

# St.Galler Kantonalbank

## Half Year Results June 30, 2012

August 15, 2012

# Agenda

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## Results June 30, 2012

Focus mortgage market

Outlook

## Overview: Encouraging interest business

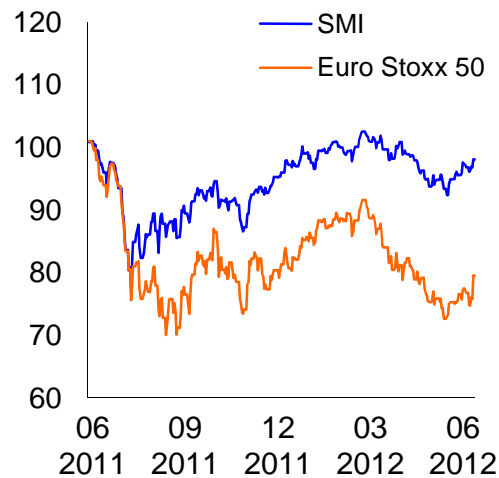
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- Gross profit 5.9% over previous year
- Interest income is a major pillar
- Operating expenses reduced by 1.7%
- Volume growth in home market
- Sound capitalization

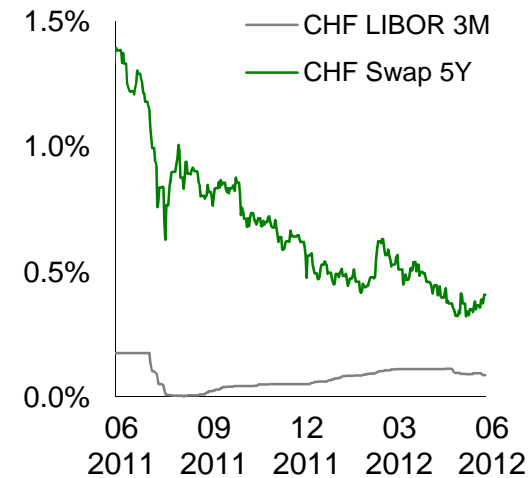
# Uneven markets and continued flattening interest rate curve

## Market Performance 2012

indexed June 30, 2011

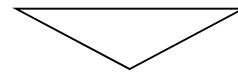
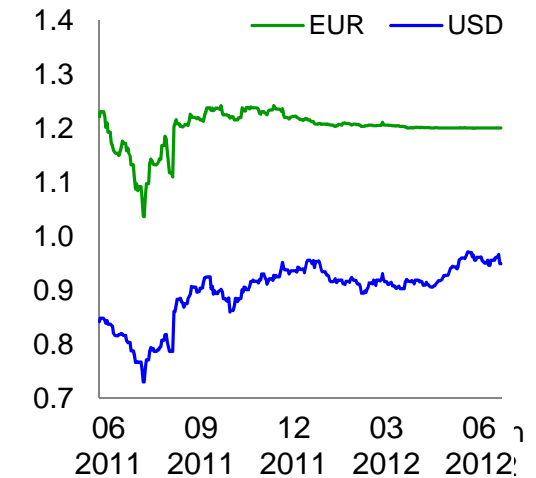


## Interest Rates 2012



## Exchange Rates 2012

indexed June 30, 2011



## Swiss economy: weaker growth in 2012

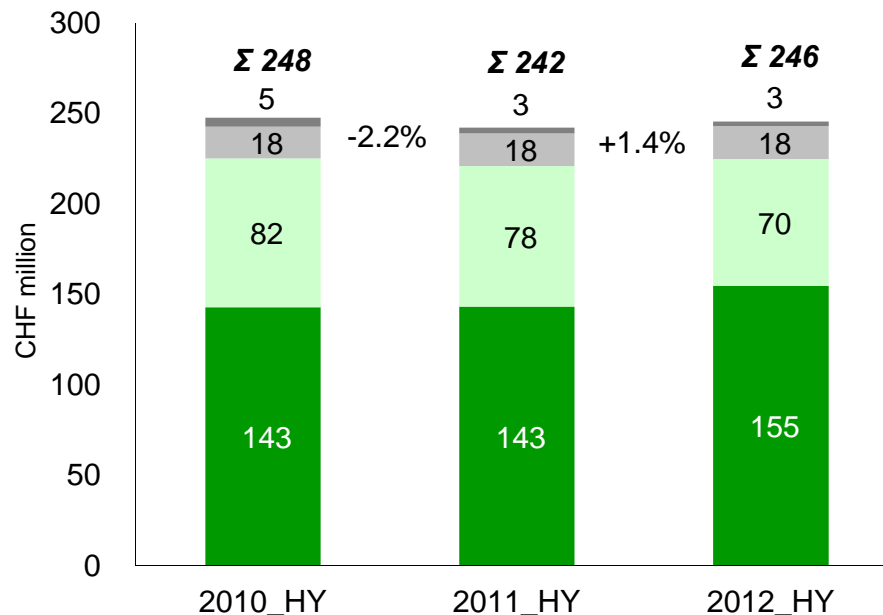
- GDP growth 1.4%
- Unemployment rate 3.2%
- Inflation -0.4%

Estimation seco June 12, 2012

## Gross profit 5.9 % over previous year

CHF million	2010_HY	△	2011_HY	△	2012_HY
Operating income	248	-2.2 %	242	1.4 %	<b>246</b>
Administrative expenses	-141	0.1 %	-141	-1.7 %	<b>-139</b>
Gross profit	106	-5.4 %	101	5.9 %	<b>107</b>
Depreciation	-18	-17.7 %	-14	8.8 %	<b>-16</b>
Valuation adjustments, provisions and losses	-2	-55.1 %	-1	-43.5 %	<b>-1</b>
Operating profit	87	-1.7 %	85	5.9 %	<b>90</b>
Extraordinary amounts, net	0	-	4	-84.9 %	<b>1</b>
Profit before taxes	87	3.4 %	90	1.5 %	<b>91</b>
Taxes	-17	1.2 %	-17	7.5 %	<b>-18</b>
Group net profit	70	3.9 %	73	0.1 %	<b>73</b>

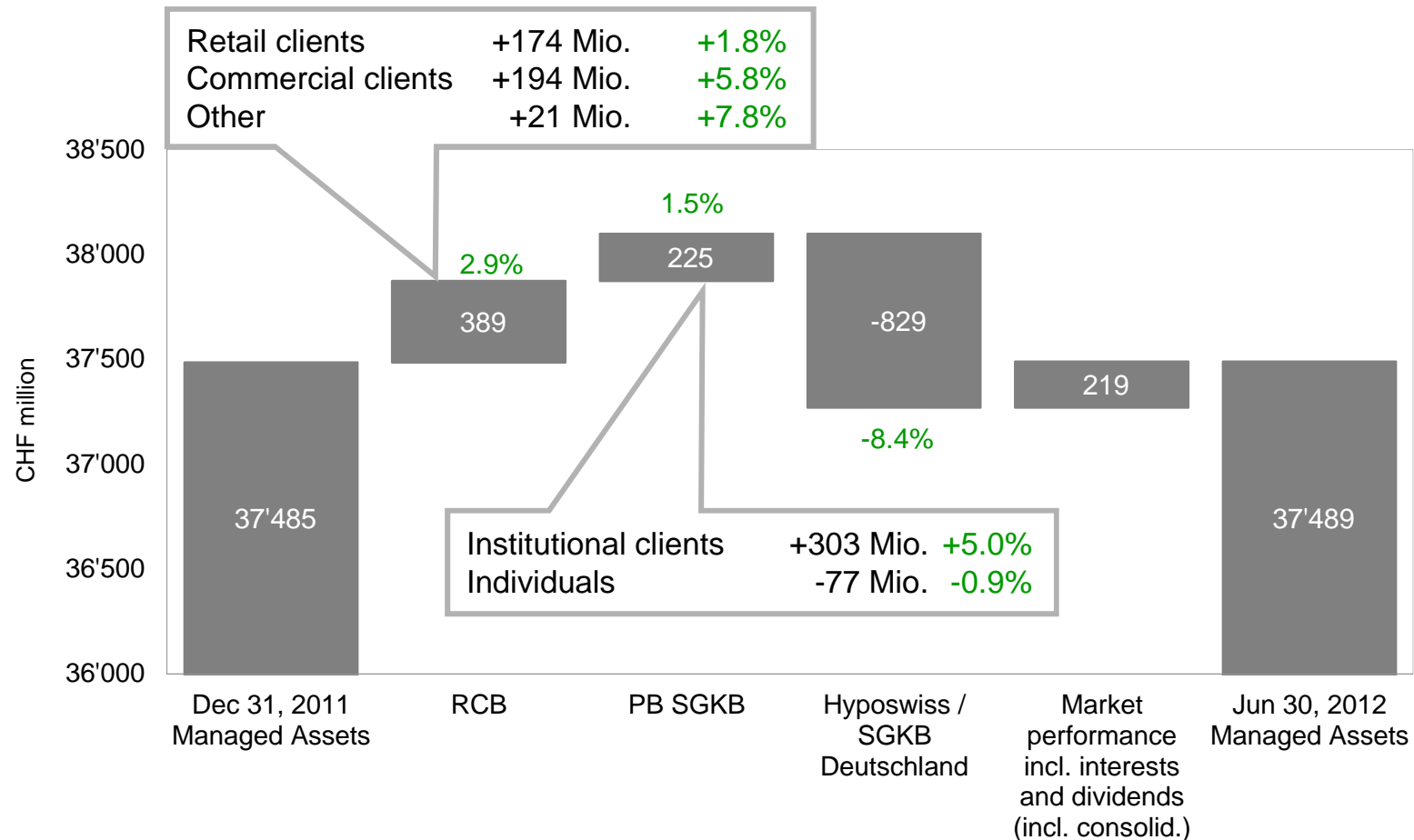
# Operating income increased due to interest income



- Other income
- Trading income
- Net fee and commission income
- Net interest income

- Strong interest business (+8.1%) due to higher loans to clients and customer funds as well as market driven lower cost for interest rate hedging.
- High liquidity and restraint among investors lead to lower income from commission and service (-9.8%).
- Stable trading business (+0.6%).

