



Goldman
Sachs



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COMMITMENT

Commitment is rooted in Goldman Sachs' distinctive culture; it has been our foundation and fuel throughout our 131-year history. Clients have come to value our commitment to helping them innovate and execute ambitious strategies. For some clients, our commitment to innovation helped them become formidable global competitors. For others, our commitment to the superior execution of complex deals reinforced their trust in us and contributed to their continued success. As a firm, we pride ourselves on our high level of client service. The people of Goldman Sachs remain committed to our culture of innovation and execution that enables us to deliver for our clients.

FELLOW SHAREHOLDERS

2000 was a remarkable year for Goldman Sachs and a rewarding one for our shareholders. In our first full year as a public company, we posted record earnings⁽¹⁾ of \$3.25 billion, up 27% from \$2.55 billion in 1999. Earnings per diluted share rose to \$6.35, a 20% increase from \$5.27 in 1999. And our return on equity reached 27%.

These results reflect more than a very good year for a number of our businesses. They are also evidence of our continued progress toward our goal of becoming the preeminent, global investment banking and securities firm. This goal is underpinned by a strategy that emphasizes expanding in key markets our core



John A. Thain / Henry M. Paulson, Jr. / John L. Thornton

businesses: Global Capital Markets (Investment Banking and Trading and Principal Investments) and Asset Management and Securities Services. Our goal is for Goldman Sachs to be the financial advisor of choice for the most important and influential corporations, institutions and individuals worldwide. It is critical that we capture — and keep — a leading share of the high value-added business of these clients. In 2000, we experienced marked success in doing so.

In Investment Banking, for instance, we were the number one advisor in merger transactions on a worldwide basis. Goldman Sachs advised on a total of \$1.3 trillion in announced transactions, including seven out of ten of the largest in the world. We hold strong leadership positions in key growth industries, including telecommunications, financial institutions, technology, healthcare and energy. Goldman Sachs was also the number one global underwriter of initial public offerings (IPOs) and all common stock

offerings. In addition, we improved our high-yield underwriting business, finishing the year with the number two market share in the United States.

In 2000, we also continued to expand our most profitable trading businesses. We placed a special emphasis on client-driven transactions and solving complex problems with highly tailored solutions. During the course of the year, we succeeded in increasing our trading revenues while lowering risk. In Fixed Income, Currency and Commodities (FICC), net revenues grew by 5% despite difficult market conditions. Our Equities business posted spectacular gains, with net revenues up 78% over 1999. In October, we strengthened our capabilities in the equity market through our combination with Spear, Leeds & Kellogg, an industry leader in securities market making and clearing. In Principal Investments, we substantially expanded our global platform, raising \$8 billion in new private equity and real estate funds. Goldman Sachs now manages more than \$30 billion of merchant banking investments for our clients and our own account.

Asset Management and Securities Services also generated strong growth in 2000. Net revenues rose 43% from 1999 and assets under management reached \$294 billion, a 14% increase over the previous year. Since 1995, our assets under management have expanded at an average rate of 41% per year, making us one of the fastest growing large asset managers in the industry. In 2000, we added \$40 billion of new client assets, building on \$34 billion and \$46 billion increases in 1999 and 1998, respectively. This growth is testimony to both our investment record and distribution power. We see attractive growth opportunities in the high-net-worth market and are investing to capture an increasing share of it.

A strong capital position is an important part of our strategy. Indeed, one of the principal reasons we became a public company was to secure the permanent capital necessary to serve our clients better. Since our IPO, our equity capital has grown from \$6.6 billion to \$16.5 billion. Despite this increase, we remain as disciplined about our capital as we were when we were a private partnership. Our capital is available to help clients meet their important needs but we use it carefully for those transactions where we can combine it with our expertise and where we believe that the potential rewards justify the risk. We owe our shareholders no less.

⁽¹⁾ Results for 2000 exclude the charge related to our combination with Spear, Leeds & Kellogg. Results for 1999 reflect the pro forma effect of our incorporation and related transactions. Source of market share information: Thomson Financial Securities Data

We continue to compete with firms with more capital than Goldman Sachs. And, in 2000, we continued to compete successfully. The reason is simple: Our clients choose us not just because of our balance sheet but because of even more important assets — our reputation for excellence and our people who provide the very best advice and execution.

Our distinctive culture — which emphasizes integrity, entrepreneurship, excellence, teamwork and fairness — has allowed us to assemble the most talented team in the business. Our IPO further strengthened our culture by giving all our employees a stake in the firm's future. Today, the people of Goldman Sachs own more than 55% of the firm, making us one of the largest employee-owned companies in the world and the employer of choice in our industry.

It is critical that Goldman Sachs continue to be a magnet for talent at both senior and entry levels. This is why attracting, retaining and rewarding the very best individuals was one of our highest priorities in 2000. As part of this effort, in November we expanded our senior leadership by selecting 114 new participating managing directors and naming 198 new managing directors. These individuals — the most diverse group of senior leaders we have ever chosen — combine tested professional excellence with a strong personal commitment to our core values.

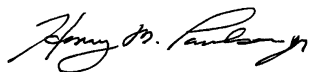
We are proud of our accomplishments in 2000. Our scope was truly global, with European and Asian operations representing more than 35% of our workforce and more than 40% of our net revenues. In key businesses — advisory services, underwriting and trading — we are leaders in every important market in the world. And our asset management business, already strong, is poised for even more global growth in the future.

In 2000, we were fortunate to exceed again our financial goals of a return on equity of more than 20% and earnings growth in the 12–15% range. These remain our objectives. But, looking forward, we do not expect a predictable, stable pattern of quarter-over-quarter earnings increases. Goldman Sachs will continue to seek faster growth in our investment banking and asset management businesses to ensure greater stability in our earnings. But fluctuating market conditions mean that the securities industry can never attain the stability of some other businesses.

The markets of the last months of 2000 and the first part of 2001 produced a much less favorable business environment than earlier in 2000, reminding us that our greatest challenge remains managing growth. We will be disciplined in our approach, but we will continue to build for the future. In our business, periods of slowing and volatility are to be expected, but they do not change our enthusiasm about the medium to long term. And, in the short term, they provide us with an opportunity to strengthen our competitive position.

The untimely death of Michael Mortara in November was a loss to the firm and to all of us who had the privilege of working with him. Mike played an instrumental role in the creation of the mortgage-backed securities market in the 1980s. As co-head of our FCC Division from 1994 to 2000 and, from May 2000, president and CEO of GS Ventures, the firm's financial services incubator, Mike was one of the most respected and beloved members of the Goldman Sachs family.

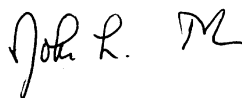
Looking ahead, the changes sweeping today's economy — globalization, deregulation, consolidation, technological transformation and pension reform — are creating a business environment of great opportunities. By virtue of the firm's global presence, unparalleled reputation and extraordinary people, Goldman Sachs is well positioned to seize those opportunities on behalf of our shareholders. We are absolutely committed to doing so in 2001 and beyond.



Henry M. Paulson, Jr.
Chairman and Chief Executive Officer



John A. Thain
President and Co-Chief Operating Officer



John L. Thornton
President and Co-Chief Operating Officer

OUR CORE BUSINESSES

Goldman Sachs is a leading global investment banking and securities firm that provides a wide range of services worldwide to a substantial and diversified client base that includes corporations, financial institutions, governments and high-net-worth individuals.

Our activities are divided into two segments:

Global Capital Markets, which comprises our Investment Banking and Trading and Principal Investments businesses, and Asset Management and Securities Services. The product and service offerings within these segments are described in the following tables:

GLOBAL CAPITAL MARKETS

INVESTMENT BANKING

- Equity and debt underwriting
- Financial restructuring advisory services
- Mergers and acquisitions advisory services
- Real estate advisory services

TRADING AND PRINCIPAL INVESTMENTS

- Bank loans
- Commodities
- Currencies
- Equity and fixed income derivatives
- Equity and fixed income securities
- Principal investments
- Proprietary arbitrage
- Specialist in securities and options

Our Investment Banking activities are divided into two categories: Financial Advisory and Underwriting. Financial Advisory includes advisory assignments with respect to mergers and acquisitions, divestitures, corporate defense activities, restructurings and spin-offs. Underwriting includes public offerings and private placements of equity and debt securities.

Our Trading and Principal Investments activities are divided into three categories: Fixed Income, Currency and Commodities; Equities; and Principal Investments. In our Trading and Principal Investments business, we facilitate client transactions and take proprietary positions through market making in, and trading of, fixed income and equity products, currencies, commodities, and swaps and other derivatives. In addition, we engage in floor-based market making as a specialist on U.S. equities and options exchanges. Principal Investments primarily represents net revenues from our merchant banking investments.

ASSET MANAGEMENT AND SECURITIES SERVICES

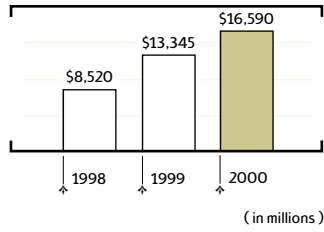
- Commissions
- Institutional and high-net-worth asset management
- Margin lending
- Matched book
- Merchant banking fees
- Increased share of merchant banking fund income and gains
- Mutual funds
- Prime brokerage
- Securities lending
- Securities and options clearing services

Our Asset Management and Securities Services activities are divided into three categories: Asset Management, Securities Services and Commissions. In Asset Management, we provide a broad array of investment advisory services to a diverse client base. Securities Services includes prime brokerage, financing services and securities lending, and our matched book businesses. Commissions include clearing and agency transactions for clients on major stock, options and futures exchanges and revenues from the increased share of the income and gains derived from our merchant banking funds.

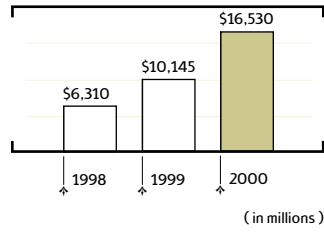
FINANCIAL HIGHLIGHTS

FIRMWIDE

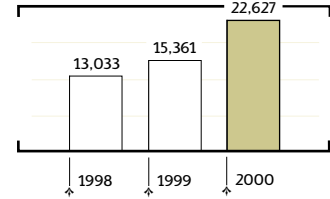
Net Revenues



Equity Capital



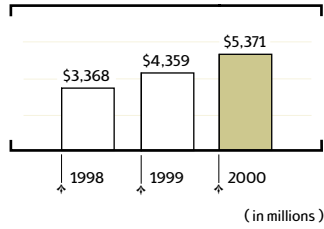
Employees



GLOBAL CAPITAL MARKETS

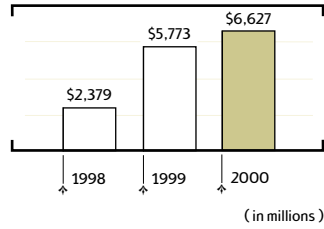
Investment Banking

Net Revenues



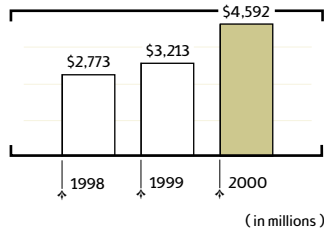
Trading and Principal Investments

Net Revenues

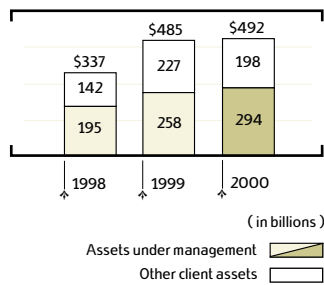


ASSET MANAGEMENT AND SECURITIES SERVICES

Net Revenues



Assets Under Supervision



Assets under management
 Other client assets

CULTURE

COMMITMENT TO:



1938

Events such as the first annual Goldman Sachs outing set the foundation for the firm's distinctive culture.

Our culture's success is based on its ability to grow and adapt to its new environments without losing its sense of cohesion or compromising its principles. As global demand for our services has increased, we have grown substantially. We are providing new products and services, entering new markets, acquiring new resources and helping new clients. This activity is all predicated on our continued ability to attract and retain some of the most talented people in the world. Our culture is the glue that makes this possible, and enables colleagues old and new to work together to meet the exacting standards of our clients and shareholders. Our firm's long-standing values of teamwork, client focus, excellence and entrepreneurship remain codified in our business principles. Over the past year, the firm has initiated new programs and expanded existing ones that encourage the people of Goldman Sachs to adhere to their principles and to keep their culture vibrant and responsive.

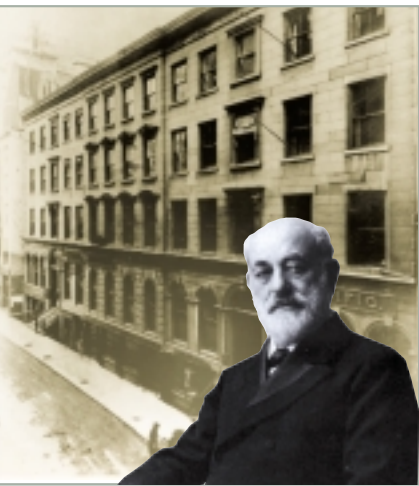


2000
Goldman Sachs continues to value teamwork, integrity, excellence and entrepreneurship. The culture has allowed us to strengthen our position as the employer of choice in our industry.

As the number of people at Goldman Sachs has increased significantly over the years, the firm has remained committed to a **CULTURE** of individual excellence within a community dedicated to teamwork and leadership.

1990s

To help further the professional development of its people, Goldman Sachs institutes a full 360-degree review process.



1984

Goldman Sachs is the only investment bank ranked in the top 10 in the first publication of *The 100 Best Companies to Work for in America*.

1922

Goldman Sachs is committed to hiring the best people and is one of the first investment banks to annually recruit MBAs from Harvard Business School.

1978

Goldman Sachs creates its original business principles.

1869

Marcus Goldman establishes M. Goldman, banker and broker, on Pine Street in New York City.

EMPLOYEE GROWTH



2000

Today, Goldman Sachs employs over 22,000 people in 42 offices in more than 20 countries. We include 130 nationalities, and we speak over 70 different languages, from Amharic to Zulu.

1997

Goldman Sachs launches an on-campus strategic recruiting initiative, *Minds. Wide Open*®.

2000

Goldman Sachs is ranked 15th in *Fortune's* 100 Best Companies to Work For. The firm is also selected as one of the 100 best companies for working mothers by *Working Mother* magazine.



1992

Goldman Sachs formalizes a long history of community service by creating the Community Service Department.

2000

Goldman Sachs continues its commitment to training, offering its people an average of 60 hours of professional development and setting up Pine Street, a training and development initiative for its managing directors.

1999

Goldman Sachs becomes a public company, sharing broad ownership across the firm.

1999

To strengthen its commitment to charitable initiatives in the field of education, the firm makes a \$200 million contribution to The Goldman Sachs Foundation.

1999

Goldman Sachs establishes the Wellness Exchange to help employees optimize their work / life balance and enhance their health and overall quality of life.

1992

1995

1999

2000

Recruiting

In a service business, to be the best firm, you must have exceptional people. Therefore, we make an unusual effort to recruit the best individual for every job, selecting our employees one by one. In fact, identifying and attracting top talent is a way of life here, and a firmwide responsibility of all of our employees across divisions and geographies. This is increasingly challenging given the firm's exceptional growth and the heightened competition for talent in the marketplace. Whether it is for opportunities in investment banking, sales and trading, or software design and systems implementation, our search for talent knows no bounds.

This process is aided by robust programs to identify undergraduates, graduates and experienced hires who are team- and goal-oriented, and who thrive on challenges. Our Minds. Wide Open® philosophy means that a wide variety of backgrounds and talents are welcomed, and that a diversity of ideas and informed opinions are encouraged — in fact, expected.



Diversity

At Goldman Sachs, we recognize that having a diverse workforce encourages increased creativity and innovation, which is crucial to improved performance and continued business success. To that end, we are committed to creating an environment that values diversity and promotes inclusion.

We are constantly strengthening our mentoring, training and work / life balance programs in an effort to ensure that all employees have access to professional and personal development opportunities. We also offer numerous ways for employees to network and explore their varied backgrounds through events sponsored by our affinity groups and programs to promote cultural awareness.

Our goals for a more inclusive workforce have resulted in a highly focused recruiting strategy. We actively seek out diverse candidates by broadening the schools that we target globally in order to reach a wide spectrum of strong candidates. In addition, we participate in several academic and organizational career conferences for minorities and women in order to find

talented individuals. Further, we offer academic scholarships, educational opportunities, summer internships and full-time positions to many outstanding students.

The firm continuously supports and sponsors a myriad of organizations in the community such as Rainbow PUSH/Wall Street Project, The Jackie Robinson Foundation and Junior Achievement. Furthermore, we actively reach out to minority- and women-owned businesses through our Supplier Diversity Program and Urban Investment Group.

We believe that our culture, built on teamwork and excellence, affords opportunities for everyone to have an important impact on the building of our businesses. We are constantly striving toward a more diverse workplace, both for the benefit of the firm and in order to more successfully meet the needs of our clients.

John C. Whitehead Award

This year, the Firmwide Marketing Committee instituted the John C. Whitehead Award, which recognizes excellence in cross-marketing the firm's services and products. Cross-marketing can involve professionals on opposite sides of the globe, working in very distinct product and service areas. Our clients benefit from the firm's ability to identify a broad range of opportunities and to utilize our geographically widespread and professionally diverse organization. Over 80 nominations were received for the initial award, representing all divisions, regions and levels of the firm. The nominations included both individuals and entire teams. In December 2000, two outstanding contributors were recognized for the inaugural award: Jack Kelly in the Global Investment Research Division and Ryan Limaye in the Investment Banking Division.

Community TeamWorks

An extension of Goldman Sachs' commitment to the communities where our employees work and live, Community TeamWorks (CTW) is a firmwide initiative that gives members of the firm a day off from work to participate in community service. During the spring of 2000, more than 15,000 of our employees participated in CTW in more than 900 programs including working with the elderly, building homes, mentoring youth and restoring the beauty of our environment. Our employees bring to their volunteer service the same qualities they bring to their professional work: energy, new ideas, and an appreciation of both the big picture and the importance of the individual. The projects sponsored by CTW are coordinated and executed by employees and provide an opportunity for team building within the firm and community building with our not-for-profit partners.



Global Training and Development

Placing clients' interests first...achieving excellence...entrepreneurship...stressing creativity...teamwork. As Goldman Sachs grows, keeping these and other core values vibrant and meaningful is of paramount importance, because the firm's unique corporate culture is entwined with the firm's success. As it has been throughout our history, sustaining and strengthening our culture depends on attracting exceptional people with exceptional knowledge and skills, and then providing them with opportunities to learn and excel in an environment that is ever more global and complex. We are committed to ensuring that the people of Goldman Sachs are offered the best learning and development possible. All of our divisions and a majority of our departments provide extensive, ongoing technical and functional instruction that keeps everyone in step with the marketplace, and ensures that our people are flexible and constantly growing.

Through the extensive use of technology, we aim to embed learning in our daily work, providing instant access to tools

and critical knowledge where and when people need them. We are continuing to build a network of world-class learning centers that, by the end of 2001, will circle the world.

Mentoring, regular reviews and our more formal training programs provide the ongoing feedback essential to optimizing each person's performance and realizing his or her potential. These programs are complemented by initiatives focused on more universal aspects of our business and on such vital issues as diversity, our culture and leadership. Pine Street, our newest leadership development program, concentrates on training the current and future leaders of our firm.

The effectiveness of this global learning enterprise circles back to our people. Our senior leaders, managing directors and business specialists, as well as highly regarded external experts, are deeply involved in the continuous and essential task of training and career development at Goldman Sachs.

INNOVATION

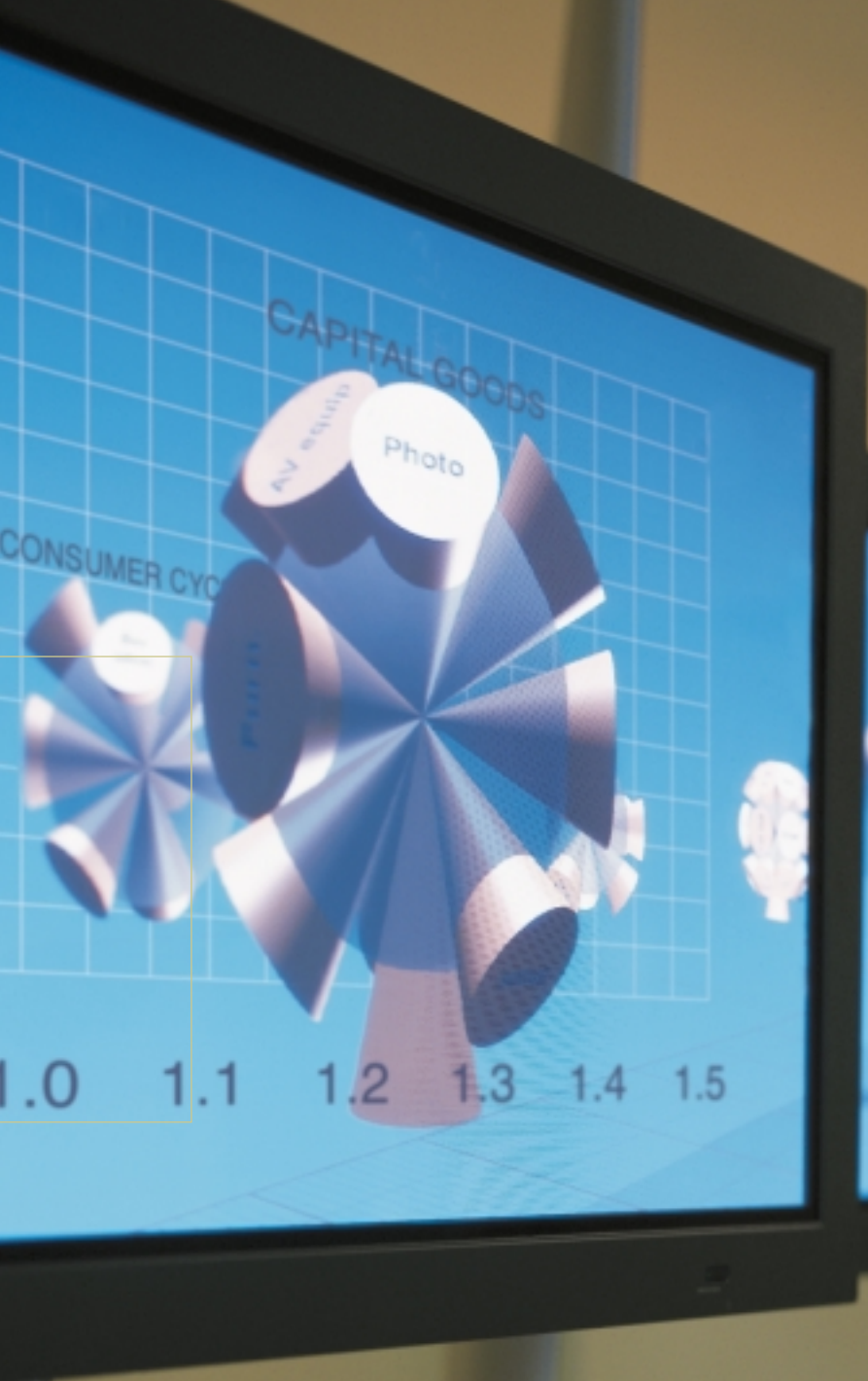
COMMITMENT TO:



1800s

Goldman Sachs' early focus on innovation was evident in the firm's receptiveness to embrace technologies that would help steer change.

