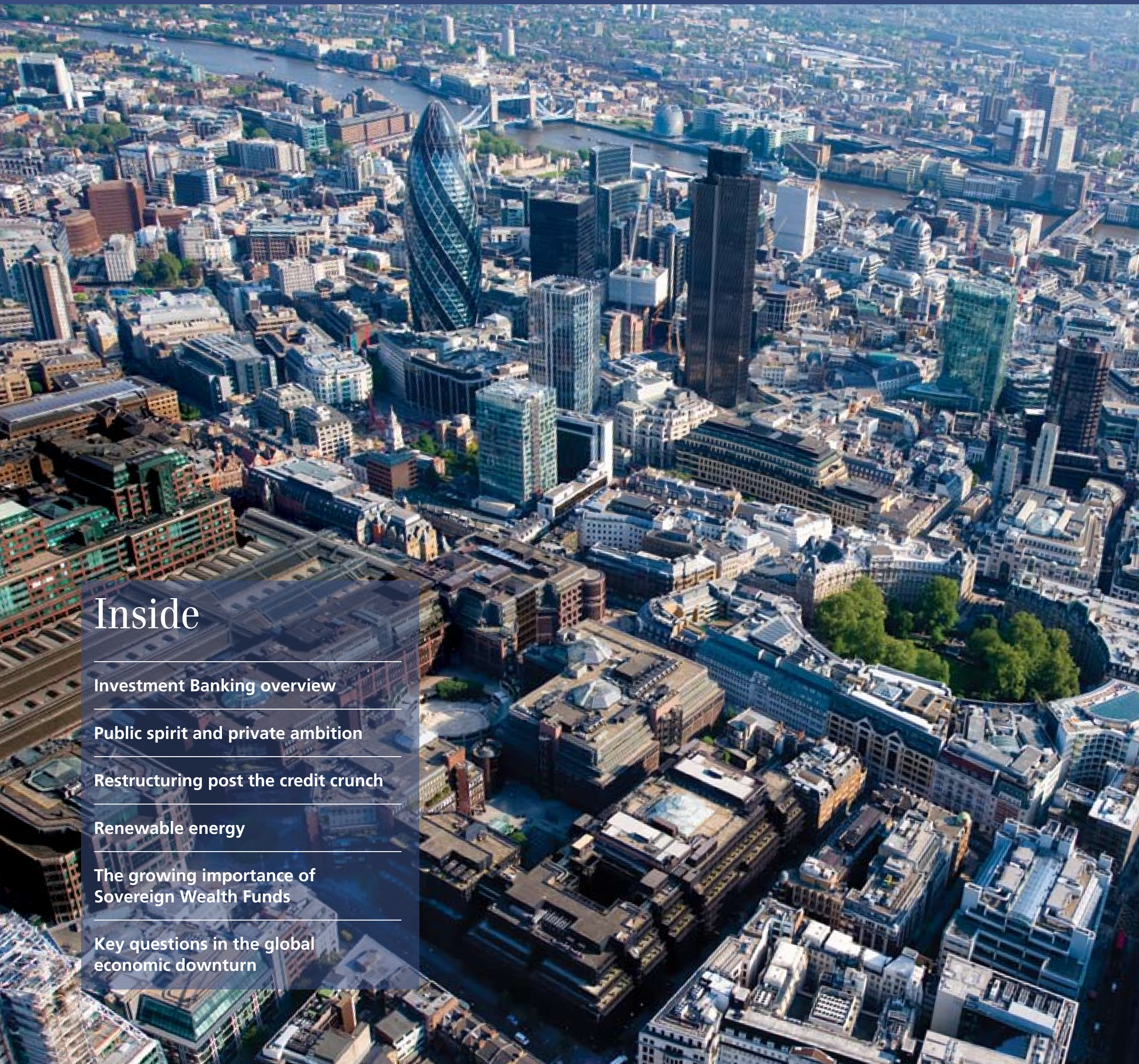
March 2009

EMEA View



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UBS Investment Bank

Welcome

Welcome to the first edition of the UBS Investment Banking EMEA View. I hope you'll find it a useful source of information, news and views.

In the coming year, the global economy is likely to remain challenging. But – as our senior economist, Paul Donovan, states in this newsletter – swift action by both governments and investors offers grounds for optimism.

Here at UBS we've taken decisive steps to strengthen our own business, making us well placed to weather the future.

We've significantly de-risked our balance sheet by transferring USD 39 billion of illiquid assets to a new fund controlled by the Swiss National Bank, and have raised capital through the sale of CHF 6 billion mandatory convertible notes to the Swiss Confederation.

We also welcome the Swiss Federal Banking Commission's new capital adequacy rules for Swiss banks. All these measures will substantially increase the safety of our clients' assets, and help to strengthen the financial system as a whole.

We have also responded to the changing market conditions by adapting our structure in ways that more closely unite the expertise and experience of our staff. For example, we have integrated our Equity and Debt Capital Market Groups into the Global Capital Markets Group, and we have aligned our UK and M&A coverage.

There are other reasons to feel positive. Despite an industry-wide slowdown in M&A and capital markets activity, our investment banking team in EMEA is still winning prestigious mandates and were No.1 in M&A in the UK in 2008 according to Thomson Reuters, Bloomberg and mergermarket.

We have been at the forefront of restructuring the Financial Institutions space where we have been advising both governments and corporates such as the UK, German and Belgian governments, along with RBS, Lloyds, Aegon and Standard Chartered.

Looking forward, in this first edition we highlight some of the trends and transactions we think will be important in 2009 and provide some insights into the events which have impacted the markets over the last few months.

Even in difficult times, there are opportunities out there – and we look forward to working with you to grasp them. In the meantime, I'd be very interested to hear your thoughts on this newsletter, so please feel free to get in touch.

Alex Wilmot-Sitwell
Chairman and CEO EMEA, UBS AG
Joint Global Head of Investment Banking

Investment Banking overview

In this first edition of the UBS Investment Banking EMEA View we take a look at current industry trends and opportunities in the coming year.

Simon Warshaw and Herman Prelle, Joint Heads of EMEA Investment Banking

Undoubtedly, 2008 was the most difficult year for the markets in quite some time. It was also a year in which the investment banking industry in particular faced huge challenges – and saw dramatic changes. Yet despite this backdrop, we at UBS performed strongly and feel well placed for the future, in contrast to many of our peers, who are still working through some of the issues created by the economic climate.

