

LETTER TO SHAREHOLDERS

Ciba Specialty Chemicals
Half Year 2006

Ciba





LETTER TO SHAREHOLDERS

Ciba Specialty Chemicals is at a major turning point in its history. With the divestment of Textile Effects, we have taken an important strategic step in focusing Ciba on its core businesses Plastic Additives, Coating Effects and Water & Paper Treatment.

After a thorough review of all of our businesses, we have refined our strategy to strengthen Ciba Specialty Chemicals as a leading specialty chemicals player that delivers higher sales and profit margins over the long term. Our strategy is complemented by the "Operational Agenda", designed to enhance efficiency across all key processes and foster profitable growth and innovation. We expect its implementation to lead to an improved cost structure on an annualized basis of CHF 400 to 500 million by 2009.

HIGHER FIRST HALF SALES AND PROFITS

In the first six months of 2006, we delivered higher sales and operating profits than in the comparable period a year ago. There was good demand for our products and services. Sales increased by 9 percent in Swiss francs (+6 percent in local currencies), rising, in local currencies, by 11 percent in Asia-Pacific, 5 percent in Europe and 2 percent in the Americas. Volumes rose 6 percent compared to a year ago.

Operating income (EBIT), before restructuring, impairment and other charges, was 5 percent higher than the first half of 2005, with a substantial improvement (+26 percent) in the second quarter, to a margin of 9.2 percent of sales. We successfully offset higher raw material and utility costs by

selectively pushing through sales price increases.

Free cash flow before restructuring payments improved by around CHF 160 million in the first half of the year, through very tight management of net working capital. Income from continuing operations, after restructuring, impairment and other charges, was CHF 95 million (previous year: CHF 99 million).

We concluded the divestment of the Textile Effects business on June 30, 2006, through a smooth handling of a rather complex separation and with significantly lower costs than earlier anticipated. The divestment resulted in a loss on disposal of CHF 224 million (compared to the previously announced CHF 250 million). Associated after tax

“We have taken an important strategic step in focusing Ciba Specialty Chemicals on its core businesses Plastic Additives, Coating Effects and Water & Paper Treatment.”

costs, net of the Textile Effects result in the first half, will total around CHF 98 million, lower than the CHF 100 to 120 million earlier anticipated. CHF 72 million of these expenses were booked in the first half, resulting, combined with the loss on disposal, in a total net loss, after restructuring, impairment and other charges, net of tax, for the first half of CHF 202 million, or CHF 3.06 per share. The remaining expenses (around CHF 26 million) will be booked in the second half of this year and in 2007.

FOCUSED GROUP STRATEGY

In the first half of this year, we completed a thorough review of all our businesses and refined our Group strategy accordingly to deliver higher sales and profit margins over the long term. We will now exploit the strengths of our remaining core businesses and allocate company resources such as capital investments, research and development and personnel through a strict, top-down approach, to maximize our return on investments.

All of our businesses have clearly defined roles, based on market attractiveness, current market position and future potential. Plastic Additives and Coating Effects are core growth businesses, with leading market positions and superior technological advantages and will receive above-average resource allocations. Water & Paper Treatment is a core business that will focus primarily on improving profitability, efficiency and cost leadership. In addition, we will strengthen niche businesses that offer attractive opportunities for profitable growth, including Electronic Materials, Personal Care, Process & Lubricant Additives and the sale of know-how through Expert Services.

Our primary objective is to fuel organic growth. We will selectively expand and strengthen our portfolio with add-on technologies as reasonable, but no larger acquisitions are planned mid-term.

Our strong commitment to innovation will continue, with investments in R&D of around four percent of sales annually. Innovation, for us, is crucial for providing added value to our customers and helping them differentiate in their markets. Allo-

cations will be made only to the most promising opportunities.

And, our investments in high-growth regions, particularly Asia, but also the Middle East and South America, will be accelerated.

OPERATIONAL AGENDA TO IMPROVE COST STRUCTURE

Our strategy is complemented, as previously mentioned, by a program, the Operational Agenda, designed to enhance efficiency across all key processes and to foster profitable growth and innovation:

- Following the Textile Effects divestment, a detailed analysis is taking place to streamline the organizational and geographical footprint to meet the needs of the remaining global core businesses. It will be implemented in 2007.
- A new company-wide system structure, which features new software to harmonize business processes and enhance data transparency, will begin to be rolled out later this year, with full integration in 2008.
- Each manufacturing site will undergo an efficiency analysis over the next two years, leveraging best practices and capabilities from throughout the global production network. Cost savings figures for the first major sites are already confirmed.
- A marketing and sales initiative is identifying new routes-to-market, strengthening Global Account Management and standardizing training, sales performance measurement and incentive plans.
- Starting early next year, we will implement measures in R&D involving such areas as technology platforms, cross-business competency sharing and external partnering.