# Net New Money: Strong inflows in the home market



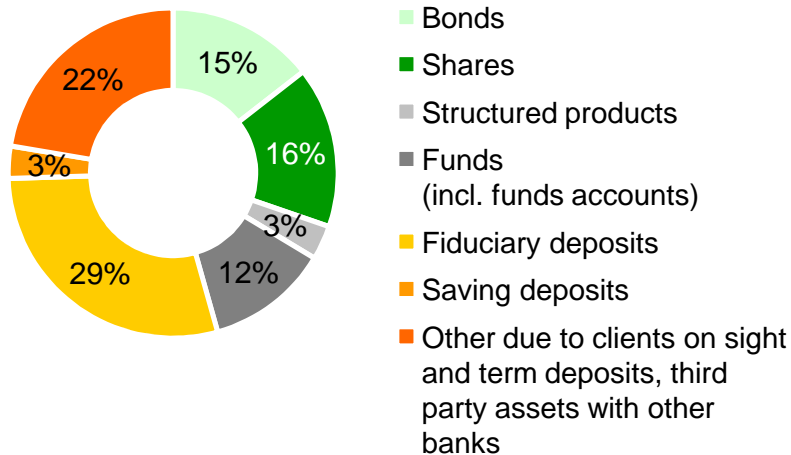
NNM Group CHF -215 million = Sum RCB + PB SGKB + Hyposwiss + SGKB Deutschland + consolidation effect (-0.4 million)

All %-numbers relate to the change in the corresponding prior year market segment amounts

# Fee and commission income: Stable AuM margin

## Asset Allocation of Clients Assets

Total 37.5 billion



### ■ Asset Allocation:

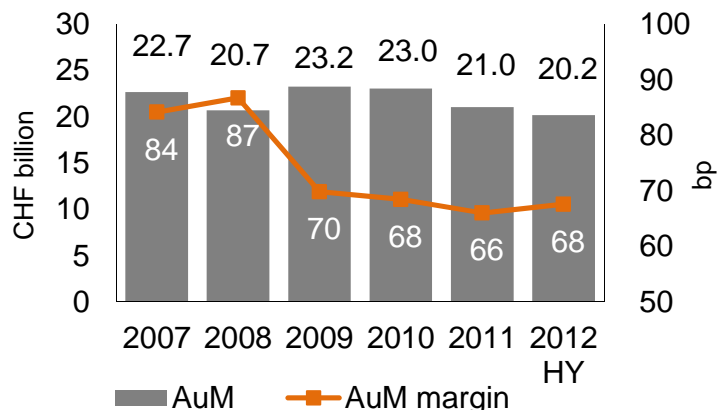
- Decline AuM by 4.2% since 1.1.2012
- No shifts into AuM
- High liquidity

### ■ AuM Margin:

- With 68bp stabilized on low level
- Risk aversion of clients
- Low trading activities

### ■ Net fee and commission income declined by 9.8%

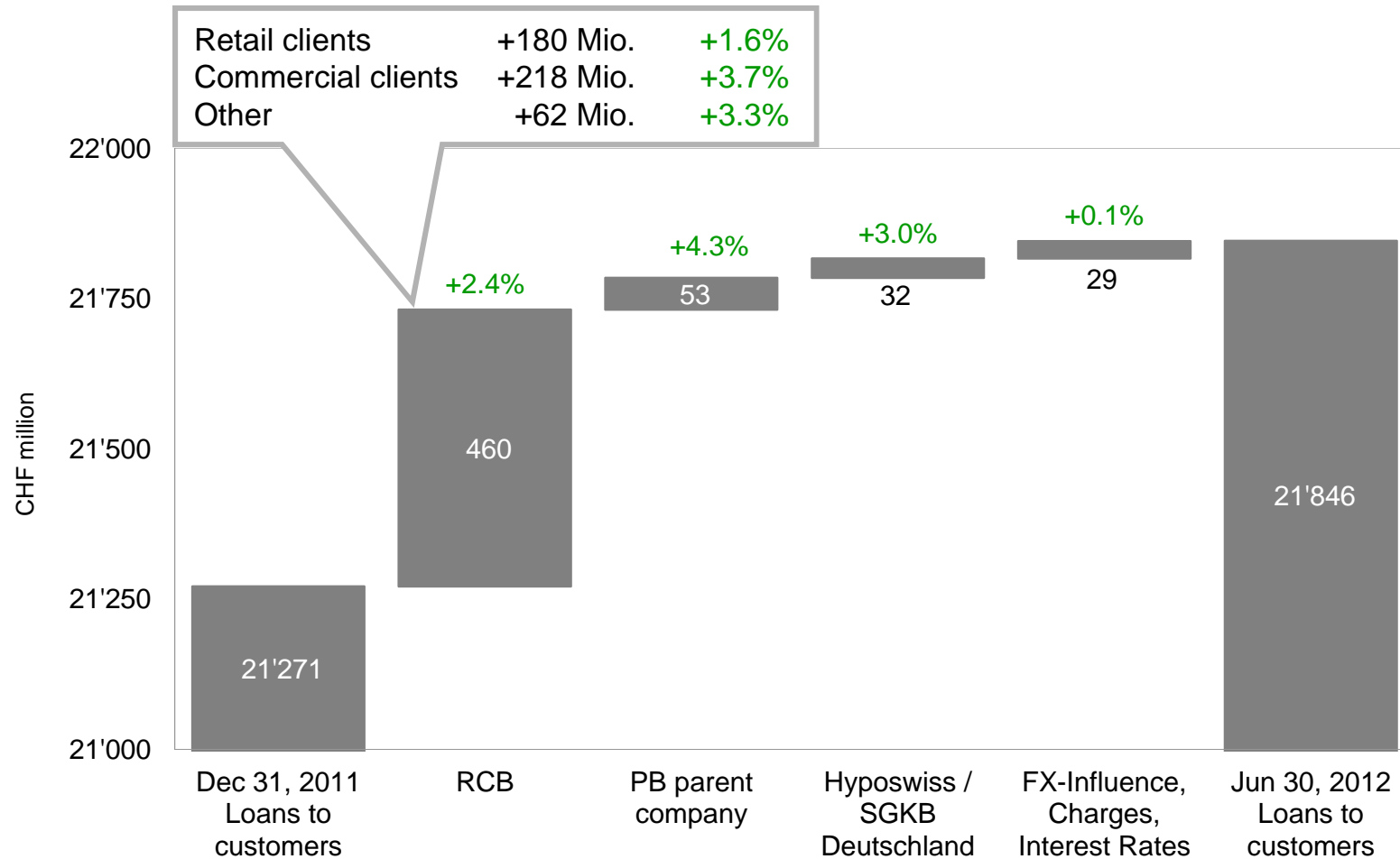
## AuM Margin\*



\*AuM margin = Net fee and commission income / Ø AuM (Client assets without client funds and double counting)



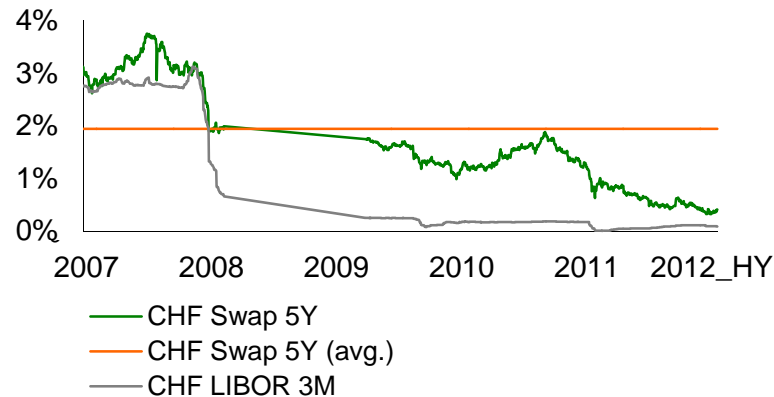
# Net new loans: Growth in the home market



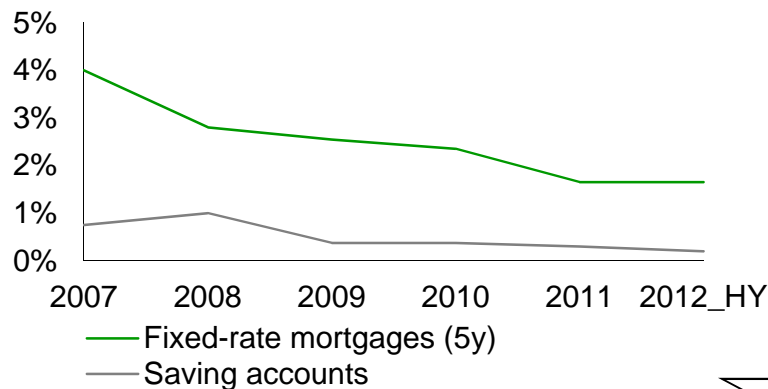
All %-numbers relate to the change in the corresponding prior year market segment amounts

# Interest income: Hedge against rising interest rates

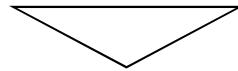
## Market Interest Rates



## Client Interest Rates

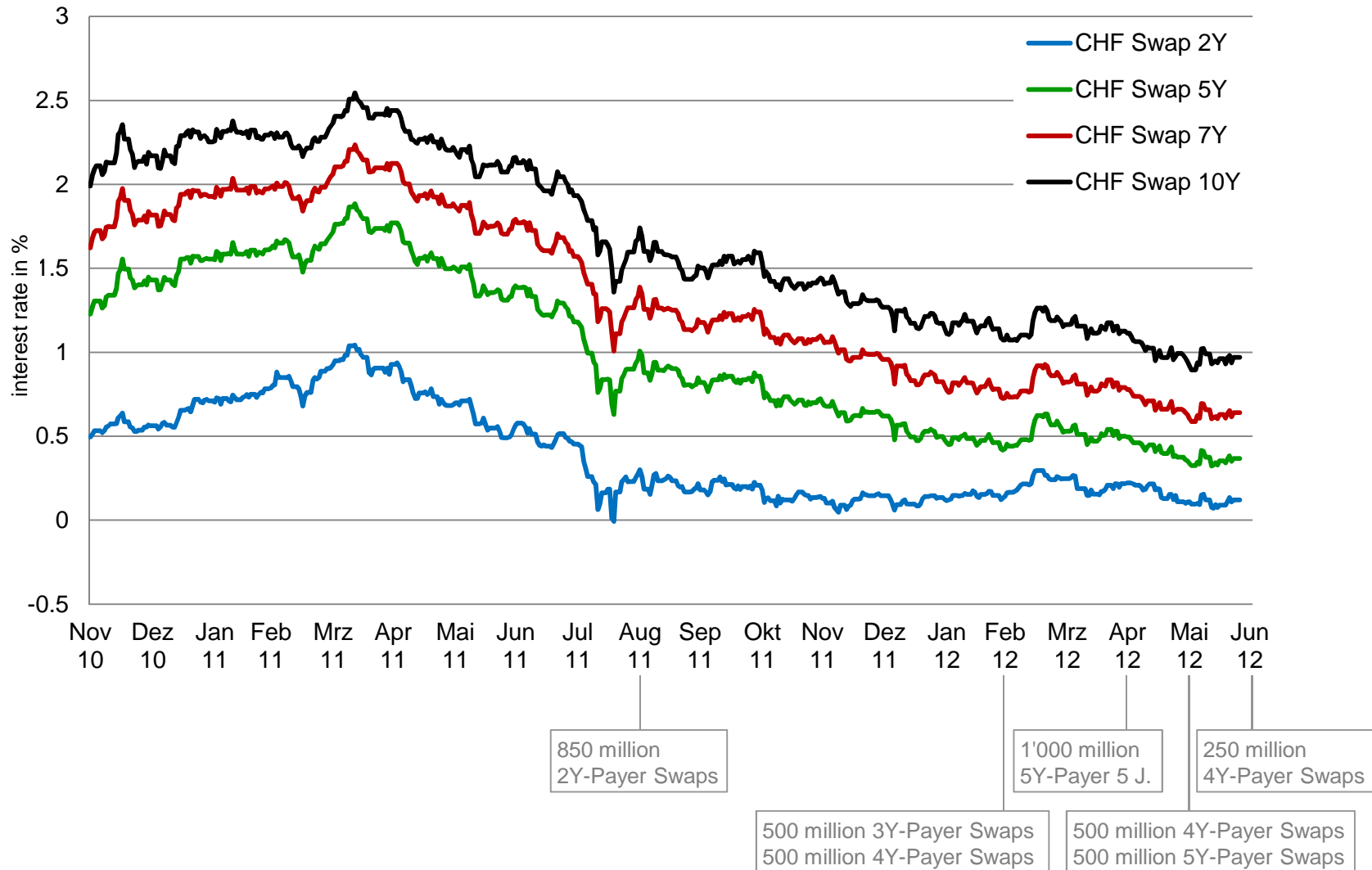


- Customer behaviour
  - Borrowers: long-term interest fixing
  - Investors: short-term interest fixing
- Consequences
  - Mismatch of maturity transformation in balance sheet
  - Risk of rising interest rates