The people of Goldman Sachs have inherited a tradition of innovation that stretches back to our founders. Innovation across all aspects of our products, services and operations continues to be a requirement of success in one of the world's most dynamic industries. Our clients have benefited from the intellectual curiosity and entrepreneurship that keep this tradition alive. They have also come to value the principles and dedication required to turn innovative strategies into reality. As we look forward to 2001, the successes of our clients during 2000 give us confidence in our ability to serve their needs in the coming years.



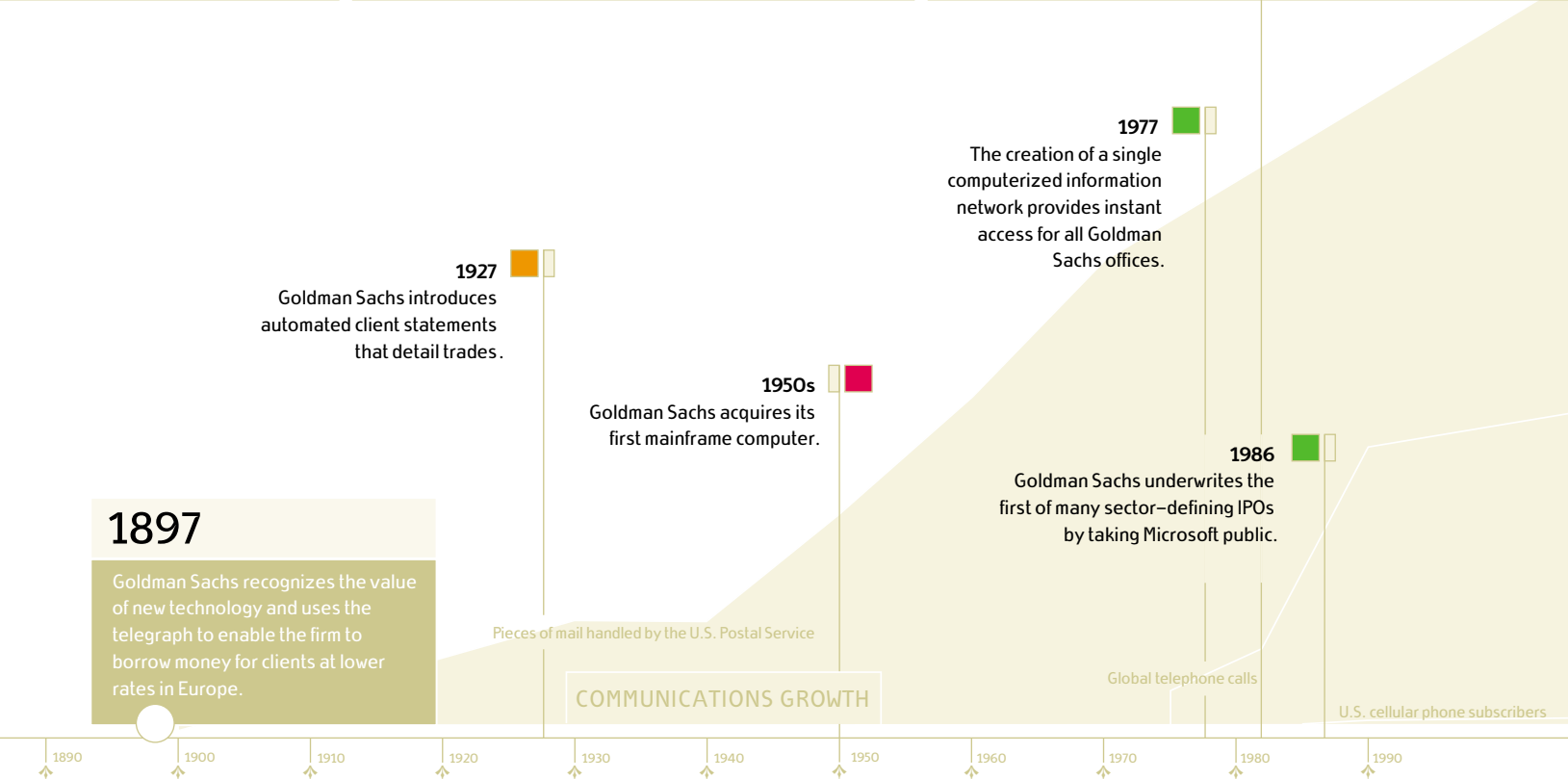
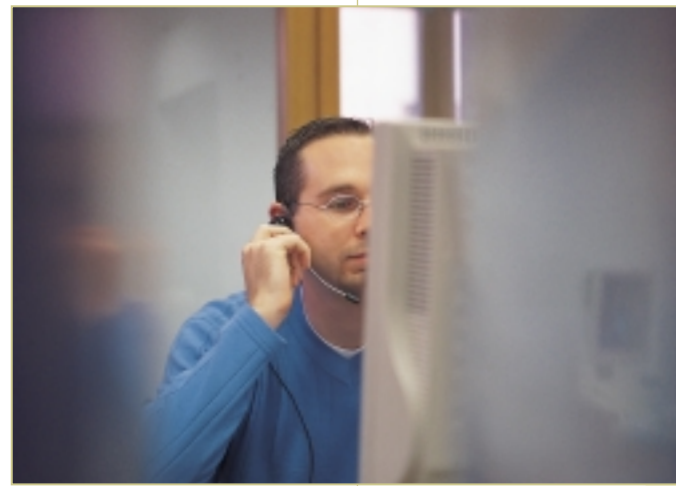
2000

We see the impact of technological change in almost every aspect of business worldwide. Our goal is to have technology that matches — and helps manage — the web of relationships we have around the world.

New technologies are just one of the most visual stimuli for business innovation; Goldman Sachs' commitment to **INNOVATION** for its clients is embodied in more than a century of invention and investment in ideas.

1982

In recognition of the special needs of a growing group of small and medium-sized companies with exceptional promise, the firm establishes a high technology group.



2000

Recognizing the importance of electronic distribution, Goldman Sachs executes a number of industry-defining electronic offerings for its clients, such as the first-ever fully integrated electronic bond offering, the first-ever Brady bond e-exchange and the first-ever municipal e-bond offering.

2000

To boost the capacity of data, video and voice that can be transmitted between offices, Goldman Sachs increases its network bandwidth by 224% globally.

1996

Goldman Sachs recognizes the potential of the Internet sector through its research analysis and the IPO of Yahoo!



1999

Goldman Sachs focuses on electronic trading of fixed income securities to help centralize liquidity and expand its sales and trading franchise across markets.

1997

Goldman Sachs makes the first of many investments in electronic equity trading platforms.

1995

Goldman Sachs enhances client service by creating a proprietary Web site, the GS Financial WorkbenchSM, helping clients plan and execute investment strategies.

1998

Goldman Sachs leads the bulge bracket by structuring its equity research around global teams.

1998

Despite market volatility, Goldman Sachs continues with the IPO of a small online auction company, eBay.

1992

Goldman Sachs releases its first Communicopia research report, which identifies key trends in the communications industry.

Global e-mail boxes

Global online population



Vodafone Group Plc

Chris Gent,
Chief Executive

“Our acquisition of Mannesmann was challenging, but from the outset Goldman Sachs came in with innovative ideas about how to structure the proposal to be maximally effective to different shareholder communities. The transaction was deemed to be attempting the impossible. The Goldman Sachs team repeatedly drew on precision thinking and outstanding technical advice to keep us going.”

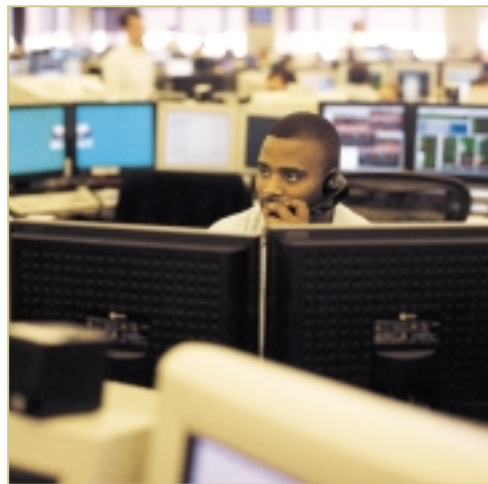
- Goldman Sachs was a financial advisor to Vodafone on its acquisition of Mannesmann, which created the world’s leading mobile telecom provider.

Corning Incorporated

James B. Flaws,
Executive Vice President and Chief Financial Officer

“We value the quality of the advice we get, which is delivered in a commonsense, practical way. Even more important to us is the cultural fit. Goldman Sachs’ business practices and integrity are exceptional. The firm is focused on doing what is right for the client, not on fees. If a transaction is not in our best interests, they will tell us so. We regard Goldman Sachs as an integral part of how we run Corning.”

- In 2000, Goldman Sachs advised Corning on \$7.8 billion in merger activity and \$7.2 billion in equity and debt financings.



Unilever

Patrick Cescau,
Foods Director

“Two words define our relationship with Goldman Sachs: continuity and teamwork. A relationship is about mutual commitment over time. Because together we have developed a true global team with a strong level of continuity, Goldman Sachs can assign us the most qualified people from around the world, work closely with us to understand our industry structure and strategy, and support us in many ways in helping to improve our business. The acquisition of Bestfoods is a product of this strategic relationship.”

- Goldman Sachs served as financial advisor to Unilever on its \$24.4 billion acquisition of Bestfoods, the largest all-cash cross-border deal ever, and was joint bookrunner of the associated acquisition financing and of approximately \$14.3 billion of debt offerings in 2000.

The World Bank Group

Gumersindo Oliveros,
Director, Treasury Finance

“Goldman Sachs was our lead manager of choice for many reasons. An electronic bond issue requires e-preparedness for book building, distribution and trading. Goldman Sachs was way ahead of the field in all these areas. Notably, it already had its electronic bond trading platform, Web.ETSM, up and running. And while many other banks were approaching electronic distribution with reluctance, Goldman Sachs early on had the strategic vision to see it as something important, and recognized it as the wave of the future. This experience has reinforced the high regard we hold for the professionalism of the Goldman Sachs team and their ability to innovate and execute.”

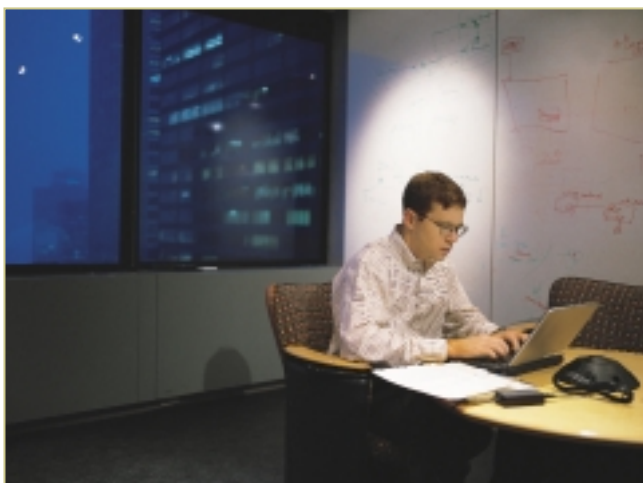
- Goldman Sachs was the sole bookrunning lead manager on the first-ever fully integrated electronic bond offering.

Infinion Technologies AG

Dr. Ulrich Schumacher,
President and Chief Executive Officer

"The Goldman Sachs team proved to be a real catalyst in enabling us to create our business model and operating strategy. The quality of this professional team is very high and they brought a very profound understanding of Infineon to our discussions. When we asked questions, we got very precise answers. This precision engendered enormous trust."

- Goldman Sachs was financial advisor to Infineon Technologies AG on its approximately €6.1 billion initial public offering, the largest corporate IPO in Germany and the largest European high-tech offering ever.



AES Corporation

Joseph Brandt

"We felt that Goldman Sachs was one of the very few investment banks that could successfully execute AES Drax's £1.3 billion financial optimization plan. The unprecedented complexity of this transaction required a very aggressive team that could think way outside of the box. Also, given the turbulence and volatility of electricity markets in the U.K., the Goldman Sachs franchise was essential in getting investors' attention. This was a very unforgiving deal to structure and execute. Nothing short of excellence would enable this deal to be done."

- Goldman Sachs was co-global financing coordinator of the £1.3 billion financial optimization plan involving one of the largest single-asset power generation financings and one of the largest dual-currency project financings ever.

Federative Republic of Brazil

With a \$5.2 billion Brady bond exchange executed entirely over Goldman Sachs' proprietary exchange system on the Internet, the largest-ever such exchange, Goldman Sachs helped the Federative Republic of Brazil optimize its debt structure to issue the first long-term callable emerging markets bond and the first 40-year bond.

Goldman Sachs Research Select FundSM

The firm has focused its product development efforts on leveraging Goldman Sachs' resources and capabilities to create unique, innovative solutions to meet investors' needs.

PGGM

Marjolein Sol,
Director Fixed Income and Treasury

"The Goldman Sachs Commodity Index (GSCI), which is our benchmark for investing in commodities, met our criteria. It has provided us with an excellent benchmark for allocating a significant percentage of our pension fund, PGGM, to commodities."

PetroChina Company Limited

Over a 13-month period, the Goldman Sachs team worked closely with Chinese oil industry executives and government officials to convert PetroChina from a state-owned, production-focused organization, operating as over 50 independent subsidiaries, into a centralized market-oriented, return-based company. Goldman Sachs was engaged in every aspect of the transformation: advising PetroChina on the separation of non-core assets and the institution of performance-linked stock option and management incentive plans.

- Goldman Sachs served as financial advisor to PetroChina on the first comprehensive restructuring of a large-scale, state-owned enterprise in China.

Deutsche Telekom AG

In the recent past, with Goldman Sachs working as its primary financial advisor, Deutsche Telekom has pursued an aggressive growth strategy through acquisitions and the purchase of broadband licenses. Given this background, Deutsche Telekom recognized the need for a large multicurrency debt offering that would include the U.S., the world's deepest and most liquid market. Working with Deutsche Telekom's legal staff in preparation for the offering, the Goldman Sachs team coordinated the establishment of the complex framework required to issue registered securities to retail and institutional investors in the U.S. At the same time, our investment banking, research, debt capital markets and sales divisions worked together to prepare and market the offering.

- Goldman Sachs was global coordinator and joint bookrunner for Deutsche Telekom's \$14.6 billion multicurrency, multi-tranche global debt offering, the largest corporate bond issue ever in international capital markets.

EXECUTION

COMMITMENT TO:



1972

Access to the most up-to-date market knowledge has always been critical to Goldman Sachs' ability to execute effectively for its clients in all its business areas.

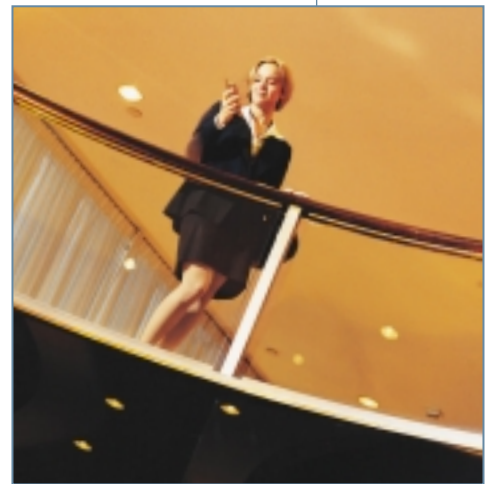
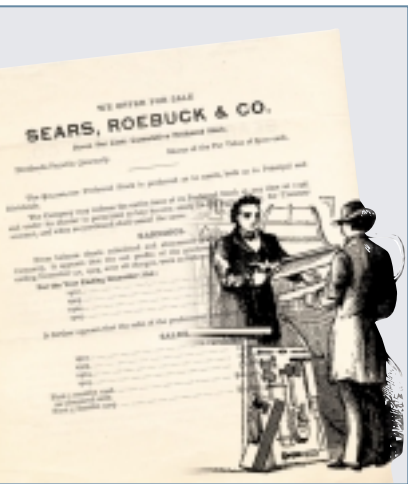
In a landmark transaction for the firm, this year Goldman Sachs combined with Spear, Leeds & Kellogg (SLK). This merger of two firms with similar cultures and highly complementary businesses creates a significant new platform for the worldwide growth of our equities businesses. SLK is a leading stock and options clearing firm in the United States, employing technology developed over years of serving highly demanding professional trading organizations. SLK also has a leadership position in providing liquidity in all major U.S. equities markets, with an important position as a New York Stock Exchange specialist, options exchange specialist and Nasdaq market maker. This transaction will enhance our ability to serve clients in our equities markets, as we offer expanded products and services to our combined client base. This move was one example of how, over the past year, the firm has continued its long tradition of searching for ways to help our clients accomplish their objectives.



2000

By combining with Spear, Leeds & Kellogg, Goldman Sachs offers a suite of integrated services that include market making, trading and execution capabilities.

As the financial markets become more global and complex, Goldman Sachs has continued to demonstrate a commitment to superior **EXECUTION** for its clients by building one of the financial industry's most advanced technological and intellectual infrastructures.



1981

To help clients reduce their borrowing costs, Goldman Sachs develops the first-ever original issue discount bond.

1960

Goldman Sachs recognizes the opportunity to provide its clients with dedicated mergers and acquisitions services and becomes one of the first investment banks to create a separate department solely for this purpose.

1981

Goldman Sachs acquires J. Aron & Co. to establish a stronger global presence in the currency and commodities markets.

1970s

Recognizing the need to better serve global clients, Goldman Sachs opens offices in Europe and Asia.

1950

By the 1950s, Goldman Sachs is a leader in the equities markets through its innovations in block trading and risk arbitrage.

1906

By utilizing the 7% preferred stock for the Sears, Roebuck & Co. IPO, Goldman Sachs anticipates the growth in equity investments and financing.

1984
For ARA Services, Goldman Sachs places one of the first registered high-yield bond financings for a leveraged buyout.

DJIA

GLOBAL INDICES

Nikkei 225

Nasdaq

Hang Seng

FTSE 100

2000

Goldman Sachs combines with Spear, Leeds & Kellogg to become one of the leading market makers of equities and options in the U.S. marketplace.

1998

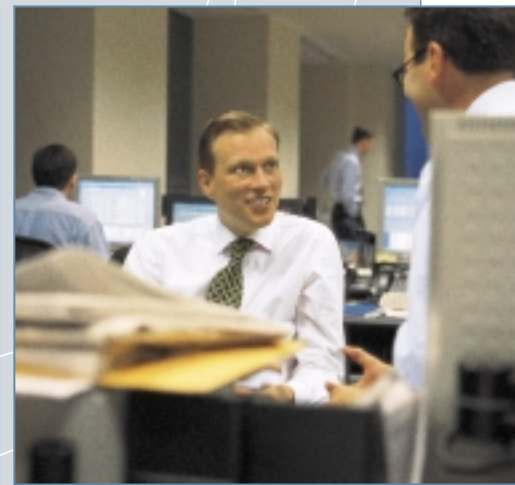
Goldman Sachs is global coordinator and bookrunner for NTT DoCoMo's IPO, the largest corporate IPO in history.

1990

In order to shorten trade execution time, Goldman Sachs invents a paperless order-taking and transaction device that has become the industry standard on the New York Stock Exchange.

2000

Goldman Sachs continues to grow its Investment Management business with over \$490 billion in assets under supervision.



1990

Goldman Sachs creates the Black-Litterman Asset Allocation Model, which continues to be a vital tool used by industry money managers.

2000

Goldman Sachs continues its global strength in M&A by advising on the Warner-Lambert/Pfizer and Vodafone/Mannesmann transactions.

1986

As the U.S. advisor and lead manager of the U.K.'s sell-off of British Gas, Goldman Sachs leads the worldwide development of government privatizations.

1999

Goldman Sachs combines with The Hull Group to complement existing businesses, to expand trading capabilities and to gain a leadership position in electronic markets.

1996

Goldman Sachs publishes the first annual Issues and Outlook research report to provide clients with a comprehensive forecast of each industry around the world.

1990

1996

1998

1999

2000

The Royal Bank of Scotland Group plc

Fred Goodwin,
Group Chief Executive

“As part of our overall advisory team, Goldman Sachs helped us create the strategy that convinced shareholders and the investment community of the merits of the takeover. Goldman Sachs was an automatic choice to play a role on our advisory team for the NatWest acquisition. Throughout this pressured, complex effort, Goldman Sachs provided a committed and supportive team approach to achieving our goals.”

- Royal Bank of Scotland’s acquisition of National Westminster Bank plc created one of the top three banks in Europe by market capitalization.

Telefónica, S.A.

José María Álvarez-Pallete,
Chief Financial Officer

“We awarded the offering mandate to Goldman Sachs because of the firm’s strengths in global distribution and research as well as its knowledge of Telefónica and the telecom industry. For many years, we have had a relationship that has covered equity and debt offerings, risk management as well as mergers and acquisitions.”

- Goldman Sachs was joint global coordinator of Telefónica’s \$6 billion multi-tranche global bond offering.



Taiwan Semiconductor Manufacturing Co. Ltd. (TSMC)

Harvey Chang,
Senior Vice President and Chief Financial Officer

“We appreciate that when we need resources or expert judgment, Goldman Sachs brings in people from around the world with superior knowledge of our industry, the technology sector and the global markets. As we worked together to map out a strategy that would ensure TSMC’s continued leadership role in our industry, the Goldman Sachs team helped us address complex regulatory issues and, in a very difficult market, position TSMC with investors as the most profitable and fastest growing semiconductor foundry in the world.”

- Goldman Sachs was the sole global coordinator and bookrunner on TSMC’s \$1.2 billion offering of American Depositary Shares, which was one of the largest corporate equity issues in non-Japan Asia at the time.

GS Capital Partners 2000 Fund (GSCP 2000)

The firm’s Principal Investment Area (PIA) has invested \$5.4 billion through its GS Capital Partners funds since 1992. In July 2000, PIA closed GS Capital Partners 2000 with \$5.25 billion in commitments, including \$1.6 billion from Goldman Sachs and our employees. GSCP 2000 is the fourth in a series of global, diversified private equity funds managed by PIA. GSCP 2000 draws on Goldman Sachs’ broad experience as an investor; its global resources for identifying, structuring, monitoring and harvesting investments; and its proprietary access to investment opportunities. The fund has a broad investment mandate and is continuing the firm’s strategy of opportunistic investing.

- With \$5.25 billion raised and a focus on merchant banking, telecommunications/broadband and technology investments, GSCP 2000 is one of the largest active private equity funds in existence today.

Putnam Investments Inc.

