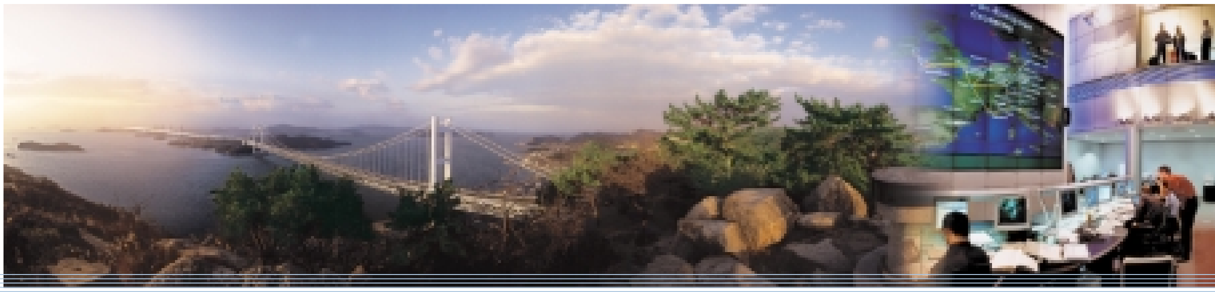
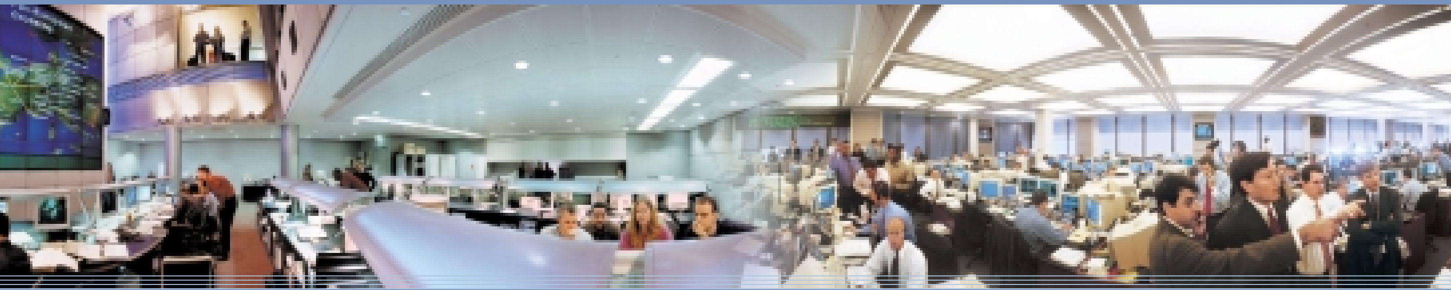
Goldman Sachs



1999 Annual Report



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NTREAL/ MOSCOW/ MUMBAI/ NEW YORK/ PARIS/ PHILADELPHIA/ PRINCETON/ SAN FRANCISCO/ SÃO PAULO/ SEOUL/ SHANGHAI/ SINGAPORE/ STOCKHOLM/ SYDNEY/ TAIPEI/ TAMPA/ TOKYO/ TORONTO/ VANCOUVER/ WASHINGTON DC/ ZURICH

Many of the year's activities reflect the pace at which clients are redefining short- and long-term goals to suit a continually transforming environment. To help clients achieve their goals, in 1999 Goldman Sachs launched new products and services, acquired new capabilities and introduced new technologies. What we did not change is how our people work with clients and with one another. Judgment, teamwork, innovation and reach are more crucially important today than ever. The unflinching pace of change and competitive pressure will not allow us to compromise any of these critical ingredients in our clients' and our own success. In the following pages, we highlight examples of how we helped clients meet the extraordinary challenges and opportunities of 1999.

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

Fellow Shareholders:

This is our first letter to shareholders, including everyone at Goldman Sachs who owns shares in the firm. Sharing ownership throughout the firm was one of our principal reasons for becoming a public company, and creating thousands of new owners has enhanced our culture and bound us more closely together. We are stewards of our own investments and yours.

In our first year as a public company, Goldman Sachs reported record financial results. On a pro forma basis,[1] the firm earned $2.6 billion in net earnings in 1999, or $5.27 per diluted share, versus $1.3 billion, or $2.62 per diluted share, in 1998. These results came from strong performances across all the firm's businesses. In 1999, we ranked first in worldwide mergers and acquisitions (M&A), advising on more than $1.3 trillion in announced merger transactions. We were also first in equity offerings worldwide, and third in global high-yield offerings, gaining momentum from a fourth-place high-yield ranking in 1998. And we enjoyed very strong performances in our trading and other businesses.

Our performance far exceeded the financial goals we set for ourselves in the lead-up to our initial public offering (IPO). We told potential investors that we saw numerous opportunities to grow the firm's businesses, but emphasized that we work in an industry that does not produce predictable earnings on a quarter-to-quarter basis. Recognizing this reality, we set financial targets of an annual return on equity of more than 20 percent and 12 to 15 percent earnings growth over the cycle. In 1999, on a pro forma basis, we had a 31 percent return on equity, and our net earnings rose by more than 100 percent.

We cannot, of course, predict a repeat of this performance in 2000, but we see favorable conditions for Goldman Sachs and our industry. Global economic growth should continue, driven by a remarkably resilient U.S. economy. Europe is one of the fastest growing investment banking markets, led by continued consolidation, restructuring, pension reform and the effects of the euro on financing markets. Asia is recovering, with the return of Asian companies to equity and debt markets creating further opportunities. Latin America is also recovering, and we are pursuing more opportunities in the region. We also see great potential to manage more private wealth around the world, an area where our strong brand and franchise give us a competitive advantage. And we have never seen more opportunities to put our market knowledge and global franchise to work by investing our capital alongside our clients in businesses ranging from Internet start-ups to real estate.

Given our industry's accelerating growth and complexity, we have chosen to focus on areas where we have distinctive skills or competitive advantages. We are emphasizing three areas: growing our core businesses around the globe, becoming the world's best technology investment bank and continuing to recruit the most talented people.

CORE BUSINESSES

This year's record performance results from efforts to build our core businesses around the world: our Global Capital Markets businesses (Investment Banking, and Trading and Principal Investments) and our Asset Management and Securities Services business. Our success has come from steadily building these businesses to sufficient scale and flexibility to serve the complex needs of our clients in today's borderless economy. In the process, we have become a truly global bank — one that thrives in every major market.

The outlook for our core businesses is bright. Our investment banking strengths — telecommunications, media and entertainment, high technology, healthcare, financial services, and energy and power — are all industries that are growing rapidly and consolidating around the world. We also have a strong and growing trading and market-making franchise. Our willingness and ability to take risk in often difficult and volatile markets distinguishes us from competitors and enhances our relationships with clients. We also enjoy great success and profitability in expanding our private equity business, in which we co-invest with clients in a diverse set of asset classes around the world. And we continue to build — through steady, organic growth — what is now a combined asset management and private wealth management business with nearly $500 billion in assets under supervision.

[1] Pro forma earnings exclude nonrecurring items associated with the firm's incorporation and related transactions, and assume these events had taken place at the beginning of the fiscal year.

Source of market share information: Thomson Financial Securities Data

TECHNOLOGY

Our aim is to become the world's premier technology investment bank, with technology embedded in everything we do. We cannot serve our most forward-looking, technology-driven clients unless we are a great technology firm in our own right.

We are the leading advisor to high-tech companies in the areas of M&A and IPOs. Goldman Sachs lead managed 47 high-tech offerings in 1999 that generated more than $150 billion in market capitalization, giving us an industry-leading 22 percent market share. This includes IPOs for Webvan, Terra Networks, Juniper Networks and Red Hat. These transactions follow IPOs in previous years for eBay, Yahoo!, Inktomi, Exodus and other leading Internet companies. We also advised on high-tech mergers totaling $145 billion during 1999, giving us the top market position in this area. We complemented this underwriting and M&A flow with the outstanding research coverage, trading and market making that our clients expect from us.

Our strong relationships with high-tech clients, and our expertise in this sector, have helped us become a significant investor in high-tech companies. In recent years, we have invested $750 million of our own and our clients' capital in more than 70 technology companies.

We are also focusing intensively on how technology can best be used within Goldman Sachs to change the way we work and serve our clients. We are doing this by drawing on our in-house experts who advise clients, what we learn from the best-of-class technology firms, and our own experience as high-tech investors. We are placing particular emphasis on innovative technologies that serve clients, including e-commerce ventures, as well as using technology to achieve operating efficiencies. The goal is to have technology that matches — and helps us manage — the web of relationships we have around the world and our knowledge of markets.

Our emphasis on technology helps explain why our first acquisition as a public company was The Hull Group, a leading options-trading and electronic market-making firm. Hull uses technology to automate trades and quickly produce a two-way price, working in nine countries and 28 exchanges around the world. Hull complements our existing businesses, expands our trading capabilities and gives us a leading position in electronic markets.

We are also looking at how our clients and the markets are affected by new technologies, particularly electronic trading. This has led to our call for a fundamental restructuring of traditional equities exchanges, including establishing an electronically driven, central market in the United States. We are also focusing on electronic trading of fixed income securities, and our investments in BrokerTec, TradeWeb, BondDesk and Bond.Hub will help to centralize liquidity and expand our sales and trading franchise across markets.

PEOPLE

Our people have driven Goldman Sachs' success for 130 years through sustained, superb execution across a range of markets and products. The best way to maintain that advantage is by recruiting, training and mentoring people as we always have — one at a time, with great care. We want Goldman Sachs to be a magnet for the very best people in the world — from new graduates to senior hires. At the same time, we are focusing on developing our very deep bench of talented people and improving and extending their skills. We are, for instance, placing young leaders in demanding positions that stretch their abilities. We are also devoting more time and attention to the formal training and development of leaders, particularly senior leaders.

As we begin the new century, we know that our success will depend on how well we respond to change and manage the firm's rapid growth. That requires a willingness to abandon old practices and discover new and innovative ways of conducting business. Everything is subject to change — everything but the values we live by and stand for: teamwork, putting clients' interests first, integrity, entrepreneurship and excellence. These values sustained the firm and set us apart during the 20th century. They must never change, but much else will. We can afford nothing less if we are to become a nimble, highly focused, technology-centered, 21st century business and remain the world's premier investment bank and securities firm.

We thank our shareholders for choosing to invest in Goldman Sachs, our clients for choosing to work with us, and our people for leading the firm's record performance this year.

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 table:

GLOBAL CAPITAL MARKETS		ASSET MANAGEMENT AND SECURITIES SERVICES
INVESTMENT BANKING	TRADING AND PRINCIPAL INVESTMENTS	
• Equity and debt underwriting	• Bank loans	• Commissions
• Financial restructuring advisory services	• Commodities	• Institutional and high-net-worth asset management
• Mergers and acquisitions advisory services	• Currencies	• Margin lending
• Real estate advisory services	• Equity and fixed income derivatives	• Matched book
	• Equity and fixed income securities	• Merchant banking fees
	• Principal investments	• Increased share of merchant banking fund income and gains
	• Proprietary arbitrage	• Mutual funds
		• Prime brokerage
		• Securities lending

GLOBAL CAPITAL MARKETS

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. Principal Investments primarily represents net revenues from our merchant banking investments.

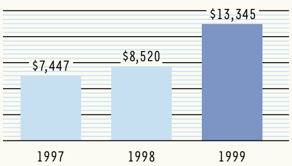
ASSET MANAGEMENT AND SECURITIES SERVICES

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 includes agency transactions for clients on major stock and futures exchanges and revenues from the increased share of the income and gains derived from our merchant banking funds.

FINANCIAL HIGHLIGHTS

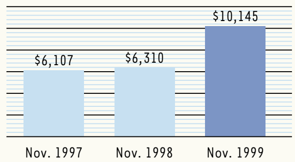
FIRMWIDE

Net Revenues



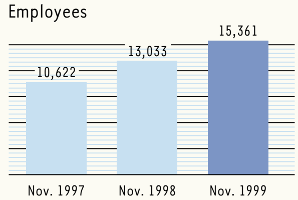
(in millions)

Equity Capital



(in millions)

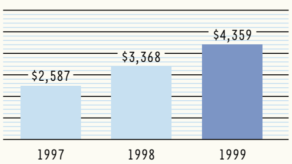
Employees



GLOBAL CAPITAL MARKETS

Investment Banking

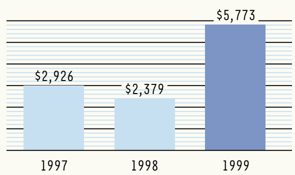
Net Revenues



(in millions)

Trading and Principal Investments

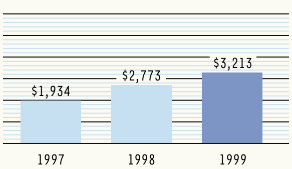
Net Revenues



(in millions)

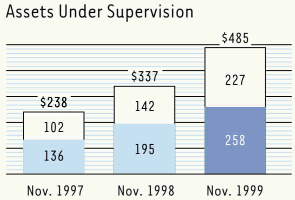
ASSET MANAGEMENT AND SECURITIES SERVICES

Net Revenues



(in millions)

Assets Under Supervision



(in billions)

Assets under management
Other client assets

JUDGMENT

ATLANTA/ BANGKOK/ BEIJING/ BOSTON/ BUENOS AIRES/ CHICAGO/ DALLAS/ FRANKFURT/ GEORGE TOWN/ HONG KONG/ HOUSTON/ JOHANNESBURG/ LONDON/ LOS ANGELES/ MADRID/ MEMPHIS/ MENLO PARK/ MEXICO CITY/ MIAMI/ MILAN/ MON

The value we create with clients springs directly from the values we hold individually and collectively. Our dedication to our clients' best interests is constant, as we have to maintain our clients' trust with every engagement. To provide the highest quality service and advice, we rely on a combination of analysis, experience and instinct. But the most important hallmark of a Goldman Sachs team is the commitment to integrity that underlies its collective judgment.

"We often use our knowledge and experience to create client solutions that no one else has thought of. And when we turn to a creative alternative—using a structured credit derivative instead of a bond, for example—our judgment reflects a proven track record in pricing risk and creating markets for specific products."

Michael Nartey, *Associate, Structured Credit Sales*

TREAL/ MOSCOW/ MUMBAI/ NEW YORK New York equities trading floor / PARIS/ PHILADELPHIA/ PRINCETON/ SAN FRANCISCO/ SÃO PAULO/ SEOUL/ SHANGHAI/ SINGAPORE/ STOCKHOLM/ SYDNEY/ TAIPEI/

"When it comes to solving our clients' problems, we have a very high bar to clear in terms of quality. As a result, we quickly get the best minds working together to make decisions. Each person brings a unique perspective and strong depth of knowledge in his or her area of expertise. Together, we develop solutions and provide analysis and advice for clients that are rock-solid and incredibly well-informed."