Indeed, 2008 was a year in which the quality of our teams and the strength of our relationships with clients have been very evident. We gained market share in EMEA, retaining our top-three position in the region and our number-one standing in the UK[1]. Our Swiss and German businesses also enjoyed a very strong year finishing second and third respectively[2]. When it comes to M&A, we are again one of the market leaders, having increased our market share in key countries, including Germany, Spain, France and the Nordic region[3].

Last year, bank refinancing was clearly at the forefront, and we played a key role in helping many financial institutions restructure their balance sheets. Governments, too, have sought our advice on these recapitalisations, including those in the UK, Germany and Belgium. In fact, we've seen a re-emergence of government advisory work in general – which has included our work with the UK government on its Policy Framework for New Nuclear Build.

We see a heightened focus from our clients on their balance sheet needs continuing throughout 2009. The recent merger of our Debt Capital Markets and Equity Capital Markets team into one business, Global Capital Markets, has positioned us well for this trend, as has the creation of our Debt Advisory Group, who explore the "battle for capital" in this newsletter (see page 7). Our clients are benefiting from better insights into financing opportunities in the debt and equity markets as a result of these developments.

We also expect a resurgence of rights issues in the coming year, and our clients will benefit from our continued investment in our pre-eminent global equity franchise. The strength of that franchise has been demonstrated in the last year by our role in major rights issues for banks including the Royal Bank of Scotland, Lloyds TSB Group, Standard Chartered and Deutsche Postbank as well as other corporates, including Centrica and AngloGold Ashanti.

But despite this increased focus on refinancing, we must not downplay the opportunities in M&A. Those corporates with the right financial resources will want to extract valuable cost benefits from synergy-based deals and exploit the opportunities arising from depressed valuations and sentiment. We expect to see continued consolidation in key industries such as that witnessed in utilities and telecoms with Gas Natural's takeover of Union Fenosa and the Vodafone's (Verizon Wireless) purchase of Alltel, two high-profile deals on which we advised in 2008. Our market-leading sector teams are now fully built out, and provide a real point of differentiation when industry knowledge is key to bringing about combinations with strong commercial rationale.

One area where we've realigned our business to better serve our clients' needs has been to strengthen our links with our wealth management business. In 2008 we created several cross-business groups designed to help clients in the Investment Bank access the resources and expertise of our wealth management team – and vice versa. Running a network of corporate relationships alongside a network of owners has delivered value for our clients, both in developed and emerging markets in EMEA. We are excited about the meaningful opportunities this cross-business approach will create for clients in 2009.

> "2008 was a year in which the quality of our teams and the strength of our relationships with clients have been very evident."

On the topic of emerging markets, 2008 saw our continued but prudent expansion

1 Source: Dealogic (by fees).
2 Source: Dealogic (by fees).
3 Source: Thomson Reuters (by volume).

in the Middle East. We've added to our senior leadership team in the region and have moved some of our best people there. Furthermore, UBS was recently granted a new license in Saudi Arabia and we will be commencing operations there soon. These moves will enable more of our clients to access exciting new markets in the region, which we are strong believers in over the medium term. One of the key drivers of the growth in the region have been Sovereign Wealth Funds (see page 11 for a detailed look at their growing importance). We also continue to go from strength to strength in Russia, where we have built a powerful coverage team.

The economic outcome is clearly uncertain at best, and 2009 will be defined by whether the equity markets genuinely recover. What is certain is that the new market environment has taken us back to a world where relationships between investment bankers and their clients are key. At UBS, long-term relationships have consistently been at the heart of our approach to business.

"What is certain is that the new market environment has taken us back to a world where relationships between investment bankers and their clients are key."

With strong teams, the right products and a powerful and focused capital markets group we feel well positioned to help you, our clients, achieve your goals, whatever the coming year brings.

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King's Comment

Introducing *King's Comment*, a new bulletin by Sir David King, Senior Scientific Advisor to UBS, offering insight into topical scientific issues. Formerly the UK Government's Chief Scientific Advisor and Head of the Government Office for Science, Sir David advises UBS on all scientific matters with particular emphasis on global climate change and the challenges it poses to sustainable economic growth.

The first of the quarterly series, "Climate Change: Poznan – the inside track" analyses the outcome of the most recent round of global climate change negotiations which took place in Poland in December 2008. To view the bulletin and register to receive future editions of King's Comments go to **www.ubs.com/sirdavidking**

Recent awards and rankings

Corporate Broker of the Year
Acquisitions Monthly Awards 2009

Best M&A House, Western Europe
Euromoney 2008

No.1 Financial Adviser (ECM Roles)
Thomson Reuters 2008

No.1 Firm for M&A Financial Advisory Benelux
Bloomberg 2008

Germany M&A Adviser of the Year
Acquisitions Monthly Awards 2009

No.1 M&A Financial Advisory, Spain
Thomson Reuters 2008

Best Investment Bank, Spain
Euromoney 2008

Best Investment Bank, Switzerland
Euromoney 2008,
Global Finance 2008

No.1 Firm for M&A Financial Advisory, United Kingdom
Bloomberg 2008, *Thomson Reuters* 2008, *mergermarket* 2008

Best Cross-Border Deal of the Year EMEA – Scottish and Newcastle
Acquisitions Monthly Awards 2009

Domestic Deal of the Year EMEA – RBS, HBOS, Lloyds TSB Group
Acquisitions Monthly Awards 2009

Energy Sector Adviser of the Year
Acquisitions Monthly Awards 2009

Support Services Sector adviser of the Year
Acquisitions Monthly Awards 2009

TMT Sector Adviser of the Year
Acquisitions Monthly Awards 2008–2009

No.1 Global Equity Derivatives for Corporates
Risk 2005–2008

Public spirit and private ambition

State intervention in the banking and insurance sectors has had a seismic effect on the industry, and has far-reaching implications for the economy as a whole. Here, Philippe Sacerdot, Managing Director, Vice Chairman Investment Banking, offers his insight into recent activity and describes the role that UBS's Advisory and Global Capital Markets teams have played in re-shaping the landscape.