Other programs, in line with the overall Operational Agenda but more specifically tailored to each segment's needs, are also being conducted.

We expect the implementation of the strategy and the complementary Operational Agenda, including the segment-specific initiatives, to improve the cost structure on an annualized basis by CHF 400 to 500 million by 2009; increase

local currency sales in the coming years by at least 3 to 4 percent per year, on average; increase operating income margins by more than 1 percent of sales per year in 2007 and 2008, with an accelerating improvement in margins thereafter; and, beginning in 2008, significantly improve free cash flow. The Operational Agenda is expected to cost CHF 250 to 300 million through 2009.

With the streamlined global footprint and more efficient processes, we will need 2,500 fewer positions. Most reductions will take place in Europe and the Americas. Since this will occur over three to four years, it is anticipated that the majority of the reductions will be able to occur through natural attrition. When redundancies are unavoidable, they will be managed in a socially responsible manner.

OUTLOOK CONFIRMED

We expect business conditions for the remainder of the year to remain similar to those experienced currently, with full year utility and raw material costs higher than 2005. Based on these assumptions, sales for the year in local currencies are expected to be higher than 2005. Excluding restructuring and impairment costs, and assuming that currency levels do not worsen, operating income is expected to increase, resulting in margins remaining around the 2005 level, and net income from continuing operations after tax is expected to improve. The Company also anticipates a strong improvement in free cash flow.

I thank our employees, also in the name of the Board of Directors and the Executive Committee, for their loyalty and commitment and for contributing to the first half results. On behalf of the Board, I would also like to thank our shareholders for their trust and support.



ARMIN MEYER
Chairman of the Board and
Chief Executive Officer

FINANCIAL SUMMARY HALF YEAR 2006

(in millions of Swiss francs, except per share data)

STATEMENTS OF INCOME

Six months ended June 30, (unaudited)	EXCLUDING RESTRUCTURING, IMPAIRMENT AND OTHER CHARGES		INCLUDING RESTRUCTURING, IMPAIRMENT AND OTHER CHARGES	
	2006	2005	2006	2005
Net sales	3 285	3 003	3 285	3 003
Gross profit	965	882	965	882
Restructuring, impairment and other charges ⁽¹⁾			(33)	(50)
Operating income	259	247	226	197
Financial income and expense, net	(88)	(57)	(88)	(57)
Income from continuing operations before income taxes and minority interest	171	190	138	140
Provision for income taxes	(46)	(53)	(35)	(39)
Minority interest	(8)	(2)	(8)	(2)
Income from continuing operations	117	135	95	99
Earnings per share from continuing operations	1.77	2.06	1.44	1.51
Income (loss) from discontinued operations, net of tax	(287)	47	(297)	47
Earnings (loss) per share from discontinued operations	(4.34)	0.71	(4.50)	0.71
Net income (loss)	(170)	182	(202)	146
Net income (loss) per share	(2.57)	2.77	(3.06)	2.22

BALANCE SHEETS

	June 30, 2006 (unaudited)	Dec 31, 2005
Current assets	3 736	4 267
Property, plant and equipment, net	2 595	2 724
Other long-term assets	3 553	3 621
Total assets	9 884	10 612
Current liabilities	1 751	1 891
Long-term liabilities	4 597	4 738
Minority interests	89	80
Shareholders' equity	3 447	3 903
Total liabilities and shareholders' equity	9 884	10 612
Net debt	2 101	1 942

STATEMENTS OF CASH FLOWS

Six months ended June 30, (unaudited)	2006	2005
Net cash provided by (used in) operating activities	99	(104)
Net cash used in investing activities	(12)	(128)
Net cash used in financing activities	(286)	(641)
Effect of exchange rate changes on cash and cash equivalents	(5)	39
Net decrease in cash and cash equivalents	(204)	(834)
Free cash flow from continuing operations before restructuring payments	2	(158)
Free cash flow from continuing operations	(35)	(180)

⁽¹⁾ For the six months ended June 30, 2006, restructuring, impairment and other charges net of taxes of CHF 11 million would be CHF 22 million and for the six months ended June 30, 2005, restructuring, impairment and other charges net of taxes of CHF 14 million would be CHF 36 million.

