

GREENHILL & CO INC
Form 10-K
February 28, 2012
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2011.

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____
Commission file number 001-32147

GREENHILL & CO., INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware **51-0500737**
(State or Other Jurisdiction) (I.R.S. Employer
Identification No.)
of Incorporation or Organization)
300 Park Avenue **10022**
New York, New York (ZIP Code)
(Address of Principal Executive Offices)
Registrant's telephone number, including area code: (212) 389-1500

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
Common Stock, par value \$.01 per share	New York Stock Exchange
Securities registered pursuant to Section 12(g) of the Act: None	

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The aggregate market value of the common stock held by non-affiliates of the registrant, computed by reference to the closing price as of the last business day of the registrant's most recently completed second fiscal quarter, June 30, 2011, was approximately \$1,475 million. The registrant has no non-voting stock.

As of February 15, 2012, there were 28,914,677 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's definitive proxy statement to be delivered to stockholders in connection with the 2012 annual meeting of stockholders to be held on April 18, 2012 are incorporated by reference in response to Part III of this Report.

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PART I

When we use the terms Greenhill , we , us , our , the company , and the firm , we mean Greenhill & Co., Inc., a Delaware corporation, and its consolidated subsidiaries. Our principal advisory subsidiaries are Greenhill & Co., LLC, a registered broker-dealer regulated by the Securities and Exchange Commission which provides investment banking and capital advisory services in North America; Greenhill & Co. International LLP, which provides investment banking and capital advisory services in Europe and is regulated by the United Kingdom Financial Services Authority; and Greenhill Caliburn Pty Limited, which provides investment banking services in Australia and is regulated by the Australian Securities and Investment Commission.

Item 1. Business

Overview

Greenhill is a leading independent investment bank focused on providing financial advice on significant mergers, acquisitions, restructurings, financings and capital raising to corporations, partnerships, institutions and governments. We act for clients located throughout the world from our offices in New York, London, Frankfurt, Sydney, Tokyo, Toronto, Chicago, Dallas, Houston, Los Angeles, Melbourne and San Francisco.

We were established in 1996 by Robert F. Greenhill, the former President of Morgan Stanley and former Chairman and Chief Executive Officer of Smith Barney. Since our founding, Greenhill has grown steadily, recruiting a number of managing directors from major investment banks (as well as senior professionals from other institutions), with a range of geographic, industry and transaction specialties as well as different sets of corporate management and other relationships. As part of this expansion, we opened a London office in 1998, opened a Frankfurt office in 2000 and began offering financial restructuring advice in 2001. On May 11, 2004, we converted from a limited liability company to a corporation, and completed an initial public offering of our common stock. We opened our Dallas office in 2005 and our Toronto office in 2006. In 2008, we opened offices in Chicago, San Francisco and Tokyo, and we entered the capital advisory business, which provides capital raising advice and related services to private equity and real estate funds. We opened our Houston and Los Angeles offices in 2009. In 2010, we acquired Caliburn Partnership Pty Limited (Caliburn or Greenhill Caliburn), with offices in Sydney and Melbourne.

Prior to 2011, we also managed merchant banking funds and similar vehicles. We raised our first private equity fund in 2000, our first venture capital fund in 2006 and our first European merchant banking fund in 2007. We completed the initial public offering of our special purpose acquisition company, GHL Acquisition Corp., in 2008, and that entity merged with Iridium Communications, Inc. (Iridium) in 2009. Following our exit from this business in 2010, we began to liquidate our historical principal investments in the merchant banking funds and Iridium and we intend to continue that process.

As of December 31, 2011, we had 316 employees globally, including 63 managing directors and 13 senior advisors. In January 2012, we promoted five of our principals to managing director.

Table of Contents**Principal Sources of Revenue**

Our principal sources of revenues are advisory and, historically, merchant banking.

	2011	For the Year Ended December 31,			2007
		2010	2009	2008	
		(In millions)			
Advisory revenues	\$ 302.8	\$ 252.2	\$ 216.0	\$ 218.2	\$ 366.7
Merchant banking and other investment revenues ^{(1) (2)}	(8.8)	26.1	82.6	3.7	33.7
Total revenues	\$ 294.0	\$ 278.3	\$ 298.6	\$ 221.9	\$ 400.4

(1) Effective at the close of business on December 31, 2010, we completed our separation from the historic merchant banking business and we ceased earning management fees. We retained our existing portfolio of investments and consequently we will continue to recognize gains and losses on those investments until liquidated.

(2) See chart detailing merchant banking revenues in Management's Discussion and Analysis of Financial Condition and Results of Operations Results of Operations Merchant Banking and Other Investment Revenues .

Advisory

We provide advisory services in connection with mergers and acquisitions, financings, restructurings, and capital raisings. For all of our advisory services, we draw on the extensive experience, corporate relationships and industry expertise of our managing directors and senior advisors.

On mergers and acquisitions engagements, we provide a broad range of advice to global clients in relation to domestic and cross-border mergers, acquisitions, and similar corporate finance matters and are generally involved at each stage of these transactions, from initial structuring to final execution. Our focus is on providing high-quality advice to senior executive management and boards of directors of prominent large and mid-cap companies and to governments in transactions that typically are of the highest strategic and financial importance to those organizations. We advise clients on strategic matters, including acquisitions, divestitures, defensive tactics, special committee projects and other important corporate events. We provide advice on valuation, tactics, industry dynamics, structuring alternatives, timing and pricing of transactions, and financing alternatives. Where requested to do so, we may provide an opinion regarding the fairness of a transaction.

In our financing advisory and restructuring practice, we advise debtors, creditors, governments and companies experiencing financial distress as well as potential acquirers of distressed companies and assets. We provide advice on valuation, restructuring alternatives, capital structures, and sales or recapitalizations. We also assist those clients who seek court-assisted reorganizations by developing and seeking approval for plans of reorganization as well as the implementation of such plans.

In our private capital and real estate capital advisory business we assist fund managers and sponsors in raising capital for new funds and provide related advisory services to private equity and real estate funds and other organizations globally. We also advise on secondary transactions.

Advisory revenues accounted for 103% (due to a loss in merchant banking and other investment revenues) and 91% of our total revenues in 2011 and 2010, respectively. Non-U.S. clients are a significant part of our business, generating 58% and 46% of our advisory revenues in 2011 and 2010, respectively. We generate revenues from our advisory services by charging our clients fees. While fees payable upon the successful conclusion of a transaction or closing of a fund generally represent the largest portion of our advisory fees, we also earn on-going retainer and strategic advisory fees, and fees payable upon the commencement of an engagement or upon the

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achievement of certain milestones, such as the announcement of a transaction or the rendering of a fairness opinion and, in our capital advisory business, upon our client's acceptance of capital commitments before the final closing of the fund.

Merchant Banking and Other Investments

We exited the merchant banking business on December 31, 2010. Prior to that time, our merchant banking activities consisted primarily of management of and investment in Greenhill's merchant banking funds, Greenhill Capital Partners I (or "GCP I"), Greenhill Capital Partners II (or "GCP II"), and collectively with GCP I, Greenhill Capital Partners (or "GCP"), Greenhill SAV Partners (or "GSAVP") and Greenhill Capital Partners Europe (or "GCP Europe"), which are families of merchant banking funds. Merchant banking funds are private investment funds raised from contributions by qualified institutional investors and financially sophisticated individuals that generally make investments in non-public companies, typically with a view toward divesting within 3 to 5 years. At the time of our exit, GCP Capital Partners Holdings LLC (or "GCP Capital"), an entity principally owned by former Greenhill employees and is independent from the firm, took over the management of our merchant banking funds. The firm retained its investments in the merchant banking funds and Iridium and began to liquidate those investments in 2011.

Merchant banking and other investment revenues accounted for negative 3% (a loss) and 9% of our revenues in 2011 and 2010, respectively. In the past, we generated merchant banking revenue from (i) management fees paid by the funds we managed, (ii) gains (or losses) on our investments in the merchant banking funds and other investments, principally Iridium, and (iii) merchant banking profit overrides. Beginning in 2011, we no longer generated management fees; however, we will continue to generate investment revenue principally from gains (or losses) on the existing investments in the merchant banking funds and Iridium until these investments are liquidated.

Employees

Our managing directors and senior advisors have an average of 25 years of relevant experience, which they use to advise on mergers and acquisitions, financing advisory and restructuring transactions, and capital raising. We spend significant amounts of time training and mentoring our junior professionals. We generally provide our junior professionals with exposure to mergers and acquisitions and financing advisory and restructurings to varying degrees, which provides us with the flexibility to allocate resources depending on the economic environment, and provides our bankers consistent transactional experience and a wide variety of experiences to assist in the development of business and financial judgment.

As of December 31, 2011, Greenhill employed a total of 316 people (including our managing directors and senior advisors), all in our advisory business, of which 174 were located in our North American offices, 81 were based in our European offices, 47 in our Australian offices, and 14 in our Japanese office. During 2011, we did not have any employees dedicated to merchant banking activities. The vast majority of our accounting, operational and administrative employees are located in the United States. We strive to maintain a work environment that fosters professionalism, excellence, diversity, and cooperation among our employees worldwide. We utilize a comprehensive evaluation process at the end of each year to measure performance, determine compensation and provide guidance on opportunities for improved performance.

Competition

As an investment bank providing advisory services, we operate in a highly competitive environment where there are no long-term contracted sources of revenue. Each revenue-generating engagement is separately awarded and negotiated. Our list of clients with whom there is an active revenue-generating engagement changes continually. To develop new client relationships, and to develop new engagements from historic client relationships, we maintain a business dialogue with a large number of clients and potential clients, as well as with their financial and legal advisors, on an ongoing basis. We have gained a significant number of new clients each

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year through our business development initiatives, through recruiting additional senior investment banking professionals who bring with them client relationships and expertise in certain industry sectors or geographies and through referrals from members of boards of directors, attorneys and other parties with whom we have relationships. At the same time, we lose clients each year as a result of the sale or merger of a client, a change in a client's senior management, competition from other investment banks and other causes.

The financial services industry is intensely competitive, and we expect it to remain so. Our competitors are global universal banking firms, mid-sized full service financial firms and specialized financial advisory firms. We compete with some of our competitors globally and with others on a regional, product or niche basis. We compete on the basis of a number of factors, including transaction execution skills, our range of products and services, innovation, reputation and price.

The global universal banking firms have the ability to offer a wider range of products, from loans, deposit-taking and insurance to brokerage, asset management and investment banking services, which may enhance their competitive position. They also have the ability to support their investment banking operations with commercial banking, insurance and other financial services revenues in an effort to gain market share, which could result in pricing pressure in our businesses. In addition to our larger competitors, over the last few years, a number of new, smaller independent boutique investment banks have emerged which offer independent advisory services on a model similar to ours and some of these firms have grown rapidly.

We believe our primary competitors in securing mergers and acquisitions and financing advisory and restructuring engagements are diversified financial institutions including Bank of America Corporation, Barclays Bank PLC, Citigroup Inc., Credit Suisse, Deutsche Bank AG, Goldman Sachs Group, Inc., JPMorgan Chase & Co., Morgan Stanley, UBS A.G. as well as other investment banking firms such as Blackstone Group, Evercore Partners Inc., Jefferies Group, Inc., Lazard Ltd. and many closely held independent firms. We believe our primary competitors in securing private capital advisory engagements are Credit Suisse, Lazard Ltd., Park Hill, and UBS A.G.

Competition is also intense for the hiring and retention of qualified employees. Our ability to continue to compete effectively in our business will depend upon our ability to attract new employees and retain and motivate our existing employees.

Regulation

Our business, as well as the financial services industry generally, is subject to extensive regulation in the United States, Europe, Australia, Japan and elsewhere. As a matter of public policy, regulatory bodies in the United States and the rest of the world are charged with safeguarding the integrity of the securities and other financial markets and with protecting the interests of customers participating in those markets. In the United States, the Securities and Exchange Commission (SEC) is the federal agency responsible for the administration of the federal securities laws. Greenhill & Co., LLC, a wholly-owned subsidiary of Greenhill through which we conduct our U.S. advisory business, is registered as a broker-dealer with the SEC and the Financial Industry Regulatory Authority (FINRA), and is licensed in all 50 states and the District of Columbia. Greenhill & Co., LLC is subject to regulation and oversight by the SEC. In addition, FINRA, a self-regulatory organization that is subject to oversight by the SEC, adopts and enforces rules governing the conduct, and examines the activities, of its member firms, including Greenhill & Co., LLC. State and local securities regulators also have regulatory or oversight authority over Greenhill & Co., LLC. Greenhill & Co. LLC is also registered as a municipal advisor with the SEC and the Municipal Securities Rulemaking Board. Similarly, Greenhill & Co. International LLP and Greenhill & Co. Europe LLP, our controlled affiliated partnerships with offices in the United Kingdom and Germany, respectively, through which we conduct our European advisory business, are licensed by and also subject to regulation by the United Kingdom's Financial Services Authority (FSA). Greenhill Caliburn, our Australian subsidiary, is licensed and subject to regulation by the Australian Securities and Investment Commission (ASIC). Greenhill & Co. Japan is registered with the Kanto Local Finance Bureau in Japan and is

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subject to regulation by the Financial Services Agency in Japan. Our business may also be subject to regulation by other governmental and regulatory bodies and self-regulatory authorities in other countries where Greenhill operates.

Broker-dealers are subject to regulations that cover all aspects of the securities business, including capital structure, record-keeping, and the conduct and qualifications of directors, officers and employees. Additional legislation, changes in rules promulgated by self-regulatory organizations or changes in the interpretation or enforcement of existing laws and rules, either in the United States or elsewhere, may directly affect the mode of operation and profitability of Greenhill.

The U.S. and non-U.S. government agencies and self-regulatory organizations, as well as state securities commissions in the United States, are empowered to conduct administrative proceedings that can result in censure, fine, the issuance of cease-and-desist orders or the suspension or expulsion of a broker-dealer or its directors, officers or employees.

In addition, Greenhill Capital Partners, LLC, our wholly owned subsidiary, which operated as and will continue to operate as general partner of GCP I and GCP II, is a registered investment adviser under the Investment Advisers Act of 1940. As such, it is subject to regulation and periodic examinations by the SEC.

Where You Can Find Additional Information

Greenhill & Co., Inc. files current, annual and quarterly reports, proxy statements and other information required by the Securities Exchange Act of 1934, as amended (the Exchange Act), with the SEC. You may read and copy any document the company files at the SEC's public reference room located at 100 F Street, N.E., Washington, D.C. 20549, U.S.A. Please call the SEC at 1-800-SEC-0330 for further information on the public reference room. The firm's SEC filings are also available to the public from the SEC's internet site at <http://www.sec.gov>. Copies of these reports, proxy statements and other information can also be inspected at the offices of the New York Stock Exchange, Inc., 20 Broad Street, New York, New York 10005, U.S.A.

Our public internet site is <http://www.greenhill.com>. We make available free of charge through our internet site, via a link to the SEC's internet site at <http://www.sec.gov>, our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and Forms 3, 4 and 5 filed on behalf of directors and executive officers and any amendments to those reports filed or furnished pursuant to the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Also posted on our website in the Corporate Governance section, and available in print upon request of any stockholder to our Investor Relations Department, are charters for our Audit Committee, Compensation Committee and Nominating & Corporate Governance Committee, our Corporate Governance Guidelines, Related Party Transaction Policy and Code of Business Conduct & Ethics governing our directors, officers and employees. You may need to have Adobe Acrobat Reader software installed on your computer to view these documents, which are in PDF format. The information on our website is not, and shall not be deemed to be, a part hereof or incorporated into this or any of our other filings with the SEC.

Item 1A. Risk Factors

Our ability to retain our senior managing directors is critical to the success of our business

The success of our business depends upon the personal reputation, judgment, integrity, business generation capabilities and project execution skills of our managing directors and senior advisors, particularly our senior managing directors. Our managing directors' personal reputations and relationships with our clients are a critical element in obtaining and maintaining client engagements. Accordingly, the retention of our managing directors is particularly crucial to our future success. The departure or other loss of Mr. Greenhill, our founder and Chairman, Scott L. Bok, our Chief Executive Officer, the regional heads of businesses in North America, Europe, Australia, or Japan, or the departure or other loss of other senior managing directors, each of whom manages

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substantial client relationships and possesses substantial experience and expertise, could materially adversely affect our ability to secure and successfully complete engagements, which would materially adversely affect our results of operations.

In addition, if any of our managing directors were to join an existing competitor or form a competing company, some of our clients could choose to use the services of that competitor instead of our services. There is no guarantee that the compensation arrangements and non-competition agreements we have entered into with our managing directors are sufficiently broad or effective to prevent our managing directors from resigning to join our competitors or that the non-competition agreements would be upheld if we were to seek to enforce our rights under these agreements.

Almost all of our revenues are derived from advisory fees

We have historically earned a significant portion of our revenues from advisory fees paid to us by our clients, in large part upon the successful completion of the client's transaction, restructuring or fund raising. Advisory revenues represented 103% (due to a loss in merchant banking and other investment revenues) and 91% of our total revenues in 2011 and 2010, respectively. Unlike diversified investment banks, which generate revenues from securities trading and underwriting, our only other source of revenue is gains or losses which we may generate from our investments in Iridium and merchant banking funds, which will decline over time as we liquidate our investments. As a result, a decline in our advisory engagements or the market for advisory services generally would have a material adverse effect on our business and results of operations.

Our engagements are singular in nature and do not provide for subsequent engagements

Our clients generally retain us on a non-exclusive, short-term, engagement-by-engagement basis in connection with specific transactions or projects, rather than under long-term contracts covering potential additional future services. As these transactions are singular in nature and our engagements are not likely to recur, we must seek out new engagements when our current engagements are successfully completed or are terminated. As a result, high activity levels in any period are not necessarily indicative of continued high levels of activity in the next-succeeding or any other period. In addition, when an engagement is terminated, whether due to the cancellation of a transaction due to market reasons or otherwise, we may earn limited or no fees and may not be able to recoup the costs that we incurred prior to that termination.

A high percentage of our advisory revenues are derived from a few clients and the termination of any one advisory engagement could reduce our revenues and harm our operating results

Each year, we advise a limited number of clients. Our top ten client engagements accounted for 35% of our total revenues in 2011 and 36% of our total revenues in 2010. We did not have any client engagements that accounted for 10% or more of our total revenue in 2011 or 2010. We earned \$1 million or more from 74 clients in 2011, compared to 57 in 2010, of which 26% of the clients were new to the firm in 2011. While the composition of the group comprising our largest clients varies significantly from year to year, we expect that our advisory engagements will continue to be limited to a relatively small number of clients and that an even smaller number of those clients will account for a high percentage of revenues in any particular year. As a result, the adverse impact on our results of operation of one lost engagement or the failure of one transaction or restructuring or fund raising on which we are advising to be completed can be significant.

We generate a significant portion of our revenues from our services in connection with mergers and acquisitions and we have not historically been able to offset a decline in revenues from merger and acquisition services with revenues from our financing advisory and restructuring services

During a period when mergers and acquisitions activity declines and debt defaults increase, we increasingly rely on financing advisory and restructuring and bankruptcy services as a source of new business. We provide various restructuring and restructuring-related advice to companies in financial distress or their creditors or other

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stakeholders. A number of factors affect demand for these advisory services, including general economic conditions and the availability and cost of debt and equity financing. Presently, our financing advisory and restructuring business is significantly smaller than our mergers and acquisitions advisory business, and we have been unable to offset declines in mergers and acquisitions revenue with revenue generated from financing advisory and restructuring assignments and expect that we will be unlikely to do so in the foreseeable future. Despite adverse market conditions, the number of debt defaults and bankruptcies has remained limited, diminishing our ability to generate revenue from financing advisory and restructuring activities. To the extent that there is limited debt default activity our ability to generate revenue from financing advisory and restructuring activities may be adversely affected.

Fees earned in connection with advisory assignments in the bankruptcy context may be subject to challenge and reduction

In our advisory business we, from time to time, advise debtors or creditors of companies which are involved in bankruptcy proceedings in the United States Bankruptcy Courts. Under the applicable rules of those courts, our fees are subject to approval by the court and other interested parties have the ability to challenge the payment of those fees. Fees earned and reflected in our revenues may from time to time be subject to successful challenges, which could result in a reduction of revenues and affect our stock price adversely.

Our business has been adversely affected by difficult market conditions and may continue to be adversely affected by market uncertainty, volatility, disruptions in the credit and equity markets and other unfavorable economic, geopolitical or market conditions

Adverse market or economic conditions would likely affect the number, size and timing of transactions on which we provide advice and therefore adversely affect our advisory fees. As demonstrated over the past few years, economic uncertainty, volatility, slow economic growth and weak financial markets negatively impact merger and acquisition and capital raising activity. Our clients engaging in mergers and acquisitions often rely on access to the credit and/or equity markets to finance their transactions. The lack of available credit, the absence of dependable equity markets and the increased cost of credit can adversely affect the size, volume, timing and ability of our clients to successfully complete merger and acquisition transactions and adversely affect our advisory business. Furthermore, market volatility also affects our clients ability and willingness to engage in stock-for-stock transactions.

While we operate in North America, Europe, Australia, and Asia our operations in the United States and Europe historically have provided most of our revenues and earnings. Consequently, our revenues and profitability are particularly affected by economic conditions in these locations. Credit downgrades of government debt in the United States and Europe could adversely affect the volume of activity in those markets and therefore, adversely affect our revenues and earnings.

Adverse market or economic conditions, including continuing volatility in the equity markets, limited access to credit as well as a slowdown of economic activity could also adversely affect the business operations of Iridium and other companies in which we have investments, and therefore, our earnings. In addition, during a market downturn, there may be fewer opportunities to exit and realize value from our investments in merchant banking funds and Iridium.

Our capital advisory business is dependent on the availability of private capital for deployment in illiquid asset classes such as private equity and real estate funds

In our capital advisory business we assist fund managers and sponsors in raising capital for new private funds. Our ability to find suitable engagements and earn fees in this business depends on the availability of private and public capital for investments in illiquid assets such as private equity and real estate funds. Following the onset of the financial crisis, there was a shortage of such capital, and far fewer new funds were raised than in the period preceding the crisis. In addition, new funds raised in the current environment generally obtain smaller aggregate

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capital commitments than in earlier years, and the fund raising process takes longer to complete. To the extent private and public capital focused on illiquid investment opportunities remains limited, our ability to earn fees in the capital advisory business may be adversely affected.

There will not be a consistent pattern in our financial results from quarter to quarter, which may result in volatility of our stock price

We can experience significant variations in revenues and profits during each quarterly period. These variations can generally be attributed to the fact that our revenues are usually earned in large amounts throughout the year upon the successful completion of a transaction or restructuring, the timing of which is uncertain and is not subject to our control. Moreover, the timing of our recognition of gains or losses from our investment portfolio may vary significantly from period to period and depends on a number of factors beyond our control, including most notably market and general economic conditions.

Compared to our larger, more diversified competitors in the financial services industry, we generally experience even greater variations in our revenues and profits. This is due to our dependence on a relatively small number of transactions for most of our revenues, with the result that our earnings can be significantly affected if any particular transaction is not completed successfully, and to the fact that we lack other, more stable sources of revenue in material amounts, such as brokerage and asset management fees, which could moderate some of the volatility in financial advisory revenues. In addition, we report the value of our investments at estimated fair value at the end of each quarter. The value of our investments may increase or decrease significantly depending upon market factors that are beyond our control. As a result, it may be difficult for us to achieve consistent results and steady earnings growth on a quarterly basis, which could adversely affect our stock price.

In many cases, we are not paid for advisory engagements that do not result in the successful consummation of a transaction or restructuring or closing of a fund. As a result, our business is highly dependent on market conditions and the decisions and actions of our clients and interested third parties. For example, a client could delay or terminate a transaction because of a failure to agree upon final terms with the counterparty, failure to obtain necessary regulatory consents or board or shareholder approvals, failure to secure necessary financing, or adverse market conditions. Anticipated bidders for assets of a client during a restructuring transaction may not materialize or our client may not be able to restructure its operations or indebtedness due to a failure to reach agreement with its principal creditors. Our clients may not raise sufficient capital to start a new fund because anticipated investors may decline to invest in such fund due to lack of liquidity, change in strategic direction of the investor, or other factors. In these circumstances, we may not receive any advisory fees, other than the reimbursement of certain out-of-pocket expenses. The failure of the parties to complete a transaction on which we are advising, and the consequent loss of revenue to us, could lead to large adverse movements in our stock price.

Investment gains from our investments in Iridium and merchant banking funds vary from period to period; these gains may not recur and may not be replaced by other gains; our investments may lose money

We retain certain principal investments in Iridium and merchant banking funds (which in turn have a limited number of investments in portfolio companies). The fair value of these investments may appreciate (or depreciate) at different rates based on a variety of factors. Historically, gains (or losses) from our investments have been significantly impacted by market factors, specific industry conditions and other factors beyond our control, and we cannot predict the timing or size of any such gains (or losses) in future periods. The lack of investment gains (and any losses which may be attributable to the investments in Iridium and the merchant banking funds) and the volatility of changes in investment values may adversely affect our results of operations and our stock price. There were no gains (or losses) from any single investment that accounted for more than 10% of total revenues in 2011 or 2010.

Our investment in Iridium was valued at \$68.9 million at December 31, 2011. Since Iridium became a publicly traded company in 2009 its share price has ranged from a high of \$11.55 and to a low of \$5.50. Iridium's share

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price was \$7.71 at December 31, 2011. A significant decline in the market value of Iridium can give rise to significant losses and adversely affect our revenue and earnings.

In October 2011 we entered into a plan to sell our Iridium shares over a period of two or more years. These shares will be sold regardless of the market price; the amounts realized from these sales may vary.

We value our investment portfolio each quarter using a fair value methodology, which could result in gains or losses to the firm; the fair value methodology may over- or under-state the ultimate value we will realize

As of December 31, 2011, the value of the firm's portfolio of investments, including its investments in merchant banking funds and Iridium, was \$112.9 million. Our investment in Iridium's common stock is recorded at its publicly traded market value. Our investments in the merchant banking funds are recorded at estimated fair value and which is determined on a quarterly basis after giving consideration to the cost of the security, the pricing of other sales of securities by the portfolio company, the price of securities of other companies comparable to the portfolio company, purchase multiples paid in other comparable third party transactions, the original purchase price multiple, market conditions, liquidity, operating results and other quantitative and qualitative factors, and in the case of publicly traded securities, the closing price of the security on the last day of the relevant period discounted for any legal or contractual restrictions on sale. Significant changes in the public equity markets and/or the operating results of the portfolio companies of the merchant banking funds and other principal investments may have a material effect on the fair value of our principal investments and therefore on our revenues and profitability during any reporting period. The estimated fair value at which the principal investments are carried on our books may vary significantly from period to period depending on a number of factors beyond our control. It may not be possible to sell these investments at the estimated fair values attributed to them in our financial statements.

A significant deterioration in the credit markets or the failure of one or more banking institutions could adversely affect our liquidity

As of December 31, 2011 we had cash and cash equivalents of \$62.1 million. We have invested these assets in instruments which we believe are highly liquid, and monitor developments relating to the liquidity of these investments on a regular basis. In the event of a significant deterioration of the credit markets or the failure of one or more banking institutions, there can be no assurance that we will be able to liquidate these assets or access our cash. Our inability to access our cash investments could have a material adverse effect on our liquidity and result in a charge to our earnings which could have a material adverse effect on the value of our stock.

We have a \$50.0 million revolving loan facility from a U.S. commercial bank which currently expires on April 30, 2012. At December 31, 2011 we had \$28.1 million drawn down from the facility. We utilize the revolving loan facility primarily to provide for our domestic cash needs, which include dividend payments, share repurchases, and working capital needs.

Historically, we have rolled over the maturity date of our revolving loan facility annually. Our inability to extend the maturity date of the loan or renew the facility on acceptable terms with the existing lender could require us to repay all or a portion of the loan balance outstanding at maturity. There is no assurance, if our credit facility is not renewed with the current lender, that we would be able to obtain a new credit facility of a similar size and terms from a different lender. In order to repay the outstanding balance of our credit facility, we could be required to repatriate funds to the U.S., liquidate some of our principal investments or issue debt or equity securities in the public or private markets, in each case on terms which may not be favorable to us. Our inability to refinance the loan facility could have a material adverse effect on our liquidity and result in our inability to meet our obligations, which could have a material adverse effect on our stock price.

Our investment portfolio contains investments in high-risk, illiquid assets

We had investments of \$41.6 million in merchant banking funds at December 31, 2011. Merchant banking funds typically invest in securities of a class that are not publicly-traded and in many cases may be prohibited by

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contract or by applicable securities laws from selling such securities for a period of time or otherwise be restricted from disposing of such securities. The ability of such funds to dispose of investments is heavily dependent on the merger and acquisition environment and the initial public offering market, which fluctuate in terms of both the volume of transactions as well as the types of companies which are able to access the market. Furthermore, the types of investments made may require a substantial length of time to liquidate. We may not be able to sell our investments in merchant banking funds or control the disposition of securities in those funds.

Our investments are reported at estimated fair value at the end of each quarter and our allocable share of realized and unrealized gains or losses will affect our revenue, which could increase the volatility of our quarterly earnings. It generally takes a substantial period of time to realize the cash value of our principal investments. Even if an investment proves to be profitable, it may be several years or longer before any profits can be realized in cash from such investment.

We face strong competition from far larger firms and other independent firms

The investment banking industry is intensely competitive and we expect it to remain so. We compete on the basis of a number of factors, including the quality of our advice and service, innovation, reputation and price. We believe we may experience pricing pressures in our areas of operation in the future as some of our competitors seek to obtain market share by reducing prices. We are a relatively small investment bank, with 316 employees (including managing directors and senior advisors) as of December 31, 2011 and total revenues of \$294.0 million for the year ended December 31, 2011. Most of our competitors in the investment banking industry have a far greater range of products and services, greater financial and marketing resources, larger customer bases, greater name recognition, more managing directors to serve their clients' needs, greater global reach and more established relationships with their customers than we have. These larger and better capitalized competitors may be better able to respond to changes in the investment banking market, to compete for skilled professionals, to finance acquisitions, to fund internal growth and to compete for market share generally.

Our full line investment banking competitors and other large commercial banks, insurance companies and other broad-based financial services firms that have established or acquired financial advisory practices and broker-dealers or have merged with other financial institutions have the ability to offer a wide range of products, from loans, deposit-taking and insurance to brokerage, asset management and investment banking services, which may enhance their competitive position. They also have the ability to support investment banking with commercial banking, insurance and other financial services revenues in an effort to gain market share, which could result in pricing pressure in our businesses. In particular, the ability to provide financing as well as advisory services has become an important advantage for some of our larger competitors, and because we are unable to provide such financing we may be unable to compete for advisory clients in a significant part of the advisory market.

In addition to our larger competitors, over the last few years, a number of new, smaller independent boutique investment banks have emerged which offer independent advisory services on a model similar to ours and some of these firms have grown rapidly. As these independent firms seek to gain market share there could be pricing pressure, which would adversely affect our revenues and earnings.

Strategic investments, acquisitions and joint ventures, or foreign expansion may result in additional risks and uncertainties in our business

We intend to grow our core business through both recruiting and internal expansion and through strategic investments, acquisitions or joint ventures. In the event we make strategic investments or acquisitions or enter into joint ventures, such as our acquisition of Caliburn, we face numerous risks and uncertainties combining or integrating the relevant businesses and systems, including the need to combine accounting and data processing systems and management controls. In the case of joint ventures, we are subject to additional risks and uncertainties in that we may be dependent upon, and subject to liability, losses or reputational damage relating to

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systems, controls and personnel that are not under our control. In addition, conflicts or disagreements between us and our joint venture partners may negatively impact our business.

To the extent that we pursue business opportunities outside the United States, we will be subject to political, economic, legal, operational and other risks that are inherent in operating in a foreign country, including risks of possible nationalization, expropriation, price controls, capital controls, exchange controls and other restrictive governmental actions, as well as the outbreak of hostilities. In many countries, the laws and regulations applicable to the financial services industries are uncertain and evolving, and it may be difficult for us to determine the exact requirements of local laws in every market. Our inability to remain in compliance with local laws in a particular foreign market could have a significant and negative effect not only on our businesses in that market but also on our reputation generally. To fund our growth we may consider a range of financing alternatives. If we expand by recruiting new managing directors, we will incur compensation, occupancy, integration and business development costs. Depending upon the extent of our recruiting, such costs may be funded from cash from operations or other financing alternatives. If we expand by strategic investment, acquisition or joint venture, depending upon the size of the acquisition we may fund such expansion through internally generated cash flow, proceeds from bank or other borrowings, or the issuance of equity. There can be no assurance that the firm will be able to generate or obtain sufficient capital on acceptable terms to fund its expansion needs which would limit the future growth of the business and adversely affect our share price.

Expansion of our business will increase our operating costs and may create funding requirements

Since our establishment we have grown our business steadily. Over the past five years we have increased our headcount from 201 to 316 employees. During that period we have expanded our operations in North America with the addition of five new offices as well as overseas with the addition of offices in Japan and two offices in Australia. This expansion has increased our total base salary expense and benefits from \$50.6 million in 2007 to \$74.8 million in 2011 and non-compensation expenses from \$39.8 million in 2007 to \$62.7 million in 2011. We generally fund our operating costs through cash generated from operations, which we generate principally from the successful completion of transactions. Because we lack a diversified base of revenues, there can be no assurance that the revenues we earn from our advisory services will generate sufficient cash flow from operations to fund our operating needs. In the event our cash generated from operations were insufficient to meet our operating needs we would be required to fund such shortfall by borrowing additional amounts from our revolving loan facility, liquidating our investments in Iridium and the merchant banking funds on terms that may not be favorable to us, or accessing the debt or equity markets. On a longer term basis we might be required to reduce our cost structure by closing office locations and reducing headcount.