Hedge against rising interest rates necessary  
(interest hedge costs June 30, 2012: CHF 6.5 million)

# Low interest rates used to develop additional hedge



## Interest rate hedging costs

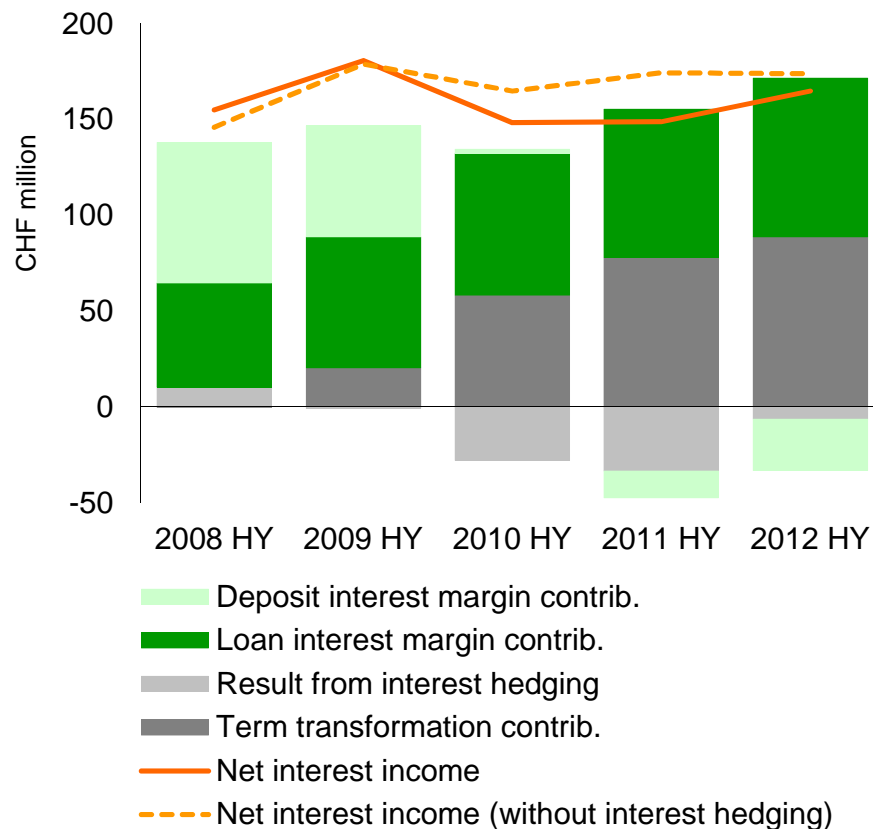
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The existing swap portfolio, plus various measures, have led to the following portfolio:

<b>Ø Portfolio swaps hedging</b>	<b>Ø Carry</b>	<b>Income (expenses)</b>
Payer CHF 8.0 billion	-1.04 %	-41.8 million
Receiver CHF 3.4 billion	1.95 %	33.3 million
Unwindings / swaption premiums / other		2.0 million
<b>Total interest rate hedging costs 2012_HY</b>		<b>-6.5 million</b>
<i>Total interest rate hedging cost half year 2011 (Reduction of 11.9 million to the previous year)</i>		<i>-18.4 million</i>

# Interest income: Deposit business suffers from interest level

## Development of Interest Income (applying the funds transfer pricing method): Interest Margin Contribution and Term Transformation Contribution



- Interest margin contribution in lending business is slightly increasing
- Relative to the market rates the saving and deposits accounts have above market interest rates. Therefore, the deposit interest margin contribution continues to be negative
- As a consequence, the term transformation contribution has increased at the expense of the deposit interest margin contribution
- With lower interest hedging costs the interest income is 11.6 million above previous year

# Balance sheet business neutral: Lower hedging costs

Actual Comparison (June 30, 2011 → June 30, 2012)

Volume effect*			
Due from banks	+540 million	Due to banks	+510 million
Loans to clients	+1'315 million	Client funds	+1'365 million
		Assets:	+16.2 million
		Liabilities:	-2.7 million
		<b>Total</b>	<b>+13.5 million</b>

Price effect			
Due from banks	-0.06%	Client funds	+0.10%
Loans to clients	-0.19%	- Savings and deposits	+0.07%
Financial investmens	-0.14%	- Due to clients	+0.09%
		Debts/loans	+0.09%
		Assets:	-21.9 million
		Liabilities:	+8.1 million
		<b>Total</b>	<b>-13.8 million</b>

**Balance sheet**

**CHF +13.5 million**

**CHF -13.8 million**

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**CHF -0.4 million**

\*based on average volumes

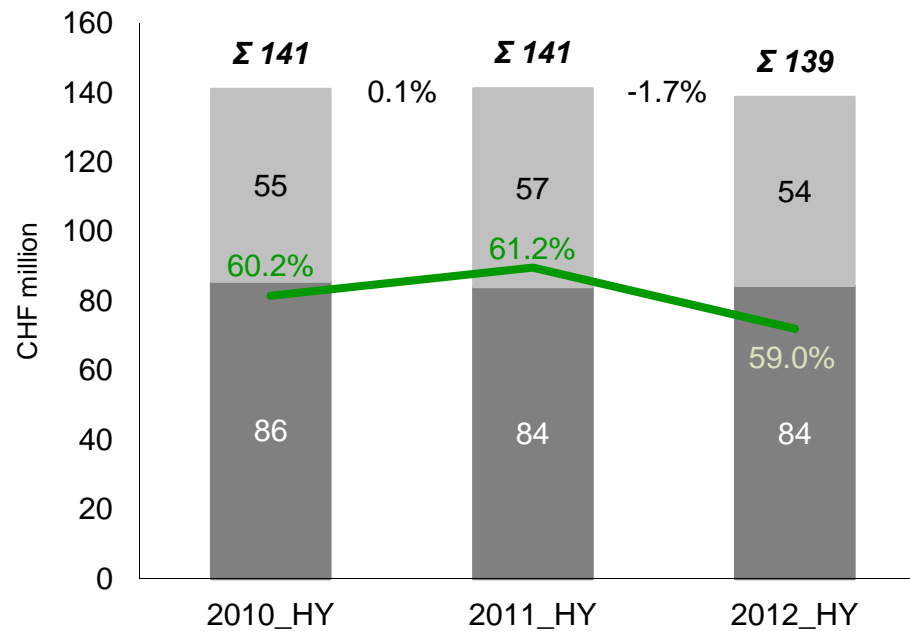
**Interest hedge cost**

**CHF +12.0 million**

**Interest income compared to last year**

**CHF +11.6 million**

# Operating expenses reduced by 1.7%



- Stable personnel expenses (+0.4%)
- Other operating expenses reduced by 4.9%
- Also in the future strict cost control

Personnel expenses  
 Other operating expenses  
 cost/income-ratio

# Quality of balance sheet: Due from banks

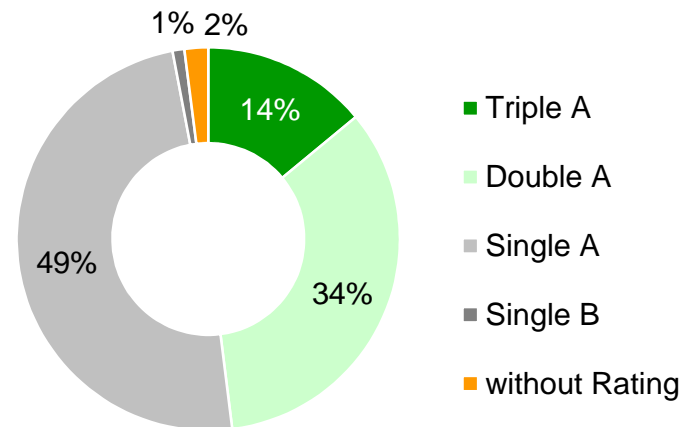
## Total due from banks

CHF 2.6 billion

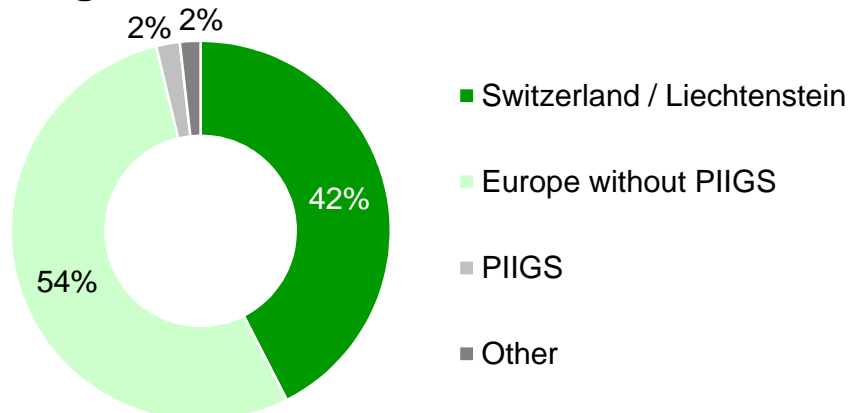
- Excellent quality of portfolio (Triple A to single A)
- Counterparty risk broadly diversified
- Still low limits for banks in PIIGS countries
- Continuous monitoring of risk exposure of the counterparties

