



The U.S. Subprime Market: An Industry in Turmoil

March, 2007

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Questions Investors Ask

- ◆ Isn't the rapid growth in subprime unsustainable and highly risky?
- ◆ Aren't underwriting standards dropping? (Higher LTVs and larger number of no docs.)
- ◆ Aren't the new loan types (IOs, 80/20s, etc.) raising the risk profile?
- ◆ Won't the housing bubble collapse and carry us all with it?
- ◆ With spreads so tight, does it make sense to play in this market at all?

Subprime Home Equities: On the Brink or Safe For Another Year?

January, 2005

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Impact of Prepayments & HPA on Subprime Losses—September 2005

HPA/CPR/LS Combination	Housing Appreciation	CPR ARM*	CPR Fixed*	CDR**	Loss Severity	Cum Defaults	Cum Loss
A	7 - 12%	70	30	Base	20	6.67	1.50
B	5 - 7%	50	25	Base	35	11.58	4.09
C	2 - 3%	45	20	Base	45	13.35	6.07
D	0%	40	18	Base	55	14.99	8.33
E	-2 - 3%	35	15	Base x 1.20	60	20.04	12.15

* ARM CPR Vectors identified by peak speed at 24 months.

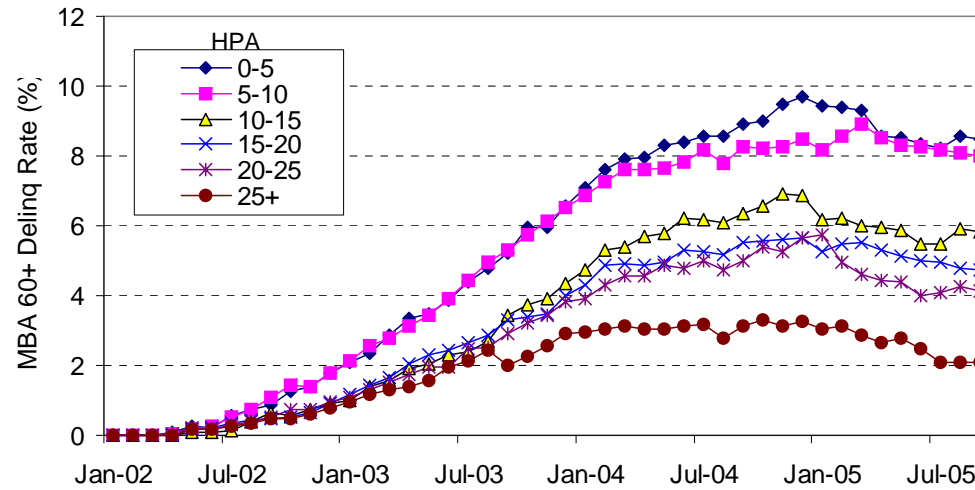
Fixed CPR Vectors identified by speed at end of 12 month seasoning ramp.

**Base CDR curve based on historical current losses.

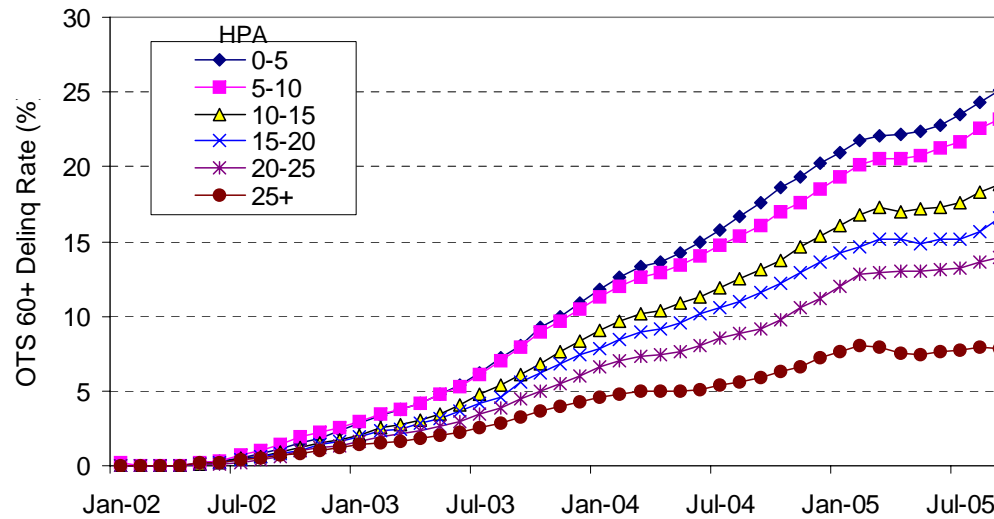
For combination E, base CDR multiplied by 1.20 to account for recession.

