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Analysis

March 2004

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Montes de Piedad y Caja de Ahorros de Ronda, Cádiz, Almería, Málaga y Antequera (Unicaja)

Strategy and Competitive Position

STRONG LOCAL BRAND-NAME RECOGNITION AND MARKET POSITIONING

With total assets amounting to €16.2 billion in December 2003, Montes de Piedad y Caja de Ahorros de Ronda, Cádiz, Almería, Málaga y Antequera (Unicaja) is a medium-sized savings bank created in 1991 as a result of the merger of five local savings banks. Unicaja ranks eighth by assets out of 46 Spanish savings banks, and fifteenth including banks. By asset size and branch network, Unicaja is by far the leading financial institution in the region of Andalucía in Southern Spain where it holds a market share of 16% for deposits and 11% for loans; but it is particularly strong in its home provinces,[1] particularly Málaga where Unicaja holds a market share of close to 40% for deposits and 23% for loans, and is the clear market leader.

Of 798 branches at year-end 2003, 91% are located in Andalucia (of which 34.5% in Málaga, 14.4% in Almería and 12.8% in Cádiz). The local franchise in the bank's home provinces - Almería, Cádiz and Málaga - accounted for about 76% of its deposits and 73% of its lending in September 2003.

… in a market whose economy lags behind the national average

Andalucia is Spain's largest region, accounting for 18% of the population. Andalucia's GDP per capita is one of the lowest in Spain, and it has one of the highest unemployment rates. Notwithstanding the above, Andalucia has been showing increased dynamism during the recent past, growing above the national average.

MANAGEMENT STABILITY HAS TRANSLATED INTO CONSISTENT STRATEGY OVER THE YEARS

Stability at the top management team has allowed Unicaja to follow a consistent and coherent strategy centered around its core retail franchise. As such, and over recent years, main strategic focuses have been the achievement of a sounder risk profile and a strong cost discipline (cost-to-income ratio at 54% at year-end 2003), to address two important weaknesses that soon emerged at the creation of Unicaja, and that continue to underpin the bank's strategic focus.

1.

Market Shares (%)	deposits	loans
Almería	25	21
Cadiz	25	17

Along these lines, and unlike its peers that have embarked on more aggressive expansionary strategies, Unicaja's network has remained relatively unchanged over the last few years, only somewhat accelerating the pace of growth of new branch openings during the last two. Selective expansion aims to reinforce the bank's leadership position in Andalucía in those areas where market share is less strong. The bank is also targeting the development of a network to cater for non-resident constituencies living on the Mediterranean coast. Unicaja also enjoys an ample network of 933 ATMs.

REINFORCED BANCASSURANCE STRATEGY IS A CLEAR POSITIVE RATING DRIVER

In 2001, Unicaja took a decisive step in its banc assurance strategy with the sale of 50% of its life insurance company, Unicorp Vida, to AVIVA (the former CGNU - the UK's largest insurance group with sizeable operations in continental Europe), entering into an exclusive agreement for the distribution of Aviva's life and insurance products, thus significantly reinforcing Unicaja's banc assurance strategy, a business line with significant growth potential in Spain where insurance remains a marginal contributor to the revenues of Spanish banks and savings banks

Three other Spanish savings banks - Bancaja (rated A1/P-1/C+), Caja España (rated A2/P-1/C+) and Caixa Galicia (A1/P-1/B) - also joined this project, which now enjoys about 3,000 points of sale across Spain. The newly created group aims to be the country's leading life insurance group and has been reporting very encouraging results for the last few months, with leading numbers in life banc assurance premiums.

Conservative accounting limits downside potential

Unicaja has chosen to follow very conservative criteria with regards to the accounting recognition of the very substantial capital gains involved in the Unicorp Vida deal that may total up to €259 million. As such, and due to the sale option features attached to the deal, only a small capital gain (a total of €61 million between 2002 and 2003) of the fixed component of the price has been booked in Unicaja's accounts, limiting the possible negative effects of having to reverse an important part of the profit in the (at this point) unlikely event that Aviva were to decide to exercise its put option. Along these lines, the capital gain annually booked is limited to the increased value of the company, leaving ample room for the possible recognition of substantial capital gains in the future. The variable component is subject to successful compliance with a five-year business plan. Unicaja, itself, has a call option on Unicorp Vida shares.