Greenhill's employees own a significant portion of the common stock of the firm and their interests may differ from those of our public shareholders

Our employees and their affiliated entities collectively owned approximately 10% of the total shares of common stock outstanding as of February 15, 2012. In addition, we have issued restricted stock units to our employees which, if fully vested as of February 15, 2012, would have resulted in our employees and their affiliates owning approximately 20% of our shares of common stock.

As a result of these shareholdings, our employees currently are able to exercise significant influence over the election of our entire board of directors, the management and policies of Greenhill and the outcome of any corporate transaction or other matter submitted to the shareholders for approval, including mergers, consolidations and the sale of all or substantially all of the assets of Greenhill.

Sales of substantial amounts of common stock by our managing directors and other employees, or the possibility of such sales, may adversely affect the price of the common stock and impede our ability to raise capital through the issuance of equity securities. There are no restrictions on the sale of the shares held by our employees other than prohibitions on sales during black-out periods imposed by us between earnings releases.

Table of Contents***A significant portion of the compensation of our managing directors is paid in restricted stock units and the shares we expect to issue on the vesting of those restricted stock units could result in a significant increase in the number of shares of common stock outstanding***

We award restricted stock units, as part of the annual bonus and incentive compensation, to managing directors and other employees. We also award restricted stock units as a long term incentive to new hires at the time they join the firm. At December 31, 2011, 2,718,950 restricted stock units were outstanding and an additional 1,242,457 restricted stock units were granted to employees subsequent to year end as part of the long-term incentive award component of our annual compensation package. Each restricted stock unit represents the holder's right to receive one share of our common stock or a cash payment equal to the fair value thereof, at our election, following the applicable vesting date. Awards of restricted stock units to our managing directors and other employees generally vest either ratably over a five year period beginning on the first anniversary of the grant date or do not vest until the fifth anniversary of their grant date, when they vest in full, subject to continued employment on the vesting date. Awards of restricted stock to our more junior professionals generally vest ratably over a three to four year period. Shares will be issued in respect of restricted stock units only under the circumstances specified in the applicable award agreements and the equity incentive plan, and may be forfeited in certain cases. Assuming all of the conditions to vesting are fulfilled, shares in respect of the 2,718,950 restricted stock units that were outstanding as of December 31, 2011 would be issued as follows: 655,399 shares in 2012, 540,847 shares in 2013, 771,203 shares in 2014, 447,917 shares in 2015, and 303,584 shares in 2016. In addition, in connection with the acquisition of Caliburn we issued 1,099,877 shares of convertible preferred stock which may be converted into common stock in April 2013 and April 2015, subject to the achievement of certain revenue performance targets. Further, in connection with the acquisition of Caliburn, we awarded restricted stock units of which 104,484 were outstanding at December 31, 2011; 62,690 of which may vest in April 2013 and 41,794 of which may vest in April 2015, subject to the achievement of certain revenue performance targets. We have generally repurchased a portion of the common stock issued to our employees upon vesting of restricted stock units to permit the payment of tax liabilities. Further, we have historically repurchased in the open market and through privately negotiated transactions a significant number of our shares of common stock. If we were to cease to or were unable to repurchase shares of common stock, the number of shares outstanding would increase over time, diluting the ownership of our existing stockholders.

Employee misconduct could harm Greenhill and is difficult to detect and deter

There have been a number of highly publicized cases involving fraud, insider trading or other misconduct by employees in the financial services industry in recent years, and we run the risk that employee misconduct could occur at our firm. For example, misconduct by employees could involve the improper use or disclosure of confidential information, which could result in regulatory sanctions and serious reputational or financial harm. Our advisory business often requires that we deal with client confidences of the greatest significance to our clients, improper use of which may have a material adverse impact on our clients. Any breach of our clients' confidences as a result of employee misconduct may impair our ability to attract and retain advisory clients. It is not always possible to deter employee misconduct and the precautions we take to detect and prevent this activity may not be effective in all cases.

In recent years, the U.S. Department of Justice and the SEC have devoted greater resources to the enforcement of the Foreign Corrupt Practices Act. In addition, the United Kingdom has recently significantly expanded the reach of its anti-bribery laws. While we have developed and implemented policies and procedures designed to ensure strict compliance by us and our personnel with the US and UK anti-bribery laws, such policies and procedures may not be effective in all instances to prevent violations. Any determination that we have violated these laws (or similar laws of other jurisdictions in which we do business) could subject us to, among other things, civil and criminal penalties, material fines, profit disgorgement, injunction on future conduct, securities litigation and reputational damage, any one of which could adversely affect our business prospects, financial position or the market value of our common stock.

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We may face damage to our professional reputation and legal liability to our clients and affected third parties if our services are not regarded as satisfactory or if conflicts of interests should arise

As an investment banking firm, we depend to a large extent on our relationships with our clients and our reputation for integrity and high-caliber professional services to attract and retain clients. As a result, if a client is not satisfied with our services, it may be more damaging in our business than in other businesses. Moreover, our role as advisor to our clients on important mergers and acquisitions or restructuring transactions involves complex analysis and the exercise of professional judgment, including rendering fairness opinions in connection with mergers and other transactions. Our activities may subject us to the risk of significant legal liabilities to our clients and aggrieved third parties, including shareholders of our clients who could bring actions against us. In recent years, the volume of claims and amount of damages claimed in litigation and regulatory proceedings against financial intermediaries have been increasing. These risks often may be difficult to assess or quantify and their existence and magnitude often remain unknown for substantial periods of time.

In addition, our clients are often concerned about conflicts of interest that may arise in the course of engagements. While we have adopted various policies, controls and procedures to reduce the risks associated with the execution of transactions, the rendering of fairness opinions and potential conflicts of interest, these policies may not be adhered to by our employees or be effective in reducing these risks. Failure to adhere to these policies and procedures may result in regulatory sanctions or client litigation.

Our engagements typically include broad indemnities from our clients and provisions to limit our exposure to legal claims relating to our services, but these provisions may not protect us or may not be enforceable in all cases. As a result, we may incur significant legal expenses in defending against litigation. Substantial legal liability or significant regulatory action against us could have material adverse financial effects or cause significant reputational harm to us, which could seriously harm our business prospects.

We are subject to extensive regulation in the financial services industry

Because we operate in the financial services industry, we are subject to extensive regulation in the United States, Europe, Australia, Asia and elsewhere. Regulatory and self-regulatory agencies as well as securities commissions in various jurisdictions in which we do business are empowered to conduct periodic examinations and administrative proceedings that can result in censure, fine, issuance of cease and desist orders or suspension of personnel or other sanctions, including revocation of our license or registration or the registration of any of our regulated subsidiaries. In addition, as a result of recent highly publicized scandals in the financial services industry, scrutiny by regulators of financial services firms has increased significantly. Even if a sanction imposed against us or our personnel is small in monetary amount, the adverse publicity arising from the imposition of sanctions against us by regulators could harm our reputation and cause us to lose existing clients or fail to gain new clients.

Change in applicable law and regulatory schemes could adversely affect our business

From time to time, the United States and other national governments in the countries in which we operate and related regulatory authorities as well as local governments may adopt new rules which affect our business. In the United States, the Dodd-Frank Wall Street Reform Act was adopted in 2010, bringing sweeping changes in the regulations of financial institutions. It will take several years for the rules under the Dodd-Frank Act to be written and become effective, and the final scope and interpretations of those rules, and their impact on our business, will not be fully known for some time, but could well have adverse implications for the manner in which we conduct our business and, consequently, its profitability.

In addition, several states and municipalities in the United States have recently adopted pay-to-play rules which, in addition to imposing registration and reporting requirements, limit our ability to charge fees in connection with certain of our private capital advisory engagements, and could therefore limit the profitability of that portion of our business.

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Beginning in 2007 and continuing through 2011, the U.S. and global financial markets experienced extraordinary disruption and volatility. As a result, the U.S. and other governments have taken actions, and may continue to take further actions, in response to this disruption and volatility, including expanding current or enacting new standards, requirements and rules that may be applicable to us and our subsidiaries. The effect of any such expanded or new standards, requirements and rules is uncertain and could have adverse consequences to our business and results of operations. Many of the requirements imposed by our regulators are designed to ensure the integrity of the financial markets and to protect customers and other third parties who deal with us and are not designed to protect our stockholders. Consequently, these regulations may serve to limit our activities, including through net capital, customer protection and market conduct requirements.

Legal restrictions on our clients may reduce the demand for our services

New laws or regulations or changes in enforcement of existing laws or regulations applicable to our clients may also adversely affect our businesses. For example, changes in antitrust enforcement could affect the level of mergers and acquisitions activity and changes in regulation could restrict the activities of our clients and their need for the types of advisory services that we provide to them.

The cost of compliance with international employment, labor, benefits and tax regulations may adversely affect our business and hamper our ability to expand internationally

Since we operate our business both in the United States and internationally, we are subject to many distinct employment, labor, benefits and tax laws in each state and country in which we operate, including regulations affecting our employment practices and our relations with our employees and service providers. If we are required to comply with new regulations or new interpretations of existing regulations, or if we are unable to comply with these regulations or interpretations, our business could be adversely affected or the cost of compliance may make it difficult to expand into new international markets. Additionally, our competitiveness in international markets may be adversely affected by regulations requiring, among other things, the awarding of contracts to local contractors, the employment of local citizens and/or the purchase of services from local businesses or that favor or require local ownership.

The potential requirement to convert our financial statements from being prepared in conformity with accounting principles generally accepted in the United States of America to International Financial Reporting Standards may strain our resources and increase our annual expenses

As a public entity, the SEC may require in the future that we report our financial results under International Financial Reporting Standards (IFRS) instead of under accounting principles generally accepted in the United States of America (U.S. GAAP). IFRS is a set of accounting principles that has been gaining acceptance on a worldwide basis. These standards are published by the London-based International Accounting Standards Board (IASB) and are more focused on objectives and principles and less reliant on detailed rules than U.S. GAAP. Today, there remain significant and material differences in several key areas between U.S. GAAP and IFRS which would affect Greenhill. Additionally, U.S. GAAP provides specific guidance in classes of accounting transactions for which equivalent guidance in IFRS does not exist. The adoption of IFRS is highly complex and would have an impact on many aspects of our operations, including but not limited to financial accounting and reporting systems, internal controls, taxes, borrowing covenants and cash management. It is expected that a significant amount of time, internal and external resources and expenses over a multi-year period would be required for this conversion.

Operational risks may disrupt our businesses, result in losses or limit our growth

We rely heavily on our financial, accounting and other data processing systems. If any of these systems do not operate properly or are disabled, we could suffer financial loss, a disruption of our businesses, regulatory intervention or reputational damage. In addition, we operate in businesses that are highly dependent on

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information systems and technology. Our information systems and technology may not continue to be able to accommodate our growth, and the cost of maintaining such systems may increase from its current level. Such a failure to accommodate growth, or an increase in costs related to such information systems, could have a material adverse effect on us.

Furthermore, we depend on our headquarters in New York City, where a large number of our personnel are located, for the continued operation of our business. A disaster or a disruption in the infrastructure that supports our businesses, including a disruption involving electronic communications or other services used by us or third parties with whom we conduct business, or directly affecting our headquarters, could have a material adverse impact on our ability to continue to operate our business without interruption. Our disaster recovery programs may not be sufficient to mitigate the harm that may result from such a disaster or disruption. In addition, insurance and other safeguards might only partially reimburse us for our losses, if at all.

We have experienced rapid growth over the past several years, which may be difficult to sustain and which may place significant demands on our administrative, operational and financial resources

Our future growth will depend, among other things, on our ability to successfully identify practice groups and individuals to join our firm. It may take more than one year for us to determine whether new professionals will be effective. During that time, we may incur significant expenses and expend significant time and resources toward training, integration and business development. If we are unable to hire and retain successful professionals, we will not be able to implement our growth strategy and our financial results may be materially adversely affected.

Sustaining growth will also require us to commit additional management, operational, and financial resources to this growth and to maintain appropriate operational and financial systems to adequately support expansion. There can be no assurance that we will be able to manage our expanding operations effectively or that we will be able to maintain or accelerate our growth and any failure to do so could adversely affect our ability to generate revenue and control our expenses.

Fluctuations in foreign currency exchange rates could adversely affect our results of operations

Because our financial statements are denominated in U.S. dollars and we receive a portion of our revenue in other currencies, predominantly in Euros, British pounds, and Australian dollars, we are exposed to fluctuations in foreign currencies. In addition, we pay certain of our expenses in such currencies. We have not entered into any transactions to hedge our exposure to these foreign exchange fluctuations through the use of derivative instruments or otherwise. An appreciation or depreciation of any of these currencies relative to the U.S. dollar would result in an adverse or beneficial impact, respectively, to our financial results.

The market price of our common stock may decline

The price of our common stock may fluctuate widely, depending upon many factors, including the perceived prospects of Greenhill and the financial services industry in general, differences between our actual financial and operating results and those expected by investors, the performance of our investments in merchant banking funds and Iridium, changes in general economic or market conditions and broad market fluctuations. Since a significant portion of the compensation of our managing directors and certain other employees is paid in restricted stock units, a decline in the price of our stock may adversely affect our ability to retain key employees, including our managing directors. Similarly, our ability to recruit new managing directors may be adversely affected by a decline in the price of our stock.

We could change our existing dividend policy in the future

We began paying quarterly cash dividends to holders of record of our common stock in June 2004. In 2011, we paid quarterly cash dividends of \$0.45 per share of our common stock to holders of record. We intend to continue to pay quarterly dividends subject to capital availability and periodic determinations that cash dividends are in

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the best interest of our stockholders. Future declaration and payment of dividends on our common stock is at the discretion of our board of directors and depend upon, among other things, our future operations and earnings, capital requirements and surplus, general financial condition, contractual restrictions and other factors as the board of directors may deem relevant. For example, in the event that there is deterioration in our financial performance and/or our liquidity position, a downturn in global economic conditions or disruptions in the credit markets and our ability to obtain financing, our board of directors could decide to reduce or even suspend dividend payments in the future. We cannot provide assurance that we will continue to declare dividends at all or in any particular amounts. A reduction in our dividend payments could have a negative effect on our stock price.

Cautionary Statement Concerning Forward-Looking Statements

We have made statements under the captions **Business** , **Risk Factors** , and **Management's Discussion and Analysis of Financial Condition and Results of Operations** and in other sections of this Form 10-K that are forward-looking statements. In some cases, you can identify these statements by forward-looking words such as **may** , **might** , **will** , **should** , **expect** , **plan** , **anticipate** , **believe** , **estimate** , **intend** , **continue** , the negative of these terms and other comparable terminology. These forward-looking statements, which are subject to risks, uncertainties and assumptions about us, may include projections of our future financial performance, based on our growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward-looking statements. In particular, you should consider the numerous risks outlined under **Risk Factors** .

These risks are not exhaustive. Other sections of this Annual Report on Form 10-K may include additional factors which could adversely impact our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for our management to predict all risk factors, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, level of activity, performance or achievements. Moreover, neither we nor any other person assumes responsibility for the accuracy or completeness of any of these forward-looking statements. You should not rely upon forward-looking statements as predictions of future events. We are under no duty to update any of these forward-looking statements after the date of this filing to conform our prior statements to actual results or revised expectations.

Forward-looking statements include, but are not limited to, the following:

the statement that we intend to continue the process to liquidate our historical principal investments in the merchant banking funds and Iridium in **Business Overview** ;

the statement that we expect the financial services industry to remain intensely competitive in **Business Competition** ;

the statement that we expect that our advisory engagements will continue to be limited to a relatively small number of clients and that an even smaller number of those clients will account for a high percentage of revenues in any particular year in **Risk Factors** . A high percentage of our advisory revenues are derived from a few clients and the termination of any one advisory engagement could reduce our revenues and harm our operating results ;

the statement that we intend to continue to pay quarterly dividends in **Risk Factors** . We could change our existing dividend policy in the future ;

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the statements that we intend to continue our efforts to recruit new managing directors with industry sector experience and to increase our geographic reach in Management's Discussion and Analysis of Financial Condition and Results of Operations Overview ;

the statement about our intention to realize value from our remaining investments over time in Management's Discussion and Analysis of Financial Condition and Results of Operations Overview ;

the statement that we will continue to record realized and unrealized gains and losses in the fair value of our retained investments until such investments are fully liquidated in Management's Discussion and Analysis of Financial Condition and Results of Operations Overview ;

the statement that our simple business model as an independent, unconflicted advisor will continue to create opportunities for us to attract new clients and increase our market share in Management's Discussion and Analysis of Financial Condition and Results of Operations Business Environment ;

the statements that we will continue to recruit senior bankers on an opportunistic basis and that our priority in the near term will be to realize the benefits of our expansion as transaction activity rebounds and seek to return towards our historic cost ratios in Management's Discussion and Analysis of Financial Condition and Results of Operations Business Environment ;

the statement that we expect our sales under Iridium's trading plan to last approximately two years in Management's Discussion and Analysis of Financial Condition and Results of Operations Merchant Banking and Other Investment Revenues ;

the statement that unless there are significant gains in the value of the portfolio companies in GCP Europe, GCP II and GSAVP it is not likely that the profit thresholds for each fund will be exceeded and accordingly is not likely that profit override revenue will be recognized in Management's Discussion and Analysis of Financial Condition and Results of Operations Merchant Banking and Other Investment Revenues ;

the statement that based upon our current headcount we expect that our fixed compensation costs for 2012 will be slightly higher than our fixed compensation costs in 2011 in Management's Discussion and Analysis of Financial Condition and Results of Operations Compensation and Benefits Expenses ;

the statement about our objective to return towards our stated policy of a ratio of compensation to revenue not to exceed 50% in Management's Discussion and Analysis of Financial Condition and Results of Operations Compensation and Benefits Expenses ;

the statement that over the long-term we expect that our non-compensation costs, particularly occupancy, travel and information services costs, will increase as we grow our business and make strategic investments in Management's Discussion and Analysis of Financial Condition and Results of Operations Non-Compensation Costs Expenses ;

the statement that we expected to generate future earnings in Germany and other jurisdictions which would allow us to fully utilize our tax loss carryforwards in Management's Discussion and Analysis of Financial Condition and Results of Operations Provision for Income Taxes ;

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the statement that we expect to pay approximately \$7.9 million in 2012 related to income taxes owed in the United States and Australia for the year ended December 31, 2011 in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources ;

the statement that we expect to continue to be compliant with all loan covenants in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources ;

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the statement that it is unlikely that we will have future needs that require us to permanently reinvest our foreign earnings in the local jurisdictions in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources ;

the statement that we would not expect to incur incremental U.S. tax from any repatriations of foreign earnings in the near future in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources ;

the statement that we expect to use the net proceeds from the sales of Iridium to repurchase our common stock in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources ;

the statement that we expect to fund repurchases of common stock from our employees in conjunction with the cash settlement of tax liabilities incurred on vesting of restricted stock units of approximately \$65.2 million over the next five years in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources ;

the statement about our expectation to fund our repurchase of shares (if any) with proceeds from our investments and/or operating cash flow in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources ;

the statement about our belief that it is probable that the revenue target for the first tranche of contingent convertible preferred shares related to the Caliburn acquisition, which will be measured on the third anniversary, will be met in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources ;

the statement that while we believe that the cash generated from operations, proceeds from the sale of Iridium and our merchant banking investments and funds available from the revolving bank loan facility will be sufficient to meet our expected operating needs, tax obligations, common dividend payments, share repurchases, commitments to the merchant banking activities, and build-out costs of new office space, we may adjust our variable expenses and non-recurring disbursements, if necessary, to meet our liquidity needs in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources ;

the statement that in the event that we are not able to meet our liquidity needs, we may consider a range of financing alternatives to meet any such need in Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources ;

the statement that we do not expect our merchant banking commitments to be drawn in full in Management's Discussion and Analysis of Financial Condition and Results of Operations Contractual Obligations ;

the statement that management believes that the firm is not exposed to significant credit risk due to the financial position of the depository institutions in which our deposits are held in Management's Discussion and Analysis of Financial Condition and Results of Operations Market Risk ; and

the statement that we may hedge our foreign currency exposure if we expect we will need to fund U.S. dollar obligations with foreign currency in Management's Discussion and Analysis of Financial Condition and Results of Operations Market Risk .

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There are no unresolved written comments that were received from the SEC staff 180 days or more before the end of the year relating to our periodic or current reports under the Securities Act of 1934.

Item 2. Properties

The firm's principal offices, all of which are leased, are as follows:

Location	Owned/Leased	Lease Expiration	Approximate Square Footage as of December 31, 2011
300 Park Avenue New York, New York	Leased	2020	105,000 square feet
<i>(Global Headquarters)</i>			
Lansdowne House 57 Berkeley Square, London	Leased	2013	19,000 square feet
Neue Mainzer Strasse 52-58 Frankfurt	Leased	2015	13,000 square feet
79 Wellington Street West Toronto	Leased	2014	5,000 square feet
Marunouchi Building Tokyo	Leased	2013	4,000 square feet
The Chiefley Tower 2 Chiefley Square, Sydney	Leased	2015	14,000 square feet

Most of the lease arrangements listed above provide for renewal options beyond the date of expiration.

Approximately 15,000 square feet of space at the New York office has been sublet to GCP Capital through 2015. The sublease may be terminated at GCP Capital's option in December 2013 pursuant to the terms of the sublease agreement.

We also have six offices with 44,000 of aggregate square feet with terms expiring through 2021.

Item 3. Legal Proceedings

The firm is from time to time involved in legal proceedings incidental to the ordinary course of its business. We do not believe any such proceedings will have a material adverse effect on our results of operations.

Item 4. Mine Safety Disclosures

Not applicable.

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EXECUTIVE OFFICERS AND DIRECTORS

Our executive officers are Scott L. Bok (Chief Executive Officer), Richard J. Lieb (Chief Financial Officer), Harold J. Rodriguez, Jr. (Chief Operating Officer, Chief Compliance Officer and Treasurer), and Ulrika Ekman (General Counsel and Secretary). Set forth below is a brief biography of each executive officer.

Scott L. Bok, 52, has served as our Chief Executive Officer since April 2010, served as Co-Chief Executive Officer from October 2007 until April 2010, served as our U.S. President from January 2004 until October 2007 and has been a member of our Management Committee since its formation in January 2004. In addition, Mr. Bok has been a director of Greenhill & Co., Inc. since its incorporation in March 2004. Mr. Bok joined Greenhill as a managing director in February 1997. Before joining Greenhill, Mr. Bok was a managing director in the mergers, acquisitions and restructuring department of Morgan Stanley & Co., where he worked from 1986 to 1997, based in New York and London. From 1984 to 1986, Mr. Bok practiced mergers and acquisitions and securities law in New York with Wachtell, Lipton, Rosen & Katz. Mr. Bok is a member of the board of directors of Iridium Communications Inc. (f/k/a GHL Acquisition Corp.). Mr. Bok served as Chief Executive Officer and Chairman of the Board of GHL Acquisition Corp. from 2007 to 2009. He has also served as a member of the Board of Directors of Heartland Payment Systems (2001–2005) and Republic Group Insurance (2003–2007).

Richard J. Lieb, 52, became Chief Financial Officer of Greenhill in March 2008. Mr. Lieb has served as our Head of North American Corporate Advisory since January 2012. Mr. Lieb has been a member of our Management Committee since March 2008. Mr. Lieb joined Greenhill in April 2005 as a Managing Director, having spent 20 years at Goldman Sachs where he headed the real estate investment banking department from 2000 to 2005.

Harold J. Rodriguez, Jr., 56, has served as our Chief Operating Officer since January 2012, served as Chief Administrative Officer from March 2008 until January 2012 and was Managing Director Finance, Regulation and Operations from January 2004 to March 2008. Mr. Rodriguez also serves as Chief Compliance Officer and Treasurer and is a member of our Management Committee. Mr. Rodriguez is the Chief Financial Officer of Greenhill's operating subsidiaries and from November 2000 through December 2003, was Chief Financial Officer of Greenhill. Mr. Rodriguez has served as the Chief Financial Officer of Greenhill Capital Partners since he joined Greenhill in June 2000. Mr. Rodriguez served as Chief Financial Officer of GHL Acquisition Corp. from 2008 to 2009. Prior to joining Greenhill, Mr. Rodriguez was Vice President Finance and Controller of Silgan Holdings, Inc., a major consumer packaging goods manufacturer, from 1987 to 2000. From 1978 to 1987, Mr. Rodriguez worked at Ernst & Young, where he was a senior manager specializing in taxation.

Ulrika Ekman, 49, has served as our General Counsel and Secretary from May 2004 to March 2008 and again since July 2009. Between April 2008 and July 2009, Ms. Ekman served as our Co-Head of U.S. Mergers and Acquisitions. Ms. Ekman is also a member of our Management Committee. Prior to joining Greenhill, Ms. Ekman was a partner in the mergers and acquisitions group of the corporate department of Davis Polk & Wardwell LLP, where she practiced law since 1990.

Our Board of Directors has six members, two of whom are employees (Robert F. Greenhill and Scott L. Bok) and four of whom are independent (Robert T. Blakely, John C. Danforth, Steven F. Goldstone and Stephen L. Key). A brief biography of each of Messrs. Greenhill, Blakely, Danforth, Goldstone and Key is set forth below.

Robert F. Greenhill, 75, our founder, has served as our Chairman since the time of our founding in 1996, served as Chief Executive Officer from 1996 until October 2007 and was a member of our Management Committee from its formation in January 2004 until October 2007. In addition, Mr. Greenhill has been a director of Greenhill & Co., Inc. since its incorporation in March 2004. Prior to founding and becoming Chairman of Greenhill, Mr. Greenhill was Chairman and Chief Executive Officer of Smith Barney Inc. and a member of the board of directors of the predecessor to the present Travelers Corporation (the parent of Smith Barney) from June 1993 to January 1996. From January 1991 to June 1993, Mr. Greenhill was President of, and from January 1989

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to January 1991, Mr. Greenhill was a Vice Chairman of, Morgan Stanley Group, Inc. Mr. Greenhill joined Morgan Stanley in 1962 and became a partner in 1970. In 1972, Mr. Greenhill directed Morgan Stanley's newly-formed mergers and acquisitions department. In 1980, Mr. Greenhill was named director of Morgan Stanley's investment banking division, with responsibility for domestic and international corporate finance, mergers and acquisitions, merchant banking, capital markets services and real estate. Also in 1980, Mr. Greenhill became a member of Morgan Stanley's management committee.

Robert Blakely, 70, has served on our Board of Directors since April 2009. Since 2008, Mr. Blakely has served as the President of Performance Enhancement Group, a position he previously held from 2002 to 2003. From February 2006 to January 2008, Mr. Blakely served as Executive Vice President of Fannie Mae and from February 2006 to August 2007, as its Chief Financial Officer. From 2003 to 2006, Mr. Blakely served as Executive Vice President and Chief Financial Officer of MCI. Mr. Blakely is a member of the board of directors of Westlake Chemical Corporation, Natural Resource Partners L.P. and Ally Financial Inc. (formerly GMAC Inc.).

John C. Danforth, 75, has served on our Board of Directors since February 2005. He served as the United States Representative to the United Nations between July 2004 and January 2005 and, except during his service at the United Nations, has been a partner in the law firm of Bryan Cave LLP since 1995. He served in the United States Senate from 1976 to 1995. Senator Danforth is a director of Cerner Corporation. He is ordained to the clergy of the Episcopal Church.

Steven F. Goldstone, 66, has served on our Board of Directors since July 2004. He currently manages Silver Spring Group, a private investment firm. From 1995 until his retirement in 2000, Mr. Goldstone was Chairman and Chief Executive Officer of RJR Nabisco, Inc. (which was subsequently named Nabisco Group Holdings following the reorganization of RJR Nabisco, Inc.). Prior to joining RJR Nabisco, Inc., Mr. Goldstone was a partner at Davis Polk & Wardwell, a law firm in New York City. He is also Non-Executive Chairman of ConAgra Foods, Inc. and a director of Merck & Co. Mr. Goldstone served as a member of the Board of Directors of Trane, Inc. (f/k/a American Standards Companies, Inc.) from 2002 until 2008.

Stephen L. Key, 68, has served on our Board of Directors since May 2004. Since 2003, Mr. Key has been the sole proprietor of Key Consulting, LLC. From 1995 to 2001, Mr. Key was the Executive Vice President and Chief Financial Officer of Textron Inc., and from 1992 to 1995, Mr. Key was the Executive Vice President and Chief Financial Officer of ConAgra, Inc. From 1968 to 1992, Mr. Key worked at Ernst & Young, serving in various capacities, including as the Managing Partner of Ernst & Young's New York Office from 1988 to 1992. Mr. Key is a Certified Public Accountant in the State of New York. Mr. Key is a member of the Board of Directors of Forward Industries, Inc. and 1-800-Contacts, Inc. Mr. Key served as a member of the Board of Directors of Sitel, Inc. from 2007 until 2008.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The principal market on which our common stock (ticker: GHL) is traded is the New York Stock Exchange. The following tables set forth, for the fiscal quarters indicated, the high and low sales prices per share of our common stock, as reported in the consolidated transaction reporting system, and the quarterly dividends declared.

	Fiscal 2011		Dividends per share of common stock
	Sales Price		
	High	Low	
First quarter	\$ 83.84	\$ 61.33	\$ 0.45
Second quarter	63.90	47.80	0.45
Third quarter	55.39	27.51	0.45
Fourth quarter	40.10	27.31	0.45

	Fiscal 2010		Dividends per share of common stock
	Sales Price		
	High	Low	
First quarter	\$ 88.33	\$ 70.04	\$ 0.45
Second quarter	89.16	60.73	0.45
Third quarter	82.39	60.80	0.45
Fourth quarter	84.51	74.21	0.45

As of February 15, 2012, there were 7 holders of record of the firm's common stock. The majority of our shares are held in street name by diversified financial broker dealers which are not counted as record holders.

On February 15, 2012, the last reported sales price for the firm's common stock on the New York Stock Exchange was \$44.50 per share.

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The following performance graph and related information shall not be deemed soliciting material or to be filed with the Securities and Exchange Commission, nor shall such information be incorporated by reference into any future filing under the Securities Act of 1933 or Securities Exchange Act of 1934, each as amended, except to the extent we specifically incorporate it by reference into such filing. Our stock price performance shown in the graph below is not indicative of future stock price performance.

**COMPARES 5-YEAR CUMULATIVE TOTAL RETURN AMONG GREENHILL & CO.,
INC., S&P MIDCAP 400 INDEX AND S&P MIDCAP 400 INVESTMENT BANKING
AND BROKERAGE INDEX**

ASSUMES \$100 INVESTED ON DECEMBER 31, 2006

ASSUMES DIVIDEND REINVESTED

FISCAL YEAR ENDING DECEMBER 31, 2011

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The following table provides information as of December 31, 2011 regarding securities issued under our equity compensation plans that were in effect during fiscal 2011.

	Plan Category	Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in the Second Column)
Equity compensation plans approved by security holders	Equity Incentive Plan ⁽¹⁾	2,718,950 ⁽²⁾	\$ ⁽³⁾	23,523,669
Equity compensation plans not approved by security holders	None			
Total		2,718,950	\$	23,523,669

(1) Our amended Equity Incentive Plan was approved by our security holders in April 2009. See Note 12 Restricted Stock Units of the Consolidated Financial Statements for a description of our Equity Incentive Plan.

(2) Excludes 1,242,457 stock units granted to employees subsequent to December 31, 2011 as part of our long term incentive awards program.

(3) The restricted stock units awarded under our Equity Incentive Plan were granted at no cost to the persons receiving them and do not have an exercise price.

Share Repurchases in the Fourth Quarter of 2011

Period	Total Number of Shares Repurchased ⁽¹⁾	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Approximate Dollar Value of Shares that May Yet Be Purchased under the Plans or Programs ⁽²⁾
October 1 - October 31	258,902	\$ 38.62	0	\$ 40,899,097
November 1 - November 30	0		0	\$ 40,899,097
December 1 - December 31	0		0	\$ 40,899,097

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- (1) Excludes 4,484 shares the firm is deemed to have repurchased at \$37.49 from employees in conjunction with the payment of tax liabilities in respect of stock delivered to employees in settlement of restricted stock units.
- (2) Effective January 25, 2012, the Board of Directors authorized the repurchase of up to \$100,000,000 of our common stock through December 31, 2012.

Table of Contents**Item 6. Selected Financial Data**

	2011	As of or for the Year Ended December 31,			2007
		2010	2009	2008	
		(in millions, except per share and number of employees data)			
Statement of Income Data:					
Advisory revenues	\$ 302.8	\$ 252.2	\$ 216.0	\$ 218.2	\$ 366.7
Merchant banking and other investment revenues	(8.8)	26.1	82.6	3.7	33.7
Total revenues	294.0	278.3	298.6	221.9	400.4
<i>% change from prior year</i>	<i>6%</i>	<i>(7%)</i>	<i>35%</i>	<i>(45%)</i>	<i>38%</i>
Employee compensation and benefits expense ^(a)	162.6	159.9	138.3	102.0	183.5
Non-compensation expenses	62.7	59.5	46.5	42.0	39.8
Income before taxes	68.7	58.9	113.8	77.9	177.1
Provision for taxes	24.1	19.5	42.7	29.4	61.8
Net income allocated to common shareholders	44.6	34.5	71.2	49.0	115.3
Diluted average shares outstanding	31,034,817	30,776,034	29,753,609	28,214,015	28,728,293
Diluted earnings per share	1.44	1.12	2.39	1.74	4.01
Balance Sheet Data:					
Total assets	\$ 460.7	\$ 508.7	\$ 334.2	\$ 265.8	\$ 374.2
Total liabilities	113.1	135.8	100.6	65.7	229.6
Stockholders' equity	346.2	370.5	232.1	198.3	

fighting the matter in court and paying substantial monetary damages in the event we were to lose; or

seeking to develop non-infringing technologies, which may not be feasible.