Impact of Slower HPA: Higher Defaults

Alt-A 2002 Vintage

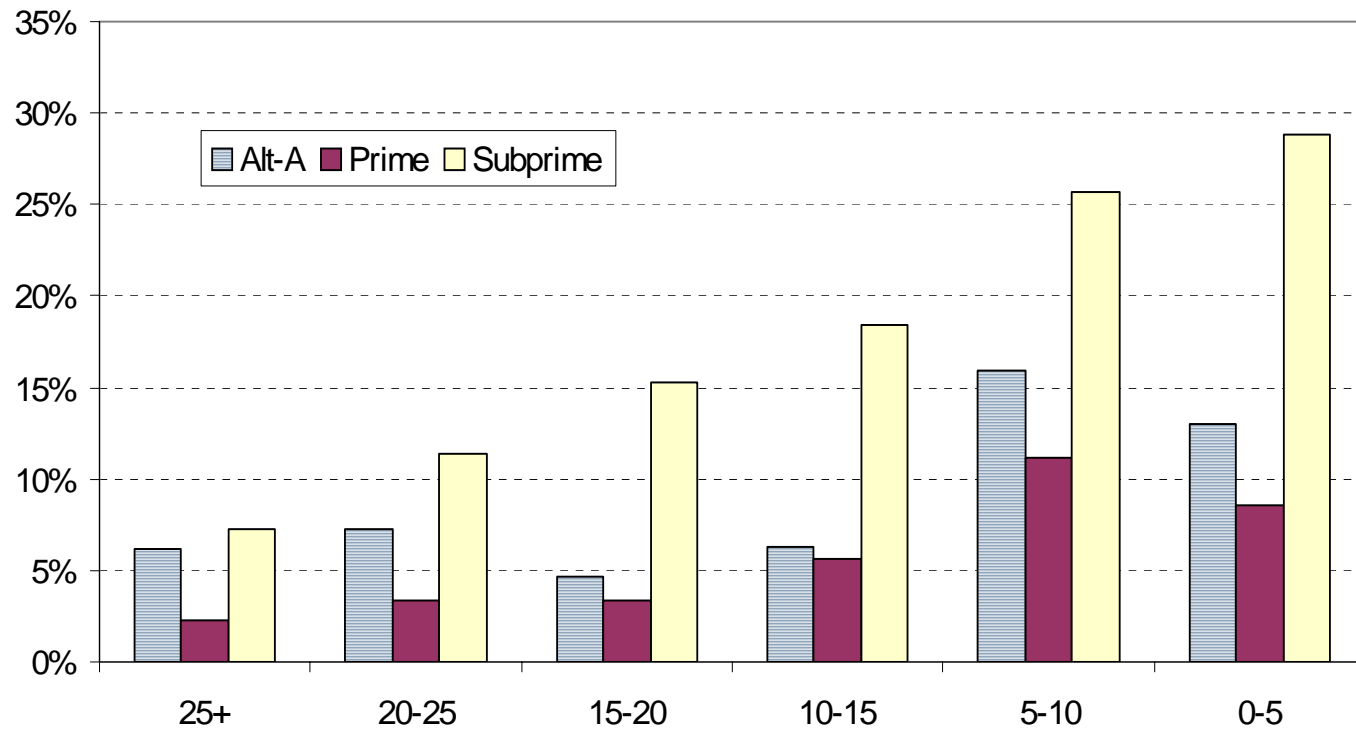


Subprime 2002 Vintage

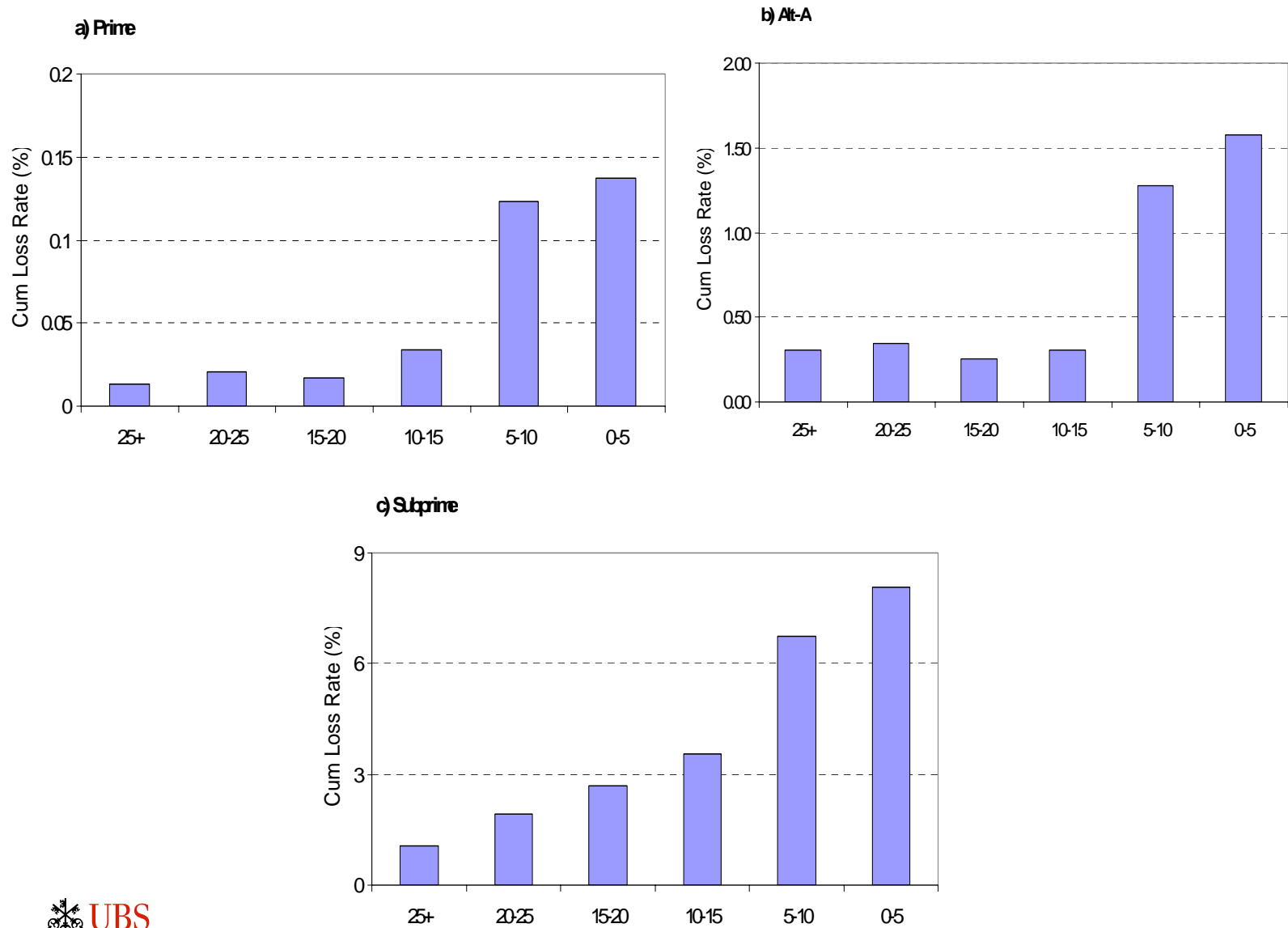


Higher Loss Severities

Loss Severity of Defaulted Loans (2000 Vintage)