The changes in the capital markets since the summer of 2007 have been fast-moving and unpredictable, if not at times bewildering. Among these changes, the call for widespread state intervention in the banking and insurance sectors represents a remarkable reversal of fortune. For those of us who have relished the steady flow of privatisations in Europe over the past twenty-five years, it is certainly a watershed moment. Initially perceived as a return to the dark ages of administrative economy by industry commentators – and a potential kiss of death for our industry – this government action has in fact been embraced as an opportunity by UBS, opening new channels for our Advisory and Global Capital Markets teams. Indeed, the past two months have shown how our business transforms itself in the face of new challenges, and UBS is proud of its role in helping European governments and financial institutions through these extraordinary times.

Since October 2008, the state authorities have moved from a role of surveillance to being direct investors in banks and insurance companies, replacing the financial markets as providers of capital and arbiters of risk. If we set aside the Northern Rock episode and the IKB and SachsenLB rescues in 2007, the moment of transformation came late in 2008 with the UK Treasury's GBP 400 billion rescue plan, announced on 8 October, which served as a model (as well as a fig-leaf) for the rest of Europe. On the continent it caused shocked amusement that the UK, the very home of "laissez-faire", should promote such a comprehensive – and interventionist – programme, but it was soon emulated everywhere. For my colleagues at UBS who spent an exhilarating few days at the Treasury helping draft this plan, it was only the latest provision of complex, bespoke advice for which our organisation has been renowned over the years.

Subsequently, and in quick succession, UBS worked on a number of state interventions. In the UK we assisted our clients the Royal Bank of Scotland and Lloyds TSB Group in their recapitalisations, leading up to the merger with HBOS. UBS also advised the Belgian Government on the state interventions into major Belgian banks and insurance companies, including the EUR 3.5 billion capital injection into KBC, the state guarantee on the USD16.5 billion financial products portfolio of FSA, Dexia's US monoliner and the EUR 1.5 billion capital injection into mutual insurer Ethias. In Holland UBS was on the side of AEGON for its EUR 3 billion recapitalisation, mediated through its largest shareholder, Vereniging AEGON. UBS also served as sole advisor to the German Financial Markets Stabilization Fund (SoFFin) on its EUR 8.2 billion capital injection into Commerzbank AG and its associated EUR 15 billion liquidity guarantee.

We won these mandates on account of our traditional strengths: capital-market skills, notably in customised securities

> "Further government intervention will be required if the dire economic predictions prevail over the next two quarters."

(whether debt or equity), assessing what the markets would have offered in steadier times; sound judgement on the fairness of terms (whichever side we were working for); an ability to diagnose rapidly the type and depth of capital support required in each situation; finally, and crucially, the trust we have built up over time with our sovereign clients.

It seems almost inevitable that further government intervention will be required if the dire economic predictions prevail over the next two quarters. On the capital markets side a Government Guaranteed Bonds (GGBs) market is now crowding the issuance calendars, with USD 133 billion raised so far and UBS bookrunning 12.7% of the volumes. Working with governments is now a fact of life.

From a public policy viewpoint, market failures and potential systemic risks fully justify these government interventions, but it is too early to say whether the pendulum has swung too far, or even in the right direction. The UK plan was clearly designed to be market-friendly, with the state as investor of last resort. However, the old reflexes of interventionism were quick to re-emerge everywhere in Europe: political retaliation for years of deregulation, widespread and general "banker bashing", and aggressive competition between states to protect their own banks most solidly – for Neelie Kroes in Brussels, it must have seemed like a new Waterloo. Evidently governments will now dominate the evolution of the banking sector in Europe for years to come, and in certain countries such as Holland, the state will effectively redesign the industry. In other countries "support", in various shapes or forms, will lead through the back door to an arbitrator's role in future consolidations. But in all cases, European treasuries will continue to need M&A and market advice to lessen their massive exposure to the sector.

For the time being, the slow trend towards cross-border aggregation we have witnessed in the past few years has, to all intents and purposes, ceased; help begins at home and if governments step in to protect their own banks, it's not in order to sell them off to foreign concerns. The takeover of Fortis by BNP Paribas will be an exception to this rule, if it goes ahead, but in general treasuries are now thinking nationally. Nevertheless, if another wave of risk-aversion rolls in, drawing the sector to new depths, it may be that the now heavily indebted governments will simply give up and surrender their ailing banks to the few remaining healthy ones, regardless of nationality. After all, market driven recapitalisations, like the recent GBP 1.8 billion Standard Chartered rights issue – bookrun by UBS, and without government underwriting – shows that there is still strong demand to back the right franchises.

Whichever scenario plays out, our teams will be present to deliver timely and specific advice to governments and boards alike, as we have for several decades past.

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Restructuring post the credit crunch:

Beating the 'battle for capital' and the fight to retain value

The wave of financial turmoil since the "credit-crunch" started to manifest itself during 2007 has been well documented in recent months. The downward spiral got into full stride with the government rescue of Freddie Mac and Fannie Mae, and continued with Lehman Brothers' bankruptcy and a long series of nationalisations and bail-out plans, impacting virtually every asset class and geography – more or less developed – in the world economy.

The global macroeconomic environment has continued to sharply deteriorate, with economists predicting that global growth in 2009 will be well below the 2.5% threshold widely recognised as the demarcation point for recession. While the US economy is leading the list of underperforming countries, weakness is widespread, affecting most European countries, non-Japan Asia and much of the emerging markets. What does this mean for the credit markets? And what are the implications for public and private companies – particularly those who continue to face difficulties?

Credit markets are amongst the most notable victims of this crisis as the large majority of financing institutions have recorded unprecedented losses (mostly driven by write-downs on sub-prime or leveraged assets). Also, the inter-bank market continues to experience set-backs (after a prolonged period of stall) despite the extraordinary liquidity injections from an ever-increasing number of governments/central banks, and a weaker macro environment is driving default-expectations, as companies face very tight liquidity conditions and pressing refinancing needs in the light of a predominantly worsening trading outlook.

The iTraxx Europe and Crossover indices, widely-used to monitor the state of health for the European investment grade and high-yield market respectively, have experienced material deterioration over the last year as the former currently trades in excess of 200bps (vs c.50bps in January 2008) and the latter surpassed the much-feared 1,000bps resistance level in December 2008 – more than three times the levels recorded in January 2008 (c.300bps). Both indices reflect the distress levels issuers and investors are currently facing.