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Any one or several of these developments could place substantial financial and administrative burdens on us and hinder our business. Litigation may also be necessary to enforce our patents or other intellectual property rights. If we fail to obtain certain licenses and if litigation relating to alleged patent infringement or other intellectual property matters occurs, it could prevent us from manufacturing particular products or applying particular technologies, which could reduce our opportunities to generate revenues. See Item 8. Financial Information Legal Proceedings in our Form 20-F, which is incorporated by reference herein, for a further discussion.

If the Ministry of Economic Affairs uses a substantial portion of our production capacity, we will not be able to service our other customers.

According to our agreement with the Industrial Technology Research Institute of Taiwan, or ITRI, the Ministry of Economic Affairs of the ROC, or an entity designated by the Ministry of Economic Affairs, has an option to purchase up to 35% of our capacity. If the Ministry of Economic Affairs, or an entity designated by the Ministry of Economic Affairs, exercises its option to any significant degree, we may not be able to provide services to all of our other customers unless we are able to increase our capacity accordingly and in a timely manner. Although the Ministry of Economic Affairs has never exercised its option, any significant exercise of this option could damage our relationship with our other customers when demand for our services is strong and may encourage them to purchase more products from our competitors in the future.

We are subject to the risk of loss due to explosion and fire because the materials we use in our manufacturing processes are highly flammable.

We use highly flammable materials such as silane and hydrogen in our manufacturing processes and are therefore subject to the risk of loss arising from explosion and fire. The risk of explosion and fire associated with these materials cannot be completely eliminated. Semiconductor companies experience explosion and fire damage from time to time. Although we maintain comprehensive fire insurance up to policy limits, including insurance for loss of property and loss of profit resulting from business interruption, our insurance coverage may not be sufficient to cover all of our potential losses. If any of our fabs were to be damaged or cease operations as a result of an explosion and fire, it would reduce our manufacturing capacity, reduce our revenues and profits and may cause us to lose important customers.

Any impairment charges required under US GAAP may have a material adverse effect on our net income on a US GAAP reconciled basis.

Under currently effective US GAAP, we are required to evaluate our equipment and other long-lived assets for impairment whenever there is an indication of impairment. If certain criteria are met, we are required to record an impairment charge. We can give no assurance that impairment charges will not be required in periods subsequent to December 31, 2002. Please see note 27 to our consolidated financial statements contained in our Form 20-F, which is incorporated by reference herein, and note 27 to our unaudited consolidated financial statements as of and for the six months ended June 30, 2002 and 2003 included in this prospectus for a discussion of the criteria which, if met, may require impairment charges.

As a result of a new standard under US GAAP that became effective on January 1, 2002, we are no longer permitted to amortize the remaining goodwill. Goodwill amortization expenses amounted to NT\$12,051 million under US GAAP for the year ended December 31, 2001. Starting from January

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2002, all goodwill must be periodically tested for impairment. As of December 31, 2002, we had NT\$47,476 million recorded as goodwill under US GAAP and we found no impairment as of that date. As of June 30, 2003, we had NT\$47,447 million recorded as goodwill under US GAAP and we found no impairment as of that date. We currently are not able to estimate the extent and timing of any goodwill impairment charge for future years. Any goodwill impairment charge required under US GAAP may have a material adverse effect on our net income for subsequent periods on a US GAAP reconciled basis. Please see note 27.i. and 28.a. to our consolidated financial statements contained in our Form 20-F, which is incorporated by reference herein, and note 27.e. to our unaudited consolidated financial statements as of and for the six months ended June 30, 2002 and 2003 included in this prospectus for a discussion of the new standard under US GAAP.

The determination of an impairment charge at any given time is based significantly on our expected results of operations over a number of years subsequent to that time. As a result, an impairment charge is more likely to occur during a period when our operating results are otherwise already depressed.

Any significant decrease in sales to one or more of our major customers may decrease our net sales and net income.

The degree to which our sales are concentrated among a limited number of customers is a function of the foundry outsourcing activities of the respective customers in a given fiscal year. Certain of our customers deal with us on the basis as their sole foundry service provider. As we have over half of the market share of the dedicated foundry segment business, our sales concentration is often a reflection of the business activities of a cross section of the semiconductor industry that depends on foundry services for wafer outsourcing. Our top ten customers have changed from time to time. In 2001 and 2002, our ten largest customers accounted for approximately 49% and 57% of our net sales, respectively. The increased sales contribution by our top ten customers in 2002 reflected the fact that the selected few customers experienced higher foundry outsourcing business activities than the rest of the customers. Although our top ten customers still accounted for 56% of our net sales in the six months ended June 30, 2003, we believe that our customer base has become more diversified given the changing composition of the top ten customers and a relatively more balanced sales contribution by various customers. While we believe our customer base is strong and diversified, the fact that a relatively limited number of customers constitute a significant portion of our revenue may remain as a business characteristic inherent to our extensive presence in the dedicated foundry segment of the semiconductor market. Our largest customer in 2001, 2002 and the six months ended June 30, 2003, NVIDIA Corporation, accounted for approximately 17% of our net sales in 2001, 20% of our net sales in 2002 and approximately 16% of our net sales in the first half of 2003. In March 2003, NVIDIA announced that it has awarded a long-term contract relating to the production of its latest graphics chips to International Business Machines Corp. NVIDIA simultaneously stated that TSMC would remain its primary foundry partner. There is no assurance that there will not be any loss or cancellation of business from NVIDIA, or from any of our other major customers, in the future. Loss or cancellation of business from our most significant customers, should there be any, could significantly reduce our net sales and net income.

Risks Relating to the ROC

Relations between the ROC and the People's Republic of China could negatively affect our business and the market value of your investment.

Our principal executive offices and our principal production facilities are located in Taiwan and a substantial majority of our net revenues are derived from our operations in Taiwan. The ROC has a unique international political status. The People's Republic of China, or PRC, does not recognize the sovereignty of the ROC. Although significant economic and cultural relations have been established during recent years between the ROC and the PRC, relations have often been strained. The government of the PRC

has indicated that it may use military force to gain control over Taiwan in some

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circumstances, such as a declaration of independence by Taiwan, or foreign power interference in Taiwanese affairs. Past developments in relations between the ROC and the PRC have on occasion depressed the market prices of the securities of Taiwanese companies, including our own. Relations between the ROC and the PRC and other factors affecting military, political or economic conditions in Taiwan could have a material adverse effect on our results of operations, as well as the market price and the liquidity of our ADSs and common shares. Further, the ROC government currently restricts certain types of investments by Taiwanese companies in the PRC. Although we have received Phase I approval to establish an 8-inch fabrication plant for producing 0.25 micron semiconductors, we have not applied for Phase II approval (involving the moving of manufacturing equipment from Taiwan to mainland China). Therefore, we cannot assure you that the ROC government will approve our Phase II application.

We are vulnerable to natural disasters which could severely disrupt the normal operation of our business and adversely affect our earnings.

Taiwan is susceptible to earthquakes. On September 21, 1999, Taiwan experienced a severe earthquake that caused significant property damage and loss of life, particularly in the central part of Taiwan. The earthquake in September 1999 caused damage to production facilities and adversely affected the operations of many companies in the semiconductor and other industries. We experienced damages to our machinery and equipment as a result of this severe earthquake. There were also interruptions to our production schedule, primarily as a result of power outages caused by the severe earthquake. Most of our production facilities, as well as many of our suppliers and customers and upstream providers of complementary semiconductor manufacturing services, are located in Taiwan. If our customers are affected by an earthquake or other natural disasters such as typhoons, it could result in a decline in the demand for our services. If our suppliers' services are affected, our production schedule could be interrupted or delayed. Although we maintain comprehensive natural perils insurance up to policy limits, including insurance for loss of property and loss of profit resulting from business interruption, our insurance coverage may not be sufficient to cover all of our potential losses. As a result, a major earthquake or natural disaster in Taiwan could severely disrupt the normal operation of our business and have a material adverse effect on our financial condition and results of operations.

Fluctuations in exchange rates could result in foreign exchange losses.

Over half of our capital expenditures and manufacturing costs are denominated in currencies other than NT dollars, primarily U.S. dollars, Japanese yen and Euros. A larger portion of our sales are denominated in U.S. dollars and other currencies, than in NT dollars. Therefore, we are particularly affected by fluctuations in the exchange rate between the U.S. dollar and the NT dollar. Any significant fluctuation to our disadvantage in that exchange rate may have an adverse effect on our financial condition. In addition, fluctuations in the exchange rate between the U.S. dollar and the NT dollar will affect the U.S. dollar value of our common shares and the market price of the ADSs and of any cash dividends paid in NT dollars on our common shares represented by ADSs.

Any future outbreak of severe acute respiratory syndrome may materially and adversely affect our business and results of operations.

Taiwan, together with mainland China, Hong Kong, Singapore and certain other areas experienced in early 2003 an outbreak of severe acute respiratory syndrome, or SARS, a new and highly contagious form of atypical pneumonia. The outbreak of SARS commenced in early 2003 and reached its peak in Taiwan in May 2003. According to the World Health Organization, over 8,400 cases of SARS and more than 900 deaths had been reported in over 30 countries as of August 7, 2003. The

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outbreak of SARS in Taiwan earlier this year was contained by the health authorities and did not significantly impact our operations. A SARS outbreak may potentially result in a quarantine of infected employees and related persons, which may affect our operations at one or more of our fabs. We cannot predict at this time the impact any future outbreak could have on our business and results of operations.

During the last SARS outbreak, we took various prevention measures and established contingency plans to ensure the safety of our employees and of our fabs, and to reduce the adverse impact, if any, in case any of our employees contracts SARS. While our prevention measures worked well during the last SARS outbreak and there has been no major impact on our results of operations as a result of SARS, we cannot assure you that a future outbreak of SARS would not have a material adverse effect on our results of operations.

Risks Relating to Ownership of ADSs

Your voting rights as a holder of ADSs will be limited.

Holders of American Depositary Receipts, or ADRs, evidencing ADSs may exercise voting rights with respect to the common shares represented by these ADSs only in accordance with the provisions of our ADS deposit agreement. The deposit agreement provides that, upon receipt of notice of any meeting of holders of our common shares, the depository bank will, as soon as practicable thereafter, mail to the holders (1) the notice of the meeting sent by us, (2) voting instruction forms and (3) a statement as to the manner in which instructions may be given by the holders.

ADS holders will not generally be able to exercise the voting rights attaching to the deposited securities on an individual basis. According to the ROC Company Law, the voting rights attaching to the deposited securities must be exercised as to all matters subject to a vote of shareholders collectively in the same manner, except in the case of an election of directors and supervisors. The election of directors and supervisors is by means of cumulative voting unless otherwise prescribed in our articles of incorporation. See Description of American Depositary Receipts Voting Rights and Item 10. Additional Information Voting of Deposited Securities in our Form 20-F, which is incorporated by reference herein, for a more detailed discussion of the manner in which a holder of ADSs can exercise its voting rights.

You may not be able to participate in rights offerings and may experience dilution of your holdings.

We may, from time to time, distribute rights to our shareholders, including rights to acquire securities. Under our ADS deposit agreement, the depository bank will not distribute rights to holders of ADSs unless the distribution and sale of rights and the securities to which these rights relate are either exempt from registration under the Securities Act of 1933 with respect to all holders of ADSs, or are registered under the provisions of the Securities Act of 1933. Although we may be eligible to take advantage of certain exemptions for rights offerings by certain foreign companies, we can give no assurances that we can establish an exemption from registration under the Securities Act of 1933, and we are under no obligation to file a registration statement with respect to any such rights or underlying securities or to endeavor to have such a registration statement declared effective. In addition, if the depository bank is unable to obtain the requisite approval from the Central Bank of China for the conversion of the subscription payments into NT dollars or if the depository determines that it is unlikely to obtain this approval, we may decide with the depository bank not to make the rights available to holders of ADSs. See Foreign Investment in the ROC and Item 10. Additional

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Information Exchange Controls in the ROC in our Form 20-F, which is incorporated by reference herein. Accordingly, holders of ADSs may be unable to participate in our rights offerings and may experience dilution of their holdings as a result.

If the depositary bank is unable to sell rights that are not exercised or not distributed or if the sale is not lawful or reasonably practicable, it will allow the rights to lapse, in which case you will receive no value for these rights.

The value of your investment may be reduced by possible future sales of common shares or ADSs by us or our shareholders.

Except for the sale of ADSs by Philips to the underwriters, Philips and the Development Fund have agreed with the underwriters not to dispose of any of our common shares or securities convertible into or exchangeable for common shares, including ADSs, during the period beginning from the date of this prospectus continuing through the date 180 days after the date of this prospectus, with respect to Philips, and 90 days after the date of this prospectus with respect to the Development Fund, except with the prior written consent of the representatives of the underwriters. We have also agreed, subject to certain exceptions, not to dispose of any of our common shares, including common shares represented by ADSs, during the period beginning from the date of this prospectus continuing through the date 90 days after the date of this prospectus, except with the prior written consent of the representatives of the underwriters. The representatives may, in their discretion, waive or terminate these restrictions. See further Common Shares Eligible for Future Sale in this prospectus for a more detailed discussion of restrictions that may apply to future sales of our ADSs or common shares by us and our affiliates.

One or more of our existing shareholders may dispose of significant numbers of common shares or ADSs. Philips sold an aggregate of 24,000,000 ADSs in October 1997 and is offering in this prospectus to sell an aggregate of 100,000,000 ADSs. In October 2003, Philips announced that it intends to gradually and orderly reduce its equity interest in us in the long term. Therefore, further sales, which may be sales similar to the present sale, by Philips of our common shares or ADSs may occur in the coming years. However, as of the date hereof, Philips has informed us that neither the method by which such reduction would take place nor the size and timing thereof are certain. The other largest shareholder, the Development Fund, has also sold significant amounts of common shares and ADSs in the past including 12,094,000 ADSs in November 1998, 12,094,000 ADSs in July 1999, 4,000,000 ADSs in April 2000, 8,680,400 ADSs in June 2000, 14,000,000 ADSs in June 2001, 20,000,000 ADSs in November 2001, 30,207,200 ADSs in February 2002 and 86,457,200 ADSs in July 2003. The Development Fund, which currently owns 7.42% of our outstanding common shares, announced in September 2003 that it intends to sell 600 million of our common shares in 2004. The Stabilization Fund also sold 26,800,000 ADSs in February 2002.

In addition, we have in place a conversion sale program that allows some of our shareholders to sell their common shares in ADS form to a specified financial intermediary during a 30-day period not more than once every three months. In the third quarter of 1999, our shareholders sold an aggregate of 5,486,000 ADSs in the program. In the first quarter of 2000, our shareholders sold an aggregate of 6,560,000 ADSs in the program. In the second quarter of 2001, our shareholders sold an aggregate of 11,682,000 ADSs in the program. In the fourth quarter of 2002, our shareholders sold an aggregate of 18,348,000 ADS in the program. We cannot predict the effect, if any, that future sales of ADSs or common shares, or the availability of ADSs or common shares for future sale, will have on the market price of ADSs or common shares prevailing from time to time. Sales of substantial amounts of ADSs or common shares in the public market, or the perception that such sales may occur, could depress the prevailing market price of our ADSs or common shares and could reduce the premium, if any, that the price per ADS on The New York Stock Exchange represents over the corresponding aggregate price of the underlying five common shares on the Taiwan Stock Exchange.

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The market value of your investment may fluctuate due to the volatility of, and government intervention in, the ROC securities market.

The Taiwan Stock Exchange has experienced substantial fluctuations in the prices and volumes of sales of listed securities and there are currently limits on the range of daily price movements on the Taiwan Stock Exchange. On March 13, 2000, the Taiwan Stock Exchange Index experienced a 617 point drop, which represented the single largest decrease in the history of the Taiwan Stock Exchange Index. From January 1, 2000 to December 31, 2000, the Taiwan Stock Exchange Index dropped from 8,448.8 to 4,739.0, or 43.9%. On October 20, 2003, the Taiwan Stock Exchange Index closed at 6,077.89.

In response to past declines and volatility in the securities markets in Taiwan, and in line with similar activities by other countries in Asia, the government of the ROC formed the Stabilization Fund, which has purchased and may from time to time purchase shares of Taiwan companies to support these markets. In addition, other funds associated with the ROC government have in the past purchased, and may from time to time purchase, shares of Taiwan companies on the Taiwan Stock Exchange or other markets. In the future, market activity by government entities, or the perception that such activity is taking place, may take place or has ceased, may cause fluctuations in the market prices of our ADSs and common shares.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The selected income statement data and cash flow data for the six months ended June 30, 2002 and 2003 and the selected balance sheet data as of June 30, 2002 and 2003 set forth below are derived from the unaudited consolidated financial statements included in this prospectus, and should be read in conjunction with, and are qualified in their entirety by reference to, those unaudited consolidated financial statements, including the notes to those financial statements. Those unaudited consolidated financial statements are prepared in accordance with ROC GAAP, which differ in some material respects from US GAAP. For a discussion of the material differences between ROC GAAP and US GAAP, see (1) note 27 to our audited consolidated financial statements included in our annual report on Form 20-F for the year ended December 31, 2002, which is incorporated herein by reference, and (2) note 27 to our unaudited consolidated financial statements included in this prospectus. For a discussion of the accounting policies used in the unaudited consolidated financial statements, see note 2 to the unaudited consolidated financial statements included in this prospectus. The results for the six months ended June 30, 2003 are not necessarily indicative of the results to be expected for the full year ending December 31, 2003.

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The following discussion of our business, financial condition and results of operations should be read in conjunction with our unaudited consolidated financial statements and the notes to our unaudited consolidated financial statements, which are included elsewhere in this prospectus. Unless stated otherwise, this discussion applies to our financial information as prepared according to ROC GAAP, which differs in some material respects from US GAAP. Please see note 27 to our unaudited consolidated financial statements as of and for the six months ended June 30, 2002 and 2003 for a discussion of the material differences. This discussion contains forward-looking statements that reflect our current views with respect to future events and financial performance. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of any number of factors, including those set forth under Risk Factors and elsewhere in this prospectus.

Selected Unaudited Consolidated Financial Information

	Six months ended and as of June 30,		
	2002	2003	2003 ⁽¹⁾
	NT\$	NT\$ (unaudited)	US\$
	(in millions, except percentages, earnings per share and per ADS, and operating data)		
Income Statement Data:			
ROC GAAP			
Net sales	80,267	89,695	2,592
Cost of sales	(50,823)	(60,734)	(1,755)
Gross profit	29,444	28,961	837
Operating expenses	(9,771)	(10,854)	(314)
Income from operations	19,673	18,107	523
Non-operating income	1,462	2,884	83
Non-operating expenses	(3,098)	(4,192)	(121)
Income before income taxes	18,037	16,799	485
Income tax (expense) benefit	(2,151)	(712)	(20)
Net income before minority interest	15,886	16,087	465
Minority interest	11	1	0
Net income	15,897	16,088	465
Basic and diluted earnings per share	0.77	0.79	0.02
Basic and diluted earnings per ADS equivalent	3.87	3.93	0.11
Average shares outstanding ⁽²⁾	20,221	20,221	20,221

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	Six months ended and as of June 30,		
	2002	2003	2003 ⁽¹⁾
	NT\$	NT\$ (unaudited)	US\$
(in millions, except percentages, earnings per share and per ADS, and operating data)			
Balance Sheet Data:			
ROC GAAP			
Working capital	72,143	89,375	2,582
Long-term equity investments	10,728	11,091	321
Properties	242,617	221,692	6,405
Total assets	396,162	381,267	11,016
Long-term bank borrowing	19,464	9,276	268
Long-term bonds payable	35,000	35,000	1,011
Guaranty deposit-in and other long-term liabilities	10,491	7,678	222
Total liabilities	106,893	82,913	2,395
Shareholders' equity	289,164	298,262	8,618
Other Financial Data:			
ROC GAAP			
Gross margin	37%	32%	32%
Operating margin	25%	20%	20%
Net margin	20%	18%	18%
Capital expenditures	17,248	16,262	470
Depreciation and amortization	30,451	34,586	999
Cash provided by operating activities	48,384	46,037	1,330
Cash used in investing activities	(20,881)	(21,740)	(628)
Cash provided by (used in) financing activities	6,265	(19,592)	(566)
Net cash flow	34,839	4,295	124
Operating Data:			
Wafers sold ⁽³⁾	1,317	1,581	1,581
Average utilization rate	76%	79%	79%

(1) Translation from NT dollars to U.S. dollars were made at the noon buying rate as of June 30, 2003, which was NT\$34.61 to US\$1.00 on that date.

(2) Retroactively adjusted for all subsequent stock dividends and employee stock bonuses, which have been paid prior to the date hereof, including a stock dividend of eight common shares per 100 common shares in July 2003 in respect of earnings in the year ended December 31, 2002.

(3) In thousands.

Six Months Ended June 30, 2003 (unaudited) Compared to Six Months Ended June 30, 2002 (unaudited)

Net Sales. Our net sales increased 11.7% from NT\$80,267 million in the first half of 2002 to NT\$89,695 million (US\$2,591.6 million) in the first half of 2003. This increase was primarily due to an increase in customer demand, which resulted in a 20.0% increase in wafer sales volume, from 1,317 thousand wafers in the first half of 2002 to 1,581 thousand wafers in the first half of 2003, offset in part by a 9.1% decrease in the average selling price of our wafers in U.S. dollar terms. The decrease in the average selling price of our wafers in U.S. dollar terms in the first half of 2003 was primarily the result of a decline in pure pricing, partially offset by a more favorable product mix.

Cost of Sales and Gross Margin. Our cost of sales increased 19.5% from NT\$50,823 million in the first half of 2002 to NT\$60,734 million (US\$1,754.8 million) in the first half of 2003. This increase resulted from higher sales, which resulted in an increase in material and labor cost, and an increase in depreciation and amortization expenses related to cost of sales from NT\$27,744 million in the first half

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of 2002 to NT\$31,794 million (US\$918.6 million) in the first half of 2003. Our depreciation and amortization expenses increased in the first half of 2003 primarily because of the increased depreciation associated with ramping up Fab 12 (Phase I) and the capacity increases at Fab 6 and Fab 8.

Our gross margin decreased from 36.7% in the first half of 2002 to 32.3% in the first half of 2003. The decrease in our gross margin was mainly the result of a decline in average selling prices and the increase in amortization and depreciation expenses related to cost of sales in the first half of 2003.

Operating Expenses. Our total operating expenses increased 11.1% from NT\$9,771 million in the first half of 2002 to NT\$10,854 million (US\$313.6 million) in the first half of 2003. Marketing expenses increased 34.9% from NT\$1,090 million in the first half of 2002 to NT\$1,470 million (US\$42.5 million) in the first half of 2003. The increase was primarily due to the increase in personnel costs as a result of increased business activities. Research and development expenses increased 6.7% from NT\$5,237 million in the first half of 2002 to NT\$5,589 million (US\$161.5 million) in the first half of 2003. The increase primarily reflects increased expenditures related to our continued development activities in 90-nanometer and 65-nanometer technologies and twelve-inch wafer manufacturing processes. We anticipate that our annual research and development expenditures will remain at a similar absolute level in 2003 as in 2002. General and administrative expenses increased 10.2% from NT\$3,444 million in the first half of 2002 to NT\$3,795 million (US\$109.6 million) in the first half of 2003. This increase primarily resulted from an increase in expenses associated with patent applications and an increase in expenses for information technology infrastructure in connection with the expansion of Fab 6 and Fab 12.

Income from Operations. Income from operations decreased 8.0% from NT\$19,673 million in the first half of 2002 to NT\$18,107 million (US\$523.2 million) in the first half of 2003. This was primarily due to a 9.1% decline in the average selling price of our wafers in U.S. dollars terms in the first half of 2003 and an 11.1% increase in operating expenses. Our operating margin decreased from 24.5% in the first half of 2002 to 20.2% in the first half of 2003.

Non-Operating Income and Expenses. Non-operating income increased 97.1% from NT\$1,463 million in the first half of 2002 to NT\$2,884 million (US\$83.3 million) in the first half of 2003. The increase primarily resulted from a NT\$1,707 million increase in the net gain realized on sales of short-term investments largely as a result of the sale of 1.5 million shares of Marvell Technology Group, Ltd. (NASDAQ: MRVL), partially offset by a NT\$323 million decrease in royalty income largely as a result of the decrease in royalty income from National Semiconductor Corporation under a technology transfer agreement, which was terminated in January 2003. See note 24.h. to our unaudited consolidated financial statements as of and for the six months ended June 30, 2002 and 2003.

Non-operating expenses increased 35.3% from NT\$3,098 million in the first half of 2002 to NT\$4,192 million (US\$121.1 million) in the first half of 2003. This increase principally resulted from a NT\$1,402 million write-off of certain fixed and idle assets and related expenses and a NT\$187 million increase in foreign exchange loss, partially offset by a NT\$256 million decrease in investment loss recognized by equity method and a NT\$217 million decrease in interest expense. The decrease in interest expense was primarily the result of a decrease in total bank loans and bonds payable, as well as lower interest rates.

Income Tax Benefit (Expense). Income tax expense decreased 66.9% from NT\$2,151 million in the first half of 2002 to NT\$712 million (US\$20.6 million) in the first half of 2003. The decrease was primarily due to a decrease in the reduction of net deferred tax assets, which was partially offset by the increase in the 10% tax on unappropriated earnings. The decrease in the reduction of net deferred tax assets was largely due to increased tax credits associated with equipment purchases and the benefit realized as a result of tax law changes in 2003. In February 2003, the ROC tax authority removed certain restrictions in utilizing tax credits.

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Net Income. Our net income increased 1.2% from NT\$15,897 million in the first half of 2002 to NT\$16,088 million (US\$464.8 million) in the first half of 2003. The improvement in our net income for the first half of 2003 primarily reflects the reduction in tax expense and net non-operating losses, largely offset by a decrease in income from operations. Our net margin decreased from 19.8% in the first half of 2002 to 17.9% in the first half of 2003.

Liquidity and Capital Resources

We had cash, cash equivalents and short-term investments of NT\$76,150 million (US\$2,200 million) as of June 30, 2003. Net cash inflow in the first half of 2003 was NT\$4,295 million (US\$124 million) as compared to a net cash inflow of NT\$34,839 million in the first half of 2002. The decrease in net cash inflow of NT\$30,544 million (US\$883 million) resulted primarily from a NT\$25,857 million decrease in cash provided by financing activities, a NT\$2,347 million decrease in cash provided by operating activities and a NT\$859 million increase in cash used in investing activities.

In the first half of 2003, our net cash provided by operating activities amounted to NT\$46,037 million (US\$1,330 million), which included non-cash depreciation and amortization expenses of NT\$34,586 million (US\$999 million), as compared to NT\$48,384 million in the first half of 2002, which included non-cash depreciation and amortization expenses of NT\$30,451 million. The decrease in cash provided by operating activities was primarily due to the increase in net receivables and payables as a result of higher business activities, offset in part by an increase in non-cash depreciation and amortization expenses. Non-cash depreciation and amortization expenses were higher in the first half of 2003 than in the first half of 2002 primarily due to increased depreciation associated with ramping up Fab 12 (Phase I) and the capacity increases at Fab 6 and Fab 8. Depreciation and amortization expenses are currently expected to remain flat through the end of 2003.

Net cash used in investing activities in the first half of 2003 was NT\$21,740 million (US\$628 million), as compared to NT\$20,881 million in the first half of 2002. The increase in cash used in investing activities was primarily due to an increase of NT\$3,108 million in short-term investments, partially offset by a reduction of NT\$986 million in acquisitions of property, plant and equipment, a reduction of NT\$852 million in long-term investments and a reduction of NT\$711 million in deferred charges.

Net cash used in financing activities in the first half of 2003 amounted to NT\$19,592 million (US\$566 million), compared with net cash provided by financing activities in the amount of NT\$6,265 million in the first half of 2002. The amount in the first half of 2003 primarily reflects the redemption of preferred stock in May 2003 in the amount of NT\$13,000 million (US\$376 million) and a payment of NT\$4,000 million made in March 2003 on long-term bonds.

As of June 30, 2003, we had aggregate short-term bank loans of NT\$554 million (US\$16 million), the current portion of our long-term bonds and long-term bank loans was NT\$6,923 million (US\$200 million), and we had aggregate long-term debt of NT\$44,276 million (US\$1,279 million). NT\$554 million (US\$16 million) of the short-term bank loans and NT\$16,199 million (US\$468 million) of the long-term debt were denominated in U.S. dollars. To protect against reductions in value and the volatility of future cash flows caused by changes in foreign exchange rates, we utilize derivative financial instruments, mainly currency forward contracts, to hedge our currency exposure. See Item 11. Quantitative and Qualitative Disclosure About Market Risk in our annual report on Form 20-F for the year ended December 31, 2002, incorporated by reference in this prospectus, for a discussion of the hedging instruments we use. All of the short-term and long-term bank loans had floating interest rates based on the London interbank offer rate, or LIBOR. NT\$35,000 million of the long-term bonds (including current

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portion) had fixed interest rates ranging from 2.60% to 5.95% (see notes 12, 13 and 14 to our unaudited consolidated financial statements). As of June 30, 2003, we had an aggregate of NT\$22,424 million (US\$648 million) in unused short-term credit lines and NT\$5,981 million (US\$173 million) in unused long-term credit lines.

Our loan agreements, credit facilities and guaranty agreements for the obligations of our consolidated subsidiaries contain covenants that, if violated, could result in our obligations under these agreements becoming due prior to the originally scheduled maturity dates. These covenants include financial covenants that require us to maintain at least:

a current assets to current liabilities ratio of 1:1;

an earnings before interest, taxes, depreciation and amortization to gross interest expense ratio of 4:1;

a total net worth to total indebtedness ratio of 1:1; and

unencumbered assets with a minimum value equal to not less than the then outstanding balance of amounts payable.

As of June 30, 2003, we were in compliance with our financial covenants. Other covenants could be triggered by a material adverse change in our business or management personnel that would impair our ability to perform our obligations under the agreements.

The following table sets forth the maturity of our long-term bank loans and short-term bank loans outstanding as of June 30, 2003:

	<u>Long-term loans</u>	<u>Short-term loans</u>
	(in millions)	
During 2003	NT\$ 6,923	NT\$ 554
During 2004		
During 2005	9,276	
During 2006		
During 2007 and thereafter		

We do not generally provide letters of credit to, or guarantees for, or engage in any repurchase financing transactions with, any entity other than our consolidated subsidiaries.

We require significant amounts of capital to build, expand, upgrade and maintain our production facilities and equipment. We made capital expenditures of NT\$103,762 million, NT\$70,201 million and NT\$55,236 million (US\$1,596 million) in 2000, 2001 and 2002, respectively. We made capital expenditures of NT\$17,248 million and NT\$16,262 million (US\$470 million) in the six months ended June 30, 2002 and 2003, respectively. We currently expect that our plans for ramping up production at Fab 12 (Phase I), upgrading the technology at Fab 3 and Fab 5, increasing the capacity and upgrading the technology at Fab 6 and Fab 8 and research and development projects will require capital expenditures of approximately NT\$41,532 million (US\$1,200 million) for 2003. We

currently expect our capital expenditures in 2004 to be higher than our capital expenditures in 2003.

We expect to fund our expansion projects and other cash requirements primarily with internally generated funds. In the future, we may consider debt and equity financing, depending on market conditions, our financial performance and other relevant factors. In particular, an extended industry downturn could adversely affect our profitability and internal generation of cash, and thereby increase our reliance on external sources of funds. We believe that we will have sufficient resources available to meet our planned capital requirements in the near future.

Table of Contents**US GAAP Reconciliation**

Our unaudited consolidated financial statements as of and for the six months ended June 30, 2002 and 2003 are prepared in accordance with ROC GAAP, which differ in certain material respects from US GAAP. The following table sets forth a comparison of our net income (loss) and shareholders' equity in accordance with ROC GAAP and US GAAP for the periods indicated:

	Six months ended and as of June 30,		
	2002	2003	2003
	NT\$	NT\$ (unaudited) (in Millions)	US\$
Net income (loss) in accordance with:			
ROC GAAP	15,897	16,088	465
US GAAP	8,524	9,559	276
Shareholders' equity in accordance with:			
ROC GAAP	289,164	298,262	8,618
US GAAP	303,867	327,813	9,472

Note 27 to the unaudited consolidated financial statements as of and for the six months ended June 30, 2002 and 2003 provides a description of the principal differences between ROC GAAP and US GAAP as they relate to us, and a reconciliation to US GAAP of certain items, including net income and shareholders' equity. Differences between ROC GAAP and US GAAP that have a material effect on our net income as reported under ROC GAAP include compensation expense pertaining to stock bonuses to employees, directors and supervisors, impairment charges for long-lived assets and amortization of goodwill.

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USE OF PROCEEDS

We will not receive any proceeds from the sale of ADSs by the selling shareholder.