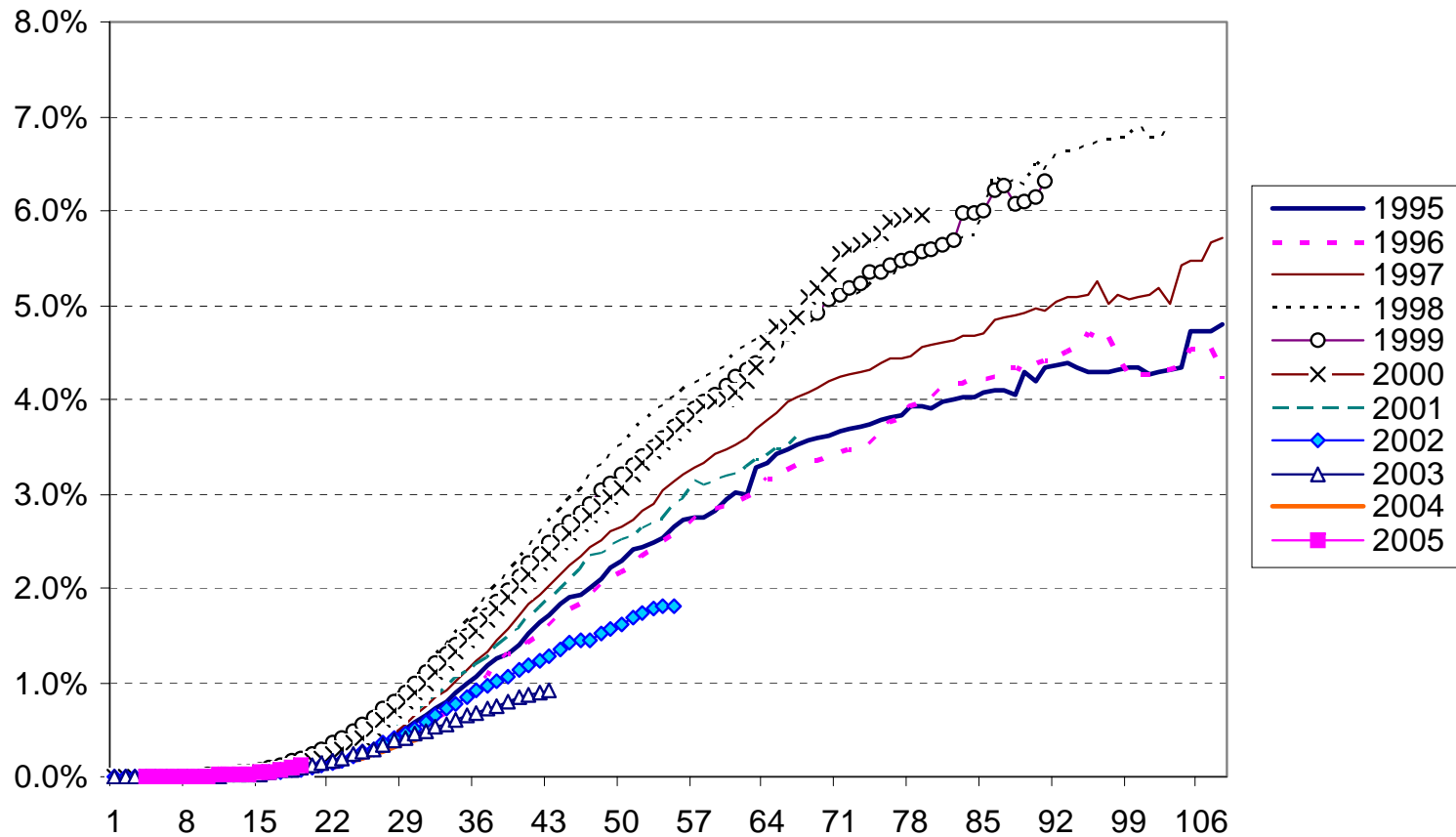


The Impact of HPA on Losses



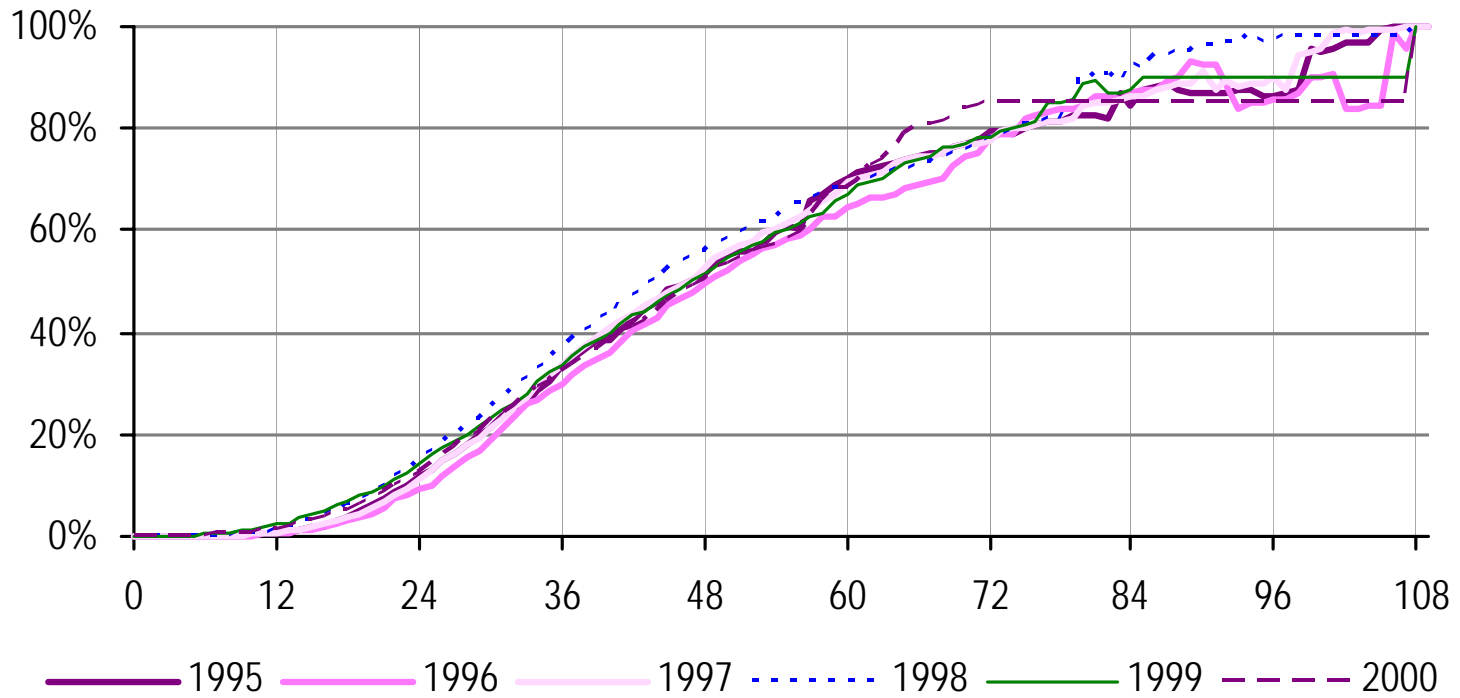
Timing of Collateral Losses—1

HEL ARMs—Cumulative Loss as % OB—Moody's



Timing of Collateral Losses—2

Subprime Loss Curves—Cumulative Distribution



Source: Moody's

Surge in EPDs Caught Industry by Surprise

- ◆ What is an EPD (Early Pay Default) or FPD (First Pay Default)?
 - Borrower misses one or two out of first three payments
- ◆ In subprime
 - before 2006, EPDs <1.0%
 - In 2006, EPDs 6-8%
- ◆ If loans sold (for example, to Wall Street conduit) any EPDs can be put back to originator.

Changing Subprime Collateral Characteristics

OrigYear	Orig Amnt	ARM %	2nd Lien %	IO %	40 Yr %	DTI	Loan Size	CLTV
2000	36,457	70.3	1.6	0.0	0.0	38.6	100.3	78.1
2001	53,549	72.0	1.4	0.0	0.0	39.1	119.8	79.6
2002	98,597	73.5	1.6	0.7	0.0	39.4	137.5	80.5
2003	181,028	67.7	1.3	3.7	0.0	39.7	157.6	82.0
2004	322,936	76.8	2.1	15.3	0.0	40.3	169.7	83.9
2005	400,553	80.9	3.3	26.5	4.8	41.0	180.9	85.7
2006	134,909	76.2	3.8	16.3	22.9	41.8	165.0	86.0

OrigYear	Stated LTV	CLTV > 80	FICO	FICO < 600	WAC	Purchase	Full Doc	Low Doc	Silent Seconds
2000	77.9	35.4	590	58.5	10.6	34.7	73.8	23.2	1.3
2001	79.0	42.4	598	52.1	9.6	29.9	72.9	26.1	3.2
2002	79.9	45.3	612	43.1	8.5	28.7	67.5	30.5	3.1
2003	80.6	51.8	621	37.1	7.5	28.5	64.9	33.7	7.7
2004	81.0	57.6	623	35.2	7.1	35.6	62.2	37.4	15.8
2005	81.2	62.3	627	32.0	7.3	41.3	58.3	41.4	24.3
2006	81.1	62.8	624	32.5	8.4	42.6	56.8	42.9	25.3

Source: Loan Performance, UBS.

