presence – a Canadian company of which we can all be proud.

On behalf of the Board and the entire Company, I want to thank Frank for everything he has done to build Morneau Shepell over the last 52 years. I would like to personally thank Frank for his support and guidance when I joined the Board and now in my role as Chair. We all wish Frank continued good health, happiness and plenty of time to enjoy his family and his pursuits as he looks to the future.

In closing, on behalf of the Board, I'd like to thank our shareholders, clients, employees and partners for their support in 2017.

Gillian (Jill) Denham
Chair

President and CEO's Message

Strategic renewal while delivering solid growth in 2017

2017 was a year of solid growth that met our expectations and delivered strong shareholder returns. We were pleased with our organic revenue and EBITDA growth. Over the past year, we also completed a review of our strategy and chose the focus areas in our business that will drive our success for many years to come.

Revenues reached $631.2 million, increasing $39.1 million or 6.6 per cent compared to the previous year. Adjusted EBIDTA increased 7.6 per cent to $120.8 million while Adjusted EBITDA margins were marginally higher at 19.1 per cent compared to 19.0 per cent last year.

The strength of our 2017 performance derives from solid performance in our four core businesses, an acceleration of our U.S. expansion strategy, the addition of new innovative products and the successful integration of four tuck-in acquisitions.

As we move forward into 2018, we do so with the confidence that Morneau Shepell is well positioned strategically, operationally and financially to continue to deliver profitable growth that meets or exceeds historical levels of performance.

2017 highlights: delivering today, ready for tomorrow

In addition to solid performance in 2017, our teams completed a comprehensive review of our corporate strategy that resulted in an updated plan for the next planning horizon. This revised strategic plan reflects our evolving perspective on how best to drive sustainable, profitable growth in a dynamic, increasingly globalized HR sector. Our strategy has five key elements:

- *Drive the successful execution of our core businesses* – building on our client base, strong talent, and innovation within our Administration, Employee Support Solutions (ESS), Absence Management and Consulting businesses.
- *Accelerate growth through U.S. expansion* – focusing on high-potential markets in the public and private sector for Defined Benefits plans, ESS, and Health and Welfare programs.
- *Deploy new technology solutions to address macro trends* – in areas such as predictive analytics, digitally-based CBT solutions as well as leveraging artificial intelligence and machine learning.
- *Collaborate across our Lines of Business to increase client value and drive growth* – ensuring we maximize our deep portfolio of solutions to create great client experiences.
- *Transform how we do business and achieve best-in-class efficiency* – to simplify how we operate, improve margins and continually improve our scalability.

Operationally, our 2017 highlights include:

Our client satisfaction levels for the Company continued to be very positive, where greater than eight out of 10 clients were very satisfied with Morneau Shepell. Our annual employee engagement survey also confirmed that our people are productively engaged in the business. We believe high client and employee satisfaction levels are important success factors in driving our business forward.

Last year, we had major client wins in the U.S. in our Administration and ESS lines of business, confirming that our growth in that important market is based on sound fundamentals.

Also during the year, we closed two and integrated four tuck-in acquisitions, including Pro Health Group, a health and wellness services company based in Quebec, and Chestnut Global Partners, a U.S.-based international EAP provider. We completed these acquisitions with available funds from operations.

In 2017, we continued to explore new growth opportunities beyond our existing core businesses. We launched a new business concept in 70 North American universities to provide international students with mental health services using phone and online chat. More recently, we began client testing a new mobile application – based on a Siri-like interface – that provides users with automated answers to their inquiries. Going forward, we see other opportunities to leverage digital competencies to transform core services and provide entirely new services in new markets

During the year, we continued to add talent to strengthen our Company with a focus on our Consulting business, ensuring we have the expertise to deliver on our strategy and maintain our competitive edge.

Community engagement has long been central to our brand and values. In 2017, we were pleased to partner with the Centre for Addiction and Mental Health (CAMH) in a joint effort to support "150 Leading Canadians for Mental Health." This national program celebrates Canadians who have changed the course of mental illness. We also continue to be the mental health partner for the Canadian Olympic Committee, supporting athletes, coaches and their families.

Looking ahead with confidence

As the scale of the Company continues to increase, along with a diversification in our geographic market and product scope, we believe we have the right strategic plan to guide us over the next few years and deliver results for all stakeholders.

In closing, I would like to acknowledge the vision, creativity and business acumen of Founder Frank Morneau, who, in 2018, has decided to retire from our Board of Directors after 52 years of distinguished service. I want to sincerely thank Frank for his guidance and support over the years and especially during my transition to CEO.

On behalf of the Company's leadership team, I would like to extend my appreciation to all the people who make this company successful – our employees, clients, business partners, Board of Directors and investors.

Stephen Liptrap
President and CEO

Management's Discussion and Analysis

Morneau Shepell Inc. ("Morneau Shepell" or the "Company") was incorporated pursuant to the laws of the Province of Ontario on October 19, 2010, and as of January 1, 2011, is the successor of Morneau Sobeco Income Fund (the "Fund").

This Management's Discussion and Analysis ("MD&A") covers the year ended December 31, 2017 and should be read in conjunction with the consolidated financial statements of Morneau Shepell and notes thereto for the years ended December 31, 2017 and 2016. Unless otherwise noted, all financial information presented has been rounded to the nearest thousand.

All financial information is presented in Canadian dollars and in accordance with International Financial Reporting Standards ("IFRS"), 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. They are based on certain factors and assumptions, including expected growth, results of operations, business prospects and opportunities. Use of words such as "may", "will", "expect", "believe", or other words of similar effect may indicate a "forward-looking" statement. These statements are not guarantees of future performance and are subject to numerous risks and uncertainties, including those described in our publicly filed documents (available on SEDAR at www.sedar.com) and in this MD&A under the heading "Risks and Uncertainties". Those risks and uncertainties include the ability to maintain profitability and manage growth, ability to pay dividends, reliance on information systems and technology, reputational risk, dependence on key clients, reliance on key professionals, and general economic conditions. Many of these risks and uncertainties can affect our actual results and could cause our actual results to differ materially from those expressed or implied in any forward-looking statement made by us or on our behalf. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. All forward-looking statements in this MD&A are qualified by these cautionary statements. These statements are made as of the date of this MD&A and, except as required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise. Additionally, we undertake no obligation to comment on analyses, expectations or statements made by third parties in respect of us, our financial or operating results or our securities.

To assist investors in assessing our financial performance, this discussion also makes reference to certain non-IFRS measures such as EBITDA, adjusted EBITDA, EBITDA margin, adjusted EBITDA margin, Free Cash Flow, Normalized Free Cash Flow, twelve-month rolling Normalized Payout Ratio, and twelve-month rolling Normalized Payout Ratio including changes in adjusted non-cash operating working capital. EBITDA and adjusted EBITDA are intended to represent an indication of Morneau Shepell's capacity to generate profit from operations before taking into account management's financing decisions and costs of consuming intangible and tangible capital assets, which vary according to their vintage, technological currency, and management's estimate of their useful life. Accordingly, EBITDA comprises profit before finance costs, income tax expenses, depreciation and amortization, while Adjusted EBITDA represents EBITDA before taking into account certain unusual expenditures. EBITDA margin represents EBITDA as a percentage of revenue, and Adjusted EBITDA margin represents Adjusted EBITDA as a percentage of revenue. We believe both EBITDA and Adjusted EBITDA are useful measures in evaluating our performance and we utilize them to monitor compliance with debt covenants. We also believe that Free Cash Flow, Normalized Free Cash Flow, the twelve-month rolling Normalized Payout Ratio, and the twelve-month rolling Normalized Payout Ratio including changes in adjusted non-cash operating working capital, are useful supplemental measures of Morneau Shepell's ability to generate cash after deducting capital expenditures required to maintain or expand the business. We also utilize them to make decisions related to dividends to shareholders. Free Cash Flow is defined as cash provided by operating activities adjusted for capital expenditures. Normalized Free Cash Flow is defined as cash provided by operating activities, adjusted for changes in non-cash

operating working capital, capital expenditures, current income taxes (net of income taxes paid) and certain unusual expenditures. These ratios, however, are non-IFRS measures and therefore, should not be seen as a substitute for cash flow from operating activities.

Non-IFRS measures do not have any standard meaning prescribed by IFRS and therefore may not be comparable to similar measures presented by other issuers. Non-IFRS measures are reconciled to IFRS measures elsewhere in this MD&A.

Outstanding Share Data

The Company is authorized to issue an unlimited number of common shares and 10 million preferred shares. Each common share entitles the holder to one vote at all meetings of shareholders and represents an interest in dividends declared by the Company and an undivided interest in the net assets of the Company. As at March 7, 2018, Morneau Shepell had 53,853,225 common shares, nil preferred shares and $86.0 million aggregate principal amount of 4.75% convertible debentures outstanding. In the event all of the outstanding 4.75% convertible debentures are converted into common shares of the Company by the holders prior to their maturity date, the total number of common shares issuable will be approximately 3,400,000. The number of long-term incentive plan ("LTIP") units, including those that remain unvested, that are outstanding and may be converted to common shares is approximately 2,600,000.

Business Overview

Morneau Shepell is the largest Canadian firm providing health and productivity, administrative and retirement solutions. We deliver solutions to assist employers in managing the financial security, health and productivity of their employees. With approximately 4,000 employees in offices across North America, we offer services to approximately 20,000 organizations in Canada, the United States and around the globe directly and through our distribution channel partners.

We derive our revenue primarily from fees charged to clients for consulting engagements, administrative solutions engagements, employee and family assistance programs, and absence management services.

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

Our Administrative Solutions practice is characterized by fixed contracts, which typically have three-year to five-year terms. Most Administrative Solutions 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 contract are usually paid on a fee-for-service basis. A small number of contracts contain a large up front customization and implementation fee, with lower ongoing maintenance fees.

In the billing for Employee Support Solutions ("ESS") services, a portion of the ESS client agreements require payment of a minimum retainer and incremental usage-based fees. The remainder of the ESS agreements are billed based on actual usage or fixed fees.

Fees from Absence Management Solutions ("AMS") services, such as attendance support and disability management are generally based on negotiated fees or a formula tied to the nature of the service being provided. Fees for workers' compensation services are charged based on billable hours or on a fee-for-service basis.

Most ESS and AMS agreements may be terminated by the client upon 30 to 60 days' notice to us. It is typical, however, for these agreements to continue for multiple years and many automatically renew on an annual basis.

Our largest operating expense is compensation and related costs. This includes salaries, annual performance-based bonuses, benefits, payroll taxes, independent service providers and temporary staffing services.

The remaining operating expenses include rent and occupancy costs, technology costs (including equipment leases, telecommunications, and software licenses and maintenance), non-recoverable client service costs, training, marketing, office costs, professional services and insurance.

2017 Summary and Outlook

(In thousands of dollars)	**Three months ended December 31, 2017**	Three months ended December 31, 2016	**Year ended December 31, 2017**	Year ended December 31, 2016
Revenue	**$158,722**	$149,089	**$631,155**	$592,057
Organic Revenue [1]	**$155,106**	$148,101	**$618,722**	$586,312
Adjusted EBITDA	**$ 29,004**	$ 26,714	**$120,820**	$112,261
Adjusted EBITDA margin	**18.3%**	17.9%	**19.1%**	19.0%
Normalized Free Cash Flow	**$ 20,466**	$ 19,690	**$ 72,331**	$ 70,902
Profit	**$ 4,289**	$ 5,660	**$ 34,582**	$ 26,000

Footnote:

(1) Organic Revenue is defined as revenue excluding acquisitions not in the comparative period and divestitures, and the U.S. Health Exchange outsourcing business which was terminated in the prior year, and is calculated as follows:

(In thousands of dollars)	**Three months ended December 31, 2017**	Three months ended December 31, 2016	**Year ended December 31, 2017**	Year ended December 31, 2016
Revenue	**$158,722**	$149,089	**$631,155**	$592,057
Acquisitions	**$ 3,616**	–	**$ 12,433**	–
U.S. Health Exchange	**–**	$ 988	**–**	$ 5,745
Organic Revenue	**$155,106**	$148,101	**$618,722**	$586,312

Fourth quarter:

We had a solid fourth quarter of 2017 and continued to deliver revenue and adjusted EBITDA growth versus the comparative quarter in 2016. Highlights of the fourth quarter include:

- Revenue growth of 6.5% versus the comparative period.
- An increase in Adjusted EBITDA of 8.6%, or $2.3 million, to $29.0 million versus the comparative period, with Adjusted EBITDA margin increasing to 18.3%.
- Profit for the fourth quarter of 2017 was $4.3 million compared to $5.7 million in the comparative period.

Highlights of 2017:

- Revenue grew by 6.6% versus last year from new business wins and continued growth with existing clients from all four lines of our business.

- Adjusted EBITDA increased by $8.6 million to $120.8 million, or 7.6% versus the prior year with Adjusted EBITDA Margin increasing to 19.1% from 19.0%.

- Profit for the year increased by $8.6 million to $34.6 million compared to $26.0 million in the prior year.

- On December 1, 2017, the Company acquired the Chestnut Global Partners Group of Companies ("Chestnut"), an international employee assistance program provider. Chestnut through Chestnut Global Partners, LLC, based in Bloomington, Illinois, has equity interests in joint ventures that have a presence internationally, including the United States, Brazil, China, Eastern Europe, India and Russia, which complements the Company's existing employee support solutions line of business and allows us to expand our presence globally.

- On October 31, 2017, the Company completed the acquisition of Groupe Pro-Santé Inc. ("Pro-Santé"), a health and wellness service provider based in Québec City. This acquisition complements the Company's existing employee support solutions line of business, and further solidifies our position as the leading employee and family assistance program provider in the Quebec region.

We are confident that our continued investment in our business, our established and prospective client base, and our financial flexibility will continue to yield positive results for the Company.

2017 Operating Results Summary

Results of Operations	Three months ended December 31,		Year ended December 31,	
Selected Consolidated Financial Information *(In thousands of dollars, except per share amounts)*	**2017**	**2016**	**2017**	**2016**
Revenue	**$158,722**	$149,089	**$631,155**	$592,057
Deduct:				
Salaries, benefits and contractor expenses	**111,408**	101,702	**429,026**	404,142
Other operating expenses	**28,024**	26,305	**100,992**	98,772
Finance costs	**3,277**	3,140	**13,165**	14,889
Depreciation and amortization	**9,808**	9,112	**38,200**	35,238
Write-down of deferred implementation costs	**–**	–	**–**	935
Income tax expenses	**1,916**	3,170	**15,190**	12,081
Profit	**4,289**	5,660	**34,582**	26,000
Add:				
Finance costs	**3,277**	3,140	**13,165**	14,889
Depreciation and amortization	**9,808**	9,112	**38,200**	35,238
Income tax expenses	**1,916**	3,170	**15,190**	12,081
EBITDA (1)	**$ 19,290**	$ 21,082	**$101,137**	$ 88,208
Adjustments:				
Sublease loss provision	**1,225**	1,800	**1,225**	2,200
Mercer Canada Outsourcing conversion costs	**1,319**	1,283	**7,157**	8,508
Retirement allowance	**–**	–	**4,131**	–
Reorganization and operational effectiveness initiatives	**6,241**	2,549	**6,241**	12,410
Lease exit costs	**929**	–	**929**	–
Write-down of deferred implementation costs	**–**	–	**–**	935
Adjusted EBITDA	**$ 29,004**	$ 26,714	**$120,820**	$112,261
EBITDA margin (2)	**12.2%**	14.1%	**16.0%**	14.9%
Adjusted EBITDA margin (2)	**18.3%**	17.9%	**19.1%**	19.0%
Cash provided by operating activities	**$ 44,005**	$ 27,947	**$ 77,588**	$ 67,039
Deduct: Capital expenditures (3)	**(11,677)**	(4,507)	**(31,415)**	(22,507)
Free Cash Flow (4)	**32,328**	23,440	**46,173**	44,532
Add (deduct):				
Changes in non-cash operating working capital	**(20,495)**	(7,467)	**14,470**	9,734
Current income taxes, net of income taxes paid	**338**	(115)	**(4,549)**	(3,990)
Adjustments to EBITDA (5)	**8,295**	3,832	**16,237**	20,626
Normalized Free Cash Flow (6)	**$ 20,466**	$ 19,690	**$ 72,331**	$ 70,902
Earnings per Share (basic and diluted)	**$ 0.08**	$ 0.10	**$ 0.62**	$ 0.49
EBITDA per share (basic)	**$ 0.35**	$ 0.38	**$ 1.83**	$ 1.67
Adjusted EBITDA per Share (basic)	**$ 0.52**	$ 0.49	**$ 2.18**	$ 2.13
Dividends declared	**$ 10,457**	$ 10,374	**$ 41,779**	$ 39,999
Twelve-month rolling Normalized Payout Ratio (7)	**57.8%**	56.4%	**57.8%**	56.4%
Twelve-month rolling Normalized Payout Ratio, including changes in adjusted non-cash operating working capital (8)	**73.6%**	66.4%	**73.6%**	66.4%

Footnotes:

(1) "EBITDA" is defined as profit before finance costs, income tax expenses, depreciation and amortization.

(2) "EBITDA margin" represents EBITDA as a percentage of revenue, and "Adjusted EBITDA margin" represents Adjusted EBITDA as a percentage of revenue.

(3) "Capital Expenditures" includes additions to capital assets and intangible assets but excludes additions to capital assets and intangible assets acquired through business acquisitions, and is presented net of disposals.

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

(5) "Adjustments to EBITDA" do not include the non-cash component of the retirement allowance of $2,027 and lease exit costs of $194, and sublease loss provisions, and for the comparative year ended December 31, 2016, non-cash reorganization and operational effectiveness initiatives costs of $292 and the write-down of deferred implementation costs. These amounts have been excluded as they have already been added back in cash from operating activities before the change in non- cash operating working capital.

(6) "Normalized Free Cash Flow" is defined as cash provided by operating activities, adjusted for changes in non-cash operating working capital, capital expenditures, current income taxes (net of income taxes paid) and certain unusual expenditures.

(7) "Twelve-month rolling Normalized Payout Ratio" is defined as dividends declared divided by Normalized Free Cash Flow for the rolling twelve-month period.

(8) "Twelve-month rolling Normalized Payout Ratio, including changes in adjusted non-cash operating working capital" is defined as dividends declared divided by the Twelve-month rolling Normalized Free Cash Flow, including changes in non-cash operating working capital adjusted for unusual fluctuations. For the twelve-month period ended December 31, 2017, non-cash operating working capital was adjusted by ($1,125), which represents the working capital impact of the retirement allowance. For the comparative twelve-month period ended December 31, 2016, the non-cash operating working capital was adjusted for by ($935), which represents the year over year change in non-cash operating working capital resulting from the write-down of deferred implementation costs for the U.S. Health Exchange business.

Analysis of Fourth Quarter 2017 Operating Results

Revenue

Revenue for the three months ended December 31, 2017 increased by $9.6 million, or 6.5%, to $158.7 million compared to $149.1 million for the same period in 2016. Organic revenue grew by $7.0 million, or 4.7%, from the same period in 2016 due to new business wins and continued growth from existing clients in all four of our lines of business, with ESS contributing 2.2% and Administrative Solutions 1.0% of the organic revenue growth.

Salaries, Benefits and Contractor Expenses

Salaries, benefits and contractor expenses for the three months ended December 31, 2017 increased by $9.7 million, or 9.5%, to $111.4 million compared to $101.7 million for the same period in 2016. Excluding the net increase in compensation expense of $2.0 million resulting from acquisitions not in the comparative period net of the U.S. Health Exchange outsourcing service business, compensation expense increased by $7.7 million. The increase is mainly attributable to $4.0 million of general increases to support the Company's continued growth and higher reorganization and operational effectiveness initiative costs of $3.7 million versus the comparative period.

Other Operating Expenses

Other operating expenses for the three months ended December 31, 2017 increased by $1.7 million, or 6.5%, to $28.0 million compared to $26.3 million for the same period in 2016. Excluding the net decrease in other operating expenses of $0.1 million resulting from the U.S. Health Exchange outsourcing service business net of acquisitions not in the comparative period, other operating expenses grew by $1.8 million. The increase is due to lease exit costs of $0.9 million not in the comparative period and $1.5 million of general increases required to support the Company's continued growth, partially offset by a lower sublease loss provision of $0.6 million.