Kathy Jennings, *VP, Leveraged Finance*

"Technology and globalization are making markets more efficient. At the same time, they're reducing the time clients have to evaluate and seize business opportunities. Clients need an investment bank they can trust to assess, react and commit capital quickly. The culture here teaches us to respond with studied aggressiveness—quickly but not rashly."

Gavin O'Connor, *VP, Assistant Controller*

JUDGMENT

REPSOL YPF

Carmelo de las Morenas, *Corporate Director Finance:*

"Repsol and Goldman Sachs have been working together since the IPO of our company in 1989. We have accomplished a number of successful transactions together—and have achieved significant milestones. Goldman Sachs was the major financial institution in all five global equity offerings we made to complete the privatization of Repsol, and lead managed our first preferred stock issue—the largest corporate issuance ever in Spain. The firm has also assisted us in hedging our oil exposures. Our acquisition of YPF and the financings related to it have been the most important transactions we have undertaken since the privatization, and Goldman Sachs was centrally involved. This acquisition represented a critical part of our strategy to strengthen Repsol's oil reserves and presence in Latin America. We took the unusual step—at least in the oil business—of making a cash offer to the government of Argentina for YPF. This presented us with substantial immediate financing needs that could be met only through a credit facility. The willingness of Goldman Sachs to play a leading role in this facility, committing a very large sum of its own capital so that we could proceed with the transaction, speaks to the trust in our relationship. We then quickly refinanced the loan in the debt capital markets and subsequently, and most importantly, we refinanced a substantial part of the debt in the equity markets, thereby restoring our gearing ratios to a more appropriate level."

- Goldman Sachs acted as financial advisor to Repsol in its two-step $16 billion acquisition of YPF.
- To date, this transaction represents the largest cash transaction in the energy industry, the largest cross-border acquisition by a Spanish company and the largest acquisition in Latin America.

Please go to www.gs.com for complete profiles on these client accomplishments:

GOLDMAN SACHS SPECIAL OPPORTUNITIES (ASIA) FUND

The Goldman Sachs Special Opportunities (Asia) Fund allows clients to participate in the economic recovery in Asia with both asset and geographic diversification. It also demonstrates our firm's ability to seize opportunity with unmatched speed anywhere in the global financial arena.

TELSTRA CORPORATION LIMITED

Goldman Sachs was the business advisor to the Commonwealth of Australia in the further privatization of Telstra, the national telecommunications company. As its advisor, the firm assisted in structuring the equity offering, in analyzing the potential investor response, and in timing and pricing the transaction.

"We look to all parts of the firm—from mergers and acquisitions, equities and debt capital markets, to new products, or the bank loan group—for information, insight and innovative ideas about how to structure transactions that best meet the needs of our clients."

Alison Rosenthal, *Analyst*
George Foussianes, *MD*
Stephan Feldgoise, *Associate*
Mergers and Acquisitions

"Our global capabilities really help us make the right decisions in the Japanese market. We can draw on our research and trading resources in all the key markets around the world. Equally important, we have an incredibly detailed understanding of our clients and work very closely with them. Together, that makes for a powerful combination."

Junko Hamamoto, *VP, Currency Sales*

CENTRAL STATES SOUTHEAST AND SOUTHWEST AREAS PENSION FUND

Mark Angerame, *Director of Finance:*

"Goldman Sachs questions everything. Nothing is assumed. Nothing is status quo. The firm continually strives to do things more efficiently and to improve performance. It has the resources to make a difference. This became apparent during our selection process. The firm demonstrated an ability to understand the actuarial side of our business and its effect on the investment decision-making process. As a result, the asset allocation plan Goldman Sachs proposed was on target and comprehensive. As we began transitioning assets to their fiduciary control, we were impressed by their thoughtfulness, attention to detail and communication. As we expected, they have taken an active role in overseeing asset managers and monitoring risk. The establishment of an Investment Oversight Committee, consisting of senior Goldman Sachs managing directors, further illustrates the firm's commitment to our business. These types of actions confirm what Goldman Sachs represented to us during our selection process, that this is not just an engagement but, rather, a valued relationship."

- **Goldman Sachs Asset Management has fiduciary responsibility for over $10 billion, 50 percent of Central States Fund's assets.**
- **This was one of the largest fiduciary mandates of its kind.**
- **Goldman Sachs Asset Management is responsible for overall investment decisions, including strategy, asset allocation, and external manager selection and oversight.**

DUKE-WEEKS REALTY CORPORATION

A. Ray Weeks, Jr., *Vice Chairman:*

"Weeks was a relatively small company when we took it public in 1994. We were concerned that we would get lost in a big, blue-chip investment bank—but that was not at all the case. Goldman Sachs led that offering and has helped us since with various capital markets transactions and strategic advisories—including our merger with Duke. What has been most impressive to me is that the firm delivers on its Business Principles year after year. Its culture is clear and consistent. Goldman Sachs is a very relationship-oriented firm that knows how to use teamwork to get the job done for the client. The firm expanded its account team for our merger with Duke, and every person it brought in was a seasoned professional. Each had the knowledge of our industry and of our company to deliver a level of expertise that was tailored to our unique needs and really helped with our analysis of options, structuring of the merger and negotiations. I am a big fan of Goldman Sachs. Its caliber of people and dedication to the client are exceptional."

- **Goldman Sachs was advisor to Weeks Corporation in its $1.7 billion merger with Duke Realty Investments, Inc.**

KOOKMIN BANK

The $500 million principal investment in Kookmin Bank led by Goldman Sachs represents a landmark transaction in South Korea and exemplifies the unique value of our global perspective and resources. Our firm is now the largest shareholder in South Korea's largest consumer bank. A global team of Goldman Sachs professionals with expertise in principal investing, research, corporate finance, financial institutions, and equity and fixed income markets evaluated and implemented the investment—working closely with Kookmin Bank. In all, more than 25 Goldman Sachs and 200 legal and accounting professionals took part in the due diligence process that involved the careful analysis of an institution with over $70 billion in assets and more than 12 million customers. Our Investment Management Division is advising Kookmin Bank on risk management strategies.

- **A $500 million principal investment makes Goldman Sachs the single largest shareholder in the largest consumer bank in Korea.**
- **Kookmin's appointment of Goldman Sachs to a director position on its board is unusual in that very few foreign executives serve on the boards of major corporations in Korea.**

"We're in the market-making business and judgment is our backbone. What gives us the ability to make superior decisions for our clients? Teamwork. We draw on experience spanning investment banking, the crude oil business and everything in between. We can synthesize the knowledge of our commodity and equity researchers with our trading expertise globally to create a very sharp understanding of world energy markets."

Edith Cooper, *MD, Energy Trading*

ATLANTA/ BANGKOK/ BEIJING/ BOSTON/ BUENOS AIRES/ CHICAGO/ DALLAS/ FRANKFURT/ GEORGE TOWN/ HONG KONG Debt capital markets team / HOUSTON/ JOHANNESBURG/ LONDON/ LOS ANGELES/ MA

"When we take a position in a company through a principal investment, we involve highly trained professionals from all over our firm to deliver everything from creative financing ideas to industry expertise and regional market knowledge. In using our knowledge base to support our investment, we add real value for clients who have invested along with us."

David Greenwald, *MD, General Counsel, Merchant Banking*

TEAMWORK

ADRID/ MEMPHIS/ MENLO PARK/ MEXICO CITY/ MIAMI/ MILAN/ MONTREAL/ MOSCOW/ MUMBAI/ NEW YORK/ PARIS/ PHILADELPHIA/ PRINCETON/ SAN FRANCISCO/ SÃO PAULO/ SEOUL/ SHANGHAI/ SINGAPORE/ STOCKHOLM/ SYDNEY/ TAIPEI/ TAMP

Helping our clients achieve competitive advantage requires unusual commitment from our people. The extraordinary productivity of a Goldman Sachs team, trained to work with colleagues from around the world who share their dedication, is the greatest asset we offer. We select our people with the same care we have always used. We support and challenge them with training and diverse assignments with which they can build a career. Despite this investment in the individual, our experience is that a person's true potential is only fully developed when he or she works as part of an outstanding team.

“Our combined resources across the entire firm give clients a distinct advantage. In Europe, we were two years ahead of the curve in beginning to analyze companies on a sector basis. That helps improve performance. At the same time, we have one of the few active risk management groups—and probably the best technical model—in our industry.”

Uchechi Orji, *Associate, Active Equity-Europe*

TEAMWORK

Please go to www.gs.com for complete profiles on these client accomplishments:

LINCOLN FINANCIAL GROUP UK

Greg Reed, *Investment Director:*

“Our goal was to team up with an investment management firm that would provide us with access to additional portfolio management and other capabilities that complement our strengths in product development and distribution.”

EOG RESOURCES, INC.

Mark G. Papa, *Chairman and Chief Executive Officer:*

“The offering that Goldman Sachs lead managed for EOG to provide financing related to the share exchange in which EOG acquired 62.27 million EOG shares from Enron Corp. was a class act. They delivered on a firmwide team effort, from Capital Markets to Research.”

JUNIPER NETWORKS, INC.

Scott Kriens, *President, Chief Executive Officer and Chairman of the Board:*

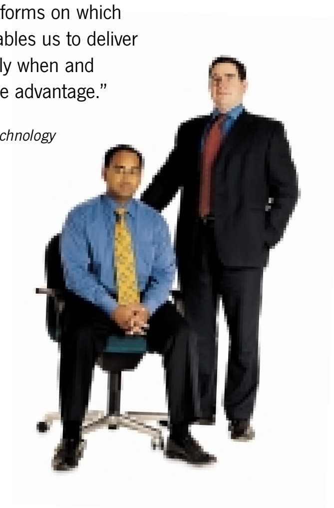
“Goldman Sachs approached each step with a level of teamwork, skill and experience that made us confident we would accomplish our objectives.”

CHINA TELECOM (HONG KONG) LTD.

Wang Xiaochu, *Chairman, Chief Executive Officer and President:*

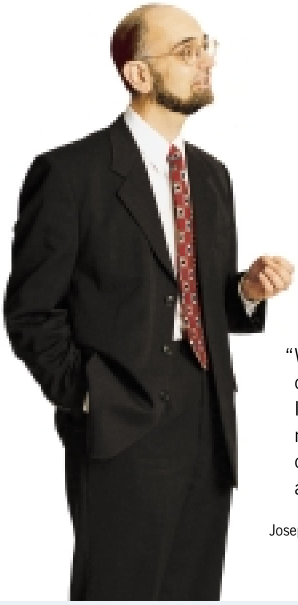
“In recent years, Goldman Sachs has provided important support to China Telecom (Hong Kong) Ltd. as we pursued our growth strategies. One of our objectives is to further strengthen our financial position by diversifying our source of financing through both equity and debt capital markets. In 1999, we followed through with an integral part of our growth strategy by acquiring three more provincial mobile assets. Goldman Sachs acted as our financial advisor. It was important to us that the necessary restructuring work prior to tapping the global capital markets be done in the most thorough and professional manner, with a clear and sound knowledge not only of our business but also of the Chinese regulatory environment. I feel that the team at Goldman Sachs did an excellent job. We also have a high regard for the strength and expertise of their capital markets and research professionals. There is no doubt that Goldman Sachs has an outstanding track record, especially in the telecommunications area, and its advisory capabilities, backed up by the firm’s attention to clients’ needs, made our selection of Goldman Sachs an easy one. We were very pleased with the firm's work and its continued long-term commitment to us.”

- Goldman Sachs was advisor, joint global coordinator and joint lead manager for China Telecom (Hong Kong) Ltd. on its $4.2 billion IPO in 1997. At that time it was the largest public offering by a Chinese entity and the largest-ever public offering in the global cellular telephone industry.
- The firm was financial advisor to China Telecom (Hong Kong) Ltd. in its $2.9 billion acquisition of Jiangsu Mobile Communications Co. Ltd. in 1998.
- In 1999, Goldman Sachs was financial advisor to China Telecom (Hong Kong) Ltd. in its $6.4 billion acquisition of the cellular assets of Fujian Mobile Limited, Henan Mobile Limited and Hainan Mobile Limited.
- The firm was the financial advisor, joint global coordinator, lead manager and bookrunner for a $2 billion equity offering in 1999.



"The firm invests heavily in recruiting and training the best people to develop its trading support systems, and in purchasing the most suitable hardware platforms on which to run these systems. This combination enables us to deliver complex decision-support information exactly when and where it is needed—and that's a competitive advantage."

Fareed Ali, *Executive Director, Information Technology*
Simon Anderson, *Associate, Swap Strategies*



"When a client is about to take a company public, our cross-functional teamwork can add enormous value. I was part of a team of investment bankers, asset managers and tax professionals. We supported the client with a very broad range of services, from pricing and marketing the IPO, to managing the proceeds."

Joseph T. Carroll, *VP, Tax Department*

VIVENDI S.A.

Guillaume Hannezo, *Deputy Chief Operating Officer:*

"Sometimes our financial needs can be met by commodity-type services that are driven by price. Then there are strategic decisions such as wanting to position Vivendi as a world leader in the water industry. Goldman Sachs provided us with the two essential factors that enabled us to accomplish this. One consisted of excellent, very timely knowledge of the utilities industry worldwide that permitted us to identify and assess acquisition candidates, including United States Filter Corporation. The second consisted of a local team of quality investment bankers who do not merely sell transactions but are oriented toward forming a close, trusting and long-term relationship with their client. Long before we appointed Goldman Sachs as our advisor, the firm had invested considerable time to learn about our company and strategy and the challenges we faced. The trust and confidence that we had built enabled us to structure successfully a large, complex international acquisition and then finance it quickly through a convertible and an equity offering totaling $6 billion. Despite their significant size, these offerings attracted tremendous interest and allowed us to complete our strategy in the most efficient way in terms of both price and timing."

- **Goldman Sachs advised Vivendi on the acquisition of United States Filter Corporation for approximately $6 billion.**
- **The acquisition financing included a $3.1 billion convertible bond offering and a $2.9 billion equity offering.**
- **The convertible bond offering was the largest ever globally and provided unique exchange features that helped to generate high investor demand.**

SUMITOMO BANK, LIMITED

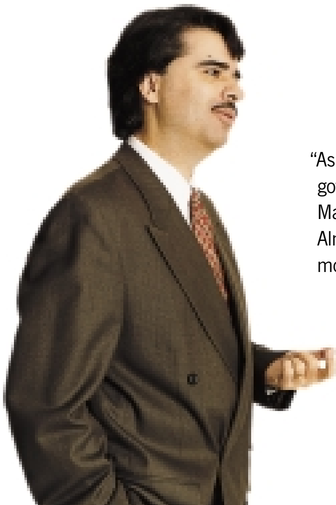
Goldman Sachs has assisted Sumitomo Bank in raising capital internationally for nearly a decade. In 1999, we were sole bookrunner for a $1 billion issue of 10-year subordinated bonds that enabled Sumitomo to strengthen its Tier II capital reserves and broaden its investor base, particularly in the United States and Europe. Although the bond market was unsettled at the time of the offering, our global team was able to assist Sumitomo in successfully communicating its business strategy and creditworthiness, creating robust demand for the bonds among a diversified base of high-quality institutional investors. Interest was so strong that the offering was increased to $1 billion from its original issue size of $800 million and was priced at the tightest end of the price-talk range.