2/28, 80/20, Low Doc

Ideal Loan for the Perfect “Credit” Storm.

Subprime Breakdown by First Reset

Origination Period	2/28	3/27	FIXED	Others	Grand Total
1999	13,325	6,738	12,452	5,292	37,808
2000	18,483	6,469	8,325	3,122	36,398
2001	30,818	7,125	12,216	3,339	53,498
2002	58,820	11,997	23,756	4,002	98,574
2003	98,803	18,826	56,171	5,127	178,926
2004	192,892	46,304	70,860	8,621	318,678
2005	263,003	51,710	68,925	19,198	402,836
2006	120,541	16,999	33,866	8,238	179,644
Grand Total	796,685	166,168	286,571	56,937	1,306,361

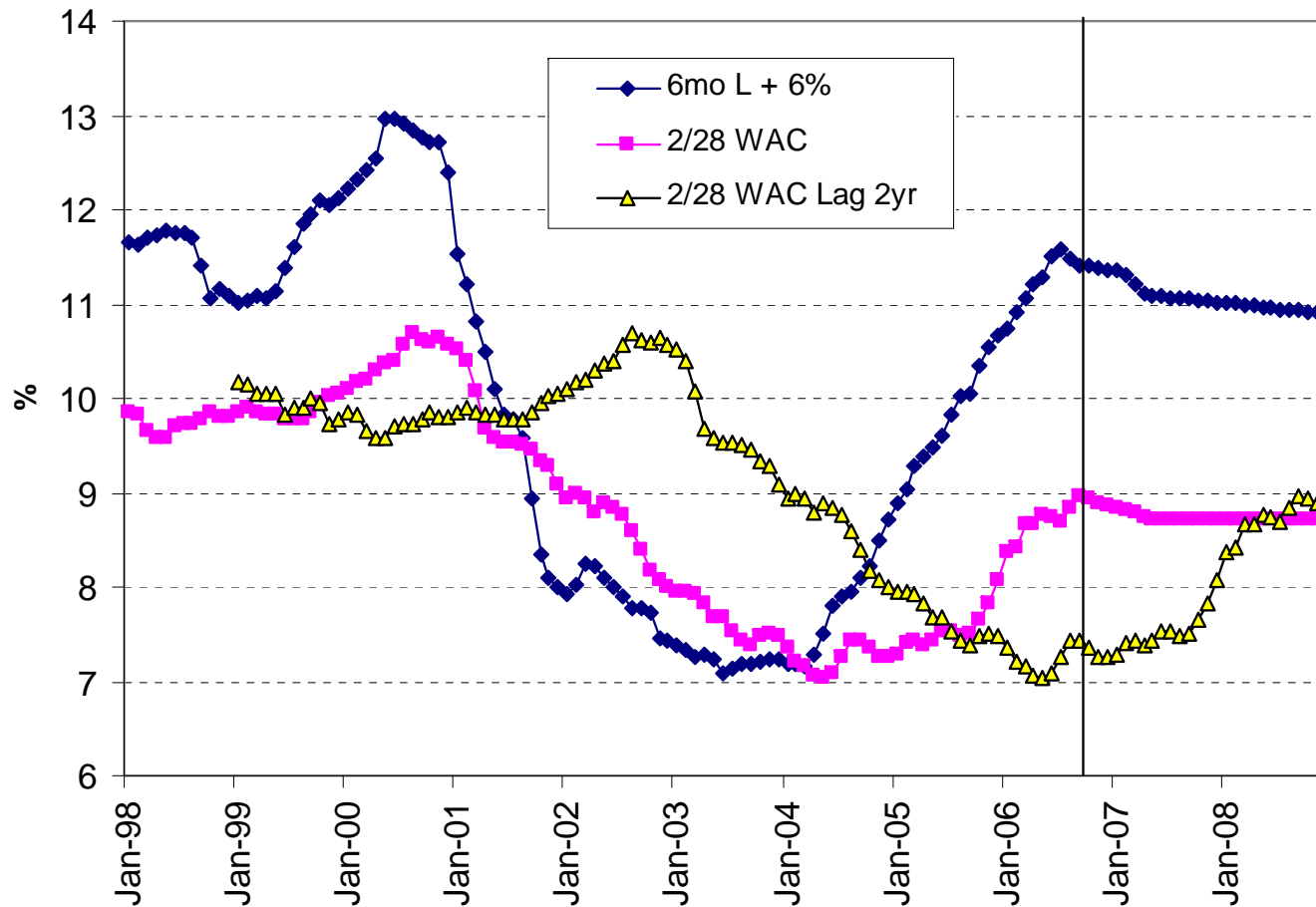
Origination Period	2/28	3/27	FIXED	Others	Grand Total
1999	35.2%	17.8%	32.9%	14.0%	100.0%
2000	50.8%	17.8%	22.9%	8.6%	100.0%
2001	57.6%	13.3%	22.8%	6.2%	100.0%
2002	59.7%	12.2%	24.1%	4.1%	100.0%
2003	55.2%	10.5%	31.4%	2.9%	100.0%
2004	60.5%	14.5%	22.2%	2.7%	100.0%
2005	65.3%	12.8%	17.1%	4.8%	100.0%
2006	67.1%	9.5%	18.9%	4.6%	100.0%
Grand Total	61.0%	12.7%	21.9%	4.4%	100.0%

Source: LoanPerformance, UBS.



2/28 Refis— No Easy Choice

Refi Incentive — 2/28 Subprime Loans

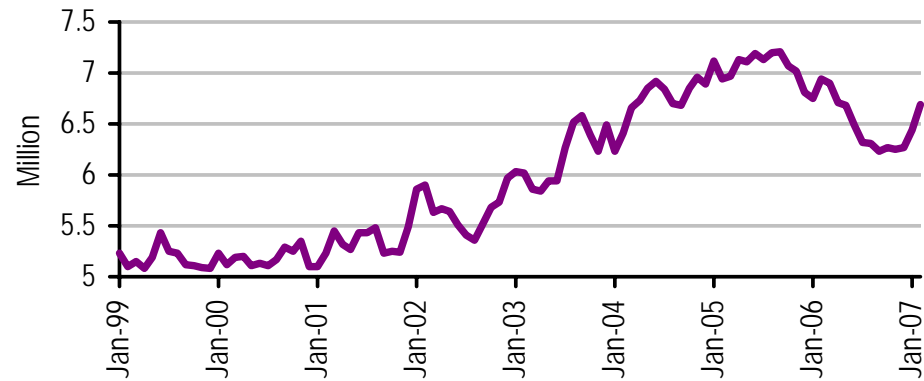


Source: Loan Performance, Bloomberg, UBS.

