



Dear Shareholders

Do you remember our last Annual General Meeting? At that time, our outlook going forward was extremely optimistic given that the Cantonal Bank of St. Gallen (SGKB) had recorded a very strong start to the year and we were anticipating an ongoing economic recovery. Now, at mid-year, those expectations have proven correct and we have yet again been able to improve on our performance in the prior year. Thus we have completed another chapter in the successful history of the SGKB – in the same way as we have continued our series of highly memorable Annual General Meetings. Every year, by inviting a specific region to host the social aspect of the event, we have underlined our proximity to our market, the cantons of St. Gallen and Appenzell Ausser rhoden. We thank you for your loyalty and the trust you place in the SGKB.

Dr. Franz Peter Oesch
Chairman of the Board of Directors

Dr. Urs Rügsegger
CEO



**St. Galler
Kantonalbank**

REVIEW AND PROSPECTS

Outstanding results for the first half of 2006

The Cantonal Bank of St. Gallen (SGKB) recorded extremely successful results for the first half of 2006. For the first time in its history, the Group reported a half-year result in excess of CHF 100 million. The pre-tax return on equity was 17.5%. Year-on-year earnings increased across the board in all of the bank's business activities, while costs remained close to their 2005 levels, thereby reflecting the productivity gains achieved by the bank in recent years. As a result, gross profit, operating profit and group net profit all increased significantly. In addition, the first half of the year was marked by the renovation of the bank's head office in St. Gallen and by preparations for the introduction of the new Avaloq IT system.

Group net profit once again at record levels

The bank's earnings in the first half of 2006 were extremely pleasing. The SGKB Group recorded an operating income of CHF 276.1 million, representing a substantial improvement on the prior year. The major contributor to this advance was the bank's net fee and commission income, which increased from CHF 90.8 million to CHF 100.2 million. These business activities benefited from the extremely positive sentiment on the share markets during the first few months of the period under review. In addition, net interest income also increased.

The 2.1% increase in administrative expenses can be primarily attributed to personnel expenses, which increased by CHF 2.9 million (4.2%) during the period under review. In addition, other operating expenses were impacted for the first time in the first half of 2006 by the forthcoming migration of the bank's IT platform to the new Avaloq system in 2007/2008. However, this was offset by the release, as extraordinary income, of a proportion of the reserves formed in previous years. Group net profit will thus not be affected by the IT migration project. Excluding these project costs, operating profit would have amounted to CHF 137.9 million, while the

cost/income-ratio would have improved to an excellent value of 45.2%.

Gross profit advanced by a pleasing 7.9% from CHF 143.0 million to CHF 154.3 million (+CHF 11.3 million). Due to the ongoing low level of required provisions for credit risks, the bank's operating profit increased from CHF 117.8 million to CHF 135.1 million. Group net profit advanced by CHF 31.6 million to CHF 112.4 million. This increase of 39.1% can be attributed – alongside the improvement in the bank's operating result – to the absence in 2006 of the project reserves formed in the prior year.

Significant growth of business in force

Thanks to intensive market cultivation, the bank was able to increase loans to customers in the first half of the year by CHF 418.0 million to CHF 16.9 billion. The economic upswing has also been reflected in the significant growth in loan volumes to corporate customers. Following a decline in the prior year, a positive advance of 2.1% was recorded in the period under review. The positive economic outlook prompted companies to increase investment spending, with an attendant decline in the extraordinary amortisation of loans. These growth rates are all the more pleasing given that the quality of the bank's credit portfolio is extremely good, resulting in a very low level of value adjustments.

Funds under management recorded a very pleasing increase to CHF 33.3 billion, of which net new money accounted for CHF 2.4 billion.

Positive outlook

Despite the correction witnessed recently on the equity markets, the Board of Directors and the Executive Board assess the economic outlook for the second half of the year as positive. Based on a stabilisation and only a marginal increase in interest rates, the SGKB Group anticipates that its operating profit for 2006 will be at least in line with the prior-year result. Due to the absence of amounts set aside for reserves, group net profit will be substantially higher than in the prior year.