THE ALLSTATE CORPORATION

Edward M. Liddy, *Chairman, President and Chief Executive Officer:*

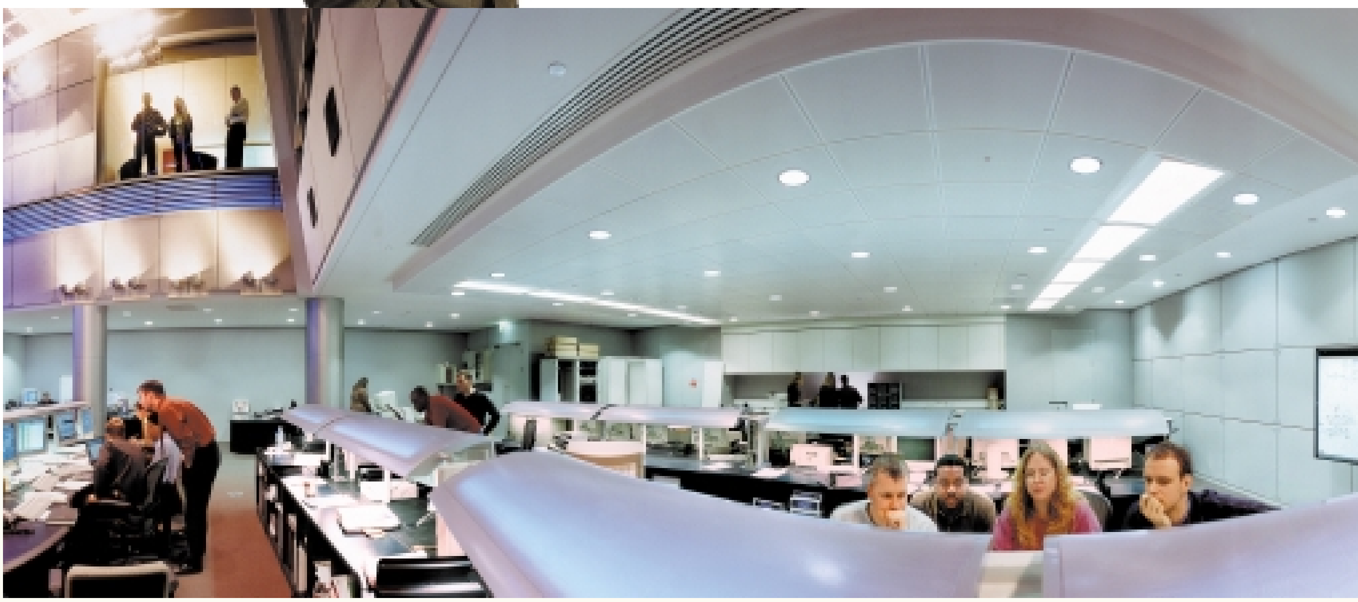
"Goldman Sachs and Allstate have a very close relationship and our work over the years bears that out. The firm lead managed our 20 percent IPO in 1993 for $2.4 billion and subsequently helped us become an independent company by distributing to shareholders the remaining 80 percent of stock in our company held by Sears. Since then, Goldman Sachs has helped us focus on the businesses we should be in—where we can have substantial wins and where it makes sense to exit. Through a series of divestitures, we are now focused on personal financial services in the property-casualty and life-savings industries. We're expanding the core and building on our strong position in these fields. In 1999, we acquired American Heritage Life Investment Corporation and the personal lines business of CNA Financial Corporation. We have benefited at every point from having access to top-quality people throughout Goldman Sachs who have the breadth of financial expertise to help us think through the options and execute our strategies. This is a relationship built on mutual trust and confidence. Time and again, our Goldman Sachs colleagues have shown that they have the best interests of Allstate at heart."

- **Goldman Sachs was lead manager for Allstate's $2.4 billion IPO in 1993.**
- **In 1995, the firm was financial advisor for Allstate's $10.7 billion spin-off from Sears and lead manager for its $1.2 billion divestiture through an IPO of PMI Group.**
- **Goldman Sachs was the exclusive financial advisor for Allstate's 1996 divestiture of Northbrook Holdings.**
- **In 1999, the firm was the exclusive financial advisor for Allstate's $1.1 billion acquisition of American Heritage Life Investment Corporation and its $1.2 billion acquisition of the personal lines business of CNA Financial Corporation.**



"As soon as we identified client needs and some key ideas, we got strong support from senior management to build our GS Wealth Management Web site. The commitment of resources was immediate. Almost overnight we went from a small effort to a project involving more than 100 people from almost every part of the firm."

Antonio Monteiro, *VP, Investment Management Technology*



ATLANTA/ BANGKOK/ BEIJING/ BOSTON/ BUENOS AIRES/ CHICAGO/ DALLAS/ FRANKFURT/ GEORGE TOWN/ HONG KONG/ HOUSTON/ JOHANNESBURG/ **LONDON** Enabling the technology revolution / LOS ANGELES/

"We're always looking for new ways to capitalize on market opportunities. Last year, for example, we developed a new private investment vehicle to help our clients take advantage of fixed income spreads that had widened out to nearly unprecedented levels. Our nimble organization and culture of teamwork enabled us to bring this opportunistic investment to market in a matter of weeks."

Suzanne Donohoe, *VP, Investment Management Product and Service Development*

INNOVATION

MADRID/ MEMPHIS/ MENLO PARK/ MEXICO CITY/ MIAMI/ MILAN/ MONTREAL/ MOSCOW/ MUMBAI/ NEW YORK/ PARIS/ PHILADELPHIA/ PRINCETON/ SAN FRANCISCO/ SÃO PAULO/ SEOUL/ SHANGHAI/ SINGAPORE/ STOCKHOLM/ SYDNEY/ TAIPEI/

Our clients are making huge investments in the technology and resources necessary to create new products and services—and even new companies—that were inconceivable a short time ago. To capture these opportunities and others, they turn to Goldman Sachs. We are also investing time, money and knowledge—continually and aggressively—to create the technology, products and capabilities that help us serve clients. Our ultimate goal is to help spark the innovation clients need to steer change.

“Our clients need real-time information to make critical, time-sensitive decisions. Through our global network of offices and our Internet-based tools, we can deliver up-to-the-minute research and analysis to clients almost anywhere in the world.”

Robert Wen-Yu Chiu, *Associate, High Technology Banking*
Winnie Hwang, *Financial Analyst, Investment Research*

INNOVATION

Please go to www.gs.com for complete profiles on these client accomplishments:

GLOBAL CROSSING LTD.

Dan Cohrs, ***Chief Financial Officer:***

“Goldman Sachs has been supporting us with a broad range of strategic advisory and financing services as we’ve moved to build a worldwide, state-of-the-art telecommunications network.”

SWISS REINSURANCE COMPANY

Dieter Enkelmann, ***Corporate Financial Management, Investor Relations:***

“We wanted to take advantage of some of our company’s equity assets to raise capital and reduce funding costs. We were open-minded about how to accomplish this and were quite willing to look at innovative solutions. Goldman Sachs suggested a “triple-play” exchangeable bond.”

GOLDMAN SACHS FUNDS

Goldman Sachs Asset Management has provided creative solutions for investor needs with the addition of several new retail funds and the continued success of others.

AstraZeneca PLC

Jonathan Symonds, ***Executive Director, Chief Financial Officer:***

“Astra had been our preferred partner over the years. We felt there was exceptional complementarity in our businesses and cultures. Even so, in bringing our companies together, we faced two critical challenges that went beyond the tax, legal and investment issues that complicate cross-border mergers. First, Astra is a crown jewel in Sweden, and our merger was subject to enormous scrutiny and the prospect of a difficult, time-consuming process. Second, the rapid consolidation of the pharmaceutical industry made both companies subject to takeover speculation. Speed was essential. What I valued most about Goldman Sachs was a team effort that literally went around the clock, seven days a week—always meeting or going beyond expectations. The firm brought an independent and thoughtful perspective to bear on issues such as valuation, structuring, likely market reaction to different structures and how to secure the combination we wanted while minimizing transaction risk. The intensity and the scope and quality of resources it brought to turning around the analyses when we were in negotiations and to the whole process really differentiated Goldman Sachs. The firm continually provided us with new information for dealing with a fast-changing situation. From the date of registration, it took us just 80 days to complete one of the largest cross-border mergers ever. This was unprecedented in the U.K. and Europe—and we could not have done it without the support of our advisors.”

- **Goldman Sachs acted as advisor to Zeneca Group PLC of the U.K. in its $34 billion merger of equals with Astra AB of Sweden.**
- **This was one of the largest pharmaceutical mergers ever.**
- **Newly formed AstraZeneca PLC is among the leading global pharmaceutical companies.**

"We're constantly talking with clients about future trends in their industries and providing strategic advice about where they should be heading. Our long-term focus forces us to think ahead of the curve and come up with innovative approaches to challenges that may arise down the road."

Dorothee Blessing, *Executive Director, Advisory Group*

"Our unrivaled experience in the convertibles market makes us highly innovative in our response to client needs. Last year our group not only developed several new convertible securities, but we also built and launched the market-leading series of convertible bond indices."

Peter Warren, *Executive Director, Global Convertibles*

LUCENT TECHNOLOGIES INC.

Donald K. Peterson, *Executive Vice President and Chief Financial Officer:*

"During our discussions with Ascend Communications, we were focused on completing an acquisition aimed at establishing Lucent's leadership in data networking and in developing the next generation of networking technology. Goldman Sachs helped us to keep the negotiations on track and moving forward. This was in keeping with the highly strategic role the firm has played for us since the formation of Lucent. Goldman Sachs had been a lead manager for AT&T in the Lucent IPO, and we have looked to the firm for ongoing advice and knowledge about companies, trends and transactions in the data networking space and how they matched up with our growth objectives. As a result of our combination with Ascend, we can say that Lucent holds the number one position in our sector in terms of market share and new products."

- Goldman Sachs acted as advisor to Lucent Technologies Inc. in its $21.4 billion acquisition of Ascend Communications Incorporated.
- To date, this was the largest technology merger ever.
- The merger significantly enhanced Lucent's position as a leader in data networking.

EXTENDIBLE COMMERCIAL NOTES (ECNs)

Goldman Sachs made a significant contribution to the world of debt capital markets through the invention of Extendible Commercial Notes. ECNs offer an attractive alternative to traditional and nontraditional institutional investors and simultaneously add new options for issuers, particularly with regard to short-term financing needs that may relate to mergers and acquisitions activity.

As a creative mechanism for accessing liquidity from investors, ECNs replicate the flexibility of a credit facility and provide a threefold benefit: They satisfy the requirements of rating agencies while simultaneously providing a premium to investors and lowering costs for issuers. ECNs were created in response to the long-standing requirement by rating agencies that certain issuers provide backup liquidity for their commercial paper notes through bank credit facilities. In recent years, however, such facilities have grown increasingly expensive. In reducing costs by as much as 20 percent, ECNs provide a valuable addition to the $1.3 trillion market for short-term commercial debt.

RED HAT, INC.

Matthew J. Szulik, *Chief Executive Officer and President:*

"Goldman Sachs' research was spot on about Red Hat. The firm came to us with a keen understanding that we are not a traditional software business but a leader in creating Internet infrastructure for the 21st century. It also understood that our brand is our predominant asset and an IPO was an opportunity to reinforce our brand. The firm's passionate belief that we would succeed as the first "open source" software company to go public was the foundation for a trusting relationship. A central challenge was to educate the investment community about how a company that freely distributes its primary product—the Red Hat Linux server operating system—on the Internet has excellent long-term growth prospects. Working as a closely synchronized team, we were able to complete one of the most successful IPOs ever within a very tight time frame in a difficult market for Internet-related offerings. Our relationship has provided another very important benefit: From top to bottom, we found the people of Goldman Sachs to be as professional, responsible and respectful as can be imagined. They are always in a service mode. We view the quality of Goldman Sachs people and the way they work as benchmarks for developing our own workforce as we grow globally."

- Goldman Sachs served as lead manager for Red Hat's $96.6 million IPO.

REACH

ATLANTA/ BANGKOK/ BEIJING/ BOSTON/ BUENOS AIRES/ CHICAGO/ DALLAS/ FRANKFURT/ GEORGE TOWN/ HONG KONG/ HOUSTON/ JOHANNESBURG/ LONDON/ LOS ANGELES/ MADRID/ MEMPHIS/ MENLO PARK/ MEXICO CITY/ MIAMI/ MILAN/ MO

Goldman Sachs goes to extraordinary lengths to help clients achieve their goals. No firm is as well positioned to do so. From Sydney to São Paulo, from Menlo Park to Milan, Goldman Sachs teams bridge time and space to give clients access to the information, insight, capital and relationships they need to grow.

"The challenge in global securities lending is to find unique solutions for our clients in markets around the world. Our depth and breadth of experience, our knowledge of markets and practices, as well as legal and regulatory issues, can make the difference between a good solution and a great solution."

Elizabeth Husted, *VP, Global Securities Services*

NTREAL/ MOSCOW/ MUMBAI/ NEW YORK/ OSAKA / PARIS/ PHILADELPHIA/ PRINCETON/ SAN FRANCISCO/ SÃO PAULO/ SEOUL/ SHANGHAI/ SINGAPORE/ STOCKHOLM/ SYDNEY/ TAIPEI/

The Seto-Ohashi Bridge near Osaka is the longest bridge in the world.

"We provide borderless 24/7 service to our clients. From London to New York to Tokyo to Hong Kong, our 24-hour operations enable us to pass on information continuously to our colleagues around the world. That supports quick decisions. And with our global transaction experience, we get those decisions right."

John Zee, *Executive Director, Equity Operations*
Matthew Koder, *Associate, Equity Capital Markets*

“We recently pooled our Latin American, Eastern European and U.K. banking analysts to meet with clients in Asia and discuss important industry trends such as foreign bank buy-in, the Internet and consolidation. These trends tend to repeat themselves from region to region and our global platform gives clients a real knowledge advantage.”

Salman U. Khan, *VP, Equity Research*

REACH

Please go to www.gs.com for complete profiles on these client accomplishments:

NIPPON TELEGRAPH & TELEPHONE CORPORATION (NTT)

Goldman Sachs worked with NTT on communicating its business goals and prospects to investors in Japan and around the globe.

THE REPUBLIC OF ARGENTINA

Noemí LaGreca, ***Financial Representative of Argentina in Washington, D.C.:***

“Goldman Sachs proposed an innovative financing structure that allowed Argentina to leverage a $250 million World Bank guarantee into a $1.5 billion offering.”