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WHERE YOU CAN FIND MORE INFORMATION

As required by the United States Securities Act of 1933, we have filed a registration statement on Form F-3 relating to the securities offered by this prospectus with the United States Securities and Exchange Commission, or the SEC. This prospectus is a part of that registration statement, which includes additional information.

We file annual reports on Form 20-F with, and furnish periodic reports on Form 6-K to, the SEC. You may read and copy this information at the SEC's public reference room at Judiciary Plaza, 450 Fifth Street, N.W., Room 1024, Washington, D.C. 20549. You can also request copies of the documents, upon payment of a duplicating fee, by writing to the public reference section of the SEC. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference room. Our filings with the SEC are also available to the public from the SEC's website at <http://www.sec.gov>. The SEC website contains reports, proxy and information statements and other information regarding registrants that make electronic filings with the SEC using its EDGAR system. Since November 4, 2002, we have been required to file annual reports on Form 20-F with, and submit reports on Form 6-K and other information to, the SEC through the EDGAR system.

The SEC allows us to incorporate by reference the information we file with the SEC. This means that we can disclose important information to you by referring you to another document filed separately with the SEC. The information incorporated by reference is considered to be part of this prospectus. Any information that we file later with the SEC and that is deemed incorporated by reference will automatically update and supersede the information in this prospectus. In all such cases, you should rely on the later information over different information included in this prospectus.

This prospectus will be deemed to incorporate by reference the following documents:

our annual report on Form 20-F for the year ended December 31, 2002, filed on June 23, 2003, to the extent the information in that report has not been updated or superseded by this prospectus;

our report on Form 6-K, dated July 30, 2003, which contains the announcement with respect to the resignation of Mr. Harvey Chang as our Senior Vice President and Chief Financial Officer and the appointment of Ms. Lora Ho as our Vice President, Chief Financial Officer and Spokesperson;

our report on Form 6-K, dated September 3, 2003, which contains the announcement with respect to the approval by our board of directors, at its meeting held on September 2, 2003, of the appointment of Ms. Lora Ho as our Vice President and Chief Financial Officer, effective as of September 8, 2003;

our report on Form 6-K, dated October 8, 2003, which contains the announcement with respect to the approval by our board of directors, at its special meeting held on October 8, 2003, to sponsor the issuance of up to 100 million ADSs by Philips;

any amendment to our annual report on Form 20-F for the year ended December 31, 2002, and any annual report on Form 20-F or amendment thereto filed subsequent to the date hereof and prior to the termination of this offering; and

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any report on Form 6-K submitted by us to the SEC prior to the termination of this offering and identified by us as being incorporated by reference into this prospectus.

You may request a copy of these filings, at no cost, by writing or telephoning us at No.8, Li-Hsin Road 6, Science-Based Industrial Park, Hsinchu, Taiwan, Attention: Wendell Huang or Diane Kao, telephone number: (8863) 666-5920 or (8863) 666-5923.

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We will furnish to Citibank, N.A., as depositary of the ADSs, our annual reports. When the depositary receives these reports, it will upon our request promptly provide them to all holders of record of ADSs. We also will furnish the depositary with all notices of shareholders meetings and other reports and communications that we make available to our shareholders (or English language translations thereof, if necessary). The depositary will make these notices, reports and communications available to holders of ADSs and will upon our request mail to all holders of record of ADSs the information contained in any notice of a shareholders meeting it receives.

You should rely only on the information that we incorporate by reference or provide in this document. We have not authorized anyone to provide you with different information. You should not assume that the information in this document is accurate as of any date other than the date on the front of this document.

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MARKET PRICE INFORMATION FOR OUR ADSs AND COMMON SHARES

The principal trading market for our common shares is the Taiwan Stock Exchange. The common shares have been listed on the Taiwan Stock Exchange under the symbol 2330 since September 5, 1994, and the ADSs have been listed on The New York Stock Exchange under the symbol TSM since October 8, 1997. The outstanding ADSs are identified by the CUSIP number 874039100. The table below sets forth, for the periods indicated, the high and low closing prices and the average daily volume of trading activity on the Taiwan Stock Exchange for the common shares and the high and low closing prices and the average daily volume of trading activity on The New York Stock Exchange for the common shares represented by ADSs.

	Taiwan Stock Exchange			New York Stock Exchange ⁽¹⁾		
	Closing price per common share ⁽²⁾		Average daily Trading volume (in thousands of shares)	Closing price per ADS ⁽²⁾		Average daily Trading volume (in thousands of ADSs)
	High	Low		High	Low	
	(NT\$)	(NT\$)	(US\$)	(US\$)		
1998	44.51	21.96	102,504	7.84	3.82	1,407
1999	80.32	25.97	85,221	21.14	5.44	2,158
2000	102.87	45.09	51,685	32.24	10.00	2,980
2001	74.92	37.12	49,944	16.06	7.45	5,049
First Quarter	63.43	48.40	54,997	15.18	10.60	3,003
Second Quarter	59.52	47.50	39,221	14.91	9.97	5,110
Third Quarter	59.34	39.14	40,329	14.35	7.47	6,074
Fourth Quarter	74.92	37.12	64,994	16.06	7.45	6,028
2002	82.07	32.96	54,479	17.47	4.95	6,449
First Quarter	82.07	67.34	53,223	17.47	13.48	6,341
Second Quarter	80.81	60.61	42,738	17.34	11.44	5,977
Third Quarter	66.20	38.06	53,960	12.68	5.88	6,340
Fourth Quarter	49.54	32.96	67,441	8.74	4.95	7,130
2003	54.48	37.22	54,658	10.13	5.93	6,553
First Quarter	46.76	37.22	52,809	7.93	5.93	5,664
Second Quarter	56.43	39.07	56,542	9.87	6.39	7,425
April	44.72	39.07	61,601	7.96	6.39	7,010
May	49.54	43.24	53,762	9.39	7.62	7,760
June	54.63	51.85	53,894	9.87	8.83	7,504
Third Quarter	71.50	47.55	42,169	12.92	9.44	8,150
July	54.43	47.55	44,367	11.05	9.48	10,432
August	67.00	50.04	45,484	11.80	9.44	7,112
September	71.50	66.00	36,448	12.92	10.83	6,796
October (through October 20, 2003)	69.77	68.12	34,772	11.74	11.36	6,361

(1) Trading in ADSs commenced on October 8, 1997 on The New York Stock Exchange. Each ADS represents the right to receive five common shares.

(2) As adjusted for a 45% stock dividend in June 1998, a 23% stock dividend in June 1999, a 28% stock dividend in July 2000, a 40% stock dividend in July 2001, a 10% stock dividend in July 2002 and an 8% stock dividend in July 2003.

The ADSs offered in this offering will be fully fungible with, will be identified by the same CUSIP number and will be eligible for trading under the same New York Stock Exchange trading symbol as, the existing ADSs.

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As of September 30, 2003, a total of 20,266,618,984 common shares were outstanding, including 2,429,490,830 common shares represented by ADSs.

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The following table sets forth our unaudited consolidated capitalization as of June 30, 2003. You should read this table together with our audited consolidated financial statements contained in our Form 20-F, which is incorporated by reference herein. The as adjusted information adjusts the actual information for:

the appropriation from the earnings of 2002 approved by our shareholders as of June 3, 2003 and paid in July 2003, including the stock dividend of eight common shares per 100 common shares, employee bonus and remuneration to directors and supervisors;

the sale of 822,809 ADSs by our wholly-owned subsidiary, TSMC Partners, in July 2003 at the price of US\$10.40 per ADS; and

the sale of 420,476 of our common shares by TSMC North America, our wholly-owned subsidiary, in the three months ended September 30, 2003 at the price range of NT\$61.5 to NT\$72.0 per common share.

We do not have any unguaranteed and secured long-term obligations, nor do we have any guaranteed and unsecured long-term obligations.

	As of June 30, 2003	
	Actual	As Adjusted
	(NT\$)	(NT\$)
	(in thousands)	
Long-term obligations (excluding current portion of long-term obligations)		
Unguaranteed and unsecured long-term debt	35,000,000	35,000,000
Guaranteed and secured long-term debt	9,276,016	9,276,016
Unguaranteed and unsecured other long-term payable	3,921,540	3,921,540
Total long-term obligations	48,197,556	48,197,556
Shareholders equity		
Common shares, NT\$10 par value	186,228,867	202,666,189
Capital surplus	56,840,751	56,847,417
Capital Stock to be issued	16,437,322	
Retained earnings	39,929,224	39,922,558
Unrealized loss on long-term investment	(7,981)	(7,981)
Cumulative translation adjustments	755,436	755,436
Treasury stock	(1,922,049)	(1,643,404)
Total shareholders equity	298,261,570	298,540,215
Total capitalization	346,459,126	346,737,771

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The following table sets forth certain information as of September 30, 2003 with respect to our common shares owned by (1) each person who, according to our records, beneficially owned five percent or more of our common shares and by (2) all directors, supervisors and executive officers as a group.

<u>Names of Shareholders</u>	<u>Number of Common Shares Owned</u>	<u>Percentage of Total Outstanding Common Shares</u>
Philips ⁽¹⁾	4,368,123,138	21.55%
Development Fund ⁽²⁾	1,504,718,198	7.42%
Capital Research and Management Company ⁽³⁾	941,003,520	5.05%
Directors, supervisors and executive officers as a group	231,432,401	1.14%

(1) Includes 2,758,806,301 common shares held by Koninklijke Philips Electronics N.V. and 1,609,316,837 common shares held by Philips Electronics Industries (Taiwan) Ltd. See Selling Shareholder .

(2) Excludes any common shares that may be owned by other funds controlled by the ROC government.

(3) According to the Schedule 13G of Capital Research and Management Corporation, or CRMC, filed with the Securities and Exchange Commission on February 10, 2003, CRMC owned 941,003,520 common shares as of December 31, 2002, which represented 5.05% of our total outstanding common shares as of December 31, 2002. CRMC's beneficial ownership of 941,003,520 common shares included 1,700,000 ADS representing 8,500,000 common shares. According to this Schedule 13G, CRMC is an investment adviser registered under the Investment Advisers Act of 1940. We do not have further information with respect to CRMC's ownership in us subsequent to CRMC's Schedule 13G filed on February 10, 2003.

Of our nine directors, two are representatives of Philips and one is a representative of the Development Fund. Philips and the Development Fund could each be deemed under the U.S. securities laws to be a controlling shareholder of us.

The Development Fund, which has sold significant amounts of shares and ADSs in the past, sold in July 2003 an additional 86,457,200 ADSs, representing 432,286,000 common shares, which further decreased the Development Fund's ownership of our common shares to 7.42%. For a description of changes in the Development Fund's and Philips' ownership in us in the last three years, see Item 7. Major Shareholders and Related Party Transactions in our Form 20-F for the year ended December 31, 2002, incorporated by reference in this prospectus.

As of September 30, 2003, a total of 20,266,618,984 common shares were outstanding. With certain limited exceptions, holders of common shares that are not ROC persons are required to hold their common shares through a brokerage account in the ROC. As of September 30, 2003, 2,429,490,837 common shares were registered in the name of a nominee of Citibank, N.A., the depository under our ADS deposit agreement. Citibank, N.A., has advised us that, as of September 30, 2003, 485,898,166 ADSs, representing 2,429,490,830 common shares, were held of record by Cede & Co. and 254 other registered shareholders domiciled in and outside of the United States. We have no further information as to common shares held, or beneficially owned, by U.S. persons.

Our major shareholders have the same voting rights as our other shareholders. For a description of the voting rights of our shareholders, see Item 10. Additional Information Description of Common Shares Voting Rights in our annual report on Form 20-F for the year ended December 31, 2002, which is incorporated herein by reference.

We are not aware of any arrangement that may at a subsequent date result in a change of control of us.

Table of Contents**SELLING SHAREHOLDER**

All of the ADSs being offered in this offering are being offered by Philips. As of September 30, 2003, Philips held an aggregate of 4,368,123,138 of our common shares, representing 21.55% of the total common shares outstanding. Following this offering, Philips, together with its subsidiaries, will own an aggregate of 3,868,123,138 of our common shares, representing 19.09% of the total common shares outstanding. The table below sets forth the beneficial ownership of our common shares by Philips prior to this offering and after giving effect to the sale of all of the ADSs offered in this offering.

Name	Status/Position	Before this offering (as of September 30, 2003)		After this offering	
		Number of common shares	Percentage of total outstanding common shares	Number of common shares	Percentage of total outstanding common shares
Philips ⁽¹⁾	Founding Shareholder	4,368,123,138	21.55%	3,868,123,138	19.09%

(1) As of September 30, 2003, includes 2,758,806,301 common shares held by Koninklijke Philips Electronics N.V. and 1,609,316,837 common shares held by Philips Electronics Industries (Taiwan) Ltd. After this offering, includes 2,258,806,301 common shares held by Koninklijke Philips Electronics N.V. and 1,609,316,837 common shares held by Philips Electronics Industries (Taiwan) Ltd.

In October 2003, Philips announced that it intends to gradually and orderly reduce its equity interest in us in the long term. However, as of the date hereof, Philips has informed us that neither the method by which such reduction would take place nor the size and timing thereof are certain. Philips has also announced that it does not expect that this offering will affect the strategic relationship between the two companies and that Philips anticipates remaining among our largest shareholders for the foreseeable future.

The principal executive offices of Philips are located at Breitner Center, Amstelplein 2, 1096 BC Amsterdam, The Netherlands.

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FORWARD-LOOKING STATEMENTS

This prospectus and the documents incorporated by reference in this prospectus contain forward-looking statements that are, by their nature, subject to significant risks and uncertainties. These forward-looking statements include, without limitation, statements relating to:

our expected development of more advanced process technologies;

our expected production capacity;

future developments in the semiconductor industry;

our future business development and economic performance;

Philips' intentions with respect to its future equity ownership in, and relationship with, us; and

The Development Fund's intentions with respect to its future equity ownership in us.

The words "anticipate," "believe," "estimate," "expect," "intend," "plan" and similar expressions, as they relate to us, are intended to identify a number of these forward-looking statements. We do not intend to update these forward-looking statements.

The forward-looking statements reflect our current views with respect to future events and are not a guarantee of future performance. Actual results may differ materially from information contained in the forward-looking statements as a result of a number of factors, including, without limitation, the risk factors set forth in this prospectus.

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DESCRIPTION OF AMERICAN DEPOSITARY RECEIPTS

Citibank, N.A. is the depositary bank for the ADSs. Citibank's depositary offices are located at 111 Wall Street, New York, New York 10043. ADSs represent ownership interests in securities that are on deposit with the depositary bank. ADSs are normally represented by certificates that are commonly known as ADRs. The depositary bank typically appoints a custodian to safekeep the securities on deposit. In this case, the custodian is Citibank, N.A. Taipei Branch, located at B1, No. 16, Nanking E. Road, Section 4, Taipei, Taiwan, Republic of China.

We have appointed Citibank as depositary bank pursuant to an amended and restated deposit agreement, dated July 14, 2003, entered into among us, Citibank and the holders and owners of beneficial interests in our ADSs. A copy of the form of the amended and restated deposit agreement is on file with the SEC under cover of a registration statement on Post-Effective Amendment No. 1 to Form F-6 filed with the SEC on June 25, 2003. You may obtain a copy of that registration statement that includes a copy of the deposit agreement from the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington D.C. 20549 and from the SEC's website at www.sec.gov.

We are providing you with a summary description of the ADSs and your rights as an owner of ADSs. Please remember that summaries by their nature lack the precision of the information summarized and that a holder's rights and obligations as an owner of ADSs will be determined by the deposit agreement and not by this summary. We urge you to review the deposit agreement in its entirety as well as the form of ADR attached to the deposit agreement. Statements printed in italics in this description are provided for your information, but are not contained in the deposit agreement.

Each ADS represents five common shares on deposit with the custodian. An ADS will also represent any other property received by the depositary bank or the custodian on behalf of the owner of the ADSs but that has not been distributed to the owners of ADSs because of legal restrictions or practical considerations.

If you become an owner of ADSs, you will become a party to the deposit agreement and therefore will be bound to its terms and to the terms of the ADR that represents your ADSs. The deposit agreement and the ADR specify our rights and obligations as well as your rights and obligations as an owner of ADSs and those of the depositary bank. As a holder of ADSs, you appoint the depositary bank to act on your behalf in certain circumstances. The deposit agreement is governed by New York law. However, our obligations to the holders of common shares will continue to be governed by the laws of the Republic of China, which may be different from the laws in the United States.

As an owner of ADSs, you may hold your ADSs either by means of an ADR registered in your name or through a brokerage or safekeeping account. If you decide to hold your ADSs through your brokerage or safekeeping account, you must rely on the procedures of your broker or bank to assert your rights as an ADS owner. Please consult with your broker or bank to determine what those procedures are. This summary description assumes you have opted to own the ADSs directly by means of an ADR registered in your name and, as such, we will refer to you as the holder, when we refer to you, we assume the reader owns ADSs or will own ADSs at the relevant time.

Dividends and Distributions

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As a holder, you generally have the right to receive the distributions we make on the securities deposited with the custodian. Your receipt of these distributions may be limited, however, by practical considerations, legal limitations and the terms of the deposit agreement. Holders will receive such distributions under the terms of the deposit agreement in proportion to the number of ADSs held as of a specified record date.

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Distributions of Cash. Whenever we make a cash distribution for the securities on deposit with the custodian, the depository bank will arrange for the funds to be converted into U.S. dollars and for the distribution of the U.S. dollars to the holders subject to any restrictions imposed by applicable laws and regulations.

The conversion into U.S. dollars will take place only if practicable and only if the U.S. dollars are transferable to the United States. The amounts distributed to holders will be net of the fees, expenses, taxes and governmental charges payable by holders under the terms of the deposit agreement.

Distributions of Shares. Subject to applicable laws, whenever we make a free distribution of common shares for the securities on deposit with the custodian, the depository bank may, and will upon our request, distribute to holders new ADSs representing the common shares deposited. Only whole new ADSs will be distributed. Fractional entitlements will be sold and the proceeds of such sale will be distributed as in the case of a cash distribution. If additional ADSs are not distributed, the ADS-to-common share ratio will be modified subject to applicable ROC law, in which case each ADS you hold will represent rights and interests in the additional common shares so deposited.

The distribution of new ADSs or the modification of the ADS-to-common share ratio upon a distribution of common shares will be made net of the fees, expenses, taxes and governmental charges payable by holders under the terms of the deposit agreement. In order to pay such taxes or governmental charges, the depository bank may sell all or a portion of the new common shares so distributed.

No such distribution of new ADSs will be made if it would violate a law (*i.e.*, the U.S. securities laws) or if it is not operationally practicable. If the depository bank does not distribute new ADSs as described above, it will use its best efforts to sell the common shares received and will distribute the proceeds of the sales as in the case of a distribution in cash.

Distributions of Rights. Subject to applicable laws, whenever we distribute rights to purchase additional common shares, we will assist the depository bank in determining whether it is lawful and reasonably practicable to distribute rights to purchase additional ADSs to holders.

The depository bank will establish procedures to distribute rights to purchase additional ADSs to holders if it is lawful and reasonably practicable to make the rights available to holders of ADSs, and if we provide all of the documentation contemplated in the deposit agreement (including opinions to address the legality of the transaction). You may have to pay fees, expenses, taxes and other governmental charges to subscribe for the new ADSs upon the exercise of your rights.

In circumstances in which rights would not otherwise be distributed, if you request the distribution of warrants or other instruments in order to exercise the rights allocable to your ADSs, the depository bank will make such rights available to you as allowed by applicable law upon written notice from us. Our notice to the depository bank must indicate that:

we have elected in our sole discretion to permit the rights to be exercised; and

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you have executed such documents as we have determined in our sole discretion are reasonably required under applicable law.

The depositary bank may sell the rights that are not exercised or not distributed if such sale is lawful and reasonably practicable. The proceeds of such sale will be allocated to the account of the holders otherwise entitled to the rights. If the depositary bank is unable to sell the rights, it will allow the rights to lapse.

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Other Distributions. Subject to applicable laws, whenever we distribute property other than cash, common shares or rights in respect of the deposited securities, the depositary bank will determine whether such distribution to holders is feasible. If it is feasible to distribute such property to you, the depositary bank will distribute the property to the holders in a manner it deems practicable. If the depositary bank considers such distribution not to be feasible, it may sell all or a portion of the property received. The proceeds of such a sale will be distributed to holders as in the case of a distribution in cash.

Any distribution will be made net of fees, expenses, taxes and governmental charges payable by holders under the terms of the deposit agreement.

Changes Affecting Common Shares

The common shares held on deposit for your ADSs may change from time to time. For example, there may be a change in nominal or par value, a split-up, consolidation or reclassification of such common shares, or a recapitalization, reorganization, merger, consolidation or sale of assets.

If any such change were to occur, your ADSs would, to the extent permitted by law, represent the right to receive the property received or exchanged in respect of the common shares held on deposit. The depositary bank may in such circumstances deliver new ADSs to you or call for the exchange of your existing ADSs for new ADSs. If the depositary bank may not lawfully distribute such property to you, the depositary bank may sell such property and distribute the net proceeds to you in cash.

Issuance of ADSs upon Deposit of Common Shares

Under current ROC law, no deposit of common shares may be made into the depositary facility, and no ADSs may be issued against such deposits, without specific approval by the Securities and Futures Commission of the ROC, or SFC, except in connection with (i) dividends on or free distributions of common shares, (ii) the exercise by holders of existing ADSs of their pre-emptive rights in connection with rights offerings or (iii) if permitted under the deposit agreement and the custodian agreement, the deposit of common shares purchased by any person directly or through the depositary bank on the Taiwan Stock Exchange or GreTai Securities Market (as applicable) or held by such person for deposit in the depositary facility; provided that the total number of ADSs outstanding after an issuance described in clause (iii) above does not exceed the number of issued ADSs previously approved by the SFC (plus any ADSs created pursuant to clauses (i) and (ii) above) and subject to any adjustment in the number of common shares represented by each ADS. Under current ROC law and regulations, the term any person referred to in clause (iii) above may be interpreted to mean either (a) any foreign national or overseas Chinese investor (excluding any ROC investors) or (b) any foreign or ROC investor. It is expected that the SFC will clarify this issue in its forthcoming review and amendment of the Guidelines for Offering and Issuance of Overseas Securities by Issuers. Under current ROC law, issuances under clause (iii) above will be permitted only to the extent that previously issued ADSs have been cancelled and the underlying shares have been withdrawn from the ADR facility. The depositary bank will refuse to accept common shares for deposit pursuant to clause (iii) unless it receives satisfactory legal opinions as described in the deposit agreement. In addition, the depositary bank may, or if so directed by us, will, refuse to accept common shares for deposit whenever we have notified the depositary bank that (i) there are outstanding common shares with rights, including rights to dividends, that are different from the common shares held by the depositary bank, (ii) we have restricted the transfer of these common shares to comply with delivery, transfer or ownership restrictions referred to in the deposit agreement or under applicable law or otherwise or (iii) we have otherwise restricted the deposit of common shares pursuant to the deposit agreement.

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The depositary bank may create ADSs on your behalf if you or your broker deposits common shares with the custodian and meets the foregoing requirements. The depositary bank will deliver

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these ADSs to the person you indicate only after you pay any applicable fees, charges and taxes payable for the transfer of the common shares to and the issuance and delivery of the ADSs by the depositary bank or custodian.

The issuance of ADSs may be delayed until the depositary bank or the custodian receives confirmation that all required approvals have been given and that the common shares have been duly transferred to the custodian. The depositary bank will only issue ADSs in whole numbers.

When you make a deposit of common shares, you will be responsible for transferring good and valid title to the depositary bank. As such, you will be deemed to represent and warrant that:

the common shares are duly and validly authorized, issued and outstanding, fully paid and non-assessable and free of any preemptive rights;

you are duly authorized to deposit the common shares; and

the common shares are not restricted securities and your deposit of common shares is not restricted by United States federal securities laws and does not violate the deposit agreement.

If any of the representations or warranties are incorrect in any way, we and the depositary bank may, at your cost and expense, take any and all actions necessary to correct the consequences of the misrepresentations.

Certificate of Payment ADSs

In connection with any new issue of common shares by us which will be sold in ADS form, under the terms of the deposit agreement, the depositary bank may issue ADSs representing the certificate of payment in respect of the underlying shares, also called certificate of payment ADSs, rather than ADSs representing our common shares. Certificate of payment ADSs will be treated as ADSs issued under the terms of the deposit agreement except that:

certificate of payment ADSs will not be fungible with ADSs and will be separately identified until exchanged for ADSs by the depositary bank upon receipt from us of the corresponding number of newly issued common shares;

holders of certificate of payment ADSs may not withdraw their corresponding interests in the deposited certificate of payment from the ADR facility;

certificate of payment ADSs shall have different CUSIP numbers than the CUSIP number assigned to the ADSs;

certificate of payment ADSs will not be exchanged for common shares;

certificate of payment ADSs will only be issued in book-entry form through The Depository Trust Company;

neither certificate of payment ADSs nor interests in the certificate of payment are eligible for pre-release transactions; and

distributions made on certificate of payment ADSs shall be made only on the basis of distributions received in respect of the certificate of payment held by the depository.

Withdrawal of Common Shares Upon Cancellation of ADSs

You may withdraw and hold the common shares represented by your ADSs unless you are a citizen of the People's Republic of China, or the PRC, or an entity organized under the laws of the

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PRC, or request the depositary bank to sell the common shares represented by your ADSs; provided that settlement for trading of common shares represented by the ADSs through the book-entry system maintained by the Taiwan Securities Central Depository Co., Ltd. is permitted. If you are a non-ROC person and elect to withdraw common shares and hold the withdrawn common shares, you will be required to appoint a tax guarantor as well as an agent and a custodian in the ROC.

In addition, in accordance with the regulations governing investment in securities by overseas Chinese and foreign nationals recently amended by the ROC Executive Yuan, if you are an overseas Chinese or foreign national not having registered as a foreign investor and elect to withdraw common shares from the depositary facility, you will be required to first register with the Taiwan Stock Exchange and, if applicable, to obtain the approval from the Central Bank of China (if you are a foreign company, that is, a company incorporated in a jurisdiction other than the ROC under the laws of such foreign jurisdiction) and then appoint a local agent to, among other things, open a general securities trading account with a local securities brokerage firm to hold or trade the withdrawn common shares.

If you or someone on your behalf plans to withdraw common shares from the depositary facility, you would be the recipient of such common shares and (i) you are a related party to us (as defined in the ROC Statements of Financial Accounting Standards No. 6) or (ii) you would be the beneficial owner of 10% or more of our issued common shares previously in the depositary facility, your withdrawal will be subject to ROC governmental disclosure and reporting requirements.

In order to withdraw the common shares represented by your ADSs, you will be required to pay to the depositary the fees for cancellation of ADSs and any charges and taxes payable upon the transfer of the common shares being withdrawn. You assume the risk for delivery of all funds and securities upon withdrawal. Once canceled, the ADSs will not have any rights under the deposit agreement.

*If you hold any ADSs registered in your name, the depositary bank may ask you to provide proof of citizenship, residence, tax payer status, exchange control approval, payment of taxes and other governmental charges, compliance with applicable laws and regulations and certain other documents as the depositary bank may deem appropriate before it will effect any withdrawal of the common shares represented by such ADS. The withdrawal of the common shares represented by your ADSs may be delayed until the depositary bank receives satisfactory evidence of compliance with all applicable laws and regulations. *If the common shares are withdrawn to or for the account of any person other than the person receiving the proceeds from the sale of ADSs, such evidence may include the disclosure of:**

your name;

the name and nationality (and the identity number, if such person is a ROC citizen) of any person in whose name the common shares you are withdrawing will be registered;

the number of common shares such person will receive upon such withdrawal;

the aggregate number of common shares such person has received upon all withdrawals since the establishment of the depositary facility; and

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any other information that we or the depositary bank may deem necessary or desirable to comply with any ROC disclosure or reporting requirements.

The depositary bank will only accept ADSs for cancellation that represent a whole number of common shares on deposit. If you surrender a number of ADSs for withdrawal representing other than

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a whole number of common shares the depositary bank will either return the number of ADSs representing any remaining fractional common shares or sell the common shares represented by the ADSs you surrendered and remit the net proceeds of that sale to you as in the case of a distribution in cash. Common shares sold in lots other than integral multiples of 1,000 may realize a lower price on the Taiwan Stock Exchange.

You will have the right to withdraw the securities represented by your ADSs at any time subject to the requirements listed above and:

temporary delays that may arise because (i) the transfer books for the shares or ADSs are closed, or (ii) common shares are immobilized on account of a shareholders' meeting, a payment of dividends or rights offering;

obligations to pay fees, taxes and similar charges; and

restrictions imposed because of laws or regulations applicable to ADSs or the withdrawal of securities on deposit.

The deposit agreement may not be modified to impair your right to withdraw the securities represented by your ADSs except to comply with mandatory provisions of law.

Voting Rights

You may direct the exercise of voting rights with respect to the common shares represented by the ADSs only in accordance with the provisions of the deposit agreement as described below and applicable ROC law. *See Risk Factors Risks Relating to Ownership of ADSs Your voting rights as a holder of ADSs will be limited .*

Except as described below, you will not be able to exercise the voting rights attaching to the common shares represented by your ADSs on an individual basis. According to the ROC Company Law, a shareholder's voting rights attached to shareholdings in an ROC company must, as to all matters subject to a vote of shareholders (other than the election of directors and supervisors, if such election is done by means of cumulative voting), be exercised as to all shares held by such shareholder in the same manner. Accordingly, the voting rights attaching to the common shares represented by ADSs must be exercised as to all matters subject to a vote of shareholders by the depositary bank or its nominee, who represents all holders of ADSs, collectively in the same manner, except in the case of an election of directors and supervisors, if such election is done by means of cumulative voting. Directors and supervisors are elected by cumulative voting unless our articles of incorporation stipulate otherwise.

In the deposit agreement, you will appoint the depositary bank as your representative to exercise the voting rights with respect to the common shares represented by your ADSs.

We will provide the depositary bank with copies (including English translations) of notices of meetings of our shareholders and the agenda of these meetings, including an indication of the number of directors or supervisors to be elected if an election of directors

or supervisors is to be held at the meeting. The depositary bank has agreed to request and we will, therefore, also provide a list of the candidates who have expressed their intention to run for an election of directors or supervisors. The depositary bank will mail these materials, together with a voting instruction form to holders as soon as practicable after the depositary bank receives the materials from us. In order to validly exercise its voting rights, the holder of ADSs must complete, sign and return to the depositary bank the voting instruction form by a date specified by the depositary bank. Additional or different candidates may be nominated at the meeting of the shareholders than those proposed in the list provided by us and after the depositary bank has mailed the voting instruction form to you. If such change were to occur, the

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depository bank may calculate your votes according to procedures not inconsistent with the provisions of the deposit agreement, but shall not exercise any discretion regarding your voting rights.

Subject to the provisions described in the second succeeding paragraph, which will apply to the election of directors and supervisors done by means of cumulative voting, if persons together holding at least 51% of the ADSs outstanding at the relevant record date instruct the depository bank to vote in the same manner in respect of one or more resolutions to be proposed at the meeting (other than the election of directors or supervisors), the depository bank will notify the instructions to the chairman of our board of directors or a person he may designate. The depository bank will appoint the chairman or his designated person to serve as the voting representative of the depository bank or its nominee and the holders. The voting representative will attend such meeting and vote all the common shares represented by ADSs to be voted in the manner so instructed by such holders in relation to such resolution or resolutions.

If, for any reason, the depository bank has not by the date specified by it received instructions from persons together holding at least 51% of all the ADSs outstanding at the relevant record date to vote in the same manner in respect of any resolution specified in the agenda for the meeting (other than the election of directors or supervisors done by means of cumulative voting), then the holders will be deemed to have instructed the depository bank or its nominee to authorize and appoint the voting representative as the representative of the depository bank and the holders to attend such meeting and vote all the common shares represented by all ADSs as the voting representative deems appropriate with respect to such resolution or resolutions, which may not be in your interests; *provided, however*, that the depository bank or its nominee will not give any such authorization and appointment unless it has received an opinion of ROC counsel addressed to the depository bank and in form and substance satisfactory to the depository bank, at its sole expense, to the effect that, under ROC law (i) the deposit agreement is valid, binding and enforceable against us and the holders and (ii) the depository bank will not be deemed to be authorized to exercise any discretion when voting in accordance with the deposit agreement and will not be subject to any potential liability for losses arising from such voting. We and the depository bank will take such actions, including amendment of the provisions of the deposit agreement relating to voting of common shares, as we deem appropriate to endeavor to provide for the exercise of voting rights attached to the common shares at shareholders meetings in a manner consistent with applicable ROC law.

The depository bank will notify the voting representative of the instructions for the election of directors and supervisors received from holders and appoint the voting representative as the representative of the depository bank and the owners to attend such meeting and vote the common shares represented by ADSs as to which the depository bank has received instructions from holders for the election of directors and supervisors, subject to any restrictions imposed by ROC law and our articles of incorporation. Holders who by the date specified by the depository bank have not delivered instructions to the depository bank will be deemed to have instructed the depository bank to authorize and appoint the voting representative as the representative of the depository bank or its nominee and the holders to attend such meeting and vote all the common shares represented by ADSs as to which the depository bank has not received instructions from the holders for the election of directors and supervisors as the voting representative deems appropriate, which may not be in your best interests. Candidates standing for election as representatives of a shareholder may be replaced by such shareholder prior to the meeting of the shareholders, and the votes cast by the holders for such candidates shall be counted as votes for their replacements.