Finance Costs

Finance costs for the three months ended December 31, 2017 increased by $0.1 million, or 4.4%, to $3.3 million compared to $3.1 million for the same period in 2016, due to increased borrowings under the Company's credit facility agreement.

Depreciation and Amortization

Depreciation and amortization for the three months ended December 31, 2017 increased by $0.7 million, or 7.6%, to $9.8 million compared to $9.1 million for the same period in 2016. The increase is due to higher amortization of internally developed software of $0.2 million and higher depreciation on capital assets of $0.4 million.

Income Tax Expenses

Income tax expenses decreased by $1.3 million to $1.9 million compared to $3.2 million for the same period in 2016 due to lower profit from operations before tax.

Profit for the period

As a result of the changes noted above, the profit for the three months ended December 31, 2017 decreased by $1.4 million to $4.3 million compared to $5.7 million for the same period in 2016.

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

Adjusted EBITDA and EBITDA

Adjusted EBITDA increased by $2.3 million, or 8.6%, to $29.0 million compared to $26.7 million for the same period in 2016. The increase is primarily due to growth in revenue of $9.6 million, partially offset by an increase in salaries and other operating expenses of $7.3 million after EBITDA adjustments. These adjusted EBITDA items do not constitute a part of the Company's on-going operating expenses, and are described in the analysis of the year ended December 31, 2017 operating results section below.

EBITDA decreased by $1.8 million to $19.3 million compared to $21.1 million for the same period in 2016.

Free Cash Flow

Free Cash Flow for the three months ended December 31, 2017 increased by $8.9 million to $32.3 million compared to $23.4 million for the same period in 2016. The increase is primarily due to higher cash provided by operating activities of $16.1 million due to more favorable changes in non-cash operating working capital of $13.0 million, partially offset by higher capital expenditures of $7.2 million (see discussion of capital expenditures in Liquidity and Capital Resources section below).

Normalized Free Cash Flow

Normalized Free Cash Flow for the three months ended December 31, 2017 increased by $0.8 million to $20.5 million compared to $19.7 million for the same period in 2016. The increase is due to higher cash generated from operating activities before changes in non-cash operating working capital and EBITDA adjustments of $7.8 million, partially offset by higher capital expenditures of $7.2 million.

Analysis of Year Ended December 31, 2017 Operating Results

Revenue

Revenue for the year ended December 31, 2017 increased by $39.1 million, or 6.6%, to $631.2 million compared to $592.1 million for 2016. Organic revenue grew by $32.4 million, or 5.5%, from the same period in 2016 due to new business wins and continued growth from existing clients in all four of our lines of business, with Administrative Solutions contributing 2.3% and ESS 1.6% of the organic revenue growth.

Salaries, Benefits and Contractor Expenses

Salaries, benefits and contractor expenses for the year ended December 31, 2017 increased by $24.9 million, or 6.2%, to $429.0 million compared to $404.1 million for the same period in 2016. Excluding the net increase in compensation expense of $4.9 million resulting from acquisitions not in the comparative period net of the U.S. Health Exchange outsourcing service business, compensation expense increased by $20.0 million. The increase is mainly attributable to general increases of $24.0 million to support the Company's continued growth and the retirement allowance for our former President and Chief Executive Officer of $4.1 million, partially offset by lower reorganization and operational effectiveness initiatives of $6.2 million, lower compensation costs for Mercer Canada Outsourcing conversion of $1.0 million, and the write-down of deferred implementation costs of $0.9 million in the comparative period.

Other Operating Expenses

Other operating expenses for the year ended December 31, 2017 increased by $2.2 million, or 2.2%, to $101.0 million compared to $98.8 million for the same period in 2016. Excluding the net decrease in other operating expenses of $0.6 million resulting from acquisitions not in the comparative period net of the U.S. Health Exchange outsourcing service business, other operating expenses grew by $2.8 million. The increase is due to lease exit costs of $0.9 million not in the

comparative period and $2.9 million of general increases required to support the Company's continued growth, partially offset by a lower sublease loss provision of $1.0 million.

Finance Costs

Finance costs for the year ended December 31, 2017 decreased by $1.7 million, or (11.6%) to $13.2 million compared to $14.9 million for the same period in 2016. The decrease in finance costs is due to lower average borrowings during the year under the Company's credit facility agreement and lower non-cash accretion and amortization on the convertible debentures.

Depreciation and Amortization

Depreciation and amortization for the year ended December 31, 2017 increased by $3.0 million, or 8.4%, to $38.2 million compared to $35.2 million for the same period in 2016. The increase is due to higher amortization of internally developed software of $1.4 million and acquired customer relationships of $0.8 million, and higher depreciation of capital assets of $1.4 million, partially offset by lower amortization of purchased software of $0.6 million.

Income Tax Expenses

Income tax expenses for the year ended December 31, 2017 increased by $3.1 million, or 25.7%, to $15.2 million compared to $12.1 million for the same period in 2016 due to higher profit from operations before tax for the year.

Profit for the year

As a result of the changes noted above, the profit for the year ended December 31, 2017 was $34.6 million compared to $26.0 million for the same period in 2016.

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

Adjusted EBITDA and EBITDA

Adjusted EBITDA increased by $8.6 million, or 7.6%, to $120.8 million compared to $112.3 million for the same period in 2016. The increase is primarily due to growth in revenue of $39.1 million, partially offset by an increase in salaries and other operating expenses of $30.5 million after EBITDA adjustments. These adjusted EBITDA items do not constitute a part of the Company's on-going operating expenses. Below is a description of the year ended December 31, 2017 adjustments:

- Mercer Canada Outsourcing conversion costs represent systems and service improvements required to support the clients acquired in November, 2012. The process commenced immediately after the acquisition and as a result of the savings realized from the original conversion, we decided in 2016 to convert the remaining clients acquired which were not included in the original conversion. The Mercer Canada Outsourcing conversion is now complete.

- Retirement allowance costs represent retirement remuneration to the former President and Chief Executive Officer of the Company after his decision to retire after twelve years with the Company, including the past eight as President and CEO.

- Reorganization and operational effectiveness initiatives represents severance costs related to corporate reorganizations, the completion of the Mercer Canada Outsourcing conversion, and employee terminations to achieve post-acquisition planned synergies.

- The sublease loss provision arose as a result of our decision to sublet excess office space now available in one of our U.S. offices as a result of the completion of significant conversion and implementation projects.

- Lease exit costs represents costs for termination penalties paid and write-off of leasehold improvements, net of extinguishment of related liabilities for leasehold inducements and straight-line rent, for early vacating a floor in one of our Montreal offices that was no longer required.

EBITDA increased by $12.9 million to $101.1 million compared to $88.2 million for the same period in 2016.

Free Cash Flow

Free Cash Flow for the year ended December 31, 2017 increased by $1.6 million to $46.2 million compared to $44.5 million for the same period in 2016. The increase is primarily due to higher cash provided by operating activities of $10.5 million due to higher profit for the period, partially offset by lower capital expenditures of $8.9 million (see discussion of capital expenditures in Liquidity and Capital Resources section below).

Normalized Free Cash Flow

Normalized Free Cash Flow for the year ended December 31, 2017 increased by $1.4 million to $72.3 million compared to $70.9 million for the same period in 2016. The increase is due to higher cash generated from operating activities before changes in non-cash operating working capital and EBITDA adjustments of $15.5 million, partially offset by higher current tax expense of $4.9 million and capital expenditures of $8.9 million.

Liquidity and Capital Resources

Cash Flows

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

Cash Flow Information

Selected Consolidated Financial Information:

(In thousands of dollars) *Cash provided by (used in):*	**Year ended December 31, 2017**	Year ended December 31, 2016
Operating activities	**$ 77,588**	$ 67,039
Financing activities	**(28,716)**	(38,554)
Investing activities	**(51,232)**	(33,441)
Decrease in cash	**$ (2,360)**	$ (4,956)

Cash provided by operating activities for the year ended December 31, 2017 increased by $10.5 million to $77.6 million compared to $67.0 million for the same period in 2016. The increase is due to higher cash generated from operating activities of $15.1 million due to higher profit for the year and items not involving cash, partially offset by higher income taxes paid of $4.3 million.

Cash used in financing activities for the year ended December 31, 2017 decreased by $9.8 million to $28.7 million compared to $38.6 million for the same period in 2016. This decrease was due to a net increase in borrowings under the credit facility (net of the proceeds received from the $86.0 convertible debentures issued in the comparative period which were used to pay down amounts borrowed under the credit facility and to fund the redemption of the previously issued convertible debentures that remained outstanding) of $8.7 million and the repayment of the $2.5 million promissory notes issued as partial consideration for the acquisition of Group AST (1993) Inc. in the comparative period, partially offset by higher dividends paid of $2.1 million.

Cash used in investing activities for the year ended December 31, 2017 increased by $17.8 million to $51.2 million compared to $33.4 million for the same period in 2016. The increase is due to higher additions to intangible and capital assets of $8.9 million (see discussion of capital expenditures below), and higher acquisition related payments of $8.9 million.

Dividends to Shareholders

Monthly dividends were declared for shareholders of record on the last business day of each month and were paid on approximately the 15th day of the following month. Monthly dividends were $0.065 per share each month for the fourth quarter of 2017. The Company continued to declare the same monthly dividend amount in January and February 2018.

We consider the amount of cash generated by the business in determining the amount of dividends to pay to shareholders. We do not generally consider profit or loss in setting the level of dividends as this is a non-cash metric and is not reflective of the level of cash flow that we generate.

The twelve-month rolling Normalized Payout Ratio at December 31, 2017 was 57.8% compared to 56.4% for the same period in 2016. The increase in the Normalized Payout Ratio is due to higher dividends paid due to shares issued upon the conversion of convertible debentures and on redemption of LTIP. The twelve-month rolling Normalized Payout Ratio, including changes in adjusted non-cash operating working capital at December 31, 2017 was 73.6% compared to 66.4% for the same period in 2016. The increase in the ratio was mainly due to the change in the adjusted non-cash operating working capital.

Capital Expenditures

Our capital expenditures typically include information technology hardware and software (external and internally developed), leasehold improvements, and office furniture. Such amounts are expected to be funded from our operating cash flow. Additional capital expenditure requirements may result from significant business expansion. Capital expenditures for the three months ended December 31, 2017 increased by $7.2 million to $11.7 million compared to $4.5 million for the same period in 2016 and for the year ended December 31, 2017 increased by $8.9 million to $31.4 million from $22.5 million in the comparative period. The increase in capital expenditures for the three months ended December 31, 2017 is due to higher hardware purchases of $0.9 million, and higher internally developed software expenditures of $5.7 million. The increase in capital expenditures for the year ended December 31, 2017 is due to increased leasehold improvements and office furniture expenditures of $1.9 million (net of increased leasehold inducements) primarily due to new office leases and improvements, an increase of $4.7 million in internally developed software expenditures, and an increase of $1.1 million in hardware purchases.

Contractual Obligations

Commitments

We lease office space and selected equipment under operating lease agreements with terms ranging from one to fifteen years. We also have revolving loans under the credit facility arrangement and convertible debentures described under the "Capital Resources" section.

We are a party to various subleases to which we would be liable for the rental payment in the case of a default by the subtenants. The minimum payments and the aggregate sublease income related to these premises have been netted against the operating leases amounts reported below. We consider the risk of default by the subtenants to be low and therefore no accrual has been set up. A summary of contractual obligations, which outlines the year the payments are due is as follows:

(In thousands of dollars)	**Total**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023 and thereafter**
Long-term debt	$180,445	$ –	$ –	$180,445	$ –	$ –	$ –
Convertible debenture	86,000	–	–	–	86,000	–	–
Operating leases, net	125,219	15,263	15,075	14,705	13,741	12,618	53,817
Total	**$391,664**	**$15,263**	**$15,075**	**$195,150**	**$99,741**	**$12,618**	**$53,817**

Contingent Consideration

The remaining purchase price for Pro-Santé, Société pour L`Avancement Des Ressources Humaines Inc. ("Solareh"), and Les Consultants Longpré & Associés Inc. ("Longpré") is contingent on future business results and the estimated remaining contingent consideration payable for these acquisitions is $3.5 million due from 2018 thru 2022. These contingent future installments have been recognized as an acquisition liability on the statement of financial position at their estimated discounted amounts as at December 31, 2017.

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

Capital Resources

The following table provides an overview of our capital resources:

(In thousands of dollars)	**As at December 31, 2017**	As at December 31, 2016
Bank indebtedness	**$ 5,416**	$ 3,056
Long-term debt, net of debt issuance costs	**179,669**	166,299
Convertible debentures, net of issuance costs and equity component of debenture	**82,080**	81,096
Shareholders' equity	**361,059**	361,707

Long-term debt

The long-term debt, net of debt issuance costs, increased by $13.4 million from $166.3 million as at December 31, 2016 to $179.7 million as at December 31, 2017. This increase is the result of an increase in borrowings under the Company's credit facility agreement to finance business growth and acquisition related payments.

The Company has a credit facility agreement (the "Credit Facility Agreement") that matures on December 20, 2020 and provides for a revolving facility of $300.0 million (including a swing line of $14.0 million). As at December 31, 2017, $180.4 million of the Credit Facility, including $7.1 million of the swing line available, had been utilized.

The interest rates for the Credit Facility Agreement are floating, based on a margin over certain referenced rates of interest. The applicable margin may vary up and down depending on the ratio of the Company's consolidated debt to Adjusted EBITDA as defined in the Credit Facility Agreement. In July 2017, the Company entered into a forward-starting interest rate swap agreement to hedge against the variable interest rate component on $50.0 million notional amount borrowed under the Credit Facility Agreement for the period from November 29, 2017 up to and ending December 20, 2020. The notional amount of this swap is $50.0 million and is used to fix the variable component of the interest rate at 1.79%, before the applicable margin, for the duration of this period and has been designated as a cash flow hedge.

The Credit Facility Agreement is secured by a general assignment of all the assets of the Company and requires the Company to maintain, on a consolidated basis, a Debt to Adjusted EBITDA financial covenant of not more than 3.0:1.0 or for the twelve month period immediately following the completion of a permitted acquisition as defined in the Credit Facility Agreement with a purchase price of $25.0 million or more, not more than 3.5:1.0, and an EBITDA to interest expense ratio of not less than 3.0:1.0.

We are in compliance with all of the required financial covenants as at December 31, 2017

Convertible debentures

In June 2016, the Company issued $86.0 million principal amount of 4.75% Convertible Unsecured Subordinated Debentures (the "4.75% Convertible Debentures") for net proceeds of $82.0 million. The 4.75% Convertible Debentures pay interest semi-annually on June 30 and December 31, commencing with the initial interest payment on December 31, 2016 and have a maturity date of June 30, 2021.

These debentures are convertible at the option of the holder to common shares at a conversion price of $25.10 per common share. The Company has the option to redeem the 4.75% Convertible Debentures on and after June 30, 2019 and at any time prior to June 30, 2020 at a redemption price equal to 100% of their principal plus accrued and unpaid interest provided that the weighted average trading price for the 20 consecutive trading days ending five days preceding the date on which the notice of redemption is given is at least 125% of the conversion price of $25.10. On and after June 30, 2020, but prior to the maturity date, the 4.75% Convertible Debentures are redeemable at a redemption price equal to 100% of their principal amount plus accrued and unpaid interest. On redemption or maturity, the Company may elect to repay the principal and satisfy its interest obligations by issuing common shares.

Selected Statement of Financial Position Data

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

(in thousands of dollars)	**As at December 31, 2017**	As at December 31, 2016
Current assets	**$190,205**	$160,938
Non-current assets	**620,065**	612,688
Current liabilities	**113,576**	97,082
Non-current liabilities	**335,635**	314,837

Current Assets

Current assets as at December 31, 2017 increased by $29.3 million to $190.2 million from $160.9 million as at December 31, 2016. The increase is primarily attributable to an increase in trade and other receivables and unbilled fees of $26.1 million, including a $10.1 million increase in the trade receivable balance from a U.S. public sector customer, due to growth in the business and billing terms in accordance with contracts, an increase in prepaid expenses of $1.5 million due to timing of vendor payments and renewal cycle, an increase in cash and investments held in trust of $0.9 million, and an increase in the current portion of deferred implementation cost of $0.8 million.

Non-current Assets

Non-current assets as at December 31, 2017 increased by $7.4 million to $620.1 million from $612.7 million as at December 31, 2016. The increase is primarily due to $6.3 million in investments in joint ventures acquired as part of the CGP acquisition, and an increase in the non-current portion of deferred implementation costs of $3.2 million due to increased deferred implementation activities, which was partially offset by a decrease in the non-current portion of unbilled fees of $3.0 million.

Current Liabilities

Current liabilities as at December 31, 2017 increased by $16.5 million to $113.6 million from $97.1 million as at December 31, 2016. This increase is primarily due to higher trade and other payables of $13.4 million due to timing of payments to vendors and timing of compensation related accruals, an increase in insurance premium liabilities of $0.9 million, an increase in bank indebtedness of $2.4 million, and higher income taxes payable of $3.3 million. This was partially offset by a decrease in future consideration related to acquisitions of $2.4 million primarily as a result of acquisition settlement payments, and the fair value of the interest rate swaps being in a liability position of $1.6 million at comparative period end.

Non-current Liabilities

Non-current liabilities as at December 31, 2017 increased by $20.8 million to $335.6 million from $314.8 million as at December 31, 2016. The increase is mainly due to an increase in the long-term debt of $13.4 million due to higher amounts borrowed under the Credit Facility Agreement, an increase of $1.0 million in the Convertible Debentures due to

non-cash accretion and amortization of issuance costs, an increase in the deferred tax liability of $2.0 million, and an increase in other liabilities of $5.4 million primarily due to leasehold inducements received, which was partially offset by a decrease of $1.5 million in the non-current portion of future consideration related to acquisitions.

As a result of the changes in current assets and current liabilities discussed above, working capital increased by $12.7 million from $63.9 million as at December 31, 2016 to $76.6 million as at December 31, 2017.

Critical Accounting Policies and Estimates

The preparation of financial statements requires us to make estimates and assumptions that affect the reported values of assets and liabilities as well as disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period.

These estimates are reviewed periodically and, as adjustments become necessary, they are reported in profit or loss in the periods in which they become known. Accordingly, actual results could differ from these estimates. The Company's significant accounting policies are presented in Note 3 of the audited consolidated financial statements and notes thereto for the years ended December 31, 2017 and 2016. The accounting policies and estimates that are critical to our business relate to the following items:

Revenue Recognition

Revenue includes fees generated from consulting engagements, Administrative Solutions engagements, ESS and AMS services.

Generally, revenue from the rendering of services is recognized when the following criteria are met:

- The amount of revenue can be reliably measured;
- The stage of completion can be reliably measured;
- The receipt of economic benefits is probable; and
- Costs incurred and to be incurred can be reliably measured.

Concurrently with the above general principles, Morneau Shepell applies the following specific revenue recognition policies:

Fees for actuarial and consulting services are billed either on a time-and-material basis or on a fixed-fee basis. Revenue is recognized as services are rendered and expenditures are incurred.

ESS revenue is recognized through a combination of the minimum contracted amount and incremental usage above the minimum thresholds. The minimum contracted amount is recognized on a basis consistent with the provision of ESS services. Incremental usage is recognized when the minimum usage threshold is exceeded.

AMS revenue is recognized on a fixed-fee or time-and-material basis. On fixed-fee basis arrangements, where the provision of service is characterized by an indeterminate number of acts, revenue is recognized on a straight-line basis over the term of the contract. On time-and-material basis arrangements, revenue is recognized as services are rendered and expenditures are incurred.

Administrative Solutions engagements typically involve both an implementation and administration component. Where a singular contract requires the delivery of multiple components, revenue recognition criteria are applied to determine whether each component of the contract qualifies for treatment as a separate unit of accounting. Multiple deliverable arrangements are determined to exist if all of the following criteria are met:

- The delivered item has value to the customer on a stand-alone basis; and

- The fair value of the undelivered item can be reliably measured.