## Distribution

### Rating (Moody's)



### Regions





# Quality of balance sheet: Financial investments

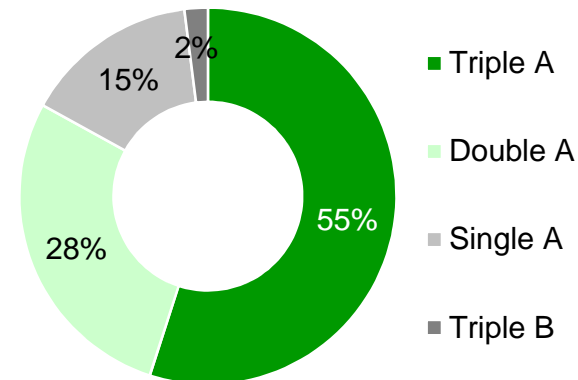
## Total financial investments

CHF 1.8 billion

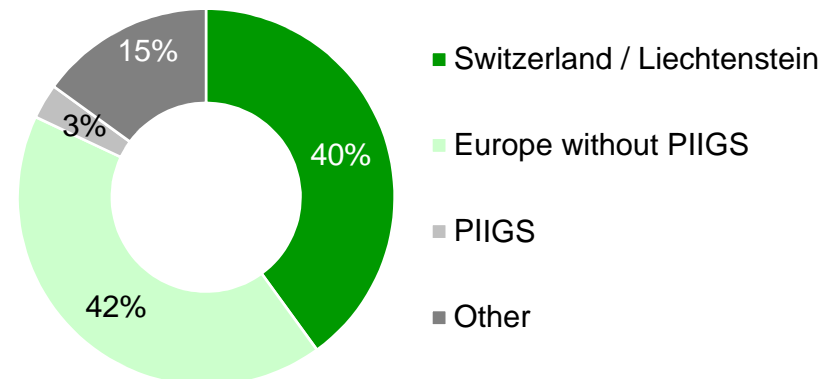
■ Bonds	74%
■ Loans secured by mortgages (Pfandbriefe)	25%
■ Shares and properties for resale	1%

## Distribution

### Rating\*

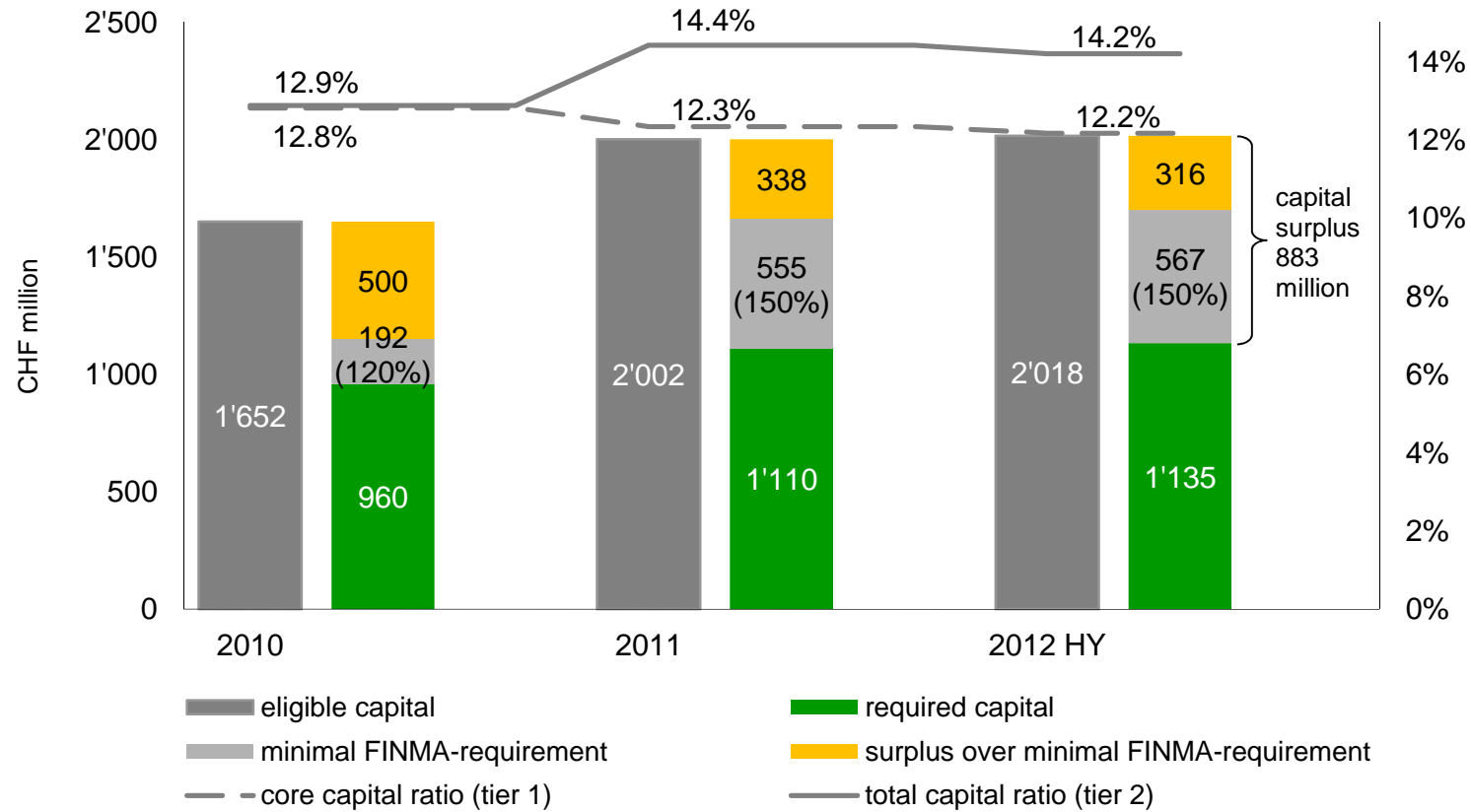


### Regions



\* Sequence of ratings: Moody's, S&P, Fitch, ZKB

# Quality of balance sheet: Solid capital base



# Agenda

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Results June 30, 2012

Focus mortgage market

Outlook

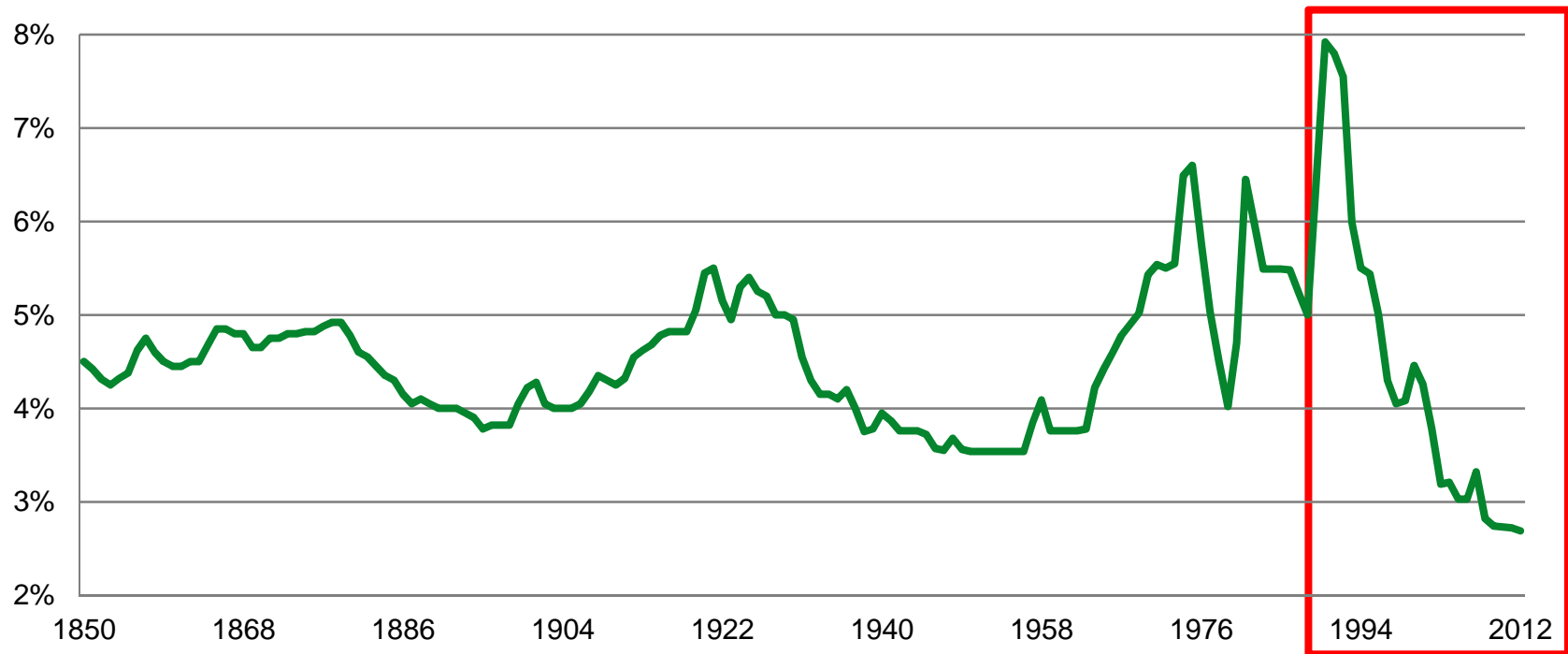
## Focus on real estate market

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- Core business SGKB
- Continued low interest rates
- Missing investment alternatives
- Wave of regulation