Richard Leibovitch,
Managing Director, Global Head of Trading and Derivatives

“We created teams at both Goldman Sachs and Putnam using various quantitative tools to identify and analyze the risks and to come up with creative ways to manage our exposures. Complete confidentiality was critical. We compared ideas and then worked as a consolidated team to develop and execute a trading strategy. Goldman Sachs really stood out for having the analytics to track the portfolio in real time as risks changed so that we could make the right trading decisions. The outcome went well beyond our expectations.”

- Putnam Investments turned to Goldman Sachs when executing a multibillion-dollar asset allocation transaction.

Kingdon Capital Management

Peter Cobos,
Chief Financial Officer and General Partner

“We rely on Goldman Sachs Global Securities Services to keep us informed of the current best practices of the investment industry. While we are one of the largest hedge funds, we can function with a relatively small back office thanks in part to Goldman Sachs’ global presence. We draw on their extensive knowledge to help us quickly and efficiently solve problems and make operating decisions. This is vitally important given the rapid changes in our marketplace.”

- Kingdon Capital, one of the largest global hedge funds, uses Goldman Sachs extensively to provide consolidated prime brokerage, administration and execution services.



Mizuho Financial Group / Sumitomo Mitsui Banking Corporation / United Financial of Japan

The Goldman Sachs advisory team worked closely with the banks to assess their position in an increasingly competitive environment and identify opportunities for structural changes and increased efficiencies.

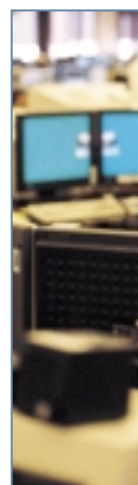
China Mobile (Hong Kong) Limited

Wang Xiaochu,
Chairman and Chief Executive Officer

“We continued to pursue our aggressive growth strategy in 2000, with Goldman Sachs continuing its role as our key advisor, supporting us in important transactions related to the acquisition of seven provincial and municipal cellular assets in Mainland China.”

Cariplo Foundation Real Estate Portfolio

When recent Italian legislation mandated the disposition of real estate holdings by charitable organizations, the Goldman Sachs Whitehall Fund purchased at auction Cariplo’s highly valued portfolio of real estate properties.



MTR Corporation Limited (MTRC)

Clement Kwok,
Finance Director

“Many complex issues were involved, and the Goldman Sachs team worked closely with us to negotiate agreements with the government defining the regulation of fares and operations. At the same time, they advised us on some key financial restructuring issues. When we initiated talks with the Hong Kong government about privatizing MTRC, Goldman Sachs already knew us well. The firm also understood the political and economic environment in Hong Kong. Goldman Sachs’ strong links to government and nongovernment institutions helped us create and communicate a strategic plan that was sensitive to the perspective of the Legislative Council, the public and the investment community.”

- The Hong Kong SAR government sold 550 million shares to institutional investors and 600 million shares to retail investors, together accounting for 23% of the company’s equity.

Lincoln Financial Group

Kelly Clevenger,
Vice President, Lincoln National Life

“When we were looking for a new sub-advisor for several substantial portfolios, Goldman Sachs’ excellent work for our affiliate in the U.K. immediately caught our attention. We had established a number of criteria for the new sub-advisor, and Goldman Sachs met them all. It has a well-known name, a model-driven quantitative portfolio management style, a good track record, and very deep resources in terms of portfolio managers, portfolio construction personnel and research analysts. Since teaming up with Goldman Sachs, we’ve already experienced significant input from its various departments.”

- Goldman Sachs is sub-advisor to Delaware Lincoln Investment Advisers on two portfolios with assets of \$4.2 billion as of December 31, 2000.

THE GOLDMAN SACHS FOUNDATION

INVESTING IN TOMORROW'S GLOBAL LEADERS

The Goldman Sachs Foundation reflects our firm's long-standing tradition of philanthropy and public leadership. The Foundation was funded at the time of our initial public offering with a donation of \$200 million. The principles of the Foundation mirror those of the firm — creativity and imagination, teamwork, integrity and determination to achieve at the highest level. Accordingly, the mission of the Foundation is to promote excellence and innovation in education worldwide, and to improve academic performance and lifelong productivity of young people.



John C. Whitehead,
Chairman of the Board of Trustees

Stephanie Bell-Rose,
President



The Foundation makes substantial investments in outstanding educational initiatives that prepare today's young people to become tomorrow's scholars, leaders and entrepreneurs. A critical component of the Foundation's strategy is strong partnerships with effective, high-quality organizations that implement achievement-oriented education programs, and that produce substantial, measurable results. Through its distinctive venture philanthropy approach, the Foundation couples sizable grants in the range of \$1 million with infusions of "social capital," in the form of professional services, volunteer time and the business expertise of Goldman Sachs executives. The Foundation allocated \$20.4 million in grants to education and youth-serving institutions worldwide in its first year of operation.

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Goldman Sachs is a leading global investment banking and securities firm that provides a wide range of services worldwide to a substantial and diversified client base. On May 7, 1999, we converted from a partnership to a corporation and completed our initial public offering.

Our activities are divided into two segments:

Global Capital Markets. This segment comprises Investment Banking, which includes Financial Advisory and Underwriting, and Trading and Principal Investments, which includes Fixed Income, Currency and Commodities (FICC), Equities and Principal Investments (Principal Investments primarily represents net revenues from our merchant banking investments); and

Asset Management and Securities Services. This segment comprises Asset Management, Securities Services and Commissions.

All references to 2000, 1999 and 1998 refer to our fiscal year ended, or the date, as the context requires, November 24, 2000, November 26, 1999 and November 27, 1998, respectively.

When we use the terms "Goldman Sachs," "we" and "our," we mean, after our conversion to corporate form, The Goldman Sachs Group, Inc., a Delaware corporation, and its consolidated subsidiaries and, prior to our conversion to corporate form, The Goldman Sachs Group, L.P., a Delaware limited partnership, and its consolidated subsidiaries.

In this discussion, we have included statements that may constitute "forward-looking statements" within the meaning of the safe harbor provisions of The Private Securities Litigation Reform Act of 1995. These forward-looking statements are not historical facts but instead represent only our belief regarding future events, many of which, by their nature, are inherently uncertain and beyond our control. These statements relate to our future plans and objectives, among other things. By identifying these statements for you in this manner, we are alerting you to the possibility that our actual results may differ, possibly materially, from the results indicated in these forward-looking statements. The factors noted below under "—Results of Operations—Certain Factors That May Affect Our Results of Operations," among others, could cause actual results to differ from those in our forward-looking statements.

Business Environment

In the first half of fiscal 2000, the global economy grew at a strong rate, reflecting low unemployment levels, low inflation and increased productivity. This expansionary economic environment provided a positive climate for all of our businesses, particularly Investment Banking and Equities, which benefited from higher levels of mergers and acquisitions activity, an increase in new issue offerings and record volumes in global equity markets. The pace of economic growth slowed in the second half of the year as increases in interest rates led to market uncertainty.

The economic expansion in the United States continued during the first half of 2000. In an attempt to alleviate possible inflationary pressures, the Federal Reserve gradually raised overnight interest rates by 100 basis points to 6.50%, the highest rate since the first quarter of 1991. The pace of growth in the second half of 2000 declined as consumer spending and corporate investment slowed. U.S. equity markets achieved record highs earlier in the year but declined markedly toward the end of the year amid market uncertainty about prospects for gross domestic product and corporate earnings growth. In particular, the Nasdaq declined 42% from its record high posted in March 2000. Fixed income markets were also affected as rising interest rates, widening credit spreads and reduced new issue activity led to a decrease in secondary market activity.

The European economy continued to grow at a steady pace during 2000 primarily due to increases in foreign demand, consumer spending and corporate investment. European equity markets were particularly active, reaching record levels during the first half of the year but suffering declines as the year came to a close. The European Central Bank raised rates throughout the year in response to rising inflation and the weakness of the euro.

Economic growth in Japan remained subdued, despite increased investment in information technology. Doubts concerning the recovery of private consumption and concerns about corporate and government debt led to declines in the Japanese equity market during the year. The Bank of Japan's zero-interest-rate policy was terminated and interest rates were raised for the first time in a decade.

Other Asian economies benefited from stronger exports and corporate investment throughout the region. However, by year end, a slowdown in Asian electronic exports to the United States led to a marked decline in gross domestic product growth.

Results of Operations

The composition of our net revenues has varied over time as financial markets and the scope of our operations have changed. The composition of net revenues can also vary over the shorter term due to fluctuations in U.S. and global economic and market conditions. As a result, period-to-period comparisons may not be meaningful.

In addition, Goldman Sachs' conversion to corporate form in 1999 has affected, and will continue to affect, our operating results in several significant ways. As a corporation, payments for services rendered by managing directors who, prior to our conversion to corporate form, were profit participating limited partners are included in compensation and benefits expense instead of being accounted for as distributions of partners' capital. In addition, restricted stock units and other forms of stock-based compensation can be awarded to employees as part of compensation. We also record a noncash expense related to the amortization of certain restricted stock units awarded to employees in connection with our initial public offering. Furthermore, as a corporation, our operating results are now subject to U.S. federal, state and local corporate income taxes, and therefore, to a higher tax rate than we incurred as a partnership.

Certain Factors That May Affect Our Results of Operations

As an investment banking and securities firm, our businesses are materially affected by conditions in the financial markets and economic conditions generally, both in the United States and elsewhere around the world. Over the last year, the financial markets in the United States and elsewhere have exhibited increased volatility and a number of financial indices have declined substantially from their record levels. Also, it is unclear how much longer the U.S. economic expansion will continue. Uncertain or unfavorable economic and market conditions may adversely affect our businesses and profitability in many ways, including the following:

- Market fluctuations and volatility may adversely affect the value of our trading, specialist and investment posi-

tions, including our merchant banking and real estate investments, and our fixed income, currency, commodity and equity positions.

- The number and size of transactions in which we provide underwriting, mergers and acquisitions advisory, and other services may decline. In particular, a decline in the investment banking services we provide to the technology and related sectors, including communications, media and entertainment, may adversely affect our results of operations.
- The volume of transactions that we execute for our customers and as a specialist may decline, which would reduce the revenues we receive from commissions and spreads. We may also suffer a decline in the fees we earn for managing assets. Moreover, even in the absence of uncertain or unfavorable economic or market conditions, investment performance by our asset management business below the performance of benchmarks or competitors could result in a decline in assets under management and therefore in the fees we receive.
- Concentration of risk in the past has increased the losses that we have incurred in our arbitrage, market making, block trading, merchant banking, underwriting and lending businesses and may continue to do so in the future.
- In our specialist business, we may be obligated by stock exchange rules to maintain an orderly market by purchasing shares in a declining market.
- A prolonged period of uncertain or unfavorable economic or market conditions could impair our operating results for a long period of time. In such a case, our revenues may decline and, if we were unable to reduce expenses at the same pace, our profit margins would erode.

If any of the variety of instruments and strategies we utilize to hedge or otherwise manage our exposure to various types of risk are not effective, we may incur losses. Our hedging strategies and other risk management techniques may not be fully effective in mitigating our risk exposure in all market environments or against all types of risk, including risks that are unidentified or unanticipated.

Liquidity, i.e., ready access to funds, is essential to our businesses. Our liquidity could be impaired by an inability to access the long-term or short-term debt capital markets,

an inability to access the repurchase and securities lending markets, or an impairment of our ability to sell assets. Our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time. In addition, a reduction in our credit ratings could adversely affect our liquidity and our competitive position and could increase our borrowing costs.

We are exposed to the risk that third parties that owe us money, securities or other assets will not perform their obligations. These parties may default on their obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons. The amount and duration of our credit exposures have been increasing over the past several years. In addition, we have also experienced, due to competitive factors, pressure to extend credit against less liquid collateral and price more aggressively the credit risks we take. As a clearing member firm, we finance our customer positions and we could be held responsible for the defaults or misconduct of our customers. Although we regularly review credit exposures to specific clients and counterparties and to specific industries, countries and regions that we believe may present credit concerns, default risk may arise from events or circumstances that are difficult to detect or foresee. In addition, concerns about, or a default by, one institution could lead to significant liquidity problems, losses or defaults by other institutions, which in turn could adversely affect Goldman Sachs.

Spear, Leeds & Kellogg

On October 31, 2000, we completed our combination with SLK LLC (SLK), a leader in securities clearing and execution, floor-based market making and off-floor market making.

The combination was accounted for under the purchase method of accounting for business combinations. In exchange for the membership interests in SLK and subordinated debt of certain retired members, we issued 35.3 million shares of common stock valued at \$3.5 billion, issued \$149 million in debentures and paid \$2.1 billion in cash. The purchase price has been preliminarily allocated to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the effective date of the combination. The excess of consideration paid over the estimated fair value of net assets acquired has been recorded as goodwill. Goodwill and identifiable intangible assets of approximately \$4.0 billion will be amortized as a charge to earnings over a weighted average life of approximately 20 years. The final allocation of the purchase price will be determined after appraisals and a comprehensive evaluation of the fair value of the SLK assets acquired and liabilities assumed are completed. We do not expect the change in amortization expense to be material.

As part of the combination with SLK, we established a \$702 million retention pool of restricted stock units for all SLK employees. A charge of \$290 million (\$180 million after taxes) related to restricted stock units for which future service was not required as a condition to the delivery of the underlying shares of common stock was included in our operating results in the fourth quarter of 2000. The remaining restricted stock units, for which future service is required, will be amortized over the five-year service period following the date of the consummation of the combination as follows: 25%, 25%, 25%, 18% and 7% in years one, two, three, four and five, respectively.

Overview

The following table sets forth a summary of our financial results:

Financial Overview

(in millions, except per share amounts)	Year Ended November			
	2000 ⁽¹⁾	1999 ⁽²⁾	1998 ⁽³⁾	Pro Forma 1999 ⁽⁴⁾
Net revenues	\$16,590	\$13,345	\$8,520	\$13,338
Pre-tax earnings	5,020	1,992	2,921	4,250
Net earnings	3,067	2,708	2,428	2,550
Diluted earnings per share	6.00	5.57	—	5.27

⁽¹⁾ In 2000, our pre-tax earnings and net earnings included a charge of \$290 million and \$180 million, respectively, related to our combination with SLK. Excluding this charge, our diluted earnings per share were \$6.35.

⁽²⁾ In 1999, our pre-tax earnings and net earnings were reduced by nonrecurring items recognized in connection with our conversion to corporate form. For a further discussion of these nonrecurring items, see “— Operating Expenses” and “— Provision for Taxes” below.

⁽³⁾ As a partnership, payments for services rendered by profit participating limited partners were accounted for as distributions of partners’ capital rather than as compensation and benefits expense. In addition, we were generally not subject to U.S. federal or state income taxes. As a result, pre-tax earnings and net earnings in 1998 are not comparable with 2000 or 1999.

⁽⁴⁾ On May 7, 1999, we converted from a partnership to a corporation and completed our initial public offering. Pro forma net earnings reflect the results of Goldman Sachs as if our conversion to corporate form and related transactions had taken place at the beginning of 1999.

Pro forma results do not give effect to the following items due to their nonrecurring nature:

- the employee initial public offering awards of restricted stock units, for which future service was not required as a condition to the delivery of the underlying shares of common stock;
- the initial irrevocable contribution of shares of common stock to the defined contribution plan;
- the recognition of certain net tax assets; and
- a contribution to The Goldman Sachs Foundation, a charitable foundation.

Pro forma results give effect to the following items:

- interest expense on junior subordinated debentures issued to retired limited partners in exchange for their partnership interests;
- the amortization of the restricted stock units awarded to employees in connection with our initial public offering, for which future service was required as a condition to the delivery of the underlying shares of common stock; and
- the provision for income taxes in corporate form.

For the purpose of calculating pro forma diluted average common shares outstanding for the year ended November 1999, we used the initial public offering price of \$53 per share from the beginning of fiscal 1999 until May 4, 1999, the day trading in our common stock commenced.

Pro forma results are not necessarily indicative of the results of operations that might have occurred had our conversion to corporate form and related transactions actually taken place at the beginning of 1999.

2000 versus 1999. Net revenues were \$16.59 billion, an increase of 24% compared with 1999. Net revenue growth was strong in both our Asset Management and Securities Services and Global Capital Markets segments, which grew 43% and 18%, respectively. Net earnings were \$3.07 billion, or \$6.00 per diluted share. Excluding the charge related to our combination with SLK, net earnings in 2000 were \$3.25 billion, or \$6.35 per diluted share, and return on average shareholders’ equity was 27%.

1999 versus 1998. Net revenues were \$13.35 billion, an increase of 57% compared with 1998. Global Capital

Markets net revenues grew significantly over 1998, as substantially all businesses recovered from the market turmoil of 1998, and Asset Management and Securities Services increased 16% compared with 1998. Our net earnings of \$2.71 billion, or \$5.57 per diluted share, in 1999 were reduced by \$672 million, or \$1.38 per diluted share, due to nonrecurring items recognized in connection with our conversion to corporate form. For a further discussion of the nonrecurring charges and benefits affecting our operating results in 1999, see “— Operating Expenses” and “— Provision for Taxes” below.

The following table sets forth the net revenues, operating expenses and pre-tax earnings of our segments:

Results by Segment

(in millions)		Year Ended November		
		2000	1999	1998
Global Capital Markets	Net revenues	\$11,998	\$10,132	\$5,747
	Operating expenses	7,844	6,232	3,978
	Pre-tax earnings	\$ 4,154	\$ 3,900	\$1,769
Asset Management and Securities Services	Net revenues	\$ 4,592	\$ 3,213	\$2,773
	Operating expenses	3,008	2,396	1,621
	Pre-tax earnings	\$ 1,584	\$ 817	\$1,152
Total	Net revenues	\$16,590	\$13,345	\$8,520
	Operating expenses	11,570 ⁽¹⁾	11,353 ⁽²⁾	5,599
	Pre-tax earnings	\$ 5,020	\$ 1,992	\$2,921

⁽¹⁾ Includes the following expenses that have not been allocated to our segments: (i) the ongoing amortization of employee initial public offering and acquisition awards of \$428 million and (ii) the acquisition awards of \$290 million related to our combination with SLK.

⁽²⁾ Includes the following expenses that have not been allocated to our segments: (i) nonrecurring employee initial public offering awards of \$2.26 billion, (ii) the ongoing amortization of employee initial public offering awards of \$268 million and (iii) the charitable contribution to The Goldman Sachs Foundation of \$200 million made at the time of our initial public offering.

Net revenues in our segments include allocations of interest income and interest expense to specific securities, commodities and other positions in relation to the cash generated by, or funding requirements of, the underlying positions. See Note 14 to the consolidated financial statements for further information regarding our segments.

Global Capital Markets

The components of the Global Capital Markets segment are set forth below:

Investment Banking. Goldman Sachs provides a broad range of investment banking services to a diverse group of corporations, financial institutions, governments and individuals. Our investment banking activities are divided into two categories:

- **Financial Advisory.** Financial Advisory includes advisory assignments with respect to mergers and acquisitions, divestitures, corporate defense activities, restructurings and spin-offs; and
- **Underwriting.** Underwriting includes public offerings and private placements of equity and debt securities.

Trading and Principal Investments. Our Trading and Principal Investments business facilitates transactions with a diverse group of corporations, financial institutions, governments and individuals and takes proprietary positions through market making in and trading of fixed income and

equity products, currencies, commodities, and swaps and other derivatives. In addition, we engage in floor-based market making as a specialist on U.S. equities and options exchanges. Trading and Principal Investments is divided into three categories:

- **FICC.** We make markets in and trade fixed income products, currencies and commodities, structure and enter into a wide variety of derivative transactions, and engage in proprietary trading and arbitrage activities;
- **Equities.** We make markets in, act as a specialist for, and trade equities and equity-related products, structure and enter into equity derivative transactions, and engage in proprietary trading and equity arbitrage; and
- **Principal Investments.** Principal Investments primarily represents net revenues from our merchant banking investments.

Net revenues from Principal Investments do not include management fees and the increased share of the income and gains from our merchant banking funds to which Goldman Sachs is entitled when the return on investments exceeds certain threshold returns to fund investors. These management fees and increased shares of income and gains are included in the net revenues of Asset Management and Securities Services.

Substantially all of our inventory is marked-to-market daily and, therefore, its value and our net revenues are subject

to fluctuations based on market movements. In addition, net revenues derived from our principal investments in privately held concerns and in real estate may fluctuate signif-

icantly depending on the revaluation or sale of these investments in any given period.

The following table sets forth the net revenues of our Global Capital Markets segment:

Global Capital Markets Net Revenues

(in millions)	Year Ended November		
	2000	1999	1998
Financial Advisory	\$ 2,592	\$ 2,270	\$1,774
Underwriting	2,779	2,089	1,594
Investment Banking	5,371	4,359	3,368
FICC	3,004	2,862	1,438
Equities	3,489	1,961	795
Principal Investments	134	950	146
Trading and Principal Investments	6,627	5,773	2,379
Total	\$11,998	\$10,132	\$5,747

2000 versus 1999. Net revenues in Global Capital Markets increased 18% to \$12.0 billion, reflecting strong performances in both Investment Banking and Trading and Principal Investments. Operating expenses increased 26% principally due to higher levels of compensation commensurate with growth in net revenues, and increased costs associated with global expansion, higher employment levels and increased business activity. Pre-tax earnings were \$4.15 billion compared with \$3.90 billion in 1999.

Investment Banking. Investment Banking generated net revenues of \$5.37 billion, a 23% increase over 1999. We maintained our leadership position in the mergers and acquisitions and new issues markets, and benefited from increased levels of activity worldwide. Net revenue growth was strong in all major regions, particularly in the high technology and communications, media and entertainment sectors.

Net revenues in Financial Advisory increased 14% over 1999. We capitalized on increased worldwide mergers and acquisitions activity, which rose 8% to a record \$3.3 trillion for transactions announced during the period from January 1, 2000 to November 30, 2000.⁽¹⁾ Underwriting net revenues rose 33% over 1999, reflecting strong investor demand for equities, particularly in the high technology and telecommunications sectors. The global equity underwriting market rose to record levels with over \$320 billion in proceeds raised during our fiscal year, including record amounts in initial public offerings.⁽¹⁾ Debt underwriting net revenues were also up slightly due to increased market activity in the earlier part of the year.

⁽¹⁾ Source: Thomson Financial Securities Data.

Trading and Principal Investments. Net revenues in Trading and Principal Investments were \$6.63 billion for the year, an increase of 15% compared with 1999, as significant net revenue growth in Equities was partially offset by a decline in Principal Investments.

Net revenues in FICC increased 5% compared with 1999, primarily due to increased activity in fixed income derivatives and currencies, partially offset by lower net revenues in our credit-sensitive businesses (which include high-yield debt, bank loans and investment-grade corporate debt). Fixed income derivatives and currencies benefited from an increase in customer activity, while the credit-sensitive businesses were negatively affected by market uncertainty and wider credit spreads. Additionally, net revenues declined in government bonds due to increased volatility and in commodities due to reduced deal flow in metals.