Financial Fundamentals

HIGHER THAN AVERAGE MARGINS REFLECT THE STRENGTH OF THE RETAIL FRANCHISE

Due to a lower than average funding cost, which stems from the strength of its deposit base that accounts for about three-quarters of total liabilities and enjoys a higher than average proportion of low yielding current and savings accounts, Unicaja enjoys, at over 3%, higher than average net interest margins. Notwithstanding the positive elements of such a funding structure - primarily in relation to its cost and stability, it also makes the bank highly vulnerable to declines in interest rate. However, Unicaja managed to partly offset the negative effect of successive cuts in interest rates and maintain its comparatively high margins thanks to the hedging effect of its large public sector debt portfolio. Similar to its peers, the bank also enjoyed good growth in lending volume.

FOCUS ON REVENUE DIVERSIFICATION THAT REMAINS LIMITED

Similar to its peers and underpinned by its retail focus, Unicaja displays a limited diversification of its revenue sources, with a high reliance on net interest income. As such, at end-September 2003, net interest income accounted for around 85% of its operating income with fees and commissions income being 0.51% of average assets.

In an environment of low interest rates and increasing competition, we believe that challenges lie ahead for any institution with this revenue mix, putting pressure on the bank's need to diversify its revenue sources. Along these lines, Unicaja has taken important steps to grow its non-interest income where, as discussed, we see plenty of room to grow. Aside from bancassurance, the credit card and pension funds businesses are solidly contributing to the increase in fees and commission income, compensating for the more stable growth of the mutual fund industry. At year-end 2003, close to three-quarters of Unicaja's fees and commission income were related to payment services and 25% to the sale of pension funds, mutual funds and insurance.

THE RETAIL BOOK HAS A LOW RISK PROFILE, BUT SOME LARGE RISK CONCENTRATIONS AND HIGH EXPOSURE TO REAL ESTATE HEIGHTEN CREDIT RISK

Unicaja's retail loan book displays high granularity, as noted by the fact that 50% of the loan portfolio has an average size of €100,000 or below (and close to 70% with an average size of €300,000 or below). We also note the relatively low risk profile of the bank's portfolio, resulting from its dominance in domestic retail business. Mortgages account for 57% of the loan book, of which 75% is residential mortgages, most of which are lower-risk first homes.

Notwithstanding the above, Unicaja also displays some large risk concentrations, most of which are real estate related. Such exposures are to solid national entities but also to well-known local real estate developers. The close monitoring and strict requirements put in place by Unicaja for its book of loans to real estate developers (7% of the mortgage book) somewhat mitigate our concerns. Some of Unicaja's largest risk exposures are also investments in companies that also benefit from large credits. This, in our view, ties Unicaja closer to the fate of these companies and heightens the bank's overall credit risk

Underpinned by a favourable operating environment and stricter credit practices, the bank's asset quality has been steadily improving, from higher than average non-performing loans ratios. With non-performing loans as a percentage of total loans at 0.56% as of 31 December 2003, and a coverage ratio of 390%, Unicaja compares favourably with its domestic and international peers. Looking ahead, non-performing loans may gradually grow on the back of weaker macroeconomic conditions. Nevertheless, we expect the bank's credit expenses to remain manageable.

GROUP COMPANIES: A DIFFERENT SET OF RISKS

Similar to its peers and in a further attempt to diversify its balance sheet and revenue sources, Unicaja has built up a portfolio of group companies, with which it consolidates results via the equity accounting method, in line with Bank of Spain rules. In the specific case of Unicaja, these investments are primarily in non-quoted regional companies or in strategic sectors such as motorways, telecoms and utilities). As discussed, the consolidation of these companies prevents them from being marked-to market. It is as yet unclear what the accounting treatment of these participations will be under IAS, but at this point they appear to be more penalising than the current domestic rules. Notwithstanding the above, Unicaja has unrealised capital gains in its quoted equity-accounted portfolio.

The contribution made by this group of companies has been overall relatively modest during the recent past, mainly due to the consolidation of losses reported by Auna (a telecommunications company in which Unicaja holds a 2.47% stake - its largest equity investment and one if its largest risk exposures), and the need to amortise the associated goodwill. These losses significantly declined in 2003, and a positive contribution to this revenue line is expected soon. As such, the yield on these investments (measured as dividends and results by equity method divided by total disbursement) has been below the 5% targeted by the bank. As discussed, some of these investments also benefit from large credits that, in our view, heighten the bank's overall credit risk.