RECONCILIATION TABLES (UNAUDITED)

(in millions of Swiss francs, except for currency exchange rates and per share data)

EXCHANGE RATES OF PRINCIPAL CURRENCIES TO CHF

	STATEMENT OF INCOME AVERAGE RATES		BALANCE SHEET PERIOD-END RATES	
	Six months ended June 30, 2006	2005	June 30, 2006	Dec 31, 2005
1 U.S. dollar (USD)	1.27	1.20	1.24	1.27
1 British pound (GBP)	2.27	2.25	2.26	2.32
1 Euro (EUR)	1.56	1.55	1.56	1.54
100 Japanese yen (JPY)	1.10	1.13	1.07	1.16

OPERATING INCOME

Six months ended June 30,	2006	2005
Excluding restructuring, impairment and other charges	259	247
Restructuring, impairment and other charges	(33)	(50)
Including restructuring, impairment and other charges	226	197

INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND MINORITY INTEREST

Six months ended June 30,	2006	2005
Excluding restructuring, impairment and other charges	171	190
Restructuring, impairment and other charges	(33)	(50)
Including restructuring, impairment and other charges	138	140

PROVISION FOR INCOME TAXES

Six months ended June 30,	2006	2005
Excluding restructuring, impairment and other charges	(46)	(53)
Tax effect of restructuring, impairment and other charges	11	14
Including restructuring, impairment and other charges	(35)	(39)

INCOME FROM CONTINUING OPERATIONS

Six months ended June 30,	2006	2005
Excluding restructuring, impairment and other charges	117	135
Restructuring, impairment and other charges, net of tax	(22)	(36)
Including restructuring, impairment and other charges	95	99

EARNINGS PER SHARE FROM CONTINUING OPERATIONS

Six months ended June 30,	2006	2005
Excluding restructuring, impairment and other charges, net of tax	1.77	2.06
Restructuring, impairment and other charges, net of tax	(0.33)	(0.55)
Including restructuring, impairment and other charges, net of tax	1.44	1.51

INCOME (LOSS) FROM DISCONTINUED OPERATIONS, NET OF TAX

Six months ended June 30,	2006	2005
Excluding restructuring, impairment and other charges, net of tax	(287)	47
Restructuring, impairment and other charges, net of tax	(10)	0
Including restructuring, impairment and other charges, net of tax	(297)	47

EARNINGS (LOSS) PER SHARE FROM DISCONTINUED OPERATIONS

Six months ended June 30,	2006	2005
Excluding restructuring, impairment and other charges, net of tax	(4.34)	0.71
Restructuring, impairment and other charges, net of tax	(0.16)	0.00
Including restructuring, impairment and other charges, net of tax	(4.50)	0.71

NET INCOME (LOSS)

Six months ended June 30,	2006	2005
Excluding restructuring, impairment and other charges, net of tax	(170)	182
Restructuring, impairment and other charges, net of tax	(32)	(36)
Including restructuring, impairment and other charges, net of tax	(202)	146

NET INCOME (LOSS) PER SHARE

Six months ended June 30,	2006	2005
Excluding restructuring, impairment and other charges, net of tax	(2.57)	2.77
Restructuring, impairment and other charges, net of tax	(0.49)	(0.55)
Including restructuring, impairment and other charges, net of tax	(3.06)	2.22

COMPONENTS OF NET DEBT

	June 30, 2006 (unaudited)	Dec 31, 2005
Short-term debt	239	268
Long-term debt	2 920	2 941
Total debt	3 159	3 209
Less: cash and cash equivalents	(1 049)	(1 253)
Less: short-term investments	(9)	(14)
Net debt	2 101	1 942

FREE CASH FLOW FROM CONTINUING OPERATIONS

Six months ended June 30,	2006	2005
Free cash flow before restructuring payments	2	(158)
Less: restructuring payments, net ⁽²⁾	(37)	(22)
Free cash flow from continuing operations	(35)	(180)
Net cash used in investing activities	6	120
Sales (acquisitions) of businesses, net of cash	138	(32)
Net cash provided by (used in) continuing operations	109	(92)

⁽²⁾ Net of proceeds from restructuring-related asset sales.

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FORWARD-LOOKING STATEMENTS

Forward-looking statements and information contained in this Shareholder Mailing are qualified in their entirety as there are certain important factors that could cause results to differ materially from those anticipated. Certain such forward-looking statements can be identified by the use of forward-looking terminology such as "believe," "expect," "may," "are expected to," "will," "will continue," "should," "would be," "seek" or "anticipate" or similar expressions or the negative thereof or other variations thereof or comparable terminology, or by discussions of strategy, plans or intentions. Such statements reflect the current views and estimates of the Company with respect to market conditions and future events and are subject to certain risks, uncertainties and assumptions. Investors are cautioned that all forward-looking statements involve risks and uncertainty. In addition to the factors discussed above, among the factors that could cause actual results to differ materially are the following: the timing and strength of new product offerings, pricing strategies of competitors, introduction of competing products by other companies, lack of acceptance of new products and services by the Company's targeted customers, changes in the Company's business strategy, the Company's ability to continue to receive adequate raw materials from its suppliers on acceptable terms, or at all, and to continue to obtain sufficient financing to meet its liquidity needs, and changes in the political, social and regulatory framework in which the Company operates or in economic or technological trends or conditions, including currency fluctuations, inflation and consumer confidence, on a global, regional or national basis and various other factors. Furthermore, the Company does not assume any obligation to update these forward-looking statements.

