UBS

Letter to Shareholders
Report to 30 September 1998

17 November 1998

Dear Shareholder,

The third quarter of the year was in many respects unusual. Financial markets worldwide were rocked by turmoil to a degree which fortunately is experienced only seldom. This turbulence left its impact on our financial results. Certainly, UBS has experienced setbacks, and these have weighed heavily on our bank. At the same time, however, we have continued to make encouraging progress with the integration. The difficulties we are currently faced with are there to be overcome, and we view them as a challenge. We have taken action where it was needed, but we have also renewed our unwavering commitment to taking UBS forward to the success it deserves. We are confident we will achieve this.

January to September in brief

The key financial figures for the first nine months can be summarized as follows:

- Group net profit after tax and minorities fell by CHF 911 million compared with end of June 1998 to total CHF 2.6 billion. The loss sustained in the third quarter therefore lies within the range announced on 24 September in our profit warning.
- Earnings per share dropped to CHF 12.20 at the end of September, compared with CHF 16.54 at the end of June 1998.
- Group profit was influenced by the following special factors:
  - The sale of Banca della Svizzera Italiana (BSI) resulted in an after-tax profit of CHF 932 million.
  - After-tax provisions of CHF 466 million were set aside to cover our share of the settlement of the class actions brought on behalf of victims of the Holocaust and their survivors in the United States.
  - Our exposure to LTCM, about which we informed you in detail in our Letter to Shareholders dated 8 October, resulted in an after-tax loss of CHF 984 million.
  - CHF 919 million in provisions were needed to cover derivative positions dating from the period before the merger.
- Headcount fell from 55,176 at the start of the year to 48,547 at end September.
- Overall assets under management remained practically constant at CHF 1,516 billion.
- After improving to 66.8% in the first half, our cost-to-income ratio rose again as a result of the disappointing earnings situation to reach 77% at the end of September.
- Our share price has recovered somewhat from its sharp drop in September but is still below its level at the start of the year.

Highlights from the divisions

The *Private Banking* Division was only marginally affected by the turmoil on the financial markets. It succeeded in increasing profits before tax to CHF 4.2 billion, equivalent to 110% of the full year results for 1997. Included in this amount are proceeds of around CHF 1 billion from the sale of BSI. At the same time, in the course of redefining client segments, CHF 265 million in revenues and CHF 78 million in costs were transferred to the Private and Corporate Clients Division. Some CHF 111 billion in client assets were also transferred. Asset withdrawals by clients remain lower than had been feared. There has even been a slight net increase.

The expansion of international private banking outside Switzerland is proceeding apace as new operations are established and existing ones expanded in a number of Southern European countries, the United Kingdom, Germany, Japan and Australia.

Outside Switzerland, integration has now been largely completed. In Switzerland, the process is taking longer mainly due to the need to merge the IT systems of the two predecessor banks.

Warburg Dillon Read, our investment banking division, was naturally affected most by the financial market turmoil. It is reporting a loss before tax of CHF 1.23 billion for the year to the end of September. This result was heavily affected by the losses associated with our exposure to the US hedge fund LTCM and substantial provisioning requirements on derivative positions dating from before the merger. Both these neg-

UBS Group Income Statement

For the nine-month period ended *Swiss francs in millions*	**30.9.1998**	30.9.1997	Change	in %
Operating income				
Net interest income	**4,954**	5,182	(228)	(4)
Less: Credit loss expense	**464**	999	(535)	(54)
Total	**4,490**	4,183	307	7
Net fee and commission income	**9,702**	9,000	702	8
Net trading income	**598**	4,539	(3,941)	(87)
Other income	**1,829**	1,083	746	69
Total	**16,619**	18,805	(2,186)	(12)
Operating expenses				
Personnel	**7,205**	8,680	(1,475)	(17)
General and administrative	**4,606**	3,861	745	19
Depreciation and amortisation	**1,343**	1,310	33	3
Total	**13,154**	13,851	(697)	(5)
Group operating profit before tax	**3,465**	4,954	(1,489)	(30)
Tax expense	**907**	1,091	(184)	(17)
Group profit / (loss)	**2,558**	3,863	(1,305)	(34)
Less: Minority interests	**(42)**	12	(54)	–
Net profit / (loss)	**2,600**	3,851	(1,251)	(32)

Segment Reporting by Business Division

For the nine-month period ended 30 September 1998

Swiss francs in millions	Private Banking	Warburg Dillon Read	Private & Corp. Clients	UBS Brinson	UBS Capital	Corporate Center	Group Total
Operating income	6,836	4566	4,516	868	499	(202)	17,083
Less: Credit loss expense (expected losses)[1]	20	294	780	0	0	(630)	464
Total	6,816	4,272	3,736	868	499	428	16,619
Personnel, general and administrative expenses	2,442	5,102	2,647	532	91	998	11,812
Depreciation and amortisation	209	400	662	41	3	27	1,343
Total	2,651	5,502	3,309	573	94	1,025	13,154
Segment performance before tax	**4,165**	**(1,230)**	**427**	**295**	**405**	**(597)**	**3,465**
Tax expense / (benefit)	666	(369)	66	87	12	445	907
Segment performance after tax	**3,499**	**(861)**	**361**	**208**	**393**	**(1,042)**	**2,558**

[1] In order to show the relevant divisional performance over time, adjusted expected loss figures are reported for all business divisions rather than the net credit loss expense. The statistically derived adjusted expected losses reflect the inherent counterparty and country risks in the respective portfolios for accrual based products (excluding traded products) of the divisions. The difference between these figures to the financially booked credit loss expense on Group level is in the Corporate Center. The divisional breakdown of the financially booked credit loss expense of CHF 464 mio. as of September 1998 is as follows: Private Banking CHF 58 mio., Warburg Dillon Read CHF 219 mio., Private and Corporate Clients CHF 187 mio.

ative factors were the result of adverse market conditions and of transactions which could not be readily adjusted to allow for fundamental changes in the market. The collapse of the economy in Russia and the severe setbacks experienced by markets in South America, Asia and Eastern Europe also took their toll. The extreme volatility which resulted and the exceptional widening of spreads in the fixed income market had a particularly heavy impact on the equities and rates businesses. Results from foreign exchange trading and corporate finance were more positive.