UNITED PAN-EUROPE COMMUNICATIONS N.V. (UPC)

Goldman Sachs’ relationship with UPC illustrates the firm’s significant role in helping communications companies gain leadership positions in businesses driven by emerging technologies.

VODAFONE AIRTOUCH PLC

Chris Gent, ***Chief Executive:***

“Over the past year, we have greatly enhanced the growth potential and competitiveness of Vodafone through significant strategic moves, and Goldman Sachs has played an essential part in our success. We first sat down together in 1998 to discuss how Vodafone could move from regional to global leadership in mobile communications. Gaining a strong footprint in the U.S. market was a requisite. Goldman Sachs helped us to construct alternative scenarios and acted as an objective sounding board as we worked through the decisions. The firm indicated that a merger with AirTouch would be well received by the public—and that turned out to be the case. The firm also took the lead in raising $10 billion to finance the merger. The scale and scope of Vodafone AirTouch immediately enhanced our purchasing power, diversified our asset base and strengthened our financial resources. It gave us much greater growth prospects in both voice and data communications, which was demonstrated in our next step—reaching an agreement with Bell Atlantic Corp. to set up a venture that will be the third largest wireless company in the world. As we continue to develop and roll out our strategy for global expansion, I value the relationship between our team and Goldman Sachs.”

- Goldman Sachs acted as sole financial advisor to Vodafone in its merger with AirTouch Communications, Inc. to form Vodafone AirTouch—one of the world’s leading mobile communications companies. Valued at $125 billion at closing, this was the largest cross-border merger ever.
- Goldman Sachs was joint bookrunner and joint lead arranger of a $10 billion senior credit facility for Vodafone to finance costs related to the merger with AirTouch. These were among the largest syndicated European bank facilities and stand-alone wireless financings ever.
- Goldman Sachs served as sole financial advisor to Vodafone in the combining of its U.S. wireless properties with those of Bell Atlantic Corp. to form the largest U.S. mobile communications operator. Valued at approximately $80 billion at signing, this was the largest joint venture transaction ever.
- Goldman Sachs served as sole financial advisor to Vodafone in the sale of its stake in German mobile operator E-plus Mobilfunk GmbH to BellSouth Corp. for $1.8 billion.

“Our recruiting is as diverse as the markets we serve. The firm conducts business in a large number of markets around the world and we recruit new talent from just about every one of them. In doing so, we broaden the perspective we provide to our clients and add rich insights into local cultures, business practices and financial mind-sets.”

Elizabeth A. Sirianni, *VP, Human Resources*

“We try to bring clients the very best ideas—tailored for any market in the world. On one recent IPO, for example, our very sharp understanding of investor perceptions and attitudes, region by region, enabled us to customize our marketing story for France, the rest of Europe and the U.S. The results? The offering was 45 times oversubscribed globally.”

Jean Raby, *Executive Director, Advisory Group*

CHARTER COMMUNICATIONS, INC.

Jerald L. Kent, *President and Chief Executive Officer:*

“The fact that Goldman Sachs helped us to raise nearly $7.5 billion in 1999 underscores how integral a part of our financing activities the firm has been since our predecessor’s first high-yield offering in 1987. During the year, Goldman Sachs led our IPO and our debut high-yield financing, each of which was one of the largest ever in the U.S. markets. Through the years, the firm has advised us on general business strategies, financings, and mergers and acquisitions. We’re constantly bouncing ideas off Goldman Sachs professionals and seeking their advice. We work well together, because we share certain values. Trust, honesty and integrity are very important to both our organizations. Like us, Goldman Sachs hires very good people and turns them loose, empowering them. We stand behind what we say and what we do—this is at the top of our culture statement. And that is what the Goldman Sachs team has done with us. During our IPO and high-yield offerings, very senior people at the firm were in touch with us to make sure our needs were met. Goldman Sachs’ CEO introduced us at our New York high-yield road show and came to our IPO pricing dinner. That kind of accessibility and concern builds long-lasting relationships.”

- **Goldman Sachs acted as global coordinator and joint bookrunner for a $3.6 billion high-yield offering—the largest ever in the media/telecommunications industry.**
- **The firm was global coordinator and sole bookrunner for the $3.7 billion IPO of Charter—one of the largest IPOs to date.**
- **Goldman Sachs has been an advisor to Charter and its predecessor company since 1987, supporting its rapid evolution into one of the largest and most successful cable operators in the United States.**

EXCHANGE FUND INVESTMENT LIMITED (EFIL)

In a watershed event for the Hong Kong markets, Goldman Sachs advised the Hong Kong government on its initial disposal of shares purchased during its market operation in August 1998 to deter the attack on Hong Kong’s financial markets. The shares had appreciated significantly, and the government’s primary objective was to launch a series of orderly sales with minimum disruption to the marketplace. Goldman Sachs assisted Exchange Fund Investment Limited, set up by the government, in designing and establishing the Tracker Fund of Hong Kong (TraHK) and in developing a marketing strategy for TraHK—an innovative exchange-traded investment fund that tracks the Hang Seng Index. One of the challenges was to attract interest among Hong Kong retail investors, a group that had traditionally shunned funds in favor of individual equities. Our firm acted as joint global coordinator for the IPO of TraHK. Drawing on extensive experience with similar products elsewhere, we helped to design the product, develop a retail marketing campaign of unprecedented scale in Hong Kong and execute a global road show for institutional investors. The offering attracted significant interest among Hong Kong retail investors and international institutional investors, enabling the government to dispose of over US$4 billion in equity with minimal disruption in the marketplace. In addition, it attracted significant new capital back into the Hong Kong markets. This was the largest IPO ever in non-Japan Asia.

INTERNET INITIATIVE JAPAN INC. (IIJ)

Internet Initiative Japan is breaking new ground in Japan and elsewhere in Asia, both as an Internet company and as a participant in the public financial markets. IIJ is one of the region’s fastest growing Internet service providers, offering a range of services that has made the company a hub of Internet business in Japan. IIJ was also the first Japanese firm to go public on NASDAQ without listing on the Tokyo Stock Exchange and the first pure-play Internet IPO ever in Japan. We advised IIJ to list on NASDAQ as a means of increasing recognition and growth prospects for the company globally. Drawing on our firm’s noted Internet-related research, we mounted a globally integrated marketing campaign with banking teams in Tokyo as well as Hong Kong, Menlo Park, New York and London, and lead managed the $187 million offering, including the “Green Shoe.” IIJ directly reached U.S. institutional investors who had a keen appreciation for Internet companies and supported a strong valuation for the IPO. The company also reached technology-oriented institutional and retail investors worldwide.

"When we got on the bus to go teach for the day, I had a great feeling about the people I work with. People from every division of the firm—managing directors, analysts and associates—were all there together, eager to take on the challenge of giving."

Andy Walter, *Analyst, Investment Management Services*

GLOBAL COMMUNITY INITIATIVES

As Goldman Sachs continues to grow in size and resources worldwide, so too does its responsibility to the global community. In 1999, we strengthened our commitment to charitable initiatives in the field of education by making a contribution of $200 million to The Goldman Sachs Foundation at the time of the firm's initial public offering. The Foundation will focus its grants on high-quality organizations' operating programs to enhance secondary school students' academic achievement, and to generate interest and educational opportunities worldwide in business and entrepreneurship.

The Year-End Charitable Initiative provided the firm with the opportunity to make direct contributions to educational and child-oriented organizations. This program, established in 1997, disburses grants to charitable organizations located around the world. The charitable activities of our domestic and international offices continue to provide funding to a variety of outstanding community-based nonprofit organizations.

As has long been the tradition at Goldman Sachs, the firm continued to support volunteerism globally with its Community TeamWorks program. During the year, more than 13,500 people participated in mentoring and other community service activities. These initiatives are very much in step with our Business Principles, strengthening our ability to work as a team as we make individual contributions to the communities in which we live and work.

"The commitment and cooperation involved in Community TeamWorks accurately reflects the culture of our firm. My participation was very personally satisfying. At the same time, I think people in the Tokyo community recognize and respect the values that guide our efforts."

Taira Watanabe, *VP, Japanese Products Trading*

"Sponsorship of educational projects and The Goldman Sachs Foundation reflect what I like to call the "culture of commitment" at Goldman Sachs. We enter into the same kind of relationships with the community as with a client—value-oriented, long-term and built on teamwork."

Ulrika Werdelin, *Associate, Advisory Group*

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Goldman Sachs is a global investment banking and securities firm that provides a wide range of services worldwide to a substantial and diversified client base.

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 1999, 1998 and 1997 refer to our fiscal year ended, or the date, as the context requires, November 26, 1999, November 27, 1998 and November 28, 1997, respectively.

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

Initial Public Offering

On May 7, 1999, we converted from a partnership to a corporation and completed our initial public offering. In that offering, we sold 51,000,000 shares of common stock.

Business Environment

We operated in a particularly favorable business environment in 1999, as global equity and many fixed income markets recovered from the turbulent conditions of the second half of 1998, though government bond markets in the United States and Europe experienced a significant rise in yields. The improved business environment provided a positive climate for our investment banking activities, as well as for our customer-driven and proprietary trading activities. Economic and market conditions were also favorable for wealth creation, which contributed positively to growth in our asset management businesses.

The macroeconomic environment in 1999 was particularly healthy in the United States, where strong economic growth and low unemployment continued to be combined with low levels of inflation. Major U.S. equity markets reached record levels during the year as corporate earnings growth was strong and activity in the new issues and mergers and acquisitions arenas increased markedly. The pace of economic growth and the restoration of more normal conditions in financial markets prompted the Federal Reserve to raise interest rates three times during the second half of 1999, returning interest rates to levels in existence before the 1998 financial market crisis.

European equity markets posted solid gains in 1999 as economic growth improved and cross-border business combinations increased to record levels following the introduction of the European Economic and Monetary Union (EMU) in January. The new European Central Bank held short-term interest rates at low levels for most of the year, despite a weakening in the euro against the U.S. dollar. In Asia, the economic recovery in Japan resulted in an appreciation of the yen versus the U.S. dollar and led Japanese equity markets higher. Financial markets throughout Asia benefited from renewed economic growth in the region.

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 has affected, and will continue to affect, our operating results in several significant ways:

1. **Former Partner Compensation.** 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. In prior years, these payments were accounted for as distributions of partners' capital rather than as compensation and benefits expense. As a result, our 1998 and 1997 compensation and benefits expense understate the cost of doing business in corporate form.

2. **Ongoing Stock-Based Compensation.** As part of compensation, restricted stock units and other forms of stock-based compensation can be awarded to employees. Of the total restricted stock units that were granted at the end of 1999, approximately 50% require future service as a condition to the delivery of the underlying shares of common stock. In accordance with Accounting Principles Board Opinion No. 25, the restricted stock units with future service requirements will generally be recorded as compensation expense over the four-year service period following the date of grant as follows: 52%, 28%, 14% and 6% in years one, two, three and four, respectively.

3. **Amortization of Employee Initial Public Offering Awards.** We have recorded, and will continue to record over the five-year vesting period following the date of grant, noncash expense related to the amortization of certain restricted stock units awarded to employees in connection with our initial public offering. These restricted stock units had a value of $1.76 billion on the date of grant, approximately 26% of which will be amortized as a noncash expense, after giving effect to forfeitures, in the 12 months following the date of grant. The remaining 74% of the value of these restricted stock units will be amortized over the next four years as follows: 26%, 26%, 15% and 7% in years two, three, four and five, respectively.

4. **Income Taxes.** As a corporation, our operating results have become, and will continue to be, subject to U.S. federal, state and local corporate income taxes and, therefore, to a higher tax rate than we incurred as a partnership. Our effective tax rate for the period from May 7, 1999 to the end of the fiscal year, excluding the effect of nonrecurring items, was 40%.

For a further discussion of the effect of these items on our actual and pro forma operating results, see "— Operating Expenses" and "— Pro Forma Operating Results" below and the notes to the consolidated financial statements.

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. The financial markets in the United States and elsewhere have achieved record or near record levels, and the favorable business environment in which we have operated will not continue indefinitely. In the event of a change in market conditions, our businesses could be adversely affected in many ways, including the following:

- We generally maintain large trading and investment positions, including merchant banking investments, in the fixed income, currency, commodity and equity markets, and in real estate and other assets, and we may incur significant losses if market fluctuations or volatility adversely affect the value of these positions.
- Unfavorable financial or economic conditions would likely reduce the number and size of transactions in which we provide underwriting, mergers and acquisitions advisory, and other services, and could thereby adversely affect our results of operations.
- A market downturn would likely lead to a decline in the volume of transactions that we execute for our cus-

tomers and, therefore, to a decline in the revenues we receive from commissions and spreads. A market downturn could also result in a decline in the fees we earn for managing assets. Moreover, even in the absence of a market downturn, below-market performance by our mutual funds 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, underwriting, and lending businesses and may continue to do so in the future. In particular, in the case of block trading, we expect the trend toward an increase in the number and size of trades to continue.
- A prolonged market downturn could impair our operating results for a long period of time. In such a downturn, 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 competitive position and 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 that we take. 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.

Overview

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

Financial Overview

(in millions, except per share amounts)	Year Ended November 1999(5)	1998	1997
Net revenues	**$13,345**	$8,520	$7,447
Pre-tax earnings(1)(2)(3)	**1,992**	2,921	3,014
Net earnings(2)	**2,708**	2,428	2,746
Diluted earnings per share	**5.57**	—	—
Pro forma pre-tax earnings(4)	**4,250**	—	—
Pro forma net earnings(4)	**2,550**	—	—
Pro forma diluted earnings per share(4)	**5.27**	—	—

(1) Management believes that for periods prior to our conversion to corporate form, the best measure by which to assess Goldman Sachs' profitability is pre-tax earnings because, as a partnership, we generally were not subject to U.S. federal or state income taxes.

(2) Our pre-tax earnings and net earnings in 1999 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) Our pre-tax earnings in 1999 reflect payments for services rendered by managing directors who, prior to our conversion to corporate form, were profit participating limited partners. In prior years, these payments were accounted for as distributions of partners' capital rather than as compensation and benefits expense. As a result, these payments are not reflected in our operating expenses in 1998 or 1997 and, therefore, the pre-tax earnings in these years are not comparable with 1999.

(4) Pro forma disclosures reflect the results of Goldman Sachs as if our conversion to corporate form and related transactions had taken place at the beginning of 1999. See "— Pro Forma Operating Results" below for a discussion of the pro forma adjustments.

(5) Includes 23 weeks as a partnership and 29 weeks as a corporation.

1999 versus 1998. Net revenues were $13.35 billion, an increase of 57% compared with 1998. Global Capital Markets experienced significant net revenue growth in both Trading and Principal Investments, as substantially all components of the business recovered from the global market turmoil of the second half of 1998, and Investment Banking, where we benefited from unprecedented levels of activity in mergers and acquisitions and equity new issues worldwide. Net revenues in Asset Management and Securities Services increased 16% compared with 1998, primarily due to growth in assets under management, increased equities commissions and higher average customer balances in securities lending and margin lending.