By accepting and continuing to hold ADSs or any interest therein, you will be deemed to have agreed to the voting provisions set forth in the deposit agreement, as such provisions may be amended from time to time to comply with applicable ROC law.

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There can be no assurance that you will receive notice of shareholders' meetings sufficiently prior to the date established by the depositary bank for receipt of instructions to enable you to give voting instructions before the cutoff date.

Fees and Charges

As an ADS holder, you will be required to pay the following service fees to the depositary bank:

<u>Service</u>	<u>Fees</u>
Issuance of ADSs upon deposit of Eligible Securities	Up to 5¢ per ADS issued
Delivery of deposited securities, property and cash upon surrender of ADSs	Up to 5¢ per ADS surrendered
Distribution of ADSs pursuant to exercise of rights or other free distribution of stock (excluding stock dividends)	Up to 5¢ per ADS issued
Distribution of cash upon sale of rights and other entitlements	Up to 2¢ per ADS held

As an ADS holder, you will also be responsible to pay certain fees and expenses incurred by the depositary bank and certain taxes and governmental charges, such as:

Fees for the transfer, custody and registration of common shares (*i.e.*, upon deposit, transfer and withdrawal of common shares);

Expenses incurred for converting foreign currency into U.S. dollars and in compliance with exchange control regulations;

Expenses for cable, telex and fax transmissions and for delivery of securities; and

Taxes and duties upon the transfer of securities (*i.e.*, when common shares are deposited or withdrawn from deposit).

We have agreed to pay certain other charges and expenses of the depositary bank. Note that the fees and charges you may be required to pay may vary over time and may be changed by agreement between us and the depositary bank. Any change will apply to you 30 days after the depositary bank provides notice of such changes.

Amendments and Termination

We may agree with the depositary bank to modify the deposit agreement at any time without your consent. We undertake to give holders 30 days' prior notice of any modifications that would prejudice any of their substantial rights under the deposit agreement.

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(except in very limited circumstances enumerated in the deposit agreement).

You will be bound by the modifications to the deposit agreement if you continue to hold your ADSs after the modifications to the deposit agreement become effective. The deposit agreement cannot be amended to prevent you from withdrawing the common shares represented by your ADSs (except to comply with applicable law).

We have the right to direct the depository bank to terminate the deposit agreement. Similarly, the depository bank may in certain circumstances on its own initiative terminate the deposit agreement. In either case, the depository bank must give notice to the holders at least 60 days before termination.

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Upon termination, the following will occur under the deposit agreement:

for a period of six months after termination, you will be able to request the cancellation of your ADSs and the withdrawal of the common shares represented by your ADSs and the delivery of all other property held by the depositary bank in respect of those common shares on the same terms as prior to the termination. During this six-month period, the depositary bank will continue to collect all distributions received on the common shares on deposit (i.e., dividends) but will not distribute any property to you until you request the cancellation of your ADSs; and

after the expiration of the six-month period, the depositary bank may sell the securities held on deposit. The depositary bank will hold the proceeds from such sale and any other funds then held for the holders of ADSs in a non-interest bearing account. At that point, the depositary bank will have no further obligations to holders other than to account for the funds then held for the holders of ADSs still outstanding.

Books of the Depositary Bank

The depositary bank will maintain ADS holder records at its depositary office. You may inspect such records at that office during regular business hours, but solely for the purpose of communicating with other holders in the interest of our business or matters relating to the ADSs and the deposit agreement.

The depositary bank will maintain in The City of New York facilities to record and process the execution and delivery, registration, registration of transfers and surrender of ADRs. These facilities may be closed from time to time, to the extent not prohibited by law.

Limitations on Obligations and Liabilities

The deposit agreement limits our obligations and the depositary bank's obligations to you. Please note the following:

We and the depositary bank are obligated only to take the actions specifically stated in the depositary agreement without negligence and in good faith.

The depositary bank disclaims any liability for any failure to carry out voting instructions, for any manner in which a vote is cast or for the effect of any vote, provided it acts in good faith and in accordance with the terms of the deposit agreement.

The depositary bank disclaims any liability to monitor or enforce our obligations under the deposit agreement, including our obligation to replace the certificate of payment in respect of common shares.

We and the depositary bank will not be obligated to perform any act that is not set forth in the deposit agreement.

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We and the depositary bank disclaim any liability if we are prevented or forbidden from acting on account of any law or regulation, any provision of our articles of incorporation, any provision of any securities on deposit or by reason of any act of God or war or other circumstances beyond our control.

We and the depositary bank disclaim any liability by reason of any exercise of, or failure to exercise, any discretion provided for in the deposit agreement.

We and the depositary bank further disclaim any liability for any action or inaction in reliance on the advice or information received from legal counsel, accountants, any person presenting common shares for deposit, any holder of ADSs or authorized representative thereof, or any other person believed by either of us in good faith to be competent to give such advice or information.

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We and the depositary bank also disclaim liability for the inability by a holder to benefit from any distribution, offering, right or other benefit which is made available to holders of common shares but is not, under the terms of the deposit agreement, made available to that holder.

We and the depositary bank may rely without any liability upon any written notice, request or other document believed to be genuine and to have been signed or presented by the proper parties.

Pre-Release Transactions

The depositary bank may, to the extent permitted by applicable laws and regulations, issue ADSs before receiving a deposit of common shares. These transactions are commonly referred to as pre-release transactions. The deposit agreement limits the aggregate size of pre-release transactions and imposes a number of conditions on such transactions (*i.e.*, the need to receive collateral, the type of collateral required, the representations required from brokers, etc.). The depositary bank may retain the compensation received from the pre-release transactions.

Taxes

You will be responsible for the taxes and other governmental charges payable on your ADSs and the securities represented by your ADSs. We, the depositary bank and the custodian may deduct from any distribution the taxes and governmental charges payable by holders and may sell any and all property on deposit to pay the taxes and governmental charges payable by holders. You will be liable for any deficiency if the sale proceeds do not cover the taxes that are due on your ADSs and the securities represented by your ADSs.

The depositary bank may refuse to transfer ADRs or to release securities on deposit until all taxes and charges are paid by the applicable holder. You may be required to provide to the depositary bank and to the custodian proof of taxpayer status and residence and such other information as the depositary bank and the custodian may require to fulfill legal obligations.

Although in certain circumstances ROC income tax imposed on certain stock dividends distributed by us may be deferred until the sale or other disposition of such stock dividends, the depositary bank will elect to waive the deferral of income tax on such stock dividends.

Foreign Currency Conversion

Subject to ROC law, the depositary bank may arrange for the conversion of all foreign currency received into U.S. dollars only if such conversion is reasonably practicable, and it will distribute the U.S. dollars in accordance with the terms of the deposit agreement. You may be required to pay fees and expenses incurred in converting foreign currency, such as fees and expenses incurred in complying with currency exchange controls and other governmental requirements.

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If the conversion of foreign currency is not reasonably practicable or lawful, or if any required approvals are denied or not obtainable at a reasonable cost or within a reasonable period, the depositary bank may take the following actions in its discretion:

convert the foreign currency and distribute the U.S. dollars to the holders for whom the conversion and distribution is permissible;

distribute the foreign currency to holders entitled to the distribution; or

hold the foreign currency (without liability for interest) for the applicable holders.

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The Custodian

The depositary bank has agreed with the custodian that the custodian will receive and hold the deposited securities for the account of the depositary bank in accordance with the deposit agreement. If the custodian resigns or is discharged from its duties under the deposit agreement, the depositary bank will promptly appoint a successor custodian that is organized under the laws of the ROC. The resigning or discharged custodian will deliver the deposited securities and related records to the custodian designated by the depositary bank. The depositary bank may also appoint an additional custodian for any deposited securities. The depositary bank will give you written notice of any such changes. If the depositary bank resigns or is discharged from its duties under the deposit agreement, the custodian will, unless otherwise instructed by the depositary bank, continue to act as custodian and will be subject to the direction of the successor depositary bank.

Governing Law

The deposit agreement is governed by the laws of the State of New York. With respect to the authorization of the deposit agreement by us, such authorization shall be governed by the laws of the ROC. We and the depositary bank have agreed that the federal or state courts in the City of New York shall have jurisdiction to hear and determine any suit, action or proceeding and to settle any dispute between us that may arise out of or in connection with the deposit agreement. We have also submitted to the jurisdiction of such courts for such purpose only and have appointed an agent for service of process in the City of New York.

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COMMON SHARES ELIGIBLE FOR FUTURE SALE

Upon completion of this offering, the 100,000,000 ADSs sold in this offering will be freely tradeable within the United States without restriction or further registration under the Securities Act by persons other than us or our affiliates, as such term is defined in Rule 144 under the Securities Act.

Our selling shareholder and the Development Fund have agreed, during the period beginning from the date of this prospectus to and including the date 180 days after the date of this prospectus, with respect to the selling shareholder, and 90 days after the date of this prospectus, with respect to the Development Fund, not to, and not to announce an intention to, offer, sell, contract to sell or otherwise dispose of, or file a registration statement or similar document relating to, any common shares or depositary shares representing our common shares, or any securities that are substantially similar to common shares or depositary shares representing our common shares, including but not limited to any securities that are convertible into or exchangeable for, or that represent the right to receive, any of these securities or any substantially similar securities, without the prior written consent of Goldman Sachs International and Merrill Lynch, Pierce, Fenner & Smith Incorporated. These restrictions do not apply to the 100,000,000 ADSs and the common shares represented thereby being offered in connection with this offering.

We have also agreed, during the period beginning from the date of this prospectus to and including the date 90 days after the date of this prospectus, not to, and not to announce an intention to, issue any common shares, including common shares represented by ADSs (other than pursuant to employee stock option plans that we may adopt or any common shares to be issued as an annual dividend or annual bonus to directors, supervisors and employees which is approved by our shareholders), without the prior written consent of Goldman Sachs International and Merrill Lynch, Pierce, Fenner & Smith Incorporated. Although we have no current plans to make such issuance during this 90-day period, we are not precluded from issuing any securities that are convertible into or exchangeable for, or that represent the right to receive, our common shares.

Additional common shares may be sold in ADS form as part of our conversion sale program, which was adopted in May 1999 and which may be amended from time to time. The purpose of this program is to enable sales of common shares in ADS form by certain of our long-term common shareholders in a gradual and coordinated fashion. Any of our shareholders, excluding our affiliates, who are holding at least 0.02% of our outstanding common shares as of the relevant announcement date and have held such shares for at least one year as of that date are eligible to file an application to sell shares under this program. Based on the 20,266,618,984 common shares outstanding as of September 30, 2003, 0.02% represents 4,053,323 common shares. The maximum amount that will be approved for participation in the program during any three-month period will be 0.5% of our outstanding shares, which, based on the 20,266,618,984 common shares outstanding as of September 30, 2003, is 101,333,094 shares. We do not recommend or promote the sale of our shares by our shareholders. Each transaction under the conversion sale program is subject to the approval by our board of directors, the approvals by certain ROC and US regulatory authorities and stock exchanges and market conditions. Eligible selling shareholders who have submitted a written application to participate in the program, whether or not required regulatory approvals are granted or whether or not any sales are made, must pay, on a pro rata basis, all fees and expenses incurred by us, the administrative agent, advisors and trade facilitator in connection with the program. We have advised the underwriters of our intention not to facilitate any conversions or exchanges of common shares into ADSs for 90 days after the date of this prospectus.

The Development Fund, which has sold significant amounts of shares and ADSs in the past and which currently owns 7.42% of our outstanding common shares, announced in September 2003 that it intends to sell 600 million of our common shares in 2004. Philips, which following this offering will own 19.09% of our outstanding common shares, announced in October 2003 that it intends to gradually and

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orderly reduce its equity interest in us in the long term. However, as of the date hereof, Philips has informed us that neither the method by which such reduction would take place nor the size and timing thereof are certain. Philips has also announced that it does not expect that this offering will affect the strategic relationship between the two companies and that Philips anticipates remaining among our largest shareholders for the foreseeable future.

Other than as discussed above, we are not aware of any plans by any major shareholders to dispose of significant numbers of common shares.

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FOREIGN INVESTMENT IN THE ROC

Historically, foreign investment in the ROC securities market has been restricted. Since 1983, the ROC government has periodically enacted legislation and adopted regulations to permit foreign investment in the ROC securities market.

On September 30, 2003, the Executive Yuan approved an amendment to Regulations Governing Investment in Securities by Overseas Chinese and Foreign National, or the Regulations, which took effect on October 2, 2003. According to the Regulations, the SFC abolished the mechanism of the so-called "qualified foreign institutional investors" and "general foreign investors" as stipulated in the Regulations before the amendment.

Under the Regulations, foreign investors are classified as either "onshore foreign investors" or "offshore foreign investors" according to their respective geographical location. Both onshore and offshore foreign investors are allowed to invest in ROC securities after they register with the Taiwan Stock Exchange. The Regulations further classify foreign investors into foreign institutional investors and foreign individual investors. Foreign institutional investors refer to those investors incorporated and registered in accordance with foreign laws outside of the ROC (i.e., offshore foreign institutional investors) or their branches set up and recognized within the ROC (i.e., onshore foreign institutional investors). Offshore foreign institutional investors are required to apply for a prior approval from the Central Bank of China before they can register with the Taiwan Stock Exchange. Offshore overseas Chinese and foreign individual investors are not required to apply for Central Bank of China approval, but are subject to a maximum investment ceiling that will be separately determined by the SFC after consultation with the Central Bank of China. On the other hand, foreign institutional investors are not subject to any ceiling for investment in the ROC securities market.

Except for certain specified industries, such as telecommunications, investments in ROC-listed companies by foreign investors are not subject to individual or aggregate foreign ownership limits. Custodians for foreign investors are also required to submit to the Central Bank of China and the Taiwan Stock Exchange a monthly report of trading activities and status of assets under custody and other matters. Capital remitted to the ROC under these guidelines may be remitted out of the ROC at any time after the date the capital is remitted to the ROC. Capital gains and income on investments may be remitted out of the ROC at any time.

Foreign investors (other than foreign investors who have registered with the Taiwan Stock Exchange for making investments in the ROC securities market) who wish to make direct investments in the shares of ROC companies are required to submit a foreign investment approval application to the Investment Commission of the ROC Ministry of Economic Affairs or other applicable government authority. The Investment Commission or such other government authority reviews each foreign investment approval application and approves or disapproves each application after consultation with other governmental agencies (such as the Central Bank of China and the SFC).

Under current ROC law, any non-ROC person possessing a foreign investment approval may repatriate annual net profits, interest and cash dividends attributable to the approved investment. Stock dividends attributable to this investment, investment capital and capital gains attributable to this investment may be repatriated by the non-ROC person possessing a foreign investment approval after approvals of the Investment Commission or other government authorities have been obtained.

In addition to the general restriction against direct investment by non-ROC persons in securities of ROC companies, non-ROC persons (except in certain limited cases) are currently prohibited from investing in certain industries in the ROC pursuant to a "negative list", as amended by the Executive Yuan. The prohibition on foreign investment in the prohibited industries specified in

the negative list is

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absolute in the absence of a specific exemption from the application of the negative list. Pursuant to the negative list, certain other industries are restricted so that non-ROC persons (except in limited cases) may invest in these industries only up to a specified level and with the specific approval of the relevant competent authority that is responsible for enforcing the relevant legislation that the negative list is intended to implement.

Depositary Receipts. In April 1992, the SFC enacted regulations permitting ROC companies with securities listed on the Taiwan Stock Exchange, with the prior approval of the SFC, to sponsor the issuance and sale to foreign investors of depositary receipts. Depositary receipts represent deposited shares of ROC companies. In December 1994, the Ministry of Finance allowed companies whose shares are traded on the ROC GreTai Securities Market or listed on the Taiwan Stock Exchange, upon approval of the SFC, to sponsor the issuance and sale of depositary receipts.

In the past, for depositary shares that represented new shares, three months after the issuance of the depositary receipts, a holder of the depositary receipts (other than citizens of the People's Republic of China and entities organized under the laws of the People's Republic of China) could request the depositary to either cause the underlying shares to be sold in the ROC and to distribute the sale proceeds to the holder or to withdraw from the depositary receipt facility the shares represented by the depositary receipts and transfer the shares to the holder. For depositary shares that represent previously issued and existing shares, a holder of the depositary receipts (other than citizens of the People's Republic of China and entities organized under the laws of the People's Republic of China) could, immediately after the issuance of the depositary receipts, request the depositary to either cause the underlying shares to be sold in the ROC and to distribute the sale proceeds to the holder or to withdraw from the depositary receipt facility the shares represented by the depositary receipts and transfer the shares to the holder. The Executive Yuan and the SFC recently amended the relevant regulations such that the three-month withdrawal restriction has been removed. Accordingly, a holder of depositary receipts (other than citizens of the People's Republic of China and entities organized under the laws of the People's Republic of China) may now withdraw shares after the issuance of the depositary receipts representing new shares to the extent permitted under the deposit agreement (in practice, four to seven business days thereafter).

We or the foreign depositary bank may not increase the number of depositary receipts by depositing shares in a depositary receipt facility or issuing additional depositary receipts against these deposits without specific SFC approval, except in limited circumstances. These circumstances include issuances of additional depositary receipts in connection with:

- (1) dividends on or free distributions of shares;
- (2) the exercise by holders of existing depositary receipts of their pre-emptive rights in connection with capital increases for cash; or
- (3) if permitted under the deposit agreement and custody agreement, the deposit of common shares purchased by any person directly or through a depositary bank on the Taiwan Stock Exchange or the GreTai Securities Market (as applicable) or held by such person for deposit in the depositary receipt facility.

Under current ROC laws and regulations, the term "any person" referred to in clause (3) above may be interpreted to mean either (a) any foreign national or overseas Chinese investor (excluding any ROC investors) or (b) any foreign or ROC investor. It is expected that the SFC will clarify this issue in its forthcoming review and amendment of the Guidelines for Offering and Issuance of Overseas Securities by Issuers.

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However, the total number of deposited shares outstanding after an issuance under the circumstances described in clause (3) above may not exceed the number of deposited shares

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previously approved by the SFC plus any depositary receipts created under the circumstances described in clauses (1) and (2) above. Issuances of additional depositary receipts under the circumstances described in clause (3) above will be permitted to the extent that previously issued depositary receipts have been canceled and the underlying shares have been withdrawn from the depositary receipt facility.

Under current ROC law, a non-ROC holder of ADSs who withdraws the underlying shares must appoint an eligible local agent to:

- (1) open a securities trading account with a local securities brokerage firm;
- (2) remit funds; and
- (3) exercise rights on securities and perform other matters as may be designated by the holder.

Under existing ROC laws and regulations, without this account, holders of ADSs that withdraw and hold the common shares represented by the ADSs would not be able to hold or transfer the common shares, whether on the Taiwan Stock Exchange or otherwise. In addition, a withdrawing non-ROC holder must appoint a local bank to act as custodian for handling confirmation and settlement of trades, safekeeping of securities and cash proceeds and reporting of information.

Holders of ADSs who are non-ROC persons withdrawing common shares represented by ADSs are required under current ROC law and regulations to appoint an agent in the ROC for filing tax returns and making tax payments. This agent, a tax guarantor, must meet certain qualifications set by the ROC Ministry of Finance and, upon appointment, becomes a guarantor of the withdrawing holder's ROC tax payment obligations. In addition, under current ROC law, repatriation of profits by a non-ROC withdrawing holder is subject to the submission of evidence of the appointment of a tax guarantor to, and approval thereof by, the tax authority, or submission of tax clearance certificates or submission of evidencing documents issued by such agent (so long as the capital gains from securities transactions are exempt from ROC income tax). As required by the Central Bank of China, if repatriation by a holder is based on a tax clearance certificate, the aggregate amount of the cash dividends or interest on bank deposits converted into foreign currencies to be repatriated by the holder shall not exceed the amount of:

- (1) the net payment indicated on the withholding tax voucher issued by the tax authority;
- (2) the net investment gains as indicated on the holder's certificate of tax payment; or
- (3) the aggregate transfer price as indicated on the income tax return for transfer of tax-deferred dividend shares, whichever is applicable.

Under existing ROC laws and regulations relating to foreign exchange control, a depositary may, without obtaining further approvals from the Central Bank of China or any other governmental authority or agency of the ROC, convert NT dollars into other currencies, including US dollars, in respect of the following: proceeds of the sale of shares represented by depositary receipts, proceeds of the sale of shares received as stock dividends and deposited into the depositary receipt facility and any cash dividends or cash distributions received. In addition, a depositary, also without any of these approvals, may convert inward remittances of payments into NT dollars for purchases of underlying shares for deposit into the depositary receipt facility against the creation of additional depositary receipts. A depositary may be required to obtain foreign exchange approval from the Central Bank of China

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on a payment-by-payment basis for conversion from NT dollars into other currencies relating to the sale of subscription rights for new shares. Proceeds from the sale of any underlying shares by holders of depositary receipts withdrawn from the depositary receipt facility may be converted into other currencies without obtaining Central Bank of China approval. Proceeds from the sale of the underlying

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shares withdrawn from the depositary receipt facility may be used for reinvestment in the Taiwan Stock Exchange or the GreTai Securities Market, subject to first registering with the Taiwan Stock Exchange and, if applicable, subject to obtaining the approval from the Central Bank of China (if the holder of depositary receipts is a foreign company, that is, a company incorporated in a jurisdiction other than the ROC under the laws of such foreign jurisdiction).

Direct Share Offerings

The ROC government has amended regulations to permit ROC companies listed on the Taiwan Stock Exchange or GreTai Securities Market to issue shares directly (not through depositary receipt facility) overseas.

Overseas Corporate Bonds. Since 1989, the ROC Securities and Futures Commission has approved a series of overseas bonds issued by ROC companies listed on the Taiwan Stock Exchange in offerings outside the ROC. Under current ROC law, these overseas corporate bonds can be:

- (1) converted by bondholders, other than citizens of the People's Republic of China and entities organized under the laws of the People's Republic of China, into shares of ROC companies; or
- (2) subject to SFC approval, may be converted into depositary receipts issued by the same ROC company or by the issuing company of the exchange shares, in the case of exchangeable bonds.

The relevant regulations also permit public issuing companies to issue corporate debt in offerings outside the ROC. Proceeds from the sale of the shares converted from overseas convertible bonds may be used for reinvestment in securities listed on the Taiwan Stock Exchange or traded on the GreTai Securities Market, subject to first registering with the Taiwan Stock Exchange and, if applicable, subject to obtaining the approval from the Central Bank of China (if the holder of depositary receipts is a foreign company, that is, a company incorporated in a jurisdiction other than the ROC under the laws of such foreign jurisdiction).

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TAXATION

ROC Taxation

The following is a general summary of the principal ROC tax consequences of the ownership and disposition of ADSs representing common shares to a non-resident individual or entity. It applies only to a holder that is:

an individual who is not an ROC citizen, who owns ADSs and who is not physically present in the ROC for 183 days or more during any calendar year; or

a corporation or a non-corporate body that is organized under the laws of a jurisdiction other than the ROC for profit-making purposes and has no fixed place of business or other permanent establishment in the ROC.

Holders of ADSs are urged to consult their own tax advisors as to the particular ROC tax consequences of owning the ADSs which may affect them.

Dividends. Dividends declared by us out of our retained earnings and distributed to the holders are subject to ROC withholding tax, currently at the rate of 20%, on the amount of the distribution in the case of cash dividends or on the par value of the common shares in the case of stock dividends. However, a 10% ROC retained earnings tax paid by us on our undistributed after-tax earnings, if any, would provide a credit of up to 10% of the gross amount of any dividends declared out of those earnings that would reduce the 20% ROC tax imposed on those distributions.

It is currently unclear whether dividends paid by us out of our capital reserves are subject to ROC withholding tax because there are two possible interpretations of the relevant tax laws and regulations that lead to different conclusions on whether such dividends will be taxable, and there is currently no authoritative guidance on this issue.

Capital Gains. Under ROC law, capital gains on transactions in the common shares are currently exempt from income tax. In addition, transfers of ADSs are not regarded as a sale of an ROC security and, as a result, any gains on such transactions are not subject to ROC income tax.

Subscription Rights. Distributions of statutory subscription rights for common shares in compliance with ROC law are not subject to any ROC tax. Proceeds derived from sales of statutory subscription rights evidenced by securities are exempted from income tax but are subject to securities transaction tax at the rate of 0.3% of the gross amount received. Proceeds derived from sales of statutory subscription rights that are not evidenced by securities are subject to capital gains tax at the rate of:

35% of the gains realized if you are a natural person; or

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25% of the gains realized if you are an entity that is not a natural person.

Subject to compliance with ROC law, we, at our sole discretion, can determine whether statutory subscription rights shall be evidenced by issuance of securities.

Securities Transaction Tax. A securities transaction tax, at the rate of 0.3% of the sales proceeds, will be withheld upon a sale of common shares in the ROC. Transfers of ADSs are not subject to ROC securities transaction tax. Withdrawal of common shares from the deposit facility is not subject to ROC securities transaction tax.

Estate and Gift Tax. ROC estate tax is payable on any property within the ROC of a deceased who is an individual, and ROC gift tax is payable on any property within the ROC donated by any such

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person. Estate tax is currently payable at rates ranging from 2% of the first NT\$600,000 to 50% of amounts over NT\$100,000,000. Gift tax is payable at rates ranging from 4% of the first NT\$600,000 to 50% of amounts over NT\$45,000,000. Under ROC estate and gift tax laws, common shares issued by ROC companies are deemed located in the ROC regardless of the location of the holder. It is unclear whether a holder of ADSs will be considered to hold common shares for this purpose.

Tax Treaty. The ROC does not have a double taxation treaty with the United States. On the other hand, the ROC has double taxation treaties with Indonesia, Singapore, South Africa, Australia, Vietnam, New Zealand, Malaysia, Macedonia, Swaziland, Gambia, The Netherlands and the United Kingdom, which may limit the rate of ROC withholding tax on dividends paid with respect to common shares in ROC companies. It is unclear whether the ADS holders will be considered to hold common shares for the purposes of these treaties. Accordingly, if the holders may otherwise be entitled to the benefits of the relevant income tax treaty, the holders should consult their tax advisors concerning their eligibility for the benefits with respect to the ADSs.

United States Federal Income Taxation

This section discusses the material United States federal income tax consequences of owning and disposing of our common shares or ADSs. It is the opinion of Sullivan & Cromwell LLP, our special tax counsel. It applies to you only if you acquire your common shares or ADSs in this offering and you hold your common shares or ADSs as capital assets for tax purposes. This section does not apply to you if you are a member of a special class of holders subject to special rules, including:

dealers in securities;

traders in securities that elect to use a mark-to-market method of accounting for their securities holdings;

tax-exempt organizations;

life insurance companies;

persons liable for alternative minimum tax;

persons that actually or constructively own 10% or more of our voting stock;

persons that hold common shares or ADSs as part of a straddle or a hedging or conversion transaction; or

U.S. holders, as defined below, whose functional currency is not the U.S. dollar.

This section is based on the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations, published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis. In addition, this section is based in part upon the representations of the depository and the assumption that each obligation in the

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deposit agreement and any related agreement will be performed in accordance with its terms. In general, for United States federal income tax purposes, if you hold ADRs evidencing ADSs, you will be treated as the owner of the shares represented by those ADSs. Exchanges of shares for ADRs, and ADRs for shares, generally will not be subject to United States federal income tax.

You are a U.S. holder if you are a beneficial owner of common shares or ADSs and you are:

a citizen or resident of the United States;

a domestic corporation;

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an estate whose income is subject to United States federal income tax regardless of its source; or

a trust if a United States court can exercise primary supervision over the trust's administration and one or more United States persons are authorized to control all substantial decisions of the trust.

A non-U.S. holder is a beneficial owner of common shares or ADSs that is not a United States person for United States federal income tax purposes.

We urge you to consult your own tax advisor regarding the United States federal, state and local tax consequences of owning and disposing of common shares or ADSs in your particular circumstances.

Taxation of Dividends

U.S. Holders. Subject to the passive foreign investment company rules discussed below, if you are a U.S. holder, the gross amount of any dividend we pay in respect of your common shares or ADSs out of our current or accumulated earnings and profits (as determined for United States federal income tax purposes) including the amount of any ROC tax withheld reduced by any credit against such withholding tax on account of the 10% retained earnings tax imposed on us, is subject to United States federal taxation. If you are a noncorporate U.S. holder, dividends paid to you in taxable years beginning before January 1, 2009 that constitute qualified dividend income will be taxable to you at a maximum tax rate of 15% provided that you hold the common shares or ADSs for more than 60 days during the 120-day period beginning 60 days before the ex-dividend date and meet other holding period requirements. Dividends we pay with respect to the common shares or ADSs will be qualified dividend income provided that, in the year that you receive the dividend, the common shares or ADSs are readily tradable on an established securities market in the United States. The dividend is taxable to you when you, in the case of common shares, or the Depository, in the case of ADSs, receives the dividend. The dividend will not be eligible for the dividends-received deduction generally allowed to United States corporations in respect of dividends received from other United States corporations. The amount of the dividend distribution that you must include in your income as a U.S. holder will be the U.S. dollar value of the NT Dollar payments made, determined at the spot NT/U.S. dollar rate on the date the dividend distribution is includible in your income, regardless of whether the payment is in fact converted into U.S. dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date you include the dividend payment in income to the date you convert the payment into U.S. dollars will be treated as ordinary income or loss and will not be eligible for the special tax rate applicable to qualified dividend income. The gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes. Distributions in excess of current and accumulated earnings and profits, as determined for United States federal income tax purposes, will be treated as a non-taxable return of capital to the extent of your basis in the common shares or ADSs and thereafter as capital gain.

Subject to generally applicable limitations and restrictions, the ROC taxes withheld from dividend distributions and paid over to the ROC (reduced by any credit against such withholding tax on account of the 10% retained earnings tax) will be eligible for credit against your U.S. federal income tax liabilities. Special rules apply in determining the foreign tax credit limitation with respect to dividends that are subject to the maximum 15% tax rate. Dividends paid will generally constitute passive income or, in the case of some U.S. financial services providers, financial services income, which is treated separately from other types of income for purposes of computing the foreign tax credit allowable to you.

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Pro rata distributions of common shares by us to holders of common shares or ADSs will generally not be subject to U.S. federal income tax. Accordingly, such distributions will generally not give rise to U.S. federal income against which the ROC tax imposed on such distributions may be credited. Any such ROC tax will generally only be creditable against a U.S. holder's U.S. federal income tax liability with respect to general limitation income and not passive income or financial services income, subject to generally applicable conditions and limitations.

In the event that the ex-dividend date on The New York Stock Exchange or other securities exchange or market for a dividend or distribution that gives rise to ROC withholding tax is after the record date for such dividend or distribution (during which period such ADSs may trade with due bills), a purchaser of ADSs during the period from the record date to the ex-dividend date likely would not be entitled to a foreign tax credit for ROC taxes paid in respect of such ADSs even if (i) the purchaser receives the equivalent of such dividend or distribution on the relevant distribution date, and (ii) an amount equivalent to the applicable ROC withholding tax is withheld therefrom or otherwise charged to the account of such purchaser.

Non-U.S. Holders. If you are a non-U.S. holder, dividends paid to you in respect of common shares or ADSs will not be subject to United States federal income tax unless the dividends are effectively connected with your conduct of a trade or business within the United States, and the dividends are attributable to a permanent establishment that you maintain in the United States if that is required by an applicable income tax treaty for which you are eligible as a condition for subjecting you to United States taxation on a net income basis. In such cases you will be taxed in the same manner as a U.S. holder. If you are a corporate non-U.S. holder, effectively connected dividends may, under certain circumstances, be subject to an additional branch profits tax at a 30% rate. You may be subject to a branch profits tax at a reduced rate if you are eligible for the benefits of an income tax treaty that provides for a reduced rate.

Taxation of Capital Gains

U.S. Holders. Subject to the passive foreign investment company rules discussed below, if you are a U.S. holder and you sell or otherwise dispose of your common shares or ADSs, you will recognize capital gain or loss for United States federal income tax purposes equal to the difference between the U.S. dollar value of the amount that you realize and your tax basis, determined in U.S. dollars, in your common shares or ADSs. Capital gain of a noncorporate U.S. holder that is recognized before January 1, 2009 is generally taxed a maximum rate of 15% where the property is held more than one year. The gain or loss will generally be income or loss from sources within the United States for foreign tax credit limitation purposes.

Non-U.S. Holders. If you are a non-U.S. holder, you will not be subject to United States federal income tax on gain recognized on the sale or other disposition of your common shares or ADSs unless:

the gain is effectively connected with your conduct of a trade or business in the United States and the gain is attributable to a permanent establishment that you maintain in the United States if that is required by an applicable income tax treaty as a condition for subjecting you to United States taxation on a net income basis; or

you are an individual and are present in the United States for 183 or more days in the taxable year of the sale and certain other conditions exist.

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If you are a corporate non-U.S. holder, effectively connected gains that you recognize may also, under certain circumstances, be subject to an additional branch profits tax at a 30% rate. You may be subject to a branch profits tax at a reduced rate if you are eligible for the benefits of an income tax treaty that provides for a reduced rate.

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Passive Foreign Investment Company Rules

We believe that common shares and ADSs should not be treated as stock of a passive foreign investment company, or PFIC, for United States federal income tax purposes, but this conclusion is a factual determination that is made annually and thus may be subject to change.

In general, if you are a U.S. holder, we will be a PFIC with respect to you if for any taxable year in which you held our common shares or ADSs:

at least 75% of our gross income for the taxable year is passive income; or

at least 50% of the value, determined on the basis of a quarterly average, of our assets is attributable to assets that produce or are held for the production of passive income.