Equities net revenues rose 78% compared with 1999, primarily due to significant growth in equity derivatives and our global shares businesses. Equity derivatives benefited from favorable market conditions and increased customer flow. Our European and U.S. shares businesses also grew due to record transaction volumes and increased market volatility.

Principal Investments net revenues decreased substantially, as market declines in the high technology and telecommunications sectors led to unrealized losses on many of our merchant banking investments. Realized gains,

primarily in our real estate portfolio, were substantially offset by these unrealized losses.

1999 versus 1998. Net revenues in Global Capital Markets were \$10.13 billion, an increase of 76% compared with 1998, reflecting substantial growth in all major components of the business. Operating expenses increased 57%, principally due to the inclusion of compensation expense related to services rendered by managing directors who, prior to our conversion to corporate form, were profit participating limited partners, higher levels of compensation commensurate with growth in net revenues, and increased costs associated with global expansion and higher levels of business activity. Pre-tax earnings were \$3.90 billion in 1999 compared with \$1.77 billion in 1998.

Investment Banking. Investment Banking generated net revenues of \$4.36 billion for the full year, a 29% increase over 1998. Net revenue growth was strong in both Financial Advisory and Underwriting as our global presence and strong client base enabled us to capitalize on record levels of global mergers and acquisitions and new issue activity. Net revenue growth was driven by strong performances across all regions, particularly in the communications, media and entertainment, high technology, energy and power, and healthcare sectors.

Financial Advisory revenues increased 28% compared with 1998. Goldman Sachs maintained its leading position in the advisory business and benefited from an increase in mergers and acquisitions activity across many industry sectors in both Europe and the United States. Worldwide mergers and acquisitions activity rose to record levels with transactions valued at over \$3 trillion announced during the period from January 1, 1999 to November 30, 1999.⁽¹⁾ Underwriting revenues increased 31% compared with 1998. Equity underwriting revenues benefited from favorable global economic conditions, which led major equity market indices higher and new issue activity to record levels. Our debt underwriting business generally benefited from a more stable economic environment in 1999.

Trading and Principal Investments. Net revenues in Trading and Principal Investments were \$5.77 billion, compared with \$2.38 billion in 1998, as substantially all components of the business recovered from the global market turmoil of the second half of 1998.

⁽¹⁾ Source: Thomson Financial Securities Data.

Net revenues in FICC nearly doubled compared with 1998, primarily due to growth in our credit-sensitive businesses and commodities that was partially offset by lower net revenues in currencies. The credit-sensitive businesses benefited from improved economic conditions as credit spreads and market liquidity returned to more normal levels following the dislocation experienced during the second half of 1998. Net revenue growth in commodities benefited from increased customer activity, while reduced activity and volatility in the global foreign exchange markets contributed to a decline in net revenues from currencies.

The significant net revenue growth in Equities was primarily due to strength in arbitrage and convertibles and increased customer flow in derivatives and global shares. Net revenue growth in arbitrage and convertibles was driven by improved market conditions following the turmoil in global markets during the second half of 1998 and by increased mergers and acquisitions and other corporate activity. Equity derivatives net revenues were substantially higher primarily as a result of increased customer activity worldwide. Increased transaction volumes in global equity markets contributed to the net revenue growth in our global shares businesses.

Net revenues from Principal Investments increased dramatically due to unrealized gains on certain merchant banking investments, particularly in the high technology and telecommunications sectors.

Asset Management and Securities Services

The components of the Asset Management and Securities Services segment are set forth below:

- **Asset Management.** Asset Management generates management fees by providing investment advisory services to a diverse client base of institutions and individuals;
- **Securities Services.** Securities Services includes prime brokerage, financing services and securities lending, and our matched book businesses, all of which generate revenues primarily in the form of fees or interest rate spreads; and
- **Commissions.** Commissions include clearing and agency transactions for clients on major stock, options and futures exchanges and revenues from the increased share of the income and gains derived from our merchant banking funds.

The following table sets forth the net revenues of our Asset Management and Securities Services segment:

Asset Management and Securities Services Net Revenues

(in millions)	Year Ended November		
	2000	1999	1998
Asset Management	\$1,345	\$ 919	\$ 675
Securities Services	940	772	730
Commissions	2,307	1,522	1,368
Total	\$4,592	\$3,213	\$2,773

Our assets under supervision consist of assets under management and other client assets. Assets under management typically generate fees based on a percentage of their value and include our mutual funds, separate accounts managed for institutional and individual investors, our merchant

banking funds and other alternative investment funds. Other client assets consist of assets in brokerage accounts of primarily high-net-worth individuals, on which we earn commissions. Substantially all assets under supervision are valued as of calendar month-end.

The following table sets forth our assets under supervision:

Assets Under Supervision

(in millions)	As of November 30		
	2000	1999	1998
Assets under management	\$293,842	\$258,045	\$194,821
Other client assets	197,876	227,424	142,018
Total	\$491,718	\$485,469	\$336,839

2000 versus 1999. Asset Management and Securities Services net revenues were \$4.59 billion, an increase of 43% compared with 1999. Operating expenses rose 26% compared with 1999, primarily due to higher levels of compensation commensurate with growth in net revenues, and increased costs associated with global expansion, higher employment levels and increased business activity. Pre-tax earnings in Asset Management and Securities Services increased to \$1.58 billion in 2000 compared with \$817 million in 1999.

Asset Management net revenues were 46% higher than last year, primarily reflecting a 31% increase in average assets under management as well as favorable changes in the composition of assets managed. Assets under management grew 14% over 1999, with net inflows of \$40 billion, partially offset by market depreciation of \$4 billion. Performance fees also contributed to the increase in net revenues. The decline in other client assets in 2000 principally reflects market depreciation in the value of our client assets. Securities Services net revenues increased 22% over 1999, primarily due to growth in our securities lending

and margin lending, partially offset by reduced spreads in the fixed income matched book. Commissions increased 52% compared with 1999 due to record transaction volumes in global equity markets and our increased share of income and gains from our merchant banking funds.

1999 versus 1998. Net revenues in Asset Management and Securities Services were \$3.21 billion, an increase of 16% compared with 1998. All major components of the business contributed to the net revenue growth in 1999. Operating expenses increased, principally due to the inclusion of compensation expense related to services rendered by managing directors who, prior to our conversion to corporate form, were profit participating limited partners and increased costs associated with the continuing expansion of the business. Pre-tax earnings in Asset Management and Securities Services were \$817 million in 1999 compared with \$1.15 billion in 1998.

Asset Management net revenues increased 36%, primarily reflecting a 32% increase in average assets under management as well as favorable changes in the composition of

assets managed. In 1999, approximately 55% of the increase in assets under management was attributable to net asset inflows, with the remaining 45% reflecting market appreciation. Securities Services net revenues increased 6%, due to higher average customer balances in our securities lending and margin lending, partially offset by reduced spreads in our fixed income matched book. Commissions rose by 11% as fees earned on higher transaction volumes in global equity markets were partially offset by a reduction in our increased share of gains from our merchant banking funds.

Operating Expenses

In recent years, our operating expenses have increased as a result of numerous factors, including higher levels of employment and compensation, increased worldwide activities, greater levels of business complexity, and additional systems and consulting costs relating to various technology initiatives.

The following table sets forth our operating expenses and number of employees:

Operating Expenses and Employees

(\$ in millions)	Year Ended November		
	2000	1999	1998
Compensation and benefits	\$ 7,773	\$ 6,459	\$3,838
Nonrecurring employee initial public offering and acquisition awards	290	2,257	—
Amortization of employee initial public offering and acquisition awards	428	268	—
Brokerage, clearing and exchange fees	573	446	424
Market development	506	364	287
Communications and technology	435	306	265
Depreciation and amortization	486	337	242
Occupancy	440	314	207
Professional services and other	639	402	336
Charitable contribution	—	200	—
Total operating expenses	\$11,570	\$11,353	\$5,599
Employees at year end ⁽¹⁾	22,627 ⁽²⁾	15,361	13,033

⁽¹⁾ Excludes employees of Goldman Sachs' property management subsidiaries. Substantially all of the costs of these employees are reimbursed to Goldman Sachs by the real estate investment funds to which these companies provide property management services.

⁽²⁾ Includes 2,600 employees related to the combination with SLK.

2000 versus 1999. Operating expenses in 2000 were \$11.57 billion compared with \$11.35 billion in 1999. Excluding the charge related to our combination with SLK in 2000 and the nonrecurring charges associated with our initial public offering in 1999, operating expenses increased 27%. This growth was primarily due to increased compensation commensurate with higher net revenues as well as the incremental costs associated with global expansion, higher employment levels and increased business activity.

Compensation and benefits expense was \$7.77 billion, an increase of 20% over 1999, primarily due to higher headcount and compensation. While total compensation and benefits increased compared with 1999, the ratio of compensation

and benefits to net revenues decreased to 47% from 48% in 1999. Employee compensation for 2000 included both restricted stock units and stock options. Employment levels increased during the year due to growth in our core businesses and our combination with SLK. Expenses associated with our temporary staff and consultants were \$680 million in 2000, an increase of 58% compared with 1999, reflecting greater business activity, global expansion and consulting costs associated with various technology initiatives.

Brokerage, clearing and exchange fees increased 28%, primarily due to higher transaction volumes in equity derivatives and U.S. and European equities. Market development expenses increased 39%, reflecting higher travel and

entertainment costs associated with growth in employment levels and business activity, and increased advertising costs. Communications and technology expenses increased 42%, reflecting higher telecommunications and market data costs associated with increased headcount. Depreciation and amortization increased 44%, principally due to goodwill related to business acquisitions, leasehold improvements related to expanded offices, and capital expenditures on telecommunications and technology-related equipment. Occupancy expenses increased 40% due to new office space needed to accommodate higher employment levels globally. Professional services and other expenses increased 59%, reflecting higher professional fees related to technology initiatives and global expansion.

1999 versus 1998. Operating expenses were \$11.35 billion in 1999, a substantial increase over 1998, primarily due to nonrecurring charges associated with Goldman Sachs' conversion to corporate form and related transactions, the inclusion of compensation expense related to services rendered by managing directors who were profit participating limited partners, higher levels of compensation commensurate with higher net revenues and amortization of employee initial public offering awards. The nonrecurring charges included \$2.26 billion for employee initial public offering awards and \$200 million for the initial charitable contribution to The Goldman Sachs Foundation made at the time of our initial public offering.

Compensation and benefits expense was \$6.46 billion, an increase of 68% compared with 1998. The ratio of compensation and benefits to net revenues was 48% in 1999. Employment levels increased 18% during the year, reflecting growth in our core businesses. Expenses associated with our temporary staff and consultants were \$430 million in 1999, an increase of 30% compared with 1998, reflecting increased global expansion and consulting costs associated with technology initiatives, including preparations for the Year 2000.

Brokerage, clearing and exchange fees increased 5%, primarily due to higher transaction volumes in equity derivatives, U.S. and European equities, and commodities. Market development expenses increased 27%, principally due to higher levels of business activity and increased spending on advertising. Communications and technology expenses increased 15%, reflecting higher telecommunications and

market data costs associated with growth in employment levels and additional spending on technology initiatives, including preparations for the Year 2000. Depreciation and amortization increased 39%, due to additional capital expenditures on leasehold improvements and technology-related and telecommunications equipment in support of higher levels of business activity. Occupancy expenses increased 52%, reflecting additional office space needed to accommodate growth in employment levels. Professional services and other expenses increased 20% due to Goldman Sachs' increased business activity.

Provision for Taxes

Our provision for taxes in 2000 was \$1.95 billion compared with a net tax benefit of \$716 million in 1999.

The net tax benefit of \$716 million in 1999 included nonrecurring net benefits of \$1.78 billion. These nonrecurring net benefits included \$825 million related to our conversion to corporate form, \$880 million related to the granting of employee initial public offering awards and \$80 million related to a contribution of \$200 million to The Goldman Sachs Foundation made at the time of our initial public offering. Goldman Sachs' effective tax rate for the period from May 7, 1999 to the end of 1999, excluding the effect of these nonrecurring items, was 40.0%. Prior to our conversion to corporate form, we generally were not subject to U.S. federal and state income taxes. As a partnership, we were primarily subject to local unincorporated business taxes and taxes in non-U.S. jurisdictions on certain of our operations.

The effective tax rate for 2000 was 38.9% compared with 40.0%, excluding the effect of the nonrecurring tax benefits in 1999. The decline in the effective tax rate was primarily due to lower state and local taxes. Our effective tax rate can vary from year to year depending on, among other factors, the geographic and business mix of our earnings. See Note 12 to the consolidated financial statements for further information regarding our provision for taxes.

Geographic Data

For a summary of the net revenues, pre-tax earnings and identifiable assets of Goldman Sachs by geographic region, see Note 14 to the consolidated financial statements.

Cash Flows

Our cash flows are primarily related to the operating and financing activities undertaken in connection with our trading and market-making transactions.

Year Ended November 2000. Cash and cash equivalents increased to \$3.87 billion in 2000. Operating activities provided cash of \$11.14 billion. Cash of \$3.66 billion was used for investing activities, primarily for our combination with SLK and purchases of technology-related equipment. Cash of \$6.66 billion was used for financing activities as decreases in short-term borrowings and net repurchase agreements were partially offset by proceeds from the net issuances of long-term borrowings.

Year Ended November 1999. Cash and cash equivalents increased to \$3.06 billion in 1999. Cash of \$12.59 billion was used for operating activities, primarily to fund higher net trading assets due to increased levels of business activity. Cash of \$654 million was used for investing activities, primarily for the purchase of telecommunications and technology-related equipment, leasehold improvements and the acquisition of The Hull Group in September 1999. Financing activities provided \$13.46 billion of cash, reflecting an increase in long-term borrowings and repurchase agreements, and proceeds from the issuance of common stock.

Year Ended November 1998. Cash and cash equivalents increased to \$2.84 billion in 1998. Cash of \$62 million was provided by operating activities. Cash of \$656 million was used for investing activities, primarily for leasehold improvements and the purchase of telecommunications and technology-related equipment and certain financial instruments. Financing activities provided \$2.10 billion of cash, reflecting an increase in the net issuance of long-term and short-term borrowings, partially offset by a decrease in net repurchase agreements, distributions to partners, cash outflows related to partners' capital allocated for income taxes and potential withdrawals, and the termination of our profit participation plans.

Liquidity

Management Oversight of Liquidity

Management believes that one of the most important issues for a company in the financial services sector is access to liquidity. Accordingly, Goldman Sachs has established

a comprehensive structure to oversee its liquidity and funding policies.

The Finance Committee has responsibility for establishing and assuring compliance with our asset and liability management policies and has oversight responsibility for managing liquidity risk, the size and composition of our balance sheet, and our credit ratings. See “—Risk Management—Risk Management Structure” below for a further description of the committees that participate in our risk management process. The Finance Committee meets monthly, and more often when necessary, to evaluate our liquidity position and funding requirements.

Our Corporate Treasury Department manages the capital structure, funding, liquidity, and relationships with creditors and rating agencies on a global basis. The Corporate Treasury Department works jointly with our global funding desk in managing our borrowings. The global funding desk is primarily responsible for our transactional short-term funding activity.

Liquidity Policies

In order to maintain an appropriate level of liquidity, management has implemented several liquidity policies as outlined below.

Diversification of Funding Sources and Liquidity Planning.

Goldman Sachs seeks to maintain broad and diversified funding sources globally. These diversified funding sources include insurance companies, mutual funds, banks, bank trust departments, corporations, individuals and other asset managers. Management believes that Goldman Sachs' relationships with its lenders are critical to its liquidity.

We access liquidity in a variety of markets in the United States, Europe and Asia. We make extensive use of the repurchase agreement and securities lending markets and have raised debt publicly as well as in the private placement and commercial paper markets, and through Eurobonds, money broker loans, commodity-based financings, letters of credit and promissory notes. We seek to structure our liabilities to avoid significant amounts of debt coming due on any one day or during any single week or year.

Asset Liquidity. Goldman Sachs maintains a highly liquid balance sheet. Many of our assets are readily funded in the repurchase agreement and securities lending markets, which generally have proven to be a consistent source of

funding, even in periods of market stress. A substantial portion of our inventory turns over rapidly and is marked-to-market daily. We maintain long-term borrowings and shareholders' equity substantially in excess of our less liquid assets.

Excess Liquidity. In addition to maintaining a highly liquid balance sheet and a significant amount of longer term liabilities to assure liquidity even during adverse conditions, we seek to maintain a liquidity cushion that consists principally of unencumbered U.S. government and agency obligations that may be sold or pledged to provide immediate liquidity. This pool of highly liquid assets averaged \$18.19 billion during 2000 and \$17.99 billion during 1999.

Dynamic Liquidity Management. Goldman Sachs seeks to manage the composition of its asset base and the maturity profile of its funding such that it should be able to liquidate its assets prior to its liabilities coming due, even in times of liquidity stress. We have traditionally been able to fund our liquidity needs through security-based and collateralized funding, such as repurchase transactions and securities lending, as well as short-term and long-term borrowings and equity capital. To further evaluate the adequacy of our liquidity management policies and guidelines, we perform weekly "stress funding" simulations of disruptions to our access to unsecured credit.

Liquidity Ratio Maintenance. It is Goldman Sachs' policy to further manage its liquidity by maintaining a "liquidity ratio" of at least 100%. Under this policy, we seek to maintain unencumbered assets in an amount that, if pledged or sold, would provide the funds necessary to replace unsecured obligations that are scheduled to mature (or where holders have the option to redeem) within the coming year. The maintenance of this liquidity ratio is intended to permit us to fund our positions on a fully secured basis in the event that we were unable to replace our unsecured debt maturing within one year.

Intercompany Funding. Most of the liquidity of Goldman Sachs is raised by the parent company, The Goldman Sachs Group, Inc. The parent company then lends the necessary funds to its subsidiaries and affiliates. We carefully manage our intercompany exposure by generally requiring intercompany loans to have maturities equal to or shorter than the maturities of the aggregate borrowings of the parent company. This policy ensures that the subsidiaries' obligations to the parent company will generally mature in

advance of the parent company's third-party long-term borrowings. In addition, many of our subsidiaries and affiliates generally pledge collateral to cover their intercompany borrowings. We generally fund our equity investments in subsidiaries with equity capital.

The Balance Sheet

Goldman Sachs maintains a highly liquid balance sheet that fluctuates significantly between financial statement dates. The following table sets forth our total assets, adjusted assets, leverage ratios and book value per share:

(\$ in billions, except per share amounts)	As of November	
	2000	1999
Total assets	\$ 290	\$ 250
Adjusted assets ⁽¹⁾	217	188
Leverage ratio ⁽²⁾	17.5x	24.7x
Adjusted leverage ratio ⁽³⁾	13.1x	18.5x
Book value per share ⁽⁴⁾	\$32.18	\$20.94

⁽¹⁾ Adjusted assets represent total assets less securities purchased under agreements to resell, certain securities borrowed transactions and the increase in total assets related to certain provisions of Statement of Financial Accounting Standards No. 125.

⁽²⁾ Leverage ratio equals total assets divided by shareholders' equity.

⁽³⁾ Adjusted leverage ratio equals adjusted assets divided by shareholders' equity.

⁽⁴⁾ Book value per share is based on common shares outstanding, including restricted stock units granted to employees with no future service requirements, of 513.7 million as of November 2000 and 484.6 million as of November 1999.

As of November 2000 and 1999, we held approximately \$2.74 billion and \$2.62 billion, respectively, in high-yield debt and emerging market securities and \$2.83 billion and \$1.80 billion, respectively, in bank loans. These assets may be relatively illiquid during times of market stress. We seek to diversify our holdings of these assets by industry and by geographic location.

As of November 2000 and 1999, the aggregate carrying value of our principal investments held directly or through our merchant banking funds was approximately \$3.52 billion and \$2.88 billion, respectively. These carrying values were comprised of corporate principal investments with an aggregate carrying value of approximately \$2.51 billion and \$1.95 billion, respectively, and real estate investments with an aggregate carrying value of approximately \$1.01 billion and \$928 million, respectively.

Credit Ratings

Goldman Sachs relies upon the debt capital markets to fund a significant portion of its day-to-day operations. The cost and availability of debt financing is influenced by our credit ratings. Credit ratings are also important to us when competing in certain markets and when seeking to engage in longer term transactions, including over-the-counter derivatives. A reduction in our credit ratings could increase our borrowing costs and limit our access to the capital markets. This, in turn, could reduce our earnings and adversely affect our liquidity.

The following table sets forth our credit ratings as of November 2000:

	Short-Term Debt	Long-Term Debt
Fitch	F1+	AA-
Moody's Investors Service	P-1	A1
Standard & Poor's	A-1+	A+

Thomson Financial BankWatch was acquired by Fitch on December 1, 2000. The most recent ratings we received from Thomson Financial BankWatch were TBW-1 for short-term debt and AA for long-term debt.

Long-Term Debt

As of November 2000, our consolidated long-term borrowings were \$31.40 billion. Substantially all of these borrowings were unsecured and consisted principally of senior borrowings with maturities extending to 2024. The weighted average maturity of our long-term borrowings as of November 2000 was approximately 4.25 years. A substantial portion of our long-term borrowings are swapped into U.S. dollar obligations with short-term floating rates of interest in order to minimize our exposure to interest rates and foreign exchange movements. See Note 6 to the consolidated financial statements for further information regarding our long-term borrowings.

Regulated Subsidiaries

Many of our principal subsidiaries are subject to extensive regulation in the United States and elsewhere. Goldman, Sachs & Co. and Spear, Leeds & Kellogg, L.P. are registered U.S. broker-dealers and futures commissions merchants, and are regulated by the Securities and Exchange Commission, the Commodity Futures Trading Commission, the Chicago Board of Trade, the New York Stock Exchange and The National Association of Securities Dealers, Inc.

Goldman Sachs International, a registered U.K. broker-dealer, is subject to regulation by the Securities and Futures Authority Limited and the Financial Services Authority. Goldman Sachs (Japan) Ltd., a Tokyo-based broker-dealer, is subject to regulation by the Financial Services Agency, the Tokyo Stock Exchange, the Tokyo International Financial Futures Exchange and the Japan Securities Dealers Association. Several other subsidiaries of Goldman Sachs are regulated by securities, investment advisory, banking, and other regulators and authorities around the world, such as the Bundesbank of Germany. Compliance with the rules of these regulators may prevent us from receiving distributions, advances or repayment of liabilities from these subsidiaries. See Note 13 to the consolidated financial statements for further information regarding our regulated subsidiaries.

Risk Management

Goldman Sachs has a comprehensive risk management process to monitor, evaluate and manage the principal risks assumed in conducting its activities. These risks include market, credit, liquidity, operational, legal and reputational exposures.

Risk Management Structure

Goldman Sachs seeks to monitor and control its risk exposure through a variety of separate but complementary financial, credit, operational and legal reporting systems. We believe that we have effective procedures for evaluating and managing the market, credit and other risks to which we are exposed. Nonetheless, the effectiveness of our policies and procedures for managing risk exposure can never be completely or accurately predicted or fully assured. For example, unexpectedly large or rapid movements or disruptions in one or more markets or other unforeseen developments can have a material adverse effect on our results of operations and financial condition. The consequences of these developments can include losses due to adverse changes in inventory values, decreases in the liquidity of trading positions, higher volatility in our earnings, increases in our credit exposure to customers and counterparties, and increases in general systemic risk.