About the front cover
Welcome! Antonia Fässler,
of the St. Gallen branch's Corporate Customer Unit, was
one of some 200 employees of
the Cantonal Bank of St. Gallen
whose efforts ensured the
success of the 2006 Annual
General Meeting.

(Photography: Donato Caspari, St. Gallen)

Group Key Figures

INCOME STATEMENT in CHF 000s	June 30, 2006	June 30, 2005	June 30, 2004
Operating income	276 139	262 323	230 236
Administrative expenses	(121 886)	(119 367)	(119 696)
Operating profit (interim result)	135 065	117 809	78 309
Group net profit	112 354	80 761	61 540
SGKB SHARE in CHF			
Earnings per share	20.23	15.54	12.24
Dividend paid out	13.00	9.00	8.50
Share price as at June 30	420.00	322.00	262.00
Stock market capitalisation as at June 30 (in CHF million)	2 340.84	1 794.64	1 317.10
KEY FIGURES			
Return on equity, pre-tax (basis: operating profit)	17.5%	17.2%	13.4%
Return on equity, after tax (basis: group net profit)	14.6%	11.8%	10.5%
Cost/income-ratio including depreciation on fixed assets	46.2%	48.4%	55.1%
BALANCE SHEET in CHF 000s			
Loans to customers	16 853 833	16 435 880	16 002 915
Customer funds	11 217 775	10 959 905	10 332 968
Balance sheet total	19 396 600	19 117 331	18 553 653
Shareholders' equity	1 594 159	1 561 681	1 308 764
EQUITY KEY FIGURES			
BIS ratio tier 1	13.3%	13.5%	11.3%
BIS ratio tier 2	14.3%	14.5%	12.7%
Excess capital ratio (CH standard)	73.6%	75.9%	52.5%
Shareholders' equity in % of balance sheet total	8.2%	8.2%	7.0%
FUNDS UNDER MANAGEMENT in CHF 000s			
Funds under management	33 301 693	30 768 851	26 482 420
HEADCOUNT			
Full-time equivalents ¹	957	957	967
MOODY'S RATING			
Senior unsecured domestic currency	Aa1	Aa1	Aa1
Bank deposits	Aa1/P-1	Aa1/P-1	Aa1/P-1
Bank financial strength	B	B	B

¹ Apprentices calculated at 50%

ANNUAL GENERAL MEETING 2006

For the fifth time, the Cantonal Bank of St. Gallen (SGKB) invited its shareholders to the OLMA Centre for its Annual General Meeting (AGM). In accordance with tradition, the social part of the programme was hosted by a region from the bank's market area with the staging of a spectacular show, accompanied by an array of culinary delights. This year's event was hosted by the Appenzellerland region. And not without reason, as the SGKB operates two branches, Herisau and Teufen, in the Canton of Appenzell Ausserrhoden. As fate would have it, the day of the AGM marked, almost to the day, the tenth anniversary of the venue, located in the canton's capital – a fact that lent additional significance to the «Appenzeller Annual General Meeting».

Facts and figures

Close to 4000 shareholders, many of them from the host region, took part in this year's Annual General Meeting. Over 5% of the bank's shareholders reside in the Appenzell region.

On a gigantic market square measuring a good 7400 square metres, over 30 artists, clubs and sporting, cultural and business groups staged a remarkable event, ensuring that the Appenzellerland region presented itself in spectacular fashion. Behind the scenes, almost 200 of the bank's employees ensured the evening's success with their efforts during the five-hour event.



INTERVIEW

Four questions to Roland Ledergerber, Member of the Executive Board, Head Retail and Commercial Banking

What was your impression of the performance by the host region of Appenzellerland at the Annual General Meeting?

In a very engaging manner, the Appenzellerland region successfully presented its great variety and tradition. For me, the unique essence of Appenzellerland is derived from the combination of the region's cultural creativity, physical beauty and social independence. In addition, the businesses represented in the market square were a reminder of the economic vitality of the Appenzell region.

Of what significance is the Annual General Meeting to the Cantonal Bank of St.Gallen?

