



Dear Shareholders

The SGKB Group performed strongly during the first half of 2004. While the Swiss economy has shown only a moderate recovery, despite optimistic forecasts, we have nevertheless been able to lift our gross profit above the record level reached in the previous year. This impressive performance was characterised above all by robust earnings on the commission and service fee side of the business, which benefited from the more bullish financial markets in the first quarter and successful market development by SGKB's client advisers.

This positive development is a source of satisfaction for us, as it confirms our strategy of recent years. We successfully diversified into the asset management business in order to reduce the one-sided dependency on interest-related operations. The high quality of our consultancy and service activities, as well as an investment policy directed towards sustained and above-average performance, has enabled us to position ourselves as a leading provider of private banking services not just in Eastern Switzerland. In return, our demanding clients are able to rely upon the security and experience of a regionally-based partner. This Shareholder's letter contains further information on key related topics.

We thank you most warmly for the confidence you have shown in SGKB.

REVIEW AND PROSPECTS

A strong first half of 2004

The first half of 2004 again proved to be very successful for the SGKB Group. Gross profit and group net profit both came ahead of the record figures reached in 2003, while operating income remained broadly in line with the previous year's performance. In addition to the encouraging development of the business, another key feature of the first half of the year was the successful launch of our Investment Center.

Strong commission and service fee business

The Group's mid-year income statement makes highly pleasing reading. Operating income reached CHF 230.2 million, which almost matches the figure achieved in the previous year. Gross profit increased to CHF 110.5 million (+2.4%). This came despite the fact that the anticipated downturn has set in on the interest side of the business, due to the large portfolio of fixed-interest mortgages. However, the commission and service fee business was able to absorb this, as stock market turnover was somewhat higher than the previous year's figures, particularly during the 1st quarter, thanks above all to brighter financial market sentiment. Accordingly, net fee and commission income improved by CHF 14.6 million or 22.7%. Income from trading activities also benefited from the improved stock market situation. Higher foreign currency earnings and net valuation gains led to an increase of trading income of CHF 3.3 million over the previous year's figure of CHF 11.9 million.

Ongoing cost control

Administrative expenses amounted to CHF 119.7 million, which is 3.3% below the figure for the previous year. This was achieved essentially by ongoing cost control measures. This led to a reduction in the ratio of administrative expenditure to operating income (the cost-income ratio) to 55%. Valuation adjustments, provisions and losses amount to CHF 12.8 million, placing them marginally below the respective figure for the previous year. Measured against the expected long-term value, they remain

low. Despite the sideways trend in the economy as a whole, the quality of the credit portfolio remained at a constant high level as compared to the end of the year.

Relative to the previous year, the operating result increased to CHF 78.3 million (+2.6%). After deduction of taxes, the SGKB Group reports a Group net profit of CHF 61.5 million as of June 30, 2004 (+2.2%).

Expansion of assets

The credit business is exposed to huge competitive pressures. Nevertheless, the SGKB Group was able to increase its loans to customers by CHF 39.1 million to CHF 16.0 billion. In overall terms, funds under management benefited from the improved stock market situation. These rose CHF 865.2 million (+3.4%) to reach CHF 26.2 billion. In addition to the positive performance, there was also a pleasing inflow of net new money.

Clear prospects for the second half of the year

The SGKB Group assumes that while the forecast economic recovery will materialise, this will only have a marginal impact on business volumes. Based on the expected extensions of due fixed-interest mortgages at a lower level, the development seen in the first half is likely to continue, leaving net interest income significantly below the figure recorded last year. Following the good start made by the commission and service fee business, it remains to be seen how this will now develop. If underlying sentiment on the financial markets remains positive, then last year's record result should be within reach this year as well.