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.

1998 versus 1997. Our net revenues were $8.52 billion in 1998, an increase of 14% compared with 1997. Net revenue growth was strong in Asset Management and Securities Services, which increased 43%, primarily due to increased equities commissions, higher customer balances in securities lending and margin lending and growth in assets under management. Net revenues in Global Capital Markets increased 4% as strong net revenue growth in Investment Banking, resulting from higher levels of mergers and acquisitions activity, was substantially offset by lower net revenues in Trading and Principal Investments, primarily due to a 30% reduction in FICC net revenues.

Pre-tax earnings in 1998 were $2.92 billion, a 3% decrease compared with $3.01 billion in the prior year. This decrease was due to losses incurred in our Trading and Principal Investments business during the global market turmoil of the second half of 1998.

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 1999	1998	1997
Global Capital Markets	Net revenues	**$10,132**	$5,747	$5,513
	Operating expenses	**6,232**	3,978	3,228
	Pre-tax earnings	**$ 3,900**	$1,769	$2,285
Asset Management and Securities Services	Net revenues	**$ 3,213**	$2,773	$1,934
	Operating expenses	**2,396**	1,621	1,205
	Pre-tax earnings	**$ 817**	$1,152	$ 729
Total	Net revenues	**$13,345**	$8,520	$7,447
	Operating expenses	**11,353**[1]	5,599	4,433
	Pre-tax earnings	**$ 1,992**	$2,921	$3,014

(1) 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) a 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 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 allocated to the Trading and Principal Investments component of Global Capital Markets and the Securities Services component of Asset Management and Securities Services. See Note 13 to the consolidated financial statements for further information regarding our segments.

The pre-tax earnings of our segments in 1999 reflect payments for services rendered by managing directors who, prior to our conversion to corporate form, were profit participating limited partners. In prior years, these payments were accounted for as distributions of partners' capital rather than as compensation and benefits expense. As a result, these payments are not reflected in the operating expenses of our segments in 1998 and 1997 and, therefore, the pre-tax earnings of our segments in these years are not comparable with 1999.

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. 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 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 significantly 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

	Year Ended November		
(in millions)	**1999**	1998	1997
Financial Advisory	**$ 2,270**	$1,774	$1,184
Underwriting	**2,089**	1,594	1,403
Investment Banking	**4,359**	3,368	2,587
FICC	**2,862**	1,438	2,055
Equities	**1,961**	795	573
Principal Investments	**950**	146	298
Trading and Principal Investments	**5,773**	2,379	2,926
Total	**$10,132**	$5,747	$5,513

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. Pre-tax earnings were $3.90 billion in 1999 compared with $1.77 billion in 1998. 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 incentive compensation commensurate with growth in net revenues, and increased costs associated with global expansion and higher levels of business activity.

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

[1] Source: Thomson Financial Securities Data, formerly known as Securities Data Company.

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.

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 (which include high-yield debt, bank loans and investment-grade corporate debt) 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 mark-to-market gains on certain merchant banking investments, particularly in the high technology and telecommunications sectors.

1998 versus 1997. Net revenues in Global Capital Markets were $5.75 billion, an increase of 4% compared with 1997, as strong net revenue growth in Investment Banking was substantially offset by a reduction in net revenues in Trading and Principal Investments. Pre-tax earnings were $1.77 billion in 1998, a 23% decrease compared with 1997, as many of our businesses were adversely affected by market conditions from mid-August 1998 to mid-October 1998. Operating expenses increased 23%, primarily due to increased compensation related to growth in employment levels and additional expenses associated with temporary staff and consultants.

Investment Banking. Investment Banking achieved net revenues of $3.37 billion in 1998, an increase of 30% compared with 1997. Net revenue growth was strong in Financial Advisory and, to a lesser extent, in Underwriting as we capitalized on higher levels of activity in many industry groups, including communications, media and entertainment, financial institutions, general industrials and retail. Net revenue growth in Investment Banking was strong in all major regions in 1998 compared with the prior year.

Financial Advisory revenues increased 50% compared with 1997, due to increased revenues from mergers and acquisitions advisory assignments, which principally resulted from consolidation within various industries and generally favorable U.S. and European stock markets. Despite a substantial decrease in the number of industry-wide underwriting transactions in August and September of 1998, Underwriting revenues increased 14% for the year, primarily due to increased revenues from equity and high-yield corporate debt underwriting activities.

Trading and Principal Investments. Net revenues in Trading and Principal Investments were $2.38 billion in 1998, a decrease of 19% compared with 1997. This decrease in net revenues was concentrated in the second half of the year, when the Russian economic crisis, the turmoil in Asian and Latin American emerging markets, and the resulting move to higher credit quality fixed income securities by many investors led to substantial declines in global financial markets. For the full year, significant net revenue reductions in FICC and Principal Investments were partially offset by increased net revenues in Equities.

Net revenues in FICC decreased 30% compared with 1997 due to an extraordinarily difficult environment in the second half of 1998. The net revenue reduction in FICC was concentrated in fixed income arbitrage and high-yield debt trading, which experienced losses in 1998 due to a reduction in liquidity and widening credit spreads in the second half of the year. An increase in net revenues from market making and trading in fixed income derivatives, currencies and commodities partially offset this decline.

Net revenues in Equities increased 39% compared with 1997 as higher net revenues in derivatives and European shares were partially offset by losses in equity arbitrage. The derivatives business generated significantly higher net revenues due, in part, to strong customer demand for over-the-counter products, particularly in Europe. Net revenues from European shares increased as Goldman Sachs benefited from generally favorable equity markets and increased customer demand. The equity arbitrage losses were due principally to the underperformance of various equity positions versus their benchmark hedges, to widening of spreads in a variety of relative value trades, and to lower prices for event-oriented securities resulting from a reduction in announced mergers and acquisitions and other corporate activity in the second half of 1998.

Net revenues from Principal Investments declined 51% compared with 1997 as investments in certain publicly held companies decreased in value during the second half of 1998. This decrease was partially offset by an increase in gains on the disposition of investments compared with the prior year.

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 revenue primarily in the form of fees or interest rate spreads; and
- **Commissions.** Commissions includes agency transactions for clients on major stock 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

	Year Ended November		
(in millions)	**1999**	1998	1997
Asset Management	**$ 919**	$ 675	$ 458
Securities Services	**772**	730	487
Commissions	**1,522**	1,368	989
Total	**$3,213**	$2,773	$1,934

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.

The following table sets forth our assets under supervision:

Assets Under Supervision

	As of November		
(in millions)	**1999**	1998	1997
Assets under management	**$258,045**	$194,821	$135,929
Other client assets	**227,424**	142,018	102,033
Total	**$485,469**	$336,839	$237,962

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. Pre-tax earnings in Asset Management and Securities Services were $817 million in 1999 compared with

$1.15 billion in 1998. 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.

Asset Management 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 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.

1998 versus 1997. Net revenues in Asset Management and Securities Services were $2.77 billion in 1998, an increase of 43% compared with 1997. All major components of the segment exhibited strong net revenue growth. Pre-tax earnings were $1.15 billion in 1998, an increase of 58% compared with 1997. Operating expenses increased 35% as higher employment levels led to increased compensation and benefits expenses.

Asset Management revenues increased 47% during this period, reflecting a 41% increase in average assets under management compared with 1997. In 1998, approximately 80% of the increase in assets under management was attributable to net asset inflows, with the remaining 20% reflecting market appreciation. Net revenues from Securities Services increased 50%, primarily due to growth in our securities borrowing and lending businesses. Commissions increased 38% as generally strong and highly volatile equity markets resulted in increased transaction volumes in listed equity securities. Revenues from the increased share of income and gains from our merchant banking funds also contributed significantly to the increase in Commissions.

Operating Expenses

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

Our operating expenses in 1999, excluding the nonrecurring charges associated with our initial public offering, increased significantly in part because, 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. In prior years, these payments were accounted for as distributions of partners' capital rather than as compensation and benefits expense. As a result, our 1998 and 1997 compensation and benefits expense understate the cost of doing business in corporate form.

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

Operating Expenses and Employees

($ in millions)	Year Ended November 1999	1998	1997
Compensation and benefits, excluding employee initial public offering awards	**$ 6,459**	$3,838	$3,097
Nonrecurring employee initial public offering awards(1)	**2,257**	—	—
Amortization of employee initial public offering awards	**268**	—	—
Brokerage, clearing and exchange fees	**446**	424	357
Market development	**364**	287	206
Communications and technology	**306**	265	208
Depreciation and amortization	**337**	242	178
Occupancy	**314**	207	168
Professional services and other	**402**	336	219
Charitable contribution	**200**	—	—
Total operating expenses	**$11,353**	$5,599	$4,433
Employees at year end(2)	**15,361**	13,033	10,622

(1) Includes expense of $666 million related to the initial irrevocable contribution of shares of common stock to a defined contribution plan.

(2) 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.

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 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.

1998 versus 1997. Operating expenses were $5.60 billion in 1998, an increase of 26% over 1997, primarily due to increased compensation and benefits expense.

Compensation and benefits increased as a percentage of net revenues to 45% from 42% in 1997, principally as a result of increases in employment levels and in expenses associated with temporary staff and consultants. Employment levels increased 23% during the year, with particularly strong growth in asset management. Expenses associated with our temporary staff and consultants were $330 million in 1998, an increase of 85% compared with 1997, reflecting greater business activity, Goldman Sachs' global expansion, and consulting costs associated with various technology initiatives, including preparations for the Year 2000 and the establishment of the EMU.

Brokerage, clearing and exchange fees increased 19%, primarily due to higher transaction volumes in European and U.S. equities and futures contracts. Market development expenses increased 39% and professional services and other expenses increased 53%, due to higher levels of business activity and Goldman Sachs' global expansion. Communications and technology expenses increased 27%, reflecting higher telecommunications and market data costs associated with higher employment levels and additional spending on technology initiatives. Depreciation and amortization increased 36%, principally due to capital expenditures on telecommunications and technology-related equipment and leasehold improvements. Occupancy expenses increased 23%, reflecting additional office space needed to accommodate higher employment levels.

Provision for Taxes

The net tax benefit of $716 million in 1999 included nonrecurring net benefits of $1.78 billion recognized during the second quarter. 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 the 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%. 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 11 to the consolidated financial statements for further information regarding our provision for taxes.

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.

Pro Forma Operating Results

The following table sets forth our pro forma condensed consolidated statement of earnings for the year ended November 1999:

Pro Forma Condensed Consolidated Statement of Earnings

	Year Ended November 1999		
($ in millions, except per share amounts)	Actual	Pro Forma Adjustments	Pro Forma
Total revenues	$25,363	$ —	$25,363
Interest expense	12,018	7 [a]	12,025
Revenues, net of interest expense	13,345	(7)	13,338
Compensation and benefits, excluding employee initial public offering awards	6,459	—	6,459
Nonrecurring employee initial public offering awards	2,257	(2,257) [b]	—
Amortization of employee initial public offering awards	268	192 [c]	460
Other operating expenses	2,369	(200) [d]	2,169
Total operating expenses	11,353	(2,265)	9,088
Pre-tax earnings	1,992	2,258	4,250
(Benefit)/provision for taxes	(716)	2,416 [e]	1,700
Net earnings	$ 2,708	$ (158)	$ 2,550
Ratio of earnings to fixed charges	1.16x		1.35x
Average common shares outstanding			
Basic	475,883,756	(505,283) [f]	475,378,473
Diluted	485,803,960	(1,877,905) [g]	483,926,055
Earnings per share			
Basic	$ 5.69		$ 5.36
Diluted	5.57		5.27

Basis of Presentation. The pro forma condensed consolidated statement of earnings was prepared as if our conversion to corporate form and related transactions had taken place at the beginning of 1999.

For purposes of calculating the ratio of earnings to fixed charges, "earnings" represent pre-tax earnings plus fixed charges and "fixed charges" represent interest expense plus that portion of rent expense that, in our opinion, approximates the interest factor included in rent expense.

The pro forma adjustments are based upon available information and certain assumptions that management believes are reasonable. The pro forma condensed consolidated statement of earnings and accompanying notes should be read in conjunction with the consolidated financial statements and their notes.

The pro forma condensed consolidated statement of earnings is 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, or that may be expected to occur in the future.

Notes to Pro Forma Adjustments.

(a) Adjustment to reflect the additional interest expense on junior subordinated debentures issued to retired limited partners in exchange for their interests in The Goldman Sachs Group, L.P. and certain affiliates.

(b) Adjustment to eliminate the nonrecurring effect of the expense related to restricted stock units, awarded to employees in connection with our conversion to corporate form, for which future service is not required as a condition to the delivery of the underlying common stock, and the initial irrevocable contribution of shares of common stock to our defined contribution plan.

(c) Adjustment to reflect additional amortization for the full fiscal year related to certain restricted stock units awarded to employees in connection with our conversion to corporate form, which vest in equal installments in years three, four and five following the date of grant (May 7, 1999). These restricted stock units had a value of $1.76 billion at date of grant, approximately 26% of which will be amortized as a noncash expense, after giving effect to forfeitures, in the 12 months following the date of grant. The remaining 74% of the value of these restricted stock units will be amortized over the next four years as follows: 26%, 26%, 15% and 7% in years two, three, four and five, respectively.

(d) Adjustment to eliminate the expense related to the charitable contribution to The Goldman Sachs Foundation made at the time of our initial public offering.

(e) Adjustment to reflect a pro forma provision for taxes for Goldman Sachs in corporate form at an effective tax rate of 40%.

(f) Adjustment to reflect the effect of share activity, primarily related to the acquisition of The Hull Group in September 1999, which is averaged over the period beginning on May 4, 1999 (the day trading in our common stock commenced) for actual purposes, and over the entire year for pro forma purposes.

(g) Adjustment to diluted average common shares outstanding, which includes both common stock and nonvoting common stock outstanding, to reflect the additional dilutive effect of the common stock deliverable pursuant to the restricted stock units and stock options, awarded to employees in connection with our conversion to corporate form, for which future service is required as a condition to the delivery of the underlying common stock. For purposes of calculating pro forma diluted average common shares outstanding, we used the initial public offering price of $53 per share from the beginning of 1999 until May 4, 1999. Thereafter, we used actual daily closing prices.

Geographic Data

For a summary of the net revenues, pre-tax earnings and identifiable assets of Goldman Sachs by geographic region, see Note 13 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 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 net 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.

Year Ended November 1997. Cash and cash equivalents decreased to $1.33 billion in 1997. Operating activities provided cash of $70 million. Cash of $693 million was used for investing activities, primarily for the purchase of certain financial instruments and technology-related equipment. Cash of $258 million was used for financing activities, principally due to a decrease in net repurchase agreements, distributions to partners, and cash outflows related to partners' capital allocated for income taxes and potential withdrawals, partially offset by the net issuance of long-term and short-term borrowings.