First let me say that the Annual General Meeting (AGM) represents the bank's highest executive body according to stock corporation law. For us, however, the AGM is of far greater significance. With the social part of the programme, which immediately follows the formal AGM, we primarily pursue three goals. First, we aim to provide a platform where people can meet and converse with one another, thereby cultivating important relationships; in short, a place where people can feel completely at home. Second, we endeavour to demonstrate our solid roots in and firm commitment to our domestic markets of St.Gallen and Appenzell Ausserrhoden. To this end, we invite a different region to host the event each year. Finally, the AGM affords us an opportunity to express our sincere gratitude to our shareholders and customers for the loyalty and trust that they have placed in the Cantonal Bank of St.Gallen (SGKB).

For 10 years, the Cantonal Bank of St.Gallen has had a presence in Herisau. Last year, the bank opened a second branch in Teufen. What experiences have you made in Appenzell Ausserrhoden?

We are extremely happy with the developments in Herisau and Teufen. The SGKB has received a very warm reception. It is evident that we fulfil a particular requirement on the part of our customers for a high level of professionalism coupled with an emotional bond and an amicable proximity to the public.

The Canton Appenzell Ausserrhoden is a vital economic region with very close ties to St.Gallen. To what extent does this create synergies with your centre of operations and are there any further expansion plans on the agenda?

Yes, there is an obvious connection there – economically, socially and culturally. Naturally, the same is also true of us as a bank: via our branch offices in Herisau and Teufen, we have a direct presence on the market and are able to maintain close proximity to our customers. At the same time, in an uncomplicated and prompt manner, we are able to draw upon the expert competence of our specialists across the entire SGKB Group, including HYPOSWISS, as well as on our complete range of products and services. Market proximity, agility and competence are important competitive advantages that set us apart from other institutions. In terms of our plans for the future, I can reveal that the bank could readily envisage further expansion.



Roland Ledergerber
Head Retail and Commercial Banking

Group Balance Sheet

ASSETS in CHF 000s	June 30, 2006	in %	Dec. 31, 2005	in %	Change	in %
Liquid funds	195 613	1.0	119 350	0.6	76 263	63.9
Receivables from money market instruments	341 221	1.8	343 071	1.8	(1 850)	(0.5)
Due from banks	887 919	4.6	1 011 850	5.3	(123 931)	(12.2)
Due from customers	2 652 881	13.7	2 502 392	13.1	150 489	6.0
Mortgage loans	14 200 952	73.2	13 933 488	72.9	267 464	1.9
<i>Total loans to customers</i>	<i>16 853 833</i>	<i>86.9</i>	<i>16 435 880</i>	<i>86.0</i>	<i>417 953</i>	<i>2.5</i>
Securities and precious metals trading portfolios	29 780	0.1	48 994	0.3	(19 214)	(39.2)
Financial investments	678 626	3.5	699 815	3.7	(21 189)	(3.0)
Non-consolidated participations	21 216	0.1	21 213	0.1	3	0.0
Fixed assets	163 429	0.8	156 938	0.8	6 491	4.1
Intangibles	67 923	0.4	76 305	0.4	(8 382)	(11.0)
Accrued income and prepaid expenses	93 177	0.5	84 400	0.4	8 777	10.4
Other assets	63 863	0.3	119 515	0.6	(55 652)	(46.6)
Total assets	19 396 600	100.0	19 117 331	100.0	279 269	1.5
Of which:						
– Total subordinated amounts receivable	1 575		1 575		0	0.0
– Total due from non-consolidated participations	128 946		128 150		796	0.6
– Total due from the Canton of St.Gallen	0		0		0	0.0