If these criteria are not met, deliverables (components) included in an arrangement are accounted for as a single unit of accounting and revenue is deferred and recognized on a basis consistent with elements of the service contract.

Unbilled fees represent fees earned for services rendered but not yet invoiced as at the reporting date; upon billing, this balance will be transferred to trade receivables. Unbilled fees are recorded at the lower of unbilled hours worked at normal billing rates and the amount which is estimated to be recoverable upon invoicing. Morneau Shepell maintains a provision for amounts expected to be unrecoverable.

Other sources of operating revenue include the following:

(i) Investment income earned in the course of normal business operations, and is recorded on the accrual basis.

(ii) Commissions income are recognized when earned, net of a provision for return commissions due to policy cancellations or change of brokers.

Intangible Assets

Intangible assets consist of customer relationships, customer contracts, proprietary software, and trade names acquired through acquisitions or business combinations, internally-developed software and purchased software.

Internally-developed software is recognized at the cost of all eligible development costs, when all the following criteria are met:

- It is technically feasible to complete the software so that it will be available for use;
- Management intends to complete the software and use or sell it;
- Morneau Shepell is able to use or sell the software;
- Future benefits associated with the software can be demonstrated;
- Adequate technical, financial, and other resources to complete the development and to use or sell the software are available; and
- The expenditures attributable to the software during its development can be reliably measured.

Eligible expenditures capitalized as part of internally-developed software include external direct costs of materials and services consumed in development, and payroll and payroll-related costs for employees who are directly associated with and who devote time to the development of the software. All costs incurred in the preliminary research stage of the projects are expensed as incurred.

Intangible assets with a finite life are amortized on a straight-line basis over their estimated useful lives. Intangible assets with an indefinite life are not amortized, but are tested for impairment annually or whenever impairment indicators are identified. Trade names have been determined to have an indefinite life based on their strength, history, and expected future use.

Amortization expense has been presented in profit or loss as depreciation and amortization. Assets are removed from asset and accumulated amortization balances once they become fully amortized. Proceeds from disposals are netted against the related assets and accumulated amortization, and resulting gains and losses are included in profit or loss.

Amortization on internally-developed software does not commence until the asset is ready for use as management intended.

Goodwill

Goodwill represents the excess of the cost of business acquisitions over the fair value of our share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill is carried at cost less accumulated impairment charges and is subject to an impairment test annually or whenever impairment indicators are identified.

Deferred implementation costs and deferred outsourcing revenues

Implementation costs incurred in connection with Administrative Solutions contracts, relate to those costs necessary to set up clients and their human resource or benefit programs onto the Company's systems and operating processes. Such costs may include internal and external costs for coding and customizing systems, client data conversion costs, and contract negotiation costs. For Administrative Solutions contracts that are accounted for as a combined unit of accounting, specific, incremental, and direct costs, net of any revenue received from the implementation component, are deferred and amortized over the term of the service contract.

If a client terminates a contract prior to its end, a loss on the contract may be recorded (if necessary), and any remaining deferred implementation revenues and costs would be recognized into income over the remaining implementation period through to the date of termination.

Deferred income tax assets and liabilities (utilization of tax losses)

Deferred income tax assets are recognized for all unused tax losses and deductible temporary differences to the extent that it is probable that taxable profit will be available against which the losses and deductible temporary differences can be utilized. Significant management judgment is required to determine the amount of deferred income tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

Future consideration related to acquisitions

The Company may pay future consideration related to acquisitions based upon performance measures contractually agreed at the time of purchase. Management estimates the future consideration payable based on underlying contract terms, and best estimates of the future performance of the acquiree. Depending on the future performance of the acquiree, management estimates of the amounts payable for future consideration related to acquisitions may materially differ from the consideration ultimately paid.

Impairment of Non-financial Assets

The Company's identifiable tangible and intangible assets with finite useful lives are reviewed for indications of impairment at each statement of financial position date and when events or changes in circumstances indicate that they may be impaired. Impairments are recorded when the recoverable amount of assets are less than their carrying amounts. The recoverable amount is the higher of an asset's fair value less cost to sell or its value in use.

Similarly, intangible assets with indefinite useful lives and goodwill are tested for impairment annually or whenever impairment indicators are identified, by estimating their recoverable amounts and comparing it to their carrying amounts. Where individual assets cannot be tested individually, they are grouped together into cash-generating units ("CGUs"), the smallest group of assets that are capable of generating cash inflows from continuing use largely independent of other groups of assets, and tested on this basis. Goodwill acquired through business combinations is allocated to each CGU or groups of CGU's but not larger than an operating segment that is expected to benefit from the synergies of the combination.

An impairment loss is recognized if the carrying amount of the CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss, and those impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the unit, and then to reduce the carrying amount of the other assets in the unit on a pro rata basis.

Impairment losses in respect of goodwill are not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, and only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization had no impairment charge been recorded.

Goodwill and intangible assets impairment review involves significant estimates and assumptions regarding cash flow projections, growth projections, economic risk, and weighted cost of capital. If future events or results differ adversely from these estimates and assumptions, the Company could incur impairment charges in future periods.

Allowance for Doubtful Accounts

We are required to assess whether accounts receivable are collectible from customers. Accordingly, management establishes an allowance for estimated losses arising from non-payment and delinquent accounts, taking into consideration customer creditworthiness, current economic trends, and past experience. If future collections differ from estimates, future earnings could be adversely affected.

Litigation and Claims

We are involved in litigation and other claims arising in the normal course of business. We must use judgment to determine whether or not a claim has any merit, the amount of the claim and whether to record a provision, which is dependent upon the potential success of the claim. We believe that none of the current claims will have a material adverse impact on our financial position.

Related party transactions

The Company's related parties include key management personnel, unconsolidated structured entities, and joint ventures. Details of these related parties, as well as the Company's related party transactions can be found in note 23 'Related Parties' of the Company's consolidated financial statements for the year ended December 31, 2017.

Changes in Accounting Policies

The accounting policies applied by the Company in its consolidated financial statements as at and for the year ended December 31, 2017 are consistent with those applied by the Company in its comparative consolidated financial statements as at and for the year ended December 31, 2016.

Future Accounting Changes

IFRS 15, Revenue from Contracts with Customers ("IFRS 15")

In May, 2014, the IASB issued IFRS 15. The new standard is effective for fiscal years beginning on or after January 1, 2018 and is available for early adoption. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized.

The Company will adopt IFRS 15 in its financial statements using the full retrospective method for the annual period beginning on January 1, 2018 and will apply the following practical expedients on the date of transition:

- Paragraph C5(a) of IFRS 15, under which the Company does not restate contracts that begin and end within the same annual reporting period, or are completed contracts at the beginning of the earliest period presented.

- Paragraph C5(c) of IFRS 15, under which the Company does not disclose the amount of consideration allocated to remaining performance obligations or an explanation of when the Company expects to recognize that amount as revenue for all reporting periods presented before the initial date of application of January 1, 2018.

The Company has also substantially completed its assessment of the impact of adopting this standard on its financial statements.

Under IFRS 15 for Administrative Solutions application service provider ("ASP") and software as a service ("SaaS") contracts that provide the customer with a right to access license to the Company's proprietary pension and benefits software over the term of the contract, the implementation component and ongoing services will be considered a single performance obligation. Currently, the Company considers the implementation component to be a separate unit of accounting, resulting in the recognition of implementation fees as revenue upon the commencement of the implementation.

Furthermore, implementation costs incurred in connection with Administrative Solutions contracts where the implementation component is not considered a separate performance obligation are currently deferred and amortized over the initial term of the service contract. Under IFRS 15, the Company will consider the renewal period as permitted in the contract in addition to the initial term of the contract, in determining the amortization period for these deferred costs.

As a result of the changes noted above, the Company estimates that the Company's deficit will increase by $4,785 on the date of adoption of January 1, 2018 and by $3,230 on January 1, 2017, with the profit of the Company for the year ended December 31, 2017 decreasing by $1,556.

IFRS 9, Financial Instruments ("IFRS 9")

In July 2014 the IASB finalized IFRS 9. The standard is effective for fiscal years beginning on or after January 1, 2018 and is available for early adoption. The new standard includes revised guidance on the classification and measurement of financial assets, a new 'expected loss' impairment model and introduces a substantially-reformed approach to hedge accounting. The Company intends to adopt IFRS 9 in its financial statements for the annual period beginning on January 1, 2018. The impact of adoption of this standard is not significant.

IFRS 16, Leases ("IFRS 16")

In January 2016, the IASB issued IFRS 16. The standard is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted for those entities that have also adopted IFRS 15. The new standard provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements. IFRS 16 supersedes IAS 17, Leases, and its associated interpretative guidance. IFRS 16 applies a control model to the identification of leases, differentiating between leases and service contracts on the basis of whether there is an identified asset controlled by the customer. Among other significant changes, the distinction between operating and finance leases is removed and assets and liabilities are recognized in respect of all leases. Furthermore, IFRS 16 requires a front-loaded pattern for the recognition of lease expense over the life of the lease. The Company intends to adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the standard has not yet been determined.

Risks and Uncertainties

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

Ability to Maintain Profitability and Manage Growth

There can be no assurance that Morneau Shepell will be able to sustain profitability in future periods. Morneau Shepell's future operating results will depend on a number of factors, including its ability to continue to successfully execute its strategic initiatives.

There can be no assurance that Morneau Shepell will be successful in achieving its strategic plan or that its strategic plan will enable the firm to maintain its historical revenue growth rates or to sustain profitability. Failure to successfully execute any material part of Morneau Shepell's strategic plan could have a material adverse effect on its business, financial condition and operating results.

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

Competition

Morneau Shepell operates in a highly competitive North American market. As a result, Morneau Shepell competes with many domestic and international firms. Some of its competitors have achieved substantially more market penetration in certain of the areas in which Morneau Shepell competes. In addition, some of Morneau Shepell's competitors have substantially more financial resources and/or financial flexibility than Morneau Shepell. Furthermore, Morneau Shepell's business relies, in part, upon its ability to develop and implement technology solutions, in a cost effective manner that anticipates and keeps pace with rapid and continuing changes in technology, industry standards and client preferences.

Morneau Shepell's competitors may offer new technologies more efficiently or cost effectively than Morneau Shepell. Competitive forces could result in reduced market share and thus have a material adverse effect on Morneau Shepell's business, financial condition and operating results.

Reliance on Information Systems and Technology and Confidentiality of Client Information

Information systems are an integral part of Morneau Shepell's business and the products and services offered to its clients. Morneau Shepell relies on these systems to maintain accurate, accessible and secure records.

In the course of delivering its products and services, Morneau Shepell collects and uses sensitive personal and financial information pertaining to its corporate, institutional and government clients as well as individual users. This information includes personal identification such as date of birth, social insurance numbers and driver's license numbers as well as health, benefits and financial information.

Due to the nature of the information involved in its products and services, Morneau Shepell may be subject to greater cybersecurity risks and consequences of disclosure than other companies. These risks can range from internal human error to uncoordinated individual attempts to gain unauthorized access to its information technology systems, to sophisticated and targeted measures directed at Morneau Shepell and its systems, clients or service providers. Any such disruptions in Morneau Shepell's systems or the failure of the systems to operate as expected could, depending on the magnitude of the problem, result in the loss of client information (including personal information), a loss of current or future business, reputational harm and/or potential claims against Morneau Shepell, all of which could have a material adverse effect on Morneau Shepell's business, financial condition and operating results.

Morneau Shepell continues to enhance its efforts to mitigate these risks.

It invests in technology security initiatives to better identify and address any vulnerabilities. This includes measures such as annual third party internal and external vulnerability assessments and third party code reviews, data monitoring and assessments. Morneau Shepell has also improved the security testing capabilities of its internal teams. In addition, Morneau Shepell continues to increase the awareness its employees have of security policies and procedures through ongoing communications and privacy and security training. Morneau Shepell ensures that its service providers adopt similar measures through the use of security agreements.

From a systems and infrastructure perspective, Morneau Shepell uses a third party co-location site for data storage to decrease the probability of loss in the event of a business interruption or disaster. Internally, it maintains a complete inventory of all servers and infrastructure components and uses data loss prevention features to reduce the likelihood of improper disclosure of personal and confidential information.

Morneau Shepell's Chief Information Officer and Chief Security Officer are responsible for establishing, monitoring and maintaining the enterprise technology and security processes and policies with support from third party consultants and the Company's internal information technology, legal and audit departments.

The Company maintains privacy and network liability insurance coverage in the event of a loss arising from a network security failure, privacy event or social engineering fraud commonly referred to a "phishing attack".

The above referenced insurance policy, technology security initiatives and employee awareness measures are assessed on an annual basis as part of Morneau Shepell's comprehensive enterprise risk management process.

While Morneau Shepell has invested and continues to invest in technology security initiatives, information technology risk management and disaster recovery plans, these measures cannot fully insulate it from cybersecurity incidents, technology disruptions or data loss, which could adversely impact its competitiveness and result of operations.

Reputational Risk

Morneau Shepell depends to a large extent upon its relationships with its clients and its reputation for high-quality services. As a result, the impact of client dissatisfaction with Morneau Shepell's services or products may be more damaging in Morneau Shepell's business than in other businesses. Moreover, if the firm fails to meet its contractual or regulatory obligations, Morneau Shepell could be subject to legal liability and a loss of client relationships.

Satisfactory Performance of Obligations

In its contracts with clients, Morneau Shepell is sometimes committed to meeting identified service levels and/or timelines. If the service levels/timelines are not met, Morneau Shepell may experience reduced revenues, incur significant additional costs or be held responsible for the costs incurred by the client for failure to meet the service level/timeline. Morneau Shepell's success depends in large part upon whether it fulfills these and other contractual obligations with clients and maintains client satisfaction. If Morneau Shepell fails to satisfactorily perform its contractual obligations, its clients could terminate contracts and/or take legal action against Morneau Shepell. Such occurrences could result in a loss of its professional reputation and in extra costs needed to defend or rectify the situation and thus have a material adverse effect on Morneau Shepell's business, financial condition and operating results.

Economic Conditions

An economic slowdown could cause a decline in demand for Morneau Shepell's services. Growth in its clients' businesses may be affected by economic slowdowns and could therefore potentially have an impact on Morneau Shepell's operating

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

Dependence on Key Clients and Key Channel Partners

As clients may terminate engagements with minimum notice, there can be no assurance that Morneau Shepell will be able to retain relationships with its largest clients. Moreover, there can be no assurance that such clients will continue to use Morneau Shepell's services in the future. Any negative change involving any of Morneau Shepell's largest clients, including but not limited to a client's financial condition or desire to continue using Morneau Shepell's services, could result in a significant reduction in revenue which could have a material adverse effect on Morneau Shepell's business, financial condition and operating results. No one Morneau Shepell client makes up more than 10% of Morneau Shepell's total revenue for the years ended December 31, 2017 and 2016.

Morneau Shepell markets its services directly to end-user employers as well as through certain channel partners, primarily insurance companies (many of which compete amongst themselves directly). There can be no assurance that Morneau Shepell will be able to maintain its existing relationships with all these channel partners, which could have a material adverse effect on Morneau Shepell's business, financial condition and operating results.

Reliance on Key Professionals

Morneau Shepell's operations are dependent upon the abilities, experience and efforts of its professionals, many of whom have excellent reputations and a significant number of contacts in the industries in which Morneau Shepell operates. Morneau Shepell's business depends, in part, on its professionals' abilities to develop and maintain client relationships and alliances with businesses such as financial services companies, healthcare organizations, insurance companies, business process outsourcing organizations and other companies, in order to develop, market and deliver its services. Profitability could be negatively impacted if Morneau Shepell's client relationships or business alliances are discontinued due to the loss of professional staff or if the firm has difficulty developing new alliances.

Should any member of its professional staff be unable or unwilling to continue his or her relationship with Morneau Shepell, this change could have a material adverse effect on Morneau Shepell's business, financial condition and operating results.

Risk of Future Legal Proceedings

Morneau Shepell may be threatened with, or may be named as a defendant in, or may become subject to, various legal proceedings in the ordinary course of conducting its business, including lawsuits based upon professional errors and omissions.

Consulting services involves assumptions and estimates concerning future events, the actual outcome of which cannot be known with certainty in advance. In addition, computational, software programming or data management errors could occur. For example, possible legal proceedings could result from a client's assertion that actuarial assumptions used in a pension plan were unreasonable, leading to plan underfunding; a claim that inaccurate data was used, which could lead to an underestimation of plan liabilities; or a claim that employee benefits plan documents were misinterpreted or plan amendments were misstated in plan documents, which could lead to overpayments to beneficiaries. The employee health and productivity services involve confidential counseling, occupational health activities and disability case management. Each of these activities could potentially put Morneau Shepell in conflict with its customers, their employees, or both. Possible legal proceedings could also result from matters such as an employee claiming for breach of confidence, failure to provide adequate counsel, or denial of benefits or employment as a result of Morneau Shepell's actions.

Defending lawsuits of this nature could require much management attention, which could divert its focus from operations. Such claims could produce negative publicity that could harm Morneau Shepell's reputation and business. A significant judgment against Morneau Shepell, or the imposition of a significant fine or penalty as a result of a finding that Morneau Shepell failed to comply with laws or regulations, could have a material adverse effect on Morneau Shepell's business, financial condition and operating results.

Protection of Intellectual Property

Morneau Shepell continually develops and improves its proprietary technology solutions for the delivery of its services. No assurance can be given that Morneau Shepell's competitors will not develop substantially similar technology.

Morneau Shepell relies on one or more of the following to protect its proprietary rights: trademarks, copyrights, trade secrets, confidentiality procedures and contractual provisions. Despite Morneau Shepell's efforts to protect its proprietary rights, unauthorized parties may attempt to obtain and use information that Morneau Shepell regards as proprietary. Stopping unauthorized use of Morneau Shepell's intellectual property may be difficult, time-consuming and costly. There can be no assurance that Morneau Shepell will be successful in protecting its proprietary rights and, if it is not, this could have a material adverse effect on Morneau Shepell's business, financial condition and operating results.

Potential Undisclosed Liabilities Associated with Acquisition/Limited Indemnification

In connection with acquisitions completed by Morneau Shepell, there may be liabilities and contingencies that Morneau Shepell failed to discover or were unable to quantify in its due diligence which it conducted prior to the execution of an acquisition, and Morneau Shepell may not be indemnified for some or all of these liabilities and contingencies. The existence of any material liabilities or contingencies could have a material adverse effect on Morneau Shepell's business, financial condition, liquidity and results of operations.

Insurance

Morneau Shepell believes that its insurance coverage, including professional errors and omissions insurance, cyber liability insurance, crime insurance, director and officer liability insurance, and commercial general liability insurance coverage address all material insurable risks, provides coverage that is similar to that which would be maintained by a prudent operator of a similar business and is subject to deductibles, limits and exclusions which are customary or reasonable given the cost of procuring insurance and current operating conditions.

However, there can be no assurance that such insurance will continue to be offered on economically feasible terms, that all events that could give rise to a loss or liability are insurable, or that the amounts of insurance will at all times be sufficient to cover each and every loss or claim that may occur involving Morneau Shepell's assets or operations.

Foreign Exchange Risk

A portion of Morneau Shepell's sales are in U.S. dollars and thus Morneau Shepell is exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar.

The net revenue exposure denominated in U.S. dollars was $22.0 million for the year ended December 31, 2017. An increase in foreign revenues would expose Morneau Shepell to fluctuations in exchange rates which may have a material adverse effect on Morneau Shepell's business, financial condition, and operating results.

Indebtedness and Interest Rates

The ability of Morneau Shepell to pay dividends or make other payments or advances will be subject to applicable laws and contractual restrictions contained in the instruments governing any indebtedness of Morneau Shepell.

The degree to which Morneau Shepell is leveraged could have important consequences including: Morneau Shepell's ability to obtain additional financing for working capital, capital expenditures or acquisitions in the future may be limited; a significant portion of Morneau Shepell's cash flow from operations may be dedicated to the payment of the principal of and interest on its indebtedness, thereby reducing funds available for future operations; certain borrowings will be at variable rates of interest, which exposes Morneau Shepell to the risk of increased interest rates; and Morneau Shepell may be more vulnerable to economic downturns and be limited in its ability to withstand competitive pressures.