Goldman Sachs has established risk control procedures at several levels throughout the organization. Trading desk managers have the first line of responsibility for managing risk within prescribed limits. These managers have in-depth

knowledge of the primary sources of risk in their individual markets and the instruments available to hedge our exposures.

In addition, a number of committees are responsible for establishing trading limits, for monitoring adherence to these limits and for general oversight of our risk management process. These committees, which are described below, meet regularly and consist of senior members of both our revenue-producing units and departments that are independent of our revenue-producing units.

Management Committee. All risk control functions ultimately report to the Management Committee. Through both direct and delegated authority, the Management Committee approves all of Goldman Sachs' operating activities, trading risk parameters and customer review guidelines.

Risk Committees. The Firmwide Risk Committee:

- reviews the activities of existing businesses;
- approves new businesses and products;
- approves divisional market risk limits and reviews business unit market risk limits;
- approves inventory position limits for selected country exposures and business units;
- approves sovereign credit risk limits and credit risk limits by ratings group; and
- reviews scenario analyses based on abnormal or "catastrophic" market movements.

The FICC and Equities Risk Committees set market risk limits for their respective product lines based on a number of measures including Value at Risk (VaR), scenario analyses and inventory levels. The Asset Management Control Oversight and the Asset Management Risk Committees oversee various operational, credit, pricing and business practice issues.

Global Compliance and Control Committee. The Global Compliance and Control Committee provides oversight of our compliance and control functions, including internal audit; reviews our legal, reputational, operational and control risks; and periodically reviews the activities of existing businesses.

Commitments Committee. The Commitments Committee approves equity and non-investment-grade debt under-

writing commitments, loans extended by Goldman Sachs, and unusual financing structures and transactions that involve significant capital exposure. The Commitments Committee has delegated to the Credit Department the authority to approve underwriting commitments for investment-grade debt and certain other products.

Credit Policy Committee. The Credit Policy Committee establishes and reviews broad credit policies and parameters that are implemented by the Credit Department.

Operational Risk Committee. The Operational Risk Committee, created in fiscal year 2000, provides oversight of our ongoing development and implementation of operational risk policies, framework and methodologies and monitors the effectiveness of operational risk management.

Finance Committee. The Finance Committee is responsible for oversight of our capital, liquidity and funding needs and for setting certain inventory position limits.

Segregation of duties and management oversight are fundamental elements of our risk management process. In addition to the committees described above, departments that are independent of the revenue-producing units, such as the Firmwide Risk, Credit, Controllers, Global Operations, Central Compliance, Management Controls and Legal departments, in part perform risk management functions, which include monitoring, analyzing and evaluating risk. Furthermore, the Controllers Department, in conjunction with the Firmwide Risk Department, independently reviews, on a regular basis, internal valuation models and the pricing of positions determined by individual business units.

Risk Limits

Business unit risk limits are established by the various risk committees and may be further allocated by the business unit managers to individual trading desks.

Market risk limits are monitored on a daily basis by the Firmwide Risk Department, and are reviewed regularly by the appropriate risk committee. Limit violations are reported to the appropriate risk committee and the appropriate business unit managers.

Inventory position limits are monitored by the Controllers Department and position limit violations are reported to the appropriate business unit managers, the Finance Committee and the appropriate risk committee.

Market Risk

The potential for changes in the market value of our trading positions is referred to as “market risk.” Our trading positions result from underwriting, market making, specialist and proprietary trading activities.

Categories of market risk include exposures to interest rates, currency rates, equity prices and commodity prices. A description of each market risk category is set forth below:

- Interest rate risks primarily result from exposures to changes in the level, slope and curvature of the yield curve, the volatility of interest rates, mortgage prepayment speeds and credit spreads.
- Currency rate risks result from exposures to changes in spot prices, forward prices and volatilities of currency rates.
- Equity price risks result from exposures to changes in prices and volatilities of individual equities, equity baskets and equity indices.
- Commodity price risks result from exposures to changes in spot prices, forward prices and volatilities of commodities, such as electricity, natural gas, crude oil, petroleum products and precious and base metals.

We seek to manage these risk exposures through diversifying exposures, controlling position sizes and establishing hedges in related securities or derivatives. For example, we may hedge a portfolio of common stock by taking an offsetting position in a related equity-index futures contract. The ability to manage an exposure may, however, be limited by adverse changes in the liquidity of the security or the related hedge instrument and in the correlation of price movements between the security and related hedge instrument.

In addition to applying business judgment, senior management uses a number of quantitative tools to manage our exposure to market risk. These tools include:

- risk limits based on a summary measure of market risk exposure referred to as VaR;
- risk limits based on scenario analyses that measure the potential effects on our trading net revenues of various market events, including a large widening of credit spreads, a substantial decline in equity markets and significant moves in emerging markets; and

- inventory position limits for selected business units and country exposures.

We also estimate the broader potential impact of abnormal market movements and certain macroeconomic scenarios on our investment banking, merchant banking, asset management and security services activities as well as our trading revenues.

VaR. VaR is the potential loss in value of Goldman Sachs’ trading positions due to adverse market movements over a defined time horizon with a specified confidence level.

For the VaR numbers reported below, a one-day time horizon and a 95% confidence level were used. This means that there is a one in 20 chance that daily trading net revenues will fall below the expected daily trading net revenues by an amount at least as large as the reported VaR. Thus, shortfalls from expected trading net revenues on a single trading day greater than the reported VaR would be anticipated to occur, on average, about once a month. Shortfalls on a single day can exceed reported VaR by significant amounts. Shortfalls can also accumulate over a longer time horizon such as a number of consecutive trading days.

The VaR numbers below are shown separately for interest rate, currency, equity and commodity products, as well as for our overall trading positions. These VaR numbers include the underlying product positions and related hedges, which may include positions in other product areas. For example, the hedge of a foreign exchange forward may include an interest rate futures position and the hedge of a long corporate bond position may include a short position in the related equity.

The modeling of the risk characteristics of our trading positions involves a number of assumptions and approximations. While management believes that these assumptions and approximations are reasonable, there is no uniform industry methodology for estimating VaR, and different assumptions and/or approximations could produce materially different VaR estimates.

We use historical data to estimate our VaR and, to better reflect current asset volatilities, these historical data are weighted to give greater importance to more recent observations. Given its reliance on historical data, VaR is most effective in estimating risk exposures in markets in which there are no sudden fundamental changes or shifts in mar-

ket conditions. An inherent limitation of VaR is that past changes in market risk factors, even when weighted toward more recent observations, may not produce accurate predictions of future market risk. Moreover, VaR calculated for a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated or offset with hedges within one day. VaR also should be evaluated in

light of the methodology's other limitations. For example, when calculating the VaR numbers shown below, we assume that asset returns are normally distributed. Nonlinear risk exposures on options and the potentially mitigating impact of intraday changes in related hedges would likely produce nonnormal asset returns. Different distributional assumptions could produce a materially different VaR.

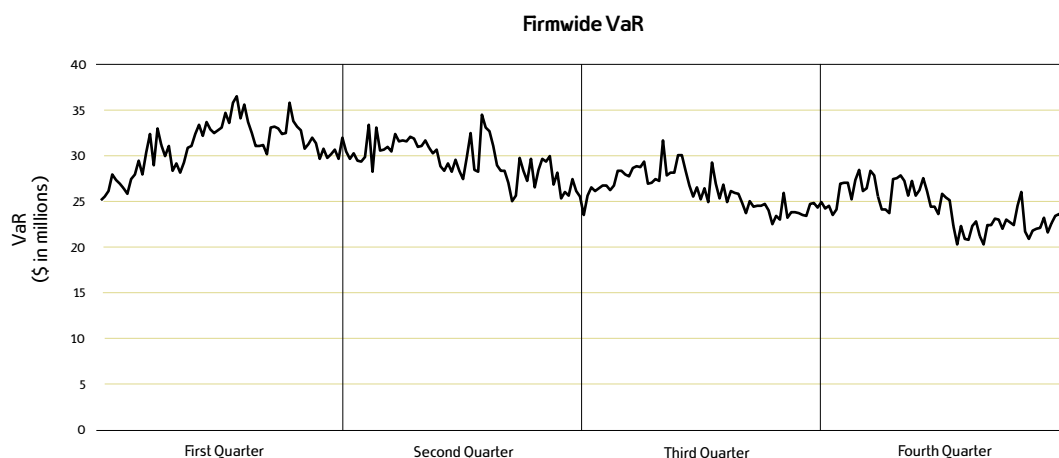
The following table sets forth the daily VaR for substantially all of our trading positions:

Daily VaR

(in millions)	As of November		Year Ended November 2000		
	2000	1999	Average	High	Low
Risk Categories					
Interest rates	\$ 11	\$ 13	\$ 13	\$ 19	\$ 9
Currency rates	11	4	6	11	3
Equity prices	17	18	21	30	13
Commodity prices	7	12	8	16	5
Diversification effect ⁽¹⁾	(21)	(22)	(20)	—	—
Firmwide	\$ 25	\$ 25	\$ 28	37	20

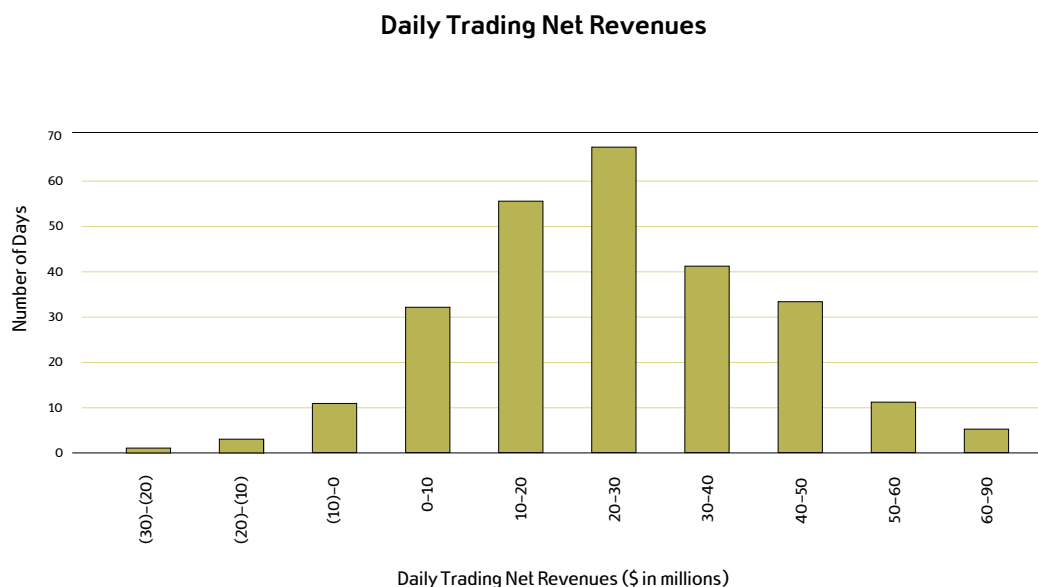
⁽¹⁾ Equals the difference between firmwide daily VaR and the sum of the daily VaRs for the four risk categories. This effect arises because the four market risk categories are not perfectly correlated.

The following chart presents the daily VaR for substantially all of our trading positions during 2000:



Trading Net Revenues Distribution

Substantially all of our inventory positions are marked-to-market on a daily basis and changes are recorded in net revenues. The following chart sets forth the frequency distribution for substantially all of our daily trading net revenues for the year ended November 2000:



As part of our overall risk control process, daily trading net revenues are compared with VaR calculated as of the end of the prior business day. Trading losses incurred on a single day did not exceed our 95% one-day VaR during 2000.

Nontrading Risk

The market risk on our nontrading financial instruments, including our merchant banking investments, is measured using a sensitivity analysis that estimates the potential reduction in our net revenues associated with a 10% decline in the S&P 500. This sensitivity analysis is based on certain assumptions regarding the relationship between changes in the S&P 500 and changes in the fair value of the individual nontrading financial instruments. Different assumptions could produce materially different risk estimates. As of November 2000, our nontrading market risk was approximately \$240 million.

Credit Risk

Credit risk represents the loss that we would incur if a counterparty, or an issuer of securities or other instruments we hold, fails to perform under its contractual obligations to us. To reduce our credit exposures, we seek to enter into net-

ting agreements with counterparties that permit us to offset receivables and payables with such counterparties. In addition, we attempt to further reduce credit risk with certain counterparties by entering into agreements that enable us to obtain collateral from a counterparty or to terminate or reset the terms of transactions after specified time periods or upon the occurrence of credit-related events, by seeking third-party guarantees of the counterparty's obligations, through the use of credit derivatives and through other structures and techniques.

For most businesses, counterparty credit limits are established by the Credit Department, which is independent of the revenue-producing departments, based on guidelines set by the Firmwide Risk and Credit Policy committees. For most products, we measure and limit credit exposures by reference to both current and potential exposure. We typically measure potential exposure based on projected worst-case market movements over the life of a transaction within a 95% confidence interval. For collateralized transactions we also evaluate potential exposure over a shorter collection period, and give effect to the value of received collateral. We further seek to measure credit exposure through the use of scenario analyses and other quantitative tools. Our global credit management systems monitor current and

potential credit exposure to individual counterparties and on an aggregate basis to counterparties and their affiliates. The systems also provide management, including the Firmwide Risk and Credit Policy committees, with information regarding overall credit risk by product, industry sector, country and region.

Derivative Contracts

Derivative contracts are financial instruments, such as futures, forwards, swaps or option contracts, that derive their value from underlying assets, indices, reference rates or a combination of these factors. Derivative instruments may be entered into by Goldman Sachs in privately negotiated contracts, which are often referred to as over-the-counter derivatives, or they may be listed and traded on an exchange.

Most of our derivative transactions are entered into for trading purposes. We use derivatives in our trading activi-

ties to facilitate customer transactions, to take proprietary positions and as a means of risk management. We also enter into nontrading derivative contracts to manage the interest rate and currency exposure on our long-term borrowings.

Derivatives are used in many of our businesses, and we believe that the associated market risk can only be understood relative to the underlying assets or risks being hedged, or as part of a broader trading strategy. Accordingly, the market risk of derivative positions is managed with all of our other nonderivative risk.

Derivative contracts are reported on a net-by-counterparty basis on our consolidated statements of financial condition where management believes a legal right of setoff exists under an enforceable netting agreement. For an over-the-counter derivative, our credit exposure is directly with our counterparty and continues until the maturity or termination of such contract.

The following table sets forth the distribution, by credit rating, of substantially all of our exposure with respect to over-the-counter derivatives as of November 2000, after taking into consideration the effect of netting agreements. The categories shown reflect our internally determined public rating agency equivalents.

Over-the-Counter Derivative Credit Exposure

(\$ in millions)

Credit Rating Equivalent	Exposure	Collateral Held ⁽²⁾	Exposure Net of Collateral	Percentage of Exposure Net of Collateral
AAA/Aaa	\$ 2,842	\$ 436	\$ 2,406	11%
AA/Aa2	5,423	1,122	4,301	19
A/A2	9,417	1,304	8,113	36
BBB/Baa2	5,298	1,102	4,196	19
BB/Ba2 or lower	4,271	977	3,294	14
Unrated ⁽¹⁾	1,098	933	165	1
	\$28,349	\$5,874	\$22,475	100%

Over-the-counter derivative credit exposure, net of collateral, by maturity is set forth below:

Credit Rating Equivalent	0 – 6 Months	6 – 12 Months	1 – 5 Years	5 Years or Greater	Exposure Net of Collateral
AAA/Aaa	\$ 119	\$ 112	\$ 547	\$1,628	\$ 2,406
AA/Aa2	2,079	275	846	1,101	4,301
A/A2	3,138	981	2,414	1,580	8,113
BBB/Baa2	1,946	608	978	664	4,196
BB/Ba2 or lower	2,285	239	499	271	3,294
Unrated ⁽¹⁾	76	26	41	22	165
	\$9,643	\$2,241	\$5,325	\$5,266	\$22,475

⁽¹⁾ In lieu of making an individual assessment of the credit of unrated counterparties, we make a determination that the collateral held in respect of such obligations is sufficient to cover a substantial portion of our exposure. In making this determination, we take into account various factors, including legal uncertainties and market volatility.

⁽²⁾ Collateral consists predominantly of cash and U.S. government and agency securities and is usually received under agreements entitling Goldman Sachs to require additional collateral upon specified increases in exposure or the occurrence of adverse credit events.

Derivatives transactions may also involve the legal risk that they are not authorized or appropriate for a counterparty, that documentation has not been properly executed or that executed agreements may not be enforceable against the counterparty. We attempt to minimize these risks by obtaining advice of counsel on the enforceability of agreements as well as on the authority of a counterparty to effect the derivative transaction.

Operational Risks

Goldman Sachs may face reputational damage, financial loss or regulatory risk as a result of inadequate or failed internal

processes, people and systems. A systems failure or failure to enter a trade properly into our records may result in an inability to settle transactions in a timely manner or a breach of regulatory requirements. Settlement errors or delays may cause losses due to damages owed to counterparties or movements in prices. These operational and systems risks may arise in connection with our own systems or as a result of the failure of an agent acting on our behalf.

The Global Operations Department is responsible for establishing, maintaining and approving policies and controls with respect to the accurate inputting and processing of transactions, clearance and settlement of transactions,

the custody of securities and other instruments, and the detection and prevention of employee errors or improper or fraudulent activities. Its personnel work closely with Information Technology in creating systems to enable appropriate supervision and management of its policies. The Global Operations Department is also responsible, together with other areas of Goldman Sachs, including the Legal and Compliance departments, for ensuring compliance with applicable regulations with respect to the clearance and settlement of transactions and the margining of positions. The Network Management Department oversees our relationships with our clearance and settlement agents, regularly reviews agents' performance and meets with these agents to review operational issues. The Operational Risk Department, created in fiscal year 2000, is responsible for establishing, maintaining and approving our operational risk management framework and policies for the overall effective management of operational risk.

Accounting Developments

In September 2000, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125," which revises the standards for accounting for securitizations and other transfers of financial assets and collateral. In addition, specific implementation guidelines have been established to further distinguish transfers of financial assets that are sales from transfers that are secured bor-

rowings. SFAS No. 140 is effective for transfers occurring after March 31, 2001 and for disclosures relating to securitization transactions and collateral for fiscal years ended after December 15, 2000. We intend to adopt the provisions of SFAS No. 140 in 2001 and are currently assessing their effect.

In June 2000, the FASB issued SFAS No. 138, "Accounting for Certain Derivative Instruments and Certain Hedging Activities," which is an amendment of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Statement is effective concurrently with SFAS No. 137, "Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133—an amendment of FASB Statement No. 133," which deferred to fiscal years beginning after June 15, 2000 the effective date of the accounting and reporting requirements of SFAS No. 133. These statements establish accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively, referred to as "derivatives"), and for hedging activities. These statements require that an entity recognize all derivatives as either assets or liabilities in the statement of financial condition and measure those instruments at fair value. The accounting for changes in the fair value of a derivative instrument depends on its intended use and the resulting designation. We adopted the provisions of these statements on November 25, 2000, the first day of our 2001 fiscal year. The effect of this adoption was not material to our financial condition or the results of our operations.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Shareholders, The Goldman Sachs Group, Inc.:

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of earnings, changes in shareholders' equity and partners' capital, cash flows and comprehensive income present fairly, in all material respects, the financial position of The Goldman Sachs Group, Inc. and its Subsidiaries (the "Company") as of November 24, 2000 and November 26, 1999, and the results of their operations and their cash flows for each of the three fiscal years in the period ended November 24, 2000, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an

opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

New York, New York
January 19, 2001

CONSOLIDATED STATEMENTS OF EARNINGS

(in millions, except per share amounts)	Year Ended November		
	2000	1999	1998
Revenues			
Global capital markets			
Investment banking	\$ 5,339	\$ 4,359	\$ 3,368
Trading and principal investments	6,528	5,758	2,015
Asset management and securities services	3,737	2,524	2,085
Interest income	17,396	12,722	15,010
Total revenues	33,000	25,363	22,478
Interest expense	16,410	12,018	13,958
Revenues, net of interest expense	16,590	13,345	8,520
Operating expenses			
Compensation and benefits	7,773	6,459	3,838
Nonrecurring employee initial public offering and acquisition awards	290	2,257	—
Amortization of employee initial public offering and acquisition awards	428	268	—
Brokerage, clearing and exchange fees	573	446	424
Market development	506	364	287
Communications and technology	435	306	265
Depreciation and amortization	486	337	242
Occupancy	440	314	207
Professional services and other	639	402	336
Charitable contribution	—	200	—
Total operating expenses	11,570	11,353	5,599
Pre-tax earnings	5,020	1,992	2,921
Provision/(benefit) for taxes	1,953	(716)	493
Net earnings	\$ 3,067	\$ 2,708	\$ 2,428
Earnings per share			
Basic	\$ 6.33	\$ 5.69	—
Diluted	6.00	5.57	—
Average common shares outstanding			
Basic	484.6	475.9	—
Diluted	511.5	485.8	—

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(in millions, except share and per share amounts)	As of November	
	2000	1999
Assets		
Cash and cash equivalents	\$ 3,870	\$ 3,055
Cash and securities segregated in compliance with U.S. federal and other regulations	17,132	9,135
Receivables from brokers, dealers and clearing organizations	6,226	4,490
Receivables from customers and counterparties	33,060	30,140
Securities borrowed	82,409	78,418
Securities purchased under agreements to resell	37,324	37,106
Right to receive securities	4,264	1,604
Financial instruments owned, at fair value		
Commercial paper, certificates of deposit and time deposits	866	1,435
U.S. government, federal agency and sovereign obligations	24,038	22,193
Corporate debt	13,317	9,821
Equities and convertible debentures	21,481	16,381
State, municipal and provincial obligations	499	756
Derivative contracts	34,627	30,661
Physical commodities	432	562
Other assets	10,215	4,734
	\$289,760	\$250,491
Liabilities and Shareholders' Equity		
Short-term borrowings, including commercial paper	\$ 33,471	\$ 37,756
Payables to brokers, dealers and clearing organizations	3,871	2,129
Payables to customers and counterparties	78,277	57,405
Securities loaned	9,215	9,169
Securities sold under agreements to repurchase	30,996	40,183
Obligation to return securities	3,355	1,595
Financial instruments sold, but not yet purchased, at fair value		
U.S. government, federal agency and sovereign obligations	23,580	19,170
Corporate debt	3,988	2,642
Equities and convertible debentures	8,829	14,002
Derivative contracts	37,815	28,488
Physical commodities	677	586
Other liabilities and accrued expenses	7,761	6,269
Long-term borrowings	31,395	20,952
	273,230	240,346
Commitments and contingencies		
Shareholders' Equity		
Preferred stock, par value \$0.01 per share; 150,000,000 shares authorized, no shares issued and outstanding	—	—
Common stock, par value \$0.01 per share; 4,000,000,000 shares authorized, 489,964,838 and 441,421,899 shares issued as of November 2000 and November 1999, respectively	5	4
Restricted stock units	4,760	4,339
Nonvoting common stock, par value \$0.01 per share; 200,000,000 shares authorized, no shares issued and outstanding as of November 2000; 7,440,362 shares issued and outstanding as of November 1999	—	—
Additional paid-in capital	11,127	7,359
Retained earnings	3,294	444
Unearned compensation	(1,878)	(2,038)
Accumulated other comprehensive (loss)/income	(130)	37
Treasury stock, at cost, par value \$0.01 per share; 6,490,145 shares as of November 2000	(648)	—
Total shareholders' equity	16,530	10,145
	\$289,760	\$250,491