Passive income generally includes dividends, interest, royalties, rents (other than certain rents and royalties derived in the active conduct of a trade or business), annuities and gains from assets that produce passive income. If a foreign corporation owns directly or indirectly at least 25% by value of the stock of another corporation, the foreign corporation is treated for purposes of the PFIC tests as owning its proportionate share of the assets of the other corporation, and as receiving directly its proportionate share of the other corporation's income.

If we are treated as a PFIC, and you are a U.S. holder that does not make a mark-to-market election, as described below, you will be subject to special rules with respect to:

any gain you realize on the sale or other disposition of your common shares or ADSs; and

any excess distribution that we make to you (generally, any distributions to you during a single taxable year that are greater than 125% of the average annual distributions received by you in respect of the common shares or ADSs during the three preceding taxable years or, if shorter, your holding period for the common shares or ADSs).

Under these rules:

the gain or excess distribution will be allocated ratably over your holding period for the common shares or ADSs,

the amount allocated to the taxable year in which you realized the gain or excess distribution will be taxed as ordinary income,

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the amount allocated to each prior year, with certain exceptions, will be taxed at the highest tax rate in effect for that year, and

the interest charge generally applicable to underpayments of tax will be imposed in respect of the tax attributable to each such year.

Special rules apply for calculating the amount of the foreign tax credit with respect to excess distributions by a PFIC.

If you own common shares or ADSs in a PFIC that are treated as marketable stock, you may make a mark-to-market election. If you make this election, you will not be subject to the PFIC rules described above. Instead, in general, you will include as ordinary income each year the excess, if any, of the fair market value of your common shares or ADSs at the end of the taxable year over your adjusted basis in your common shares or ADSs. These amounts of ordinary income will not be eligible for the favorable tax rates applicable to qualified dividend income or long-term capital gains. You will also be allowed to take an ordinary loss in respect of the excess, if any, of the adjusted basis of your common shares or ADSs over their fair market value at the end of the taxable year (but only to the extent of the net amount of previously included income as a result of the mark-to-market election).

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Your basis in the common shares or ADSs will be adjusted to reflect any such income or loss amounts. Your gain, if any, recognized upon the sale of your common shares or ADSs will be taxed as ordinary income.

In addition, notwithstanding any election you make with regard to the common shares or ADSs, dividends that you receive from us will not constitute qualified dividend income to you if we are a PFIC either in the taxable year of the distribution or the preceding taxable year. Dividends that you receive that do not constitute qualified dividend income are not eligible for taxation at the 15% maximum rate applicable to qualified dividend income. Instead, you must include the gross amount of any such dividend paid by us out of our accumulated earnings and profits (as determined for United States federal income tax purposes) in your gross income, and it will be subject to tax at rates applicable to ordinary income as well as the special rules provided with respect to excess distributions, if applicable, as described above.

If you own common shares or ADSs during any year that we are a PFIC, you must file Internal Revenue Service Form 8621.

Backup Withholding and Information Reporting

If you are a noncorporate U.S. holder, information reporting requirements, on Internal Revenue Service Form 1099, generally will apply to:

dividend payments or other taxable distributions made to you within the United States, and

the payment of proceeds to you from the sale of common shares or ADSs effected at a United States office of a broker.

Additionally, backup withholding may apply to such payments if you are a noncorporate U.S. holder that:

fails to provide an accurate taxpayer identification number,

is notified by the Internal Revenue Service that you have failed to report all interest and dividends required to be shown on your federal income tax returns, or

in certain circumstances, fails to comply with applicable certification requirements.

If you are a non-U.S. holder, you are generally exempt from backup withholding and information reporting requirements with respect to:

dividend payments made to you outside the United States by us or another non-United States payor and

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other dividend payments and the payment of the proceeds from the sale of common shares or ADSs effected at a United States office of a broker, as long as the income associated with such payments is otherwise exempt from United States federal income tax, and:

the payor or broker does not have actual knowledge or reason to know that you are a United States person and you have furnished the payor or broker:

an Internal Revenue Service Form W-8BEN or an acceptable substitute form upon which you certify, under penalties of perjury, that you are a non-United States person, or

other documentation upon which it may rely to treat the payments as made to a non-United States person in accordance with U.S. Treasury regulations, or

you otherwise establish an exemption.

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Payment of the proceeds from the sale of common shares or ADSs effected at a foreign office of a broker generally will not be subject to information reporting or backup withholding. However, a sale of common shares or ADSs that is effected at a foreign office of a broker will be subject to information reporting and backup withholding if:

the proceeds are transferred to an account maintained by you in the United States,

the payment of proceeds or the confirmation of the sale is mailed to you at a United States address, or

the sale has some other specified connection with the United States as provided in U.S. Treasury regulations,

unless the broker does not have actual knowledge or reason to know that you are a United States person and the documentation requirements described above are met or you otherwise establish an exemption.

In addition, a sale of common shares or ADSs effected at a foreign office of a broker will be subject to information reporting if the broker is:

a United States person,

a controlled foreign corporation for United States tax purposes,

a foreign person 50% or more of whose gross income is effectively connected with the conduct of a United States trade or business for a specified three-year period, or

a foreign partnership, if at any time during its tax year:

one or more of its partners are U.S. persons, as defined in U.S. Treasury regulations, who in the aggregate hold more than 50% of the income or capital interest in the partnership, or

such foreign partnership is engaged in the conduct of a United States trade or business,

unless the broker does not have actual knowledge or reason to know that you are a United States person and the documentation requirements described above are met or you otherwise establish an exemption. Backup withholding will apply if the sale is subject to information reporting and the broker has actual knowledge that you are a United States person.

You generally may obtain a refund of any amounts withheld under the backup withholding rules that exceed your income tax liability by filing a refund claim with the United States Internal Revenue Service.

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ENFORCEABILITY OF CIVIL LIABILITIES

We are a company limited by shares and incorporated under the ROC Company Law. Most of our directors and executive officers, our supervisors and some of the experts named in this prospectus are residents of the ROC and a substantial portion of our assets and our directors, supervisors or executive officers are located in the ROC. As a result, it may be difficult or may not be possible for investors to effect service of process upon us or our directors, supervisors or executive officers within the United States, or to enforce against them judgments obtained in the United States courts, including those predicated upon the civil liability provisions of the federal securities laws of the United States. We have been advised by our ROC counsel, Lee and Li, that in their opinion any final judgment obtained against us in any court other than the courts of the ROC in respect of any legal suit or proceeding arising out of or relating to the ADSs will be enforced by the courts of the ROC without further review of the merits only if the court of the ROC in which enforcement is sought is satisfied that:

the court rendering the judgment has jurisdiction over the subject matter according to the laws of the ROC;

the judgment and the court procedures based on which such judgment was rendered are not contrary to the public order or good morals of the ROC;

if the judgment was rendered by default by the court rendering the judgment, (x) we were duly served during a reasonable time within the jurisdiction of that court in accordance with the laws and regulations of such jurisdiction, or (y) process was served on us with judicial assistance of the ROC; and

judgments of the courts of the ROC are recognized and enforceable in the jurisdiction of the court rendering the judgment on a reciprocal basis.

A party seeking to enforce a foreign judgment in the ROC would be required to obtain foreign exchange approval from the Central Bank of China for the remittance out of the ROC of any amounts recovered in respect of a judgment denominated in a currency other than NT dollars.

VALIDITY OF SECURITIES

The validity of the ADSs is being passed upon for Philips and for us by Sullivan & Cromwell LLP, and for the underwriters by Cleary, Gottlieb, Steen & Hamilton. The validity of the common shares is being passed upon for Philips and for us by Lee and Li, Taipei, Taiwan, ROC, and for the underwriters by Tsar & Tsai, Taipei, Taiwan, ROC.

EXPERTS

Our consolidated balance sheets as of December 31, 2001 and 2002 and our consolidated statements of income, shareholders equity and cash flows for the years ended December 31, 2000, 2001 and 2002 incorporated by reference herein have been audited by TN Soong & Co., independent auditors, an associate member firm of Deloitte Touche Tohmatsu effective April 22, 2002, as indicated in their report, which expresses an unqualified opinion and includes explanatory paragraphs relating to the adoption of

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Statement of Financial Accounting Standards No. 30, Accounting for Treasury Stock, on January 1, 2002 and the reconciliation to accounting principles generally accepted in the United States of America, and have been so incorporated in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

TN Soong & Co and Deloitte & Touche (Taiwan) combined to establish Deloitte & Touche effective June 1, 2003.

The offices of Deloitte & Touche are located at 6th Floor, 2 Prosperity Road I, Science-Based Industrial Park, Hsinchu, ROC.

Table of Contents**UNDERWRITING**

We, the selling shareholder and the underwriters for this offering named below have entered into an underwriting agreement with respect to the ADSs being offered both within and outside the United States. Subject to certain conditions, each underwriter has severally agreed to purchase the number of ADSs indicated in the following table. Goldman Sachs International and Merrill Lynch, Pierce, Fenner & Smith Incorporated, the joint bookrunners for this offering, are the representatives of the underwriters. The address of Goldman Sachs International is Peterborough Court, 133 Fleet Street, London, EC4A 2BB, England. The address of Merrill Lynch, Pierce, Fenner & Smith Incorporated is North Tower, World Financial Center, New York, New York, 10281.

<u>Underwriters</u>	<u>Number of ADSs</u>
Goldman Sachs International Merrill Lynch, Pierce, Fenner & Smith Incorporated	
Total	100,000,000

The underwriters are committed to take and pay for all of the ADSs being offered, if any are taken.

The following table shows the per ADS and total underwriting discounts and commissions to be paid to the underwriters by the selling shareholder.

	<u>Paid by the selling shareholder</u>
Per ADS	US\$
Total	US\$

Total expenses for this offering are estimated to be approximately US\$4.5 million, including depository bank fees and expenses of approximately US\$2.0 million, registration fees of US\$90,568, printing fees of approximately US\$70,000, legal fees of approximately US\$700,000 and accounting fees of approximately US\$700,000. The underwriters have agreed to reimburse us for or pay on our behalf the fees and expenses we incur in connection with this offering, and will also bear their own expenses and certain expenses of the selling shareholder in connection with this offering.

ADSs sold by the underwriters to the public will initially be offered at the initial price to public set forth on the cover of this prospectus. Any ADSs sold by the underwriters to securities dealers may be sold at a discount of up to US\$ per ADS from the initial price to public. Any such securities dealers may resell any ADSs purchased from the underwriters to certain other brokers or dealers at a discount of up to US\$ per ADS from the initial price to public. If all the ADSs are not sold at the initial price to public, the underwriters may change the offering price and the other selling terms.

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We have been advised by the underwriters that some of the underwriters are expected to make offers and sales both inside and outside of the United States through their respective selling agents. Any offers and sales in the United States will be conducted by broker-dealers registered with the Securities and Exchange Commission. Goldman Sachs International is expected to make offers and sales in the United States through its selling agent, Goldman, Sachs & Co. Merrill Lynch, Pierce, Fenner & Smith Incorporated, a registered broker-dealer, shall make offers and sales in the United States.

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The underwriters have entered into an agreement in which they agree to restrictions on where and to whom they and any dealer purchasing from them may offer shares or ADSs as a part of the distribution of the shares and ADSs. The underwriters also have agreed that they may sell shares and ADSs among themselves.

The selling shareholder and the Development Fund have agreed, with certain exceptions, during the period beginning from the date of this prospectus to and including the date 180 days after the date of this prospectus, with respect to the selling shareholder, and 90 days after the date of this prospectus, with respect to the Development Fund, not to, and not to announce an intention to, offer, sell, contract to sell or otherwise dispose of, or file a representation statement or similar document relating to, ADSs or common shares or any security convertible into or exchangeable for common shares or ADSs or other instruments representing interests in or the right to receive ADSs or common shares or any securities substantially similar thereto, without the prior written consent of representatives of the underwriters.

We have also agreed, during the period beginning from the date of this prospectus to and including the date 90 days after the date of this prospectus, not to, and not to announce an intention to, issue any common shares, including common shares represented by ADSs (other than pursuant to employee stock option plans that we may adopt or any common shares to be issued as an annual dividend or annual bonus to directors, supervisors and employees which is approved by our shareholders), without the prior written consent of representatives of the underwriters. Although we have no current plans to make any such issuance during this 90-day period, we are not precluded from issuing any securities that are convertible into or exchangeable for, or that represent the right to receive, our common shares. See [Common Shares Eligible for Future Sale](#) for a discussion of material transfer restrictions.

No ADSs are offered or sold and, prior to the expiry of a period of six months from the closing date of the issuance of the ADSs, no ADSs will be offered or sold, to persons in the United Kingdom, except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances that have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995. Each underwriter has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000) received by it in connection with the issue or sale of any ADSs in circumstances in which section 21(1) of the Financial Services and Markets Act 2000 does not apply to our company. Each underwriter has complied, and will comply with, all applicable provisions of the Financial Services and Markets Act 2000 and the Public Offers of Securities Regulations 1995 with respect to anything done by it in relation to the ADSs in, from or otherwise involving the United Kingdom.

The ADSs have not been and will not be registered under the Securities and Exchange Law of Japan and are not being offered or sold and may not be offered or sold, directly or indirectly, in Japan or to, or for the account or benefit of, any resident of Japan or to, or for the account or benefit of, any person for reoffering or resale, directly or indirectly, in Japan or to, or for the account or benefit of, any resident of Japan, except (1) pursuant to an exemption from the registration requirements of, or otherwise in compliance with, the Securities and Exchange Law of Japan and (2) in compliance with any other relevant laws and regulations of Japan.

The ADSs have not been offered or sold, and will not be offered or sold in Hong Kong, by means of any document, other than to persons whose ordinary business is to buy or sell shares or debentures, whether as principal or agent, or in circumstances which do not constitute an offer to the public within the

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meaning of the Companies Ordinance (Cap. 32) of Hong Kong. No advertisement, invitation or document relating to the ADSs, whether in Hong Kong or elsewhere, has been or will be issued, which is directed at, or the contents of which are likely to be accessed or read by, the public in Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to ADSs which are or are intended to be disposed of only to persons outside Hong Kong or only to professional investors within the meaning of the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made thereunder.

This prospectus has not been registered as a prospectus with the Monetary Authority of Singapore. Accordingly, this prospectus and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the ADSs may not be circulated or distributed, nor may the ADSs be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (1) to an institutional investor or other person specified in Section 274 of the Securities and Futures Act, Chapter 289, of Singapore (the Securities and Futures Act), (2) to a sophisticated investor, and in accordance with the conditions, specified in Section 275 of the Securities and Futures Act or (3) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the Securities and Futures Act.

The ADSs may not be, directly or indirectly, offered, sold, transferred or delivered in or from The Netherlands, as part of their initial distribution or as part of any re-offering, and neither this prospectus nor any other document in respect of the offering may be distributed or circulated in The Netherlands, other than to individuals or legal entities which include, but are not limited to, banks, brokers, dealers, institutional investors and undertakings with a treasury department, who or which trade or invest in securities in conduct of a business or profession.

No action has been or will be taken in any jurisdiction other than the United States that would permit a public offering of the ADSs or the possession, circulation or distribution of this prospectus in any jurisdiction where action for that purpose is required. Accordingly, the ADSs may not be offered or sold, directly or indirectly, and neither the prospectus nor any other offering material or advertisements in connection with the ADSs may be distributed or published, in or from any country or jurisdiction except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

The ADSs have not been offered or sold, and will not be offered or sold, directly or indirectly, in the Republic of China.

In connection with this offering, the underwriters may, subject to applicable laws and regulations, purchase and sell the ADSs or shares in the open market. These transactions may include short sales, stabilizing transactions and purchases to cover positions created by short sales. Short sales involve the sale by the underwriters of a greater number of shares or ADSs than they are required to purchase in this offering. Stabilizing transactions consist of certain bids or purchases made for the purpose of preventing or retarding a decline in the market price of the shares and ADSs while the offering is in progress.

The underwriters also may, subject to applicable laws and regulations, impose a penalty bid. This occurs when a particular underwriter repays to the underwriters a portion of the underwriting discount received by it because a representative of the underwriters has repurchased shares or ADSs sold by or for the account of that underwriter in stabilizing or covering short transactions.

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These activities by the underwriters may stabilize, maintain or otherwise affect the market price of the shares or ADSs. As a result, the price of the shares or ADSs may be higher than the price that otherwise might exist in the open market. If these activities are commenced, they may be discontinued by the underwriters at any time. These transactions may be effected on The New York Stock Exchange, in the over-the-counter market or otherwise.

We and the selling shareholder have agreed to indemnify the underwriters against certain liabilities, including liabilities under the Securities Act.

Purchasers of the ADSs offered in this offering may be required to pay stamp taxes and other charges in accordance with the laws and practices of the country of purchase in addition to the offering price set forth on the cover page of this prospectus.

This prospectus may be used by the underwriters and other dealers in connection with offers and sales of the ADSs, including sales of ADSs initially sold by the underwriters in this offering being made outside of the United States, to persons located in the United States.

A prospectus in electronic format may be made available on the Web sites maintained by the underwriter or one or more securities dealers. The underwriter may agree to allocate a number of ADSs for sale to its online brokerage account holders. ADSs to be sold pursuant to an internet distribution will be allocated on the same basis as other allocations. In addition, ADSs may be sold by the underwriter to securities dealers who resell ADSs to online brokerage account holders.

The underwriters have engaged in, and may in the future engage in, investment banking activities and other commercial dealings in the ordinary course of business with us. They have received customary fees and commissions for these transactions.

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Table of Contents**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****UNAUDITED CONSOLIDATED BALANCE SHEETS**

(In Millions of New Taiwan and US Dollars, Except Shares and Par Value)

	Notes	June 30		
		2002	2003	2003
		NT\$ (Unaudited)	NT\$	US\$ (Note 4)
ASSETS				
CURRENT ASSETS				
Cash and cash equivalents	2, 5	72,395.5	72,084.7	2,082.8
Short-term investments	2, 6	213.2	4,065.7	117.5
Receivables net	2, 7	20,468.4	24,871.9	718.6
Receivable from related parties	21	347.8	687.9	19.9
Inventories net	2, 8	12,960.0	12,639.4	365.2
Deferred income tax assets net	2, 17	4,571.4	3,424.1	98.9
Prepaid expenses and other current assets	21, 24	3,126.0	2,560.3	74.0
Total current assets		114,082.3	120,334.0	3,476.9
LONG-TERM INVESTMENTS	2, 9, 19	10,727.7	11,091.0	320.5
PROPERTY, PLANT AND EQUIPMENT NET	2, 10, 13, 21	242,616.7	221,691.6	6,405.4
GOODWILL	2	10,531.8	9,484.5	274.0
OTHER ASSETS				
Deferred income tax assets net	2, 17	12,005.4	9,207.6	266.0
Deferred charges net	2, 11	5,431.0	8,794.4	254.1
Refundable deposits	21	599.7	398.5	11.5
Idle assets	2	51.3	154.3	4.5
Assets leased to others	2	88.7	85.8	2.5
Miscellaneous		27.8	25.5	0.7
Total other assets		18,203.9	18,666.1	539.3
TOTAL ASSETS		396,162.4	381,267.2	11,016.1

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

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

UNAUDITED CONSOLIDATED BALANCE SHEETS

(In Millions of New Taiwan and US Dollars, Except Shares and Par Value)

	Notes	June 30		
		2002	2003	2003
		NT\$ (Unaudited)	NT\$	US\$ (Note 4)
LIABILITIES AND SHAREHOLDERS EQUITY				
CURRENT LIABILITIES				
Short-term bank loans	12	536.9	553.8	16.0
Payable to related parties	21	1,827.9	2,552.5	73.8
Accounts payable		5,705.0	5,587.6	161.4
Payable to contractors and equipment suppliers		17,146.0	6,668.4	192.7
Accrued expenses and other current liabilities	24	7,723.1	8,674.1	250.6
Current portion of long-term liabilities	13	9,000.0	6,922.7	200.0
Total current liabilities		41,938.9	30,959.1	894.5
LONG-TERM LIABILITIES				
Long-term bank loans	13	19,463.6	9,276.0	268.0
Long-term bonds payable	14	35,000.0	35,000.0	1,011.3
Other long-term payables	15	1,470.0	3,921.5	113.3
Total long-term liability		55,933.6	48,197.5	1,392.6
OTHER LIABILITY				
Accrued pension cost	2, 16	2,050.0	2,433.1	70.3
Guarantee deposits	23	6,622.2	1,225.8	35.4
Deferred gain on sales and leaseback	2	191.5	38.3	1.1
Others		156.8	59.7	1.7
Total other liabilities		9,020.5	3,756.9	108.5
COMMITMENTS AND CONTINGENCIES				
MINORITY INTEREST IN SUBSIDIARIES	23	104.9	92.1	2.7
SHAREHOLDERS EQUITY				
Capital stock NT\$10 par value	2, 19			
Authorized: 24,600,000,000 shares				
Issued:				
Preferred 1,300,000,000 shares		13,000.0		
Common 18,622,886,745 shares		186,228.9	186,228.9	5,380.8
To be issued: 1,643,732,239 shares	19		16,437.3	474.9

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Capital surplus	2, 3, 19	57,004.8	56,840.8	1,642.3
Retained earnings		35,079.3	39,929.2	1,153.7
Unrealized loss on long-term investments	2		(8.0)	(0.2)
Cumulative translation adjustments	2	(233.8)	755.4	21.8
Treasury stock 42,001,461 shares in 2002, and 41,961,461 shares in 2003	2, 3, 20	(1,914.7)	(1,922.0)	(55.5)
Total shareholders equity		<u>289,164.5</u>	<u>298,261.6</u>	<u>8,617.8</u>
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY		<u>396,162.4</u>	<u>381,267.2</u>	<u>11,016.1</u>

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

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF INCOME

(In Millions of New Taiwan and US Dollars, Except Shares and Earnings Per Share)

		Six Months Ended June 30		
		2002	2003	
		NT\$ (Unaudited)	NT\$	US\$ (Note 4)
NET SALES	2, 7, 21, 25	80,266.9	89,695.1	2,591.6
COST OF SALES	21	50,823.4	60,733.9	1,754.8
GROSS PROFIT		29,443.5	28,961.2	836.8
OPERATING EXPENSES				
Research and development	21	5,237.1	5,589.2	161.5
General and administrative	21	3,443.8	3,794.6	109.6
Marketing	2, 7	1,090.0	1,470.2	42.5
Total operating expenses		9,770.9	10,854.0	313.6
INCOME FROM OPERATIONS		19,672.6	18,107.2	523.2
NON-OPERATING INCOME				
Gain on sales of short-term investments net	2	79.2	1,786.3	51.6
Interest		520.9	402.4	11.6
Gain on sales of property, plant, and equipment	2	250.8	295.8	8.6
Technical service income	21, 23	84.4	76.5	2.2
Gain on sales of long-term investments net	2		4.5	0.1
Royalty income	21	322.9		
Premium income from option contracts net	2, 24	11.8		
Others		192.6	318.5	9.2
Total non-operating income		1,462.6	2,884.0	83.3
NON-OPERATING EXPENSES				
Loss on sales of and provision for loss on property, plant and equipment	2	94.8	1,663.8	48.1
Interest	10, 24	1,363.9	1,146.8	33.1
Investment loss recognized by equity method net	2, 9	957.6	701.7	20.3
Permanent loss on long-term investments net	2	378.4	312.9	9.0
Casualty loss net	2	117.5		
Foreign exchange loss net	2, 24	60.4	246.9	7.1
Premium expenses from option contracts net	2, 24		96.7	2.8
Loss on sales of long-term investments net	2	37.9		
Others		87.3	23.5	0.7
Total non-operating expenses		3,097.8	4,192.3	121.1

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INCOME BEFORE INCOME TAX AND MINORITY INTEREST		18,037.4	16,798.9	485.4
INCOME TAX EXPENSE	2, 17	2,151.3	712.3	20.6
INCOME BEFORE MINORITY INTEREST		15,886.1	16,086.6	464.8
MINORITY INTEREST IN LOSS OF SUBSIDIARIES	2	11.2	1.2	
NET INCOME		15,897.3	16,087.8	464.8
BASIC AND DILUTED EARNINGS PER SHARE	2, 21			
Before income tax and minority interest		0.88	0.82	0.02
Net income		0.77	0.79	0.02
BASIC AND DILUTED EARNINGS PER EQUIVALENT ADS	2			
Before income tax and minority interest		4.40	4.11	0.12
Net income		3.87	3.93	0.11
BASIC AND DILUTED WEIGHTED AVERAGE SHARES OUTSTANDING	2, 20	20,220,853,000	20,221,270,000	

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

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

(In Millions of New Taiwan Dollars Except Shares and Par Value)

Capital Stock (NT\$10 Par Value)

Authorized Shares	Preferred Stock		Common Stock		To Be Issued		Capital Surplus	Retained Earnings	Unrealized Gain (Loss) on Long-term Investments	Cumulative Translation Adjustments	Treasury Stock
	Shares	Amount	Shares	Amount	Shares	Amount					
		NT\$		NT\$		NT\$	NT\$	NT\$	NT\$	NT\$	NT\$
24,600,000,000	1,300,000,000	13,000.0	16,832,553,051	168,325.6			57,128.4	37,507.5		1,228.7	
			107,078,388	1,070.8				(1,070.8)			
								(455.0)			
			1,683,255,306	16,832.5				(16,832.5)			
								(133.8)			
								15,897.3			
							(166.5)	166.5			
							(0.1)	0.1			
										(1,462.5)	

											(1,914.7)
							43.0				
24,600,000,000	1,300,000,000	13,000.0	18,622,886,745	186,228.9			57,004.8	35,079.3		(233.8)	(1,914.7)
24,600,000,000	1,300,000,000	13,000.0	18,622,886,745	186,228.9			57,004.8	40,792.2	(194.3)	945.1	(1,923.5)
					153,901,299	1,539.0		(1,539.0)			
										(455.0)	
					1,489,830,940	14,898.3		(14,898.3)			
										(58.5)	
										16,087.8	
	(1,300,000,000)	(13,000.0)									
										20.6	
										165.7	
										(164.4)	
											(189.7)
							0.4				1.5
24,600,000,000			18,622,886,745	186,228.9	1,643,732,239	16,437.3	56,840.8	39,929.2	(8.0)	755.4	(1,922.0)
				5,380.8		474.9	1,642.3	1,153.7	(0.2)	21.8	(55.5)

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

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In Millions of New Taiwan and US Dollars)

	Six Months Ended June 30		
	2002	2003	
	NT\$ (Unaudited)	NT\$	US\$ (Note 4)
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	15,897.3	16,087.8	464.8
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	30,450.8	34,586.1	999.3
Deferred income taxes	2,019.1	543.3	15.7
Investment loss recognized by equity method net	957.6	701.7	20.3
Loss (gain) on sales of long-term investments net	37.9	(4.5)	(0.1)
Permanent loss on long-term investments	378.4	312.9	9.0
Loss (gain) on sales of and provision for loss on property, plant and equipment net	(156.0)	1,368.0	39.5
Pension cost accrued	193.4	221.5	6.4
Allowance for doubtful receivables	72.6	47.1	1.4
Allowance for sales returns and others	755.4	(294.9)	(8.5)
Minority interest in loss of subsidiaries	(11.2)	(1.2)	
Changes in operating assets and liabilities:			
Decrease (increase) in:			
Forward exchange contract receivable	(1,128.1)	183.1	5.3
Receivables	(4,844.2)	(8,338.7)	(240.9)
Receivable from related parties	146.9	(248.3)	(7.2)
Inventories net	(3,131.7)	(1,437.9)	(41.5)
Prepaid expenses and other current assets	951.6	522.2	15.1
Increase (decrease) in:			
Payable to related parties	779.6	776.3	22.4
Accounts payables	4,307.1	449.0	13.0
Forward exchange contract payables	(306.5)	143.0	4.1
Accrued expenses and other current liabilities	1,013.7	420.2	12.1
Net cash provided by operating activities	48,383.7	46,036.7	1,330.2
CASH FLOWS FROM INVESTING ACTIVITIES			
Increase in short-term investments net	(708.9)	(3,816.8)	(110.3)
Acquisitions of:			
Long-term investments	(2,114.8)	(1,262.7)	(36.5)
Property, plant and equipment	(17,248.2)	(16,261.9)	(469.9)
Proceeds from sales of:			
Long-term investments	70.6	15.5	0.4
Property, plant and equipment	440.0	132.4	3.8
Increase in restricted cash	(15.5)	(1.0)	
Increase in deferred charges	(1,422.3)	(711.2)	(20.5)

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Decrease in refundable deposits	194.6	158.7	4.6
Decrease (increase) in other assets miscellaneous	(0.5)	9.3	0.3
Decrease in minority interest in subsidiaries	(75.7)	(2.2)	(0.1)
	<u> </u>	<u> </u>	<u> </u>
Net cash used in investing activities	(20,880.7)	(21,739.9)	(628.2)
	<u> </u>	<u> </u>	<u> </u>

(Continued)

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Table of Contents**TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES****UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In Millions of New Taiwan and US Dollars)

	Six Months Ended June 30		
	2002	2003	
	NT\$	NT\$	US\$ (Note 4)
CASH FLOWS FROM FINANCING ACTIVITIES			
Issuance of:			
Short-term bank loans	203.0		
Long-term bonds	15,000.0		
Payments on:			
Short-term bank loans	(5,745.2)	(173.1)	(5.0)
Long-term bonds		(4,000.0)	(115.6)
Long-term bank loans	(2,013.5)	(1,736.4)	(50.2)
Decrease in guarantee deposits and other liabilities	(590.5)	(169.2)	(4.9)
Redemption of preferred stock		(13,000.0)	(375.6)
Cash dividends paid on preferred stock	(455.0)	(455.0)	(13.1)
Remuneration to directors and supervisors	(133.8)	(58.5)	(1.7)
Net cash provided by (used in) financing activities	6,265.0	(19,592.2)	(566.1)
EFFECTS OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	1,071.2	(410.1)	(11.8)
NET INCREASE IN CASH AND CASH EQUIVALENTS	34,839.2	4,294.5	124.1
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	37,556.3	67,790.2	1,958.7
CASH AND CASH EQUIVALENTS, END OF PERIOD	72,395.5	72,084.7	2,082.8
SUPPLEMENTAL INFORMATION			
Interest paid (excluding the amounts capitalized)	498.8	872.7	25.2
Income tax paid	176.2	27.9	0.8
Noncash investing and financing activities:			
Transfer from long-term investments to short-term investments		93.2	2.7
Current portion of long-term liabilities	9,000.0	6,922.7	200.0
Reclassification of parent company stock held by subsidiaries from short/ long-term investments to treasury stock	1,914.7	(1.4)	

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

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

1. GENERAL

Taiwan Semiconductor Manufacturing Company Ltd. (TSMC), a Republic of China (ROC) corporation, was incorporated as a venture among the government of the ROC, acting through the Development Fund of the Executive Yuan, Koninklijke Philips Electronics N.V. and certain of its affiliates (Philips), and certain other private investors. In September 1994, its shares were listed on the Taiwan Stock Exchange (TSE). On October 8, 1997, TSMC listed its shares of stock on the New York Stock Exchange in the form of American Depositary Shares.

TSMC is engaged mainly in the manufacturing, selling, packaging, testing and designing of integrated circuits and other semiconductor devices, and the manufacturing of masks.

TSMC has five direct wholly-owned subsidiaries, namely, TSMC North America (TSMC-North America), Taiwan Semiconductor Manufacturing Company Europe B.V (TSMC-Europe), TSMC Japan K. K. (TSMC-Japan), TSMC International Investment Ltd. (TSMC International) and TSMC Partners Ltd. (TSMC Partners). In addition, TSMC also has a 99.5% owned subsidiary, Emerging Alliance Fund, LP (Emerging Alliance), and two 36% owned affiliates, Chi Cherng Investment Co., Ltd. (Chi Cherng, which is 36% owned by TSMC and 64% owned by Hsin Ruey Investment Co., Ltd.) and Hsin Ruey Investment Co., Ltd. (Hsin Ruey, which is 36% owned by TSMC and 64% owned by Chi Cherng). TSMC International has two wholly-owned subsidiaries, TSMC Development, Inc. (TSMC Development) and TSMC Technology, Inc. (TSMC Technology), and two 97%-owned subsidiaries, InveStar Semiconductor Development Fund, Inc. (InveStar) and InveStar Semiconductor Development Fund, Inc. (II) LDC (InveStar II). TSMC Development has an approximately 100% owned subsidiary, WaferTech, LLC (WaferTech).

The following diagram presents information regarding the relationship and ownership percentages among TSMC and its subsidiaries as of June 30, 2003:

TSMC-North America is engaged in the sales and marketing of integrated circuits and semiconductor devices. TSMC-Europe, TSMC-Japan, TSMC Development and TSMC Technology are engaged mainly in marketing and engineering support activities. TSMC Partners, Chi Cherng and Hsin Ruey are engaged in investments. TSMC International is engaged in investing in companies involved in design, manufacture, and other related business in the semiconductor industries. Emerging Alliance, InveStar and InveStar II are engaged in investing in new start-up companies in the fields of high technology. WaferTech is engaged in the manufacturing, selling, testing and designing of integrated circuits and other semiconductor devices.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation

TSMC consolidates the accounts of all majority (directly and indirectly) owned subsidiaries. The consolidated financial statements include, as of and for the six months ended June 30, 2002 and 2003, the accounts of TSMC, TSMC-North America, TSMC-Europe, TSMC-Japan, TSMC Partners, Emerging Alliance, Chi Cherng, Hsin Ruey and TSMC International and its subsidiaries, InveStar, InveStar II, TSMC Development (including WaferTech) and TSMC Technology. TSMC and the foregoing subsidiaries are hereinafter referred to collectively as the Company. All significant intercompany balances and transactions have been eliminated in these consolidated financial statements.