These factors may increase the sensitivity of free cash flow to interest rate variations. Interest rate swap agreements are used as part of Morneau Shepell's program to manage the floating interest rate of Morneau Shepell's Credit Facility.

The Credit Facility contains numerous restrictive covenants that limit the discretion of management with respect to certain business matters. These covenants place significant restrictions on, among other things, the ability of Morneau Shepell to create liens or other encumbrances, to pay dividends or make certain other payments, investments, loans and guarantees and to sell or otherwise dispose of assets and merge or consolidate with another entity.

In addition, the Credit Facility contains financial covenants that require Morneau Shepell to meet certain financial ratios and financial condition tests. A failure to comply with the obligations in the Credit Facility could result in a default which, if not cured or waived, could result in a reduction or termination of dividends by Morneau Shepell and permit acceleration of the relevant indebtedness. If the indebtedness under the Credit Facility was to be accelerated, there can be no assurance that the assets of Morneau Shepell would be sufficient to repay in full that indebtedness. In addition, the Credit Facility matures on December 20, 2020. There can be no assurance that future borrowings or equity financing will be available to Morneau Shepell or available on acceptable terms, in an amount sufficient to fund Morneau Shepell's needs.

Credit risk

If a counterparty to a financial instrument held by Morneau Shepell fails to discharge their obligation, this could lead to a financial loss for the Company. As at December 31, 2017, the Company's credit risk was limited to the carrying amount of the cash and accounts receivable as at this date, with one U.S. public sector customer comprising $14.1 million of the accounts receivables balance, $10.6 million of which was greater than ninety days past due. The Company believes that the credit risk of accounts receivable, including the customer noted above, is limited for the following reasons:

(a) Risk associated with concentration of credit risk with respect to accounts receivable is limited due to the credit rating of the Company's top 10 clients.

(b) Management regularly reviews and assesses customer accounts and credit risk. Historically, bad debt as a percentage of revenue has been minimal.

The credit risk on cash and investments held in trust is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

Cash Dividends are not Guaranteed and will Fluctuate with the Business Performance

As a corporation, Morneau Shepell's dividend policy is at the discretion of its Board of Directors. The ability of Morneau Shepell to make dividend payments, and the actual amount paid is entirely dependent on the operations and assets of its subsidiaries and is subject to various factors applicable to Morneau Shepell and its subsidiaries including financial performance, obligations under credit facilities, fluctuations in working capital, the sustainability of margin and capital expenditure requirements, and applicable laws and regulations.

Market Price and Dilution of Common Shares

The market price of Morneau Shepell's common shares may be subject to wide fluctuations in response to many factors, including variations in operating results of Morneau Shepell, divergence in financial results from expectations, changes in business prospects for Morneau Shepell, general economic conditions, legislative changes, and other events and factors outside Morneau Shepell's control.

Sales of a substantial number of common shares by a significant shareholder in the public market or otherwise could adversely affect the prevailing market prices of the common shares and could impair the Company's ability to raise additional capital through an offering of common shares. The possible perception among the public that these sales will occur could also produce the same effect.

Pursuant to its articles of incorporation, Morneau Shepell is authorized to issue an unlimited number of common shares and 10 million preferred shares for the consideration and on such terms established by the Board of Directors without the approval of any shareholders. Any further issuance of common shares may dilute the interests of existing shareholders. Furthermore, Morneau Shepell may make future acquisitions or enter into financings or other transactions involving the issuance of securities of Morneau Shepell which may be dilutive. In addition, Morneau Shepell may issue shares upon the conversion, redemption or maturity of payment of interest on its convertible debentures. Accordingly, if the debentures are converted this may have a dilutive impact on the Company's earnings per share.

Selected Annual Information

(In thousands of dollars, except per share amounts)	**Year ended December 31, 2017**	Year ended December 31, 2016	Year ended December 31, 2015
Revenue	**$631,155**	$592,057	$567,286
Profit for the year (1)	**34,582**	26,000	16,418
Earnings per share (basic and diluted)	**0.62**	0.49	0.33
Dividends declared per share	**0.78**	0.78	0.78
Total assets	**810,270**	773,626	755,648
Total long-term debt (2)	**261,749**	247,395	315,606

Footnotes:

(1) The profit for the year ended December 31, 2015 includes the write-down of deferred implementation costs and impairment charges totaling $15,100 related to HRINY.

(2) Includes convertible debentures.

Supplementary Summary of Quarterly Results

Selected Unaudited Consolidated Financial information:

(in thousands of dollars except per share amounts)

Quarter ended	**December 31, 2017**	**September 30, 2017**	**June 30, 2017**	**March 31, 2017**	December 31, 2016	September 30, 2016	June 30, 2016	March 31, 2016
Revenue	**158,722**	**153,782**	**160,814**	**157,837**	149,089	144,594	149,251	149,123
Profit	**4,289**	**9,654**	**12,475**	**8,164**	5,660	5,210	8,081	7,049
EBITDA	**19,290**	**26,960**	**29,585**	**25,302**	21,082	19,098	25,449	22,579
Adjusted EBITDA	**29,004**	**28,968**	**31,823**	**31,025**	26,714	27,187	29,533	28,828
EBITDA margin	**12.2%**	**17.5%**	**18.4%**	**16.0%**	14.1%	13.2%	17.1%	15.1%
Adjusted EBITDA margin	**18.3%**	**18.8%**	**19.8%**	**19.7%**	17.9%	18.8%	19.8%	19.3%
Earnings per share (basic)	**0.08**	**0.17**	**0.23**	**0.15**	0.10	0.09	0.16	0.14
Earnings per share (diluted)	**0.08**	**0.17**	**0.22**	**0.15**	0.10	0.09	0.16	0.14
Normalized Free Cash Flow	**20,466**	**17,862**	**15,913**	**18,090**	19,690	17,323	18,585	15,308
Dividends declared	**10,457**	**10,525**	**10,417**	**10,380**	10,374	10,355	9,857	9,413
Twelve-month rolling normalized payout ratio	**57.8%**	**58.3%**	**58.5%**	**55.6%**	56.4%	56.2%	58.3%	59.8%
Twelve-month rolling normalized payout ratio, including changes in adjusted non-cash operating working capital	**73.6%**	**97.5%**	**70.7%**	**72.4%**	66.4%	54.2%	60.1%	58.7%
Total assets	**810,270**	**785,712**	**793,315**	**777,627**	773,626	760,402	768,256	757,357
Total long-term debt (1)	**261,749**	**266,082**	**267,277**	**247,638**	247,395	253,293	262,031	316,292

Footnotes:

(1) Includes convertible debentures.

Disclosure Controls and Procedures

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

The Chief Executive Officer and the Chief Financial Officer have concluded that the disclosure controls and procedures are appropriately designed and operating effectively as at December 31, 2017.

Internal Control over Financial Reporting

Management is responsible for designing internal controls over financial reporting, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with IFRS. In designing these controls, Management used the *Internal Control – Integrated Framework* (COSO 2013 Framework) published by The Committee of Sponsoring Organizations of the Treadway Commission.

The Chief Executive Officer and the Chief Financial Officer have concluded that the internal controls over financial reporting are appropriately designed and operating effectively to provide this assurance based on the evaluation of these controls conducted as of December 31, 2017. No changes were made in our internal controls over financial reporting during the fourth quarter ended December 31, 2017, that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Additional Information

Morneau Shepell's shares and convertible debentures currently trade on the Toronto Stock Exchange under the symbols MSI and MSI.DB.A, respectively. Additional information relating to us, including all public filings and our Annual Information Form, is available on the SEDAR website (sedar.com) and on our own website at morneaushepell.com.

The content of this MD&A reflects information known as of March 7, 2018.

KPMG LLP
Chartered Professional Accountants
Bay Adelaide Centre
Suite 4600
333 Bay Street
Toronto, ON M5H 2S5

Telephone (416) 777-8500
Fax (416) 777-8818
www.kpmg.ca

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Morneau Shepell Inc.

We have audited the accompanying consolidated financial statements of Morneau Shepell Inc., which comprise the consolidated statements of financial position as at December 31, 2017 and 2016, the consolidated statements of income and comprehensive income, changes in equity and cash flows for the years then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained in our audits is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Morneau Shepell Inc. as at December 31, 2017 and 2016, and its consolidated financial performance and its consolidated cash flows for the years then ended in accordance with International Financial Reporting Standards.

KPMG LLP

Chartered Professional Accountants, Licensed Public Accountants

March 7, 2018
Toronto, Canada

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KPMG Canada provides services to KPMG LLP.

Morneau Shepell Inc.

Consolidated Statements of Financial Position

(In thousands of Canadian dollars)

December 31, 2017 and December 31, 2016

	2017	2016
Assets		
Current assets:		
Trade and other receivables (note 5)	**$ 76,050**	$ 67,291
Unbilled fees	**78,432**	61,131
Prepaid expenses and other	**9,696**	8,159
Cash and investments held in trust	**18,102**	17,211
Deferred implementation costs (note 6)	**7,925**	7,146
Total current assets	**190,205**	160,938
Non-current assets:		
Unbilled fees	**2,135**	5,128
Deferred implementation costs (note 6)	**22,579**	19,406
Interest rate swaps (note 13)	**433**	–
Capital assets (note 7)	**35,701**	34,499
Intangible assets (note 8)	**227,061**	230,572
Goodwill (note 9)	**324,100**	320,757
Deferred tax asset (note 16)	**1,794**	2,326
Investments in joint ventures (note 23)	**6,262**	–
Total non-current assets	**620,065**	612,688
Total assets	**$810,270**	$773,626

Morneau Shepell Inc.

Consolidated Statements of Financial Position

(In thousands of Canadian dollars)

December 31, 2017 and December 31, 2016

	2017	2016
Liabilities and Equity		
Current liabilities:		
Bank indebtedness (note 13)	**$ 5,416**	$ 3,056
Trade and other payables (note 10)	**72,581**	59,157
Income taxes payable	**5,540**	2,200
Deferred revenue	**5,632**	5,121
Insurance premium liabilities	**18,102**	17,211
Future consideration related to acquisitions (note 26)	**2,842**	5,252
Dividends payable	**3,463**	3,460
Interest rate swaps (note 13)	**–**	1,625
Total current liabilities	**113,576**	97,082
Non-current liabilities:		
Long-term debt (note 13)	**179,669**	166,299
Convertible debenture payable (note 14)	**82,080**	81,096
Future consideration related to acquisitions (note 26)	**733**	2,258
Other liabilities (note 11)	**18,280**	12,838
Provisions (note 12)	**4,286**	3,764
Deferred tax liability (note 16)	**50,587**	48,582
Total non-current liabilities	**335,635**	314,837
Equity:		
Share capital (note 19)	**558,972**	552,038
Contributed surplus (note 19)	**27,339**	27,369
Equity component of convertible debenture (note 14)	**1,045**	1,045
Accumulated other comprehensive loss (note 19)	**(2,806)**	(2,451)
Deficit	**(223,491)**	(216,294)
Total equity	**361,059**	361,707
Total liabilities and equity	**$ 810,270**	$ 773,626

Commitments and contingencies (notes 4, 25 and 26)

On behalf of the Board:

Audit Committee Chair

President & CEO

See accompanying notes to the consolidated financial statements.

Morneau Shepell Inc.

Consolidated Statements of Income and Comprehensive Income

(In thousands of Canadian dollars, except per share amounts)

Years ended December 31, 2017 and 2016

	2017	2016
Operating revenue	**$631,155**	$592,057
Operating expenses:		
Salary, benefits and contractors (note 24)	**429,026**	404,142
Office and administration	**71,124**	68,700
Rent and occupancy	**29,868**	30,072
Depreciation and amortization	**38,200**	35,238
Write-down of deferred implementation costs	**–**	935
Total operating expenses	**568,218**	539,087
Finance costs (note 13)	**13,165**	14,889
Profit before income taxes	**49,772**	38,081
Income taxes (note 16):		
Current	**15,356**	10,452
Deferred	**(166)**	1,629
Total income taxes	**15,190**	12,081
Profit for the year	**34,582**	26,000
Other comprehensive income (loss):		
Items that may be reclassified subsequently to profit:		
Effective portion of change in interest rate cash flow hedges	**2,058**	2,050
Foreign currency translation differences for foreign operations	**(1,995)**	(1,132)
Income taxes on the above items	**(551)**	(552)
	(488)	366
Items that will not be reclassified to profit:		
Actuarial gain on post-employment benefit plans	**185**	39
Income taxes on the above item	**(52)**	(6)
	133	33
Other comprehensive income (loss), net of tax effect	**(355)**	399
Comprehensive income for the year	**$ 34,227**	$ 26,399
Earnings per share (note 20):		
Basic	**$ 0.62**	$ 0.49
Diluted	**$ 0.62**	$ 0.49

See accompanying notes to the consolidated financial statements.

Morneau Shepell Inc.

Consolidated Statements of Changes in Equity

(In thousands of Canadian dollars)
Years ended December 31, 2017 and 2016

2017	**Share capital**	**Contributed surplus**	**Deficit**	**Accumulated other comprehensive loss**	**Equity component of convertible debenture**	**Total equity**
Balance, January 1, 2017	**$552,038**	**$27,369**	**$(216,294)**	**$(2,451)**	**$1,045**	**$361,707**
Long-term incentive plan-issuance (notes 18 and 19)	**–**	**6,904**	**–**	**–**	**–**	**6,904**
Long-term incentive plan – redemption	**6,934**	**(6,934)**	**–**	**–**	**–**	**–**
Profit for the year	**–**	**–**	**34,582**	**–**	**–**	**34,582**
Dividends	**–**	**–**	**(41,779)**	**–**	**–**	**(41,779)**
Other comprehensive income (note 19)	**–**	**–**	**–**	**(355)**	**–**	**(355)**
Balance, December 31, 2017	**$558,972**	**$27,339**	**$(223,491)**	**$(2,806)**	**$1,045**	**$361,059**

2016	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Equity component of convertible debenture	Total equity
Balance, January 1, 2016	$477,500	$23,312	$(202,295)	$(2,850)	$ 757	$296,424
Long-term incentive plan-issuance (note 18 and 19)	–	5,448	–	–	–	5,448
Long-term incentive plan – redemption	1,417	(1,417)	–	–	–	–
Equity component of convertible debentures issuance (note 14)	–	–	–	–	1,045	1,045
Shares issued upon conversion of convertible debentures (note 14)	73,121	–	–	–	(731)	72,390
Redemption of convertible debentures (note 14)	–	26	–	–	(26)	–
Profit for the year	–	–	26,000	–	–	26,000
Dividends	–	–	(39,999)	–	–	(39,999)
Other comprehensive income (note 19)	–	–	–	399	–	399
Balance, December 31, 2016	$552,038	$27,369	$(216,294)	$(2,451)	$1,045	$361,707

See accompanying notes to the consolidated financial statements.

Morneau Shepell Inc.

Consolidated Statements of Cash Flows

(In thousands of Canadian dollars)

Years ended December 31, 2017 and 2016

	2017	2016
Operating activities:		
Profit for the year	**$ 34,582**	$ 26,000
Items not involving cash:		
Depreciation and amortization	**38,200**	35,238
Finance costs (note 13)	**13,165**	14,889
Long-term incentive plan expense (note 18)	**6,692**	4,868
Income taxes (note 16)	**15,190**	12,081
Change in provisions	**522**	1,397
Other	**5,909**	(87)
	114,260	94,386
Change in non-cash operating working capital (note 22)	**(14,470)**	(9,734)
Cash generated from operating activities	**99,790**	84,652
Finance costs paid	**(11,395)**	(11,151)
Income taxes paid	**(10,807)**	(6,462)
Cash provided by operating activities	**77,588**	67,039
Financing activities:		
Change in revolving loan (net)	**13,060**	(75,071)
Credit facility agreement amendment fees	**–**	(794)
Redemption of convertible debenture (notes 14 and 22)	**–**	(2,512)
Dividends paid	**(41,776)**	(39,659)
Proceeds from convertible debentures (net of issuance costs) (note 14)	**–**	81,982
Repayment of promissory note	**–**	(2,500)
Cash used in financing activities	**(28,716)**	(38,554)
Investing activities:		
Business acquisitions, net of cash acquired (note 4)	**(19,817)**	(10,934)
Additions to intangible assets	**(16,953)**	(13,326)
Additions to capital assets	**(14,462)**	(9,181)
Cash used in investing activities	**(51,232)**	(33,441)
Decrease in cash for the year	**(2,360)**	(4,956)
Cash/(Bank indebtedness), beginning of year	**(3,056)**	1,900
Bank indebtedness, end of year	**$ (5,416)**	$ (3,056)

See accompanying notes to the consolidated financial statements.

1. Organization and nature of the business:

Morneau Shepell Inc. was incorporated pursuant to the laws of the Province of Ontario on October 19, 2010 and is a continuation of Morneau Sobeco Income Fund, which was converted from an income trust structure into Morneau Shepell Inc., effective January 1, 2011.

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

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

These consolidated financial statements were approved by the Company's Board of Directors on March 7, 2018.

2. Basis of preparation:

(a) Statement of compliance:

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS").

(b) Basis of measurement:

The consolidated financial statements have been prepared on the historical cost basis except for the following material items in the consolidated statements of financial position:

(i) interest rate swap is measured at fair value;

(ii) future consideration related to acquisitions is measured at fair value; and

(iii) net pension benefit liability is measured in accordance with the employee benefit policy (see note 17).

(c) Functional currency:

These consolidated financial statements are presented in Canadian dollars, which is the Company's presentation currency and the functional currency of Morneau Shepell Inc. Items included in the financial statements of each of Morneau Shepell Inc.'s subsidiaries are measured using their functional currency, which is the currency of the primary economic environment in which they operate in. Unless otherwise noted, all financial information presented herein is in thousands of Canadian dollars.

(d) Use of estimates and judgments:

The preparation of the consolidated financial statements requires management to make judgments, estimates and assumptions that affect the application of accounting policies and 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 year.

Estimated values of the reported amounts of assets and liabilities on the consolidated financial statements usually depend upon estimates of the profitability of the related business which, in turn, depend upon assumptions regarding future conditions in the general or specific industry, including the effects of economic cycles, and other factors that affect the operating revenue. These assumptions are limited by the availability of reliable comparable data, economic uncertainty and the uncertainty of predictions concerning future events. Accordingly, by their nature, estimates of fair value are subjective and do not necessarily result in precise determinations. Should the underlying assumptions change, the estimated value could change by a material amount, and actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed by management on an ongoing basis, and revisions to accounting estimates are recognized in the period giving rise to the change.

Information about the most significant estimates and judgments that the Company is required to make is included in the following notes:

(i) Revenue recognition (Administrative Solutions contracts) (note 3(c)):

Where a singular Administrative Solutions contract requires the delivery of multiple components, the Company is required to assess the criteria for the recognition of revenue related to each component. These assessments require judgment by management to determine whether separately identifiable components exist, and where applicable, the appropriate fair value allocations to each. Amongst other factors, management considers whether implementation services have stand-alone value to the customer, and look to budgeted salary costs associated with each phase of the service contract to derive fair value estimates.

Additional discussion on the Company's revenue recognition policies can be found in note 3(c). Changes in management's estimates could affect the timing of recognizing the revenues and expenses associated with these contracts.

(ii) Unbilled fees:

The Company is required to assess the recoverability of fees on services provided but not yet billed. This assessment requires judgment by management to determine whether fees will be less than fully recoverable through invoicing. Amongst other factors, management considers the solvency of the client, the age of the outstanding unbilled fees balance, the fee arrangement and historic client experience. If future billings differ from estimates, future profits could be materially affected.

(iii) Intangible assets (note 8):

(a) Internally-developed software:

The Company is required to estimate the expected period of benefit over which costs should be amortized. Management considers the anticipated rate and timing of technological obsolescence and competitive pressures, historical usage patterns, and internal business plans for the projected use of the software in deriving its useful life. Due to the rapidly changing technological environment and the uncertainty of the development processes themselves, future results could be affected if management's current assessment of future benefits materially differs from actual performance.