Warburg Dillon Read has now established itself as the preeminent European investment bank and is also in the top tier internationally. Given the strength of its client franchise and its high level of professionalism, we are confident of its ability to put its present difficulties rapidly behind it.

The merger process in investment banking is now virtually complete. Only a number of IT issues remain to be solved.

The *Private and Corporate Clients* Division performed well. It contributed CHF 427 million to pre-tax profit, which is well ahead of our expectations. Revenue growth and lower costs are responsible for this good result. It was also influenced by the transfer, referred to earlier, of client assets from Private Banking to the newly created business area Investment Clients. As a consequence, assets under management in the Private and Corporate Clients Division rose to CHF 416 billion.

Since the start of the year, some 150,000 banking relationships, equivalent to roughly 2.7% of our overall customer base, have been terminated by clients, a figure well below what we had anticipated in the context of the merger. The average amount of assets withdrawn was around CHF 10,000.

The integration is moving ahead according to plan. It is in our domestic division that the process is the most complex. The biggest challenge is in the IT sector as some 5 million clients have to be brought together on a common IT system and served with uniform products and services. The amalgamation of branches in various locations throughout Switzerland where both banks had been represented before the merger will mainly take place in the first half of 1999.

The *UBS Brinson* Division (institutional asset management) earned a pre-tax profit of CHF 295 million in the first nine months of the year, slightly ahead of the equivalent 1997 result. Compared with its first half performance, however, the division also experienced a setback, mainly due to the price collapse on various equity markets.

At the end of September 1998, UBS Brinson had some CHF 513 billion in assets under management, virtually the same as at the end of June. Institutional assets fell by 4% while mutual fund assets were 18% higher.

In the UBS Brinson Division the merger is now practically complete.

UBS Capital, our fifth core business, posted a pre-tax profit of CHF 405 million in the first nine months of the year, maintaining its first half performance. Divestment activity is, however, likely to be slower in the foreseeable future in the light of the adverse market conditions. The book value of the overall portfolio was CHF 1.7 billion at the end of September.

Credit loss expense

Total write-offs and allowances for the nine-month period amounted to approximately CHF 2.4 billion, of which CHF 1.93 billion were funded by the release of allowances established in earlier periods. This resulted in a net charge of CHF 464 million to the income statement. The dramatic deterioration in the emerging markets, especially Russia, led to a substantial increase in both country and individual counterparty write-offs and allowances.

The international loan portfolio required provisioning of CHF 801 million, of which CHF 220 million were charged to the income statement and CHF 581 million were funded through the release of allowances established in earlier periods. In Switzerland, net new write-offs and allowances for credit risk amounted to CHF 1.54 billion. Roughly 12% of this concerned counterparties not previously identified as being of higher risk. Overall, however, the situation in Switzerland has improved, and third quarter provisioning requirements were significantly lower than for the first half of 1998.

The Group’s loan assets classed as non-performing totalled CHF 15.4 billion, a reduction of CHF 1.26 billion compared with the end of 1997. Non-performing loans account for 4.4% of the overall loan portfolio, down from 4.7% at the end of June. Provision has been made for 88% of these positions. Asset quality can therefore be described as very good.

Cost trend

Personnel costs fell by a substantial 17% compared with the previous year to total CHF 7.2 billion, partly as a result of merger-related reductions in headcount and partly of lower bonus payments due to the disappointing results. Severance payments for redundancies and lock-in payments for staff critical to the merger process were funded from the restructuring provision. Payments to employees whose profit-linked compensation component would be adversely affected by the merger although their job performance is good were also charged to the restructuring provision. Overall, about one third of the CHF 7 billion set aside for restructuring costs had been utilized at the end of September.

General and administrative expense was significantly higher compared with the previous year, rising by 19% to CHF 4.6 billion. Most of this increase related to the overall CHF 570 million provision before tax set up to cover the settlement of the class actions filed in the United States on behalf of victims and survivors of the Holocaust. Investments associated with the "Year 2000" project and the introduction of the euro also affected the cost base.

Outlook

The more stable trend on the financial markets following the interest rate cuts in various countries and the expected IMF support package for Brazil should contribute to an improvement in operating income in the fourth quarter. At the same time, it seems probable from the present perspective that there will be an increase in the provision relating to the settlement reached in the United States. This means that results for the fourth quarter are likely to be only moderately positive and profit for the full year will probably fall short of the first-half performance.

Our growth potential nevertheless remains intact. Our bank has a solid earnings capability, an attractive business portfolio and a strong equity base of CHF 32 billion. The Board of Directors and the Group Executive Board will be directing all their energies to achieving the objectives we have set ourselves. We thank our shareholders for their continuing loyalty even in these more difficult times and our customers for their understanding and forbearance for any inconvenience they may experience as a result of the merger. We are doing our utmost to keep it to a minimum. Last but not least, we owe a debt of gratitude to our staff whose efforts to make the new UBS a success have been tremendous.

Sincerely yours,

UBS AG

Alex Krauer
Chairman of the Board of Directors

Marcel Ospel
President and Group CEO

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A detailed report on the first nine months is available in English on the Internet (www.ubs.com). It can also be obtained in printed form from: UBS AG, RTQ6-BXL, P.O. Box, CH-8098 Zurich.