Market volatility, scarce liquidity and a general unwillingness from financing institutions to commit new capital or increase their exposure to vulnerable sectors drastically impacted the volumes of new financings in the second half of 2008.

Early action

The difficulties currently experienced by the financing markets and the high volatility that experts believe will continue well into 2009 make for a fairly gloomy scenario. Recent UBS research states that over USD 1.4 trillion of debt is expected to mature in 2009. With financing markets virtually closed, companies – particularly those that fall outside the strong investment-grade universe – should start thinking early on about ways to address refinancing issues in order to avoid a last-minute "battle for capital", which could lead to higher refinancing costs and potentially more serious issues given the scarcity of available capital and banks' current propensity to limit or reduce their exposures to certain borrowers, sectors and asset/rating classes.

Corporate Europe as a whole is not overleveraged; Utilities being the only sector geared in excess of 2.0x as a whole and IT being, conversely, in a net cash position. Given that a high number of companies will have to raise large amounts of financing over the same, compressed period, they will find themselves relying on a limited number of alternatives as equity/convertible markets continue to operate under stress and debt markets remain characterised by unprecedented volatility. Swift and decisive action will be key to success.

The new wave of covenants and maturity waivers

One possible remedy for companies trying to solve their potential refinancing issues – without raising new capital – is for them to agree with their lenders an amendment to the maturity dates of their financing. Extending by, for instance, 1-2 years could be sufficient to enable such companies to survive the current storm. While the subject of revised maturity dates has become a hot topic of discussion between borrowers and lenders, of even greater concern is the fear of covenant breaches. The large gearings on company balance sheets – particularly in the case of aggressively structured LBOs – do not cope well with worsening macro-economic and trading outlooks. Again, in these cases, the only available solution to avoid a default and the potential destruction of value will be for companies to seek an amendment of their covenant levels. This will give them the headroom needed to more comfortably focus on the improvement of their business operations without the fear of a financial default. Empirical evidence suggests that lenders tend to be fairly supportive of these processes, both in case of covenant and/or maturities renegotiation. Banks are also equally keen to be compensated for providing borrowers with greater peace of mind, resulting in one-off consent fees and an increase in margins (i.e. higher cost of debt) in order to reflect the deterioration of the borrower's credit profile.

Deleveraging – risk for some, opportunity for others

Nonetheless, at times banks have been reluctant to concede any such amendments in the absence of a deleveraging event, whether financed by an asset-sale or a new equity injection (although these cases are typically limited to companies with very high gearing and/or substantial deterioration in their volumes/profitability). But deleveraging may bring its own problems. Leveraging powered large-scale global growth – a "great unwinding" will have the opposite affect, softening demand and weakening spending and growth, or as one commentator puts it: "what leveraging did for growth, deleveraging will take back." If "cash is king", deleveraging could represent an opportunity for companies with excess cash on their balance sheet or shareholders willing to put new capital to work.For example, a reduction of debt can also be achieved through the purchase of the company's own debt at deeply-discounted prices given the depressed secondary loan and bond markets. Notwithstanding the legal implications of following such a route, which require careful attention, the market has seen an increasing number of buy-backs in recent months, although the current "bargain" prices are not expected to last forever.

UBS Debt Advisory and Restructuring

The credit crunch has put renewed emphasis on corporate and financial restructuring, bringing into sharp contrast both problems and opportunities. Retaining business value lies at the heart of such activity. Restructuring, not just to achieve business viability but to substantially improve profitability and efficiency, can be looked upon as an opportunity in its own right. Those who stand the best chance of surviving the current economic shakedown are likely to be working more closely than ever with their trusted financial advisors.
At UBS, our European Debt Advisory and Restructuring practice, based in London and comprising more than 20 professionals, is founded on our strong M&A/Restructuring expertise, and gives clients unparalleled access to the debt and equity markets around the world. The team is currently working with a diverse number of management teams across the public and private sectors to renegotiate maturities and reset covenants, achieve discount/volume through debt buy-backs, and minimise the erosion of value in restructuring processes. These are tailored solutions that help soothe the damaging effect of market turbulence and optimise the opportunities today's unprecedented market conditions have created. In each case, our advisory and execution services are designed to engender the confidence and trust that is so important to our clients' success.

Recent transactions on which the UBS team has advised include:

- assisting with negotiation of a debt-for-equity swap in relation to New Star Asset Management;
- assisting several large, pan-European, real estate investment and development businesses with lender negotiations, asset disposals and raising of additional capital;
- assisting potential acquirers of listed and unlisted target companies facing financial stress; and
- assisting several large public and private European companies with covenant/maturity re-negotiation with lenders and innovative M&A approaches.

Whilst many financial institutions are re-tooling for the downturn, we believe that the UBS advisory offering for Debt Advisory and Restructuring situations is unique:

- unparalleled breadth and depth, accessing the full spectrum of expertise in (and access to) debt and equity capital markets, sector knowledge and geographic reach;
- professionals who are amongst the leading advisors in the European Debt and Equity markets; and
- a cultural focus within the firm on meeting client needs as a trusted advisor on business critical issues.

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Renewable energy

Transforming the economy and the investment landscape

Renewable energy has seen substantial growth over the past decade, maturing into a sizeable industry of increasing importance for the economy as a whole. Supported by sustained political determination to mitigate climate change and a steady improvement in costs and technology, future growth prospects are robust.

The renewable energy industry's foundations were laid at the 1992 Earth Summit, held in Rio de Janeiro, and the subsequent 1997 Kyoto Summit that, under the auspices of the United Nations led to the establishment of the Kyoto Protocol, presently ratified by 183 countries, the US being the notable exception. By establishing binding commitments for the reduction of greenhouse gases (GHG), primarily carbon dioxide (CO_2), the Kyoto Protocol aims to achieve "stabilisation of greenhouse gas concentrations in the atmosphere at a level that would prevent dangerous interference with the climate system." Under the framework, industrialised nations agreed to a reduction of their collective GHG emissions by 2012 of 5.2% compared to the year 1990, with national limits ranging from 8% for the European Union (EU), 7% for the United States (US), 6% for Japan, to a 0% increase for Russia. Non-industrialised nations, India and China in particular, were not assigned any emission limitation but agreed to a common responsibility for reducing GHG.

