Ciba Specialty Chemicals Inc.
Switzerland

Ciba Spezialitätenchemie AG
Schweiz

Ciba Spécialités Chimiques SA
Suisse

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Documentation

Address by Armin Meyer, Chairman and CEO

Ciba Specialty Chemicals Annual General Meeting 2005

Dear Shareholders

2004 was an important year for Ciba Specialty Chemicals:

We took a number of major decisions. They include our acquisition of Raisio Chemicals as well as Project Shape. We were able to increase sales and profitability, despite a demanding competitive environment and a severely negative currency impact.

We have successfully addressed the various challenges facing us, meaning we are well positioned for the future.

Thanks to our inherent strength, along with the measures taken in 2004 and a clear strategic focus, we are in the position to once again propose a payout to the shareholders of CHF 3 per share. This represents a dividend earning of 3.7 per cent gross and over 4 per cent including tax effects.

These are the most important points.

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I've already touched on the important decisions taken last year.

First and foremost is our acquisition of the Finnish paper chemical producer Raisio Chemicals, with sales of over CHF 700 million.

Two factors were crucial to this:

First, the existing paper chemical offering of Ciba Specialty Chemicals and the newly acquired product portfolio are an excellent fit, as you can see from this chart. Our core focal points – such as water treatment, drainage and retention systems, along with dyes and whiteners – are now complemented by Raisio Chemicals' paper coatings, latex binders and starches.

Together we offer in one stop a comprehensive line-up of chemicals for the paper manufacturing process. This puts us at a strong advantage given that paper producers are increasingly concentrating on a few large-scale suppliers. With sales of over CHF 1.3 billion, Ciba Specialty Chemicals has at the same time advanced to become the world's leading supplier of paper chemicals.

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Second, the two businesses are an excellent fit in geographic terms too.
Raisio Chemicals' focus on the Nordic region, Russia and China is a perfect complement to the strong market position of Ciba Specialty Chemicals in Europe, NAFTA and the Asia-Pacific region.

What's more, with the state-of-the-art technology center in Turku, southern Finland, we now have three new research facilities for paper production, paper coating and new print technologies.

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This acquisition should already contribute to net income in its second year, and help us to meet our sales and profitability targets. In order to achieve these objectives a swift, focused and systematic integration is crucial.

To help with this process, we began implementing Project Shape in the fall.

The first priority of the projects is to optimize the production and support organization of the Water & Paper Treatment segment following the acquisition of Raisio Chemicals. Once the integration process and Project Shape have been concluded, we expect the Water & Paper Treatment segment to be generating an EBITDA margin of 14-15% in 2006.

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Second, Project Shape is also aimed at re-focusing the Textile Effects business towards the Asian growth regions, and simultaneously reducing its presence in Europe.

The textile business is currently undergoing a dramatic geographic shift. In North America and Europe, textile production has been falling for years. At the same time, Asia – and China in particular – are rapidly increasing their share of global production. When the WTO textile quotas expire, we are likely to see this process accelerate even more.

Our Textile Effects segment has already been adapting to this situation in recent years by opening production sites in China and through its Asian growth strategy. However, the speed and the scale of this geographic change require us to move up a gear. In particular, there is a need to scale back both the production structure that has grown up over the years and our central marketing organization in Europe. This is likewise being implemented within the parameters of Project Shape.

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We expect to realize annual cost savings of CHF 90 million as a result of Project Shape.

A significant portion of the savings will come from the program's scheduled elimination of 950 positions over the next two years.

This is a difficult, but necessary step. We are carrying it out as a responsible and conscientious employer, and are doing everything we can to support those affected.

In Switzerland, for instance, we have put in place a social plan and will implement the reductions primarily through internal placements, early retirement and natural attrition, thus limiting actual redundancies to under a quarter of the total job cuts. We're also taking a responsible approach at our other affected sites, and are working out solutions with the local employee representatives.

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Project Shape is well on track, and has already passed its first key milestone. That means we will already see some of the projected savings both this year and next. We anticipate having the full benefit of the annual CHF 90 million savings from 2007 onwards.

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That brings me to my overview of our results for year 2004.

Overall, Ciba Specialty Chemicals achieved a sound performance last year in a demanding environment.

Our employees around the globe played a major part in this through their expertise and hard work. At this point, I would like also on your behalf to sincerely thank all our employees.