MARKET RISK EXPOSURE MITIGATED BY LIMITED CONTRIBUTION TO BOTTOM LINE

In addition to the group companies, Unicaja has also built up a sizeable investment portfolio in which most of the bank's market risk is concentrated (the trading portfolio is, in fact, small). The contribution from this portfolio changed to positive in 2003 on the back of a better market performance of its largest investment - Endesa (rated Baa1/P-2). This has allowed Unicaja to release some of the sizeable provisions that had to be made in previous years to cover unrealized capital losses as mandated by Bank of Spain regulations, and that resulted in a net negative contribution of the "results from financial operations" in 2002. Notwithstanding the above, the contribution of this more volatile revenue line has been limited over the last few years (to about 5% of Unicaja's operating income), as profits from these investments have been used to build up general reserves, and the bank has been able to compensate losses by realising some of its unrealised capital gains (i.e. the sale of Vodafone shares in 2002).

At end-December 2003, Unicaja had about €354 million in unrealised capital gains in its quoted equity portfolio, of which close to 60% was concentrated in Vodafone shares.

Unicaja participates in the Confederación Española de Cajas de Ahorros (CECA)[2] global risk-management project, focusing on the development of management tools for market, credit and operational risk, as well as others such as liquidity or legal issues. Derivatives are used only for hedging purposes.

TIGHTENED LIQUIDITY BUT STILL LIMITED RELIANCE ON WHOLESALE FUNDING

As discussed, the bulk of Unicaja's funding comes from deposits, reflecting its strong retail franchise. However, similar to its peers, loan growth has outpaced deposit growth, resulting in an increasing reliance on more costly market sources. Notwithstanding the above, and partly due to the bank's focus on achieving a balanced growth of its loans and

2. *CECA is the Spanish Federation of Savings Banks.*

deposits, Unicaja's reliance on market funds remains relatively moderate evidenced by the fact that retail funding accounted for a high 84% of total funding at year-end 2003.

Wholesale funding has been limited to an EMTN programme, structured covered bonds *(cedulas hipotecarias)* in conjunction with other *cajas*, and more lately domestic commercial paper targeted to other financial institutions. Although the issuances of CP have somewhat concentrated debt maturities in the short-end, Unicaja maintains a liquidity cushion in its balance sheet sufficient to cover its maximum daily short-term liquidity needs (estimated over the analysis of the maximum liquidity needs of the last ten years and adding the current CP programme). Unicaja remains a net lender in the interbank market.

ROBUST ECONOMIC CAPITALISATION

At a 9.69% Tier 1 (with no hybrid instruments) and 12.02% total BIS, Unicaja is strongly capitalised. In addition, Unicaja's relatively low-risk business mix, strong internal capital generation, unrealised capital gains and excess provisioning all materially enhance the group's economic capitalisation, a positive factor as regards portfolio and business risks.

Related Research

Banking System Outlook:

Spain, December 2003 (80354)

Banking Statistical Supplement:

Spain, November 2003 (80076)

Rating Methodology:

Bank Credit Risk (Analytical Framework for Banks in Developed Markets), April 1999 (44246)

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

Unicaja (Consolidated)

	31/12/2003	31/12/2002	31/12/2001	31/12/2000	31/12/1999
Summary Balance Sheet (EUR million)					
Cash & central bank	429	265	412	279	437
Due from banks	1,295	1,222	905	692	563
Securities	1,608	2,446	2,603	2,441	2,398
Gross loans	11,993	10,273	8,866	7,602	6,440
Loan loss reserves (LLR)	(261)	(215)	(197)	(154)	(138)
Insurance assets	0	0	0	0	0
Fixed assets	417	406	377	365	363
Other assets	754	386	391	356	224
Total assets	16,234	14,781	13,358	11,582	10,287
Total assets (USD million) [1]	20,385	15,495	15,080	12,300	10,245
Total assets (EUR million)	16,234	14,781	13,358	11,582	10,287
Demand deposits	6,340	5,702	5,168	4,542	4,238
Savings deposits [2]	6,295	5,876	5,439	5,053	4,270
Due to banks	100	316	224	184	216
Market funds	1,020	629	370	0	0
Insurance liabilities	0	0	0	0	0
Other liabilities	727	767	846	617	533
Total liabilities	14,482	13,289	12,047	10,396	9,257
Subordinated debt	386	296	267	264	234
Shareholders' equity	1,362	1,193	1,040	918	793
Total capital funds	1,753	1,493	1,311	1,186	1,030
Total liabilities & capital funds	16,234	14,781	13,358	11,582	10,287
Derivatives - notional amount	2,642	2,109	0	2,003	1,010
Derivatives - replacement value	0	0	0	0	0
Contingent liabilities	3,064	2,640	2,287	2,051	2,318
Risk weighted assets (RWA)	12,179	10,743	9,373	6,908	6,639
Assets under management (EUR million) [3]	0	0	0	0	0
Number of employees	4,547	4,489	4,209	4,342	4,423
Summary Income Statement					
+Interest income	660	678	669	566	500
-Interest expense	197	236	260	194	135
=Net interest income	463	442	410	373	365
+Trading income	6	(27)	28	21	27
+Fee & commission income	81	72	63	58	53
+Insurance income (net)	0	0	0	0	0
+Other operating income	33	26	23	21	16
=Operating income	583	513	524	474	461
-Personnel expenses	196	186	173	167	163
-Other operating expenses	91	85	85	71	65
= Operating funds flow	296	242	266	235	234
-Amortisation/depreciation	34	36	34	34	55
(Total operating expenses)	321	307	292	272	283
=Preprovision income (PPI)	262	206	232	202	179
-Loan loss provisions	61	52	48	27	14
+Other non operating adjustments [4]	30	33	(3)	(7)	(12)
+Extraordinary profit / loss	(3)	13	6	9	(0)
=Pretax income	227	199	186	176	153
-Taxes	37	35	46	55	47
=Net income	190	164	140	122	105
-Minority interests	1	1	1	0	0
=Net income (group share)	189	164	140	122	105