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY AND PARTNERS' CAPITAL

(in millions, except per share amounts)	Year Ended November		
	2000	1999	1998
Partners' capital			
Balance, beginning of year	\$ —	\$ 6,310	\$ 6,107
Transfer of beginning partners' capital allocated for income taxes and potential withdrawals	—	74	—
Net earnings	—	2,264 ⁽¹⁾	2,428
Capital contributions	—	48	9
Return on capital and certain distributions to partners	—	(306)	(619)
Termination of profit participation plans	—	—	(368)
Transfers to partners' capital allocated for income taxes and potential withdrawals, net	—	—	(1,247)
Distributions of remaining partners' capital	—	(4,520) ⁽²⁾	—
Exchange of partnership interests for shares of common stock	—	(3,901)	—
Transfer to accumulated other comprehensive income	—	31	—
Balance, end of year	—	—	6,310
Common stock, par value \$0.01 per share			
Balance, beginning of year	4	—	—
Issued	1	4	—
Balance, end of year	5	4	—
Restricted stock units			
Balance, beginning of year	4,339	—	—
Granted	1,150	4,381	—
Delivered	(507)	—	—
Forfeited	(222)	(42)	—
Balance, end of year	4,760	4,339	—
Nonvoting common stock, par value \$0.01 per share			
Balance, beginning of year	—	—	—
Issued	—	—	—
Exchanged	—	—	—
Balance, end of year	—	—	—
Additional paid-in capital			
Balance, beginning of year	7,359	—	—
Exchange of partnership interests for shares of common stock	—	3,901	—
Issuance of common stock	3,651	2,891	—
Issuance of common stock contributed to a defined contribution plan	1	674	—
Tax benefit related to delivery of equity-based awards	116	—	—
Dividends paid	—	(107) ⁽³⁾	—
Balance, end of year	11,127	7,359	—
Retained earnings			
Balance, beginning of year	444	—	—
Net earnings	3,067	444 ⁽⁴⁾	—
Dividends paid	(217)	—	—
Balance, end of year	3,294	444	—
Unearned compensation			
Balance, beginning of year	(2,038)	—	—
Restricted stock units granted	(842)	(2,334)	—
Restricted stock units forfeited	163	23	—
Amortization of restricted stock units	839	273	—
Balance, end of year	(1,878)	(2,038)	—
Accumulated other comprehensive (loss)/income			
Balance, beginning of year	37	—	—
Transfer from partners' capital	—	(31)	—
Currency translation adjustment	(167)	68	—
Balance, end of year	(130)	37	—
Treasury stock, at cost, par value \$0.01 per share			
Balance, beginning of year	—	—	—
Shares repurchased	(648)	—	—
Balance, end of year	(648)	—	—
	\$16,530	\$10,145	\$ 6,310

⁽¹⁾ Represents net earnings of the partnership from November 28, 1998 through May 6, 1999.

⁽²⁾ Represents the retired limited partners' exchanges of partnership interests for cash and junior subordinated debentures, the redemption of senior limited partnership interests for cash and other distributions of partners' capital in accordance with the partnership agreement.

⁽³⁾ Represents two quarterly dividends of \$0.12 per common share each.

⁽⁴⁾ Represents net earnings of the corporation from May 7, 1999 through November 26, 1999.

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in millions)	Year Ended November		
	2000	1999	1998
Cash flows from operating activities			
Net earnings	\$ 3,067	\$ 2,708	\$ 2,428
Noncash items included in net earnings			
Depreciation and amortization	486	337	242
Deferred income taxes	(352)	(1,387)	23
Stock-based compensation	1,345	2,989	—
Changes in operating assets and liabilities			
Cash and securities segregated in compliance with U.S. federal and other regulations	(5,389)	(1,248)	(2,984)
Net receivables from brokers, dealers and clearing organizations	336	1,453	(789)
Net payables to customers and counterparties	14,570	(3,990)	14,664
Securities borrowed, net	(916)	(11,179)	(21,158)
Financial instruments owned, at fair value	(8,386)	(13,718)	148
Financial instruments sold, but not yet purchased, at fair value	5,507	9,059	7,559
Other, net	867	2,387	(71)
Net cash provided by/(used for) operating activities	11,135	(12,589)	62
Cash flows from investing activities			
Property, leasehold improvements and equipment	(1,552)	(656)	(476)
Financial instruments owned, at fair value	(116)	189	(180)
Business combinations, net of cash acquired	(1,988)	(187)	—
Net cash used for investing activities	(3,656)	(654)	(656)
Cash flows from financing activities			
Short-term borrowings, net	(11,550)	755	2,193
Issuance of long-term borrowings	16,060	11,000	10,527
Repayment of long-term borrowings	(782)	(753)	(2,058)
Securities sold under agreements to repurchase, net	(9,528)	4,304	(5,909)
Common stock repurchased	(648)	—	—
Dividends paid	(217)	(107)	—
Proceeds from issuance of common stock	1	2,633	—
Capital contributions	—	48	9
Returns on capital and certain distributions to partners	—	(306)	(619)
Termination of the profit participation plans	—	—	(368)
Partners' capital distributions, net	—	(4,112)	—
Partners' capital allocated for income taxes and potential withdrawals	—	—	(1,673)
Net cash (used for)/provided by financing activities	(6,664)	13,462	2,102
Net increase in cash and cash equivalents	815	219	1,508
Cash and cash equivalents, beginning of year	3,055	2,836	1,328
Cash and cash equivalents, end of year	\$ 3,870	\$ 3,055	\$ 2,836

SUPPLEMENTAL DISCLOSURES:

Cash payments for interest approximated the related expense for each of the fiscal years presented.

Payments of income taxes were \$1.96 billion and \$463 million for the years ended November 2000 and November 1999, respectively, and were immaterial for the year ended November 1998.

Noncash activities:

Common stock issued in connection with business combinations was \$3.41 billion and \$245 million for the years ended November 2000 and November 1999, respectively.

In connection with the firm's conversion to corporate form in 1999, junior subordinated debentures of \$371 million were issued to retired limited partners in exchange for their partnership interests.

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(in millions)	Year Ended November		
	2000	1999	1998
Net earnings	\$3,067	\$2,708	\$2,428
Currency translation adjustment, net of tax	(167)	37	(31)
Comprehensive income	\$2,900	\$2,745	\$2,397

The accompanying notes are an integral part of these consolidated financial statements.

Note 1/Description of Business

The Goldman Sachs Group, Inc. (Group Inc.), a Delaware corporation, together with its consolidated subsidiaries (collectively, the firm), is a global investment banking and securities firm that provides a wide range of financial services worldwide to a substantial and diversified client base. On May 7, 1999, the firm converted from a partnership to a corporation and completed its initial public offering.

The firm's activities are divided into two segments:

Global Capital Markets. This segment comprises Investment Banking, which includes Financial Advisory and Underwriting, and Trading and Principal Investments, which includes Fixed Income, Currency and Commodities (FICC), Equities and Principal Investments (Principal Investments primarily represents net revenues from the firm's merchant banking investments); and

Asset Management and Securities Services. This segment comprises Asset Management, Securities Services and Commissions.

Note 2/Significant Accounting Policies

Basis of Presentation

The consolidated financial statements include the accounts of Group Inc. and its U.S. and international subsidiaries including Goldman, Sachs & Co. (GS&Co.), J. Aron & Company and Spear, Leeds & Kellogg, L.P. in New York, Goldman Sachs International (GSI) in London and Goldman Sachs (Japan) Ltd. (GSJL) in Tokyo. Certain reclassifications have been made to prior-year amounts to conform to the current-year presentation. All material intercompany transactions and balances have been eliminated.

These consolidated financial statements have been prepared in accordance with generally accepted accounting principles that require management to make estimates and assumptions regarding trading inventory valuations, the outcome of pending litigation, and other matters that affect the consolidated financial statements and related disclosures. These estimates and assumptions are based on judgment and available information and, consequently, actual results could be materially different from these estimates.

Unless otherwise stated herein, all references to 2000, 1999 and 1998 refer to the firm's fiscal year ended, or the date, as the context requires, November 24, 2000, November 26, 1999 and November 27, 1998, respectively.

Cash and Cash Equivalents

The firm defines cash equivalents as highly liquid overnight deposits held in the ordinary course of business.

Repurchase Agreements and Collateralized Financing Arrangements

Securities purchased under agreements to resell and securities sold under agreements to repurchase, principally U.S. government, federal agency and investment-grade non-U.S. sovereign obligations, represent short-term collateralized financing transactions and are carried at their contractual amounts plus accrued interest. These amounts are presented on a net-by-counterparty basis when the applicable requirements of Financial Accounting Standards Board Interpretation No. 41 are satisfied. The firm takes possession of securities purchased under agreements to resell, monitors the market value of these securities on a daily basis and obtains additional collateral as appropriate.

Securities borrowed and loaned are recorded on the statements of financial condition based on the amount of cash collateral advanced or received. These transactions are generally collateralized by either cash, securities or letters of credit. The firm takes possession of securities borrowed, monitors the market value of securities loaned and obtains additional collateral as appropriate. Income or expense is recognized as interest over the life of the transaction.

Financial Instruments

Gains and losses on financial instruments and commission income and related expenses are recorded on a trade date basis in the consolidated statements of earnings. The consolidated statements of financial condition generally reflect purchases and sales of financial instruments, including agency transactions, on a trade date basis.

Substantially all financial instruments used in the firm's trading and nontrading activities are carried at fair value or amounts that approximate fair value, and unrealized gains and losses are recognized in earnings. Fair value is based generally on listed market prices or broker or dealer price quotations. To the extent that prices are not readily available, or if liquidating the firm's position is reasonably expected to affect market prices, fair value is based on either internal valuation models or management's estimate of amounts that could be realized under current market conditions, assuming an orderly liquidation over a reason-

able period of time. Certain over-the-counter (OTC) derivative instruments are valued using pricing models that consider, among other factors, current and contractual market prices, time value, and yield curve and/or volatility factors of the underlying positions. The fair value of the firm's trading and nontrading assets and liabilities is discussed further in Notes 4, 5 and 6.

Principal Investments

Principal investments are carried at fair value, generally based upon quoted market prices or comparable substantial third-party transactions. Where fair value is not readily ascertainable, principal investments are recorded at cost or management's estimate of the realizable value.

The firm is entitled to receive merchant banking overrides (i.e., an increased share of a fund's income and gains) when the return on the fund's investments exceeds certain threshold returns. Overrides are based on investment performance over the life of each merchant banking fund, and future investment underperformance may require amounts previously distributed to the firm to be returned to the funds. Accordingly, overrides are recognized in earnings only when management determines that the probability of return is remote. Overrides are included in "Asset management and securities services" on the consolidated statements of earnings.

Derivative Contracts

Derivatives used for trading purposes are reported at fair value and are included in "Derivative contracts" on the consolidated statements of financial condition. Gains and losses on derivatives used for trading purposes are generally included in "Trading and principal investments" on the consolidated statements of earnings.

Derivatives used for nontrading purposes include interest rate futures contracts and interest rate and currency swap agreements, which are primarily utilized to convert a substantial portion of the firm's fixed rate debt into U.S. dollar-based floating rate obligations. Gains and losses on these derivatives are generally deferred and recognized as adjustments to interest expense over the life of the derivative contract. Gains and losses resulting from the early termination of derivatives used for nontrading purposes are generally deferred and recognized over the remaining life of the underlying debt. If the underlying debt is terminated prior to its stated maturity, gains and losses on these

transactions, including the associated hedges, are recognized in earnings immediately.

Derivatives are reported on a net-by-counterparty basis on the consolidated statements of financial condition where management believes a legal right of setoff exists under an enforceable netting agreement.

Property, Leasehold Improvements and Equipment

Depreciation and amortization generally are computed using accelerated cost recovery methods for all property and equipment and for leasehold improvements where the term of the lease is greater than the economic useful life of the asset. All other leasehold improvements are amortized on a straight-line basis over the term of the lease. Certain internal use software costs are capitalized and amortized on a straight-line basis over the expected useful life.

Goodwill

The cost of acquired companies in excess of the fair value of net assets at acquisition date is recorded as goodwill and amortized over periods of 15 to 20 years on a straight-line basis.

Investment Banking

Underwriting revenues and fees from mergers and acquisitions and other corporate finance advisory assignments are recorded when the underlying transaction is completed under the terms of the engagement. Syndicate expenses related to securities offerings in which the firm acts as an underwriter or agent are deferred until the related revenue is recognized.

Earnings Per Share

Earnings per share (EPS) is computed in accordance with Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings Per Share." Basic EPS is calculated by dividing net earnings by the weighted average number of common shares outstanding. Common shares outstanding includes common stock and nonvoting common stock as well as restricted stock units for which no future service is required as a condition to the delivery of the underlying common stock. Diluted EPS includes the determinants of basic EPS and, in addition, reflects the dilutive effect of the common stock deliverable pursuant to stock options and to restricted

stock units for which future service is required as a condition to the delivery of the underlying common stock.

Stock-Based Compensation

The firm has elected to account for stock-based employee compensation plans in accordance with Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees," as permitted by SFAS No. 123, "Accounting for Stock-Based Compensation." In accordance with APB No. 25, compensation expense is not recognized for stock options that have no intrinsic value on the date of grant. Compensation expense is recognized immediately for restricted stock units for which future service is not required as a condition to the delivery of the underlying shares of common stock. For restricted stock units with future service requirements, compensation expense is recognized over the relevant vesting period using an accelerated amortization methodology.

Income Taxes

The firm accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," which requires the recognition of tax benefits or expenses on the temporary differences between the financial reporting and tax bases of its assets and liabilities. As a partnership, the firm was primarily subject to unincorporated business taxes and taxes in foreign jurisdictions on certain of its operations. As a corporation, the earnings of the firm are subject to U.S. federal, foreign, state and local taxes. As a result of its conversion to corporate form, the firm recognized the tax effect of the change in its income tax rate on both its deferred tax assets and liabilities and the earnings attributable to the period from May 7, 1999 to the end of fiscal year 1999. The firm's tax assets and liabilities are presented as a component of "Other assets" and "Other liabilities and accrued expenses," respectively, on the consolidated statements of financial condition.

Foreign Currency Translation

Assets and liabilities denominated in non-U.S. currencies are translated at rates of exchange prevailing on the date of the statement of financial condition, and revenues and expenses are translated at average rates of exchange for

the fiscal year. Gains or losses on translation of the financial statements of a non-U.S. operation, where the functional currency is other than the U.S. dollar, are reflected as a separate component of equity. Gains or losses on foreign currency transactions are included in the consolidated statements of earnings.

Note 3/Spear, Leeds & Kellogg

On October 31, 2000, the firm completed its combination with SLK LLC (SLK), a leader in securities clearing and execution, floor-based market making and off-floor market making. The combination was accounted for under the purchase method of accounting for business combinations. In exchange for the membership interests in SLK and subordinated debt of certain retired members, the firm issued 35.3 million shares of common stock valued at \$3.5 billion, issued \$149 million in debentures and paid \$2.1 billion in cash. The purchase price has been preliminarily allocated to tangible and identifiable intangible assets acquired and liabilities assumed based on their estimated fair values as of the effective date of the combination. The excess of consideration paid over the estimated fair value of net assets acquired has been recorded as goodwill. Goodwill and identifiable intangible assets of approximately \$4.0 billion will be amortized as a charge to earnings over a weighted average life of approximately 20 years. The final allocation of the purchase price will be determined after appraisals and a comprehensive evaluation of the fair value of the SLK assets acquired and liabilities assumed are completed. The firm does not expect the change in amortization expense to be material.

As part of the combination with SLK, the firm established a \$702 million retention pool of restricted stock units for all SLK employees. A charge of \$290 million (\$180 million after taxes) related to restricted stock units for which future service was not required as a condition to the delivery of the underlying shares of common stock was included in the firm's operating results in the fourth quarter of 2000. The remaining restricted stock units, for which future service is required, will be amortized over the five-year service period following the date of the consummation of the combination as follows: 25%, 25%, 25%, 18% and 7% in years one, two, three, four and five, respectively.

The following table sets forth the unaudited pro forma combined operating results of the firm and SLK for the years ended November 2000 and November 1999. These pro forma results were prepared as if the firm's combination with SLK had taken place at the beginning of the periods presented.

Pro Forma Operating Results (unaudited)

(in millions, except per share amounts)	Year Ended November	
	2000	1999
Revenues, net of interest expense	\$18,630	\$14,652
Net earnings	3,459	2,595
Basic EPS	6.66	5.06
Diluted EPS	6.32	4.97

Note 4/Financial Instruments

Financial instruments, including both cash instruments and derivatives, are used to manage market risk, facilitate customer transactions, engage in proprietary transactions and meet financing objectives. These instruments can be either executed on an exchange or negotiated in the OTC market.

Transactions involving financial instruments sold, but not yet purchased, entail an obligation to purchase a financial instrument at a future date. The firm may incur a loss if the market value of the financial instrument subsequently increases prior to the purchase of the instrument.

Fair Value of Financial Instruments

Substantially all of the firm's assets and liabilities are carried at fair value or amounts that approximate fair value.

Trading assets and liabilities, including derivative contracts used for trading purposes, are carried at fair value and reported as "Financial instruments owned" and "Financial instruments sold, but not yet purchased," on the consolidated statements of financial condition. Nontrading assets and liabilities are generally carried at fair value or amounts that approximate fair value.

Nontrading assets include cash and cash equivalents; cash and securities segregated in compliance with U.S. federal and other regulations; receivables from brokers, dealers and clearing organizations; receivables from customers and counterparties; securities borrowed; securities purchased under agreements to resell; right to receive securities; and certain investments, primarily those made in connection with the firm's merchant banking activities.

Nontrading liabilities include short-term borrowings; payables to brokers, dealers and clearing organizations;

payables to customers and counterparties; securities loaned; securities sold under agreements to repurchase; obligation to return securities; other liabilities and accrued expenses; and long-term borrowings. The fair value of the firm's long-term borrowings and associated hedges is discussed in Note 6.

Trading and Principal Investments

The firm's Trading and Principal Investments business, a component of the Global Capital Markets segment, facilitates customer transactions, takes proprietary positions through market making in and trading of securities, currencies, commodities and swaps, and other derivatives, and engages in floor-based market making as a specialist on U.S. equities and options exchanges. Derivative financial instruments are often used to hedge cash instruments or other derivative financial instruments as an integral part of the firm's strategies. As a result, it is necessary to view the results of any activity on a fully integrated basis, including cash positions, the effect of related derivatives and the financing of the underlying positions.

Net revenues include allocations of interest income and interest expense to specific securities, commodities and other positions in relation to the cash generated by, or funding requirements of, the underlying positions. See Note 14 for further information regarding the firm's segments.

The following table sets forth the net revenues of Trading and Principal Investments:

(in millions)	Year Ended November		
	2000	1999	1998
FICC	\$3,004	\$2,862	\$1,438
Equities	3,489	1,961	795
Principal Investments	134	950	146
Total	\$6,627	\$5,773	\$2,379

Risk Management

The firm seeks to monitor and control its risk exposure through a variety of separate but complementary financial, credit, operational and legal reporting systems. Management believes that it has effective procedures for evaluating and managing the market, credit and other risks to which it is exposed. The Management Committee, the firm's primary decision-making body, determines (both directly and through delegated authority) the types of business in which the firm engages, approves guidelines for accepting customers for all product lines, outlines the terms under which customer business is conducted and establishes the parameters for the risks that the firm is willing to undertake in its business.

The Firmwide Risk Committee, which reports to senior management and meets weekly, is responsible for managing and monitoring all of the firm's risk exposures. In addition, the firm maintains segregation of duties, with credit review and risk-monitoring functions performed by groups that are independent from revenue-producing departments.

Market Risk. The potential for changes in the market value of the firm's trading positions is referred to as "market risk." The firm's trading positions result from underwriting, market making, specialist and proprietary trading activities.

Categories of market risk include exposures to interest rates, currency rates, equity prices and commodity prices. A description of each market risk category is set forth below:

- Interest rate risks primarily result from exposures to changes in the level, slope and curvature of the yield curve, the volatility of interest rates, mortgage prepayment speeds and credit spreads.
- Currency rate risks result from exposures to changes in spot prices, forward prices and volatilities of currency rates.
- Equity price risks result from exposures to changes in prices and volatilities of individual equities, equity baskets and equity indices.
- Commodity price risks result from exposures to changes in spot prices, forward prices and volatilities of commodities, such as electricity, natural gas, crude oil, petroleum products and precious and base metals.

These risk exposures are managed through diversification, by controlling position sizes and by establishing hedges in

related securities or derivatives. For example, the firm may hedge a portfolio of common stock by taking an offsetting position in a related equity-index futures contract. The ability to manage these exposures may, however, be limited by adverse changes in the liquidity of the security or the related hedge instrument and in the correlation of price movements between the security and the related hedge instrument.

Credit Risk. Credit risk represents the loss that the firm would incur if a counterparty or issuer of securities or other instruments held by the firm fails to perform its contractual obligations to the firm. To reduce credit exposures, the firm seeks to enter into netting agreements with counterparties that permit the firm to offset receivables and payables with such counterparties. In addition, the firm attempts to further reduce credit risk by entering into agreements that enable us to obtain collateral from a counterparty, to terminate or reset the terms of transactions after specified time periods or upon the occurrence of credit-related events, by seeking third-party guarantees of the counterparty's obligations, and through the use of credit derivatives.

Credit concentrations may arise from trading, underwriting and securities borrowing activities and may be impacted by changes in economic, industry or political factors. The firm's concentration of credit risk is monitored actively by the Credit Policy Committee. As of November 2000 and 1999, U.S. government and federal agency obligations represented 6% and 7%, respectively, of the firm's total assets. In addition, most of the firm's securities purchased under agreements to resell are collateralized by U.S. government, federal agency and other sovereign obligations.

Derivative Activities

Most of the firm's derivative transactions are entered into for trading purposes. The firm uses derivatives in its trading activities to facilitate customer transactions, to take proprietary positions and as a means of risk management. The firm also enters into nontrading derivative contracts to manage the interest rate and currency exposure on its long-term borrowings. Nontrading derivatives related to the firm's long-term borrowings are discussed in Note 6.