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Let's now take a closer look at our results for 2004.

Sales were up 6 percent in Swiss francs compared with the prior year. In local currencies, there was an 8 percent rise to just over CHF 7 billion. The newly acquired Raisio Chemicals' business turned in an especially strong performance with a 7 percent increase in local currencies. Adjusted for acquisitions, consolidated sales rose 2 percent in local currencies, while in Swiss francs they were flat due to the exchange-rate situation – especially the weak US dollar.

Three of our four segments improved their sales on an acquisition-adjusted basis. Plastic Additives was up 6 percent, Coating Effects 3 percent and Water & Paper Treatment 2 percent. Textile Effects unfortunately achieved only 95 percent of its prior-year sales figure. Project Shape is partly geared toward countering the structural factors that are at the root of this decline.

Geographically speaking, Latin America and China with double-digit expansion were the main growth drivers in local currency terms. On another encouraging note, there was strong growth of 4 percent in the U.S. – our largest market. And even in Europe, sales were higher everywhere in local currency terms with the exception of the U.K The acquisition of Raisio Chemicals particularly strengthened sales in North and East Europe.

Including acquisitions, profitability improved in 2004 to give an EBITDA margin of 14.3 percent of sales. As expected, margins in the acquired business of Raisio Chemicals remained below-average.

Excluding acquisitions, the core businesses of Ciba Specialty Chemicals raised their EBITDA margin from 14.1 to 14.7 percent of sales.

Net income, before restructuring and special charges, increased by 10 percent in 2004 to CHF 379 million. This equates to earnings per share of CHF 5.74. This figure is actually 14 percent higher than the prior year, due to the reduced number of shares following the share buyback program.

After exceptional restructuring and special charges of CHF 68 million in the fourth quarter, net income comes to CHF 311 million.

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Free cash flow was CHF 270 million. Included in this are cash outs of around 46 million Swiss francs for specific one-time, acquisition-related measures. They included the build-up of current assets for two new plants in China stemming from the former Raisio Chemicals. As expected, the growth achieved in Asia in particular during 2004 led to a limited increase in inventories and receivables. This follows the exceptionally low level of net current assets at the end of 2003.

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Our balance sheet remains strong even after the acquisitions carried out in 2004 as well as the share buyback program on the second trading line.

The chart shows that we still have liquid assets of over CHF 1.6 billion. Gross debt is practically unchanged at around CHF 3.5 billion. And, at around CHF 1.8 billion, net debt is still equivalent to only about 45 percent of shareholders' equity, even after the acquisitions that have been made.

Therefore, our business is in excellent health.

Thanks to our inherent strength, along with the measures taken in 2004 and a clear strategic focus, we are again in the position to propose a shareholder payout of CHF 3 per share.

We are once again taking the opportunity to reduce the nominal value of the Ciba share by CHF 2 – happily this will not be subject to either withholding tax or income tax for most of our shareholders. We are also proposing a CHF 1 dividend. We will come back to these points in agenda items 2 and 5.

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Our results for 2004 mean we are not yet quite where we want to be with the business, but we are convinced that we have taken the right measures in order to get there.

You may well object that the stock market does not share our optimism, and that Ciba's stock price performance has not been meeting everyone's expectations. However,
I believe a more considered approach is called for in order to arrive at a proper assessment.

The price of Ciba stock has in the last four years or so outperformed the Swiss Market Index SMI®. Even though other companies managed to recover in 2004, our performance since January 2001 is still ahead of the total market. In this time frame, Ciba Specialty Chemicals has never suffered the major price setback that others have experienced. As a specialty chemicals business, we are demonstrably less susceptible to economic ups and downs compared with players in the base chemicals sector. Last but not least, Ciba shares are still producing an attractive yield that currently stands at over 4 percent including tax effects.

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Let me clarify our viewpoint: As far as we're concerned our stock price performance is not entirely satisfactory. But at the same time we believe we've achieved a sound performance in a difficult environment.

Even more important, however, is our future performance.

We are convinced that we are well equipped to tackle current and future challenges and that our solid, strategic focus will ensure we remain on a successful long-term course.

I'd now like to take a more detailed look at this in the second part of my presentation.