Unicaja (Consolidated)

	31/12/2003	31/12/2002	31/12/2001	31/12/2000	31/12/1999
Growth Rates (%)					
Gross loans	16.74	15.86	16.63	18.04	17.81
Total assets	9.83	10.66	15.33	12.59	12.18
Customer deposits (demand and savings)	9.14	9.15	10.54	12.78	13.23
Net interest income	4.74	7.89	9.89	1.99	(0.92)
Fee and commission income	12.12	14.52	8.32	10.42	18.71
Operating expenses	4.52	5.22	7.36	(3.73)	1.94
Preprovision income	27.24	(11.05)	14.84	12.81	3.59
Net income	15.77	17.15	14.64	15.63	14.70
Income Statement in % Average Risk Weighted Assets					
Net interest income	4.04	4.39	5.03	5.50	5.96
Trading income	0.05	(0.27)	0.35	0.32	0.45
Fee and commission income	0.71	0.72	0.78	0.86	0.86
Insurance income	-	-	-	-	-
Operating income	5.09	5.10	6.43	7.00	7.52
Operating expenses	2.80	3.06	3.59	4.02	4.61
Preprovision income	2.29	2.05	2.85	2.98	2.91
Loan loss provisions	0.54	0.52	0.59	0.40	0.23
Extraordinary profit	(0.03)	0.12	0.07	0.13	(0.00)
Net income	1.66	1.63	1.72	1.80	1.72
Liquidity, Funding (including sub debt) & Balance Sheet Composition					
Avg. liquid assets % avg. total assets	23.42	27.91	29.40	31.14	34.18
Avg. gross loans % avg. total assets	71.79	68.02	66.03	64.21	61.20
Avg. customer deposits % avg. total funding	89.81	91.35	93.92	95.27	94.76
Avg. interbank funds % avg. total funding	1.54	2.22	1.90	2.10	2.83
Avg. market funds (excl. interbank) % avg. total funding	6.11	4.11	1.72	-	-
Avg. sub debt % avg. total funding	2.53	2.32	2.47	2.63	2.42
Avg. liquid assets % avg. customer deposits	30.00	35.40	36.30	37.62	41.51
Avg. gross loans % avg. customer deposits	91.96	86.27	81.52	77.57	74.31
Avg. market funds reliance [5]	(26.20)	(37.43)	(44.18)	(51.42)	(58.83)
Avg. RWA % avg. total assets	73.90	71.49	65.28	61.95	63.06
Breakdown of Operating Income in %					
Net interest income % operating income	79.32	86.06	78.19	78.66	79.19
Trading income % operating income	1.04	(5.22)	5.44	4.52	5.94
Fee & commission income % operating income	13.90	14.09	12.06	12.31	11.44
Insurance income % operating income	0.00	0.00	0.00	0.00	0.00
Other operating income % operating income	5.73	5.07	4.31	4.51	3.43
Profitability					
Yield on avg. earning assets (%)	4.70	5.15	5.78	5.61	5.56
Cost of interest bearing liabilities (%)	1.46	1.95	2.41	2.04	1.59
Net interest margin (%)	3.35	3.35	3.54	3.69	4.06
Recurring earning power (PPI % avg. assets)	1.69	1.46	1.86	1.84	1.84
Risk-weighted recurring earning power (PPI % avg. RWA)	2.29	2.05	2.85	2.98	2.91
Post-provision income % avg. assets	1.29	1.09	1.47	1.60	1.69
Post-provision income % avg. risk weighted assets	1.75	1.53	2.26	2.58	2.68
Return on average assets (%)	1.23	1.17	1.12	1.11	1.08
Return on avg. RWA (%)	1.66	1.63	1.72	1.80	1.72
Post-provision income % tier 1 capital	17.01	-	-	-	22.29
Return on equity (period end) (%)	13.90	13.71	13.42	13.26	13.29
Net interest income coverage of loan loss provisions	7.54	8.44	8.56	13.75	25.47
Loan loss provisions % preprovision income	23.43	25.40	20.67	13.44	8.02
Pre-tax income % operating income	38.94	38.77	35.58	37.24	33.09
Internal capital growth (%)	15.87	15.72	15.20	15.37	14.86
Dividend payout ratio (%)	0.00	0.00	0.00	0.00	0.00