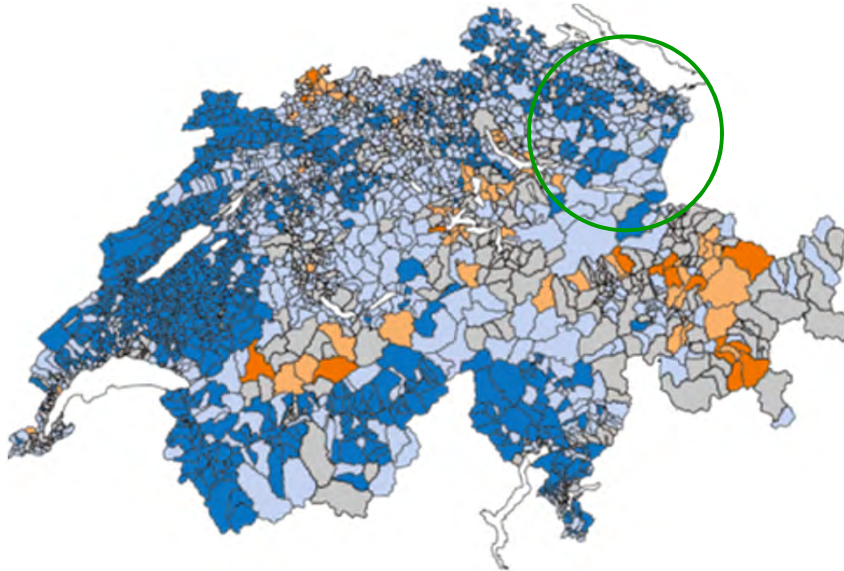
# Record deep level of interest rates

## Interest rates of variable mortgages since 1850

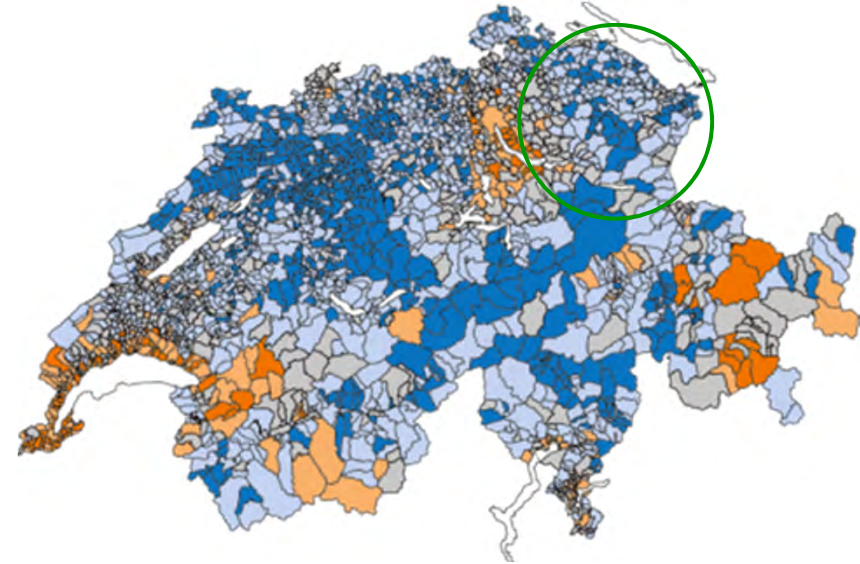


# Real estate market Eastern Switzerland: No overheating

Heatmap 2000



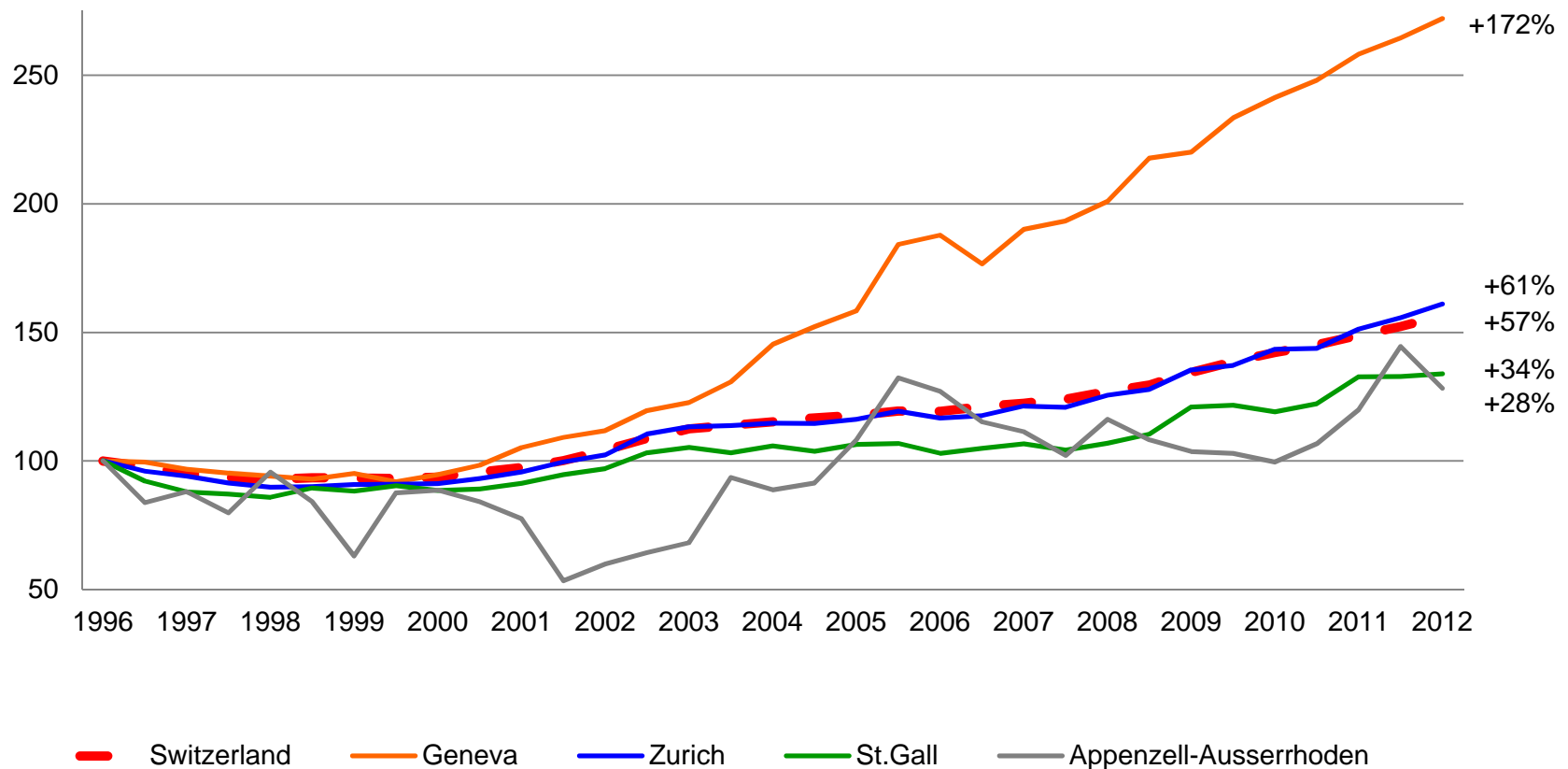
Heatmap 2012



■ very small   ■ small   ■ medium   ■ large   ■ very large

# Real estate market Eastern Switzerland: Solid development

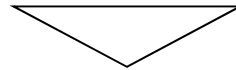
## Development of condominiums



## Real estate market Eastern Switzerland: No bubble

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- Moderate price development in comparison to Switzerland as a whole
- Price level on a realistic level
- Development in Eastern Switzerland can be fundamentally justified



Realistic price development in Eastern Switzerland



# Economic outlook Eastern Switzerland

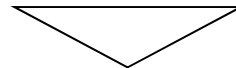
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## Background: Large uncertainties

- Overpriced Swiss franc
- Euro zone: Recession
- USA: moderate growth
- Switzerland: domestic economy with robust construction industry and positive consumer spending

## Eastern Switzerland: Economic activity index with several question marks

- Industry
  - Strong exports decline (-8%)
  - The industry assumes a slight increase in new orders
- Construction industry
  - Represents one of the pillars of the Eastern Switzerland economy
  - Robust construction activity and order books at a high level

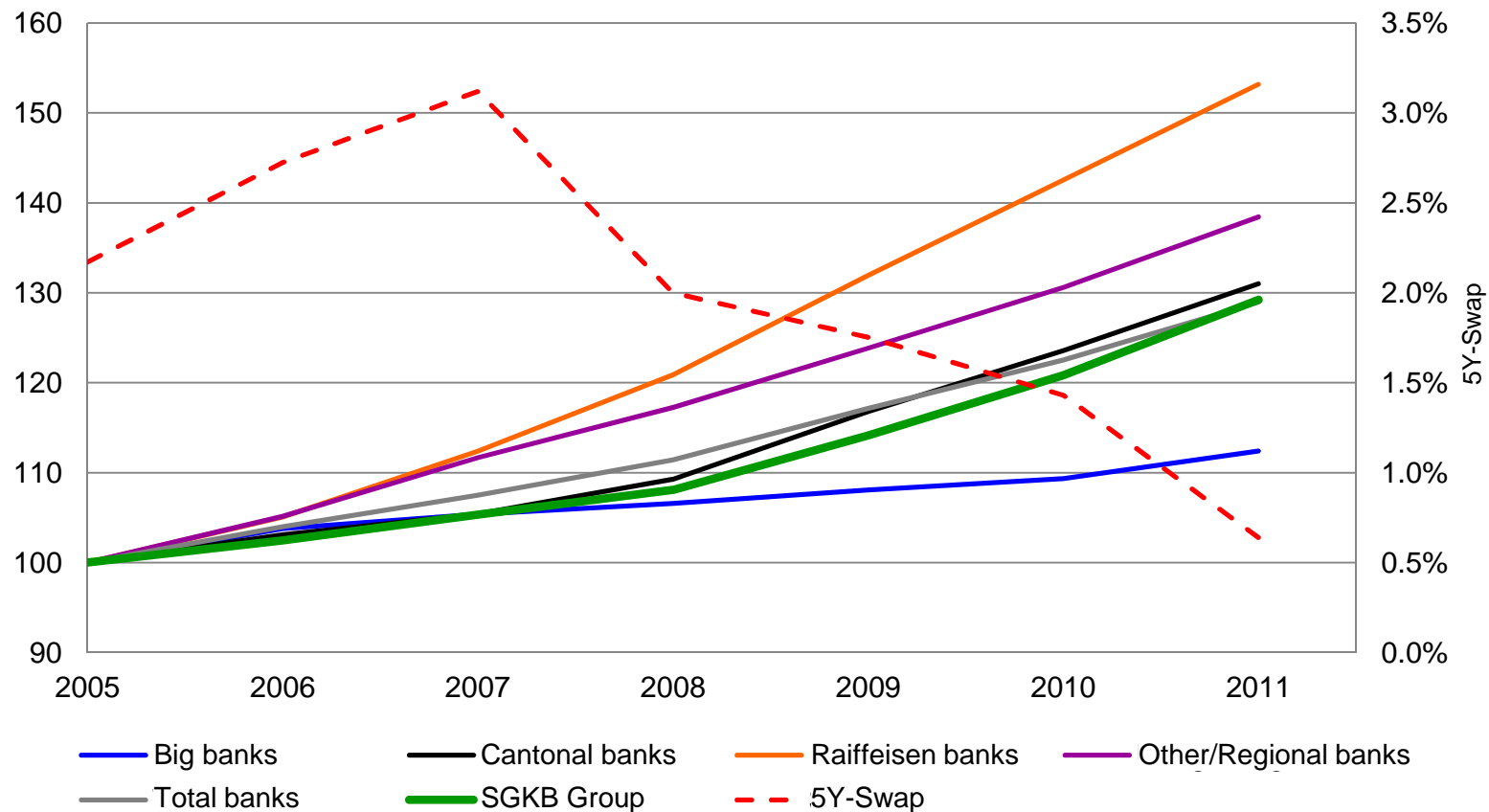


Decline in building permits and possible feedbacks of the weakening export industries urge caution

# Switzerland: Growth of banks in the mortgage business

## Development of mortgage loans over time

(Indexed 2005 = 100, nominal)

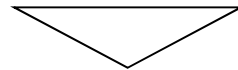


## SGKB: Consistent credit policy

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### **Swiss National Bank: Critical eye on credit risks in Switzerland**

- Increase in credit volume driven by rising mortgage loans
- Dangerous combination despite high quality of credit portfolios:
  - Low interest rates
  - Rising real estate prices and intense competition



### **SGKB: Unchanged credit policies**

- Transparent valuation
- Conservative loan to value ratio
- Sustainable income coverage ratio

## Our credit policies: Proven and solid (1/2)

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### ■ Real estate valuation

- Bank's own tools, hedonistic models and external valuation experts
- Lowest value principle (market value / purchase price)
- No financing merely based on initial costs

### ■ Loan to value ratio

- Generally up to 80% on residential buildings, amortization of the second mortgage down to 66% in 20 (owner-occupied) and 15 years (income property)
- Commercial buildings / Commercial: 70% (amortization down to 60%)
- Industrial buildings: 60% (amortization to zero)

## Our credit policies: Proven and solid (2/2)

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### ■ **Income Coverage Ratio**