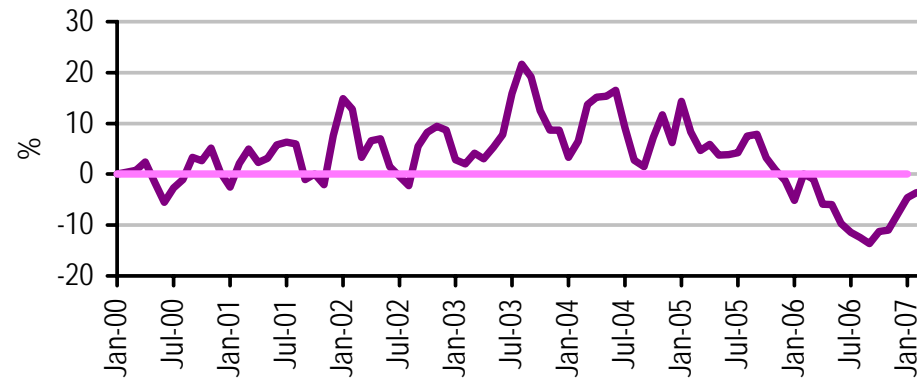


Existing Home Sales Down

Annual Rate

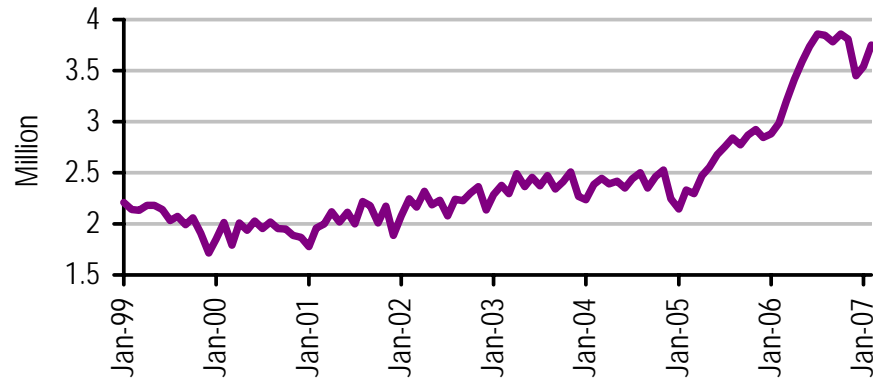


% Change YOY

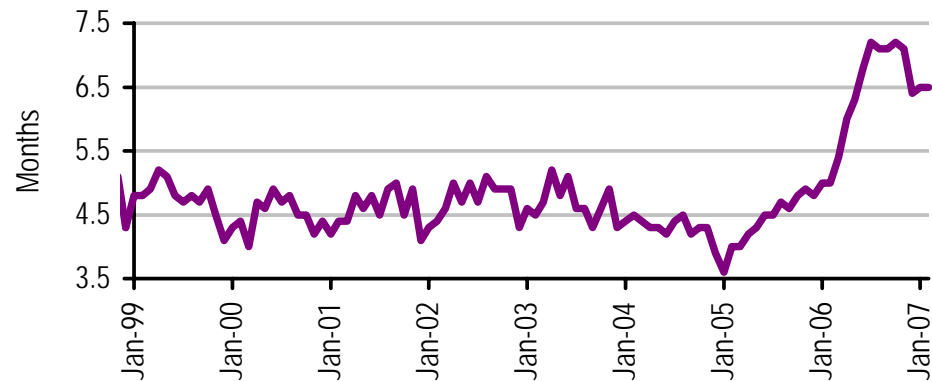


Existing Home Inventory Up

Existing Home Inventory

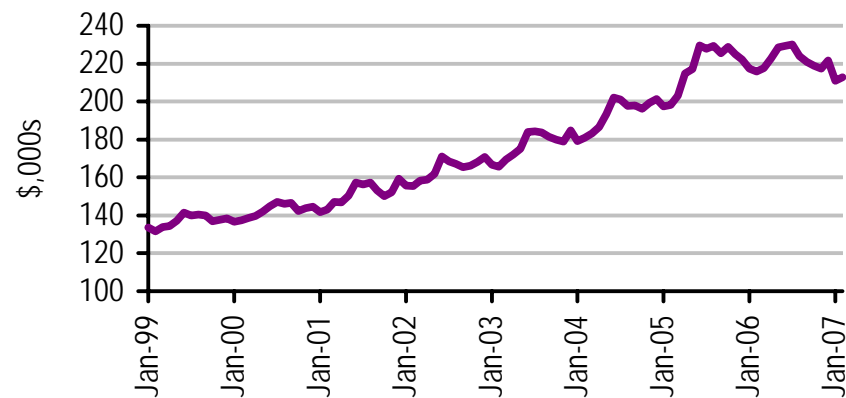


Existing Home Inventory—Months Supply

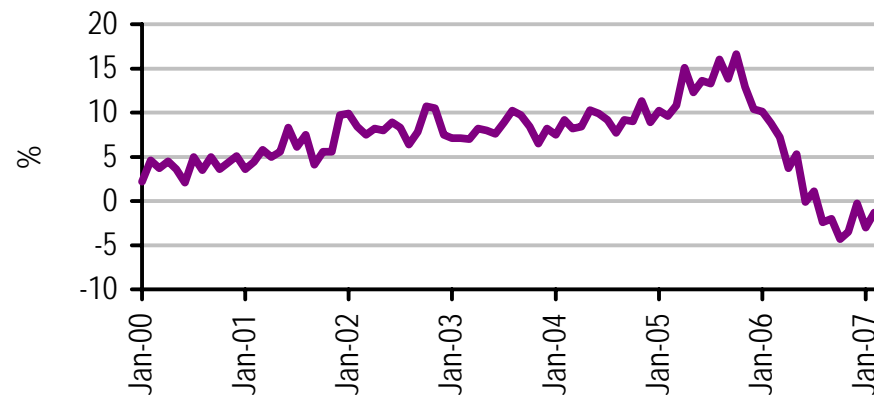


Existing Home Prices Have Stalled

Existing Home Sales—Median Price



Existing Home Sales—Median Price Change YOY

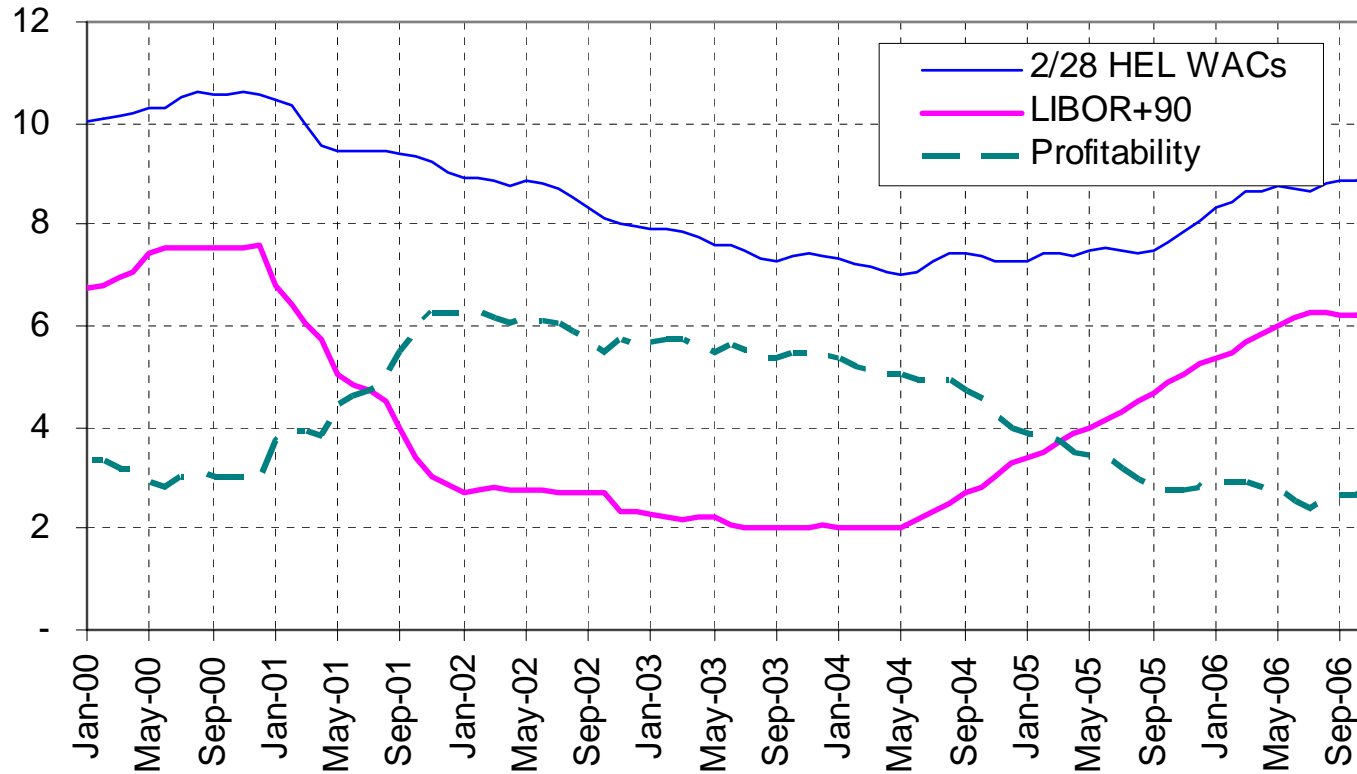


Last date: 2/28/07

EPDs? Who Are Those People?

- ◆ Speculators taking advantage of a free option in the form of 0% down payment?
- ◆ Serial cash-out refiers, refing for one last time?
- ◆ Renters looking for a years free rent?

Rough Measure of Subprime Profitability



Impact of EPDs on Economics of Subprime Origination

	Early 2006	Early 2007
Origination Cost	101.50	102.00
Price of Loan Sales	102.50	98.50
Profit (Loss)	1.00	(3.50)
Less EPDs	<u>0.20</u>	<u>2.10</u>
Net Profit (Loss) per \$100	0.80	(5.60)

Subprime Trap—For Originators

- ◆ To reduce EPDs, originators must slash production by large percentage (25-50?)
- ◆ But then large overhead built in recent years means unprofitable operation
- ◆ Industry
 - a) Needs a new, viable product
 - b) Needs to shrink volume dramatically

Subprime Originations (\$ million) – Rankings & Current Status

Rank	Lender	2006 Volume	Mkt Share	Chg in Vol 05-06	Notes
1	HSBC Finance, IL	\$52,800.00	8.30%	-9.90%	HSBC Household Finance (rumored to be up for sale); Decision One (owned by HSBC (rumored to be up for sale)
2	New Century Financial, CA	\$51,600.00	8.10%	-2.10%	In breach of debt covenants; restating '06 earnings downwards; major shareholder lawsuits; blanket national layoffs beginning; stopped accepting loan applications, speculation of bankruptcy, stock de-listed from NYSE, SEC starts investigation; 5 additional states issued cease-and-desist orders; announced Fannie Mae will no longer purchase its loans.
3	Countrywide Financial, CA	\$40,596.00	6.30%	-9.10%	Countrywide stopped offering no money down loans.
4	CitiMortgage, NY	\$38,040.00	5.90%	85.50%	
5	WMC Mortgage, CA	\$33,157.00	5.20%	4.30%	WMC (subsidiary of GE) stopped offering hi CLTV loans and announced to lay off 460 workers on the loan production front
6	Fremont Investment & Loan, CA	\$32,300.00	5.00%	-10.90%	3/2/07 Fremont announced shut down of subprime business; Credit Suisse doubled Fremont's line of credit to \$1bb.