> "Owing to its potential for large-scale roll-out, onshore wind power has so far attracted most investment."

EU leading the way

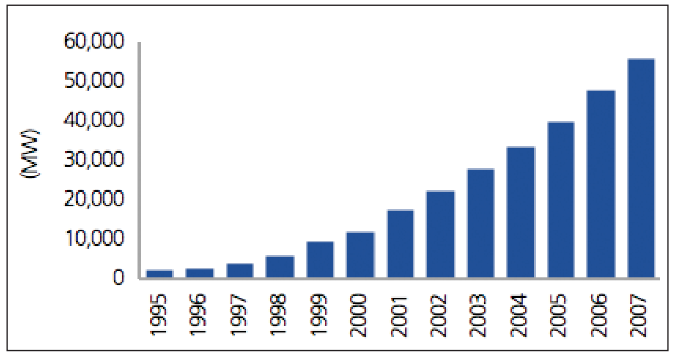
The EU has led the way towards achieving these goals and further institutionalised its global leadership role in the promotion of the use of renewable energy by adding the principle of sustainable development to its key objectives and, in 1997, after the Kyoto summit, it announced a further target: that 12% of total energy consumption should come from renewable sources by 2010.

In Europe, the strong political endorsement for renewable energy since the industry's infancy rapidly translated into favourable legal and regulatory frameworks for renewable energy sources across EU member states. Aiming to achieve the envisaged targets in an economically viable fashion fostered the development of a vibrant pan-European renewable energy industry, spanning the entire value chain from research and development to equipment manufacturing and power generation.

Power – generating strong investor interest

The power generation sector attracted particular attention as the largest source of CO_2 emissions. Governments have consequently implemented a number of policy incentives, which typically feature favourable tariff mechanisms whereby operators of renewable energy installations are eligible to feed their power output into the national electricity grid on a guaranteed basis and are remunerated by fixed electricity tariffs. In most cases, these are secured for 15-20

years and generally linked to inflation. The overall investment proposition, supplemented at times by grants and tax breaks in certain jurisdictions, attracted strong, sustained investor interest and allowed the renewables power generation industry to emerge and mature rapidly into its current shape. As the most mature technology in terms of cost competitiveness and owing to its potential for large-scale roll-out, onshore wind power has so far attracted most investment. Germany and Spain have emerged as world leaders in the field, with installed capacities of 22 GW and 15 GW, respectively, at the end of 2007, representing two thirds of total EU-27 installed capacity. In addition to onshore wind, an array of new technologies, led



Year on year growth in wind capacity in Europe.

by solar, but also comprising offshore wind, mini-hydro, biomass, tidal, wave and geothermal power are emerging as efficient, reliable and economically viable sources of power, and have the potential to meet a growing share of demand.

As a key pillar of its market-based approach to reducing CO_2 emissions, the EU established a CO_2 "cap-and-trade" emissions trading scheme in 2005. Carbon trading controls the release of CO_2 by providing economic incentives for achieving emissions reductions. Under the scheme, carbon-emitting installations across a range of industrial sectors are permitted to emit a given amount of CO_2, with any excess emissions having to be made up by either purchasing certificates from other players with a surplus of certificates or by investing in more efficient equipment to lower own emissions below

"Carbon capture and storage (CCS) is set to be a prevailing trend in world energy."

the required level, creating a surplus of certificates available for sale. The scheme is presently in its second phase, spanning 2008-12, with a more stringent post-2012 regime in negotiation, and is serving as a model for similar projects currently being established around the world. Instead of rigidly enforcing the reduction of emissions country-by-country, or company-by-company, the market choice is this: either spend to cover the costs of cutting emissions, or continue polluting (emitting) and pay someone else to cut their emissions. In theory this enables emissions to be cut with the minimum price tag.

False premise or global imperative?
In spite of current adverse economic, equity and debt market conditions, and some governments' recent opposition to a further tightening of climate change targets, the commitment to climate change goals remains strong. The fundamental rationale and necessity for renewable energy is as pertinent as ever. In the International Energy Agency's (IEA)

recently published World Energy Outlook 2008 it estimates a required carbon price of USD 90 per tonne for the creation of incentives to limit global warming to 3°C and USD 180 per tonne to achieve 2°C, levels already considered too high by some members of the scientific community.

In this context, EU member states are currently debating a series of proposals for climate change targets to be met by 2020. It proposes that a 20% share of final energy demand should come from renewable energy, a 20% fall in CO_2 emissions, and an end to free allocations of CO_2 emission certificates to the power sector from 2012 (and to all sectors by 2020), as well as targets and objectives for 2030 and beyond. With the Kyoto agreement due to expire in 2012, the UN is firm in its intention to negotiate a successor treaty at its 2009 Copenhagen meeting. Continued European leadership, coupled with Obama's commitment to reduce US carbon emissions and a more co-operative approach by Australia and Japan, are setting the scene for a continuation of global commitment to climate change policy.

New climate, new technology, new opportunity
It is clear that climate change has given rise to more than global warming. It has spawned new technology, new business practices plus a raft of new legislation that is driving the adoption of alternative energies. Europe has been quick to capitalise on new opportunities and its dominance in renewable energy has led to the creation of a number of corporate world leaders in various segments of the value chain; European utilities have established a strong presence in the space. Iberdrola of Spain (through Iberdrola Renovables), EDP of Portugal (through EDP Renovaveis) and Acciona (through Acciona Energia) were pioneers in this field, and have emerged as leaders in European wind with global reach via their substantial presence in the US. They are growing fast and all successfully raised fresh equity capital by floating their renewables subsidiaries over the past year. European companies are also the main players in the component and equipment manufacturing segment for wind installations, with Vestas of Denmark, Nordex, Siemens and RePower of Germany and Gamesa of Spain the pre-eminent companies in wind turbine manufacturing. European companies in solar energy are similarly well-placed: Norway's Renewable Energy Corporation (REC) continues to go from strength to strength and Germany's Q-Cells is a leading manufacturer in its space.