(b) Other intangible assets:

Other intangible assets consist of those acquired through business acquisitions. Purchase price allocations involve significant estimates and assumptions regarding cash flow projections, growth projections, economic risk, and cost of capital. If future events or results differ adversely from these estimates and assumptions, the Company could incur increased amortization or impairment charges in future periods.

(iv) Goodwill (note 9):

Goodwill impairment review involves significant estimates and assumptions regarding cash flow projections, growth projections, economic risk, and cost of capital. If future events or results differ adversely from these estimates and assumptions, the Company could incur impairment charges in future periods. Additional discussion on impairment of non-financial assets can be found in notes 8 and 9.

(v) Trade receivables (allowance for doubtful accounts) (note 5):

The Company is required to assess whether accounts receivables are collectible from customers. Accordingly, management establishes an allowance for estimated losses arising from non-payment and delinquent accounts, current economic trends, and past experience. If future collections differ from estimates, future profits could be adversely affected.

(vi) Deferred income tax assets and liabilities (utilization of tax losses) (note 16):

Deferred income tax assets are recognized for all unused tax losses and deductible temporary differences to the extent that it is probable that taxable profit will be available against which the losses and deductible temporary differences can be utilized. Significant management judgment is required to determine the amount of deferred income tax assets that can be recognized, based upon the likely timing and the level of future taxable profits together with future tax planning strategies.

(vii) Provisions (note 12):

In identifying required provisions, the Company has to assess the probability of the future outflows of resources. Estimates must subsequently be made by management to approximate the timing and amount of these liabilities. If future events or results differ adversely from these estimates, future profits could be adversely affected.

(viii) Future consideration related to acquisitions (note 26):

The Company may pay future consideration related to acquisitions based upon performance measures contractually agreed at the time of purchase. Management estimates the future consideration payable based on underlying contract terms, and best estimates of the future performance of the acquiree. Depending on the future performance of the acquiree, management estimates of the amounts payable for future consideration related to acquisitions may materially differ from the consideration ultimately paid.

3. Significant accounting policies:

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements.

(a) Basis of consolidation:

(i) Business combinations:

Acquisitions of businesses are accounted for using the acquisition method. The acquisition cost is measured at the acquisition date at the fair value of the consideration transferred, including all contingent consideration. Subsequent changes in contingent consideration are accounted for through the statement of income and comprehensive income.

Goodwill arising on acquisition is initially measured at cost, being the difference between the fair value of the consideration transferred including the recognized amount of any non-controlling interest in the acquiree and the net recognized amount (generally fair value) of the identifiable assets and liabilities assumed at the acquisition date. If the net of the amounts of the identifiable assets acquired and liabilities assumed exceeds the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held interest in the acquiree (if any), the excess is recognized immediately in profit or loss as a bargain purchase gain.

Acquisition-related costs, other than those that are associated with the issue of debt or equity securities that the Company incurs in connection with a business combination, are expensed as incurred.

(ii) Subsidiaries:

These consolidated financial statements include the assets, liabilities, revenue and expenses of all the Company's subsidiaries. Subsidiaries are entities that the Company controls either when it is exposed, or has rights, to variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. Subsidiaries are consolidated from the date control is transferred to the Company, and de-consolidated from the date control ceases.

These consolidated financial statements include the assets, liabilities, revenue and expenses of all the Company's subsidiaries including the following operating entities:

	% Ownership
Morneau Shepell Ltd.	100.0
Morneau Shepell Limited	100.0
Morneau Shepell Asset & Risk Management Ltd.	100.0
Morneau Shepell (Bahamas) Ltd.	100.0
Groupe AST (1993) Inc.	100.0
Morneau Shepell BDA Limited	100.0
Chestnut Global Partners, LLC	100.0

All intercompany transactions and balances between subsidiaries have been eliminated upon consolidation.

(iii) Joint ventures:

Joint ventures are those entities over which the Company exercises joint control, requiring unanimous consent of the parties sharing control of relevant activities such as strategic, financial and operating decision-making. Investments in joint ventures are accounted for using the equity method. They are initially recognized at cost and subsequent to initial recognization, the consolidated financial statements include the Company's share of the joint ventures' profit or loss and other comprehensive income.

(b) Foreign currency translation:

Transactions denominated in currencies other than the functional currency are recorded at the exchange rates prevailing at the date of the transaction. At each reporting date, monetary assets and liabilities denominated in foreign currencies are translated at the rates prevailing as at that date. Non-monetary items that are measured in terms of historical cost in a foreign currency are not re-translated.

Assets and liabilities of subsidiaries with applicable functional currencies other than the Canadian dollar are translated at period-end rates of exchange, and operating results are translated at average rates of exchange for the period. The resulting translation adjustments are included in accumulated other comprehensive income in shareholders' equity.

(c) Revenue recognition and unbilled fees:

Revenues include fees generated from consulting services, Administrative Solutions, Employee Support Solutions ("ESS"), and absence management solutions contracts.

Generally, revenue from the rendering of services is recognized when the following criteria are met:

(i) the amount of revenue can be reliably measured;

(ii) the stage of completion can be reliably measured;

(iii) the receipt of economic benefits is probable; and

(iv) costs incurred and to be incurred can be reliably measured.

Concurrently with the above general principles, the Company applies the following specific revenue recognition policies:

Fees for actuarial and consulting services are billed either on a time-and-material basis or on a fixed-fee basis. Revenue is recognized as services are rendered and expenditures are incurred.

ESS revenue is recognized through a combination of the minimum contracted amount and incremental usage above the minimum thresholds. The minimum contracted amount is recognized on a basis consistent with provision of ESS services. Incremental usage is recognized when the minimum usage threshold is exceeded.

Absence management solutions revenue is recognized on a fixed-fee or time-and-material basis. On fixed-fee basis arrangements, where the provision of service is characterized by an indeterminate number of acts, revenue is recognized on a straight-line basis over the term of the contract. On time-and-material basis arrangements, revenue is recognized as services are rendered and expenditures are incurred.

Administrative Solutions engagements typically involve both an implementation and administration component. Where a single contract requires the delivery of multiple components, revenue recognition criteria are applied to determine whether each component of the contract qualifies for treatment as a separate unit of account. Multiple deliverable arrangements are determined to exist if both of the following criteria are met:

(i) the delivered item has value to the customer on a stand-alone basis; and

(ii) the fair value of the undelivered item can be reliably measured.

If these criteria are not met, deliverables (components) included in an arrangement are accounted for as a single unit of accounting and revenue is deferred and recognized on a basis consistent with elements of the service contract.

Unbilled fees represent fees earned for services rendered but not yet invoiced as at the reporting date; upon billing, this balance will be transferred to trade receivables. Unbilled fees on time and material basis arrangements are recorded at the lower of unbilled hours worked at normal billing rates and at the amount which is estimated to be recoverable upon invoicing. The Company maintains a provision for amounts expected to be unrecoverable.

Other sources of operating revenue include the following:

(i) Investment income earned in the course of normal business operations, and is recorded on the accrual basis.

(ii) Commissions income is recognized when earned, net of a provision for return commissions due to policy cancellations or change of brokers.

(d) Deferred implementation costs and deferred outsourcing revenues:

Implementation costs incurred in connection with Administrative Solutions contracts, relate to those costs necessary to set up clients and their human resource or benefit programs onto the Company's systems and operating processes. Such costs may include internal and external costs for coding and customizing systems, client data conversion costs, and contract negotiation costs. For Administrative Solutions contracts that are accounted for as a combined unit of accounting, specific, incremental, and direct costs, net of any revenue received from the implementation component, are deferred and amortized over the term of the service contract.

If a client terminates an outsourcing contract prior to its end, a loss on the contract may be recorded (if necessary), and any remaining deferred implementation revenues and costs would be recognized into income over the remaining implementation period through to the date of termination.

(e) Cash and bank indebtedness:

Cash is comprised of bank balances and banker's deposit notes with an original maturity of three months or less, and are primarily held in Canadian and U.S. dollars. Where the cash is in a net overdraft position, it has been presented as bank indebtedness.

(f) Trade and other receivables:

Trade receivables are fees due from customers from the rendering of services in the ordinary course of business. Trade receivables are classified as current if payment is due within one year of the reporting period date, and are initially recognized at fair value and subsequently measured at amortized cost.

The Company maintains an allowance for doubtful accounts to provide for impairment of trade receivables. An impairment loss is recognized when there is evidence that the Company will not be able to collect the amount due under the original terms of the invoice. Expenses related to doubtful accounts are reported as office and administration expenses.

Other receivables are those amounts incidental to the Company's normal business operations and are classified as current when they are expected to be settled within one year of the reporting period date. Other receivables are initially recognized at fair value, and are subsequently measured at amortized cost, less impairment.

(g) Capital assets:

Capital assets are recognized at initial cost less accumulated depreciation and impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset, including those attributable to bringing the asset to its intended working condition. Where significant parts of a capital asset have different useful lives, they are accounted for and depreciated as separate components. Software, to the extent that it is integral to the operation of the related computer equipment, has been included as part of the cost of computer equipment.

Gains and losses on disposals of a capital asset item are determined by comparing the proceeds from disposal with its carrying amount, and are recognized as a gain (loss) on disposal in the consolidated statement of income and comprehensive income.

Depreciation is calculated over the depreciable amount, which is the cost of the asset less its residual value. Depreciation is recognized on a straight-line basis, over the assets' estimated useful lives, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. The estimated useful lives of the Company's capital assets are as follows:

Computer hardware	3 - 5 years
Furniture and fixtures	5 years
Leasehold improvements	Over the term of the lease

Residual values, useful lives, and depreciation methods are reviewed at the end of each reporting period and adjusted prospectively as required.

(h) Intangible assets:

Intangible assets consist of customer relationships, customer contracts, proprietary software, and trade names acquired through acquisitions or business combinations, internally-developed software, and purchased software.

Internally-developed software is recognized at the aggregate cost of all eligible development costs, when all the following criteria are met:

(i) it is technically feasible to complete the software so that it will be available for use;

(ii) management intends to complete the software and use or sell it;

(iii) the Company is able to use or sell the software;

(iv) future benefits associated with the software can be demonstrated;

(v) adequate technical, financial, and other resources to complete the development and to use or sell the software are available; and

(vi) the expenditures attributable to the software during its development can be reliably measured.

Eligible expenditures capitalized as part of internally-developed software include external direct costs of materials and services consumed in development, and payroll and payroll-related costs for employees who are directly associated with and who devote time to the development of the software. All costs incurred in the preliminary research stage of the projects are expensed as incurred.

Purchased software is recognized at initial cost.

Other intangible assets acquired as part of business acquisitions are measured initially at fair value.

Intangible assets with a finite life are amortized on a straight-line basis over their estimated useful lives. Amortization is recognized over the assets' estimated useful lives as follows:

Customer relationships	5 - 20 years
Customer contracts	1 - 3 years
Proprietary software	5 - 10 years
Clawback agreements	10 years
Trade names	Indefinite
Internally-developed software	3 - 10 years
Purchased software	3 years

Intangible assets with an indefinite life are not amortized, but are subject to impairment tests annually or whenever impairment indicators are identified. Trade names have been determined to have an indefinite life based on their strength, history, and expected future use.

Amortization expense has been presented in profit or loss as depreciation and amortization. Assets are removed from asset and accumulated amortization balances once they become fully amortized. Proceeds from disposals are netted against the related assets and accumulated amortization, and resulting gains and losses are included in profit or loss.

Amortization on internally-developed software does not commence until the asset is ready for use as management intended.

(i) Goodwill:

Goodwill represents the excess of the cost of the Company's business acquisitions over the fair value of the Company's share of the net identifiable assets of the acquired subsidiary at the date of acquisition. Goodwill is carried at cost less accumulated impairment charges, and is not amortized but is subject to an impairment test annually and whenever impairment indicators are identified.

(j) Impairment of non-financial assets:

The Company's identifiable tangible and intangible assets with finite useful lives are reviewed for indicators of impairment at each statement of financial position date and when events or changes in circumstances indicate that they may be impaired. Impairments are recorded when the recoverable amount of assets are less than their carrying amounts. The recoverable amount is the higher of an asset's fair value less cost of disposal or its value in use.

Similarly, intangible assets with indefinite useful lives and goodwill are tested annually and whenever impairment indicators are identified, by estimating their recoverable amounts and comparing it to their carrying amounts. Where individual assets cannot be tested individually, they are grouped together into cash-generating units ("CGUs"), which represent the smallest group of assets that are capable of generating cash inflows from continuing use largely independent of other groups of assets, and tested on this basis. Goodwill acquired through a business combination is allocated to each CGU, or groups of CGUs but not larger than an operating segment, that are expected to benefit from the synergies of the combination.

An impairment loss is recognized if the carrying amount of the CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss, and those impairment losses recognized in respect of CGUs

are allocated first to reduce the carrying amount of any goodwill allocated to the CGU, and then to reduce the carrying amount of the other non-financial assets in the CGU on a pro rata basis.

Impairment losses in respect of goodwill are not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount, and only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, had no impairment charge been recorded.

(k) Provisions:

Provisions are recognized when the Company has a present obligation to a third-party and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. The obligation may be legal, regulatory or contractual or it may represent a constructive obligation deriving from the Company's actions where, by an established pattern of past practice or published policies, the Company creates a valid expectation on the part of other parties that the Company will discharge certain responsibilities.

(l) Deferred revenue:

Deferred revenue represents the excess of retainer amounts billed over revenue earned on service contracts. The amount is recognized as revenue in profit or loss as services are rendered, in accordance with the revenue recognition policies described above.

(m) Convertible debentures:

Compound financial instruments issued by the Company comprise convertible debentures that can be converted to share capital at the option of the holder, and the number of shares to be issued does not vary with changes in their fair value.

The liability component of a convertible debenture is recognized initially at the fair value of a similar liability that does not have an equity conversion option. The equity component is recognized initially as the difference between the fair value of the convertible debenture as a whole and the fair value of the liability component. Any directly attributable transaction costs are allocated to the liability and equity components in proportion to their initial carrying amounts.

Subsequent to initial recognition, the liability component of the convertible debenture is measured at amortized cost using the effective interest rate method. The equity component of the convertible debenture is not remeasured subsequent to initial recognition.

Interest, losses and gains relating to the financial liability are recognized in profit or loss.

(n) Share capital:

Common shares are classified as an equity instrument. Incremental costs directly attributable to the issuance of common shares are recognized as a reduction of equity, net of the related tax effect.

(o) Insurance premium liabilities and related cash and investments:

In its capacity as consultants, the Company collects premiums from insurers and remits premiums, net of agreed deductions, such as taxes, administrative fees and commissions, to insurance underwriters. The cash and investment balances and the related liabilities have been presented separately in the Company's consolidated statements of financial position.

(p) Employee benefits:

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

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

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. A defined benefit plan is a post-employment benefit plan other than a defined contribution plan.

(i) Defined benefit plan:

The liability recognized in the consolidated statements of financial position in respect of the defined benefit is the present value of the defined benefit obligation at the end of the reporting period less the fair value of plan assets. The defined benefit obligation is calculated using the projected benefit method pro-rated on service. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating the terms of the related pension obligation. Past service costs are recognized immediately in profit or loss. Interest is recognized on the net defined benefit liability using market yields on high quality bonds.

(ii) Defined contribution plan:

Under the defined contribution option, each member is required to contribute a percentage of earnings. The Company matches this required contribution. Each member may elect to make an optional contribution in addition to the required contribution. The Company contributes 50% of the optional contributions.

For members who had completed at least 10 years of service on December 31, 2010, their contributions follow grandfathered provisions. Each of these members 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 up to 300% of the member's required contribution. The Company matches required contributions and contributes 75% of optional contributions for these grandfathered members.

The Company has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expense when they are due.

(q) Share-based compensation plan:

The Company offers an equity-settled compensation plan under which it receives services from employees as consideration for equity instruments of the Company. Under the long-term incentive plan ("LTIP"), the Company may grant participants restricted share units ("RSUs"), retirement deferred share units ("Retirement DSUs"), or post-retirement deferred share units ("Post-Retirement DSUs"), collectively referred to as "LTIP Units".

Expense related to LTIP Units is measured based on the fair value of the awards at the grant date. The expense is recognized as salary, benefit and contractor expense over the vesting period, which is the period over which all of the specified vesting conditions are satisfied. When LTIP Units are redeemed, they are issued to the participant and are recorded as share capital. At the option of the Company, holders of LTIP Units are entitled to either additional LTIP Units as determined based on the fair market value of those LTIP Units on the date credited or cash bonuses equivalent to the dividends payable had those Units been common shares. LTIP Units credited under the dividend reinvestment policy ("DRIP") vest at the same rate as the LTIP Units to which they are determined. Cash bonuses are recorded as salary, benefit, and contractor expense.

At the end of each reporting period, the Company reassesses its estimates of the number of awards that are expected to vest and be forfeited, and recognizes the impact of any revisions into profit or loss.

(r) Income taxes:

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

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

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

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

In determining the amount of current and deferred taxes, the Company takes into account the impact of uncertain tax positions and whether additional taxes and interest may be due. The Company believes that its accruals for tax liabilities are adequate for all open tax years based on its assessment of many factors, including interpretations of tax laws and prior experience. This assessment relies on estimates and assumptions and may involve a series of judgments about future events. New information may become available that causes the Company to change its judgment regarding the adequacy of existing tax liabilities; such changes to tax liabilities will impact tax expense in the period that such a determination is made.

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

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

(s) Financial instruments:

Financial assets and liabilities are recognized initially at fair value, defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In certain circumstances, however, the initial fair value may be based on other observable current market transactions in the same instrument, without modification or on a valuation technique using market based inputs. Subsequent measurement of the Company's financial assets and liabilities is dependent on their classification as held for trading, loans and receivables, other financial liabilities or derivative instruments.

The Company initially recognizes loans and receivables on the date that they originated. All other financial assets (including assets designated at fair value through profit or loss) are recognized initially on the trade date or when the Company becomes a party to the contractual provisions of the instrument.

The Company derecognizes a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by the Company is recognized as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the consolidated statements of financial position, when and only when, the Company has a legal right to offset the amounts and intends either to settle on a net basis or to realize the asset and settle the liability simultaneously.

The Company assesses as at each reporting period whether there is objective evidence that a financial asset or group of financial assets is impaired. When an impairment has occurred, the cumulative loss is recognized into profit or loss. The cumulative loss is measured as the difference between the amortized cost and the current fair value, less any impairment loss previously recognized in profit or loss.

(i) Non-derivative financial assets:

(a) Financial assets at fair value through profit and loss:

Financial assets at fair value through profit and loss are comprised of cash and investments held in trust. A financial asset is classified at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if it is a part of an identified portfolio of financial instruments that the Company manages and has an actual pattern of short-term profit-taking. Upon initial recognition, attributable

transaction costs are recognized in profit or loss as incurred. Financial assets at fair value through profit or loss are measured at fair value at each reporting date, and any unrealized gains or losses from market fluctuations are recognized in profit or loss.

(b) Loans and receivables:

Loans and receivables comprise trade and other receivables. Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value and subsequently measured at amortized cost using the effective interest method, less any impairment losses.

(ii) Non-derivative financial liabilities:

The Company initially recognizes debt securities issued and subordinated liabilities on the date that they originated. All other financial liabilities are recognized initially on the trade date at which time the Company becomes a party to the contractual provisions of the instrument.

Financial liabilities are recognized initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition these financial liabilities are measured at amortized cost using the effective interest method. Financial liabilities are derecognized when the contractual obligations are discharged, cancelled or expire.

Non-derivative financial liabilities of the Company include long-term debt, convertible debenture payable (see note 3(m) above), bank indebtedness, trade and other payables, and insurance premium liabilities.

(iii) Derivative financial instruments:

Derivative financial instruments are used by the Company in the management of its interest rate risk exposure on debt financing. Derivatives that have been designated and function effectively as hedges are accounted for using hedge accounting principles (see note 3(t) below). Derivative financial instruments that are not accounted for as a hedging instrument are measured at fair value through profit or loss.

(iv) Fair value of financial instruments:

Fair values of financial instruments are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3 - inputs for the asset or liability that are not based on observable market data.