- Owner-occupied properties:  
Interest rate cost, amortisation and additional expenses should not exceed 1/3 of the sustainable gross income
- Income property:  
Positive income coverage ratio exists when the achieved net rents are sufficient to cover the interest, possible construction law interests, amortization and maintenance costs (taking into account the total debt)

### ■ **Pledging of pension money**

- The client has to contribute 10% of own capital on a mandatory basis
- Imputation of maximum half of the pension money that is pledgeable by law

# Income coverage ratio calculation

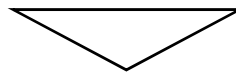
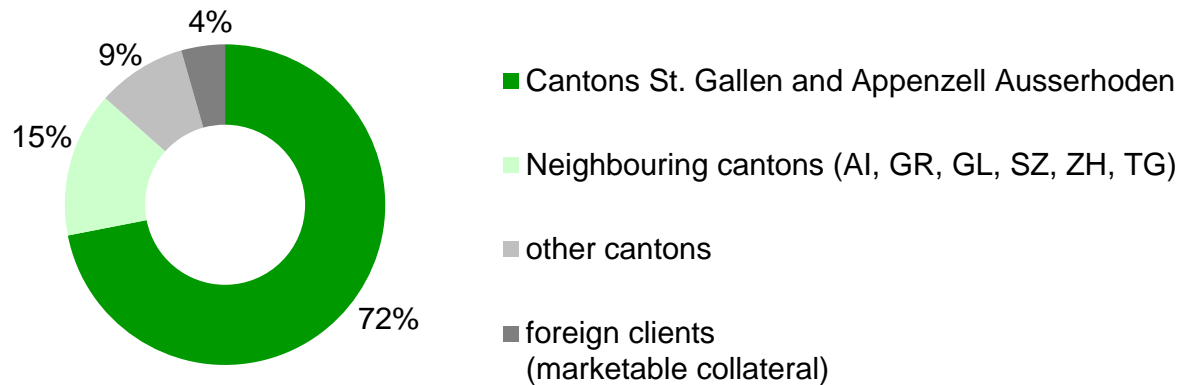
Financing key data		
Market value	CHF	900'000
Equity	CHF	250'000  at least 20%
Financing needs	CHF	650'000
Income p.a. (gross)	CHF	100'000

Income coverage ratio			
<b>Today</b>	 27% of income		
<b>Long term</b>	 41% of income		
<p><b>The income coverage ratio with the actual interest rate is 27 % , therefore the portability is given. The long term income coverage ratio with theoretical interest rate of 5 % is no longer given with 41 % of the income.</b></p>			
The calculation in detail			
		Income coverage ratio today	Income coverage ratio long term
Interests	1 <sup>st</sup> Mortgage CHF 600'000	2.75 %	16'500
	2 <sup>nd</sup> Mortgage CHF 50'000	3.75 %	1'875
Amortisation	2 <sup>nd</sup> Mortgage in 20 years		2'500
Maintenance	0.7 % of market value		6'300
<b>Total / Years</b>		<b>27'175</b>	<b>41'300</b>

# Quality of credit: Focus on home market

## Loans to Clients: Domicile of debtors

Total CHF 20.7 billion

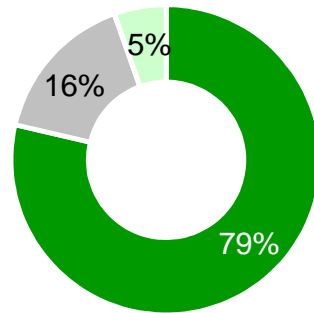


Business focus on the cantons of St. Gallen and Appenzell Ausserhoden

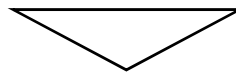
# Quality of credit: Focus on home market

## Mortgage: Domicil of objects

Total CHF 18.1 billion



- Cantons St. Gallen and Appenzell Ausserhoden
- Neighbouring cantons (AI, GR, GL, SZ, ZH, TG)
- other cantons



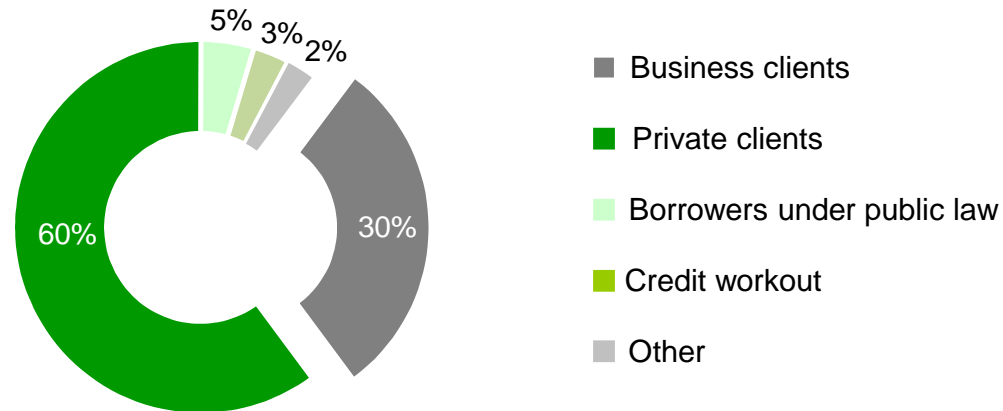
95% of all mortgages originate from the Canton of St. Gallen and neighboring cantons



# Quality of credit: Broad diversification

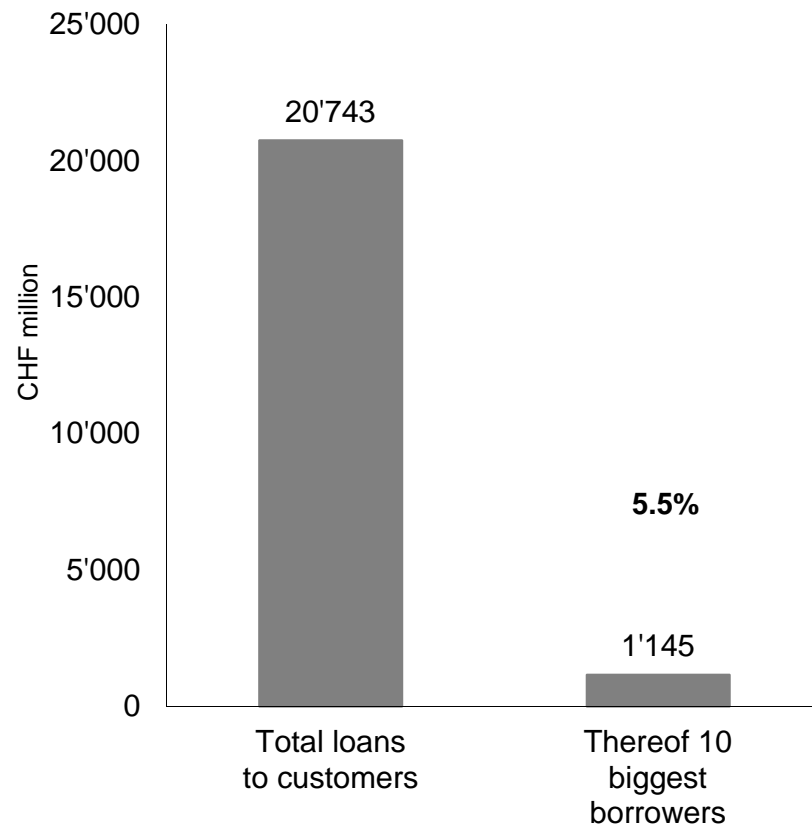
## Loans to Clients

Total CHF 20.7 billion

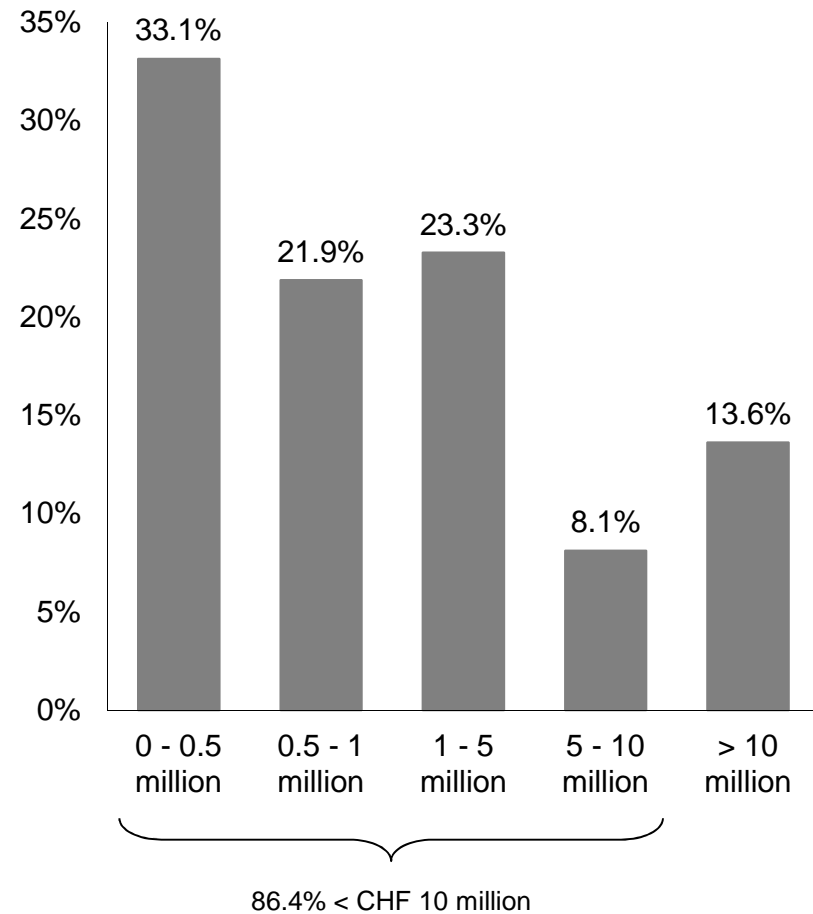


# Quality of credit: Broad diversification

## Share of 10 largest borrowers

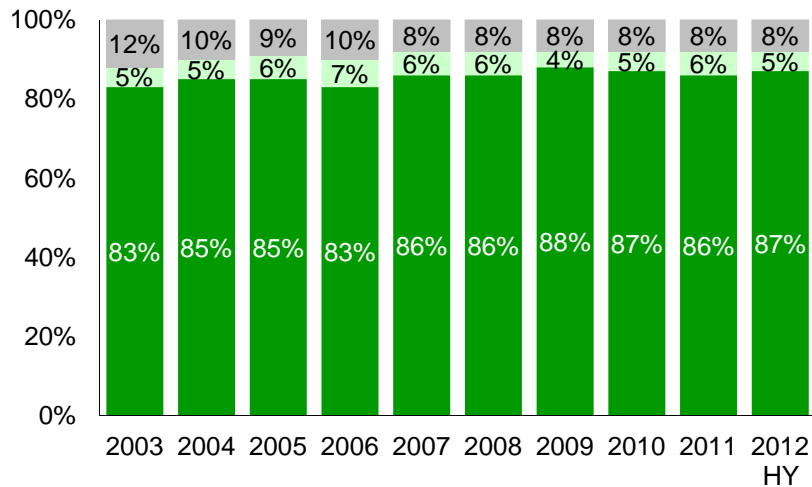


## Credit portfolio by size



# Quality of credit: 92% collateralised credits

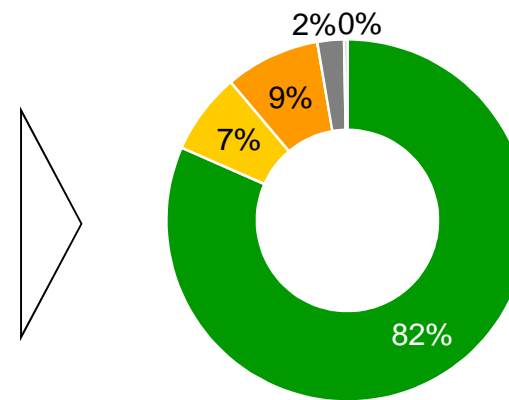
## Collateral character of loans to clients