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 Treasury Department manages our capital structure, funding, liquidity, and relationships with creditors and rating agencies on a global basis. The 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 diversified funding sources with both banks and nonbank lenders globally. Management believes that Goldman Sachs' relationships with its lenders are critical to its liquidity.

Goldman Sachs also has access to diversified funding sources with numerous creditors, including banks, insurance companies, mutual funds, bank trust departments and other asset managers. We monitor our creditors to maintain broad and diversified credit.

We access liquidity in a variety of markets in the United States as well as in Europe and Asia. We make extensive use of the repurchase agreement 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. In addition, we maintain and update annually a liquidity crisis plan that provides guidance in the event of a liquidity crisis. The annual update of this plan is reviewed and approved by our Finance Committee.

Asset Liquidity. Goldman Sachs maintains a highly liquid balance sheet. Many of our assets are readily funded in the repurchase agreement 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 stockholders' equity substantially in excess of our less liquid assets.

Dynamic Liquidity Management. Goldman Sachs seeks to manage the composition of its asset base and the maturity profile of its funding to ensure that it can 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.

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 to ensure the availability of immediate liquidity. This pool of highly liquid assets averaged $17.99 billion during 1999 and $14.17 billion during 1998.

Liquidity Ratio Maintenance. It is Goldman Sachs' policy to further manage its liquidity by maintaining a "liquidity ratio" of at least 100%. This ratio measures the relationship between the loan value of our unencumbered assets and our short-term unsecured liabilities. The maintenance of this liquidity ratio is intended to ensure that we could fund our positions on a fully secured basis in the event that we were unable to replace our unsecured debt maturing within one year. 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.

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 the advances made to our subsidiaries and affiliates are secured by marketable securities or other liquid collateral. 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. In the fourth quarter of 1998, we temporarily decreased our total assets to reduce risk and increase liquidity in response to difficult conditions in the global financial markets. The following table sets forth our total assets, adjusted assets, leverage ratios and book value per share:

	As of November	
($ in billions, except per share amounts)	1999	1998
Total assets	$ 250	$ 217
Adjusted assets[1]	188	145
Leverage ratio[2]	24.7x	34.5x
Adjusted leverage ratio[3]	18.5x	23.0x
Book value per share[4]	$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 equity capital.

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

(4) Book value per share was based on common shares outstanding, including restricted stock units granted to employees with no future service requirements, of 484,566,184 as of November 1999.

As of November 1999 and November 1998, we held $2.62 billion and $2.21 billion, respectively, in high-yield debt and emerging market securities and $1.80 billion and $1.59 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 1999, the aggregate carrying value of our principal investments held directly or through our merchant banking funds was $2.88 billion, which consisted of corporate principal investments with an aggregate carrying value of $1.95 billion and real estate investments with an aggregate carrying value of $928 million.

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 1999:

	Short-Term Debt	Long-Term Debt
Moody's Investors Service, Inc.	P-1	A1
Standard & Poor's Ratings Services	A-1+	A+
Fitch IBCA, Inc.	F1+	AA-
CBRS Inc.	A-1 (High)	A+

Long-Term Debt

As of November 1999, our consolidated long-term borrowings were $20.95 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 1999 was approximately five years. Substantially all 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 5 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., a registered U.S. broker-dealer, is regulated by the SEC, the Commodity Futures Trading Commission, the Chicago Board of Trade, the NYSE and the NASD. 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 Japanese Ministry of Finance, the Financial Supervisory 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 12 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 Risk Committee sets market risk limits for individual business units and sets issuer-specific net inventory position limits. The Equities Risk Committee sets market risk limits for individual business units that consist of gross and net inventory position limits and, for equity derivatives, limits based on market move scenario analyses. 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 underwriting 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.

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 and the Finance Committee. When inventory position limits are used to monitor market risk, they are also monitored by the Firmwide Risk Department, and violations are reported to 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 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 Value-at-Risk (VaR);
- risk limits based on a scenario analysis that measures the potential effect on our trading net revenues of a significant widening of credit spreads;
- inventory position limits for selected business units and country exposures; and
- scenario analyses that measure the potential effect on our trading net revenues of abnormal market movements.

We also estimate the broader potential impact of certain macroeconomic scenarios, including a sustained downturn, on our investment banking and merchant banking activities.

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 asset volatilities and correlations, 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 market 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

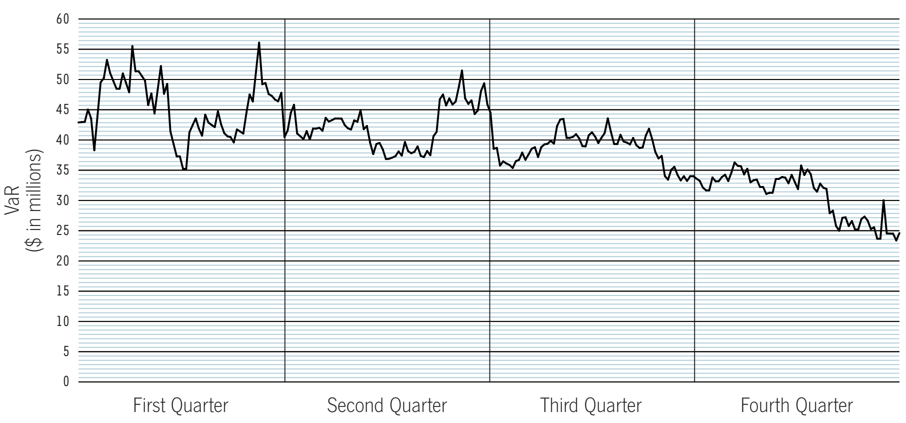
(in millions)	As of November		Year Ended November 1999		
Risk Categories	**1999**	1998	Average	High	Low
Interest rates	**$ 13**	$ 27	$ 23	$ 35	$ 10
Currency rates	**4**	9	9	25	4
Equity prices	**18**	25	23	37	18
Commodity prices	**12**	7	9	13	3
Diversification effect[1]	**(22)**	(25)	(25)	—	—
Firmwide	**$ 25**[2]	$ 43	$ 39	56	23

(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.

(2) Not necessarily indicative of future VaR levels.

The following chart sets forth the daily VaR for substantially all of our trading positions during 1999:

Firmwide VaR

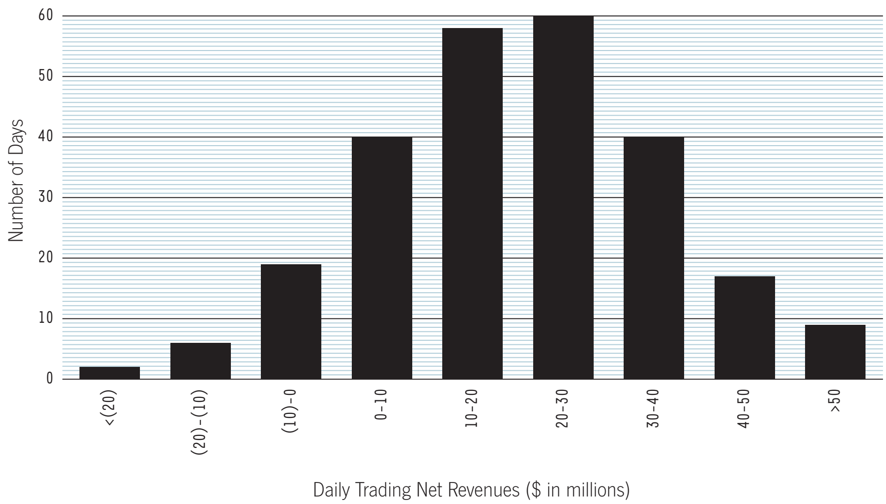


The general decline in our VaR during 1999 reflects lower levels of market volatility and a decrease in trading exposures, particularly with respect to interest rates. As described above, the historical data used to estimate VaR is weighted to give greater importance to more recent observations and, accordingly, our VaR levels in the beginning of 1999 were significantly affected by the market turmoil of the second half of 1998.

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 1999:

Daily Trading Net Revenues



As part of our overall risk control process, daily trading net revenues are compared with the VaR calculated as of the end of the prior business day. During 1999, trading losses incurred on a single day exceeded our 95% one-day VaR on only one occasion.

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 1999, our nontrading market risk was approximately $200 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 netting agreements with counterparties that permit us to offset receivables and payables with such counterparties. In addition, we attempt to further reduce credit risk 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, and through the use of credit derivatives.

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 measure potential exposure based on projected worst-case market movements over the life of a transaction within a 95% confidence interval. 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 activities 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 credit exposure with respect to over-the-counter derivatives as of November 1999, 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 Exposures

($ in millions)

Credit Rating Equivalent	Exposure	Collateral Held[2]	Exposure Net of Collateral	Percentage of Exposure Net of Collateral
AAA/Aaa	$ 2,603	$ 452	$ 2,151	11%
AA/Aa2	5,132	557	4,575	24
A/A2	9,663	2,211	7,452	39
BBB/Baa2	3,246	516	2,730	14
BB/Ba2 or lower	2,618	625	1,993	11
Unrated[1]	2,486	2,228	258	1
	$25,748	$6,589	$19,159	100%

(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.

Derivative 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

Operational Risk. Goldman Sachs may face reputational damage, financial loss or regulatory risk in the event of an operational failure or error. 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.

Year 2000. Goldman Sachs has dedicated resources over the past several years to address the potential hardware, software, and other computer and technology issues and related concerns associated with the transition to the Year 2000 and to confirm that our service providers took similar measures. As a result of those efforts, we have not experienced any material disruptions in our operations in connection with, or following, the transition to the Year 2000. We currently estimate that our Year 2000 costs will total approximately $185 million, of which $170 million had been spent through November 1999.

Accounting Developments

In June 1999, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 137, "Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of Financial Accounting Standards Board Statement No. 133—an amendment of Financial Accounting Standards Board Statement No. 133," which deferred to fiscal years beginning after June 15, 2000 the effective date of the accounting and reporting requirements of Statement of Financial Accounting Standards No. 133. Statement of Financial Accounting Standards No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. This Statement requires 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 intend to adopt the provisions of Statement of Financial Accounting Standards No. 133 deferred by Statement of Financial Accounting Standards No. 137 in fiscal 2001 and are currently assessing their effect.

In March 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," effective for fiscal years beginning after December 15, 1998. Statement of Position No. 98-1 requires that certain costs of computer software developed or obtained for internal use be capitalized and amortized over the useful life of the related software. We previously expensed the cost of all software development in the period it was incurred. The adoption of Statement of Position No. 98-1 is not expected to have a material effect on our results of operations or financial condition. We intend to adopt the provisions of Statement of Position No. 98-1 in fiscal 2000.

REPORT OF INDEPENDENT ACCOUNTANTS

To the 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 stockholders' equity and partners' capital, cash flows and comprehensive income present fairly, in all material respects, the consolidated financial position of The Goldman Sachs Group, Inc. and Subsidiaries (the "firm") as of November 26, 1999 and November 27, 1998, and the results of their consolidated operations and their consolidated cash flows for each of the three fiscal years in the period ended November 26, 1999, in conformity with accounting principles generally accepted in the United States. These financial statements are the responsibility of the firm'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, 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP
New York, New York
January 21, 2000.

CONSOLIDATED STATEMENTS OF EARNINGS

(in millions, except share and per share amounts)	Year Ended November 1999	1998	1997
Revenues			
Global capital markets			
Investment banking	$ 4,359	$ 3,368	$ 2,587
Trading and principal investments	5,758	2,015	2,303
Asset management and securities services	2,524	2,085	1,456
Interest income	12,722	15,010	14,087
Total revenues	25,363	22,478	20,433
Interest expense	12,018	13,958	12,986
Revenues, net of interest expense	13,345	8,520	7,447
Operating expenses			
Compensation and benefits, excluding employee initial public offering awards	6,459	3,838	3,097
Nonrecurring employee initial public offering awards(1)	2,257	—	—
Amortization of employee initial public offering awards	268	—	—
Brokerage, clearing and exchange fees	446	424	357
Market development	364	287	206
Communications and technology	306	265	208
Depreciation and amortization	337	242	178
Occupancy	314	207	168
Professional services and other	402	336	219
Charitable contribution	200	—	—
Total operating expenses	11,353	5,599	4,433
Pre-tax earnings	1,992	2,921	3,014
(Benefit)/provision for taxes	(716)	493	268
Net earnings	$ 2,708	$ 2,428	$ 2,746
Earnings per share			
Basic	$ 5.69	—	—
Diluted	5.57	—	—
Average common shares outstanding			
Basic	475,883,756	—	—
Diluted	485,803,960	—	—

(1) Includes expense of $666 million related to the initial irrevocable contribution of shares of common stock to a defined contribution plan.