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

(t) Cash flow hedge – derivative instruments:

Derivative instruments are initially recognized at fair value on the date the contract is entered into and are subsequently re-measured to fair value at each reporting date. The Company holds derivative instruments for hedging purposes only, and does not enter into derivative contracts for speculative purposes.

The Company prepares formal documentation at the inception of the transaction to detail the relationship between derivative hedging instruments and hedged items, as well as its risk management objectives and strategy in partaking in the hedging transaction. The Company also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivative used in hedging transactions is highly effective in offsetting the changes in cash flows of the hedged items.

Non-performance risk, inclusive of the Company's credit risk, is considered in determining the fair value of the financial instruments.

The Company has designated its derivative instruments as cash flow hedges. Cash flow hedges are hedges against highly probable forecasted transactions. The effective portion of changes in the fair value of derivatives that are designated as a cash flow hedge is recognized as a component of other comprehensive income. The gain or loss relating to the ineffective portion is recognized immediately into profit or loss. Amounts accumulated in other comprehensive income are recycled into profit or loss in the period in which the hedged item will affect profit or loss. When a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss in other comprehensive income remains in other comprehensive income and is recognized when the original forecasted transaction is ultimately recognized into profit or loss. If a forecasted transaction is no longer expected to occur, the cumulative gain or loss in other comprehensive income is immediately recognized into profit or loss.

(u) Changes in accounting policies:

The accounting policies applied by the Company in its consolidated financial statements as at and for the year ended December 31, 2017 are consistent with those applied by the Company in its comparative consolidated financial statements as at and for the year ended December 31, 2016.

(v) Future accounting changes:

(i) IFRS 15, Revenue ("IFRS 15")

In May 2014, the IASB issued IFRS 15. The new standard is effective for fiscal years beginning on or after January 1, 2018 and is available for early adoption. The standard contains a single model that applies to contracts with customers and two approaches to recognizing revenue: at a point in time or over time. The model features a contract-based five-step analysis of transactions to determine whether, how much and when revenue is recognized. New estimates and judgmental thresholds have been introduced, which may affect the amount and/or timing of revenue recognized.

The Company will adopt IFRS 15 in its financial statements using the full retrospective method for the annual period beginning on January 1, 2018 and will apply the following practical expedients on the date of transition:

- Paragraph C5(a) of IFRS 15, under which the Company does not restate contracts that begin and end within the same annual reporting period, or are completed contracts at the beginning of the earliest period presented.

- Paragraph C5(c) of IFRS 15, under which the Company does not disclose the amount of consideration allocated to remaining performance obligations or an explanation of when the Company expects to recognize that amount as revenue for all reporting periods presented before the initial date of application of January 1, 2018.

The Company has also substantially completed its assessment of the impact of adopting this standard on its financial statements.

Under IFRS 15 for Administrative Solutions application service provider ("ASP") and software as a service ("SaaS") contracts that provide the customer with a right to access license to the Company's proprietary pension and benefits software over the term of the contract, the implementation component and ongoing services will be considered a single performance obligation. Currently, the Company considers the implementation component to be a separate unit of accounting, resulting in the recognition of implementation fees as revenue upon the commencement of the implementation.

Furthermore, implementation costs incurred in connection with Administrative Solutions contracts where the implementation component is not considered a separate performance obligation are currently deferred and amortized over the initial term of the service contract. Under IFRS 15, the Company will consider the renewal period as permitted in the contract in addition to the initial term of the contract, in determining the amortization period for these deferred costs.

As a result of the changes noted above, the Company estimates that the Company's deficit will increase by $4,785 on the date of adoption of January 1, 2018 and by $3,230 on January 1, 2017, with the profit of the Company for the year ended December 31, 2017 decreasing by $1,556.

(ii) IFRS 9, Financial Instruments ("IFRS 9")

In July 2014 the IASB finalized IFRS 9. The standard is effective for fiscal years beginning on or after January 1, 2018 and is available for early adoption. The new standard includes revised guidance on the classification and measurement of financial assets, a new 'expected loss' impairment model and introduces a substantially-reformed approach to hedge accounting. The Company intends to adopt IFRS 9 in its financial statements for the annual period beginning on January 1, 2018. The impact of adoption of this standard is not significant.

(iii) IFRS 16, Leases ("IFRS 16")

In January 2016, the IASB issued IFRS 16. The standard is effective for annual periods beginning on or after January 1, 2019, with earlier adoption permitted for those entities that have also adopted IFRS 15. The new standard provides a comprehensive model for the identification of lease arrangements and their treatment in the financial statements. IFRS 16 supersedes IAS 17, Leases, and its associated interpretative guidance. IFRS 16 applies a control model to the identification of leases, differentiating between leases and service contracts on the

basis of whether there is an identified asset controlled by the customer. Among other significant changes, the distinction between operating and finance leases is removed and assets and liabilities are recognized in respect of all leases. Furthermore, IFRS 16 results in a front-loaded pattern for the recognition of lease expense over the life of the lease. The Company intends to adopt IFRS 16 in its financial statements for the annual period beginning on January 1, 2019. The extent of the impact of adoption of the standard has not yet been determined.

4. Business acquisitions:

(a) Groupe Pro-Santé Inc.

On October 31, 2017, the Company completed the acquisition of Groupe Pro-Santé Inc. ("Pro-Santé"), a health and wellness service provider based in Québec City. This acquisition complements the Company's existing employee support solutions line of business, and expands our presence in the Quebec region.

The consideration for Pro-Santé included an initial payment of $3,774 that was settled on closing, and estimated future cash consideration of $900 which is dependent on achieving certain revenue targets, $450 of which is due within 60 days of October 31, 2018 and the remaining $450 of which is due within 60 days of October 31, 2019. At the date of acquisition, $632 was recognized as an acquisition liability representing the estimated future cash payments discounted.

The acquisition has been accounted for using the acquisition method of accounting. The allocation of the purchase consideration for this acquisition is preliminary and is as follows:

Net working capital	$ 545
Capital assets	32
Intangible assets	3,930
Goodwill	720
Deferred tax liability	(821)
	$4,406

The goodwill is attributable primarily to the network of providers acquired and from the ability to expand the Company's existing employee support solutions practice. The goodwill is not deductible for tax purposes.

From the date of acquisition up to and including December 31, 2017, the acquisition has contributed revenues of $1,192 and profit of $107. Had this acquisition occurred on January 1, 2017, the Company estimates that the impact on consolidated revenues and profit of the Company would not be significant. In determining these amounts, the Company has assumed that the fair value adjustments that arose on the acquisition date would have been the same had the acquisition occurred on January 1, 2017.

(b) Chestnut Global Partners

On December 1, 2017, the Company acquired the Chestnut Global Partners Group of Companies ("Chestnut"), an international employee assistance program provider. Chestnut through Chestnut Global Partners, LLC, based in Bloomington, Illinois, has equity interests in joint ventures that have a presence internationally, including the United States, Brazil, China, Eastern Europe, India and Russia, which complements the Company's existing employee support solutions line of business and allows us to expand our presence globally. The consideration paid for Chestnut was $11,449 ($8,994 US) and was settled on closing.

The acquisition of Chestnut has been accounted for using the acquisition method of accounting. The allocation of the purchase consideration for Chestnut is preliminary, including the Company's assessment ot its equity interests, and is as follows:

Net working capital	$ (10)
Investments in joint ventures	6,145
Intangible assets	2,040
Goodwill	3,274
	$11,449

The goodwill is attributable primarily to the network of providers acquired and from the ability to expand the Company's existing employee support solutions practice. The goodwill is deductible for tax purposes.

The investments in joint ventures includes the following joint ventures that were acquired as part of the acquisition:

	Ownership percentage
Chestnut Global Partners do Brasil, LLC	90.0
CGP Employee Assistance Solutions of India Private Limited (India)	70.0
CGP Europe Kurlátolt Felelõsségũ Társaság	66.7
CGP – China	51.0
Memorial Employee Assistance Services, L.L.C. (Illinois)	50.0
Corporate Health, LLC (Russia)	37.5

The Company accounts for its investments in the joint ventures using the equity method based on its prelimary assessment that it has joint control.

From the date of acquisition up to and including December 31, 2017, Chestnut has contributed revenues of $597 and profit of $122. Had this acquisition occurred on January 1, 2017, the Company estimates that the impact on consolidated revenues and profit of the Company would not be significant. In determining these amounts, the Company has assumed that the fair value adjustments that arose on the acquisition date would have been the same had the acquisition occurred on January 1, 2017.

(c) Employees Support Solutions acquisitions in the Quebec region

On December 20, 2016, the Company completed the acquisitions of Solareh, Société pour L`Avancement Des Ressources Humaines Inc. ("Solareh"), a national health and wellness services company based in Montreal and Les Consultants Longpré & Associés Inc. ("Longpré"), an employee assistance and wellness program provider based in Montreal. These acquisitions complement the Company's existing employee support solutions line of business, and expand our presence in the Quebec region.

The consideration for Solareh included an initial payment of $7,650 that was settled on closing, and estimated future cash consideration of $1,350 which is dependent on achieving certain revenue targets and is due within 60 days of January 1, 2018. At the date of acquisition, $994 was recognized as an acquisition liability representing the estimated future cash payments discounted.

The consideration for Longpré included an initial payment of $2,250 that was settled on closing and estimated future cash consideration of $1,650 which is dependent on achieving certain revenue targets, $750 of which is due within 80 days of January 1, 2018 and the remaining $900 which is to be paid over the next five years, of which $75 was paid in 2017. At the date of acquisition, $1,107 was recognized as an acquisition liability representing the estimated future cash payments discounted.

These acquisitions have been accounted for using the acquisition method of accounting. The allocation of the purchase consideration for these acquisitions is final, and is as follows:

Net working capital	$ 764
Capital assets	667
Intangible assets	7,989
Goodwill	3,111
Deferred tax liability	(530)
	$12,001

The goodwill is attributable primarily to the network of providers acquired and from the ability to expand the Company's existing employee support solutions practice. The goodwill is deductible for tax purposes.

(d) Other Acquisition during year ended December 31, 2016

In 2016, the Company completed one other smaller strategic acquisition which complements the Administrative Solutions line of business for total cash consideration of $604 ($450 US), of which $351 was paid in 2017 and the remaining $253 expected to be paid in 2018.

At December 31, 2016, $604 has been recognized as an acquisition liability on the statement of financial position, representing the fair value of future cash consideration discounted.

This acquisition has been accounted for using the acquisition method of accounting. The allocation of the $604 purchase consideration for this acquisition is final, and is as follows:

Intangible assets	$585
Capital assets	19
	$604

5. Trade and other receivables:

The Company's trade and other receivables are as follows:

	December 31, 2017	December 31, 2016
Trade receivables	**$71,392**	$68,205
Less: allowance for doubtful accounts	**(362)**	(1,111)
Net trade receivables	**71,030**	67,094
Other receivables	**5,020**	197
	$76,050	$67,291

The aging of the trade receivables at each reporting date was as follows:

	December 31, 2017	December 31, 2016
Current	**$33,570**	$37,697
Past due 1 - 30 days	**15,045**	14,933
Past due 31 - 90 days	**11,326**	9,507
Past due > 90 days	**11,451**	6,068
	$71,392	$68,205

The change in allowance for doubtful accounts was as follows:

Balance, January 1, 2016	$ 802
Additions	811
Amounts written off as uncollectible	(502)
Balance, December 31, 2016	1,111
Additions	510
Amounts written off as uncollectible	(1,259)
Balance, December 31, 2017	$ 362

6. Deferred implementation costs:

The Company's deferred implementation costs comprise the following:

	Cost	**Accumulated amortization**	**Net book value**
Balance, January 1, 2016	$50,050	$(33,779)	$16,271
Deferred implementation costs for the year, net of revenue	17,114	–	17,114
Write-down of deferred implementation costs	–	(935)	(935)
Amortization for the year	–	(5,936)	(5,936)
Effect of movements in exchange rates	(486)	524	38
Balance, December 31, 2016	66,678	(40,126)	26,552
Deferred implementation costs for the year, net of revenue	12,892	–	12,892
Amortization for the year	–	(7,805)	(7,805)
Effect of movements in exchange rates	(2,697)	1,562	(1,135)
Balance, December 31, 2017	$76,873	$(46,369)	$30,504
Less current portion			7,925
Non-current portion			$22,579

7. Capital assets:

The Company's capital assets comprise the following:

	Computer hardware	Furniture and fixtures	Leasehold improvements	Total
Cost				
Balance, January 1, 2016	21,986	8,467	27,992	58,445
Additions	7,132	811	1,238	9,181
Acquired through business acquisitions (note 4)	405	161	120	686
Disposals of fully depreciated assets	(4,846)	(448)	(2,571)	(7,865)
Effect of movements in exchange rates	(83)	(41)	(119)	(243)
Balance, December 31, 2016	24,594	8,950	26,660	60,204
Additions	9,130	1,167	4,165	14,462
Acquired through business acquisitions (note 4)	24	8	–	32
Disposals of fully depreciated assets	(6,255)	(1,064)	(3,151)	(10,470)
Effect of movements in exchange rates	(22)	(130)	(350)	(502)
Balance, December 31, 2017	$27,471	$ 8,931	$27,324	$ 63,726

	Computer hardware	Furniture and fixtures	Leasehold improvements	Total
Accumulated depreciation				
Balance, January 1, 2016	10,536	3,270	8,981	22,787
Depreciation	6,533	1,371	2,960	10,864
Disposals of fully depreciated assets	(4,846)	(448)	(2,571)	(7,865)
Effect of movements in exchange rates	(27)	(7)	(47)	(81)
Balance, December 31, 2016	12,196	4,186	9,323	25,705
Depreciation	7,546	1,635	3,063	12,244
Disposals of fully depreciated assets	(6,255)	(1,064)	(3,151)	(10,470)
Impairment loss	–	34	743	777
Effect of movements in exchange rates	(123)	(30)	(78)	(231)
Balance, December 31, 2017	$13,364	$ 4,761	$ 9,900	$ 28,025
Carrying amount				
December 31, 2016	$12,398	$ 4,764	$17,337	$ 34,499
December 31, 2017	$14,107	$ 4,170	$17,424	$ 35,701

8. Intangible assets:

The Company's intangible assets comprise the following:

	Indefinite useful life	Finite useful life						
	Trade names	Customer relationships	Customer contracts	Proprietary software	Internally-developed software	Purchased software	Other	Total
Cost								
Balance, January 1, 2016	70,000	233,772	4,720	4,179	48,975	7,815	155	369,616
Internally developed	–	–	–	–	11,349	–	–	11,349
Purchased	–	–	–	–	–	1,977	–	1,977
Acquired through business acquisitions	–	8,322	–	–	–	252	–	8,574
Disposals of fully depreciated assets	–	–	–	–	(3,223)	(3,188)	–	(6,411)
Effects of movements in exchange rates	–	(208)	–	–	–	9	–	(199)
Balance, December 31, 2016	70,000	241,886	4,720	4,179	57,101	6,865	155	384,906
Internally developed	–	–	–	–	15,005	–	–	15,005
Purchased	–	–	–	–	–	1,948	–	1,948
Acquired through business acquisitions	–	4,888	1,082	–	–	–	–	5,970
Disposals of fully depreciated assets	–	–	–	–	(3,953)	(2,958)	–	(6,911)
Effects of movements in exchange rates	–	(525)	(46)	–	–	(23)	–	(594)
Balance, December 31, 2017	$70,000	$246,249	$5,756	$4,179	$68,153	$ 5,832	$155	$400,324

	Indefinite useful life	Finite useful life						
	Trade names	Customer relationships	Customer contracts	Proprietary software	Internally-developed software	Purchased software	Other	Total
Accumulated amortization								
Balance, January 1, 2016	–	109,355	4,654	1,149	17,025	4,090	38	136,311
Amortization	–	14,039	66	400	7,157	2,708	15	24,385
Disposals of fully depreciated assets	–	–	–	–	(3,223)	(3,188)	–	(6,411)
Effects of movements in exchange rates	–	45	–	–	–	4	–	49
Balance, December 31, 2016	–	123,439	4,720	1,549	20,959	3,614	53	154,334
Amortization	–	14,853	15	400	8,576	2,099	16	25,959
Disposals of fully depreciated assets	–	–	–	–	(3,953)	(2,958)	–	(6,911)
Effects of movements in exchange rates	–	(87)	–	–	–	(32)	–	(119)
Balance, December 31, 2017	$ –	$138,205	$4,735	$1,949	$25,582	$ 2,723	$ 69	$173,263
Carrying amount								
Balance, December 31, 2016	$70,000	$118,447	$ –	$2,630	$36,142	$ 3,251	$102	$230,572
Balance, December 31, 2017	$70,000	$108,044	$1,021	$2,230	$42,571	$ 3,109	$ 86	$227,061

As at December 31, 2017, $14,761 (2016 - $7,428) of internally-developed software remained under development and had not been put into use.

Impairment test of indefinite-lived intangible assets:

For the purposes of impairment testing, the cash flows associated with the Company's trade name have been allocated to the ESS CGU. In accordance with our policy described in note 2, an impairment test for the trade name was performed as part of the impairment testing of goodwill included in the ESS CGU (see note 9), and no impairment charge was required.

9. Goodwill:

(i) The change in goodwill was as follows:

Balance, January 1, 2016	$316,834
Acquired through business acquisition – Bensigner Du Pont & Associates, Inc. ("BDA")	1,035
Acquired through business acquisition – Solareh (note 4)	3,111
Effect of movements in exchange rates	(223)
Balance, December 31, 2016	320,757
Acquired through business acquisition – Pro-Santé (note 4)	720
Acquired through business acquisition – Chesnut (note 4)	3,274
Effect of movements in exchange rates	(651)
Balance, December 31, 2017	$324,100

(ii) Impairment test of goodwill

For the purposes of impairment testing, goodwill has been allocated to the Company's lines of business, which represent the Company's operating segments and the lowest level within the Company at which goodwill is monitored for internal management purposes, as defined in IAS 36. The aggregate carrying amount of goodwill allocated to each prior to the recognition of any impairment charges was as follows:

	December 31, 2017	December 31, 2016
Consulting	**$113,536**	$113,536
Administrative Solutions	**64,854**	65,059
Employee Support Solutions	**130,007**	126,459
Absence Management Solutions	**15,703**	15,703
	$324,100	$320,757

Goodwill impairment is assessed on an annual basis and whenever there is an indication that the asset may be impaired. The valuation techniques, significant assumptions and sensitivities applied in the goodwill impairment test as at December 31, 2017 are described below. For the comparative year ended December 31, 2016 annual impairment review, the calculations from December 31, 2015 were carried forward as the calculation of the recoverable amount exceeded the carrying amount by a substantial margin, the assets and liabilities making up the CGUs had not changed significantly and no events had occurred or circumstances changed, such that the likelihood of the carrying amount exceeding the recoverable amount were remote.

(a) Valuation technique:

The recoverable amount of each CGU was calculated based on value-in-use using an income approach to estimate its fair value. The recoverable amount of each CGU was as follows:

	December 31, 2017
Consulting	$ 381,700
Administrative Solutions	379,900
Employee Support Solutions	528,200
Absence Management Solutions	106,500
	$1,396,300

The income approach is predicated upon the value of the future cash flows that the business is expected to generate going forward. The discounted cash flow ("DCF") method was used which involved projecting cash flows and converting them into a present value equivalent through discounting. The discounting process uses a rate of return that is commensurate with the risks associated with the business and the time value of money. This approach requires assumptions about revenue growth rates, operating margins, prevailing tax rates, and discount rates, which are Level 3 inputs based on the fair value hierarchy.

The significant assumptions and sensitivities of this methodology considered are described below.

(b) Growth and EBITDA margins:

The assumptions used were based on the Company's internal forecasts. The Company projected revenue, EBITDA margins, working capital, and capital expenditures for a period of five years, and applied a perpetual long-term growth rate thereafter. Customer retention rates, past experience, economic trends (i.e. GDP, CPI, interest rate, and unemployment rate projections), and human resource industry and market trends were also considered in deriving these forecasts. A perpetuity growth rate of 2.5% was applied in determining the recoverable amount of the CGUs.