7	Ameriquest Mortgage, CA	\$29,500.00	4.60%	-61.00%	Ameriquest (On life support from Citigroup; may end up acquired. Owned by ACC); Recently shut most offices and settled with 30 states over predatory lending; laid off workers.
8	Option One Mortgage, CA	\$28,792.00	4.50%	-28.60%	Owned by H&R Block; up for sale; stopped funding loans for subprime/alt-a with CLTVs>95%; H&R Block reduced the value of Option One's residuals by \$29.2mm.
9	Wells Fargo Home Mortgage, IA*	\$27,869.00	4.40%	-8.10%	Wells announced staff reductions for their subprime operations
10	First Franklin Financial Corp, CA	\$27,665.50	4.30%	-5.70%	First Franklin (acquired by Merrill Lynch from National City for \$1.3bln)
11	Washington Mutual, WA	\$26,600.00	4.20%	-21.50%	Washington Mutual's Long Beach Mortgage cut 50 jobs in response to problems in subprime mkt.
12	Residential Funding Corp., MN	\$21,200.00	3.30%	-16.10%	GMAC-RFC (Major layoffs in ResCap; Reports 4th qtr loss due to losses on subprime loans)
13	Aegis Mortgage Corp., TX	\$17,000.00	2.70%	-4.70%	Aegis (recently closed two subprime operations centers)
14	American General Finance, IN	\$15,070.00	2.40%	-2.40%	
15	Accredited Home Lenders, CA	\$15,766.80	2.50%	-4.90%	Accredited Home is delaying earnings filing; announced sale of \$2.7bb of its loans in HFS portfolio, will take \$150mm hit on sale; may cut jobs; received \$200mm loan from Farallon Capital Mat (hedge fund manager).
16	BNC Mortgage, CA	\$14,500.00	2.30%	-3.30%	Lehman subsidiary
17	Chase Home Finance, NJ	\$11,550.00	1.80%	19.70%	
18	Equifirst, NC	\$10,750.00	1.70%	21.60%	Acquired by Barclays
19	NovaStar Financial, KS	\$10,232.70	1.60%	10.20%	Novastar (serious impairments; likely no dividends in 2007, no taxable income through 2011, shareholder lawsuits, stopped offering high CLTV loans; cuts 17% of its staff)
20	Ownit Mortgage Solutions, CA	\$9,500.00	1.50%	14.60%	12/7/06 Ownit (partially-owned by Merrill and BofA) filed for bankruptcy
21	ResMae Mortgage Corp., CA	\$7,659.00	1.20%	11.60%	2/13/07 ResMAE filed for bankruptcy -- acquired by Citadel
22	Mortgage Lenders Network USA, CT	\$6,000.00	0.90%	100.00%	2/5/07 - filed for bankruptcy
23	ECC Capital Corp., CA	\$5,484.50	0.90%	291.20%	ECC/Encore (fire-sale bought out by Bear-Stearns); trading of ECC stock has been suspended
24	Fieldstone Mortgage Company, MD	\$4,991.30	0.80%	-33.70%	Fieldstone (2007-02-16, bought by C-Bass); C-Bass will pay 28% less for Fieldstone under an amended purchase agreement
25	Nationstar Mortgage (Centex), TX	\$4,619.00	0.70%	-23.00%	Owned by Fortress Investment Group
	Total for Top 25 Lenders:	\$543,243	84.90%	-10.20%	
	Total B&C Originations:	\$640,000	100.00%	-3.80%	