Group Key Figures

INCOME STATEMENT in CHF 000s	June 30, 2004	June 30, 2003	June 30, 2002 ¹
Operating income	230 236	231 786	203 346
Administrative expenses	(119 696)	(123 818)	(116 497)
Operating profit	78 309	76 309	69 087
Group net profit	61 540	60 233	57 665
EARNINGS PER SHARE in CHF			
Earnings per share	12.24	12.07	11.56
Dividend paid out	8.50	8.00	8.00
KEY FIGURES			
Return on equity, pre-tax (basis: operating profit)	13.4%	13.8%	13.2%
Return on equity, after tax (basis: group net profit)	10.5%	10.9%	11.0%
Administrative expenses incl. depreciation on fixed assets/operating income	55.1%	56.4%	60.3%
BALANCE SHEET in CHF 000s			
	June 30, 2004	Dec. 31, 2003	Dec. 31, 2002
Loans to customers	15 950 577	15 911 512	15 720 538
Customer funds	10 213 515	10 536 306	10 249 851
Balance sheet total	18 852 658	18 912 789	18 314 332
Shareholders' equity	1 205 148	1 181 192	1 116 038
EQUITY KEY FIGURES			
BIS ratio tier 1	10.0%	9.8%	9.1%
BIS ratio tier 2	11.6%	11.4%	11.0%
Surplus of own means over required means as per Swiss banking law	38.5%	35.8%	30.5%
Shareholders' equity in % of balance sheet total	6.4%	6.3%	6.1%
FUNDS UNDER MANAGEMENT in CHF 000s			
Funds under management	26 177 107	25 311 915	23 033 289
HEADCOUNT			
Full-time equivalents ²	970	1 003	1 081
MOODY'S RATING			
Senior unsecured domestic currency	Aa1	Aa1	Aa2
Bank deposits	Aa1/P-1	Aa1/P-1	Aa2/P-1
Bank financial strength	B	B	B

¹ HYPOSWISS included only for the 2nd quarter up to the 4th quarter

² Apprentices calculated at 50%

INVESTMENT CENTER

Investment expertise from a single source

The Cantonal Bank of St.Gallen regards it as crucially important to safeguard and increase the assets of its private and institutional clients. A consistent investment philosophy is essential in order to achieve above-average returns and to guarantee the quality of investment advice in the long term. To achieve these aims, the Cantonal Bank of St.Gallen Group has focused its investment expertise to create an Investment Center with responsibility for all client segments. As of 1 July 2004, this Center has been attached to our Private Banking subsidiary HYPOSWISS and it is headed by its Chief Investment Officer, Dr. Stefan Jäggi (see the interview opposite).

The Investment Center handles all questions related to the investment business. It draws up a uniform investment policy for the whole Group, and defines investment goals that are tailored to the individual requirements of our private and institutional clients. The service provided by the Investment Center is primarily used by our investment advisers, who are guided by the market opinions and investment recommendations provided by the experts, enabling them to offer their clients solutions that match their needs. It remains the case, however, that decisions on investments are still up to the clients themselves. The second purpose of the Investment Center is to take care of the asset management mandates for the entire Group. In this case, the clients (including institutional investors) specify the goals for return and growth, entrusting the investment decisions to the specialists at the Investment Center. They take decisions on individual investments within a framework of clearly stipulated conditions.

Know-how for the whole Group

The Investment Center consists of four teams. The first one is primarily responsible for developing the investment strategy, fund research, lists of recommendations and publications. These include the monthly brochure entitled «Investment Policy» which is available to advisers as well as clients; alongside other information, it contains the cur-

rently recommended securities. The main task of the two «Portfolio Management» teams is to handle the asset management mandates, which (in simple terms) take the form of standard or special mandates, depending on the client's wishes and the size. Finally, there is the Product Center where new products are developed, launched and sold. In particular, these include the Structured Products which are now being successfully used throughout the entire Group. These investment products offer suitable instruments for every market environment, allowing them to be adapted to our clients' individual return/risk profiles.

Value added for clients' assets

Whichever approach our clients choose to take, the emphasis at the SGKB Group is on comprehensive personal service in accordance with clients' particular needs, combined with the expertise of a professional asset management facility – in the Group's investment consulting, asset management and private banking activities alike. The Investment Center guarantees that our investment advisers receive optimal support, enabling them to achieve a sustainable performance for our clients' portfolios.

OUR INVESTMENT CENTER – YOUR BENEFITS

- a consistent and uniform investment policy
- experienced teams with short decision-making pathways
- customised management to meet your individual needs
- ongoing asset management and market analysis
- close contact with first-class research providers
- direct access to global financial centres
- SPPS certification for SGKB Private Banking

› sustainable performance

INTERVIEW

Diversifying risk with sound alternative investments: three questions for Dr. Stefan Jäggi

The Investment Center is based in the premises of our private banking subsidiary HYPOSWISS. So the SGKB Group's investment policy is now controlled from Zurich?

Definitely not. The expertise is concentrated in Zurich, but advice is still provided locally, as it always has been and as befits a Cantonal bank. Furthermore, our approach is not so centralised as to prevent client advisers from voicing their own opinions. Restricting their freedom would mean demoting them to nothing more than sales staff. Nevertheless, the aim is for the recommendations from the Investment Center to be offered from a single source, as far as possible. These should also be promoted with conviction by client advisers throughout the Group. Thanks to HYPOSWISS, the Group has ideal access to the Zurich financial centre, via our own Investment Center. This is where the relevant national and global markets are located, and it is also possible to establish better contacts with other banks here.