TSMC's investees Hsin Ruey, Chi Hsin Investment Co., Ltd. (Chi Hsin) and Kung Cherng Investment, Co., Ltd. (Kung Cherng) were merged on October 30, 2002, with Hsin Ruey as the surviving company. In addition, TSMC's investees Chi Cherng, Cherng Huei Investment, Co., Ltd. (Cherng Huei) and Po Cherng Investment Co., Ltd. (Po Cherng) were merged on October 30, 2002, with Chi Cherng as the surviving company. The mergers were accounted for as combinations of entities under common control. Chi Hsin, Kung Cherng, Cherng Huei and Po Cherng were consolidated entities as of and for the six months ended June 30, 2002.

Minority interests in Emerging Alliance (0.5%), InveStar (3%), InveStar II (3%) and WaferTech (0.008% in 2002 and 0.004% in 2003) are presented separately in the consolidated financial statements.

Classification of current and non-current assets and liabilities

Current assets are those expected to be converted to cash, sold or consumed within one year. Current liabilities are obligations due on demand within one year from the balance sheet date. Assets and liabilities that are not classified as current are non-current assets and liabilities, respectively.

Cash Equivalents

Government bonds acquired with maturities less than three months from the date of purchase are classified as cash equivalents.

Short-term Investments

Short-term investments are carried at the lower of cost or market value. The costs of investments sold are determined by the specific identification method.

Allowances for Doubtful Receivables

Allowances for doubtful receivables are provided based on a review of the collectibility of accounts receivable. We determine the amount of allowance for doubtful accounts by examining our historical collection experience and current trends in the credit quality of our customers as well as our internal credit policies.

Revenue Recognition and Allowance for Sales Returns and Others

The four criteria that we use to recognize revenue are the existence of evidence of a contractual arrangement, whether delivery or performance has occurred, whether the selling price is fixed or determinable and whether collectibility is reasonably assured. Allowance for sales returns and

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

others is estimated based on historical experience and any known factors that would affect the allowance. Such provisions are deducted from sales in the year the products are sold and the estimated related costs are deducted from cost of sales.

Sales are determined using fair value taking into account related sales discounts agreed to by the Company and customers. Since the receivables from sales are collectible within one year and such transactions are frequent, the fair value of receivables is equivalent to the nominal amount of cash received.

Inventories

Inventories are stated at the lower of cost or market value. Inventories are recorded at standard cost and adjusted to approximate weighted-average cost at the end of each period. Market value represents net realizable value for finished goods and work in process, and replacement value for raw materials, supplies and spare parts.

Long-term Investments

Investments in shares of stock of companies wherein the Company exercises significant influence on the operating and financial policy decisions are accounted for using the equity method. The Company's proportionate share in the net income or net loss of investee companies is recognized as a component of the Investment income/loss recognized by equity method net account. When acquiring shares of stock, the difference between the cost of investment and the Company's proportionate share of the investee's net book value is amortized using the straight-line method over five years and is also recorded as a component of the investment income/loss recognized by equity method net. The Company adopted ROC Statement of Financial Accounting Standards (SFAS) No. 30, Accounting for Treasury Stock, on January 1, 2002. SFAS No. 30 requires a parent company to reclassify its capital stock held by its subsidiaries from short/long-term investments to treasury stock.

When the Company subscribes to additional investee shares at a percentage different from its existing equity interest, the resulting carrying amount of the investment in equity investee differs from the amount of Company's proportionate share in the investee's net equity. The Company records such difference as an adjustment to the capital surplus as well as the long-term investments accounts. In the event an investee uses its capital surplus (excluding reserve for asset revaluation) to offset its accumulated deficit, the Company will also record a corresponding entry equivalent to its proportionate share of the investee's adjustment.

Other stock investments are accounted for using the cost method. Cash dividends are recognized as income in the year received but are accounted for as reductions in the carrying values of the long-term investments if the dividends are received in the same year that the related investments are acquired. Stock dividends are recognized neither as investment income nor as increases in

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long-term investment but are recorded only as increases in the number of shares held. An allowance is recognized for any decline in the market value of investments using quoted market prices with the corresponding amount charged to shareholders' equity. A reversal of the allowance will result from a subsequent recovery of the market value of such investments. The carrying values of investments with no quoted market price are reduced to reflect an other than temporary decline in their values, with the related impairment loss charged to income.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Investments in foreign mutual funds are stated at the lower of cost or net asset value (NAV). An allowance is recognized when the cost of the funds are lower than their net asset values, with the corresponding amount debited to shareholders' equity. A reversal of the allowance will result from a subsequent recovery of the net asset value.

Investment in convertible notes and stock purchase warrants are carried at cost.

The costs of investments sold are determined using the weighted-average method.

If an investee company recognizes an unrealized loss on a long-term investment based on the lower-of-cost-or-market method, the Company recognizes a corresponding unrealized loss in proportion to its equity interest and records the amount as a component of its own shareholders' equity.

Gains or losses on transactions with investee companies wherein the Company owns at least 20% of the outstanding common stock but less than a controlling interest are deferred in proportion to the ownership percentage until realized through a transaction with a third party. The entire amount of gains or losses on sales to majority-owned subsidiaries are deferred until such gains or losses are realized through the subsequent sale of the related products to third parties. Gains or losses from sales by investee companies to the Company are deferred in proportion to the ownership percentage until realized through transactions with third parties.

Property, Plant and Equipment, Assets Leased to Others and Idle Assets

Property, plant and equipment and assets leased to others are stated at cost less accumulated depreciation. When impairment loss occurs, the related assets are stated at the lower of fair value or book value. Idle assets are stated at the lower of book value or net realizable value. Significant additions, renewals, betterments and interest expense incurred during the construction period are capitalized. Maintenance and repairs are expensed in the period incurred. Property, plant and equipment covered by agreements qualifying as capital leases are carried at the lower of the present value of future minimum rent payments or the market value of the property at the inception dates of the leases. The effective interest method is used to allocate each lease payment between principal and interest expense.

Depreciation is computed using the straight-line method over the estimated service lives, which range as follows: Land improvements 20 years; buildings 10 to 20 years; machinery and equipment 5 to 10 years; and office equipment 3 to 7 years.

Upon sale or disposal of property, plant and equipment, the related cost and accumulated depreciation are removed from the corresponding accounts, and any gain or loss is charged to income in the period of disposal.

Goodwill

Goodwill represents the excess of the consideration paid for acquisitions over the fair market value of identifiable net assets acquired. Goodwill is amortized using the straight-line method over the estimated life of 10 years.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred Charges

Deferred charges consist of software and system design costs, technology know-how, bond issuance costs and financing costs, and technology license fees. The amounts are amortized as follows: Software and system design costs 3 to 5 years; technology know-how 5 years; bond issuance costs and financing costs the term of the bonds or the related line of credit; technology license fees the shorter of the estimated life of the technology or the term of the technology transfer contract.

Pension Costs

Net periodic pension costs are recorded on the basis of actuarial calculations. Unrecognized net transition obligation and unrecognized net gain/loss are amortized over 25 years.

Deferred Gain on Sale and Leaseback

The gain on the sale of property that is simultaneously leased back is deferred by the Company. This deferred gain on sale and leaseback transactions is amortized as follows: (a) operating leases adjustment of rental expenses over the term of the leases and (b) capital leases adjustment of depreciation expenses over the estimated useful life of the property or the term of the lease, whichever is shorter.

Casualty Loss

Casualty losses mainly caused from the March 31, 2002 earthquake are recorded when incurred and any insurance recoveries are recorded when probable up to the amount of the loss. Recoveries in excess of the amount of the loss are recorded when realized.

Income Tax

The Company uses an inter-period tax allocation method for income tax. Deferred income tax assets and liabilities are recognized for the tax effects of temporary differences, unused tax credits and operating loss carry forwards. Valuation allowances are provided to the extent, if any, that it is more likely than not that deferred income tax assets will not be realized. A deferred tax asset

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or liability is, according to the classification of its related asset or liability, classified as current or non-current. However, if a deferred tax asset or liability does not relate to an asset or liability in the financial statements, then it is classified as current or non-current based on the expected length of time before it is realized.

Any tax credits arising from the purchase of machinery, equipment and technology, research and development expenditures, personnel training, marketing expenses for international branding and investments in important technology-based enterprises are recognized using the current method.

Adjustments to prior years' tax liabilities are added to or deducted from the current year's tax provision.

As of January 1, 1998, income taxes on unappropriated earnings (excluding earnings from foreign consolidating subsidiaries) of 10% are expensed in the year of shareholder approval, which is usually the year subsequent to the year incurred.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Concentration of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash and cash equivalents, receivables, investments and deposits. The Company limits its exposure to credit loss by depositing its cash and cash equivalents with high credit quality financial institution. The Company's sales are primarily denominated in currencies other than NT Dollars, primarily US Dollars. One customer's revenue represented 24% and 16% of the consolidated revenue for the six months ended June 30, 2002 and 2003, respectively. The Company routinely assesses the financial strength of substantially all customers. The financial condition of the counter-party to investments and guarantee deposits is assessed by management on a regular basis.

Foreign Currency Transactions

Foreign currency transactions are recorded in New Taiwan dollars at the current rate of exchange in effect when the transaction occurs. Gains or losses derived from foreign currency transactions or monetary assets and liabilities denominated in a foreign currency are recognized in current operations. At the end of each period, foreign currency assets and liabilities are revalued at the prevailing exchange rate with the resulting gain or loss recognized in current operations.

Derivative Financial Instruments

The Company enters into foreign currency forward contracts to manage currency exposures in cash flow and in foreign currency-denominated assets and liabilities. The differences in the New Taiwan dollar amounts translated using the spot rate and the amounts translated using the contracted forward rates on the contract date are amortized over the terms of the forward contracts using the straight-line method. At the balance sheet dates, the receivables or payables arising from forward contracts are restated using the prevailing spot rate at the balance sheet date and the resulting differences are recognized and charged to income. Also, the receivables and payables related to the forward contract are netted with the resulting amount presented as either an asset or a liability. Any resulting gain or loss upon settlement is charged to income in the period of settlement.

The Company enters into interest rate swap transactions to manage exposures to changes in interest rates on existing liabilities. These transactions are accounted for on an accrual basis, in which the cash settlement receivable or payable is recorded as an adjustment to interest income or expense.

The notional amount of foreign currency option contracts entered into for hedging purposes are not recognized as an asset or liability on the contract dates. The premiums paid or received for the call or put options are amortized and charged to income on a

straight-line basis over the term of the related contract. Any resulting gain or loss upon settlement is charged to income in the period of settlement.

Translation of Foreign Currency Financial Statements

ROC SFAS No. 14, Accounting for Foreign Currency Transactions, applies to foreign subsidiaries that use the local foreign currency as its functional currency. The financial statements

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of foreign subsidiaries are translated into New Taiwan dollars at the following exchange rates: assets and liabilities current rate on balance sheet date; shareholders equity historical rate; income and expenses weighted average rate during the year. The resulting translation adjustment is recorded as a separate component of shareholders equity.

Reclassification

Certain accounts in the financial statements as of and for the six months ended June 30, 2002 have been reclassified to conform to the financial statements as of and for the six months ended June 30, 2003.

Earnings Per Share

Earnings per share is calculated by dividing net income by the average number of shares outstanding in each period, adjusted retroactively to the beginning of the year for stock dividends and stock bonuses issued subsequently. Earnings per equivalent American Depository Share (ADS) is calculated by multiplying earnings per share by five (one ADS represents five common shares).

3. NEW ACCOUNTING PRONOUNCEMENTS

In accordance with the ROC SFAS No. 30, Accounting for Treasury Stock, and other relevant regulations from the ROC Securities and Futures Commission (SFC), the Company is required to reclassify its common stock held by subsidiaries from short/long-term investments to treasury stock. The reclassification is based on the carrying value recorded by the Company's subsidiaries as of January 1, 2002. The adoption of SFAS No. 30 resulted in the decrease of long-term investments and the increase of treasury stock by NT\$1,922,049 thousand as of June 30, 2003, and the decrease in net income for the six months ended June 30, 2003 by NT\$255,016 thousand.

4. US DOLLAR AMOUNTS

The Company maintains its accounts and expresses its consolidated financial statements in New Taiwan dollars. For convenience only, US dollar amounts presented in the accompanying consolidated financial statements have been translated from New Taiwan dollars at the noon buying rate in The City of New York for cable transfers in New Taiwan dollars as certified for customs purposes by the Federal Reserve Bank of New York as of June 30, 2003, which was NT\$34.61 to US\$1.00. The convenience translations should not be construed as representations that the New Taiwan dollar amounts have been, could have been, or could in the future be, converted into US dollars at this or any other rate of exchange.

5. CASH AND CASH EQUIVALENTS

	June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Cash and bank deposits	71,097.7	69,051.9
Government bonds acquired under repurchase agreements	1,297.8	3,032.8
	72,395.5	72,084.7

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. SHORT-TERM INVESTMENTS

	June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Government bonds		3,054.1
Listed stocks-carry value	213.2	1,011.6
	<u>213.2</u>	<u>4,065.7</u>
Market value	<u>2,894.2</u>	<u>5,325.0</u>

The market values of listed stocks and government bonds as of June 30, 2002 and 2003 were based on the average closing price and the daily volume-weighted average yield/price conversion of Gre Tai Securities Market, respectively.

7. RECEIVABLES NET

	June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Notes receivable	124.5	13.5
Accounts receivable	24,854.0	27,916.2
	<u>24,978.5</u>	<u>27,929.7</u>
Less allowance for doubtful receivables	(1,173.1)	(980.1)
Less allowance for sales returns and others	(3,337.0)	(2,077.7)
	<u>(4,510.1)</u>	<u>(3,057.8)</u>
	<u>\$ 20,468.4</u>	<u>\$ 24,871.9</u>

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The changes in the allowances are summarized as follows:

	Six Months Ended June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Allowance for doubtful receivables		
Balance, beginning of the period	1,100.5	933.0
Additions	88.6	48.4
Deductions	(16.0)	(1.3)
	<u>1,173.1</u>	<u>980.1</u>
Balance, end of the period	1,173.1	980.1
Allowance for sales returns and others		
Balance, beginning of the period	2,581.6	2,372.5
Additions	2,002.9	1,817.8
Deductions	(1,247.5)	(2,112.6)
	<u>3,337.0</u>	<u>2,077.7</u>
Balance, end of the period	3,337.0	2,077.7

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. INVENTORIES NET

	June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Finished goods	1,774.1	1,967.8
Work in process	10,951.7	11,439.1
Raw materials	530.7	526.7
Supplies and spare parts	1,040.2	950.0
	14,296.7	14,883.6
Less inventory reserve	(1,336.7)	(2,244.2)
	<u>12,960.0</u>	<u>12,639.4</u>

The changes in inventory reserve are summarized as follows:

	Six Months Ended	
	June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Balance at beginning of the period	1,191.8	1,736.3
Additions	2,418.2	2,656.3
Write-offs	(2,273.3)	(2,148.4)
	<u>1,336.7</u>	<u>2,244.2</u>

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. LONG-TERM INVESTMENTS

	June 30			
	2002		2003	
	Carrying Value	% of Ownership	Carrying Value	% of Ownership
	NT\$		NT\$	
Equity method:				
Publicly traded stock				
Vanguard International Semiconductor Corporation (VIS)	3,102.9	25	3,848.0	28
Non-publicly traded stock				
Systems on Silicon Manufacturing Company Pte Ltd. (SSMC)	3,449.3	32	2,609.9	32
Global UniChip Corp. (GUC)			387.4	47
	<u>6,552.2</u>		<u>6,845.3</u>	
Cost method:				
Common stock				
Publicly traded stock				
Amkor Technology, Inc.	280.7		280.7	
Monolithic System Technology, Inc.	104.3	2	104.3	2
Taiwan Mask Corp.	32.1	2	32.1	2
Non-publicly traded stock				
United Gas Co., Ltd.	193.6	11	193.6	11
Global Testing Corp. (GTC)	180.0	10	180.0	10
Global Investment Holding	102.9	6	106.1	6
Shin-Etsu Handotai Co., Ltd.	105.0	7	105.0	7
EoNEX Technologies, Inc.			103.6	6
Hong Tung Venture Capital	150.0	10	83.9	10
Procoat Technology, Inc.	65.1	12	67.5	12
Goyatek Technology, Inc.			62.1	8
W.K. Technology, Fund IV	50.0	2	50.0	2
RichTek Technology Corp.	44.1	10	47.0	9
Advanced Power Electronics Corp.	46.8	6	46.8	6
Auden Technology MFG. Co., Ltd.	37.4	4	38.8	4
Conwise Technology Corp. Ltd.			33.6	14
Eon Technology, Inc.			33.6	10
TrendChip Technologies Corp.			30.0	5
Programmable Microelectronics (Taiwan) Corp.	59.1	4	20.8	5
ChipStrate Technology, Inc.	10.5	9	10.5	9
Signia Technologies, Inc.			10.5	10
eChannel Option Holding, Inc.			8.7	6
GeoVision, Inc.	4.4	2	4.5	2

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Capella Microsystems Inc.	4.5	2	3.0	2
Elcos Microdisplay Technology, Ltd.			0.9	2
Divio, Inc.	0.1		0.1	
EmpowerTel Networks, Inc.	1.2	1		
Equator Technologies, Inc.	3.0			
3DFX Interactive, Inc.	10.0			
	<u>1,484.8</u>		<u>1,657.7</u>	

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	June 30			
	2002		2003	
	Carrying Value	% of Ownership	Carrying Value	% of Ownership
	NT\$		NT\$	
Preferred stock				
Non-publicly traded stock				
Sonics, Inc.	221.9	10	228.9	10
Tropian, Inc.	145.4	5	150.0	5
Reflectivity, Inc.	67.1	6	145.1	14
Monolithic Power Systems, Inc.	132.3	16	136.6	16
Atheros Communications, Inc.	120.6	3	124.3	3
Elcos Microdisplay Technology			121.1	16
Memsic, Inc.	102.7	24	105.9	22
Ikanos Communication	50.3	3	89.0	3
Pixim, Inc.	83.9	3	82.4	3
Quicksilver Technology, Inc.	139.3	30	81.0	4
Kilopass Technology, Inc.			69.2	19
Fang Tek, Inc.			69.2	44
NanoAmp Solutions, Inc.	62.2	4	64.1	4
NetLogic Microsystems	62.1	1	64.0	1
Alchip Technologies Ltd.			58.9	24
Newport Opticom, Inc.	73.9	15	55.4	16
Ralink Technologies, Inc.	50.3	7	52.1	5
SiRF Technology Holdings, Inc.	49.1	1	50.7	1
OEpic, Inc.	83.9	7	45.6	8
Advanced Analogic Technology, Inc.	42.3	2	43.6	2
Integrated Memory Logic, Inc.	60.7	12	42.2	12
Axiom Microdevices, Inc			34.7	5
Optichron			34.7	6
Litchfield Communications	33.6	6	34.6	6
Accelerant Networks	33.6	1	34.6	1
Quake Technology	33.6	1	34.6	1
IP Unity			34.0	2
Match Lab, Inc.	58.7	11	30.2	11
LightSpeed Semiconductor Corp.	102.8	3	28.7	2
Silicon Data, Inc.	33.6	7	26.0	7
XHP Microsystem			26.0	6
Angstrom Systems, Inc.	25.2	7	26.0	2
Iridigm Display	16.8	2	17.4	2
Mosaic Systems	16.8	6	17.4	6
Zenesis Technologies	16.8	4	17.4	4
Divio, Inc.	16.8	4	17.3	3

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Capella Microsystems, Inc.	77.1	9	12.0	9
Incentia Design Systems, Inc.	16.8	2	11.8	2
Sensory, Inc.	41.9	5	10.8	5
Oridus, Inc. (CreOsys, Inc.)	50.3	8	10.4	8
Signia Technologies, Inc.	75.5	22		
LeadTONE Wireless, Inc.	5.8	4	4.5	6
eBest!, Inc.			2.8	1
FormFactor, Inc.	67.1	1		
HiNT Corp.	33.6	5		
Equator Technologies, Inc.	95.3	2		

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	June 30			
	2002		2003	
	Carrying Value	% of Ownership	Carrying Value	% of Ownership
	NT\$	(Unaudited) (In Millions)	NT\$	
EmpowerTel Networks, Inc.	17.2	7		
Rise Technology Company	50.3	3		
OmegaBand, Inc. (Seagull Semiconductor, Inc.)	10.2	4		
	<u>2,477.4</u>		<u>2,345.2</u>	
Bonds				
Rise Technology Co.	10.0			
	<u>10.0</u>			
Funds				
Horizon Ventures	160.6		195.4	
Crimson Asia Capital	39.5		47.4	
	<u>200.1</u>		<u>242.8</u>	
Equity certificate				
OEpic, Inc.				
Warrant				
eBest!, Inc.	3.2			
	<u>10,727.7</u>		<u>11,091.0</u>	

On January 4, 2003, TSMC purchased 52% of the outstanding shares of GUC for NT\$341.2 million (US\$9.8 million). On February 26, 2003, GUC issued new shares and TSMC purchased 6,500 thousand of these new shares for NT\$ 68.7 million. As a result, its ownership in GUC decreased from 52% to 47%.

The investment losses of the equity-method investee companies consist of the following:

	Six Months Ended June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
VIS	274.6	172.4
SSMC	683.0	515.2
GUC		14.1
	957.6	701.7

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The market value of publicly traded stocks accounted under the cost method was NT\$486.6 million and NT\$506.6 million as of June 30, 2002 and 2003, respectively.

10. PROPERTY, PLANT AND EQUIPMENT NET

	June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
Cost		
Land and land improvements	841.3	871.4
Buildings	72,922.8	78,250.2
Machinery and equipment	312,107.4	360,735.4
Office equipment	6,759.9	7,037.8
	<u>392,631.4</u>	<u>446,894.8</u>
Construction in progress	32,522.8	18,601.0
	<u>425,154.2</u>	<u>465,495.8</u>
Accumulated depreciation		
Land and improvements	276.2	430.3
Buildings	22,654.8	31,917.0
Machinery and equipment	156,076.3	207,404.7
Office equipment	3,530.2	4,052.2
	<u>182,537.5</u>	<u>243,804.2</u>
	<u>242,616.7</u>	<u>221,691.6</u>

Depreciation expense on property, plant and equipment was NT\$28,800.6 million and NT\$32,253.9 million in the six months ended June 30, 2002 and 2003, respectively.

Interest expense (before deducting capitalized amounts of NT\$48.6 million and NT\$2.9 million in the six months ended June 30, 2002 and 2003, respectively) was NT\$1,412.5 million and NT\$1,149.7 million in the six months ended June 30, 2002 and 2003, respectively. The interest rate used for purpose of calculating the capitalized amount was 5.283% for the six months ended June

30, 2002 and 2003, respectively.

Information on the status of the expansion or construction plans of TSMC's manufacturing facilities as of June 30, 2003, is as follows:

Construction/Expansion Plan	Estimated		Actual Date	Expected Date of Starting Operations
	Complete Cost	Accumulated Expenditures	of Starting Operations	
	NT\$	NT\$		
	(Unaudited)			
	(In Millions)			
Fab 6	93,932.0	87,699.4	March 2000	
Fab 12 phase 1	80,318.4	61,581.7	March 2002	
Fab 14 phase 1				second half of 2004 at the earliest
	30,411.0	13,690.4		

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. DEFERRED CHARGES NET

	June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
Technology license fees	2,305.0	5,711.4
Software and system design costs	2,876.0	2,956.0
Bond issuance costs and financing costs	152.4	101.7
Technology know-how	76.5	22.5
Others	21.1	2.8
	<u>5,431.0</u>	<u>8,794.4</u>

Amortization expense on deferred charges was NT\$1,090.7 million and NT\$1,790.4 million for the six months ended June 30, 2002 and 2003, respectively.

As of June 30, 2003, the Company's estimated aggregate amortization expense for each of the five succeeding fiscal years is as follows:

Year	Amount
	NT\$ (Unaudited) (In Millions)
July to December, 2003	1,171.0
2004	2,170.2
2005	1,967.1
2006	1,007.1
2007	508.2
2008 and thereafter	1,970.8
	<u>8,794.4</u>

12. SHORT-TERM BANK LOANS

	June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
Unsecured loans in US dollars: US\$16.0 million, annual interest at 1.9125% and 1.73% in 2002 and 2003, respectively	536.9	553.8

As of June 30, 2003, TSMC provided a NT\$1,384.5 million (US\$40.0 million) guarantee for the above US\$16.0 million loan.

Unused credit lines as of June 30, 2003 aggregated approximately NT\$9,930.0 million and US\$361.0 million, respectively.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

13. LONG-TERM BANK LOANS

	June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
Secured loan: US\$440.0 million, repayable by February 2005, US\$122.0 million and US\$50.0 million was repaid in 2002 and 2003, annual floating interest at 2.515% and 2.015% in 2002 and 2003, respectively	12,752.0	9,276.0
Unsecured loan: US\$200.0 million, repayable by December 2003, annual interest at 2.725% and 1.9125% in 2002 and 2003, respectively	6,711.6	6,922.7
	<u>19,463.6</u>	<u>16,198.7</u>

As of June 30, 2003, all of the loans above were guaranteed by TSMC. In addition, all assets of WaferTech with a carrying amount of approximately NT\$20,681.4 million (US\$597.5 million) were pledged for the US\$440.0 million secured loan. WaferTech is required to be in compliance with certain financial covenants beginning December 31, 2002 under the secured loan. As of June 30, 2003, WaferTech was in compliance with all such financial covenants. Under the unsecured loan, TSMC is required to maintain certain financial covenants which, if violated, could result in the payment of this obligation becoming due prior to the originally scheduled maturity date. These financial covenants require TSMC to, among other things, maintain minimum levels of working capital, earnings before interest, taxes, depreciation and amortization, and net worth. TSMC was in compliance with these financial covenants as of June 30, 2003.

As of June 30, 2003, future minimum principal payments under the Company's long-term bank loan arrangements are as follows:

Year	Amount
	NT\$ (Unaudited) (In Millions)
July to December 2003	6,922.7
2004	
2005	9,276.0
	<u>16,198.7</u>

Unused credit lines for long-term bank loans as of June 30, 2003 aggregated approximately NT\$27.5 million and US\$172.0 million, respectively.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

14. BONDS

	June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
Domestic unsecured bonds:		
Issued in March 1998 and payable in March 2003 in one lump sum payment, 7.71% annual interest payable semi-annually	4,000.0	
Issued in October 1999 and payable in October 2002 and 2004 in two equal payments, 5.67% and 5.95% annual interest payable annually, respectively	10,000.0	5,000.0
Issued in December 2000 and payable in December 2005 and 2007 in two installments, 5.25% and 5.36% annual interest payable annually, respectively	15,000.0	15,000.0
Issued in January 2002 and payable in January 2007, 2009 and 2012 in three installments, 2.6%, 2.75% and 3% annual interest payable annually, respectively	15,000.0	15,000.0
	<u>44,000.0</u>	<u>35,000.0</u>

As of June 30, 2003, future principal payments under the Company's bonds are as follows:

<u>Year of Repayment</u>	<u>Amount</u>
	NT\$ (Unaudited) (In Millions)
July to December, 2003	
2004	5,000.0
2005	10,500.0
2006	
2007	7,000.0
2008 and thereafter	12,500.0
	<u>35,000.0</u>

15. OTHER LONG-TERM PAYABLES

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TSMC entered into several license arrangements for certain semiconductor-related patents. Future payments under the agreements as of June 30, 2003 are as follows:

<u>Year</u>	<u>Amount</u>
	NT\$ (Unaudited) (In Millions)
July to December, 2003	809.9
2004	1,221.8
2005	983.0
2006	467.3
2007	484.5
2008 and thereafter	1,107.6
	<hr/>
	5,074.1
	<hr/>

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

16. PENSION PLAN

TSMC has a pension plan for all regular employees that provides benefits based on length of service and average monthly salary for the six-month period prior to retirement.

TSMC contributes at an amount equal to 2% of salaries paid every month to a Pension Fund (the Fund). The Fund is administered by a pension fund monitoring committee (the Committee) and deposited in the Committee's name with the Central Trust of China.

The changes in the Fund and accrued pension cost for the six months ended June 30, 2002 and 2003 are summarized as follows:

	Six Months Ended June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
Plan Assets		
Balance, beginning of the period	804.4	993.4
Contribution	87.3	91.0
Interest	29.6	20.7
Payment	(5.3)	(3.5)
	<u>916.0</u>	<u>1,101.6</u>
Unfunded accrued pension cost		
Balance, beginning of the period	1,856.6	2,211.6
Accruals	193.4	221.5
	<u>2,050.0</u>	<u>2,433.1</u>

17. INCOME TAXES

- a. A reconciliation of income tax expense before minority interest at the statutory rate and current income tax expense before income tax credits is shown below:

	Six Months Ended June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	
Income tax expense based on income before minority interest at statutory rate	4,554.8	4,233.9
Tax-exempt income	(2,665.0)	(2,027.8)
Temporary and permanent differences	235.6	(43.7)
	<hr/>	<hr/>
Current income tax expense before income tax credits	2,125.4	2,162.4
	<hr/>	<hr/>

The ROC statutory rate for 2002 and 2003 was 25%.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- b. Income tax expense consists of:

	Six Months Ended June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
Current income tax expense before income tax credits	2,125.4	2,162.4
Additional 10% tax on the unappropriated earnings	164.7	1,273.5
Income tax credits	(2,163.8)	(3,269.2)
Other income tax	5.9	2.3
Income tax expense	132.2	169.0
Net change in deferred income tax assets (liabilities)		
Net operating loss carryforwards	1,854.1	(543.0)
Investment tax credits	(2,268.6)	(2,573.3)
Temporary differences	2,394.8	(1,529.9)
Valuation allowance	38.8	5,189.4
	2,151.3	712.3

- c. Deferred income tax assets (liabilities) consist of the following:

	June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
Current		
Investment tax credits	4,547.1	3,320.0
Temporary differences	24.3	104.1
	4,571.4	3,424.1
Noncurrent		
Net operating loss	4,264.2	8,395.3

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Investment tax credits	21,778.9	25,820.9
Temporary differences	(4,779.8)	(6,845.1)
Valuation allowance	(9,257.9)	(18,163.5)
	<u>12,005.4</u>	<u>9,207.6</u>

d. Integrated income tax information:

The balances of the imputation credit account (ICA) as of June 30, 2002 and 2003 were NT\$2.5 million and NT\$14.7 million, respectively.

The actual creditable ratios for 2001 and 2002 were 0.04% and 0.08%, respectively.

e. All retained earnings generated prior to December 31, 1997 were appropriated as of June 30, 2002.

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

f. As of June 30, 2003, TSMC's investment tax credits consisted of the following:

Regulation	Items	Total	Remaining	Expiration
		Creditable	Creditable	
		Amounts	Amounts	Year
		NT\$	NT\$	
		(Unaudited)	(Unaudited)	
		(In Millions)	(In Millions)	
Statute for Upgrading Industries	Purchase of machinery and equipment	4,767.3	1,798.5	2003
		8,210.6	8,210.6	2004
		3,814.4	3,814.4	2005
		4,905.9	4,905.9	2006
		332.3	332.3	2007
		<u>22,030.5</u>	<u>19,061.7</u>	
Statute for Upgrading Industries	Research and development expenditures	671.5	376.6	2003
		1,974.3	1,974.3	2004
		3,111.5	3,111.5	2005
		3,322.4	3,322.4	2006
		836.3	836.3	2007
		<u>9,916.0</u>	<u>9,621.1</u>	
Statute for Upgrading Industries	Personnel training	16.1	16.1	2003
		43.3	43.3	2004
		28.9	28.9	2005
		27.3	27.3	2006
				<u>115.6</u>
Statute for Upgrading Industries	Marketing expenses for international branding	0.3	0.3	2003
Statute for Upgrading Industries	Investments in important technology-based enterprise	5.4		2003
		203.3	203.3	2004
		138.9	138.9	2005

347.6	342.2
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- g. The sales generated from the following expansion and construction of TSMC's manufacturing plants are exempt from income tax:

	<u>Tax-exemption Period</u>
Construction of Fab 6	2001 to 2004
Construction of Fab 8 module B	2002 to 2005
Expansion of Fab 2 modules A and B, Fab 3 and Fab 4, Fab 5 and Fab 6	2003 to 2006

- h. The tax authorities have examined income tax returns of the Company through 1999. However, the Company is contesting the assessment by the tax authority for 1992, 1993,

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

1996, 1997 and 1998 and believes any additional assessment would not be significant. The Company believes the remaining unused tax credits would be sufficient to offset any additional tax expense that may arise from the assessment.