Source: Inside B&C Lending, Copyright 2007



Government Regs Will Reduce Subprime Refi Options

- ◆ New Federal banking rules targeting IOs and Option ARMs became effective September 29, 2006.
- ◆ Expect State Regulatory agencies to adopt similar rules.
- ◆ Fed bank regulators considering how to deal with 2/28s and 3/27s.
- ◆ Congress is gearing up for hearings on rising delinquencies and subprime.

Subprime Trap—For Borrowers

- ◆ Capital markets will no longer buy subprime RMBS backed by large numbers of: 2nd liens, 80/20s, low docs, etc.
- ◆ Bank regulators will shortly enforce a tougher rule for subprime 2/28s and 3/27s. Qualify borrower at fully indexed, fully amortized rate.
- ◆ New Subprime product will reduce number of eligible subprime borrowers and it will carry a much higher loan rate.
- ◆ Existing 2/28 and 3/27 borrowers from 2005 and 2006 vintages will find it very difficult to refinance.
- ◆ Without government assistance, losses could be much greater than historical data would suggest.

Outstanding Mortgage Securities (Dollars in Millions)

Year	GNMA	FHLMC	FNMA	Total Agency	Non-Agency	Total MBS	% of total MBS		1-4 Mtg Outstanding	MBS as % of total Mtg Outstanding
							% Agency	% Non-Agency		
1980	93,874	16,962	51,775	162,611		162,611	100%	0%	957,872	17%
1981	105,790	19,897	56,703	182,390		182,390	100%	0%	1,030,173	18%
1982	118,940	42,952	80,949	242,841		242,841	100%	0%	1,070,159	23%
1983	159,981	57,720	98,166	315,867		315,867	100%	0%	1,186,114	27%
1984	179,981	70,025	118,389	368,395	11,000	379,395	97%	3%	1,321,062	29%
1985	212,145	99,908	146,953	459,006	24,016	483,022	95%	5%	1,518,601	32%
1986	262,698	169,186	184,828	616,712	16,617	633,329	97%	3%	1,721,971	37%
1987	315,832	205,992	210,996	732,820	27,800	760,620	96%	4%	1,920,501	40%
1988	340,527	219,701	252,905	813,133	34,865	847,998	96%	4%	2,154,074	39%
1989	369,687	266,060	306,235	941,982	43,325	985,307	96%	4%	2,378,882	41%
1990	401,278	308,369	383,115	1,092,762	55,029	1,147,791	95%	5%	2,614,681	44%
1991	425,241	351,906	462,923	1,240,070	96,732	1,336,802	93%	7%	2,781,692	48%
1992	419,516	401,525	560,471	1,381,512	142,265	1,523,777	91%	9%	2,947,273	52%
1993	414,066	434,499	638,780	1,487,345	167,899	1,655,244	90%	10%	3,106,228	53%
1994	450,934	460,656	681,237	1,592,827	183,002	1,775,829	90%	10%	3,283,212	54%
1995	472,283	512,238	735,170	1,719,691	193,759	1,913,450	90%	10%	3,451,230	55%
1996	506,340	551,513	801,025	1,858,878	215,357	2,074,235	90%	10%	3,674,711	56%
1997	536,810	576,846	854,782	1,968,438	253,804	2,222,242	89%	11%	3,909,870	57%
1998	537,431	643,465	977,708	2,158,604	321,869	2,480,473	87%	13%	4,266,203	58%
1999	582,263	744,619	1,097,707	2,424,589	353,660	2,778,249	87%	13%	4,691,181	59%
2000	611,553	816,602	1,197,298	2,625,453	377,472	3,002,925	87%	13%	5,109,867	59%
2001	591,368	940,933	1,442,230	2,974,531	434,056	3,408,587	87%	13%	5,639,478	60%
2002	537,888	1,066,303	1,708,409	3,312,600	488,307	3,800,907	87%	13%	6,373,511	60%
2003	473,738	1,129,540	1,790,743	3,394,021	609,386	4,003,407	85%	15%	7,174,311	56%
2004	441,235	1,193,683	1,832,535	3,467,453	1,007,730	4,475,183	77%	23%	8,243,879	54%
2005	405,246	1,321,268	1,881,435	3,607,949	1,581,158	5,189,107	70%	30%	9,378,783	55%
Q1-06	403,500	1,335,044	1,899,951	3,638,495	1,641,743	5,280,238	69%	31%	9,612,261	55%
Q2-06	405,853	1,361,953	1,935,833	3,703,639	1,695,736	5,399,375	69%	31%	9,845,658	55%
Q3-06	410,031	1,398,511	1,981,643	3,790,186	1,746,869	5,537,055	68%	32%	10,028,912	55%
Q4-06	411,487	1,436,470	2,022,627	3,870,584	1,802,106	5,672,690	68%	32%	10,245,622	55%

Source: Inside MBS & ABS. Estimates in italics

Non-Agency Sector Break Down

LoanPerformance Non-Agency Sector Break Down

	\$ million	%
Alt-A	544,602	35.20%
PRIME	399,168	25.80%
Subprime	570,903	36.90%
Other	32,490	2.10%
Total	1,547,164	100.00%

Source: LoanPerformance, UBS

Fed Non-Agency Amount Allocated By LP Percentages

	LP %	Non-Agency Fed Amount Allocated	Sector % of Total Fed MBS
Alt-A	35.20%	634,360	11.18%
PRIME	25.80%	464,957	8.20%
Subprime	36.90%	664,997	11.72%
Other	2.10%	37,845	0.67%
Total	100.00%	1,802,160	31.77%
			5,672,690

Source: Inside MBS & ABS, LoanPerformance, UBS

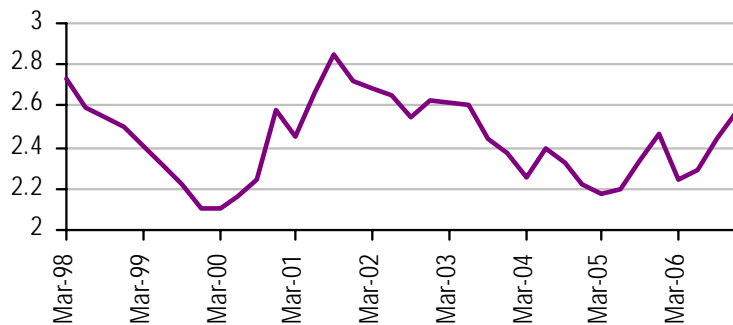
Mortgage Sector Share by Number of Loans