Derivative contracts are financial instruments, such as futures, forwards, swaps or option contracts, that derive their value from underlying assets, indices, reference rates or a combination of these factors. Derivatives may involve future commitments to purchase or sell financial instruments or commodities, or to exchange currency or interest pay-

ment streams. The amounts exchanged are based on the specific terms of the contract with reference to specified rates, securities, commodities or indices.

Derivative contracts exclude certain cash instruments, such as mortgage-backed securities, interest-only and principal-only obligations, and indexed debt instruments, that derive their values or contractually required cash flows from

the price of some other security or index. Derivatives also exclude option features that are embedded in cash instruments, such as the conversion features and call provisions embedded in bonds. The firm has elected to include commodity-related contracts in its derivative disclosure, although not required to do so, as these contracts may be settled in cash or are readily convertible into cash.

The gross notional (or contractual) amounts of derivative financial instruments represent the volume of these transactions and not the amounts potentially subject to market risk. In addition, measurement of market risk is meaningful only when all related and offsetting transactions are taken into consideration. Gross notional (or contractual) amounts of derivative financial instruments used for trading purposes with off-balance-sheet market risk are set forth below:

(in millions)	As of November	
	2000	1999
Interest Rate		
Financial futures and forward settlement contracts	\$ 320,811	\$ 422,465
Swap agreements	3,588,814	2,581,100
Written option contracts	350,977	509,841
Equity		
Financial futures and forward settlement contracts	12,508	10,082
Swap agreements	4,520	3,423
Written option contracts	115,327	113,653
Currency and Commodity		
Financial futures and forward settlement contracts	415,282	460,941
Swap agreements	185,288	110,159
Written option contracts	226,058	193,989

Market risk on purchased option contracts is limited to the market value of the option; therefore, purchased option contracts have no off-balance-sheet market risk. The gross notional (or contractual) amounts of purchased option contracts used for trading purposes are set forth below:

(in millions)	As of November	
	2000	1999
Purchased Option Contracts		
Interest rate	\$427,176	\$484,104
Equity	123,645	114,680
Currency and commodity	212,583	210,421

The firm utilizes replacement cost as its measure of derivative credit risk. Replacement cost, as reported in "Financial instruments owned, at fair value" on the consolidated statements of financial condition, represents amounts receivable from various counterparties, net of any unrealized losses, where management believes a legal right of setoff exists under an enforceable netting agreement.

Replacement cost for purchased option contracts is the market value of the contract. The firm controls its credit risk through an established credit approval process, by monitoring counterparty limits, obtaining collateral where appropriate and, in some cases, entering into enforceable netting agreements.

The fair value of derivative financial instruments used for trading purposes, computed in accordance with the firm's netting policy, is set forth below:

(in millions)	As of November			
	2000		1999	
	Assets	Liabilities	Assets	Liabilities
Year End				
Forward settlement contracts	\$ 6,315	\$ 6,748	\$ 4,555	\$ 4,625
Swap agreements	15,767	15,879	12,052	11,587
Option contracts	12,543	15,118	14,018	12,274
Total	\$34,625	\$37,745	\$30,625	\$28,486
Monthly Average				
Forward settlement contracts	\$ 5,040	\$ 4,862	\$ 3,877	\$ 3,619
Swap agreements	14,720	14,639	10,414	11,210
Option contracts	13,438	13,727	9,249	9,707
Total	\$33,198	\$33,228	\$23,540	\$24,536

Note 5/Short-Term Borrowings

The firm obtains secured short-term financing principally through the use of repurchase agreements and securities lending agreements, collateralized mainly by U.S. government, federal agency, investment-grade foreign sovereign obligations and equity securities. The firm obtains unsecured short-term borrowings through issuance of commercial paper, promissory notes and bank loans. The carrying value of these short-term obligations approximates fair value due to their short-term nature.

Short-term borrowings are set forth below:

(in millions)	As of November	
	2000	1999
Commercial paper	\$10,721	\$ 9,403
Promissory notes	14,516	11,061
Bank loans and other ⁽¹⁾	8,234	17,292
Total⁽²⁾	\$33,471	\$37,756

⁽¹⁾ As of November 2000 and November 1999, short-term borrowings included \$4.06 billion and \$10.82 billion of long-term borrowings maturing within one year, respectively.

⁽²⁾ As of November 2000 and November 1999, weighted average interest rates for short-term borrowings, including commercial paper, were 6.43% and 5.66%, respectively.

The firm maintains unencumbered securities with a market value in excess of all uncollateralized short-term borrowings.

Note 6/Long-Term Borrowings

The firm's long-term borrowings are set forth below:

(in millions)	As of November	
	2000	1999
Fixed Rate Obligations⁽¹⁾		
U.S. dollar	\$11,825	\$ 8,236
Non-U.S. dollar	3,238	1,980
Floating Rate Obligations⁽²⁾		
U.S. dollar	13,873	9,697
Non-U.S. dollar	2,459	1,039
Total⁽³⁾	\$31,395	\$20,952

⁽¹⁾ During 2000 and 1999, interest rates on U.S. dollar fixed rate obligations ranged from 5.75% to 12.00%, and from 5.56% to 12.00%, respectively. During 2000 and 1999, non-U.S. dollar fixed rate obligations interest rates ranged from 0.55% to 8.88%, and from 0.85% to 9.51%, respectively.

⁽²⁾ Floating interest rates generally are based on LIBOR, the U.S. treasury bill rate or the federal funds rate. Certain equity-linked and indexed instruments are included in floating rate obligations.

⁽³⁾ Long-term borrowings have maturities that range from one to 30 years from the date of issue.

Long-term borrowings by maturity date are set forth below:

(in millions)	As of November					
	2000			1999		
	U.S. Dollar	Non-U.S. Dollar	Total	U.S. Dollar	Non-U.S. Dollar	Total
Maturity Dates						
2000	\$ —	\$ —	\$ —	\$ 2,527	\$ 114	\$ 2,641
2001	3,506	—	3,506	3,145	327	3,472
2002	6,041	804	6,845	1,638	594	2,232
2003	2,853	341	3,194	1,522	404	1,926
2004	2,011	116	2,127	1,857	134	1,991
2005	4,256	2,562	6,818	1,421	172	1,593
2006–Thereafter	7,031	1,874	8,905	5,823	1,274	7,097
Total	\$25,698	\$5,697	\$31,395	\$17,933	\$3,019	\$20,952

The firm enters into nontrading derivative contracts, such as interest rate and currency swap agreements, to effectively convert a substantial portion of its fixed rate long-term borrowings into U.S. dollar-based floating rate obligations.

Accordingly, the aggregate carrying value of these long-term borrowings and related hedges approximates fair value.

The effective weighted average interest rates for long-term borrowings, after hedging activities, are set forth below:

(\$ in millions)	As of November			
	2000		1999	
	Amount	Rate	Amount	Rate
Fixed rate obligations	\$ 852	10.41%	\$ 650	10.17%
Floating rate obligations	30,543	6.96	20,302	6.03
Total	\$31,395	7.06	\$20,952	6.16

As of November 2000 and November 1999, the notional amounts of the related swap agreements used for nontrading purposes were \$26.26 billion and \$12.94 billion, respectively. The fair value and carrying value of these agreements are set forth below:

(in millions)	As of November			
	2000		1999	
	Assets	Liabilities	Assets	Liabilities
Fair value	\$3	\$442	\$3	\$159
Carrying value	2	70	36	2

Note 7/Commitments and Contingencies

Litigation

The firm is involved in a number of judicial, regulatory and arbitration proceedings concerning matters arising in connection with the conduct of its businesses. Management believes, based on currently available information, that the results of such proceedings, in the aggregate, will not have a material adverse effect on the firm's financial condition, but might be material to the firm's operating results for any particular period, depending, in part, upon the operating results for such period.

Leases

The firm has obligations under long-term noncancelable lease agreements, principally for office space, expiring on various dates through 2029. Certain agreements are subject to periodic escalation provisions for increases in real estate taxes and other charges. Minimum rental commitments, net of minimum sublease rentals, under noncancelable leases for 2001 and the succeeding four years and thereafter and rent charged to operating expense for the last three years are set forth below:

(in millions)	
Minimum Rental Commitments	
2001	\$ 355
2002	334
2003	335
2004	391
2005	374
2006-Thereafter	2,524
Total	\$4,313
Net Rent Expense	
2000	\$ 240
1999	154
1998	104

Other Commitments

The firm had commitments to enter into repurchase and resale agreements of \$37.36 billion and \$30.58 billion as of November 2000 and November 1999, respectively.

The firm had pledged securities of \$34.91 billion and \$35.83 billion as collateral for securities borrowed of approximately equivalent value as of November 2000 and November 1999, respectively.

In connection with loan origination and participation, the firm had loan commitments of \$10.43 billion and \$9.38 billion as of November 2000 and November 1999, respectively. These commitments are agreements to lend to counterparties, have fixed termination dates and are contingent on all conditions to borrowing set forth in the contract having been met. Since these commitments may expire unused, the total commitment amount does not necessarily reflect the actual future cash flow requirements.

The firm provides letters of credit issued by various banks to counterparties in lieu of securities or cash to satisfy various collateral and margin deposit requirements. Letters of credit outstanding were \$9.61 billion and \$10.30 billion as of November 2000 and November 1999, respectively.

The firm acts as an investor in merchant banking transactions, which includes making long-term investments in equity and debt securities in privately negotiated transactions, corporate acquisitions and real estate transactions. In connection with these activities, the firm had commitments to invest up to \$1.74 billion and \$1.09 billion in corporate and real estate merchant banking investment funds and a bridge loan fund as of November 2000 and November 1999, respectively.

The firm also had outstanding guarantees of \$284 million and \$575 million relating primarily to its fund management activities as of November 2000 and November 1999, respectively.

Note 8/Equity Capital

On August 21, 2000, Sumitomo Bank Capital Markets, Inc. exchanged all 7.4 million shares of its nonvoting common stock, par value \$0.01 per share, of Group Inc. for an equal number of shares of voting common stock.

On March 20, 2000, the Board of Directors of Group Inc. approved a common stock repurchase program authorizing the repurchase of up to 15 million shares of the firm's

common stock. For the year ended November 2000, the firm repurchased approximately 6.5 million shares of its common stock at a cost of \$648 million.

On May 7, 1999, the firm converted from a partnership to a corporation and completed its initial public offering. In that offering, the firm sold 51 million shares of common stock. In addition, the firm completed a number of transactions to have Group Inc. succeed to the business of The Goldman Sachs Group, L.P. These transactions included the exchange of the partnership interests of the participating limited partners, retired limited partners, Sumitomo Bank Capital Markets, Inc. and Kamehameha Activities Association for shares of common stock.

Note 9/Earnings Per Share

The computations of basic and diluted EPS are set forth below:

(in millions, except per share amounts)	Year Ended November	
	2000	1999
Numerator for basic and diluted EPS—earnings available to common shareholders	\$3,067	\$2,708
Denominator for basic EPS—weighted average number of common shares	484.6	475.9
Effect of dilutive securities		
Restricted stock units	16.2	5.6
Stock options	10.7	4.3
Dilutive potential common shares	26.9	9.9
Denominator for diluted EPS—weighted average number of common shares and dilutive potential common shares	511.5	485.8
Basic EPS	\$ 6.33	\$ 5.69
Diluted EPS	6.00	5.57

Note 10/Employee Benefit Plans

The firm sponsors various pension plans and certain other postretirement benefit plans, primarily healthcare and life insurance, which cover most employees worldwide. The firm also provides certain benefits to former or inactive employees prior to retirement. A summary of these plans is set forth below:

Defined Benefit Pension Plans and Postretirement Plans

The firm maintains a defined benefit pension plan for substantially all U.S. employees. Employees of certain non-U.S. subsidiaries participate in various local defined benefit plans. These plans generally provide benefits based on years of credited service and a percentage of the employee's eligible compensation. In addition, the firm has unfunded postretirement benefit plans that provide medical and life insurance for eligible retirees, employees and dependents in the United States.

The following table provides a summary of the changes in the plans' projected benefit obligations and the fair value of assets for 2000 and 1999, and a statement of the funded status of the plans as of November 2000 and November 1999:

(in millions)	November 2000			November 1999		
	U.S. Pension	Non-U.S. Pension ⁽¹⁾	Post-retirement	U.S. Pension	Non-U.S. Pension	Post-retirement
Benefit Obligation						
Balance, beginning of year	\$108	\$148	\$ 61	\$108	\$120	\$ 60
Service cost	4	28	2	4	15	3
Interest cost	8	7	4	8	5	4
Plan amendments	—	1	—	—	—	—
Actuarial loss/(gain)	2	6	(9)	(10)	(4)	(4)
Benefits paid	(2)	(6)	(2)	(2)	(4)	(2)
Effect of foreign exchange rates	—	(21)	—	—	6	—
Balance, end of year	\$120	\$163	\$ 56	\$108	\$138	\$ 61
Fair Value of Plan Assets						
Balance, beginning of year	\$148	\$116	\$ —	\$133	\$ 75	\$ —
Actual return on plan assets	2	6	—	17	11	—
Firm contributions	—	29	2	—	26	2
Benefits paid	(2)	(6)	(2)	(2)	(4)	(2)
Effect of foreign exchange rates	—	(17)	—	—	2	—
Balance, end of year	\$148	\$128	\$ —	\$148	\$110	\$ —
Prepaid/(Accrued) Benefit Cost						
Funded status	\$ 28	\$ (35)	\$(56)	\$ 40	\$ (28)	\$(61)
Unrecognized actuarial loss/(gain)	11	19	(5)	2	14	5
Unrecognized transition (asset)/obligation	(34)	19	—	(37)	23	—
Unrecognized prior service cost	—	3	(2)	—	—	(2)
Prepaid/(accrued) benefit cost	\$ 5	\$ 6	\$(63)	\$ 5	\$ 9	\$(58)

⁽¹⁾ Includes certain plans for the fiscal year ended November 1999 that had previously been deemed immaterial.

For plans in which the accumulated benefit obligation exceeded plan assets, the projected benefit obligation and aggregate accumulated benefit obligation was \$57 million and \$35 million as of November 2000, respectively, and \$138 million and \$121 million as of November 1999, respectively. The fair value of plan assets for these plans was \$19

million and \$110 million as of November 2000 and November 1999, respectively. For plans in which the accumulated benefit obligation exceeded the fair value of plan assets, the effect of recognizing this amount would not have been material to the consolidated statements of financial condition or comprehensive income.

The components of pension (income)/expense and postretirement expense are set forth below:

(in millions)	Year Ended		
	U.S. Pension	Non-U.S. Pension	Post- retirement
November 2000			
Service cost	\$ 4	\$28	\$2
Interest cost	8	7	4
Expected return on plan assets	(10)	(8)	—
Net amortization	(3)	1	—
Total	\$ (1)	\$28	\$6
November 1999			
Service cost	\$ 4	\$15	\$3
Interest cost	8	5	4
Expected return on plan assets	(10)	(5)	—
Net amortization	(2)	3	—
Total	\$ —	\$18	\$7
November 1998			
Service cost	\$ 3	\$11	\$2
Interest cost	7	4	4
Expected return on plan assets	(10)	(4)	—
Net amortization	(3)	2	—
Total	\$ (3)	\$13	\$6

The weighted average assumptions used to develop net periodic pension cost and the actuarial present value of the projected benefit obligation are set forth below. The assumptions represent a weighted average of the assumptions used for the U.S. and international plans and are based on the economic environment of each applicable country.

	Year Ended November		
	2000	1999	1998
Defined Benefit Pension Plans			
U.S. Plans			
Discount rate	7.5%	7.5%	7.0%
Rate of increase in future compensation levels	5.0	5.0	5.0
Expected long-term rate of return on plan assets	8.5	7.5	7.5
International Plans			
Discount rate	4.7	4.6	5.0
Rate of increase in future compensation levels	4.3	4.3	4.7
Expected long-term rate of return on plan assets	5.8	6.0	6.0
Postretirement Plans			
Discount rate	7.5	7.5	7.0
Rate of increase in future compensation levels	5.0	5.0	5.0

For measurement purposes, a 7.6% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for the fiscal year ending November 2001. The

rate was assumed to decrease gradually to 5.0% for the fiscal year ending November 2008 and remain at that level thereafter.

The assumed cost of healthcare has an effect on the amounts reported for the firm's healthcare plans. A 1% change in the assumed healthcare cost trend rate would have the following effects:

(in millions)	1% Increase		1% Decrease	
	2000	1999	2000	1999
Cost	\$1	\$1	\$(1)	\$(1)
Obligation	7	9	(6)	(8)

Defined Contribution Plans

The firm contributes to employer-sponsored U.S. and international defined contribution plans. The firm's contribution to these plans was \$129 million, \$94 million and \$70 million for 2000, 1999 and 1998, respectively.

The firm has also established a nonqualified defined contribution plan (the Plan) for certain senior employees. Shares of common stock contributed to the Plan and outstanding as of November 2000 were 12.7 million. The shares of common stock will vest and generally be distributable to the participant on specified future dates if the participant satisfies certain conditions and the participant's employment with the firm has not been terminated, with certain exceptions for terminations of employment due to death or a change in control. Dividends on the underlying shares of common stock are paid currently to the participants. Forfeited shares remain in the Plan and are reallocated to other participants. Contributions to the Plan are expensed on the date of grant. Plan expense was immaterial for the year ended November 2000 and was \$674 million for the year ended November 1999, which included \$666 million granted in connection with the firm's initial public offering.

Note 11/Employee Incentive Plans

Stock Incentive Plan

The firm sponsors a stock incentive plan that provides for grants of incentive stock options, nonqualified stock options, stock appreciation rights, dividend equivalent

rights, restricted stock, restricted stock units and other stock-based awards.

The total number of shares of common stock that may be issued under the stock incentive plan through fiscal 2002 may not exceed 300 million shares and, in each fiscal year thereafter, may not exceed 5% of the issued and outstanding shares of common stock, determined as of the last day of the immediately preceding fiscal year, increased by the number of shares available for awards in previous fiscal years but not covered by awards granted in such years. As of November 2000 and November 1999, 156.2 million shares and 183.4 million shares were available for grant under the stock incentive plan, respectively.

Restricted Stock Units

The firm issued restricted stock units to employees under the stock incentive plan, primarily in connection with its initial public offering and as part of year-end compensation. Of the total restricted stock units outstanding as of November 2000 and November 1999, (i) 46.3 million units and 40.3 million units, respectively, required future service as a condition to the delivery of the underlying shares of common stock, and (ii) 33.5 million units and 35.7 million units, respectively, did not require future service. In all cases, delivery of the underlying shares of common stock is conditioned on the grantee's satisfying certain other requirements outlined in the award agreements.

The activity related to these restricted stock units during 2000 and 1999 is set forth below:

	Restricted Stock Units Outstanding	
	No Future Service Required	Future Service Required
Outstanding, November 1998	—	—
Granted	36,127,314	40,780,999
Forfeited	(355,177)	(436,518)
Delivered	(68,214)	—
Outstanding, November 1999	35,703,923	40,344,481
Granted ⁽¹⁾	6,401,796	10,900,941
Forfeited	(1,189,406)	(2,752,278)
Delivered	(9,571,298)	—
Vested	2,157,204	(2,157,204)
Outstanding, November 2000	33,502,219	46,335,940

⁽¹⁾ Includes restricted stock units granted in connection with the combination with SLK and restricted stock units granted to employees, subsequent to November 2000, as part of year-end compensation for fiscal 2000.

Noncash compensation expense, net of forfeitures, was \$1.35 billion and \$2.32 billion for the years ended November 2000 and November 1999, respectively.

Stock Options

Stock options granted to employees will generally become exercisable in installments on or about the third, fourth and fifth anniversaries of the date of grant if the grantee has satisfied certain conditions and the grantee's employment with the firm has not been terminated, with certain excep-

tions for terminations of employment due to death, retirement, extended absence or a change in control. Once service requirements have been met, these options will generally remain exercisable, subject to satisfaction of certain conditions, until the tenth anniversary of the date of grant. Pursuant to APB No. 25, compensation expense was not recognized for those options that had no intrinsic value on the date of grant. The dilutive effect of these options is included in diluted common shares outstanding under SFAS No. 128.

The activity of these stock options during 2000 and 1999 is set forth below:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Life (years)
Outstanding, November 1998	—	\$ —	
Granted	40,863,172	52.91	
Exercised	—	—	
Forfeited	(503,506)	53.00	
Outstanding, November 1999	40,359,666	52.91	9.42
Granted ⁽¹⁾	19,685,230	82.89	
Exercised	(18,901)	48.13	
Forfeited	(2,590,237)	52.88	
Outstanding, November 2000	57,435,758	63.19	8.96
Exercisable, November 2000	131,432	\$48.13	

⁽¹⁾ Includes stock options granted to employees, subsequent to November 2000, as part of year-end compensation for fiscal 2000.

The weighted average fair value of options granted during 2000 and 1999 was \$28.13 per option and \$16.13 per option, respectively. Fair value was estimated as of the grant date based on a binomial option pricing model using the following weighted average assumptions:

	Year Ended November	
	2000	1999
Risk-free interest rate	5.6%	6.1%
Expected volatility	35.0	30.0
Dividend yield	0.6	1.0
Expected life	7 years	7 years

Pro Forma Effect of SFAS No. 123

If the firm were to recognize compensation expense under the fair value-based method of SFAS No. 123 with respect to options granted, net earnings would have decreased resulting in pro forma net earnings and EPS as set forth below:

	Year Ended November	
	2000	1999
(in millions, except per share amounts)		
Net earnings, as reported	\$3,067	\$2,708
Pro forma net earnings	2,971	2,650
EPS, as reported		
Basic	\$ 6.33	\$ 5.69
Diluted	6.00	5.57
Pro forma EPS		
Basic	\$ 6.13	\$ 5.57
Diluted	5.81	5.45

In the preceding table, pro forma compensation expense associated with option grants is recognized over the relevant vesting period.

Note 12/Income Taxes

Prior to its conversion to corporate form, the firm operated as a partnership and generally was not subject to U.S. federal and state income taxes. The earnings of the firm, however, were subject to local unincorporated business taxes. In addition, certain non-U.S. subsidiaries were subject to income taxes in their local jurisdictions. The partners of the firm's predecessor partnership were taxed on their proportionate share of the partnership's taxable income or loss. Effective with the conversion from a partnership to a corporation on May 7, 1999, the firm became subject to U.S. federal, state and local corporate income taxes.

The components of the net tax expense/(benefit) reflected on the consolidated statements of earnings are set forth below:

(in millions)	Year Ended November		
	2000	1999	1998
Current Taxes			
U.S. federal	\$1,063	\$ 16	\$ 16
State and local	285	67	28
Non-U.S.	957	588	426
Total current tax expense	2,305	671	470
Deferred Taxes			
U.S. federal	(299)	(688)	—
State and local	49	(342)	(3)
Non-U.S.	(102)	(357)	26
Total deferred tax (benefit)/expense	(352)	(1,387)	23
Net tax expense/(benefit)	\$1,953	\$ (716)	\$493

Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities. These temporary differences result in taxable or deductible amounts in future years and are measured using the tax rates and laws that will be in

effect when such differences are expected to reverse. In connection with the conversion from a partnership to a corporation, the firm recognized a deferred tax benefit related to the revaluation of net deferred tax assets recorded as a partnership.