What are the characteristic features of the Cantonal Bank of St. Gallen Group's investment policy?

Due to our ideal size, we are able to take advantage of market opportunities that are either too large or too small for other banks. At the same time, we gauge our risks and we protect ourselves against adjustments by backing special alternative investments – and we do not mean Hedge Funds or real estate funds here. Personally speaking, I prefer asset-backed investments in sound companies with clearly understandable business models. Natural resources always have a real counter-value. Oil, gas and metals don't simply vanish into thin air – quite unlike the flights of fancy involving the Internet, for example.

The analysts at the Cantonal Bank of St. Gallen consistently occupy top positions in competitions for model securities accounts. Is there a success formula?

There's no such thing as the perfect investment. On the one hand, shares in gold mines have proven to be successful just recently, because they offer an interesting addition to a securities account – a kind of insurance. On the other hand, equity investments in Austria and Eastern Europe (where the keyword is the Donau Tiger Fund) as well as Russia are also cornerstones. That's because these investments correlate weakly with the leading share markets, so they are able to cushion fluctuating returns. Austria is far more dependent on Eastern Europe than on America, and it usually reports better performance when Western European markets are developing poorly. But I would stress that secondary market commitments of this kind, based on diversification and risk considerations, make up no more than a third of the proportion of shares – the great majority are still invested on the main markets.



Dr. Stefan Jäggi
Head of the Investment Center
HYPOSWISS Zurich

Group Balance Sheet

ASSETS in CHF 000s	June 30, 2004	in %	Dec. 31, 2003	in %	Change	in %
Liquid funds	132 185	0.7	130 816	0.7	1 369	1.0
Receivables from money market instruments	274 583	1.5	285 515	1.5	(10 932)	(3.8)
Due from banks	1 292 511	6.8	1 339 291	7.1	(46 780)	(3.5)
Due from customers	2 623 658	13.9	2 689 118	14.2	(65 460)	(2.4)
Mortgage loans	13 326 919	70.7	13 222 394	69.9	104 525	0.8
Total loans to customers	15 950 577	84.6	15 911 512	84.1	39 065	0.2
Securities and precious metals trading portfolios	21 975	0.1	13 321	0.1	8 654	65.0
Financial investments	723 186	3.8	735 132	3.9	(11 946)	(1.6)
Non-consolidated participations	33 001	0.2	32 723	0.2	278	0.8
Fixed assets	170 256	0.9	181 108	0.9	(10 852)	(6.0)
Intangibles	111 523	0.6	123 262	0.7	(11 739)	(9.5)
Accrued income and prepaid expenses	92 663	0.5	81 683	0.4	10 980	13.4
Other assets	50 198	0.3	78 426	0.4	(28 228)	(36.0)
Total assets	18 852 658	100.0	18 912 789	100.0	(60 131)	(0.3)
Of which:						
– Total subordinated amounts receivable	2 250		4 287		(2 037)	(47.5)
– Total due from non-consolidated participations	91 321		91 870		(549)	(0.6)
– Total due from the Canton of St.Gallen	0		0		0	0.0

LIABILITIES in CHF 000s

Due to money market instruments	205	0.0	254	0.0	(49)	(19.3)
Due to banks	902 614	4.8	1 027 408	5.4	(124 794)	(12.1)
Due to customers in savings and deposits	6 424 665	34.0	6 346 605	33.6	78 060	1.2
Other due to customers	3 092 145	16.4	3 430 296	18.1	(338 151)	(9.9)
Medium-term notes	696 705	3.7	759 405	4.0	(62 700)	(8.3)
Total customer funds	10 213 515	54.1	10 536 306	55.7	(322 791)	(3.1)
Debt and loans secured by mortgages	5 893 983	31.3	5 596 445	29.6	297 538	5.3
Accrued expenses and deferred income	224 338	1.2	191 571	1.0	32 767	17.1
Other liabilities	193 035	1.0	154 059	0.8	38 976	25.3
Valuation adjustments and provisions	219 820	1.2	225 554	1.2	(5 734)	(2.5)
Share capital	502 714	2.7	500 000	2.6	2 714	0.5
Capital reserves	35 349	0.2	6 420	0.0	28 929	450.6
Profit reserves	608 869	3.2	571 465	3.1	37 404	6.5
less treasury shares	(3 324)	0.0	(1 378)	0.0	(1 946)	(141.2)
Group net profit	61 540	0.3	104 685	0.6	(43 145)	(41.2)
Total shareholders' equity	1 205 148	6.4	1 181 192	6.3	23 956	2.0
Total liabilities	18 852 658	100.0	18 912 789	100.0	(60 131)	(0.3)
Of which:						
– Total subordinated amounts payable	260 000		260 000		0	0.0
– Total due to non-consolidated participations	1 181 576		1 447 580		(266 004)	(18.4)
– Total due to the Canton of St.Gallen	88 531		239 393		(150 862)	(63.0)