- Mortgage collateral
- Other collateral
- Without collateral

## Collateral of mortgage loans

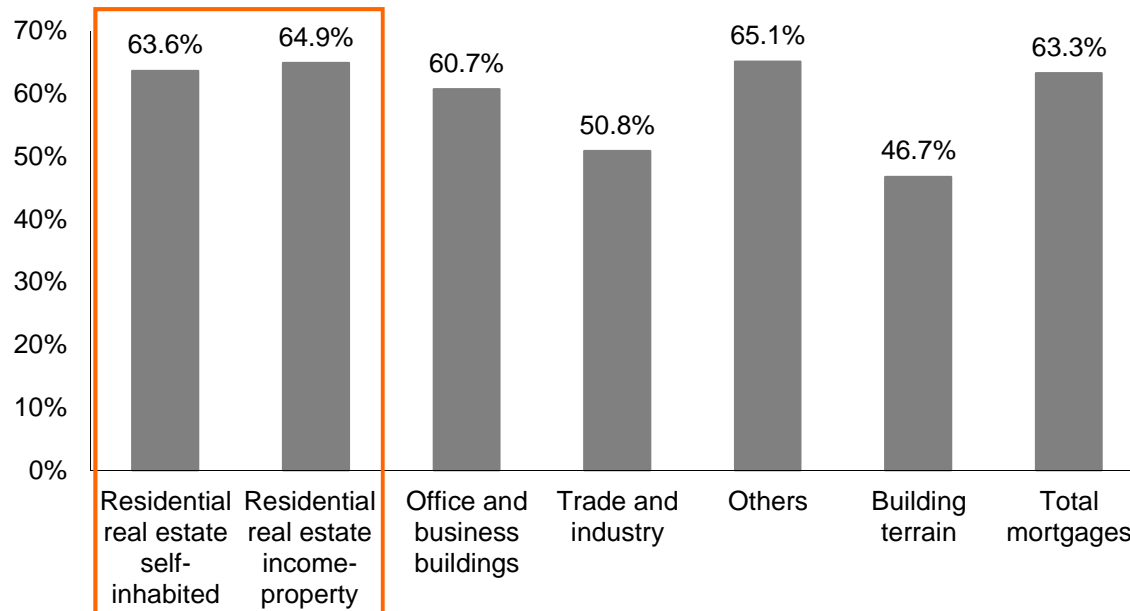
Total CHF 18.6 billion



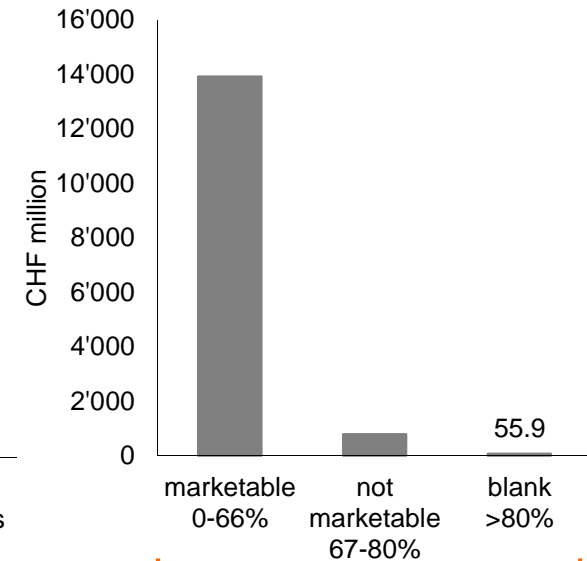
- Residential real estate
- Office and business buildings
- Trade and industry
- Other
- Without collateral

# Quality of credit: Mortgages mostly covered with marketable collateral

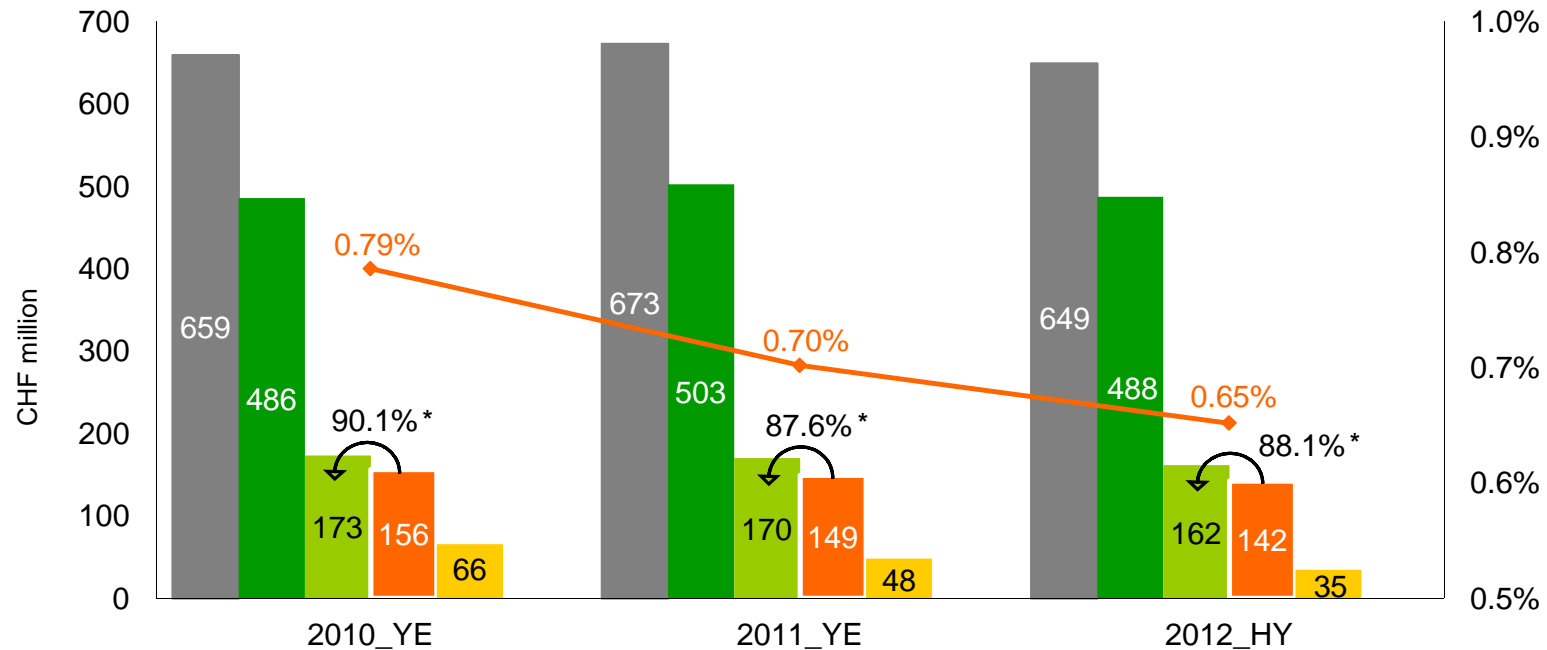
## Average loan to value



## Reinsurance arrangements of residential mortgage loans



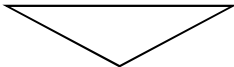
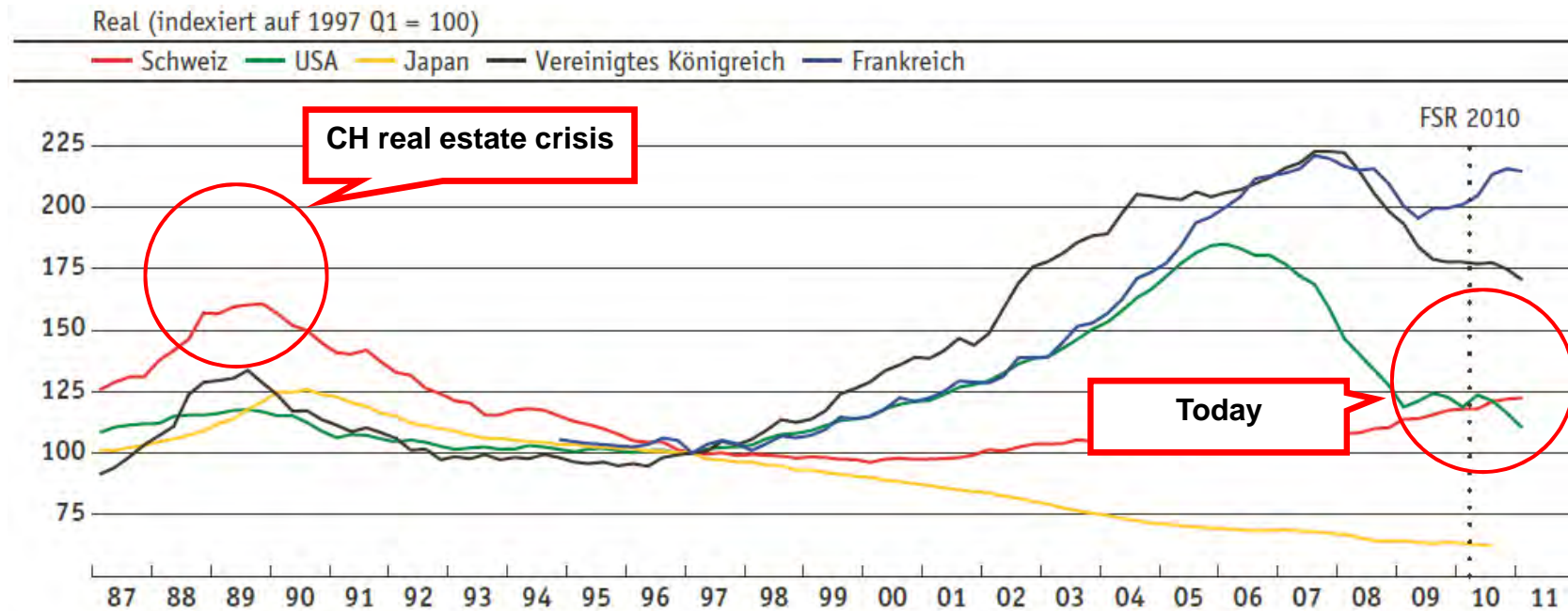
# Quality of credit: Conservative risk provisioning



- Impaired loans
- Estimated proceeds from liquidation
- Impaired loans, net
- Provisions for credit risk (Individual provisions)
- Non performing loans
- ◆ Provisions for credit risk in % of total loans to clients (right scale)
- \* Individual provisions for credit risk in % of impaired loans, net

# Swiss real estate market: Repetition of the crisis?

## Price development of residential properties

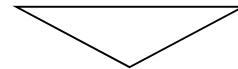


Are the two situations comparable?