Unicaja (Consolidated)

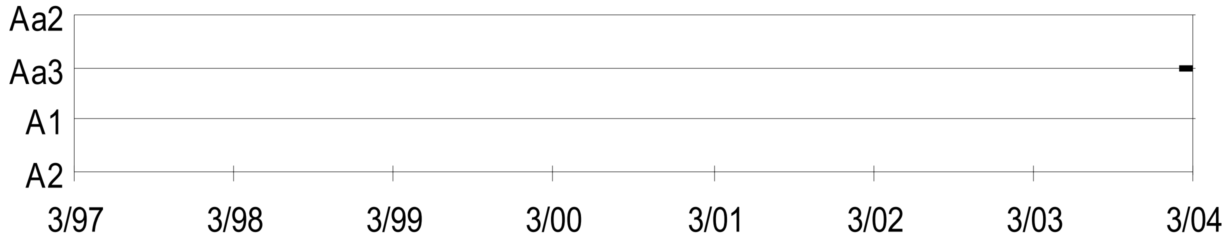
	31/12/2003	31/12/2002	31/12/2001	31/12/2000	31/12/1999
Efficiency					
Cost/income ratio (operating expenses % operating income)	55.08	59.88	55.78	57.44	61.26
Operating expenses % average assets	2.07	2.19	2.34	2.49	2.91
Operating income / employee (EUR thousand)	128.33	114.39	124.45	109.13	104.34
Operating expenses / employee (EUR thousand)	70.68	68.49	69.42	62.68	63.92
PPI / employee (EUR thousand)	57.65	45.89	55.03	46.45	40.42
Asset Quality and Risk Measurement					
Problem loans % gross loans	0.56	0.68	0.87	1.06	1.44
LLR % problem loans	389.82	306.44	253.98	190.12	148.76
LLR % gross loans	2.18	2.10	2.22	2.02	2.14
Loan loss provisions % gross loans	0.51	0.51	0.54	0.36	0.22
Problem loans % (shareholders' equity + LLR)	4.13	4.99	6.27	7.54	9.97
Replacement value % shareholder's equity	0.00	0.00	0.00	0.00	0.00
Capital Adequacy (Period End)					
Tier 1 ratio (%)	9.69	9.76	9.98	-	11.11
Hybrid capital % tier 1 capital	-	-	-	-	-
Total capital ratio (%)	13.16	11.90	12.40	14.25	14.50
Shareholders' equity % total assets	8.39	8.07	7.79	7.93	7.71
Equity participations % shareholders' equity	23.92	1.47	1.64	2.47	2.80

[1] USD and EUR figures use historical exchange rate against the EUR
[2] Full disclosure may not be available for all years. The amount is then included in "demand deposits".
[3] As reported by the bank
[4] This may include value adjustments of securities.
[5] Avg. [(market funds-liquid assets) % (earning assets-liquid assets)]

Description	Coupon (%)	Currency	Face Amount (mil)	Maturity	Moody's Rating
Unicaja					
Long-Term Bank Deposit Rating	—	—	—	—	Aa3
Bank Financial Strength Rating	—	—	—	—	B
Short-Term Bank Deposit Rating	—	—	—	—	P-1

Rating History

Long-term Bank Deposits



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