LIABILITIES in CHF 000s

Due to money market instruments	256	0.0	206	0.0	50	24.3
Due to banks	922 756	4.8	822 460	4.3	100 296	12.2
Due to customers in savings and deposits	6 277 645	32.3	6 523 200	34.1	(245 555)	(3.8)
Other due to customers	4 282 549	22.1	3 818 579	20.0	463 970	12.2
Medium-term notes	657 581	3.4	618 126	3.2	39 455	6.4
<i>Total customer funds</i>	<i>11 217 775</i>	<i>57.8</i>	<i>10 959 905</i>	<i>57.3</i>	<i>257 870</i>	<i>2.4</i>
Debt and loans secured by mortgages	5 116 545	26.4	5 263 935	27.5	(147 390)	(2.8)
Accrued expenses and deferred income	186 553	1.0	180 446	0.9	6 107	3.4
Other liabilities	164 382	0.8	128 739	0.7	35 643	27.7
Valuation adjustments and provisions	194 174	1.0	199 959	1.1	(5 785)	(2.9)
Reserves for general banking risks	58 140	0.3	61 000	0.3	(2 860)	(4.7)
Share capital	557 343	2.9	557 343	2.9	0	0.0
Capital reserve	82 921	0.4	82 810	0.4	111	0.1
Profit reserve	797 752	4.1	702 155	3.7	95 597	13.6
less treasury shares	(14 351)	(0.1)	(9 929)	0.0	(4 422)	(44.5)
Group net profit	112 354	0.6	168 302	0.9	(55 948)	(33.2)
<i>Total shareholders' equity</i>	<i>1 594 159</i>	<i>8.2</i>	<i>1 561 681</i>	<i>8.2</i>	<i>32 478</i>	<i>2.1</i>
Total liabilities	19 396 600	100.0	19 117 331	100.0	279 269	1.5
Of which:						
– Total subordinated amounts payable	260 000		260 000		0	0.0
– Total due to non-consolidated participations	1 159 045		1 176 938		(17 893)	(1.5)
– Total due to the Canton of St.Gallen	293 724		377 856		(84 132)	(22.3)

OFF-BALANCE-SHEET TRANSACTIONS in CHF 000s

Contingent liabilities	312 996		286 021		26 975	9.4
Irrevocable commitments	145 045		175 943		(30 898)	(17.6)
Liabilities for calls on shares and other equities	40 411		40 411		0	0.0
Derivative financial instruments:						
– Contract volume	5 614 193		5 136 411		477 782	9.3
– Positive replacement values	37 248		69 784		(32 536)	(46.6)
– Negative replacement values	50 964		35 860		15 104	42.1
Fiduciary transactions	4 419 169		2 131 622		2 287 547	107.3

Group Income Statement

in CHF 000s	June 30, 2006	June 30, 2005	Change	in %
Interest and discount income	271 643	266 323	5 320	2.0
Interest and dividend income on trading portfolios	348	475	(127)	(26.7)
Interest and dividend income on financial investments	9 678	9 777	(99)	(1.0)
Interest expenses	(128 392)	(127 537)	(855)	(0.7)
<i>Net interest income</i>	<i>153 277</i>	<i>149 038</i>	<i>4 239</i>	<i>2.8</i>
Commission income from lending activities	1 081	773	308	39.8
Commission income from securities and investment activities	93 961	85 063	8 898	10.5
Commission income from other service fee activities	9 261	8 965	296	3.3
Commission expenses	(4 121)	(3 960)	(161)	(4.1)
<i>Net fee and commission income</i>	<i>100 182</i>	<i>90 841</i>	<i>9 341</i>	<i>10.3</i>
<i>Net trading income</i>	<i>17 835</i>	<i>19 239</i>	<i>(1 404)</i>	<i>(7.3)</i>
Results from the sale of financial investments	1 199	1 651	(452)	(27.4)
Income from non-consolidated participations	1 154	979	175	17.9
Results from real estate	1 136	795	341	42.9
Other ordinary income	1 956	2 323	(367)	(15.8)
Other ordinary expenses	(600)	(2 543)	1 943	76.4
<i>Net other income</i>	<i>4 845</i>	<i>3 205</i>	<i>1 640</i>	<i>51.2</i>
Operating income	276 139	262 323	13 816	5.3
Personnel expenses	(71 985)	(69 112)	(2 873)	(4.2)
Other operating expenses	(49 901)	(50 255)	354	0.7
<i>Administrative expenses</i>	<i>(121 886)</i>	<i>(119 367)</i>	<i>(2 519)</i>	<i>(2.1)</i>
Gross profit	154 253	142 956	11 297	7.9
Depreciation and write-offs on fixed assets and participations	(5 891)	(8 119)	2 228	27.4
Depreciation of intangibles	(12 219)	(11 739)	(480)	(4.1)
Valuation adjustments, provisions and losses	(1 078)	(5 289)	4 211	79.6
Operating profit (interim result)	135 065	117 809	17 256	14.6
Extraordinary income	3 441	69	3 372	4 887.0
<i>of which release of reserves for general banking risks</i>	<i>2 860</i>	<i>0</i>	<i>2 860</i>	<i>100.0</i>
Extraordinary expenses	(2)	(13 001)	12 999	100.0
<i>of which creation of reserves for general banking risks</i>	<i>0</i>	<i>(13 000)</i>	<i>13 000</i>	<i>100.0</i>
Group profit before taxes	138 504	104 877	33 627	32.1
Taxes	(26 150)	(24 116)	(2 034)	(8.4)
Group net profit	112 354	80 761	31 593	39.1