(c) Discount rate:

A discount rate was required in order to calculate the present value of projected cash flows. The discount rate represented a weighted average cost of capital ("WACC") applicable to each CGU. The WACC is an estimate of the overall required after-tax rate of return on investment required by all investors of capital and serves as the basis for developing the appropriate discount rate. Determination of the discount rate requires separate analysis of the cost of equity and debt, and considers a market risk premium based on an assessment of specific risks related to the projected cash flows of each CGU. Discount rates represent the volatility assessment of expected cash flows based on past performance, competition, market conditions, and other factors.

The following discount rates were applied in determining the recoverable amount of the CGUs:

	December 31, 2017
Consulting	8.8%
Administrative Solutions	8.8%
Employee Support Solutions	8.4%
Absence Management Solutions	9.5%

The recoverable amounts of the Consulting, Administrative Solutions, Employee Support Solutions, and Absence Management Solutions CGUs assessed as at December 31, 2017 and 2016 were all in excess of their respective carrying amounts.

The Company has also performed a sensitivity analysis on the perpetuity growth rate and discount rate in assessing the recoverable amounts of each of the CGUs. Sensitivity analysis indicates reasonable changes to key assumptions will not result in an impairment loss for the CGUs.

10. Trade and other payables:

The Company's trade and other payables comprise the following:

	December 31, 2017	December 31, 2016
Trade payables and accrued liabilities	**$34,476**	$27,142
Accrued salaries and compensation	**33,149**	28,651
Other current liabilities	**4,956**	3,364
	$72,581	$59,157

11. Other liabilities:

The Company's other liabilities were as follows:

	December 31, 2017	December 31, 2016
Acquired above-market leases	**$ 734**	$ 1,073
Deferred lease obligations	**17,744**	11,821
Net pension benefit liability/(asset) (note 17)	**(198)**	(56)
	$18,280	$12,838

12. Provisions:

The Company has recognized sublease loss provisions associated with the lease of excess office space, and for expenditures related to contingency reserves on legal matters that the Company may become aware of in the normal course of operations. The sublease loss provision has been initially measured at the discounted present value of the minimum rental payments liable on the subleased properties and related commissions, net of sublease income related to these premises, and subsequently measured at best estimate. The estimate of the contingency reserve corresponds to the expenditure likely to be incurred by the Company to settle its obligation.

	December 31, 2017	December 31, 2016
Contingency reserve	**$ 317**	$ 277
Sublease loss provisions	**3,969**	3,487
	$4,286	$3,764

The following tables present the movement in provisions for the years ended December 31, 2017 and 2016:

	Sublease loss provisions	Contingency reserve	Total provisions
Balance, January 1, 2016	$1,771	$ 596	$2,367
Accrual and accretion	2,200	150	2,350
Utilization	(484)	(469)	(953)
Balance, December 31, 2016	$3,487	$ 277	$3,764
Accrual and accretion	1,364	132	1,496
Utilization	(882)	(92)	(974)
Balance, December 31, 2017	$3,969	$ 317	$4,286

13. Long-term debt:

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

	December 31, 2017	December 31, 2016
Revolving loans	**$180,445**	$167,385
Less: debt issuance costs, net of accumulated amortization	**(776)**	(1,086)
	$179,669	$166,299

The Company has a credit facility agreement (the "Credit Facility Agreement") that matures on December 20, 2020 and provides for a revolving facility of $300.0 million (including a swing line of $14.0 million).

The interest rates for the Credit Facility Agreement are floating, based on a margin over certain referenced rates of interest. The applicable margin may vary up or down depending on the ratio of the Company's consolidated Debt to Adjusted EBITDA as defined in the Credit Facility Agreement.

The Credit Facility Agreement is secured by a general assignment of all the assets of the Company and requires the Company to maintain, on a consolidated basis, a Debt to Adjusted EBITDA financial covenant of not more than 3:1 or for the twelve month period immediately following the completion of a permitted acquisition as defined in the Credit Facility Agreement with a purchase price of $25,000 or more, not more than 3.5:1.0, and an EBITDA to interest expense ratio of not less than 3:1.

In the calculation of the consolidated Debt to Adjusted EBITDA financial covenant under the Credit Facility Agreement, Debt excludes the Convertible Debenture payable.

EBITDA in the Credit Facility Agreement is defined as profit before finance costs, income taxes, depreciation, amortization, non-controlling interest, non-recurring gains, and limited non-recurring losses. Adjusted EBITDA is defined as EBITDA plus the pro-forma EBITDA from permitted acquisitions' entities.

At December 31, 2017, the Company had utilized the following amounts under the Credit Facility Agreement:

- $161,000 of BA loans under the revolving loan. The BA loans are renewed on a monthly basis, bearing interest at the one-month BA rate plus an applicable margin of 1.45%.

- $12,545 (US $10,000) of U.S. Libor loans under the revolving loan. The U.S. Libor loans are renewed on a monthly basis, bearing interest at the one-month Libor rate plus an applicable margin of 1.45%.

- $6,900 (US $5,500) of U.S. Base Rate loans under the revolving loan. The U.S. Base Rate loans are renewed on a monthly basis, bearing interest at the one-month U.S. Base Rate plus an applicable margin of 0.45%.

- $7,065 of the swing line available. The swing line carries interest at prime plus an applicable margin of 0.45%.

As at December 31, 2017, the Company complied with all of the required financial covenants.

(a) Interest rate swaps:

The Company had entered into a forward-starting interest rate swap agreement in February 2014 to hedge against the variable interest rate component on $160,000 notional amount borrowed under the Credit Facility Agreement for the period from January 5, 2015 up to and ending November 29, 2017. The notional amount of this swap was $160,000 and was used to fix the variable component of the interest rate at 1.98%, before the applicable margin, for the duration of this period and was designated as a cash flow hedge. The cash flow hedge terminated on November 29, 2017, as the hedging instrument in the hedging relationship was extinguished.

In July 2017, the Company entered into a forward-starting interest rate swap agreement to hedge against the variable interest rate component on $50,000 notional amount borrowed under the Credit Facility Agreement for the period from November 29, 2017 up to and ending December 20, 2020. The notional amount of this swap is $50,000 and is used to fix the variable component of the interest rate at 1.79%, before the applicable margin, for the duration of this period and has been designated as a cash flow hedge. The fair value of this interest rate swap at December 31, 2017 was an asset of $433.

(b) Finance costs:

The Company's finance costs comprise the following:

	2017	2016
Interest on term loan, revolving loan, bank indebtedness and other charges	**$ 6,804**	$ 7,712
Interest on convertible debenture	**4,355**	4,478
Amortization of debt issuance costs	**1,023**	1,748
Other	**983**	951
	$13,165	$14,889

14. Convertible debentures:

In June 2016, the Company issued $86,000 principal amount of 4.75% Convertible Unsecured Subordinated Debentures (the "4.75% Convertible Debentures") for net proceeds of $81,982. The 4.75% Convertible Debentures pay interest semi-annually on June 30 and December 31, commencing with the initial interest payment on December 31, 2016 and have a maturity date of June 30, 2021. These debentures are convertible at the option of the holder to common shares at a conversion price of $25.10 per common share.

The Company has the option to redeem the 4.75% Convertible Debentures on and after June 30, 2019 and at any time prior to June 30, 2020 at a redemption price equal to 100% of their principal plus accrued and unpaid interest provided that the weighted average trading price for the 20 consecutive trading days ending five days preceding the date on which the notice of redemption is given is at least 125% of the conversion price of $25.10. On and after June 30, 2020, but prior to the maturity date, the 4.75% Convertible Debentures will be redeemable at a redemption price equal to 100% of their principal amount plus accrued and unpaid interest. On redemption or maturity the Company may elect to repay the principal and satisfy its interest obligations by issuing common shares.

Upon issuance of the 4.75% Convertible Debentures, the liability component of the 4.75% Convertible Debentures was recognized initially at the fair value of a similar liability that does not have an equity conversion option, using an effective interest rate of 5.2%. The fair value of $84,504 was allocated to the long-term debt component and the difference of $1,496 versus the principal amount has been recorded as the equity component, before allocation of the transaction costs.

The discount on the 4.75% Convertible Debentures is being accreted such that the liability at maturity will equal the face value of $86,000. The transaction costs of $4,018 were proportionally allocated to the liability and equity components.

The 4.75% Convertible Debentures were allocated as follows:

Long-term liability, net of transaction costs	$80,556
Equity component, net of transaction costs and deferred tax	1,045
Deferred tax on equity component of convertible debentures	381
Transaction costs	4,018
Face value	$86,000

The following table indicates the changes in the 4.75% Convertible Debentures during the year:

	Debt component	**Equity component**
Balance June 2016	**$80,556**	**$1,045**
Accretion and amortization on convertible debentures	**540**	**–**
Balance, December 31, 2016	**81,096**	**1,045**
Accretion and amortization on convertible debentures	**984**	**–**
Balance, December 31, 2017	**$82,080**	**$1,045**

On March 27, 2012, the Company issued $75,000 principal amount of $5.75% Convertible Unsecured Subordinated Debentures (the "5.75% Convertible Debentures") for net proceeds of $71,432 with a maturity date of March 31, 2017. The 5.75% Convertible Debentures were convertible at the option of the holder to common shares at a conversion price of $15.00 per common share, and the Company had the option to redeem the 5.75% Convertible Debentures after March 31, 2016 at a redemption price equal to 100% of their principal amount plus accrued and unpaid interest. In May 2016, the Company issued a notice of redemption for the remaining outstanding 5.75% Convertible Debentures. During the six months ended June 30, 2016, 5.75% Convertible Debentures in the principal amount of $72,392 were converted by holders to common shares. In June 2016, the Company exercised its option to redeem the $2,512 principal amount of 5.75% Convertible Debentures that still remained issued and outstanding for cash.

The following table indicates the changes in the 5.75% Convertible Debentures during the year ended December 31, 2016:

	Debt component	Equity component
Balance January 1, 2016	$ 73,760	$ 757
Accretion and amortization*	1,124	–
Conversion of 5.75% Convertible Debenture holders	(72,390)	(731)
Redemption of 5.75% Convertible Debenture holders	(2,494)	(26)
Balance, December 31, 2016	$ –	$ –

* Included in accretion and amortization is $750 of unamortized debenture issuance costs and remaining accretion on 5.75% Convertible Debentures when the Company notified these debenture holders of its intention to redeem these debentures prior to maturity.

15. Financial instruments:

(a) Financial risk management:

The Company's financial instruments are exposed to certain financial risks, including interest rate risk, credit risk, currency risk and liquidity risk. The Company's exposure to these risks and its methods of managing the risks remain consistent.

(i) Interest rate risk:

The Company's exposure to the risk of changes in market interest rates relates primarily to the Company's long-term debt obligations with floating interest rates. Specifically, the Company is subject to interest rate risk as its long-term debt bears interest at market rates. Interest rate swap agreements are used as part of the Company's program to manage the floating interest rate mix of the Company'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.

Interest rate sensitivity analysis:

A sensitivity analysis that assumes interest rates increased or decreased by 50 basis points with all other variables held constant would result in an increase or decrease of the Company's interest expense, excluding the interest subjected to interest-rate swap agreements, by $118 (2016 - $246).

(ii) Credit risk:

The Company's exposure to credit risk is limited to the carrying amount of cash and accounts receivable recognized at the reporting date.

No allowance for credit losses on financial assets was required as of December 31, 2017, other than the allowance for doubtful accounts (note 5). The Company determines its allowance for doubtful accounts based on its best estimate of the net recoverable amount by customer account. Accounts that are considered uncollectible are written off. The Company's bad debt expense for the year ended December 31, 2017 was $510 (2016 - $811).

As at December 31, 2017, one U.S. public sector customer comprised $14,134 (December 31, 2016 - $4,083) of the trade and other receivables balance, of which $10,599 (December 31, 2016 - 504) is greater than ninety days past due.

The Company believes that the credit risk of accounts receivable, including the customer noted above, is limited for the following reasons:

(a) Risk associated with concentration of credit risk with respect to accounts receivable is limited due to the credit rating of the Company's top 10 clients.

(b) Management regularly reviews and assesses customer accounts and credit risk. Historically, bad debt as a percentage of revenue has been minimal.

The credit risk on cash and investments held in trust is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

(iii) Currency risk:

The Company realizes a portion of sales in U.S. dollars and has operations in the United States and thus is exposed to fluctuations in the value of the U.S. dollar relative to the Canadian dollar. Morneau Shepell Inc.'s U.S. operations functional currency is the U.S. dollar. Any fluctuations in the value of the U.S. dollar relative to the Canadian dollar on the Company's U.S. operations net assets will result in a change in other comprehensive income for the year. The net revenue exposure after accounting for related expenses denominated in U.S. dollars for the year ended December 31, 2017 was $21,982 (2016 - $13,853).

Foreign exchange sensitivity analysis:

As at December 31, 2017, the Company's net exposure to currency risk through its current assets and liabilities denominated in U.S. dollars was US $16,747. An appreciation (depreciation) of the Canadian dollar against the U.S. dollar would have resulted in an increase (decrease) of $1,050 in the Company's profit and other comprehensive income as a result of the Company's net exposure to currency risk through its current assets and liabilities denominated in U.S. dollars. This analysis is based on a foreign currency exchange rate variance of 5% which the Company considered to be reasonably possible at the end of the reporting period. The analysis assumes that all other variables, in particular interest rates, remain constant.

(iv) Liquidity risk:

Liquidity risk is the risk that the Company is not able to meet its financial obligations as they fall due. The Company manages liquidity risk through regular monitoring of financial results and actual cash flows, and also the management of its capital structure and financial leverage as outlined in note 28.

The Company's principal liquidity needs arise from working capital requirements, debt servicing and repayment obligations, capital expenditures, dividends to shareholders and acquisition funding requirements. The Company has historically utilized cash from operations to satisfy the above needs, with the exception of acquisition funding requirements.

The tables below set forth non-derivative and derivative financial liabilities by maturity based on the remaining period from December 31 to the contractual maturity date. The amounts disclosed are the contractual undiscounted cash flows.

2017	**<1 year**	**1 - 2 years**	**3 - 5 years**
Non-derivative financial liabilities:			
Bank indebtedness	**$ 5,416**	**$ –**	**$ –**
Trade and other payables	**72,581**	**–**	**–**
Dividends payable	**3,463**	**–**	**–**
Insurance premium liabilities	**18,102**	**–**	**–**
Future consideration related to acquisitions	**3,047**	**632**	**431**
Long-term debt	**–**	**–**	**180,445**
Convertible debentures	**–**	**–**	**86,000**
	$102,609	**$632**	**$266,876**

2016	<1 year	1 - 2 years	3 - 5 years
Non-derivative financial liabilities:			
Bank indebtedness	$ 3,056	$ –	$ –
Trade and other payables	59,157	–	–
Dividends payable	3,460	–	–
Insurance premium liabilities	17,211	–	–
Future consideration related to acquisitions	5,252	1,964	294
Long-term debt	–	–	167,385
Convertible debentures	–	–	86,000
Derivative financial liabilities:			
Cash flow hedges – interest rate swaps	1,625	–	–
	$89,761	$1,964	$253,679

It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

(b) Fair values:

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

The following table summarizes information regarding the carrying value, fair value and level used to determine the fair value measurement of the Company's financial assets and liabilities carried at fair value:

	Carrying Value and Fair Value		
	December 31, 2017	December 31, 2016	Level
Assets carried at fair value:			
Cash and investments held in trust	**$18,102**	$17,211	1
Interest rate swaps	**433**	–	2
	$18,535	$17,211	
Liabilities carried at fair value:			
Bank indebtedness	**5,416**	3,056	1
Interest rate swaps	**–**	1,625	2
Future consideration related to acquisitions	**3,575**	7,510	3
	$ 8,991	$12,191	

Fair value hierarchy:

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

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly; and
- Level 3: inputs for the asset or liability that are not based on observable market data

During the year ended December 31, 2017, there were no transfers between any levels.

The interest rate swaps are financial instruments carried at fair value through other comprehensive income.

The future consideration related to acquisitions is a financial instrument carried at fair value through profit or loss. Contingent consideration arose on the acquisitions of Pro-Santé, Longpré, Solareh, BDA, and the U.S. health and welfare benefits administration business of Ceridian. In these acquisitions, there is a clause that entitles the seller to an amount based on exceeding revenue targets. The fair value of the future consideration related to these acquisitions is determined considering the estimated payment, discounted to present value (Level 3). The contingent consideration remaining to be paid for these acquisitions ranges from a contractual amount of $nil to a contractual maximum as follows:

	December 31, 2017	December 31, 2016
Solareh	**$1,350**	$1,350
Longpré	**1,545**	1,650
Pro-Santé	**900**	–
BDA	**–**	4,028
U.S. health and welfare benefits administration business of Ceridian	**–**	1,470
Other acquisitions	**216**	516
	$4,011	$9,014

The estimated payment is calculated considering different scenarios of projected revenue and EBITDA, and the amount to be paid under each scenario, weighted by the probability of each scenario. The key unobservable inputs include anticipated revenue and EBITDA, and the discount rate. The estimated fair value increases the higher the annual revenue and EBITDA, and the lower the discount rate, with estimated payments being limited to a contractual maximum for each of the acquisitions.

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

The following tables indicate the changes in the future consideration related to acquisitions during the year ended December 31, 2017 and December 31, 2016:

2017	**Future consideration related to acquisitions**
Balance at January 1, 2017	**$ 7,510**
Fair value for acquisitions	**632**
Installment contingent consideration for BDA, PAE and Dion Durrell Workers' Compensation	**(4,966)**
Accretion	**806**
Foreign exchange	**86**
Re-measurement	**(493)**
	$ 3,575

2016	Future consideration related to acquisitions
Balance at January 1, 2016	$ 4,581
Fair value for acquisitions	2,705
Installment contingent consideration for BDA, PAE and Dion Durrell Workers' Compensation	(1,034)
Accretion	779
Foreign exchange	(112)
Re-measurement	591
	$ 7,510

Financial instruments carried at amortized cost:

The carrying values of trade and other receivables, trade and other payables, insurance premium liabilities, and dividends payable are amortized cost and approximate their fair value because of their short-term nature.

The convertible debenture payable and long-term debt are financial instruments carried at amortized cost whose carrying values do not equal their fair market values. The convertible debenture payable has a carrying value of $82,080 (December 31, 2016 - $81,096) and a fair value of $93,740 (December 31, 2016 - $90,300). The fair value is determined using quoted market values (Level 1) for the convertible debentures at the end of the year. The long-term debt has a carrying value of $179,669 (December 31, 2016 - $166,299) and a fair value of $180,445 (December 31, 2016 - $167,385). The fair value is determined based on the cost of borrowing for a company with a similar risk profile (Level 2).

16. Income taxes:

The income taxes recognized in profit or loss comprise the following:

	2017	2016
Current tax expense:	**$15,356**	$10,452
Deferred tax expense (benefit):		
Origination and reversal of temporary differences	**(1,080)**	1,637
Effect of changes in tax rates	**914**	(8)
	(166)	1,629
Total income tax expense	**$15,190**	$12,081

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

	2017	2016
Income taxes at statutory rates:		
Federal	**15.00%**	15.00%
Provincial	**11.78%**	11.81%

	2017	2016
Income tax provision applied to profit before income taxes:		
Combined basic federal and provincial income taxes at statutory rates	**$13,331**	$10,210
Non-deductible expenses	**2,291**	1,805
Adjustment to deferred income taxes and liabilities for change in income tax rate	**914**	(8)
Other	**(1,346)**	74
	$15,190	$12,081

The income taxes recognized on components of other comprehensive income for the years ended December 31, 2017 and 2016 are as follows:

	Before taxes	**Tax expense**	**2017 Net of taxes**
Change in fair value of interest rates swaps	**$(2,058)**	**$551**	**$(1,507)**
Actuarial gain on post-employment benefit plans	**(185)**	**52**	**(133)**
	$(2,243)	**$603**	**$(1,640)**

	Before taxes	Tax expense	2017 Net of taxes
Change in fair value of interest rates swaps	$(2,050)	$552	$(1,498)
Actuarial gain on post-employment benefit plans	(39)	6	(33)
	$(2,089)	$558	$(1,531)

The approximate tax effect of each item that gives rise to the Company's deferred tax assets and liabilities are as follows:

	December 31, 2017	December 31, 2016
Loss carry forwards	**$ 4,188**	$ 6,080
Interest rate swaps	**(116)**	435
Post-employment benefit plans	**116**	168
Other assets	**7,307**	4,991
Deferred implementation costs	**(8,116)**	(9,043)
Capital assets	**(2,312)**	(1,728)
Intangible assets	**(47,409)**	(44,853)
Other liabilities	**(2,451)**	(2,306)
Net deferred tax liabilities	**$(48,793)**	$(46,256)

Recorded on the consolidated statements of financial position as follows:

Deferred tax asset	$ 1,794	$ 2,326
Deferred tax liability	(50,587)	(48,582)
Net deferred tax liabilities	$(48,793)	$(46,256)

The Company has losses available to offset future taxable income of $19,150, all of which been recognized, that expire commencing from 2034.