Year/Qtr	Total	# of loans outstanding				% of total			
		Prime	Subprime	VA	FHA	Prime	Subprime	VA	FHA
1998	23,792,360	16,421,549	575,335	2,101,722	4,693,755	69.0%	2.4%	8.8%	19.7%
1999	27,485,686	19,730,199	589,992	2,136,549	5,027,952	71.8%	2.1%	7.8%	18.3%
2000	29,429,526	21,367,109	719,179	2,079,676	5,320,948	72.6%	2.4%	7.1%	18.1%
2001	31,864,248	23,500,063	825,967	2,079,741	5,556,126	73.8%	2.6%	6.5%	17.4%
2002	33,592,875	25,386,840	1,149,565	1,881,036	5,248,172	75.6%	3.4%	5.6%	15.6%
2003	35,266,040	27,058,891	1,864,313	1,558,801	4,443,624	76.7%	5.3%	4.4%	12.6%
2004	38,598,047	28,741,113	4,448,353	1,404,932	4,003,650	74.5%	11.5%	3.6%	10.4%
Q1.2005	39,429,369	29,372,320	5,063,248	1,306,455	3,687,346	74.5%	12.8%	3.3%	9.4%
Q2.2005	39,860,523	29,699,392	5,333,400	1,271,771	3,555,960	74.5%	13.4%	3.2%	8.9%
Q3.2005	40,690,078	30,696,020	5,343,037	1,223,666	3,427,355	75.4%	13.1%	3.0%	8.4%
Q4.2005	41,234,414	31,143,532	5,527,341	1,259,016	3,304,525	75.5%	13.4%	3.1%	8.0%
Q1.2006	41,328,397	31,409,726	5,562,517	1,153,698	3,202,456	76.0%	13.5%	2.8%	7.7%
Q2.2006	42,500,342	32,405,067	5,713,326	1,194,450	3,187,499	76.2%	13.4%	2.8%	7.5%
Q3.2006	42,600,636	32,595,723	5,774,716	1,126,828	3,103,369	76.5%	13.6%	2.6%	7.3%

Source: Mortgage Banker Association

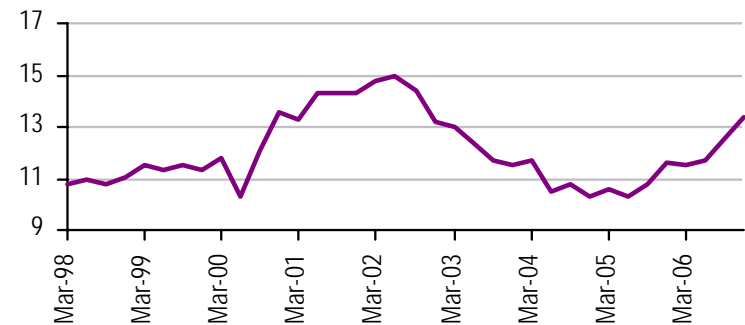
Loan Delinquencies—Prime vs. Subprime

Prime Loan Delinquencies (% of total loans)



Source: MBA

Subprime Loan Delinquencies (% of total loans)



Source: MBA

Why Did Subprime & Alt-A Capture Such a Large Market Share?

RMBS Issuance—By Type (\$million)

Date	Agency	Alt-A	Prime	Jumbo	Subprime	Seconds	S&D	Re-MBS	Other	Total MBS	% of Total			
											Agency	Alt-A	Jumbo	Subprime
1995	269,132	498	25,838	17,772	2,012	2,068	739			318,058	84.6	0.2	8.1	5.6
1996	370,648	1,803	31,419	30,769	5,141	0	762			440,541	84.1	0.4	7.1	7.0
1997	367,884	6,518	49,975	56,921	4,570	924	224			487,016	75.5	1.3	10.3	11.7
1998	725,952	21,236	97,365	75,830	7,375	790	616			929,163	78.1	2.3	10.5	8.2
1999	685,078	12,023	74,631	55,852	3,266	1,374	754			832,977	82.2	1.4	9.0	6.7
2000	479,011	16,444	53,585	52,467	10,106	2,374	983			614,970	77.9	2.7	8.7	8.5
2001	1,087,499	11,374	142,203	87,053	15,512	5,522	4,736	921		1,354,819	80.3	0.8	10.5	6.4
2002	1,444,426	53,463	171,534	122,681	24,803	25,172	14,357	1,945		1,858,381	77.7	2.9	9.2	6.6
2003	2,131,953	74,151	237,455	194,959	20,351	47,033	7,748	4,520		2,718,170	78.4	2.7	8.7	7.2
2004	1,018,684	158,586	233,378	362,549	49,123	34,701	21,383	4,432		1,882,836	54.1	8.4	12.4	19.3
2005	966,319	332,323	280,704	464,990	60,736	29,004	16,786	6,721		2,157,582	44.8	15.4	13.0	21.6
2006	904,547	365,616	219,037	448,837	74,240	16,236	13,464	8,182		2,050,159	44.1	17.8	10.7	21.9
2005-Q1	198,851	59,563	64,118	98,220	10,356	6,674	2,631	791		441,202	45.1	13.5	14.5	22.3
2005-Q2	229,104	82,050	66,522	119,213	12,366	8,147	10,371	774		528,547	43.3	15.5	12.6	22.6
2005-Q3	287,455	103,755	70,775	118,974	21,414	7,081	2,820	2,706		614,980	46.7	16.9	11.5	19.3
2005-Q4	250,909	86,955	79,289	128,583	16,600	7,102	965	2,450		572,854	43.8	15.2	13.8	22.4
2006-Q1	221,675	76,505	67,185	113,808	19,440	5,118	1,434	1,510		506,674	43.8	15.1	13.3	22.5
2006-Q2	216,642	103,787	48,707	127,012	16,263	3,173	2,268	1,702		519,554	41.7	20.0	9.4	24.4
2006-Q3	234,499	89,178	57,308	101,110	19,780	3,208	7,885	2,987		515,954	45.4	17.3	11.1	19.6
2006-Q4	231,731	96,147	45,837	106,908	18,758	4,737	1,877	1,983		507,977	45.6	18.9	9.0	21.0

Source: Inside MBS & ABS, based on SEC filings and industry surveys.

Note: MBS are backed by 1-4 family mortgage loans. Agency CMO/REMICs are backed by FNMA, FHLMC or GNMA collateral. Starting January 2001, Non-Agency MBS include private-label jumbo and Alt-A transactions, plus mortgage-related ABS, including subprime HEL, second liens, HELOCs, high LTV loans and manufactured housing loans. ABS data prior to 2001 include some mortgage-related collateral.

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