OFF-BALANCE-SHEET TRANSACTIONS in CHF 000s

Contingent liabilities	161 617		212 198		(50 581)	(23.8)
Irrevocable commitments	119 006		99 576		19 430	19.5
Liabilities for calls on shares and other equities	40 411		40 394		17	0.0
Derivative financial instruments:						
– Contract volume	5 103 318		4 590 246		513 072	11.2
– Positive replacement values	27 651		52 611		(24 960)	(47.4)
– Negative replacement values	58 460		73 299		(14 839)	(20.2)
Fiduciary transactions	1 369 709		1 397 712		(28 003)	(2.0)

Group Income Statement

in CHF 000s	June 30, 2004	June 30, 2003	Change	in %
Interest and discount income	256 780	286 335	(29 555)	(10.3)
Interest and dividend income on trading portfolios	85	259	(174)	(67.2)
Interest and dividend income on financial investments	9 765	10 806	(1 041)	(9.6)
Interest expenses	(133 530)	(147 511)	13 981	9.5
Net interest income	133 100	149 889	(16 789)	(11.2)
Commission income from lending activities	845	919	(74)	(8.1)
Commission income from securities and investment activities	72 756	57 371	15 385	26.8
Commission income from other service fee activities	8 933	8 364	569	6.8
Commission expenses	(3 713)	(2 426)	(1 287)	(53.1)
Net fee and commission income	78 821	64 228	14 593	22.7
Net trading income	15 223	11 925	3 298	27.7
Results from the sale of financial investments	917	3 459	(2 542)	(73.5)
Income from non-consolidated participations	981	688	293	42.6
Results from real estate	1 373	1 698	(325)	(19.1)
Other ordinary results	1 327	1 825	(498)	(27.3)
Other ordinary expenses	(1 506)	(1 926)	420	21.8
Net other income	3 092	5 744	(2 652)	(46.2)
Operating income	230 236	231 786	(1 550)	(0.7)
Personnel expenses	(62 997)	(67 783)	4 786	7.1
Other operating expenses	(56 699)	(56 035)	(664)	(1.2)
Administrative expenses	(119 696)	(123 818)	4 122	3.3
Gross profit	110 540	107 968	2 572	2.4
Depreciation and write-offs on fixed assets and participations	(7 651)	(6 913)	(738)	(10.7)
Depreciation of intangibles	(11 739)	(11 739)	0	0.0
Valuation adjustments, provisions and losses	(12 841)	(13 007)	166	1.3
Operating profit (interim result)	78 309	76 309	2 000	2.6
Extraordinary income	1 691	2 063	(372)	(18.0)
Taxes	(18 460)	(18 139)	(321)	(1.8)
Group net profit	61 540	60 233	1 307	2.2

Divisional Accounts

in CHF 000s	Retail and commercial banking		Private Banking		Corporate Center		Group	
	2004	Change	2004	Change	2004	Change	2004	Change
Operating income	125 413	(7.6%)	79 235	26.8%	25 588	(23.8%)	230 236	(0.7%)
Administrative expenses	(74 998)	5.8%	(36 255)	4.4%	(8 443)	(34.6%)	(119 696)	3.3%
Gross profit	50 415	(10.1%)	42 980	75.0%	17 145	(37.2%)	110 540	2.4%
Depreciation and write-offs on fixed assets and intangibles	0	0.0%	(2 134)	(17.2%)	(17 256)	(2.5%)	(19 390)	(4.0%)
Valuation adjustments, provisions and losses	(12 428)	0.7%	(173)	46.8%	(240)	(43.7%)	(12 841)	1.3%
Operating profit (interim result)	37 987	(12.8%)	40 673	81.5%	(351)	(103.4%)	78 309	2.6%
Extraordinary income, net	0	0.0%	0	0.0%	1 691	(18.0%)	1 691	(18.0%)
Taxes	(6 389)	(5.3%)	(8 362)	(57.7%)	(3 709)	45.2%	(18 460)	(1.8%)
Group net profit	31 598	(15.8%)	32 311	88.8%	(2 369)	(142.2%)	61 540	2.2%
Other data								
Funds under Management ¹	8 191 097	0.2%	17 987 010	4.9%	(1 000)	0.0%	26 177 107	3.4%
Headcount ^{1,2}	483	(2.8%)	215	(4.0%)	272	(3.5%)	970	(3.3%)