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The number one issue is the sharp rise in the cost of raw materials. While the raw materials we use are mostly several stages downstream of crude oil, and so hikes in the price of oil have had less effect on us, the record prices we are seeing at the moment are nonetheless impacting on us.

We are addressing this in two key ways.

We are exploiting the benefits of our centralized purchasing operations. In 2004, this enabled us to reduce raw material costs for the entire group even further in the first half of the year. For the year as a whole, we were at least able to keep them stable.

However, our focus now must be on offsetting higher raw material costs through increases in the prices of our products. Since the third quarter of 2004, we have been announcing and implementing a series of – in some cases – double-digit price increases in various product areas.

This has led to a reversal in the price trend. In the first half of 2004 we were seeing prices fall from quarter to quarter, in line with the trend of past years. But in the third and fourth quarters we virtually brought this price erosion to a halt, as the chart illustrates. And price increases will continue to have an additional impact in the first quarter of 2005.

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Exchange rate influences were also reflected in our results for the year.

The dollar strengthened in the period up to 2001, but has since then weakened against the Swiss currency from year to year. This is causing problems for us.
For instance, our operating profit for 2004 was up 16 percent in local currencies, but after conversion into Swiss francs the rise was only 7 percent.

In the short term we are alleviating the impact of this by exploiting currency differences within our purchasing operations. Compared with 2003, for instance, we have increased dollar-based purchases by 15 percent but reduced our purchases in euros. We shall continue along these lines in future too.

The hedging of currency transactions also allows us to counter the impact on consolidated net income in the short term.

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In response to our third challenge – that is, the persistently slow growth in our traditional markets – we initiated the "Managing for Growth" program two years ago. Through a large number of projects, we are working systematically to achieve our goal of profitable growth. The fact is that our traditional markets still harbor potential for growth.

This is also mirrored in the success of various "Managing for Growth" projects over the last couple of years. Here are just two examples:

Industrial production still frequently results in the creation of a large volume of polluted water. In many cases, this waste water is cleaned externally at high cost. Our Industrial Water Treatment project provides an alternative to this: The water used in production is treated and re-used with the help of the specialist know-how and chemicals of Ciba Specialty Chemicals – often on site where possible. Another example includes dye concentrates for plastics, otherwise known as masterbatches. We are now systematically exploiting our knowledge as a provider of specialty chemicals for household and personal care products in order to offer customized masterbatches for the plastic packaging of household and personal care products. We have chalked up major successes, in particular with special effects such as fluorescent dyes and shades that alter depending on the angle of vision.

In overall terms, the "Managing for Growth" projects were already making a significant contribution to the growth in sales in 2004, and we expect this impact to strengthen in 2005 and beyond.

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In most case we are able to tackle the challenges that have been mentioned through short-term measures.

But we are also pursuing long-term strategies in order to secure the future success of our company on a lasting basis.

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Innovation is right at the top of this list.

Being able to bring innovative products to market swiftly and continuously is crucial for profitable growth and international competitiveness. We consistently invest more than 4 percent of sales in research and development. In addition, through a special research fund we are fostering some CHF 15 million of projects annually – projects geared to developing fundamental new technologies. Focal points here include biotechnology, nanotechnology and surface structures. Medium-term, around one third of our sales should be generated by products that are less than five years old - an increase of around 25 percent.

In 2004, for instance, we launched a unique, patented coatings' treatment that transforms plastics – even metallic plastic film – into a high-quality print medium.

The new Ciba® Prime IT™ product creates a permanent bond between the printing ink and plastic, thereby preventing the color from flaking off. And unlike other technologies, Ciba® Prime IT™ can be applied long before the printing stage. The potential applications are tremendous, ranging from plastic packaging and extending as far as credit cards. What's more, the plastic packaging for this year's annual report also uses this new technology.

We are complementing our own research through cooperation with leading external partners. The latest example is our collaboration with the Federal Institute of Technology (ETH) in Zurich, which this year celebrates its 150th birthday. Functional materials with special mechanical, optical and electronic properties are set to play a major role in specialty chemicals in the future. For that reason, we are providing the Department for Materials Science at the ETH Zurich with CHF 1 million annually to fund projects that will also be of interest to us in terms of future business opportunities.

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Second, in strategic terms we are increasingly offering integrated solutions and services alongside chemical products.