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

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	As of November	
(in millions, except share and per share amounts)	1999	1998
Assets		
Cash and cash equivalents	$ 3,055	$ 2,836
Cash and securities segregated in compliance with U.S. federal and other regulations	9,135	7,887
Receivables from brokers, dealers and clearing organizations	4,490	4,321
Receivables from customers and counterparties	30,140	14,953
Securities borrowed	78,418	69,158
Securities purchased under agreements to resell	37,106	37,484
Right to receive securities	1,604	7,564
Financial instruments owned, at fair value		
Commercial paper, certificates of deposit and time deposits	1,435	1,382
U.S. government, federal agency and sovereign obligations	22,193	24,789
Corporate debt	9,821	10,744
Equities and convertible debentures	16,381	11,066
State, municipal and provincial obligations	756	918
Derivative contracts	30,661	21,299
Physical commodities	562	481
Other assets	4,734	2,498
	$250,491	$217,380
Liabilities and Equity		
Short-term borrowings, including commercial paper	$ 37,756	$ 27,430
Payables to brokers, dealers and clearing organizations	2,129	730
Payables to customers and counterparties	57,405	46,208
Securities loaned	9,169	11,088
Securities sold under agreements to repurchase	40,183	36,257
Obligation to return securities	1,595	9,783
Financial instruments sold, but not yet purchased, at fair value		
U.S. government, federal agency and sovereign obligations	19,170	22,360
Corporate debt	2,642	1,441
Equities and convertible debentures	14,002	6,406
Derivative contracts	28,488	24,722
Physical commodities	586	966
Other liabilities and accrued expenses	6,269	3,699
Long-term borrowings	20,952	19,906
	240,346	210,996
Commitments and contingencies		
Partners' capital allocated for income taxes and potential withdrawals	—	74
Partners' capital	—	6,310
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, 441,421,899 shares issued and outstanding	4	—
Restricted stock units; 76,048,404 units issued and outstanding	4,339	—
Nonvoting common stock, par value $0.01 per share; 200,000,000 shares authorized, 7,440,362 shares issued and outstanding	—	—
Additional paid-in capital	7,359	—
Retained earnings	444	—
Unearned compensation	(2,038)	—
Accumulated other comprehensive income	37	—
	10,145	6,310
	$250,491	$217,380

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

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

	Year Ended November		
(in millions, except per share amounts)	**1999**	1998	1997
Partners' capital			
Balance, beginning of year	**$ 6,310**	$ 6,107	$ 5,309
Transfer of beginning partners' capital allocated for income taxes and potential withdrawals	**74**	–	–
Net earnings	**2,264** [1]	2,428	2,746
Capital contributions	**48**	9	89
Return on capital and certain distributions to partners	**(306)**	(619)	(557)
Termination of profit participation plans	**–**	(368)	–
Transfers to partners' capital allocated for income taxes and potential withdrawals, net	**–**	(1,247)	(1,480)
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	6,107
Common stock, par value $0.01 per share			
Balance, beginning of year	**–**	–	–
Common stock issued	**4**	–	–
Balance, end of year	**4**	–	–
Restricted stock units			
Balance, beginning of year	**–**	–	–
Restricted stock units granted, net of forfeitures of $42 million	**4,339**	–	–
Balance, end of year	**4,339**	–	–
Nonvoting common stock, par value $0.01 per share			
Balance, beginning of year	**–**	–	–
Nonvoting common stock issued	**–**	–	–
Balance, end of year	**–**	–	–
Additional paid-in capital			
Balance, beginning of year	**–**	–	–
Exchange of partnership interests for shares of common stock	**3,901**	–	–
Issuance of common stock	**2,891**	–	–
Issuance of common stock contributed to a defined contribution plan	**674**	–	–
Dividends paid	**(107)** [3]	–	–
Balance, end of year	**7,359**	–	–
Retained earnings			
Balance, beginning of year	**–**	–	–
Net earnings	**444** [4]	–	–
Balance, end of year	**444**	–	–
Unearned compensation			
Balance, beginning of year	**–**	–	–
Restricted stock units granted, net of forfeitures of $23 million	**(2,311)**	–	–
Amortization of restricted stock units	**273**	–	–
Balance, end of year	**(2,038)**	–	–
Accumulated other comprehensive income			
Balance, beginning of year	**–**	–	–
Transfer from partners' capital	**(31)**	–	–
Currency translation adjustment	**68**	–	–
Balance, end of year	**37**	–	–
	$10,145	$ 6,310	$ 6,107

(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

	Year Ended November		
(in millions)	**1999**	1998	1997
Cash flows from operating activities			
Net earnings	**$ 2,708**	$ 2,428	$ 2,746
Noncash items included in net earnings			
Depreciation and amortization	**337**	242	178
Deferred income taxes	**(1,387)**	23	32
Stock-based compensation	**2,989**	—	—
Changes in operating assets and liabilities			
Cash and securities segregated in compliance with U.S. federal and other regulations	**(1,248)**	(2,984)	(670)
Net receivables from brokers, dealers and clearing organizations	**1,453**	(789)	(1,599)
Net payables to customers and counterparties	**(3,990)**	14,664	5,029
Securities borrowed, net	**(11,179)**	(21,158)	(10,814)
Financial instruments owned, at fair value	**(13,718)**	148	(7,439)
Financial instruments sold, but not yet purchased, at fair value	**9,059**	7,559	11,702
Other, net	**2,387**	(71)	905
Net cash (used for)/provided by operating activities	**(12,589)**	62	70
Cash flows from investing activities			
Property, leasehold improvements and equipment	**(656)**	(476)	(259)
Financial instruments owned, at fair value	**189**	(180)	(360)
Acquisitions, net of cash acquired	**(187)**	—	(74)
Net cash used for investing activities	**(654)**	(656)	(693)
Cash flows from financing activities			
Short-term borrowings, net	**755**	2,193	1,082
Securities sold under agreements to repurchase, net	**4,304**	(5,909)	(4,717)
Issuance of long-term borrowings	**11,000**	10,527	7,734
Repayment of long-term borrowings	**(753)**	(2,058)	(1,855)
Capital contributions	**48**	9	89
Dividends paid	**(107)**	—	—
Returns on capital and certain distributions to partners	**(306)**	(619)	(557)
Termination of the profit participation plans	**—**	(368)	—
Proceeds from issuance of common stock	**2,633**	—	—
Partners' capital distributions, net	**(4,112)**	—	—
Partners' capital allocated for income taxes and potential withdrawals	**—**	(1,673)	(2,034)
Net cash provided by/(used for) financing activities	**13,462**	2,102	(258)
Net increase/(decrease) in cash and cash equivalents	**219**	1,508	(881)
Cash and cash equivalents, beginning of year	**2,836**	1,328	2,209
Cash and cash equivalents, end of year	**$ 3,055**	$ 2,836	$ 1,328

SUPPLEMENTAL DISCLOSURES:

Cash payments for interest approximated the related expense for each of the fiscal years presented. Payments of income taxes were $463 million for the year ended November 1999 and were immaterial for the years ended November 1998 and 1997.

Noncash activities:

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

Common stock issued in connection with acquisitions was $245 million in 1999.

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Year Ended November		
(in millions)	**1999**	1998	1997
Net earnings	**$2,708**	$2,428	$2,746
Other comprehensive income, net of tax			
Currency translation adjustment	**37**	(31)	(28)
Comprehensive income	**$2,745**	$2,397	$2,718

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

NOTES TO 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 business 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.) and J. Aron & Company 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 1999, 1998 and 1997 refer to the firm's fiscal year ended, or the date, as the context requires, November 26, 1999, November 27, 1998 and November 28, 1997, 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 where management believes a legal right of setoff exists under an enforceable netting agreement. 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 statement of financial condition as of November 1999 generally reflects purchases and sales of financial instruments, including agency transactions, on a trade date basis. The consolidated statement of financial condition as of November 1998 generally reflects these transactions on a settlement date basis. Recording these transactions on a trade date basis would not have resulted in a material adjustment to the consolidated statement of financial condition as of November 1998.

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 reasonable 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 3, 4 and 5.

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.

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 common stock deliverable pursuant to the restricted stock units and stock options 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 the fiscal year. 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.

As a partnership, the firm reported the cumulative translation adjustment as a component of "Partners' capital allocated for income taxes and potential withdrawals" on the consolidated statement of financial condition. Effective with the firm's conversion to corporate form, the cumulative translation adjustment is reported as "Accumulated other comprehensive income" on the consolidated statement of financial condition.

Accounting Developments

In June 1999, the Financial Accounting Standards Board issued 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, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively, referred to as derivatives), and for hedging activities. This Statement requires 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. The firm intends to adopt the provisions of SFAS No. 133 deferred by SFAS No. 137 in fiscal 2001 and is currently assessing their effect.

In March 1998, the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants issued Statement of Position (SOP) No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use," effective for fiscal years beginning after December 15, 1998. SOP No. 98-1 requires that certain costs of computer software developed or obtained for internal use be capitalized and amortized over the useful life of the related software. The firm previously expensed the cost of all software development in the period it was incurred. The adoption of SOP No. 98-1 is not expected to have a material effect on the firm's results of operations or financial condition. The firm intends to adopt the provisions of SOP No. 98-1 in fiscal 2000.

Note 3/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 5.

Trading and Principal Investments

The firm's Trading and Principal Investments business, a component of the Global Capital Markets segment, facilitates customer transactions and takes proprietary positions through market making in and trading of securities, currencies, commodities and swaps, and other derivatives. 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 expense to specific securities, commodities and other positions in relation to the cash generated by, or funding requirements of, the underlying positions.

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

	Year Ended November		
(in millions)	1999	1998	1997
FICC	$2,862	$1,438	$2,055
Equities	1,961	795	573
Principal Investments	950	146	298
Total	$5,773	$2,379	$2,926

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 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 1999 and 1998, U.S. government and federal agency obligations represented 7% 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 5.

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 payment 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:

	As of November	
(in millions)	**1999**	1998
Interest Rate		
Financial futures and forward settlement contracts	**$ 422,465**	$ 406,302
Swap agreements	**2,581,100**	1,848,977
Written option contracts	**509,841**	423,561
Equity		
Financial futures and forward settlement contracts	**10,082**	7,405
Swap agreements	**3,423**	2,752
Written option contracts	**113,653**	54,856
Currency and Commodity		
Financial futures and forward settlement contracts	**460,941**	420,138
Swap agreements	**110,159**	51,502
Written option contracts	**193,989**	183,929

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:

	As of November	
(in millions)	1999	1998
Purchased Option Contracts		
Interest rate	$484,104	$509,770
Equity	114,680	59,571
Currency and commodity	210,421	186,748

The firm utilizes replacement cost as a 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, owed 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:

	As of November			
	1999		1998	
(in millions)	Assets	Liabilities	Assets	Liabilities
Year End				
Forward settlement contracts	$ 4,555	$ 4,625	$ 4,061	$ 4,201
Swap agreements	12,052	11,587	10,000	11,475
Option contracts	14,018	12,274	7,140	9,038
Total	$30,625	$28,486	$21,201	$24,714
Monthly Average				
Forward settlement contracts	$ 3,877	$ 3,619	$ 4,326	$ 3,979
Swap agreements	10,414	11,210	7,340	8,158
Option contracts	9,249	9,707	6,696	8,958
Total	$23,540	$24,536	$18,362	$21,095

Note 4/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:

	As of November	
(in millions)	**1999**	1998
Commercial paper	**$ 9,403**	$10,008
Promissory notes	**11,061**	10,763
Bank loans and other[1]	**17,292**	6,659
Total[2]	**$37,756**	$27,430

(1) As of November 1999 and November 1998, short-term borrowings included $10.82 billion and $2.96 billion, respectively, of long-term borrowings maturing within one year.

(2) As of November 1999 and November 1998, weighted average interest rates for short-term borrowings, including commercial paper, were 5.66% and 5.19%, respectively.

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

Note 5/Long-Term Borrowings

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

	As of November	
(in millions)	**1999**	1998
Fixed Rate Obligations[1]		
U.S. dollar	**$ 8,236**	$ 5,260
Non-U.S. dollar	**1,980**	2,066
Floating Rate Obligations[2]		
U.S. dollar	**9,697**	11,858
Non-U.S. dollar	**1,039**	722
Total[3]	**$20,952**	$19,906

(1) During 1999 and 1998, interest rates on U.S. dollar fixed rate obligations ranged from 5.56% to 12.00% and from 5.74% to 10.10%, respectively. During 1999 and 1998, non-U.S. dollar fixed rate obligations interest rates ranged from 0.85% to 9.51% and from 1.90% 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 bear fixed or floating interest rates and have maturities that range from one to 30 years from the date of issue.

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

	As of November					
	1999			1998		
(in millions)	U.S. Dollar	Non-U.S. Dollar	Total	U.S. Dollar	Non-U.S. Dollar	Total
Maturity Dates						
1999	$ —	$ —	$ —	$ 2,443	$ 199	$ 2,642
2000	2,527	114	2,641	4,293	272	4,565
2001	3,145	327	3,472	2,261	148	2,409
2002	1,638	594	2,232	1,669	265	1,934
2003	1,522	404	1,926	1,409	412	1,821
2004	1,857	134	1,991	1,310	43	1,353
2005—Thereafter	7,244	1,446	8,690	3,733	1,449	5,182
Total	$17,933	$3,019	$20,952	$17,118	$2,788	$19,906

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:

	As of November			
	1999		1998	
($ in millions)	Amount	Rate	Amount	Rate
Fixed rate obligations	$ 650	10.17%	$ 222	8.09%
Floating rate obligations	20,302	6.03	19,684	5.63
Total	$20,952	6.16	$19,906	5.66

As of November 1999 and November 1998, the notional amounts of the related swap agreements used for nontrading purposes were $12.94 billion and $10.21 billion, respectively.

The fair value and carrying value of these agreements are set forth below:

	As of November			
	1999		1998	
(in millions)	Assets	Liabilities	Assets	Liabilities
Fair value	$ 3	$159	$519	$7
Carrying value	36	2	98	8

Note 6/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 2019. Certain agreements are subject to periodic escalation charges for increases in real estate taxes and other charges. Minimum rental commitments, net of minimum sublease rentals, under noncancelable leases for 2000 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	
2000	$ 203
2001	183
2002	182
2003	181
2004	154
2005–Thereafter	836
Total	$1,739
Net Rent Expense	
1999	**$ 154**
1998	104
1997	87

Other Commitments

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 $1.09 billion and $1.39 billion in corporate and real estate merchant banking investment funds and a bridge loan fund as of November 1999 and November 1998, respectively.

In connection with loan origination and participation, the firm had loan commitments of $9.38 billion and $1.51 billion as of November 1999 and November 1998, 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 also had outstanding guarantees of $575 million and $790 million relating to its fund management activities as of November 1999 and November 1998, respectively.

The firm had pledged securities of $35.83 billion and $22.88 billion as collateral for securities borrowed of approximately equivalent value as of November 1999 and November 1998, respectively.

The firm had commitments to enter into repurchase and resale agreements of $30.58 billion and $46.26 billion as of November 1999 and November 1998, respectively.

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 $10.30 billion and $8.81 billion as of November 1999 and November 1998, respectively.

Note 7/Equity Capital

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 51,000,000 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 (PLPs), retired limited partners, Sumitomo Bank Capital Markets, Inc. and Kamehameha Activities Association for shares of common stock. As of November 1999, the firm had equity of $10.15 billion.

Shares of nonvoting common stock are convertible into shares of common stock on a one-for-one basis upon transfer by Sumitomo Bank Capital Markets, Inc., the beneficial owner of such shares as of November 1999, to a third party, and in certain other circumstances.

As of November 1998, the firm had $6.31 billion in partners' capital, which included both the general partner's and limited partners' capital. Partners' capital allocated for income taxes and potential withdrawals represented management's estimate of net amounts distributable, primarily to the PLPs, under the Partnership Agreement, for items including, among other things, income taxes and capital withdrawals.