Significant components of the firm's deferred tax assets and liabilities are set forth below:

(in millions)	As of November	
	2000	1999
Deferred Tax Assets		
Compensation and benefits	\$1,781	\$1,397
Foreign tax credits	114	140
Depreciation and amortization	—	57
Other, net	219	226
	2,114	1,820
Less: valuation allowance ⁽¹⁾	(37)	(83)
Total deferred tax assets	2,077	1,737
Deferred Tax Liabilities		
Depreciation and amortization	35	—
Unrealized gains	158	257
Total deferred tax liabilities	193	257
Net deferred tax assets	\$1,884	\$1,480

⁽¹⁾ Relates primarily to the ability to recognize tax benefits associated with non-U.S. operations.

The decrease of \$46 million in the valuation allowance was primarily due to increased utilization of foreign tax credits.

Foreign tax credits of \$114 million will begin to expire in 2005.

A reconciliation of the U.S. federal statutory income tax rate to the firm's effective income tax rate is set forth below:

	Year Ended November		
	2000	1999	1998 ⁽¹⁾
U.S. federal statutory income tax rate	35.0%	35.0%	—%
Increase related to			
State and local taxes, net of U.S. income tax effects	4.3	5.0	0.9
Foreign	—	—	15.5
Other	(0.4)	—	0.5
Rate before one-time events	38.9	40.0	16.9
Revaluation of deferred tax assets upon change in tax status	—	(41.4) ⁽²⁾	—
Rate benefit for partnership period	—	(37.7) ⁽³⁾	—
Other	—	3.2	—
Effective income tax rate	38.9%	(35.9)%	16.9%

⁽¹⁾ The U.S. federal statutory income tax rate is not applicable to 1998 because the firm operated as a partnership and generally was not subject to corporate federal income taxes. U.S. federal taxes paid by subsidiary corporations are included in "Other" for 1998.

⁽²⁾ The deferred tax benefit recognized upon the firm's change in tax status from partnership to corporate form primarily reflects the revaluation of the deferred tax assets and liabilities at the firm's corporate income tax rate.

⁽³⁾ The rate benefit for the partnership period relates to the firm's earnings prior to its conversion to corporate form, which generally were not subject to corporate income taxes.

A tax benefit of approximately \$116 million, related to the delivery of restricted stock units and the exercise of options, was included in "Additional paid-in capital" on the consolidated statements of financial condition and changes in shareholders' equity and partners' capital as of November 2000.

Note 13/Regulated Subsidiaries

GS&Co. and Spear, Leeds & Kellogg, L.P. are registered U.S. broker-dealers and futures commission merchants subject to Rule 15c3-1 of the Securities and Exchange Commission and Rule 1.17 of the Commodity Futures Trading Commission which specify uniform minimum net capital requirements, as defined, for their registrants. They have elected to compute their net capital in accordance with the "Alternative Net Capital Requirement" as permitted by Rule 15c3-1. As of November 2000 and November 1999, GS&Co. had regulatory net capital, as defined, of \$4.50 billion and \$2.92 billion, respectively, which exceeded the amounts required by \$3.81 billion and \$2.31 billion, respectively. As of November 2000, Spear, Leeds & Kellogg, L.P. had regulatory net capital, as defined, of \$837 million, which exceeded the amounts required by \$803 million.

GSI, a registered U.K. broker-dealer, is subject to the capital requirements of the Securities and Futures Authority

Limited, and GSJL, a Tokyo-based broker-dealer, is subject to the capital requirements of the Financial Services Agency. As of November 2000 and November 1999, GSI and GSJL were in compliance with their local capital adequacy requirements.

Certain other subsidiaries of the firm are also subject to capital adequacy requirements promulgated by authorities of the countries in which they operate. As of November 2000 and November 1999, these subsidiaries were in compliance with their local capital adequacy requirements.

Note 14/Business Segments

In reporting to management, the firm's operating results are categorized into the following two principal segments: Global Capital Markets, and Asset Management and Securities Services.

Global Capital Markets

The Global Capital Markets segment includes services related to the following:

Investment Banking. The firm provides a broad range of investment banking services to a diverse group of corporations, financial institutions, governments and individuals.

The firm's investment banking activities are divided into two categories:

- **Financial Advisory.** Financial Advisory includes advisory assignments with respect to mergers and acquisitions, divestitures, corporate defense activities, restructurings and spin-offs; and
- **Underwriting.** Underwriting includes public offerings and private placements of equity and debt securities.

Trading and Principal Investments. The firm's Trading and Principal Investments business facilitates transactions with a diverse group of corporations, financial institutions, governments and individuals and takes proprietary positions through market making in and trading of fixed income and equity products, currencies, commodities, and swaps and other derivatives. In addition, the firm engages in floor-based market making as a specialist on U.S. equities and options exchanges. Trading and Principal Investments is divided into three categories:

- **FICC.** The firm makes markets in and trades fixed income products, currencies and commodities, structures and enters into a wide variety of derivative transactions, and engages in proprietary trading and arbitrage activities;
- **Equities.** The firm makes markets in, acts as a specialist for, and trades equities and equity-related products, structures and enters into equity derivative transactions, and engages in proprietary trading and equity arbitrage; and
- **Principal Investments.** Principal Investments primarily represents net revenues from the firm's merchant banking investments.

Asset Management and Securities Services

The Asset Management and Securities Services segment includes services related to the following:

- **Asset Management.** Asset Management generates management fees by providing investment advisory services to a diverse client base of institutions and individuals;
- **Securities Services.** Securities Services includes prime brokerage, financing services and securities lending, and the firm's matched book businesses, all of which generate revenue primarily in the form of fees or interest rate spreads; and

- **Commissions.** Commissions include clearing and agency transactions for clients on major stock, options and futures exchanges and revenues from the increased share of the income and gains derived from the firm's merchant banking funds.

Basis of Presentation

In reporting segments, certain of the firm's business lines have been aggregated where they have similar economic characteristics and are similar in each of the following areas: (i) the nature of the services they provide, (ii) their methods of distribution, (iii) the types of clients they serve and (iv) the regulatory environments in which they operate.

The firm allocates revenues and expenses between the two segments. Due to the integrated nature of the business segments, estimates and judgments have been made in allocating certain revenue and expense items. Transactions between segments are based on specific criteria or approximate third-party rates. Total operating expenses include corporate items that have not been allocated to either business segment. The allocation process is based on the manner in which management views the business of the firm.

The segment information presented in the table below is prepared according to the following methodologies:

- Revenues and expenses directly associated with each segment are included in determining pre-tax earnings.
- Net revenues in the firm's segments include allocations of interest income and interest expense to specific securities, commodities and other positions in relation to the cash generated by, or funding requirements of, the underlying positions. Net interest is included within segment net revenues as it is consistent with the way in which management assesses segment performance.
- Overhead expenses not directly allocable to specific segments are allocated ratably based on direct segment expenses.
- The nonrecurring expenses associated with the firm's acquisition awards and conversion to corporate form and related transactions are not allocated to individual segments as management excludes them in evaluating segment performance.

Segment Operating Results

Management believes that the following information provides a reasonable representation of each segment's contribution to consolidated pre-tax earnings and total assets:

		Year Ended November		
(in millions)		2000	1999	1998 ⁽⁶⁾
Global Capital Markets	Net revenues ⁽¹⁾	\$ 11,998	\$ 10,132	\$ 5,747
	Operating expenses ⁽²⁾	7,844	6,232	3,978
	Pre-tax earnings	\$ 4,154	\$ 3,900	\$ 1,769
	Segment assets	\$149,459	\$127,515	\$102,724
Asset Management and Securities Services	Net revenues ⁽¹⁾	\$ 4,592	\$ 3,213	\$ 2,773
	Operating expenses ⁽²⁾	3,008	2,396	1,621
	Pre-tax earnings	\$ 1,584	\$ 817	\$ 1,152
	Segment assets	\$139,215	\$121,693	\$114,293
Total	Net revenues ⁽¹⁾	\$ 16,590	\$ 13,345	\$ 8,520
	Operating expenses ⁽²⁾	11,570	11,353	5,599
	Pre-tax earnings	\$ 5,020 ⁽⁴⁾	\$ 1,992 ⁽⁵⁾	\$ 2,921
	Total assets ⁽³⁾	\$289,760	\$250,491	\$217,380

⁽¹⁾ Net revenues include net interest as set forth in the table below:

		Year Ended November		
(in millions)		2000	1999	1998
Global Capital Markets		\$131	\$ 15	\$ 364
Asset Management and Securities Services		855	689	688
Total net interest		\$986	\$704	\$1,052

⁽²⁾ Operating expenses include depreciation and amortization as set forth in the table below:

		Year Ended November		
(in millions)		2000	1999	1998
Global Capital Markets		\$336	\$228	\$158
Asset Management and Securities Services		150	109	84
Total depreciation and amortization		\$486	\$337	\$242

⁽³⁾ Includes deferred tax assets relating to the firm's conversion to corporate form, acquisition awards and certain assets that management believes are not allocable to a particular segment.

⁽⁴⁾ Pre-tax earnings for the year ended November 2000 include the following expenses that have not been allocated to the firm's segments: (i) the ongoing amortization of employee initial public offering and acquisition awards of \$428 million and (ii) the acquisition awards of \$290 million related to the firm's combination with SLK.

⁽⁵⁾ Pre-tax earnings for the year ended November 1999 include the following expenses that have not been allocated to the firm's segments: (i) nonrecurring employee initial public offering awards of \$2.26 billion, (ii) the ongoing amortization of employee initial public offering awards of \$268 million and (iii) the charitable contribution to The Goldman Sachs Foundation of \$200 million made at the time of the firm's initial public offering.

⁽⁶⁾ As a partnership, payments for services rendered by profit participating limited partners were accounted for as distributions of partners' capital rather than as compensation and benefits expense. As a result, pre-tax earnings in 1998 are not comparable with 2000 or 1999.

The following table sets forth the net revenues of the firm's two segments:

(in millions)	Year Ended November		
	2000	1999	1998
Financial Advisory	\$ 2,592	\$ 2,270	\$1,774
Underwriting	2,779	2,089	1,594
Investment Banking	5,371	4,359	3,368
FICC	3,004	2,862	1,438
Equities	3,489	1,961	795
Principal Investments	134	950	146
Trading and Principal Investments	6,627	5,773	2,379
Total Global Capital Markets	11,998	10,132	5,747
Asset Management	1,345	919	675
Securities Services	940	772	730
Commissions	2,307	1,522	1,368
Total Asset Management and Securities Services	4,592	3,213	2,773
Total net revenues	\$16,590	\$13,345	\$8,520

Geographic Information

Due to the highly integrated nature of international financial markets, the firm manages its businesses based on the profitability of the enterprise as a whole. Accordingly, management believes that profitability by geographic region is not necessarily meaningful.

The firm's revenues, expenses and identifiable assets are generally allocated based on the country of domicile of the legal entity providing the service.

The following table sets forth the total net revenues, pre-tax earnings, and identifiable assets of the firm and its consolidated subsidiaries by geographic region allocated on the basis described above:

(in millions)	As of or for Year Ended November		
	2000	1999	1998 ⁽⁴⁾
Net Revenues			
United States	\$ 9,767	\$ 8,536	\$ 5,133
Other Americas	189	327	308
United Kingdom	4,400	3,103	1,893
Other Europe	622	375	333
Asia	1,612	1,004	853
Total net revenues	\$ 16,590	\$ 13,345	\$ 8,520
Pre-tax Earnings			
United States	\$ 2,845	\$ 2,878	\$ 1,315
Other Americas	104	184	209
United Kingdom	1,882	1,203	746
Other Europe	391	198	216
Asia	516	254	435
Other	(718)	(2,725)	—
Total pre-tax earnings	\$ 5,020⁽²⁾	\$ 1,992⁽³⁾	\$ 2,921
Identifiable Assets			
United States	\$ 287,938	\$ 238,875	\$ 213,971
Other Americas	7,791	6,118	6,596
United Kingdom	121,257	119,350	94,025
Other Europe	7,979	11,737	8,820
Asia	16,848	18,088	19,536
Eliminations and other ⁽¹⁾	(152,053)	(143,677)	(125,568)
Total identifiable assets	\$ 289,760	\$ 250,491	\$ 217,380

⁽¹⁾ Reflects eliminations and certain assets that are not allocable to a particular geographic region.

⁽²⁾ Pre-tax earnings for the year ended November 2000 include the following expenses that have not been allocated to the firm's segments: (i) the ongoing amortization of employee initial public offering and acquisition awards of \$428 million and (ii) the acquisition awards of \$290 million related to the firm's combination with SLK.

⁽³⁾ Pre-tax earnings for the year ended November 1999 include the following expenses that have not been allocated to the firm's segments: (i) nonrecurring employee initial public offering awards of \$2.26 billion, (ii) the ongoing amortization of employee initial public offering awards of \$268 million and (iii) the charitable contribution to The Goldman Sachs Foundation of \$200 million made at the time of the firm's initial public offering.

⁽⁴⁾ As a partnership, payments for services rendered by profit participating limited partners were accounted for as distributions of partners' capital rather than as compensation and benefits expense. As a result, pre-tax earnings in 1998 are not comparable with 2000 or 1999.

Note 15/Subsequent Event

The Board of Directors of Group, Inc. declared a dividend of \$0.12 per share to be paid on February 22, 2001 to common shareholders of record on January 22, 2001.

SUPPLEMENTAL FINANCIAL INFORMATION

Quarterly Results (unaudited)

The following represents the firm's unaudited quarterly results for 2000 and 1999. These quarterly results conform with generally accepted accounting principles and reflect all adjustments, consisting only of normal recurring adjustments, that are, in the opinion of the management, necessary for a fair presentation of the results.

(in millions, except per share amounts)	2000 Fiscal Quarter			
	First	Second	Third	Fourth
Total revenues	\$7,964	\$ 8,196	\$8,851	\$7,989
Interest expense	3,471	4,041	4,324	4,574
Revenues, net of interest expense	4,493	4,155	4,527	3,415
Operating expenses	3,014	2,897	3,154	2,505
Pre-tax earnings	1,479	1,258	1,373	910 ⁽¹⁾
Provision for taxes	592	503	549	309
Net earnings	\$ 887	\$ 755	\$ 824	\$ 601 ⁽¹⁾
Earnings per share				
Basic	\$ 1.83	\$ 1.56	\$ 1.71	\$ 1.23
Diluted	1.76	1.48	1.62	1.16 ⁽²⁾
Dividends paid per share	0.12	0.12	0.12	0.12

⁽¹⁾ The fourth quarter pre-tax earnings and net earnings included a charge of \$290 million and \$180 million, respectively, related to the firm's combination with SLK.

⁽²⁾ Excluding the charges related to the combination with SLK, the firm's diluted earnings per share were \$1.50.

(in millions, except per share amounts)	1999 Fiscal Quarter			
	First	Second	Third	Fourth
Total revenues	\$5,856	\$ 6,355	\$6,440	\$6,712
Interest expense	2,861	2,886	3,032	3,239
Revenues, net of interest expense	2,995	3,469	3,408	3,473
Operating expenses	1,807	4,956	2,326	2,264
Pre-tax earnings/(loss)	1,188	(1,487) ⁽¹⁾	1,082	1,209
Provision/(benefit) for taxes	181	(1,827) ⁽²⁾	444	486
Net earnings	\$1,007	\$ 340	\$ 638	\$ 723
Earnings per share				
Basic	—	\$ 0.72	\$ 1.34	\$ 1.51
Diluted	—	0.71	1.32	1.48
Dividends paid per share	—	—	0.12	0.12

⁽¹⁾ Includes nonrecurring expenses of \$2.26 billion associated with the firm's conversion to corporate form and the firm's charitable contribution to The Goldman Sachs Foundation of \$200 million made at the time of the firm's initial public offering.

⁽²⁾ Includes a net tax benefit of \$825 million related to the firm's conversion to corporate form, a benefit of \$880 million related to the granting of employee initial public offering awards and a benefit of \$80 million related to the charitable contribution to The Goldman Sachs Foundation.

Common Stock Price Range

On May 4, 1999, the firm's common stock commenced trading on the New York Stock Exchange under the symbol "GS." Prior to that date, there was no public market for the firm's common stock. The following table sets forth, for the fiscal quarters indicated, the high and low closing prices per share of the firm's common stock as reported by the Consolidated Tape Association.

	Closing Price			
	2000		1999	
	High	Low	High	Low
First Quarter	\$ 94.19	\$74.50	\$ —	\$ —
Second Quarter	121.31	69.81	74.13	64.50
Third Quarter	120.75	72.00	72.25	55.81
Fourth Quarter	132.00	79.94	82.81	57.69

As of January 31, 2001, there were approximately 1,930 holders of record of the firm's common stock.

On January 31, 2001, the last reported sales price for the firm's common stock on the New York Stock Exchange was \$113.75 per share.

Selected Financial Data

(\$ and share amounts in millions, except per share amounts)	As of or for Year Ended November				
	2000 ⁽⁵⁾	1999 ⁽⁶⁾	1998	1997	1996
Income Statement Data					
Total revenues	\$ 33,000	\$ 25,363	\$ 22,478	\$ 20,433	\$ 17,289
Interest expense	16,410	12,018	13,958	12,986	11,160
Net revenues	16,590	13,345	8,520	7,447	6,129
Compensation and benefits ⁽¹⁾	7,773	6,459	3,838	3,097	2,421
Nonrecurring employee initial public offering and acquisition awards	290	2,257	—	—	—
Amortization of employee initial public offering and acquisition awards	428	268	—	—	—
Other operating expenses	3,079	2,369	1,761	1,336	1,102
Pre-tax earnings ⁽¹⁾	\$ 5,020	\$ 1,992	\$ 2,921	\$ 3,014	\$ 2,606
Balance Sheet Data					
Total assets	\$289,760	\$250,491	\$217,380	\$178,401	\$152,046
Long-term borrowings	31,395	20,952	19,906	15,667	12,376
Total liabilities	273,230	240,346	210,996	171,864	145,753
Shareholders' equity	16,530	10,145	—	—	—
Partners' capital	—	—	6,310	6,107	5,309
Common Share Data					
Earnings per share—basic	\$ 6.33	\$ 5.69	—	—	—
Earnings per share—diluted	6.00	5.57	—	—	—
Dividends paid per share	0.48	0.24	—	—	—
Book value per share	32.18	20.94	—	—	—
Average common shares outstanding—basic	484.6	475.9	—	—	—
Average common shares outstanding—diluted	511.5	485.8	—	—	—
Pro Forma Data (unaudited)⁽²⁾					
Pro forma net earnings	—	\$ 2,550	—	—	—
Pro forma diluted earnings per share	—	5.27	—	—	—
Pro forma diluted shares	—	483.9	—	—	—
Selected Data (unaudited)					
Employees					
United States	14,755	9,746	8,349	6,879	5,818
International	7,872	5,615	4,684	3,743	3,159
Total employees ⁽³⁾	22,627 ⁽⁷⁾	15,361	13,033	10,622	8,977
Assets under supervision⁽⁴⁾					
Assets under management	\$293,842	\$258,045	\$194,821	\$135,929	\$ 94,599
Other client assets	197,876	227,424	142,018	102,033	76,892
Total assets under supervision	\$491,718	\$485,469	\$336,839	\$237,962	\$171,491

⁽¹⁾ As a partnership, payments for services rendered by profit participating limited partners were accounted for as distributions of partners' capital rather than as compensation and benefits expense. As a result, pre-tax earnings in 1998, 1997 and 1996 are not comparable with 2000 or 1999.

⁽²⁾ On May 7, 1999, the firm converted from a partnership to a corporation and completed its initial public offering. Pro forma results reflect the results of Goldman Sachs as if its conversion to corporate form and related transactions had taken place at the beginning of 1999. For more detailed information concerning pro forma results, see "Management's Discussion and Analysis—Results of Operations—Overview."

⁽³⁾ Excludes employees of Goldman Sachs' property management subsidiaries. Substantially all of the costs of these employees are reimbursed to Goldman Sachs by the real estate investment funds to which these subsidiaries provide property management services.

⁽⁴⁾ Substantially all assets under supervision are valued as of calendar month-end.

⁽⁵⁾ In 2000, pre-tax earnings included a charge of \$290 million (\$180 million after taxes) related to the firm's combination with SLK. Excluding this charge, diluted earnings per share were \$6.35.

⁽⁶⁾ In 1999, pre-tax earnings were reduced by nonrecurring expenses of \$2.26 billion associated with the conversion to corporate form and the charitable contribution to The Goldman Sachs Foundation of \$200 million made at the time of the initial public offering.

⁽⁷⁾ Includes 2,600 employees related to the combination with SLK.

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Operating Officer

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1✦ Our clients' interests always come first. Our experience shows that if we serve our clients well, our own success will follow.

2✦ Our assets are our people, capital and reputation. If any of these is ever diminished, the last is the most difficult to restore. We are dedicated to complying fully with the letter and spirit of the laws, rules and ethical principles that govern us. Our continued success depends upon unswerving adherence to this standard.

3✦ Our goal is to provide superior returns to our shareholders. Profitability is critical to achieving superior returns, building our capital, and attracting and keeping our best people. Significant employee stock ownership aligns the interests of our employees and our shareholders.

4✦ We take great pride in the professional quality of our work. We have an uncompromising determination to achieve excellence in everything we undertake. Though we may be involved in a wide variety and heavy volume of activity, we would, if it came to a choice, rather be best than biggest.

5✦ We stress creativity and imagination in everything we do. While recognizing that the old way may still be the best way, we constantly strive to find a better solution to a client's problems. We pride ourselves on having pioneered many of the practices and techniques that have become standard in the industry.

6✦ We make an unusual effort to identify and recruit the very best person for every job. Although our activities are measured in billions of dollars, we select our people one by one. In a service business, we know that without the best people, we cannot be the best firm.

7✦ We offer our people the opportunity to move ahead more rapidly than is possible at most other places. We have yet to find the limits to the responsibility that our best people are able to assume. Advancement depends solely on ability, performance and contribution to the firm's success, without regard to race, color, religion, sex, age, national origin, disability, sexual orientation, or any other impermissible criterion or circumstance.

8✦ We stress teamwork in everything we do. While individual creativity is always encouraged, we have found that team effort often produces the best results. We have no room for those who put their personal interests ahead of the interests of the firm and its clients.

9✦ The dedication of our people to the firm and the intense effort they give their jobs are greater than one finds in most other organizations. We think that this is an important part of our success.

10✦ We consider our size an asset that we try hard to preserve. We want to be big enough to undertake the largest project that any of our clients could contemplate, yet small enough to maintain the loyalty, the intimacy and the esprit de corps that we all treasure and that contribute greatly to our success.

11✦ We constantly strive to anticipate the rapidly changing needs of our clients and to develop new services to meet those needs. We know that the world of finance will not stand still and that complacency can lead to extinction.

12✦ We regularly receive confidential information as part of our normal client relationships. To breach a confidence or to use confidential information improperly or carelessly would be unthinkable.

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