Notes:

¹ Changes in percent of other data refer to December 31, 2003

² Full-time equivalents; apprentices calculated at 50%

The divisional accounts include the following changes compared to the prior year:

- Due to the integration of St. Galler Vermögensberatung into the parent company (SGKB), the private banking activities of HYPOSWISS and SGKB are compiled in the segment Private Banking.

- The interest structure contribution from the interest rate curve is now shown in the corporate center whereas it was included in the retail and commercial banking segment in the prior year.

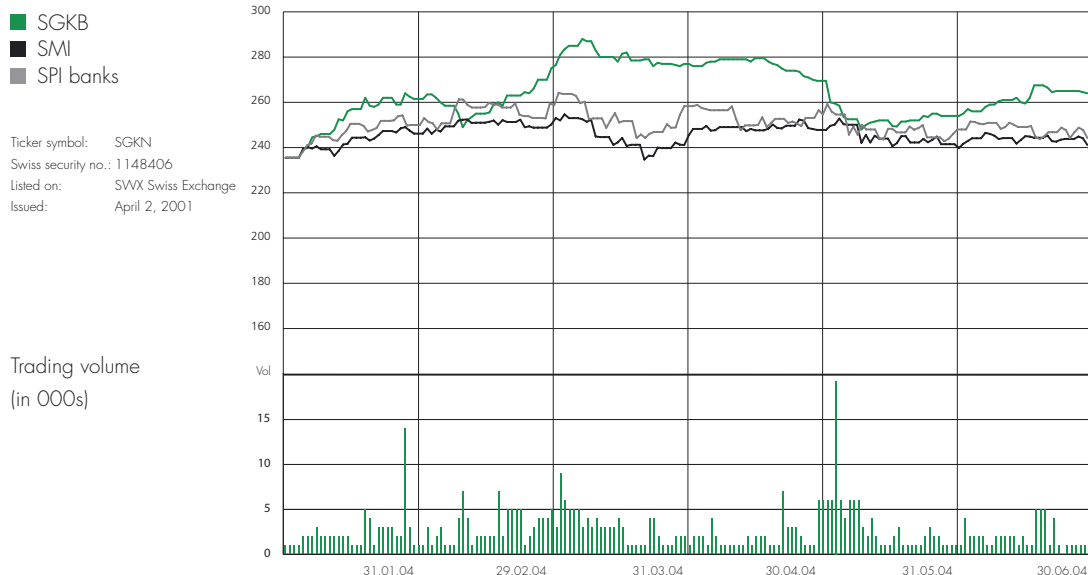
- Certain minor modifications have been made to the internal cost allocation between segments.

All figures of the prior year have been restated accordingly.

Information for investors

PRICE DEVELOPMENT

The price of SGKB shares performed very well in comparison with the Swiss market as a whole. The value of our stock improved by 63.8% between the first day of listing (April 2, 2001) and June 30, 2004.



JUNE 30, 2004

Earnings per share	CHF 12.24
Dividend per share	CHF 8.50 ¹
Total shares issued	5 027 139 (Floating 1 971 578)
Time-weighted number of dividend-bearing shares	4 993 121
Number of shares held by SGKB (ave.)	14 286
Shareholders	23 641
Issue price (IPO)	CHF 160.00
Market price	CHF 262.00
Market capitalization	CHF 1 317.1 million
Ratio of market capitalization/shareholders' equity	109.3%
Return on equity (basis: operating profit)	13.4%
Reported shareholders' equity	CHF 1 205.1 million
Dividend yield	3.2%
Price-earnings ratio	10.7 x (annualized)
Payout ratio	34.7% (annualized)

¹ For the financial year ended as of December 31, 2003.

KEY DATES

General Meeting	April 20, 2005
Publication of annual results	February 17, 2005
Media conference	February 17, 2005

CONTACT

Investor Relations, Dr. Cornelia Gut-Villa
St. Leonhardstrasse 25, CH-9001 St. Gallen
phone ++41 (0)71 231 36 92
fax ++41 (0)71 231 37 94
e-mail cornelia.gut@sgkb.ch