18. LABOR COST, DEPRECIATION AND AMORTIZATION EXPENSE

	Six Months Ended June 30, 2002		
	Classified as Cost of Sales	Classified as Operating Expense	Total
	NT\$	NT\$ (Unaudited) (In Millions)	NT\$
Labor cost			
Salary	3,987.1	2,179.6	6,166.7
Labor and health insurance	191.4	98.0	289.4
Pension	190.8	97.6	288.4
Other	138.7	130.0	268.7
Depreciation	27,430.8	1,369.8	28,800.6
Amortization	312.9	1,417.3	1,730.2
	<u>32,251.7</u>	<u>5,292.3</u>	<u>37,544.0</u>

	Six Months Ended June 30, 2003		
	Classified as Cost of Sales	Classified as Operating Expense	Total
	NT\$	NT\$ (Unaudited) (In Millions)	NT\$
Labor cost			
Salary	4,141.3	2,300.9	6,442.2
Labor and health insurance	223.6	115.2	338.8
Pension	207.0	105.9	312.9
Other	114.9	131.7	246.6
Depreciation	31,038.7	1,215.2	32,253.9
Amortization	755.8	1,679.9	2,435.7
	<u>37,516.2</u>	<u>5,442.7</u>	<u>42,958.9</u>

36,481.3	5,548.8	42,030.1
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19. SHAREHOLDERS EQUITY

TSMC has issued a total of 485,898 thousand American Depositary Shares (ADS), which trade on the New York Stock Exchange (NYSE), as of September 30, 2003. The total number of common shares represented by all issued ADSs is 2,429,491 thousand shares (one ADS represents five common shares).

Capital surplus can only be used to offset a deficit under the ROC Company Law. However, the components of capital surplus generated from donated capital and the excess of the issue price over the par value of capital stock (including stock issued for new capital, mergers and the purchase of treasury stock) can be transferred to capital stock as stock dividends.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

TSMC's Articles of Incorporation provide that the following shall be appropriated from annual net income if in excess of any cumulative deficit:

- a. 10% legal reserve;
- b. Special reserve in accordance with relevant laws or regulations;
- c. Remuneration to directors and supervisors and bonuses to employees equal to 0.3% and at least 1% of the remainder, respectively. Individuals eligible for the employee bonuses may include employees of affiliated companies as approved by the board of directors or a representative of the board of directors;
- d. Dividends to holders of preferred shares at a 3.5% annual rate, based on the period which the preferred shares have been outstanding. Following the redemption of all of its issued and outstanding preferred shares in May 2003, TSMC amended its Articles of Incorporation on June 3, 2003 to remove the provision for issuance of any future dividends to preferred shareholders as of that date;
- e. The appropriation of any remaining balance shall be approved by the shareholders.

Dividends are distributed in shares of common stock or a combination of cash and common stock. Distribution of profits is usually made in the form of a stock dividend. The total of cash dividends paid in any given year may not exceed 50% of total dividends distributed in that year.

Any appropriations of net income are recorded in the financial statements in the year of shareholder approval.

The appropriation for legal reserve is made until the reserve equals the aggregate par value of TSMC's outstanding capital stock. The reserve can only be used to offset a deficit or be distributed as a dividend up to half of the reserve balance when the balance has reached 50% of the aggregate par value of the outstanding capital stock of TSMC.

A special reserve equivalent to the debit balance of any account shown in the shareholder's equity section of the balance sheet (except for the recorded costs of treasury stocks held by subsidiaries), other than the deficit, shall be made from unappropriated retained earnings pursuant to existing regulations promulgated by the ROC SFC. The special reserve is allowed to be appropriated when the debit balance of such accounts is reversed.

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The appropriations of the earnings of 2001 and 2002 were approved in the shareholders meeting on May 7, 2002 and June 3, 2003, respectively. The appropriations and dividend per share are as follows:

	Appropriation of Earnings		Dividend Per Share (NT\$)	
	For Fiscal Year 2001	For Fiscal Year 2002	For Fiscal Year 2001	For Fiscal Year 2002
	NT\$	NT\$		
	(Unaudited)			
	(In Millions)			
Legal reserve	1,448.3	2,161.0		
Special reserve	(349.9)	69.0		
Bonus paid to employees-in stock	1,070.8	1,539.0		
Preferred stock dividend-in cash	455.0	455.0	0.35	0.35
Common stock dividend-in stock	16,832.6	14,898.3	1.00	0.80
Remuneration to directors and supervisors-in cash	133.8	58.5		
	<u>19,590.6</u>	<u>19,180.8</u>		

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The above appropriation of the earnings in fiscal year 2001 and 2002 is consistent with the resolution of the meetings of board of directors on March 26, 2002 and March 4, 2003, respectively. If the above employee bonus and remuneration to directors and supervisors were paid in cash and charged against income for 2001 and 2002, the basic earnings per share for the years ended December 31, 2001 and 2002 would decrease from NT\$0.83 to NT\$0.76 and NT\$1.14 to NT\$1.05, respectively. The shares distributed as a bonus to employees represented 0.64% and 0.83% of the Company's total outstanding common shares as of December 31, 2001 and 2002, respectively.

Under the Integrated Income Tax System that became effective on January 1, 1998, ROC resident shareholders are allowed a tax credit for their proportionate share of the income tax paid by TSMC on earnings generated as of January 1, 1998. An Imputation Credit Account (ICA) is maintained by TSMC for such income tax and the tax credit allocated to each shareholder.

Preferred Stock

TSMC issued 1,300,000 thousand shares of unlisted Series A preferred stock to certain investors on November 29, 2000. All of the preferred stock was redeemed at par value and retired on May 29, 2003. Under TSMC's Articles of Incorporation, as amended on June 3, 2003, the Company is no longer authorized to issue preferred stock.

The following are the rights of the preferred shareholders and the related terms and conditions prior to redemption:

Preferred shareholders

- a. are entitled to receive cumulative cash dividends at an annual rate of 3.5%.
- b. are not entitled to receive any common stock dividends (whether declared out of unappropriated earnings or capital surplus).
- c. have priority over the holders of common shares to the assets of the Company available for distribution to shareholders upon liquidation or dissolution; however, the preemptive rights to the assets shall not exceed the issue value of the shares.
- d. have voting rights similar to that of the holders of common shares.

- e. have no right to convert their shares into common shares. The preferred shares are to be redeemed within thirty months from their issuance. The preferred shareholders have the aforementioned rights and the Company's related obligations remain the same until the preferred shares are redeemed by the Company.

Employee Stock Compensation

Stock Option Plans

On June 25, 2002, the SFC approved TSMC's Employee Stock Option Plan (Plan I). Plan I provides option rights with each unit representing one common share of stock to qualified employees of TSMC and its subsidiaries, including TSMC-North America and WaferTech. The option rights are valid for ten years and exercisable at certain percentages subsequent to the

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

second anniversary of issuance. Under the terms of Plan I, stock options are granted at an exercise price equal to the closing price of TSMC's common shares listed on the Taiwan Stock Exchange (TSE) on the date of grant. The maximum number of shares authorized to be granted under Plan I is 100,000 thousand option rights. The options vest 50% two years after the grant date, 75% vest three years after the grant date and 100% vest four years after the grant date. Under Plan I, there were 52,820 thousand option rights that had never been granted, or had been granted but cancelled. These un-granted or cancelled option rights expired on June 25, 2003.

Options are generally exercisable when vested, and unvested options are cancelled and returned to Plan I upon termination of service. If employment is terminated by an option holder voluntarily or by the Company, any vested options must be exercised within 3 months from the employment termination date.

Information with respect to stock option rights activities under Plan I is as follows:

	Outstanding Option Rights	
	Number of Option Rights	Range of Weighted Average Exercise Prices
	(In Thousands)	NT\$
Balance, January 1, 2003	19,369	51.0~53.0
Options granted	28,411	41.6~58.5
Options cancelled	(600)	41.6~58.5
Balance, June 30, 2003	47,180	

The following table sets forth the range of exercise prices, number of options, weighted-average exercise price and remaining contractual life of options outstanding at June 30, 2003:

Range of Exercise	Number of Options (in Thousands)	Remaining Contractual Life (Years)	Weighted Average Exercise
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<u>Prices (NT\$)</u>	_____	_____	<u>Price (NT\$)</u>
41.6	6,483	9.68	41.6
51.0	1,075	9.35	51.0
53.0	17,851	9.14	53.0
58.5	21,771	9.93	58.5
_____	_____	_____	_____
41.6-58.5	47,180	9.58	53.9
_____	_____	_____	_____

No options were exercisable as of June 30, 2003.

On September 2, 2003, the Board of Directors approved the 2003 employee stock option plan (2003 Plan). The 2003 Plan has been submitted to the SFC for final approval. The 2003 Plan will provide option rights with each unit representing one common share of stock to qualified employees of TSMC and its subsidiaries. The option rights are valid for ten years and exercisable at certain percentages subsequent to the second anniversary of issuance. Under the terms of the 2003 Plan, stock options are granted at an exercise price equal to the closing price of TSMC s

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common shares listed on the TSE on the date of grant. The maximum number of shares authorized to be granted is 120,000 thousand option rights. The options vest 50% two years after the grant date, 75% vest three years after the grant date and 100% vest four years after the grant date.

In 1996, WaferTech adopted an Executive Incentive Plan, which was amended in 1997. Under the 1997 amendment, the Board of Directors approved the Senior Executive Incentive Plan and the Employee Incentive Plan (Plan II) under which officers, key employees and non-employee directors may be granted option rights, appreciation rights and/or performance units. As WaferTech is a limited liability company and does not have units of stock, each option right granted pursuant to Plan II provided grantees rights to purchase ownership interests in WaferTech. Plan II provides for a maximum of 15,150 thousand option rights. While WaferTech may grant employees option rights that are exercisable at different times or within different periods, it has generally granted option rights that are exercisable on a cumulative basis in annual installments of 25% each on the first, second, third and fourth anniversaries of the date of grant.

Information with respect to stock option rights activities under Plan II is as follows:

	Option Rights Available for Grant	Outstanding Option Rights	
		Number of Option Rights	Exercise Price
	(In Thousands)		US\$
Balance, January 1, 2002	4,608	3,062	1.43
Options granted			
Options exercised	(244)	(917)	1.22
Options cancelled		(117)	1.93
Balance, June 30, 2002	4,364	2,028	
Balance, January 1, 2003	4,824	1,586	1.53
Options exercised		(599)	1.33
Options cancelled	129	(129)	1.77
Balance, June 30, 2003	4,953	858	

The option rights granted will expire if not exercised at specified dates between May 2006 and June 2011.

WaferTech Buyback Program

In December 2000, WaferTech implemented the Stock Option Buyback Program (Buyback) with its employees. The Buyback program provides employees with the right to sell back all vested stock options and outstanding ownership interests granted prior to January 1, 2001 to WaferTech. The repurchase price for outstanding ownership interests is US\$6 per option. The repurchase price for vested stock options is US\$6 per option less the exercise price of the option. Unvested option rights continue to vest in accordance with the vesting schedule prescribed under Plan II and can be sold back to WaferTech once vested. As of June 30, 2002 and 2003, WaferTech had repurchased 2,581 thousand and 2,593 thousand outstanding ownership interests at a cost of US\$15.5 million and US\$15.6 million, respectively.

The difference between the share repurchase price of US\$6 and the exercise price is recognized as compensation expense over the vesting period of the option rights. As of June 30, 2002 and 2003, US\$6.8 million and US\$3.3 million remained as deferred compensation in connection with the stock option buyback program, respectively. For the six months ended June 30, 2002 and

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2003, US\$1.6 million and US\$0.1 million had been recognized as compensation expense, respectively. Of the 858 thousand shares outstanding as of June 30, 2003, 408 thousand shares have vested and may be resold to the Company.

Stock Appreciation Rights

Effective in December 2000, TSMC-North America adopted a stock appreciation rights program (SAR Plan) whereby employees are entitled to receive cash bonuses based on the appreciation of TSMC stock as quoted by the TSE. As of June 30, 2003, TSMC-North America had approximately 11.4 million stock appreciation rights outstanding, and no employees had elected to exercise their rights. During 2002, benefits under the SAR Plan were replaced by the 2002 Stock Option Plan (Plan I) and, accordingly, TSMC-North America does not intend to provide additional SAR Plan benefits subsequent to the adoption of Plan I.

In December 2000, in conjunction with WaferTech's Buyback program, WaferTech implemented the Employee Stock Appreciation Incentive Plan (Appreciation). The Appreciation plan is designed to provide employees with a long-term incentive plan that tracks the appreciation of TSMC common stock through stock appreciation rights (SARs). SARs provide each participant the right to receive, upon exercise, an amount in cash from WaferTech that is the excess of the market price of TSMC common stock on the date of exercise over the exercise price on the date of grant. The exercise price is equivalent to the per share price of TSMC common stock on the date of grant as quoted on the Taiwan Stock Exchange. SARs granted prior to March 10, 2001 vest 25% per year for four years and expire five years from the date of grant. In May 2001, the Board of Directors approved a reduction in the vesting period from four years to two years for SARs grants made after March 10, 2001. As of June 30, 2003, WaferTech had granted 11,380,655 SARs under the Appreciation plan at a weighted average exercise price of US\$1.75. As of June 30, 2003, there were 4.7 million vested SARs under the Appreciation plan.

Compensation expense is recorded based on the difference between the grant price and market price at the end of each period. This expense is recognized ratably over the vesting period and adjusted based on changes in TSMC's stock price on TSE. The Company recorded compensation expense of approximately US\$0.1 million and US\$1.3 million at June 30, 2002 and 2003, respectively.

20. TREASURY STOCK (COMMON STOCK)

<u>Purpose</u>	<u>Beginning Shares</u>	<u>Increase</u>	<u>Decrease</u>	<u>Ending Shares</u>
	(Shares in Thousands)			
<i>Six months ended June 30, 2002</i>				
Reclassification of parent company stock held by subsidiaries from short/long-term investment	39,270	3,818	1,087	42,001

Six months ended June 30, 2003

Reclassification of parent company stock held by subsidiaries
from short/long-term investment

	<u> </u>	<u> </u>	<u> </u>	<u> </u>
	42,001		40	41,961
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Proceeds from the sale of treasury stock for the six months ended June 30, 2002 and 2003 were NT\$96.5 million and NT\$1.9 million, respectively. As of June 30, 2002 and 2003, the book value of the treasury stock was NT\$1,914.7 million and NT\$1,922.0 million, respectively; the market value was NT\$3,120.4 million and NT\$2,463.7 million, respectively. Capital stock held by a subsidiary as an investment is recorded as treasury stock, with the holder having the same rights as other common shareholders.

21. EARNINGS PER SHARE

Earnings per share (EPS) are computed as follows:

	Amounts (Numerator)		Share (Denominator) (Thousands)	EPS (NT\$)	
	Income Before Income Tax And Minority Interest NT\$ (Unaudited) (In Millions)	Net Income NT\$		Income Before Income Tax And Minority Interest	Net Income
<i>Six months ended June 30, 2002</i>					
Income	18,037.4	15,897.3			
Less: preferred stock dividends	(227.5)	(227.5)			
	<u>17,809.9</u>	<u>15,669.8</u>			
Basic and diluted earnings per Share					
Income available to common Shareholders	<u>17,809.9</u>	<u>15,669.8</u>	<u>20,220,853</u>	<u>0.88</u>	<u>0.77</u>
<i>Six months ended June 30, 2003</i>					
Income	16,798.9	16,087.8			
Less: preferred stock dividends	(184.5)	(184.5)			
	<u>16,614.4</u>	<u>15,903.3</u>			
Basic and diluted earnings per Share					
Income available to common Shareholders	<u>16,614.4</u>	<u>15,903.3</u>	<u>20,221,270</u>	<u>0.82</u>	<u>0.79</u>

The potential common shares issuable under the employee stock option plans (see Note 19) are included in the denominator of the diluted EPS computation, but such shares result in a non-dilutive per share amount by using the treasury stock method under the ROC SFAS No. 24, Earnings Per Share . The average number of shares outstanding for purposes of the EPS calculation has been adjusted retroactively for issuance of stock dividends and stock bonuses. The retroactive adjustment caused the basic EPS before income tax and after income tax for the six months ended June 30, 2002 to decrease from NT\$0.96 to NT\$0.88 and from NT\$0.88 to NT\$0.77, respectively.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

22. RELATED PARTY TRANSACTIONS

The Company engaged in business transactions with the following related parties:

- a. Industrial Technology Research Institute (ITRI), one of whose directors is the Chairman of TSMC
- b. Koninklijke Philips Electronics N.V., (Philips), a major shareholder of TSMC
- c. Investees of TSMC

VIS

SSMC

GUC

The transactions with the aforementioned parties, in addition to those disclosed in other notes, are summarized as follows:

	Six Months Ended June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
<i>During the period</i>		
Sales		
Philips and its affiliates	1,293.5	1,396.5
GUC		343.5
ITRI	31.2	24.6
SSMC	6.4	0.9
VIS	91.8	
	1,422.9	1,765.5
Purchases		

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SSMC	988.3	2,676.3
VIS	1,663.5	2,286.5
	<u>2,651.8</u>	<u>4,962.8</u>
Operating expense rental		
ITRI	40.4	
Manufacturing expenses technical service fee		
Philips (see Note 24a)	1,455.9	1,493.9
Sales of property, plant and equipment		
VIS		8.1
Non-operating income		
SSMC (technical service income mainly) (see Note 24f)	46.8	54.8
VIS		0.3
	<u>46.8</u>	<u>55.1</u>

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

	Six Months Ended June 30	
	2002	2003
	NT\$ (Unaudited) (In Millions)	NT\$ (Unaudited) (In Millions)
<i>At end of the period</i>		
Receivables		
Philips and its affiliates	253.3	508.5
GUC		149.4
SSMC	42.6	13.0
ITRI	9.2	11.5
VIS	42.7	5.5
	<u>347.8</u>	<u>687.9</u>
Payables		
Philips and its affiliates	651.5	1,160.4
VIS	1,165.3	996.8
SSMC	11.1	395.3
	<u>1,827.9</u>	<u>2,552.5</u>
Refundable deposits		
VIS (see Note 24i)	550.7	349.2

Sales to related parties are based on normal selling prices and collection terms, except for sales of property, plant and equipment and technical service fees, which were in accordance with the related contracts.

23. SIGNIFICANT LONG-TERM LEASES

TSMC leases land from the Science-Based Industrial Park (SBIP) Administration where its Fab 2 through Fab 14 manufacturing facilities reside. These agreements expire on various dates from March 2008 to December 2020 and have annual rent payments aggregating NT\$225.6 million. The agreements can be renewed upon their expiration.

TSMC-North America leases its office premises and certain equipment under non-cancelable operating agreements, which will expire in 2020. TSMC-Europe and TSMC-Japan entered into lease agreements for their office premises, which will expire in 2005. Current annual rent payments under these lease agreements aggregate to NT\$343.3 million.

Future remaining lease payments are as follows:

<u>Year</u>	<u>Amount</u>
	NT\$
	(Unaudited)
	(In Millions)
July to December, 2003	171.2
2004	344.3
2005	340.6
2006	339.3
2007	336.4
2008 and thereafter	2,071.9
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	3,603.7
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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Rental expense for the six months ended June 30, 2002 and 2003 was NT\$193.2 million and NT\$191.6 million, respectively.

24. SIGNIFICANT COMMITMENTS AND CONTINGENCIES

The significant commitments and contingencies of TSMC and its subsidiaries as of June 30, 2003 are as follows:

- a. Under a Technical Cooperation Agreement with Philips, as amended on May 12, 1997, TSMC shall pay technical assistance fees at a percentage of net sales (as defined in the agreement) with respect to certain products. The agreement shall remain in force through July 8, 2007 and may be automatically renewed for successive periods of three years thereafter. Under the amended agreement, starting from the fifth anniversary date of the amended agreement, the fees are subject to reduction by the amounts TSMC pays to any third party for settling any licensing/infringement disputes, provided that the fees to be paid after reduction will not be below a certain percentage of the net sales.
- b. Subject to certain equity ownership and notification requirements, Philips and its affiliates can avail themselves each year of up to 30% of TSMC's production capacity.
- c. Under a technical cooperation agreement with ITRI, TSMC shall reserve and allocate up to 35% of certain of its production capacity for use by the Ministry of Economic Affairs (MOEA) or any other party designated by the MOEA.
- d. Under several foundry agreements, TSMC shall reserve a portion of its production capacity for certain major customers who have made guarantee deposits to TSMC. As of June 30, 2003, TSMC had a total of US\$34.3 million of guarantee deposits.
- e. Under a Shareholders Agreement entered into with Philips and EDB Investments Pte Ltd. on March 30, 1999, the parties formed a joint venture company, SSMC, for the purpose of constructing an integrated circuit foundry in Singapore, and allowed TSMC to invest in 32% of SSMC's capital. TSMC and Philips committed to buy a specific percentage of the production capacity of SSMC. If any party defaults on the commitment and the capacity utilization of SSMC falls below a specific percentage of its total capacity, the defaulting party is required to compensate SSMC for all related unavoidable costs.
- f. TSMC provides technical services to SSMC under a Technical Cooperation Agreement (the Agreement) entered into on May 12, 1999. TSMC receives compensation for such services computed at a specific percentage of net selling prices of certain products sold by SSMC. The Agreement shall remain in force for ten years and may be automatically renewed for successive periods of five years unless pre-terminated by either party under certain conditions.
- g. TSMC provided guarantees on loans amounting to US\$200 million, US\$40 million and US\$440 million for TSMC Development, Inc., TSMC-North America and WaferTech, respectively.

- h. Under a Technology Transfer Agreement (TTA) with National Semiconductor Corporation (National) entered into on June 27, 2000, TSMC shall receive payments for license of certain technology to National. The agreement will remain in force for ten years and will be automatically renewed for successive periods of two years thereafter unless either party gives

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

notice for early termination under certain conditions. In January 2003, TSMC and National entered into a Termination Agreement whereby the TTA was terminated for convenience. Under the termination agreement, TSMC will be relieved of any further obligation to transfer any additional technology. In addition, TSMC granted National an option to request additional technology transfers under the same terms and conditions as the terminated TTA through January 2008.

- i. TSMC entered into a Manufacturing Agreement with VIS. VIS agrees to reserve certain production capacity for TSMC to manufacture certain logic devices or other technologies required by TSMC's customers at selling prices as agreed upon by the parties. TSMC paid NT\$1,200.0 million to VIS as a guarantee deposit. VIS shall return portions of the guarantee deposit without any interest to TSMC upon reaching certain levels of purchase commitment by the Company. The contract will remain in force for five years. As of June 30, 2003, the refundable deposit was NT\$349.2 million.
- j. Starting from 2001, TSMC entered into several license arrangements for certain semiconductor patents. The terms of the contracts range from five to ten years with payments to be paid in the form of royalties over the term of the related contracts. TSMC has recorded the related amounts as a liability, which is amortized and charged to cost of sales on a straight-line basis over the estimated life of the technology or the term of the contract, whichever is shorter.
- k. TSMC-North America has an outstanding irrevocable standby letter of credit with a financial institution for US\$1.5 million. The standby letter of credit was entered into as security to the landlord of TSMC-North America's office spaces in San Jose, California. In the event TSMC-North America defaults under this lease agreement, the landlord will draw on the standby letter of credit up to the amount of the default, but not to exceed the amount of the standby letter of credit. The standby letter of credit expires on October 9, 2003, and is renewable on an annual basis.
- l. In November 2002, TSMC entered into an Amended and Restated Joint Technology Cooperation Agreement with Philips, Motorola, Inc. and ST-Microelectronics to jointly develop 90-nanometer to 65-nanometer advanced CMOS Logic and e-DRAM technologies. TSMC also agreed to align 0.12 micron CMOS Logic technology to enhance its foundry business opportunities. TSMC will contribute process technologies and share a portion of the costs associated with this joint development project.
- m. TSMC entered into investment related agreements with Shanghai Songjiang District People's Government on June 8, 2003. Subject to the ROC government's approval and market demands, the Company contemplates establishing semiconductor fabs in Shanghai Songjiang Science and Technology Park.
- n. Amounts available under unused letters of credit as of June 30, 2003 were NT\$6.5 million, US\$2.4 million, EUR0.1 million and Singapore dollar \$0.1 million.

25. FINANCIAL INSTRUMENTS

The Company entered into derivative financial instrument transactions for the six months ended June 30, 2002 and 2003 to manage exposures related to foreign-currency denominated

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NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

receivables and payables, and interest rate fluctuations. Certain information on these contracts is as follows:

- a. Outstanding forward exchange contracts as of June 30, 2002 and 2003:

	Currency To Be Received	Amounts (In Millions)	Currency To Pay	Amounts (In Millions)	Maturity	Fair Value (In Millions)
2002						
Sell	EUR	EUR 71.0	US\$	US\$ 67.6	Jul. ~ Sep. 2002	NT\$ 2,357.8
Sell	JPY	JPY 10,375.9	US\$	US\$ 85.6	Jul. 2002	NT\$ 2,926.2
Sell	NT\$	NT\$ 45,097.7	US\$	US\$ 1,315.0	Jul. ~ Sep. 2002	NT\$ 45,134.1
Buy	US\$	US\$ 110.0	NT\$	NT\$ 3,778.3	Jul. ~ Aug. 2002	NT\$ 3,767.2
2003						
Sell	NT\$	NT\$ 44,543.3	US\$	US\$ 1,290.0	Jul. ~ Dec. 2003	NT\$ 44,583.7
Buy	EUR	EUR 14.0	US\$	US\$ 6.1	Jul. 2003	NT\$ 554.2
Buy	JPY	JPY 6,580.4	US\$	US\$ 56.0	Jul. ~ Aug. 2003	NT\$ 1,902.9

As of June 30, 2002 and 2003, receivables from forward exchange contracts (included in other current assets account) aggregated approximately NT\$1,128.1 million and NT\$16.5 million, respectively. As of June 30, 2002 and 2003, payables from forward exchange contracts (included in other current liabilities account) aggregated approximately NT\$90.6 million and NT\$160.5 million, respectively. Net exchange gain for the six months ended June 30, 2002 was NT\$2,215.4 million. Net exchange loss for the six months ended June 30, 2003 was NT\$144.0 million.

The net assets and liabilities related to the above forward exchange contracts are as follows:

	June 30	
	2002	2003
	(Unaudited) (In Millions)	
Accounts receivable	US\$ 678.2	US\$ 721.2
Accounts payable	JPY 12,084.9	JPY 8,040.1
Accounts payable	EUR 46.5	EUR 35.7
Accounts payable	US\$ 265.9	

- b. Interest rate swaps

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The Company has entered into interest rate swap transactions to manage exposures to rising interest rates on its floating rate long-term bank loans. Interest expense on these transactions for the six months ended June 30, 2002 and 2003 was NT\$127.0 million and NT\$114.1 million, respectively.

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Outstanding contracts as of June 30, 2002 and 2003 were as follows:

<u>Contract Date</u>	<u>Contract Amount (Unaudited) (In Millions)</u>	<u>Contract Period</u>	<u>Interest Rate Received</u>	<u>Interest Rate paid</u>
<i>2002</i>				
April 28, 1998	NT\$2,000.0	May 21, 1998 to May 21, 2003	One month LIBOR	7.25%
April 29, 1998	NT\$1,000.0	May 21, 1998 to May 21, 2003	One month LIBOR	7.25%
June 26, 1998	NT\$1,000.0	June 26, 1998 to June 26, 2003	One month LIBOR	7.20%
June 26, 1998	NT\$1,000.0	July 6, 1998 to July 6, 2003	One month LIBOR	7.20%
July 1, 1999	US\$ 11.4	July 1, 1999 to June 28, 2004	One month LIBOR	5.95%
<i>2003</i>				
June 26, 1998	NT\$1,000.0	July 6, 1998 to July 6, 2003	One month LIBOR	7.20%
July 1, 1999	US\$ 8.6	July 1, 1999 to June 28, 2004	One month LIBOR	5.95%

c. Options contracts

The Company entered into foreign currency option contracts to manage exchange rate fluctuations arising from its anticipated US dollar cash receipts on export sales and its Yen currency obligations for purchases of machinery and equipment.

Outstanding option contracts as of June 30, 2002 and 2003 were as follows:

<u>Contract</u>	<u>Contract Amount (Unaudited) (In Millions)</u>	<u>Fair Value (Unaudited) (In Millions)</u>	<u>Strike Price</u>	<u>Maturity</u>
<i>2002</i>				
Put option bought	US\$ 410.0	NT\$ 40.8	33.465-34.57	Jul. ~ Sep. 2002
Call option written	US\$ 497.5	(NT\$ 5.1)	(US\$/NT\$) 34.81-33.465	Jul. ~ Sep. 2002
Call option written	US\$ 60.0	(NT\$ 8.0)	(US\$/NT\$) 33.47	Aug. ~ Sep. 2002
			(US\$/NT\$)	

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2003					
Put option bought	US\$	45.0	(NT\$72.7)	32.915-33.077	Jul. ~ Aug. 2003
				(US\$/NT\$)	
Put option bought	US\$	19.0	(NT\$14.7)	117-119	Jul. ~ Sep. 2003
				(US\$/JPY)	

For the six months ended June 30, 2002 and 2003, the Company realized premium income of NT\$160.3 million and NT\$50.2 million, and premium expenses of NT\$148.5 million and NT\$146.9 million, respectively.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

- d. The estimated fair values of the Company's financial instruments are as follows.

	June 30, 2002		June 30, 2003	
	Carrying/ Notional Amount	Fair Value	Carrying/ Notional Amount	Fair Value
	NT\$	NT\$	NT\$	NT\$
<i>(Unaudited)</i> <i>(In Millions)</i>				
<i>Non-derivative financial instruments</i>				
Short-term investments	213.2	2,894.2	4,065.7	5,328.6
Long-term investments	10,727.7	19,723.4	11,091.0	12,290.5
Bonds payable (including current portion)	44,000.0	44,755.3	35,000.0	35,838.3
<i>Derivative financial instruments</i>				
Forward exchange contracts (buy)	(86.9)	(11.1)	(39.8)	(39.6)
Forward exchange contracts (sell)	842.1	1,147.8	(104.2)	(65.8)
Interest rate swaps	23.7	(289.2)	1.0	(22.1)
Options	17.4	27.8	0.8	(87.4)

The above summary excludes cash and cash equivalents, receivables-net, receivables from related parties, refundable deposits, short-term bank loans, payable to related parties, accounts payable, payable to contractors and equipment suppliers and guarantee deposits that are carried at amounts that approximate fair value.

Fair values of financial instruments were determined as follows:

- a) Short-term investments market values.
- b) Long-term investments market value for traded companies and net equity value for non-traded companies.
- c) Long-term liabilities based on forecasted cash flows discounted at interest rates. Bonds payable is discounted to present value. Fair values of other long-term liabilities are also their carrying values as they use floating interest rate.
- d) Derivative financial instruments based on bank quotations.

The fair values of non-financial instruments were not included in the fair values disclosed above. Accordingly, the sum of the fair values of the financial instruments listed above does not represent the fair value of the Company and its subsidiaries as a whole.

26. SEGMENT INFORMATION

- a. The Company engages mainly in the manufacturing of integrated circuits and other semiconductor devices. The Company's chief operating decision maker is the Chief Executive Officer, who reviews consolidated results of manufacturing operations when making decisions about allocating resources and assessing performance of the Company. The Company believes it operates in one segment, and all financial segment information can be found in the consolidated financial statements.

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TAIWAN SEMICONDUCTOR MANUFACTURING COMPANY LIMITED AND SUBSIDIARIES

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

b. Geographic information

	Overseas	Taiwan	Adjustments and Elimination	Consolidated
	NT\$	NT\$	NT\$ (Unaudited) (In Millions)	NT\$
<i>Six Months Ended June 30, 2002</i>				
Sales to unaffiliated customers	48,222.4	32,044.5		80,266.9
Transfers between geographic areas	5,819.0	47,927.6	(53,746.6)	
Total sales	54,041.4	79,972.1	(53,746.6)	80,266.9
Gross profit	1,172.1	28,449.7	(178.3)	29,443.5
Operating expenses				(9,770.9)
Non-operating income				1,462.6
Non-operating expenses				(3,097.8)
Income before income tax				18,037.4
Identifiable assets	81,854.4	339,293.7	(35,713.4)	385,434.7
Long-term investments				10,727.7
Total assets				396,162.4
<i>Six Month Ended June 30, 2003</i>				
Sales to unaffiliated customers	53,018.5	36,676.6		89,695.1
Transfers between geographic areas	4,733.2	52,570.9	(57,304.1)	
Total sales	57,751.7	89,247.5	(57,304.1)	89,695.1
Gross profit	428.9	28,737.3	(205.0)	28,961.2
Operating expenses				(10,854.0)
Non-operating income				2,884.0
Non-operating expenses				(4,192.3)

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Income before income tax				16,798.9
				<u> </u>
Identifiable assets	78,808.0	328,735.6	(37,367.4)	370,176.2
	<u> </u>	<u> </u>	<u> </u>	
Long-term investments				11,091.0
				<u> </u>
Total assets				381,267.2
				<u> </u>

The Company entered into an exclusive distribution agreement with TSMC-North America on January 1, 2002. Under the distribution agreement, TSMC-North America purchases inventory from the Company and in turn sells the inventory to third-party customers. Sales by location are based on billed regions.

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c. Gross revenues:

<u>Area</u>	Six Months Ended June 30	
	2002	2003
	NT\$	NT\$
	(Unaudited)	
	(In Millions)	
United States	42,233.4	43,783.0
Asia and others	24,359.8	28,457.3
ROC	9,046.2	11,609.8
Europe	4,538.5	5,171.1
North Americas	2,221.8	2,666.5
	82,399.7	91,687.7

The gross revenue information is presented by billed regions.

d. Major customers representing at least 10% of total net sales:

The Company only has one customer that accounts for at least 10% of its total sales. The sales to such customer amounted to NT\$22,175.5 million and NT\$15,074.6 million for the six months ended June 30, 2002 and 2003, representing 27% and 16% of its total sales, respectively.

e. Net sales by product categories:

<u>Products</u>	Six Months Ended June 30	
	2002	2003