Renewable energy and UBS
Having recognised the significance of renewable energy early in its evolution, UBS has remained at the forefront of the sector acting as the lead adviser for most renewable energy deals worldwide in 2006-08. We assisted EDP in the IPO of EDP Renovaveis, raising c. EUR 1.8 billion on the equity markets in June 2008; c. EUR 930 million in the IPO of REC in May 2006 followed by a c. EUR 593 million follow-on offering in March 2007 and c. EUR 150 million in equity for Q-Cells.

Outlook
Continued rapid growth in renewable energy complemented by improvements in energy efficiency and clean fossil power generation via technologies such as carbon capture and storage (CCS) is set to be a prevailing trend in world energy as the driver for steadily falling CO_2 emissions. Europe possesses the corporate and R&D know-how to continue its leadership in the space.

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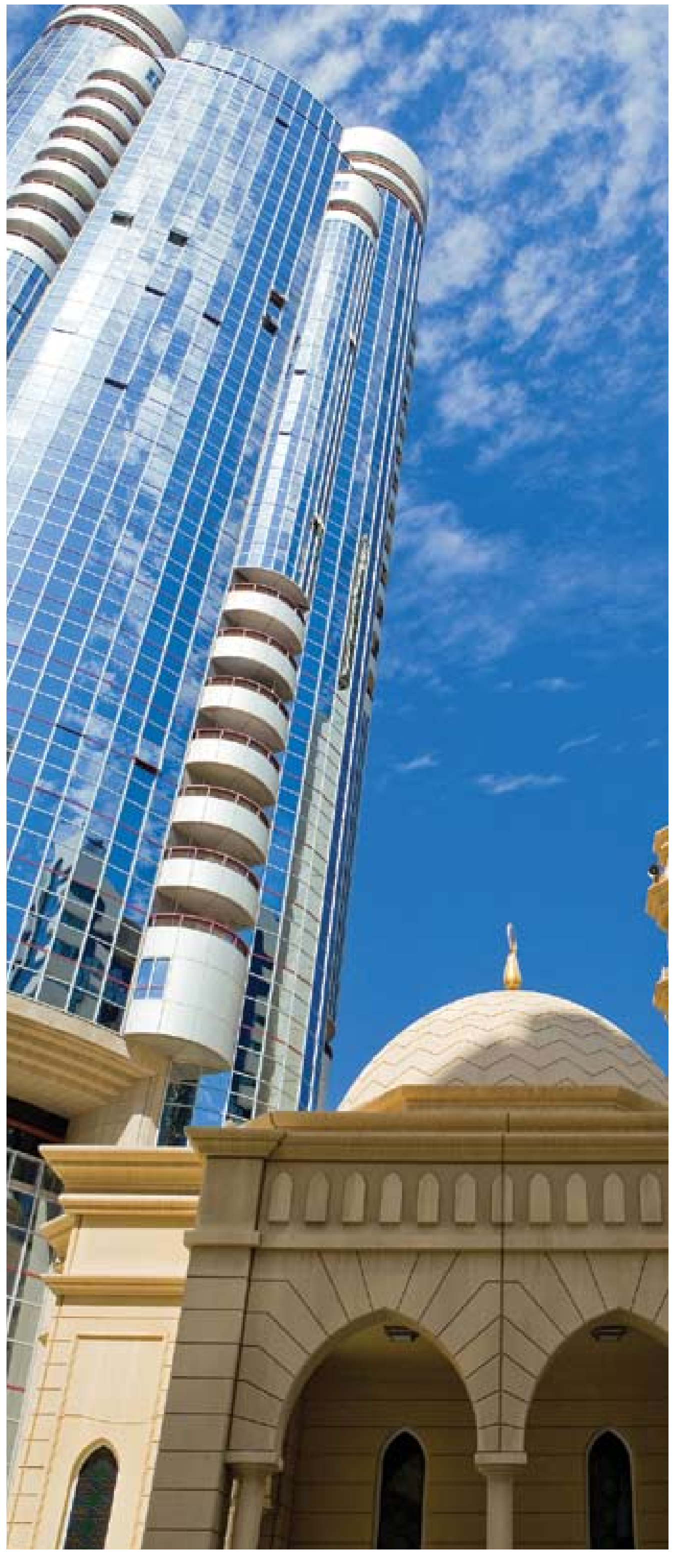
The growing importance of Sovereign Wealth Funds

Sovereign Wealth Funds (SWFs) have emerged as a growing force in the world's capital markets. Their liquid assets have swollen as a result of soaring commodity prices and the ballooning current account surpluses in many of the countries in which they are based. At a time of global financial stress and with concerns mounting over commodity prices and inflation, the role that these funds have to play in today's economy could not be more important.



Leading force in M&A – overtaking private equity
SWFs have been around since the 1950s but until recently were familiar to only a few investors. These government-controlled investment pools are now making headlines virtually every day, and their cash surfacing in deals of almost every type. According to Global, Insight SWFs accounted for 35% of global M&A activity in 2007 and 28% of total M&A activity in the United States in January 2008. They have overtaken private equity buyouts as the leading force in M&A, with private equity buyouts falling to below USD 3 billion in the fourth quarter of 2007, from USD15 billion in the previous quarter. From 2000-07, SWFs made strategic acquisitions and disposals of around USD 115 billion (based on external disclosures). This does not include foreign investments by state-controlled corporations (e.g. Dubai Ports), which are estimated at an additional USD 100 billion over the same period.

"Sovereign Wealth Funds have an important role to play in international financial markets."

Dominant investors in property and financial services
Most deals involving SWFs centre on the acquisition or disposal of minority stakes in listed or unlisted firms. The property and financial institutions sectors dominate the figures. Since 2006, SWFs have invested around USD 82 billion in financial services, (e.g. Abu Dhabi Investment Authority in Citigroup, Kuwait Investment Authority in Merrill Lynch and the Qatar Investment Authority in Barclays).

The ultimate long-term investors
Sometimes described as "the ultimate long-term investors", SWFs view financial institutions as attractive long-term investments with good returns anticipated when markets stabilise and economic conditions return to more normal levels. Sovereign Wealth Funds have an important role to play in international financial markets and typically share the economic objectives of traditional long-term institutional investors such as pension funds and insurance companies.