Divisional Accounts

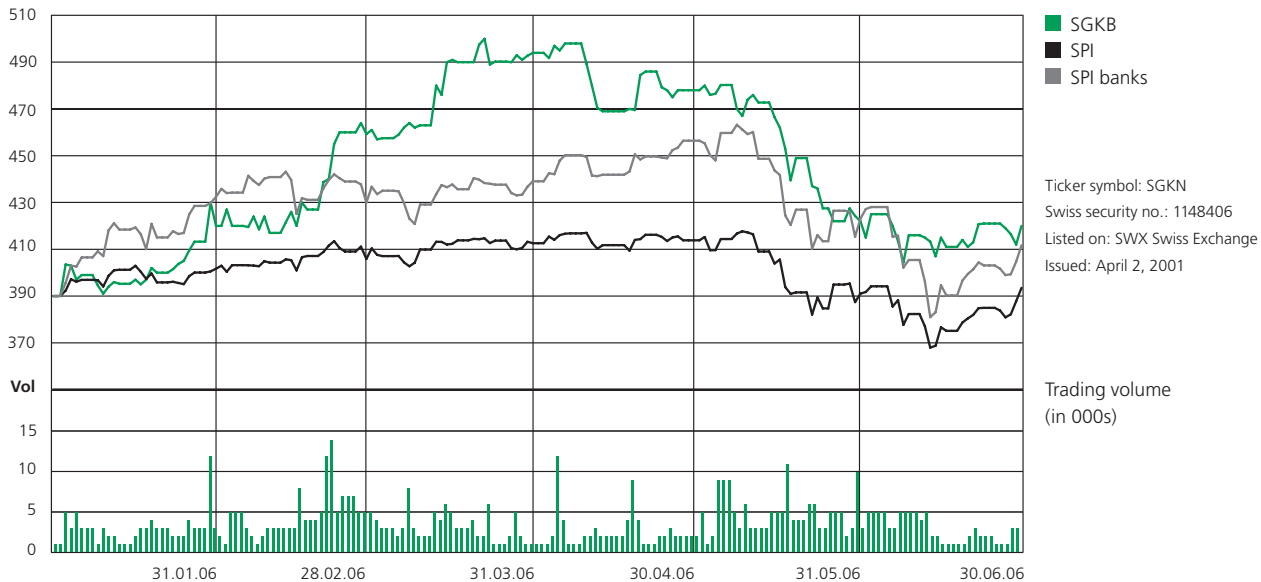
in CHF 000s	Retail and commercial banking		Private Banking		Corporate Centre		Group	
	June 30, 06	June 30, 05	June 30, 06	June 30, 05	June 30, 06	June 30, 05	June 30, 06	June 30, 05
<i>Operating income</i>	<i>138 147</i>	<i>129 831</i>	<i>109 867</i>	<i>94 021</i>	<i>28 125</i>	<i>38 471</i>	<i>276 139</i>	<i>262 323</i>
<i>Administrative expenses</i>	<i>(68 606)</i>	<i>(69 306)</i>	<i>(41 456)</i>	<i>(40 419)</i>	<i>(11 824)</i>	<i>(9 642)</i>	<i>(121 886)</i>	<i>(119 367)</i>
<i>Gross profit</i>	<i>69 541</i>	<i>60 525</i>	<i>68 411</i>	<i>53 602</i>	<i>16 301</i>	<i>28 829</i>	<i>154 253</i>	<i>142 956</i>
Depreciation and write-offs on fixed assets and intangibles	0	0	(596)	(2 272)	(17 514)	(17 586)	(18 110)	(19 858)
Valuation adjustments, provisions and losses	(731)	(5 052)	(156)	(68)	(191)	(169)	(1 078)	(5 289)
<i>Operating profit (interim result)</i>	<i>68 810</i>	<i>55 473</i>	<i>67 659</i>	<i>51 262</i>	<i>(1 404)</i>	<i>11 074</i>	<i>135 065</i>	<i>117 809</i>
Extraordinary income, net	0	0	1 180	0	2 259	(12 932)	3 439	(12 932)
Taxes	(10 211)	(9 910)	(12 160)	(10 121)	(3 779)	(4 085)	(26 150)	(24 116)
<i>Group net profit</i>	<i>58 599</i>	<i>45 563</i>	<i>56 679</i>	<i>41 141</i>	<i>(2 924)</i>	<i>(5 943)</i>	<i>112 354</i>	<i>80 761</i>
Cost/income-ratio	49.7%	53.4%	38.3%	45.4%	n/a	n/a	46.2%	48.4%
<i>Other data</i>	<i>June 30, 06</i>	<i>Dec. 31, 05</i>	<i>June 30, 06</i>	<i>Dec. 31, 05</i>	<i>June 30, 06</i>	<i>Dec. 31, 05</i>	<i>June 30, 06</i>	<i>Dec. 31, 05</i>
Loans to customers	15 332 969	15 025 711	1 520 864	1 410 169	0	0	16 853 833	16 435 880
Customer funds	8 073 983	7 900 946	3 143 792	3 058 959	0	0	11 217 775	10 959 905
Funds under management	9 043 742	8 961 172	24 257 951	21 807 679	0	0	33 301 693	30 768 851
Headcount (in accordance with RRV-EBK) ¹	481	486	217	217	259	254	957	957