Our specialist expertise enables us to develop integrated solutions and manage entire processes and procedures on behalf of our clients. This can also be done independently of our products, as evidenced by the successful start-up of our new Ciba® Expert Services business unit. Spanning a worldwide network, it provides a broad array of services in the field of registration, environment and security, testing, as well as education and training. We already have a large number of customers on board.

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A consistent focus on the needs of customers as well as consumers is a core strategic factor in terms of building value beyond the confines of the chemical sector. We have made major progress in this area in the past few years, but still have huge potential for growth.

I have therefore asked Hermann Angerer, Head of the Coating Effects segment and a member of the Executive Committee, to provide you with a more detailed look at how we are systematically exploiting our specialist expertise across the entire value chain – from industrial users of our products through to consumers – and achieving optimal results in the process.

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Achieving a geographic balance is strategically important on two counts.

On the one hand, emerging economies in regions like Asia have the dual role of being new markets for our products but also being new competitors. As explained in detail at last year's general meeting, we shall be continuing to expand our position in Asia in order to remain competitive in the face of greater competition from Asia and China in particular, and at the same time with a view to exploiting growth opportunities in these markets.

On the other hand, a business can lessen the impact from currency fluctuations on a long-term basis by dovetailing the share of revenue and costs in each currency.

With 27 percent of our sales in Asia-Pacific, we occupy a leading position in our industry. On the cost side, however, Europe's share of fixed assets is significantly higher than its share of sales; by contrast, Asia-Pacific's share is around two thirds smaller in comparison.

We are, however, on the right track: We are not only achieving above-average growth in Asia. We have also raised our investment in Asia markedly, and it is primarily there that the expansion of our production capacity is taking place. The latest example is our increased capacity for manufacturing plastic stabilizers in Shanghai, China. The scaling down of Textile Effects production and marketing in Europe – under the auspices of Project Shape – also points in this direction. Overall, this needs to be seen in a longer-term context, given that shifting production facilities is no easy matter.

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Another pillar is the achievement of persistent excellence in operations performance. Ciba Specialty Chemicals has already taken major steps toward this goal, in the form of a unified financial system, a supply chain that extends across all businesses, and focused regional support structures. Having reorganized the group into four customer-focused segments in 2004, we will now be turning our attention to a further streamlining of business processes. This includes worldwide standardization of processes in production marketing and sales, supported by cutting-edge software.

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Finally, our long-term strategic focus is not only on our financial performance but also on sustainability – in other words responsibility toward the environment and society at large. We aim to achieve good results in all three of these areas. It is our firmly held view that a responsible and sustainable business policy is essential if we are to achieve profitable growth for our shareholders on sustainable, long-term basis.

In the annual report, our environmental and social performance is placed alongside the purely financial aspects of our business.

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We also take our responsibility seriously for the disposal of chemical waste that occurred in the past. Consequently we have, together with other chemical companies in the Basel region, contracted the association for landfill safety to conduct a risk assessment and have committed to support the development of all necessary measures.

In view of the complexity – the 11 landfills are in three different countries with different laws – the association is progressing satisfactorily with its assessment. As a result we were able last week to reach an agreement with the French authorities on the way forward.

Only when the conclusions are available can decisions be made as to whether and which remediation measures are necessary. Total remediation, as demanded by some environmental groups should not be an end in its own right. Preferable, is a risk-managed solution to the problem. We are conscious of the responsibility and want to comprehensively face up to it.

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That finally brings me to the outlook for the current year.

Our inherent strength, along with the measures taken in 2004 and a clear strategic focus, provides us with the basis for confidence going forward.

However, we expect to continue to face some difficult challenges in 2005, particularly a tough competitive environment, rising raw materials costs and an ongoing negative currency impact. I've also shown you how we are tackling these challenges through targeted measures in the short and medium term.

Assuming business conditions in 2005 are equivalent to last year, and that currency levels do not worsen further, we expect sales for the current year to be higher in local currency terms. In Swiss francs, we expect EBITDA and a comparable net income above last year's levels. Free cash flow in 2005 is expected to be between CHF 250 - CHF 350 million.

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With our solid balance sheet, clear operational priorities and long-term, well-planned strategy, Ciba is well positioned for the future.

I would like to take this opportunity to express my thanks to you, our shareholders, for your loyalty and support.