Globally, SWF assets are highly concentrated with the top ten funds accounting for 80% of total assets. The majority of SWFs derive their income from commodities, the single largest contributor being oil, whilst other large SWFs derive their income from current account surpluses and growing fiscal reserves.

No	Sovereign Wealth Fund (Country)	Funding source	AuM (USD bn)
1	Abu Dhabi Investment Authority (UAE)	Oil	650-700
2	Norway Government Pension Fund (Norway)	Oil	350-400
3	GIC (Singapore)	Fiscal/Reserves	330
4	Saudi Arabia Monetary Authority (Saudi Arabia)	Oil	300
5	Kuwait Investment Authority (Kuwait)	Oil	250
6	China Investment Corporation (China)	Fiscal/Reserves	200
7	Temasek Holdings (Singapore)	Fiscal	160
8	Russia Reserve Fund (Russia)	Oil & Gas	150
9	Hong Kong Monetary Authority (Hong Kong)	Fiscal/Reserves	140
10	Libya Reserve Fund (Libya)	Oil	50-100

Source: Global Insight, UBS estimates

Looking ahead to 2009, SWF investment strategies are likely to mirror private equity, hedge funds, and other closed investment vehicles, with varying transparency and disclosure of their holdings. A number of transactions have already been completed, including the 100% acquisition of the electrical engineering group Cegelec by Qatari Diar, which has shown how SWF – backed entities in the Middle East can successfully secure such deals where there is a strong strategic rationale.

Middle Eastern Sovereign Wealth Funds – continuing to expand

While it remains difficult to gauge these funds' total assets under management, estimates suggest they amount to around USD 3.5 trillion, making them slightly larger than the combined assets of hedge funds (USD 1.5 trillion) and private equity (USD 1.5 trillion); but this excludes central bank reserves of an additional USD 4.5 trillion.

Against this background, the Middle East's sovereign wealth continues to expand. The sources of sovereign wealth are principally linked to the generation of current-account surpluses on the back of revenues from the oil and gas sectors. Most funds are keen to diversify their local economy's asset base before these natural resources are exhausted.

> "We expect sovereign wealth fund reserves to increase throughout the UAE, especially in Abu Dhabi."

United Arab Emirates

The United Arab Emirates (UAE) is home to the world's largest Sovereign Wealth Fund, the Abu Dhabi Investment Authority (ADIA). Abu Dhabi has prospered on the back of hydrocarbon exports, pushing its contribution to the UAE's GDP to 60%. Hydrocarbon revenue represented 75% of government revenue in 2007. We expect Sovereign Wealth Fund reserves to increase throughout the UAE, especially in Abu Dhabi, owing to its substantial oil reserves.

The investment objectives of Sovereign Wealth Funds in the UAE are quite diverse. ADIA, for example, has an investment remit to diversify revenues internationally, whilst elsewhere, state-funded entities such as the Mubadala Development Company are engaged as strategic investors and are focused on the broader economic development of Abu Dhabi.

As a result of Dubai's relatively modest oil reserves, it is unable to grow its Sovereign Funds (primarily the Investment Corporation of Dubai) in line with Abu Dhabi and has consequently sought to further its capabilities via the use of increased leverage, both in individual assets and at a portfolio level.

Saudi Arabia

Saudi Arabia, the world's largest oil producer, continues to demonstrate its significant reserves, which are managed via the Saudi Arabia Monetary Authority (SAMA). SAMA operates in a way that is far more comparable to a central bank than a Sovereign Wealth Fund. Saudi Arabia announced the creation of a new USD 5.3 billion Sovereign Wealth Fund earlier this year, but to date its activities have been limited.

Kuwait

Kuwait continues to have a significant presence in international markets via its Sovereign Wealth Fund, the Kuwait Investment Authority. The Kuwaiti government is required by law to deposit at least 10% of its oil revenues in its Sovereign Funds, in spite of budget surpluses or deficits. However, Kuwait has suffered substantial book losses on its positions in the financial sector (e.g. Citigroup and Merrill Lynch, in which it invested USD 5 billion in January 2008).

Qatar

Gas assets have largely driven Qatar's economic growth, which has led to the creation of one of the largest Sovereign Wealth Funds in the region, reported at USD 60 billion. Unofficial estimates of the true size of the fund indicate that its assets may be significantly higher than this. Qatar is somewhat unique amongst funds in the region because of its relatively aggressive investment approach, demonstrated by its bid for J Sainsbury (in which it still holds a significant stake) and statements that it will not curb investments because of the global financial crisis.

UBS and Sovereign Wealth Funds

In recognition of the significance of SWFs, UBS Investment Bank and Global Asset Management hosted the inaugural UBS Sovereign Wealth Fund Conference in Abu Dhabi on 21-23 April 2008. The event marked a natural evolution in UBS's sovereign relationships, which are managed in close collaboration by our two business groups. The conference in Abu Dhabi was attended by 40 senior clients from 25 institutions around the world, generating insights and debate at the highest level.

The largest SWFs were represented at the conference alongside a select handful of countries which have growing reserves. Key decision makers, such as Bob Zoellick, President of the World Bank, also participated. Covering topics such as Best Practices for Sovereign Wealth Funds, Asset Allocation and the Implications of Strategic Equity Holdings, the event was unique in its SWF-only composition. Keynote speeches covered the themes of Public Relations Strategy, the Establishment of SWFs in Georgia, Private Equity and Significant Cross-Border Capital Flows.

Within the Middle East, the UBS Middle East & North Africa Team, headed by Omar Al-Salehi and Chris Niehaus, manage the coverage of SWFs for IBD.

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Q&A

Key questions in the global economic downturn

Paul Donovan, Deputy Head of Global Economic Research, UBS Investment Bank, gives his views on the key questions in the global economic downturn.

How bad is this downturn?

We are probably looking at the weakest economic growth the world has experienced in almost a generation. We have to go back to 1982 to find global growth as weak as it is expected to be in 2009. UBS is forecasting global growth of just 0.4% next year. Every member of the G7 is forecast to have negative growth, which is (fortunately) an extremely rare occurrence. The euro area economy is likely to be relatively weak in 2009 – at -2.0% growth is projected to be worse than in the United States (at -1.2%).