¹ Full-time equivalents; apprentices calculated at 50%

Information for investors

PRICE DEVELOPMENT

In overall terms, the SGKB share price developed positively during the past year. From 1 January to 30 June 2006 the value of the share rose by 7.7%.



SHARE STATISTICS

JUNE 30, 2006

Earnings per share	CHF 20.23
Dividend per share	CHF 13.00 ¹
Total shares issued	5 573 426 (Floating 2 429 750)
Time-weighted number of dividend-bearing shares	5 552 640
Number of shares held by SGKB (ave.)	20 786
Shareholders	26 211
Issue price (IPO)	CHF 160.00
Market price	CHF 420.00
– Lowest price in the first half of 2006	CHF 390.00
– Highest price in the first half of 2006	CHF 500.00
Market capitalisation	CHF 2 340.8 million
Ratio of market capitalisation/ shareholders' equity	146.8%
Return on equity (basis: operating profit)	17.5% (annualised)
Reported shareholders' equity	CHF 1 594.2 million
Dividend yield	3.1%
Price-earnings ratio	10.38 x (annualised)

¹ For the financial year ended as of December 31, 2005.

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IMPORTANT INFORMATION SOURCES

	Frequency
Annual conference for media/analysts	annual
Annual report (German)	annual
Annual report (English)	annual
Shareholders' Meeting	annual
Interim report (newsletter to shareholders)	annual
Interim conference for media/analysts	annual
Newsletter to shareholders in German and English	semi-annual
Press releases	as required
www.sgkb.ch	ongoing

For current publication and event dates, see www.sgkb.ch