## SGKB: Learnings from real estate crisis implemented

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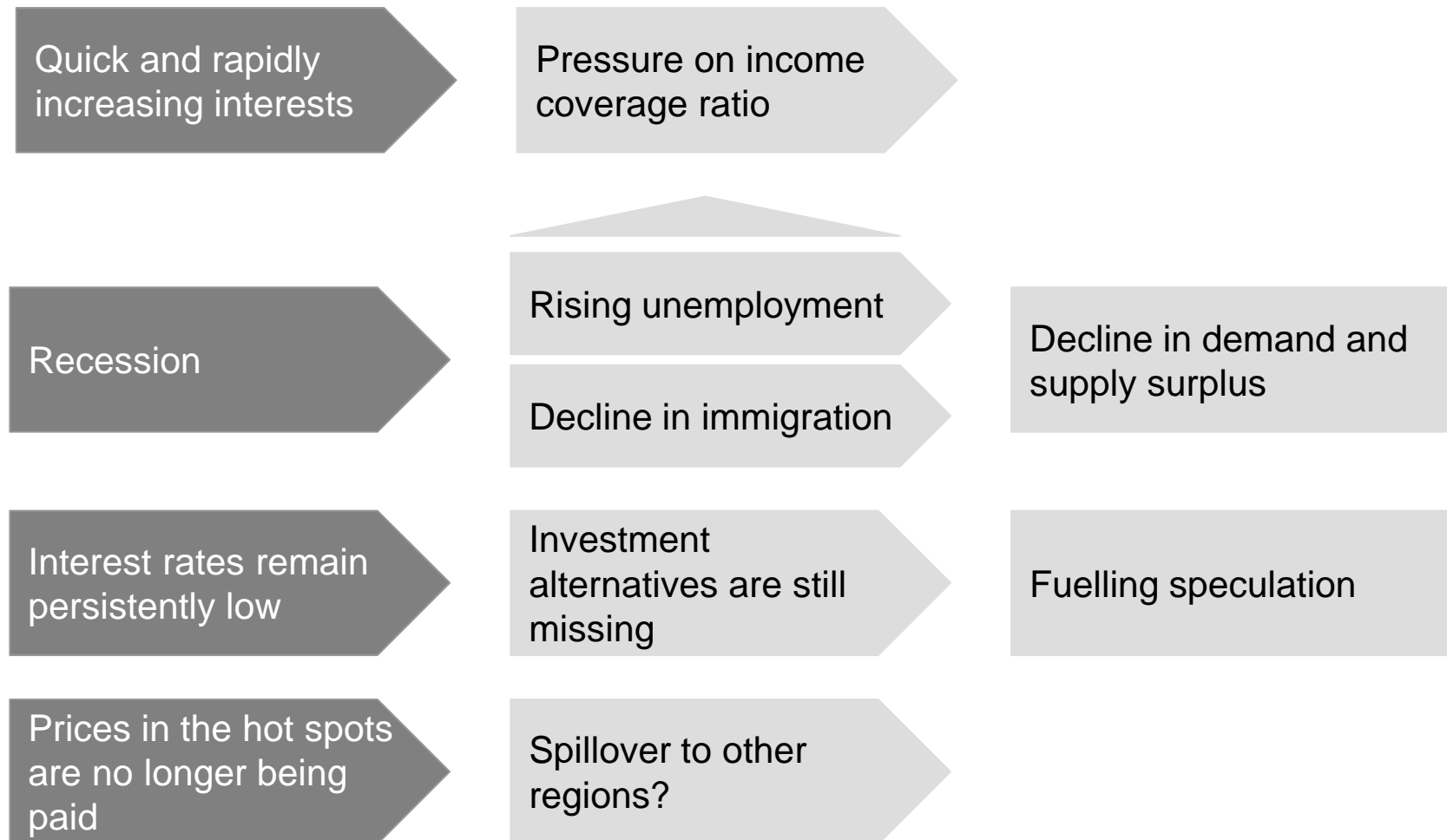
- Separation of power
- Reliability and quality of real estate assessment
- Extensive market research
- Consistent application of the credit policy



Credit business has been professionalized

## Outlook: Potential risks remain

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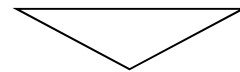




# Current developments: Assessment of SGKB

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- Real estate market Eastern Switzerland
  - Healthy development in recent years
  - Slight slowdown of economy
- SGKB credit policy
  - Proven credit policy
- SGKB credit portfolio
  - Sound and healthy credit portfolio



SGKB has not built up excessive risks

# Agenda

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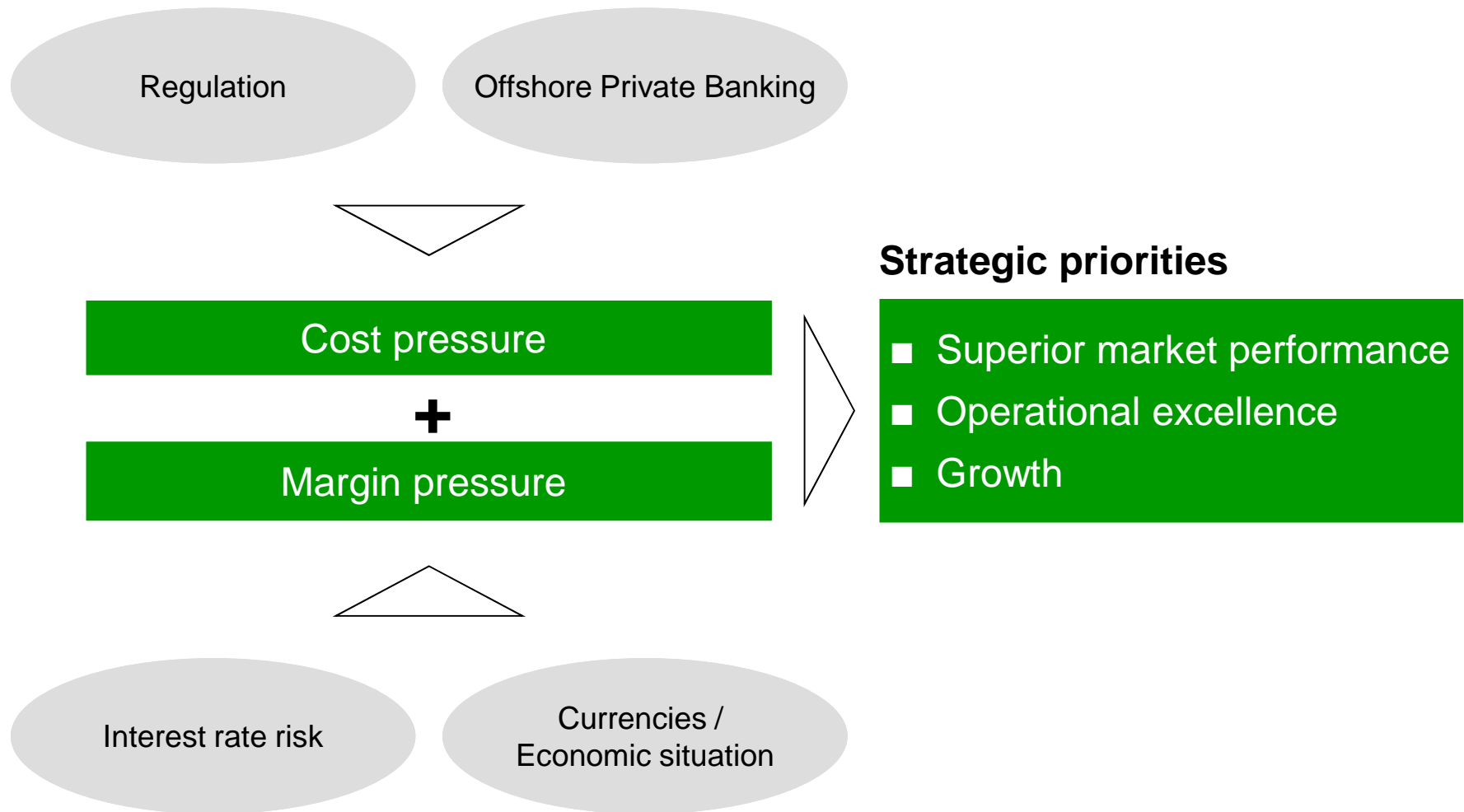
Results June 30, 2012

Focus mortgage market

Outlook

# Strategic challenges

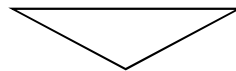
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## Flat rate tax model: Position of the SGKB

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- Need to take action
- Great significance for SGKB
  - Indirect:  
Switzerland can solve a problem with foreign countries in compliance with national interests (protection of financial privacy)
  - Direct:  
As a bank in a border region, SGKB is strongly affected by a possible agreement
- Complex, time intensive and expensive implementation:
  - Cash out: ~ CHF 1-2 million
  - Internal expenditure: ~ 2000 man days

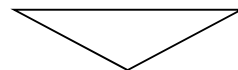


The idea of the flat rate tax will be supported under the assumption of a permanent and sustainable solution.

## Outlook 2012: Net income slightly above previous year

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- No sign of decreasing economic uncertainty in the short term
- Slowdown of the world economy
- No significant improvement in the financial market environment in sight
- Actual profit forecast depends on the following points:
  - Development of the problems of public debt in the euro area
  - Further development of the major currencies USD and EUR
  - Timing and extent of possible interest rate increases
  - Restoring investor confidence in markets
    - Reduction of high liquidity
    - Increase in transaction volume



Assumptions: persisting low level of interest rates and no increase  
in commission and fee income

→ Net income slightly above previous year

# Share SGKB: Development of share price



# Disclaimer

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## Caution regarding forward-looking statements

- This communication contains statements that constitute «forward-looking statements», including, but not limited to, statements relating to the implementation of strategic initiatives, such as the expansion in private banking, and other statements relating to our future business development and economic performance.
- While these forward-looking statements represent our judgments and future expectations concerning the development of our business, a number of risks, uncertainties and other important factors could cause actual developments and results to differ materially from our expectations.
- These factors include, but are not limited to, (1) general market, macro-economic, governmental and regulatory trends, (2) movements in local and international securities markets, currency exchange rates and interest rates, (3) competitive pressures, (4) technological developments, (5) changes in the financial position or creditworthiness of our customers, obligors and counterparties and developments in the markets in which they operate, (6) federal and local legislative developments, (7) management changes and changes to our Business Group structure.
- St.Galler Kantonalbank is not under any obligation to (and expressly disclaims any such obligations to) update or alter its forward-looking statements whether as a result of new information, future events, or otherwise.

## Contact

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