The recovery process is also likely to be fairly sluggish. We are not forecasting another year of negative G7 growth in 2010. Two consecutive year's negative GDP would require major errors on the part of policy makers. However, it is unlikely that growth will return to a trend-like level in 2010. We see global growth recovering to just 2.8%, which is still some way below trend. The euro area will underperform the United States. Europe is seen achieving 0.6% growth, still far below its potential output.

How long does the downturn last?

Only in 2011 do we expect global growth will achieve its trend rate. We may also have to recognise that trend growth for the global economy is lower in the coming years than it has been in the recent past. With risk premia rising, the global cost of capital is likely to go up in real and nominal terms. This will restrict investment, restrict productivity growth, and ultimately slow the potential rate of GDP growth.

Why is this situation so bad?

The driver of this downturn is an unwinding of the credit expansion of recent years. The banking system is signalling that it does not wish to resume "normal" lending growth until borrowers have reduced their leverage ratios. Normal economic growth is not likely to be achieved until normal bank lending is achieved.

Because borrowing has been so important to growth in recent years, removing that borrowing is a major negative impulse for the world economy. What is making things worse is that banks are now looking for borrowers not just to stop borrowing, but to start saving as well. There are thus two negative impulses for the economy (the absence of the positive impulse of borrowing, and the addition of the negative impulse of higher saving). The necessary reduction in leverage is going to take some time, and realistically 2011 is the earliest point at which the economy could normalise.

Who has to cut their leverage levels?

For the Anglo-Saxon world, it is the consumer that needs to reduce their leverage. Consumers have expanded their borrowing very rapidly in recent years – the US household debt to disposable income ratio has risen 40% since the start of the decade to stand at over 140%. In the UK, the level is around 180%. Clearly, as consumers cease to borrow, and indeed start to save, there will be a negative impact on consumer spending

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growth. That in turn will slow the economic growth of these countries.

In Europe, the problem is not generally with the consumers' level of debt. For some countries (Spain and Ireland in particular) consumer debt is an issue. However, for most of euro area, the debt burden lies with the corporate sector. The level of non-financial corporate debt has risen dramatically – around 40% – in recent years. However it is not the large, listed companies that have acquired this debt. Listed companies have in fact been reducing their debt levels. The problem lies with the European Mittelstand: small and medium sized businesses have led the European leverage.

The fact that smaller corporates have become dependent on borrowing to finance expansion creates a significant problem for the wider euro area economy. Small companies are the most important part of the euro area economy in terms of their contribution to GDP, and have dominated employment growth over the last few years. As small companies are denied credit, they are denied the ability to expand. As they fail to invest, they will fail to increase employment. Thus, the pressure will be for European unemployment rates to increase.

What can be done to limit the damage?

It is worth stating at the outset that policy is essentially confined to damage limitation rather than to outright stimulus. It is highly unlikely that policy makers will be able to prevent a period of negative GDP growth for the advanced industrialised economies. Instead, policy measures need to concentrate on limiting the near term economic damage and shortening the duration of the downturn as much as is possible. However all three levers of policy can be used to help minimise the economic pain. We need government spending, tax cuts, and monetary policy to work to help the economy recover.

How does government spending help?

Government spending is a straight forward substitution. The private sectors of the G7 economies are reducing their demand. Therefore, if we are to limit the damage to growth, we need the public sectors of the G7 economies to step in and increase their demand to offset the decline in private sector demand. This is important, not only in providing a support to growth in the near term, but in preventing too much damage to confidence in the economy. If confidence were to be significantly undermined, this could encourage even more conservative behaviour from the financial system. Banks may require even more deleverage before they would be prepared to normalise lending, for instance. Thus, without government spending there is a risk that the economic downturn lasts even longer.

How do tax cuts help?

Tax cuts are probably the least effective policy option available (though politically probably the most palatable). The concept of tax cuts is pretty simple. If the private sector wishes to save, the government borrows the money to enable the private sector to achieve its desired level of saving. This means that the private sector does not have to reduce its consumption (households) or investment (corporates), but instead can save the tax cuts given to it. As such this is another way of mitigating the effects of the downturn.

How do interest rate cuts help?

Interest rate cuts are probably the most effective policy response to the current crisis. Interest rate reductions do not raise growth in the near term. Monetary policy stimulus works by stimulating borrowing, and if banks are unwilling to lend that is clearly not a viable policy proposition. However, monetary stimulus also transfers wealth from savers to borrowers. An interest rate cut, if passed through to a borrower, will increase the post debt-service real disposable income that is available to a borrower. This increase in income can be used to delever the borrower's balance sheet – and potentially this can be a very powerful policy tool. The policy is highly targeted, because of course it is those who have already borrowed who will benefit from the reductions in interest rates.

What happens as interest rates approach zero?

Monetary policy does not cease to be an option just because official interest rates approach zero, though central banks may have to be more creative in how they apply policy. There are two mechanisms that are now open to central banks to ensure that monetary stimulus is still applied to the economy.

First, central banks can apply moral suasion to the commercial banking system to make sure that interest rate cuts are passed through. To date, the consumer or the corporate has not benefited from all of the policy rate cuts. Prior to October, for instance, only around a third of the US rate cuts were transmitted through to consumers. Commercial banks have, clearly, expanded their margins as rates have come down. Even if policy rates are near zero, if central banks can persuade commercial banks to reduce their margins, the real economy will continue to experience interest rate cuts.

Second, central banks can move to influence longer term interest rates. All central banks can and do buy government bonds. By stepping up their purchases of longer dated government securities, central banks can seek to influence the longer duration interest rates, and provide stimulus to borrowers at these longer maturities.

So should we be optimistic or pessimistic?

The bad news is that we face the worst economic cycle since the early 1980s. The global economy is weak, and there is no prospect of a rapid return to trend growth. It will take time to work through the deleveraging process, and that process is likely to be economically painful. However, there are some grounds for optimism. Policy responses have come through early, they have generally been aggressive, and as a result we can be relatively confident that the worst case scenarios have been avoided. The next couple of years are likely to be bad, but by learning the lessons of history we can avoid depression – style scenarios. As long as governments and investors continue to heed the advice of economists, the world can be put right.

"Even in difficult times, there are opportunities out there – and we look forward to working with you to grasp them."

Alex Wilmot-Sitwell
Chairman and CEO EMEA, UBS AG
Joint Global Head of Investment Banking

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