Note 8/Earnings Per Share

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

(in millions, except share and per share amounts)	Year Ended November 1999
Numerator for basic and diluted EPS—earnings available to common stockholders	$2,708
Denominator for basic EPS—weighted average number of common shares	475,883,756
Effect of dilutive securities	
Restricted stock units	5,657,350
Stock options	4,262,854
Dilutive potential common shares	9,920,204
Denominator for diluted EPS—weighted average number of common shares and dilutive potential common shares	485,803,960
Basic EPS	$ 5.69
Diluted EPS	5.57

Note 9/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 tables provide a summary of the changes in the plans' projected benefit obligations and the fair value of assets for 1999 and 1998, and a statement of the funded status of the plans as of November 1999 and November 1998:

	November 1999			November 1998		
(in millions)	U.S. Pension	Non-U.S. Pension	Post-retirement	U.S. Pension	Non-U.S. Pension	Post-retirement
Benefit Obligation						
Balance, beginning of year	$108	$120	$ 60	$ 90	$ 77	$ 52
Service cost	4	15	3	3	11	2
Interest cost	8	5	4	7	4	4
Actuarial (gain)/loss	(10)	(4)	(4)	10	30	4
Benefits paid	(2)	(4)	(2)	(2)	(1)	(2)
Effect of foreign exchange rates	—	6	—	—	(1)	—
Balance, end of year	$108	$138	$ 61	$108	$120	$ 60
Fair Value of Plan Assets						
Balance, beginning of year	$133	$ 75	$ —	$131	$ 56	$ —
Actual return on plan assets	17	11	—	4	11	—
Firm contributions	—	26	2	—	10	3
Benefits paid	(2)	(4)	(2)	(2)	(1)	(3)
Effect of foreign exchange rates	—	2	—	—	(1)	—
Balance, end of year	$148	$110	$ —	$133	$ 75	$ —
Prepaid/(Accrued) Benefit Cost						
Funded Status	$ 40	$ (28)	$(61)	$ 25	$ (45)	$(60)
Unrecognized actuarial loss	2	14	5	20	23	9
Unrecognized transition obligation	(37)	23	—	(40)	22	—
Unrecognized prior service cost	—	—	(2)	—	—	(2)
Prepaid/(accrued) benefit cost	$ 5	$ 9	$(58)	$ 5	$ —	$(53)

For plans in which the accumulated benefit obligation exceeded plan assets, the projected benefit obligation and aggregate accumulated benefit obligation was $138 million and $121 million as of November 1999, respectively, and $85 million and $85 million as of November 1998, respectively. The fair value of plan assets for these plans was $110 million and $57 million as of November 1999 and November 1998, 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 expense/(income) and postretirement expense are set forth below:

	Year Ended November 1999			Year Ended November 1998		
(in millions)	U.S. Pension	Non-U.S. Pension	Post-retirement	U.S. Pension	Non-U.S. Pension	Post-retirement
Service cost	$ 4	$15	$3	$ 3	$11	$2
Interest cost	8	5	4	7	4	4
Expected return on plan assets	(10)	(5)	—	(10)	(4)	—
Net amortization	(2)	3	—	(3)	2	—
Total	$ —	$18	$7	$ (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		
	1999	1998	1997
Defined Benefit Pension Plans			
U.S. Plans			
Discount rate	7.5%	7.0%	7.5%
Rate of increase in future compensation levels	5.0	5.0	5.0
Expected long-term rate of return on plan assets	7.5	7.5	7.5
International Plans			
Discount rate	4.6	5.0	5.7
Rate of increase in future compensation levels	4.3	4.7	5.3
Expected long-term rate of return on plan assets	6.0	6.0	7.0
Postretirement Plans			
Discount rate	7.5	7.0	7.5
Rate of increase in future compensation levels	5.0	5.0	5.0

For measurement purposes, a 6.6% annual rate of increase in the per capita cost of covered healthcare benefits was assumed for the fiscal year ending November 2000. 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:

	1% Increase		1% Decrease	
(in millions)	**1999**	1998	**1999**	1998
Cost	**$1**	$1	**$(1)**	$(1)
Obligation	**9**	9	**(8)**	(7)

Defined Contribution Plans

The firm contributes to employer-sponsored U.S. and international defined contribution plans. The firm's contribution to these plans was $94 million, $70 million and $68 million for 1999, 1998 and 1997, 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 in 1999 and outstanding as of November 1999 were 12,660,685. 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 in 1999 was $674 million, including $666 million granted in connection with the firm's initial public offering.

Note 10/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 stock incentive plan also permits the making of loans to purchase shares of common stock.

The total number of shares of common stock that may be issued under the stock incentive plan through fiscal 2002 may not exceed 300,000,000 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 1999, 183,440,631 shares were available for grant under the stock incentive plan.

Restricted Stock Units

The firm issued restricted stock units to employees in 1999 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 1999, (i) 40,344,481 units required future service as a condition to the delivery of the underlying shares of common stock, and (ii) 35,703,923 units 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 1999 is set forth below:

	Restricted Stock Units Outstanding	
(in millions, except unit amounts)	No Future Service Required	Future Service Required
Outstanding, beginning of year	—	—
Granted	36,127,314	40,780,999
Forfeited	(355,177)	(436,518)
Delivered	(68,214)	—
Outstanding, end of year	35,703,923	40,344,481
Noncash compensation expense, net of forfeitures	$2,042	$273

The future noncash compensation expense related to the restricted stock units for which future service is required is set forth below:

(in millions)	Compensation Expense
2000	$ 733
2001	610
2002	429
2003	214
2004	52
Total	$2,038

Stock Options

Stock options granted to employees during 1999 will generally become exercisable in equal 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 exceptions 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 1999 is set forth below:

	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Life (years)
Outstanding, beginning of year	—	$ —	—
Granted	40,863,172	52.91	—
Exercised	—	—	—
Forfeited	(503,506)	53.00	—
Outstanding, end of year	40,359,666	52.91	9.42

The weighted average fair value of options granted through November 1999 was $16.13 per option. Fair value is estimated as of the grant date based on a binomial option pricing model using the following weighted average assumptions:

Risk-free interest rate	6.1%
Expected life	7 years
Expected volatility	30.0%
Dividend yield	1.0%

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 follows:

(in millions, except per share amounts)	Year Ended November 1999
Net earnings, as reported	$2,708
Pro forma net earnings	2,650
EPS, as reported	
Basic	$ 5.69
Diluted	5.57
Pro forma EPS	
Basic	$ 5.57
Diluted	5.45

In the table above, pro forma compensation expense associated with option grants is recognized over the relevant vesting period. The effect of applying SFAS No. 123 in the pro forma disclosure above is not representative of the potential pro forma effect on net earnings in future periods.

Note 11/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 (benefit)/expense reflected on the consolidated statements of earnings are set forth below:

	Year Ended November		
(in millions)	**1999**	1998	1997
Current Taxes			
U.S. federal	**$ 16**	$ 16	$ 5
State and local	**67**	28	87
Non-U.S.	**588**	426	144
Total current tax expense	**671**	470	236
Deferred Taxes			
U.S. federal	**(688)**	–	–
State and local	**(342)**	(3)	(4)
Non-U.S.	**(357)**	26	36
Total deferred tax (benefit)/expense	**(1,387)**	23	32
Net tax (benefit)/expense	**$ (716)**	$493	$268

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. Additionally, deferred tax assets were recorded as a result of acquisitions during 1999.

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

	As of November	
(in millions)	**1999**	1998
Deferred Tax Assets		
Compensation and benefits	**$1,397**	$44
Foreign tax credits	**140**	–
Depreciation and amortization	**57**	14
Other, net	**226**	14
	1,820	72
Less: valuation allowance [1]	**(83)**	–
Total deferred tax assets	**1,737**	72
Deferred Tax Liabilities		
Unrealized gains	**257**	33
Total deferred tax liabilities	**257**	33
Net deferred tax assets	**$1,480**	$39

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

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		
	1999	1998 (1)	1997 (1)
U.S. federal statutory income tax rate	**35.0%**	—%	—%
Increase related to:			
State and local taxes, net of U.S. income tax effects	**5.0**	0.9	2.8
Foreign	**—**	15.5	6.0
Other	**—**	0.5	0.1
Rate before one-time events	**40.0**	16.9	8.9
Revaluation of deferred tax assets upon change in tax status	**(41.4)** (2)	—	—
Rate benefit for partnership period	**(37.7)** (3)	—	—
Other	**3.2**	—	—
Total tax (benefit)/expense	**(35.9)%**	16.9%	8.9%

(1) The U.S. federal statutory income tax rate is not applicable to 1998 or 1997 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 and 1997.

(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.

Note 12/Regulated Subsidiaries

GS&Co. is a registered U.S. broker-dealer subsidiary, which is subject to the Securities and Exchange Commission's "Uniform Net Capital Rule," and has elected to compute its net capital in accordance with the "Alternative Net Capital Requirement" of that rule. As of November 1999 and November 1998, GS&Co. had regulatory net capital, as defined, of $2.92 billion and $3.25 billion, respectively, which exceeded the amounts required by $2.31 billion and $2.70 billion, respectively.

GSI, a registered U.K. broker-dealer and subsidiary of Group Inc., 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 Japanese Ministry of Finance and the Financial Supervisory Agency. As of November 1999 and November 1998, 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 1999 and November 1998, these subsidiaries were in compliance with their local capital adequacy requirements.

Note 13/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. 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 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 agency transactions for clients on major stock 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 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 allocated to the Trading and Principal Investments component of Global Capital Markets and the Securities Services component of Asset Management and Securities Services. 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 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)		**1999**	1998	1997
Global Capital Markets	Net revenues(1)	**$ 10,132**	$ 5,747	$ 5,513
	Operating expenses(2)	**6,232**	3,978	3,228
	Pre-tax earnings(3)	**$ 3,900**	$ 1,769	$ 2,285
	Segment assets	**$ 127,515**	$ 102,724	$ 99,974
Asset Management and Securities Services	Net revenues(1)	**$ 3,213**	$ 2,773	$ 1,934
	Operating expenses(2)	**2,396**	1,621	1,205
	Pre-tax earnings(3)	**$ 817**	$ 1,152	$ 729
	Segment assets	**$ 121,693**	$ 114,293	$ 78,193
Total	Net revenues(1)	**$ 13,345**	$ 8,520	$ 7,447
	Operating expenses(2)	**11,353**(5)	5,599	4,433
	Pre-tax earnings	**$ 1,992**	$ 2,921	$ 3,014
	Total assets(4)	**$250,491**	$ 217,380	$ 178,401

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

	Year Ended November		
(in millions)	**1999**	1998	1997
Global Capital Markets	**$ 15**	$ 364	$ 623
Asset Management and Securities Services	**689**	688	478
Total net interest	**$704**	$1,052	$1,101

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

	Year Ended November		
(in millions)	**1999**	1998	1997
Global Capital Markets	**$228**	$ 158	$ 119
Asset Management and Securities Services	**109**	84	59
Total depreciation and amortization	**$337**	$ 242	$ 178

(3) The pre-tax earnings of the firm's segments in 1999 reflect payments for services rendered by managing directors who, prior to the firm's conversion to corporate form, were profit participating limited partners. In prior years, these payments were accounted for as distributions of partners' capital rather than as compensation and benefits expense. As a result, these payments are not reflected in the operating expenses of the firm's segments in 1998 and 1997 and, therefore, the pre-tax earnings of the firm's segments in these years are not comparable with 1999.

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

(5) Includes 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.

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

	Year Ended November		
(in millions)	**1999**	1998	1997
Financial Advisory	**$ 2,270**	$1,774	$1,184
Underwriting	**2,089**	1,594	1,403
Investment Banking	**4,359**	3,368	2,587
FICC	**2,862**	1,438	2,055
Equities	**1,961**	795	573
Principal Investments	**950**	146	298
Trading and Principal Investments	**5,773**	2,379	2,926
Total Global Capital Markets	**10,132**	5,747	5,513
Asset Management	**919**	675	458
Securities Services	**772**	730	487
Commissions	**1,522**	1,368	989
Total Asset Management and Securities Services	**3,213**	2,773	1,934
Total net revenues	**$13,345**	$8,520	$7,447

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:

	Year Ended November		
(in millions)	1999	1998	1997
Net Revenues			
United States	$ 8,536	$ 5,133	$ 4,724
Other Americas	327	308	379
United Kingdom	3,103	1,893	1,570
Other Europe	375	333	190
Asia	1,004	853	584
Total net revenues	$ 13,345	$ 8,520	$ 7,447
Pre-tax Earnings[1]			
United States	$ 2,878	$ 1,315	$ 1,737
Other Americas	184	209	302
United Kingdom	1,203	746	625
Other Europe	198	216	89
Asia	254	435	261
Other	(2,725)[3]	—	—
Total pre-tax earnings	$ 1,992	$ 2,921	$ 3,014
Identifiable Assets			
United States	$ 238,875	$ 213,971	$ 189,622
Other Americas	6,118	6,596	8,512
United Kingdom	119,350	94,025	69,260
Other Europe	11,737	8,820	7,555
Asia	18,088	19,536	13,085
Eliminations and other[2]	(143,677)	(125,568)	(109,633)
Total identifiable assets	$ 250,491	$ 217,380	$ 178,401

(1) The pre-tax earnings of the firm in 1999 reflect payments for services rendered by managing directors who, prior to the firm's conversion to corporate form, were profit participating limited partners. In prior years, these payments were accounted for as distributions of partners' capital rather than as compensation and benefits expense. As a result, these payments are not reflected in the firm's operating expenses in 1998 and 1997 and, therefore, the pre-tax earnings in these years are not comparable with 1999.

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

(3) Includes the following expenses that have not been allocated to the firm's geographic regions: (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.

Note 14/Subsequent Events

On December 20, 1999, the Board of Directors of Group Inc. declared a dividend of $0.12 per share to be paid on February 24, 2000 to voting and nonvoting common shareholders of record on January 24, 2000.

SUPPLEMENTAL FINANCIAL INFORMATION

Quarterly Results (unaudited)

The following represents the firm's unaudited quarterly results for 1999 and 1998. 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 management, necessary for a fair presentation of the results.

	1999 Fiscal Quarter			
(in millions, except per share data)	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.

	1998 Fiscal Quarter			
(in millions)	First	Second	Third	Fourth
Total revenues	$5,903	$ 6,563	$5,735	$4,277
Interest expense	3,431	3,574	3,591	3,362
Revenues, net of interest expense	2,472	2,989	2,144	915
Operating expenses	1,450	1,952	1,389	808
Pre-tax earnings	1,022	1,037	755	107
Provision for taxes	138	190	102	63
Net earnings	$ 884	$ 847	$ 653	$ 44

Stock Price Range

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

	1999 Fiscal Quarter							
	First		Second		Third		Fourth	
	High	Low	High	Low	High	Low	High	Low
Closing price (in dollars)	—	—	74.13	64.50	72.25	55.81	82.81	57.69

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Information about the firm, including all quarterly earnings releases and financial filings with the Securities and Exchange Commission, can be accessed at our Web site: www.gs.com.

Shareholder inquiries can also be directed to Investor Relations online at investor-relations@gs.com or by calling 212-357-2674.

Annual Report on Form 10-K for 1999

Copies of the firm's Annual Report on Form 10-K as filed with the Securities and Exchange Commission can be accessed on our Web site at www.gs.com/shareholders/. Copies can also be obtained by contacting Investor Relations at investor-relations@gs.com or by calling 212-357-2674.

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OUR BUSINESS PRINCIPLES

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.

13/Our business is highly competitive, and we aggressively seek to expand our client relationships. However, we must always be fair competitors and must never denigrate other firms.

14/Integrity and honesty are at the heart of our business. We expect our people to maintain high ethical standards in everything they do, both in their work for the firm and in their personal lives.

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