Movement in temporary differences during the year 2017:

	Balance at January 1, 2017	**Recognized in profit or loss**	**Recognized in other comprehensive income**	**Acquisition & other**	**Balance at December 31, 2017**
Capital assets	**$ (1,728)**	**$ (584)**	**$ –**	**$ –**	**$ (2,312)**
Intangible assets	**(44,853)**	**(1,606)**	**–**	**(950)**	**(47,409)**
Tax value – losses carried forward	**6,080**	**(1,892)**	**–**	**–**	**4,188**
Interest rate swaps	**435**	**–**	**(551)**	**–**	**(116)**
Post-employment benefit plans	**168**	**–**	**(52)**	**–**	**116**
Deferred implementation	**(9,043)**	**927**	**–**	**–**	**(8,116)**
Other	**2,685**	**3,321**	**–**	**(1,150)**	**4,856**
	$(46,256)	**$ 166**	**$(603)**	**$(2,100)**	**$(48,793)**

Movement in temporary differences during the year 2016:

	Balance at January 1, 2016	Recognized in profit or loss	Recognized in other comprehensive income	Acquisition & other	Balance at December 31, 2016
Capital assets	$ (1,799)	$ 71	$ –	$ –	$ (1,728)
Intangible assets	(43,437)	(885)	–	(531)	(44,853)
Tax value – losses carried forward	4,171	1,909	–	–	6,080
Interest rate swaps	987	–	(552)	–	435
Post-employment benefit plans	174	–	(6)	–	168
Deferred implementation	(5,236)	(3,807)	–	–	(9,043)
Other	3,099	1,083	–	(1,497)	2,685
	$(42,041)	$(1,629)	$(558)	$(2,028)	$(46,256)

17. Employee future benefits:

The Company offers a pension benefit plan for its employees, which includes a defined contribution option and a defined benefit option. Under the defined contribution option, each member is required to contribute a percentage of earnings. The Company matches this required contribution. Each member may elect to make an optional contribution in addition to the required contribution. The Company contributes 50% of the optional contributions. For members who had completed at least 10 years of service on December 31, 2010, their contributions follow the grandfathered provisions.

For the year ended December 31, 2017, the Company's contributions to the defined contribution option of the plan were $10,358 (2016 – $9,956), which are included in salary, benefits and contractor expenses in the consolidated statement of income and comprehensive income.

The defined benefit option was closed effective January 1, 1998 and included 52 members as at December 31, 2017 (December 31, 2016 – 56 members), comprising active employees, retirees, and deferred vested members. All other employees are covered by the defined contribution option of the plan.

The pension benefit plan is administered by Morneau Shepell Ltd. and is registered under the Pension Benefits Act (Ontario).

(a) Funding:

The defined benefit option is funded by the Company based on the pension plan's actuaries' calculation. The members are not required to contribute to the defined benefit option.

The Company expects to contribute $118 to the defined benefit option during the upcoming fiscal year.

(b) Amounts recognized in the consolidated financial statements:

The amounts recognized in the consolidated statements of financial position in respect of the defined benefit option are determined as follows:

	December 31, 2017	December 31, 2016
Present value of funded obligations	**$(4,665)**	$(4,530)
Fair value of plan assets	**4,863**	4,683
Impact of minimum funding requirement/asset ceiling	**–**	(97)
Asset in the consolidated statements of financial position	**$ 198**	$ 56

The movement in the defined benefit obligation during the year is as follows:

	2017	2016
Defined benefit obligations at January 1	**$4,530**	$4,640
Included in profit or loss:		
Current service cost	**25**	30
Interest cost	**204**	169
	229	199
Included in other comprehensive income:		
Actuarial gains arising from experience adjustments	**(17)**	–
Changes in financial assumptions	**191**	–
	174	–
Other:		
Benefits paid by the plan	**(268)**	(309)
Defined benefit obligations at December 31	**$4,665**	$4,530

The movement in the fair value of plan assets during the year is as follows:

	2017	2016
Fair value of plan assets at January 1	**$4,683**	$4,580
Included in profit or loss:		
Estimated interest income on plan assets	**171**	166
Included in other comprehensive income:		
Return on plan assets in excess of estimated interest income	**249**	39
Other:		
Employer contributions	**28**	207
Benefits paid	**(268)**	(309)
	(240)	(102)
Fair value of plans assets at December 31	**$4,863**	$4,683

The movement in the impact of the minimum funding requirement/asset ceiling is as follows:

	2017	2016
Minimum funding requirement/asset ceiling at January 1	**$ 97**	$97
Included in profit or loss:		
Interest on asset ceiling	**4**	–
Included in other comprehensive income:		
Change in asset ceiling, excluding amounts recognized in interest expense	**(101)**	–
Minimum funding requirement/asset ceiling at December 31	**$ –**	$97

(c) Plan Assets:

The allocation of fair value of plan assets as a percentage of total plan assets was as follows:

	December 31, 2017	December 31, 2016
Pooled Equities Fund	**58%**	55%
Pooled Bond Fund	**42%**	43%
Pooled Low Volatility Fund	**0%**	2%
	100%	100%

Pooled funds are valued at the unit values supplied by the pooled fund administrator, which represent the pension plan's proportionate share of the fair value of the underlying net assets.

The strategic investment policy of the defined benefit option of the pension plan, implemented in 2013, can be summarized as follows:

A strategic asset mix comprising 26% to 47% equity securities (return and yield funds), 30% to 45% fixed income investments, and 7% to 45% low volatility investments (mortgages, real estate and infrastructure), with a target asset mix of 33% equity securities, 43% fixed income investments and 24% low volatility investments.

(d) Actuarial assumptions:

The principal actuarial assumptions were as follows:

	2017	2016
Discount rate at the end of the current fiscal period used to determine the accrued benefit obligation	**3.40%**	3.75%
Discount rate at the end of preceding period used to determine the benefit cost	**3.75%**	3.75%
Rate of compensation increase used to determine the accrued benefit obligation	**3.50%**	3.50%
Rate of compensation increase used to determine the benefit cost	**3.50%**	3.50%

(e) Mortality assumptions:

Assumptions regarding future mortality experience are based on published statistics and mortality tables.

The calculation of the defined benefit obligation is sensitive to mortality assumptions. For the Company, an increase in life expectancy of one year across all age groups would result in a $138 increase in the defined benefit obligation as of December 31, 2017.

18. Long-term incentive plan:

Under the LTIP, the Company may grant participants restricted share units ("RSUs"), performance share units ("PSUs"), retirement deferred share units, or post-retirement deferred share units, collectively referred to as LTIP Units. The characteristics of each are as follows:

(a) Retirement DSU:

Retirement DSUs generally vest three years after the date of grant and become redeemable only on the participant's termination of employment. Retirement DSUs are redeemable either for one common share or for an amount in cash equal to the fair market value of one common share (at the option of the Company). The value of the award is determined at grant date, and the related salary expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are satisfied. Participants are entitled to receive cash bonuses or additional Units equivalent to the dividends payable had those Units been common shares. The number of DSUs awarded as bonus is determined based on the fair market value of those DSUs on the date credited.

(b) Post-Retirement DSU:

Post-Retirement DSUs vest at such times as determined by the Company, with each being redeemable for one common share issued from treasury of the Company. Except in certain circumstances or in the retirement of a participant, any unvested LTIP Units will terminate on their termination date.

The value of the award is determined as at grant date, and related salary expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are satisfied.

(c) RSU:

RSUs generally vest three years after the date of grant. RSUs are redeemable either for one common share or for an amount in cash equal to the fair market value of one common share (at the option of the Company). The value of the award is determined at grant date, and the related expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are satisfied. Participants are entitled to receive cash bonuses or additional Units equivalent to the dividends payable had those Units been common shares. The number of RSUs awarded as bonus is determined based on the fair market value of those RSUs on the date credited.

(d) PSU:

PSUs granted vest over a three year period based on market-based financial performance targets being met, with the conversion ratio for vested PSUs being from 0% to 200%. PSUs are redeemable for common shares or for an amount in cash equal to the fair value of the common shares based on the conversion ratio at the option of the Participant, with the Company having the overriding right to settle in common shares.

The value of the PSUs is determined as at the grant date, and the related expense is recognized over the vesting period, which is the period over which all of the specified vesting conditions are satisfied.

The fair value at grant date is calculated with reference to the closing price of the Company's common shares on the Toronto Stock Exchange ("TSX") for the five business days preceding grant date.

The change in the number of awards outstanding, and their related weighted average grant prices for the years ended December 31, 2017 and 2016 were as follows:

	RSU	PSU	Retirement DSU	Post-retirement DSU	Total
Awards outstanding, January 1, 2016	45,596	–	2,227,306	117,768	2,390,670
Granted (at $15.23 per unit)	149,502	–	417,989	36,435	603,926
Exercised	(39,883)	–	(52,812)	(37,199)	(129,894)
Forfeited	(12,190)	–	(62,783)	–	(74,973)
Awards outstanding, December 31, 2016	143,025	–	2,529,700	117,004	2,789,729
Granted (at $19.66 per unit)	218,121	30,680	173,881	41,131	463,813
Exercised	(24,555)	–	(557,148)	(43,052)	(624,755)
Forfeited	–	–	(8,460)	–	(8,460)
Awards outstanding, December 31, 2017	336,591	30,680	2,137,973	115,083	2,620,327
Total vested awards, December 31, 2016	–	–	1,760,887	117,004	1,877,891
Total vested awards, December 31, 2017	–	–	1,624,424	115,083	1,739,507
Share-based compensation expense, year ended December 31, 2016					$ 4,868
Share-based compensation expense, year ended December 31, 2017					$ 6,692

19. Equity:

(a) Share capital:

(i) Common shares:

The Company is authorized to issue an unlimited number of common shares, with no par value.

(ii) Preferred shares:

The Company is authorized to issue 10 million preferred shares, with no limit on their value. As of December 31, 2017 and 2016, no preferred shares were issued or outstanding.

(iii) Dividends:

Dividends are declared in Canadian dollars. The monthly dividend rate was $0.065 for the year ended December 31, 2017 (2016—$0.065). The Company continued to declare the same monthly dividend amount in January and February of 2018.

The change in share capital, including contributed surplus was as follows:

	Number of common shares	Share capital	Contributed surplus
Balance, January 1, 2016	48,272,449	$477,500	$23,312
LTIP issuance	–	–	5,448
Shares issued on redemption of LTIP	129,894	1,417	(1,417)
Shares issued on conversion of convertible debentures	4,826,127	73,121	–
Redemption of convertible debentures	–	–	26
Balance, December 31, 2016	53,228,470	552,038	27,369
LTIP issuance	–	–	6,904
Shares issued on redemption of LTIP	624,755	6,934	(6,934)
Balance, December 31, 2017	53,853,225	$558,972	$27,339

(b) Accumulated other comprehensive income:

The changes in the components of accumulated other comprehensive income, net of tax, are as follows:

	Cash flow hedge reserve	Post-employment benefit plans	Foreign exchange translation reserve	Total
Balance, January 1, 2016	$(2,670)	$(469)	$ 289	$(2,850)
Actuarial gain on post-employment benefit plans	–	33	–	33
Effective portion of change in interest rate cash flow hedges	1,498	–	–	1,498
Foreign currency translation differences for foreign operations	–	–	(1,132)	(1,132)
Balance, December 31, 2016	(1,172)	(436)	(843)	(2,451)
Actuarial gain on post-employment benefit plans	–	133	–	133
Effective portion of change in interest rate cash flow hedges	1,507	–	–	1,507
Foreign currency translation differences for foreign operations	–	–	(1,995)	(1,995)
Balance, December 31, 2017	$ 335	$(303)	$(2,838)	$(2,806)

20. Earnings per share:

Basic earnings per share was calculated by dividing profit attributable to common shares by the sum of the weighted average number of common shares outstanding during the period, plus vested LTIP awards.

Diluted earnings per share was calculated using the basic calculation described above, and adjusting for the potentially dilutive effect of total number of additional common shares that would have been issued by the Company on unvested LTIP awards and the redemption of convertible debentures.

The following details the earnings per share, basic and diluted, calculations for the years ended December 31, 2017 and 2016:

	2017	2016
Profit attributable to common shares (basic and diluted)	**$ 34,582**	$ 26,000
Weighted average number of common shares (in actual number of shares):		
January 1	**53,228,470**	48,272,449
Shares issued on redemption of LTIP	**349,676**	22,780
Shares issued upon redemption of convertible debentures	**–**	2,766,002
Vested LTIP awards	**1,753,368**	1,747,447
Basic	**55,331,514**	52,808,678
Dilutive effect of unvested LTIP awards	**581,712**	579,673
Diluted	**55,913,226**	53,388,351

	2017	2016
Earnings per share:		
Basic	**$0.62**	$0.49
Diluted	**$0.62**	$0.49

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

21. Segmented information:

The Company provides health and productivity, administrative and retirement solutions to assist employers in managing the financial security, health and productivity of their employees. As at December 31, 2017, aggregation of operating segments was applied to determine that the Company had only one reportable segment. The primary factors considered in the application of the aggregation criteria included that the long-term average gross margins and growth rates across the segments are similar, the nature of the services provided by the segments are all related to helping employers with their human resources needs, and the similarity in the regulatory environments that the segments operate in.

The Company operates primarily within two geographical areas: Canada and the United States. The following details the revenues and total assets by geographical area, reconciled to the Company's consolidated financial statements:

	2017	2016
Revenue:		
Canada	**$532,778**	$512,660
United States	**98,377**	79,397
Consolidated total	**$631,155**	$592,057

	2017	2016
Total assets:		
Canada	**$723,272**	$712,779
United States	**86,998**	60,847
Consolidated total	**$810,270**	$773,626

22. Supplementary cash flow information:

Change in non-cash operating working capital for the years ended December 31, 2017 and 2016 was as follows:

	2017	2016
Trade and other receivables	**$ (7,780)**	$ 576
Unbilled fees, current and non-current	**(14,308)**	(1,818)
Prepaid expenses and other	**(1,370)**	(1,712)
Deferred implementation costs, current and non-current [1]	**(5,087)**	(10,243)
Trade and other payables	**13,713**	1,573
Deferred revenue	**362**	1,890
	$(14,470)	$ (9,734)

[1] Includes write-down of deferred implementation costs

Significant non-cash transactions for the year ended December 31, 2016 included the conversion of the 5.75% convertible debentures (see note 14).

23. Related parties:

These consolidated financial statements include the assets, liabilities, revenue and expenses of the Company's subsidiaries; all intercompany balances and transactions have been eliminated upon consolidation and therefore are not disclosed in this note.

(a) Compensation of key management personnel:

Key management personnel include the Company's executive officers and directors; remuneration related to this group was as follows:

	2017	2016
Salaries and other benefits	**$ 8,114**	$ 7,957
Share-based payments	**5,132**	3,594
	$13,246	$11,551

(b) Unconsolidated structured entities:

The Company's wholly owned subsidiary, Morneau Shepell Asset & Risk Management Ltd. is the sponsor and manages the financial and operating activities of the Company's funds. In exchange, each fund pays an administrative fee of 0.08% of the fund's net asset value to cover regulatory filing fees and other day-to-day operating expenses. The Company does not hold any units of the funds.

The Company is considered to sponsor the funds as it was significantly involved in their design and formation, and has continuing involvement as described above. The Company does not control the funds and therefore, does not consolidate them. The Company has no interests in the funds apart from the agreements outlined above. The Company did not transfer any assets to the funds during the reporting periods.

(c) Joint Ventures:

As detailed in note 4, as part of the acquisition of Chestnut the Company acquired ownership interests in joint ventures who provide employee assistance programs, including CGP-China, in which the Company has an ownership interest of 51%. The following table summarizes the financial information of this joint venture as included in its own financial statements, adjusted for fair value adjustments at acquisition and differences in accounting policies, as at December 31, 2017.

The table also reconciles the summarized financial information to the carrying amount of the Company's interest in this joint venture:

	December 31, 2017
Current assets	$1,332
Current liabilities	(57)
Net assets (100%)	1,275
Company's share of net assets	650
Intangible assets	2,466
Goodwill	1,184
Deferred tax liabilities	(507)
Carrying amount of interest in joint venture	$3,793

The Company has no significant balances with any of the joint ventures as at December 31, 2017, and the Company's share of income from joint ventures for the year ended December 31, 2017 was not significant.

24. Salary, benefits and contractors:

The Company's salary, benefit and contractor expenses are comprised of the following:

	2017	2016
Salaries and other benefits	**$361,618**	$342,557
Contractors	**67,408**	61,585
	$429,026	$404,142

25. Commitments:

The Company has lease commitments for office premises and equipment with options for renewal. As at December 31, 2017, the minimum payments not including operating expenses, due in each of the next five years and thereafter, are expected to be as follows for each year ending December 31:

	Gross commitment	Sublease income	Net commitment
2018	$ 16,179	$ (916)	$ 15,263
2019	15,925	(850)	15,075
2020	15,491	(786)	14,705
2021	14,439	(698)	13,741
2022	13,135	(517)	12,618
Thereafter	53,962	(145)	53,817
Total	$129,131	$(3,912)	$125,219

The Company is party to various subleases to which the Company would be liable for the rental payment in the case of a default by the subtenants. The minimal payments and the aggregate sublease income related to these premises have been included above. The Company considers the risk of default by the subtenants to be low therefore no accrual has been setup.

26. Contingencies:

(a) Lawsuits and legal claims:

From time to time, the Company is involved in routine litigation incidental to the Company'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 Company.

(b) Business combinations:

The Company has obligations to pay additional consideration for prior acquisitions, typically based upon performance measures contractually agreed at the time of purchase.

As at December 31, 2017, the fair value of the contingent consideration has been recognized as future consideration related to acquisitions on the consolidated statements of financial position.

27. Management of capital:

The Company views its capital as the combination of its cash (bank indebtedness), long-term debt, convertible debentures and equity attributable to equity holders of Morneau Shepell Inc. As at December 31, 2017 the Company's capital is $628,224 (2016 - $612,158), comprised of $267,165 (2016 - $250,451) bank indebtedness and debt, and $361,059 (2016 - $361,707) equity. The Company's objectives when managing capital are to safeguard the entity's ability to continue as a going concern while maintaining dividends to its shareholders and the growth of the Company's business through organic growth and new acquisitions.

The Company manages the capital structure and makes adjustments to it in accordance with the aforementioned objectives, as well as taking into consideration changes in economic conditions and the risk characteristics of the underlying assets. To maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders, issue new or repurchase existing shares and assume new or repay existing debt.

No changes were made in the objectives, policies or processes for managing capital during the year.

The credit facilities require the Company to maintain certain financial covenants. Management also uses these ratios as key indicators in managing the Company's capital. Dividends are made to shareholders monthly. Ratios of dividends to free cash flow, cash from operating activities, and EBITDA are used by management to assist with the determination of dividends.

The Company is subject to externally imposed capital requirements to maintain certain financial covenants as mentioned above. The Company complied with all the required financial covenants at December 31, 2017.

Head office

895 Don Mills Road, Tower One Suite 700
Toronto, ON M3C 1W3

T: 416.445.2700
F: 416.445.7989