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Documentation

Presidential Address, Annual General Meeting 2006

Armin Meyer, Chairman of the Board and CEO

Dear Shareholders,

2005 was the most challenging year so far in the history of Ciba Specialty Chemicals. And this General Meeting is my most difficult so far because, ladies and gentlemen, I must to some extent disappoint you. In 2005, we missed our targets. I regret this also for the sake of our employees, who in 2005 again showed a strong commitment to our company.

We have received responses, written and oral, to the financial results announced four weeks ago as well as to the agreement to sell the textile business. Responses from you, our Shareholders, and from you, our colleagues. Among them were factual questions, understandable concerns about your own and the company's future and disagreement with particular decisions.

The Board of Directors and I do not want to whitewash anything, and we accept that people may have divergent opinions on any subject. A case in point is textile effects – the root of Basel's chemical industry, the root of Ciba Specialty Chemicals, not merely a business that is good or less good, but rather and above all an emotional topic. Also for the Board of Directors. Some criticize us for divesting the textile business too late, others for doing so at all or too soon, while still others find fault with the sale price. Some criticize us because we supposedly have no strategy, some believe we must do more for the share price and restructure more aggressively, others think we pay too much attention to the share price and demand too much of people too soon. Still others write to us saying a dividend of 3 Swiss francs is too much, first because it has not been generated by our operations and second because employees are left empty-handed.

All of this is part of the free expression of opinions, which I might add is characteristic of Ciba Specialty Chemicals' very open communication culture. But there are also facts and business fundamentals that one cannot change at will. It is on these that we must

focus. In the name of the Board of Directors and the Executive Committee, I will now present all of these points, which concern you as well as us, in light of the facts.

Ladies and gentlemen, before I come to the financial results for the year 2005, allow me to make three introductory remarks:

1. Ciba Specialty Chemicals has excellent employees all over the world. To them I offer my very personal thanks.
2. Ciba Specialty Chemicals continues to have a healthy balance sheet and is fully capable of action.
3. Ciba Specialty Chemicals has an outstanding reputation among customers and competitors worldwide.

As I have said, 2005 was the most demanding year in the history of Ciba Specialty Chemicals. Instead of having a wind at our backs, we faced a headwind most of the way. By this I do not mean to excuse the fact that our results, although not bad, are also not good enough – neither for you nor for us. Rather, today I would like to present to you what we have done and will do, despite the obstacles, to regain our lead – also in a financial sense.

Allow me to begin by commenting on our recent decision to sell the textile business. As you know, for several years now the customer base for the textile business has been shifting more and more strongly out of Europe and North America toward Asia. At the same time, competition has increased due to new – particularly, cheaper – suppliers of textile dyes and textile chemicals in Asia.

Ciba Specialty Chemicals already started building up production sites for the textile business in China back in the 1990s. Faced with declining margins, it also launched Project Shape in 2004. However, the end of WTO textile quotas led to a boom in textile imports from Asia in the 2004/2005 winter half year and a corresponding slump for the textile industry in Europe and North America.

Last year, the Board of Directors therefore initiated a fundamental analysis of how our company's textile business might be repositioned in the longer term. The analysis included evaluations of both internal and external solutions, including the possibility of a divestment. With advisement from an investment bank, several bids were studied in detail as part of a formal auction.

After an extensive and intensive examination of all the options, the Board decided that the sale of the textile business to Huntsman is the best solution – not only for the textile business itself, but also for employees and for Ciba Specialty Chemicals as a company.

The buyer, Huntsman, is a seasoned US chemical company with annual sales revenue of over USD 11 billion. Also, as a result of the takeover of Ciba Specialty Chemicals' former Performance Polymers division, Huntsman also already has a presence in Basel.

With the sale, the 3,300 staff employed in the textile business and a further 900 support staff will cross over from Ciba Specialty Chemicals to Huntsman; no one will fall between the cracks as a result of this deal.

As a very regional business, Textile Effects poses specific demands in terms of business structures, with numerous local sites all over the world. The sale of this business will allow our company to tailor its structure to the needs of the three remaining segments.

The sale will make Ciba Specialty Chemicals stronger. With the textile business, 22 percent of the workforce and 17 percent of sales will go to Huntsman. However, this business accounted for only 11 percent of operating profit; hence the sale will result in an increase in Ciba Specialty Chemicals' profit margins.

Above all, however, this move will allow us to focus both our strategy and our limited resources on our core businesses of Plastic Additives, Coating Effects and Water & Paper Treatment. I will come back to our strategy in these areas later.

We are aware that this decision has an emotional impact, and not just for employees. The production of synthetic textile dyes is an important historical root of the chemical industry in Basel. Changes enabling a focus on the future, however, have always characterized the development of our industry. In the last ten years alone, there have been a large number of both mergers and spin-offs, from which Basel's chemical industry has doubtless emerged stronger than before. We now of course also wish Huntsman the same kind of success with the textile business.

What will the financial impact of the sale be? An auction process with a number of potential buyers established a price of CHF 332 million in cash and in assumption of debt. During this process, Ciba Specialty Chemicals was advised by the investment bank Greenhill, which specializes in this type of transaction. With the sale, Ciba Specialty Chemicals will be able to reduce its net debt by around CHF 200 million in the current year, and by a further CHF 80 to 100 million later on. The Board is convinced that this also represented the best solution in financial terms.

On the other hand, mainly in this year, net costs after tax will arise from the transaction, the separation of the segment and organizational adjustments; these costs will add up to CHF 100 to 120 million. Moreover, on completion of the deal, which is expected for the third quarter of 2006, we will have to write off some CHF 250 million after tax. The write-off results from the difference between the sale price and the value at which Textile Effects is still listed in our books.

As can be seen in our Annual Report, we also recorded an impairment of the textile business already at the end of 2005. We were forced to take this step after the value of the textile business declined sharply due to the dramatic change in the textile market. A further CHF 120 million went on restructuring costs and other charges relating to Project Shape in 2005.

After the aforementioned special effects, this ultimately resulted in a net loss of CHF 256 million. However, this loss mainly arises from the reduction in book values, which is a non-cash charge; in other words, it does not entail an outflow of funds from the company. Our balance sheet therefore remains sound and there will be a reduction in net debt.

Before I go into the future of Ciba Specialty Chemicals after the sale of its textile business, I would like to make a few brief remarks regarding the operating result for the 2005 business year.

We achieved pleasing sales growth of 6 percent in Swiss francs and 4 percent in local currencies thanks to higher sales prices, robust growth in the Asia-Pacific region and the acquisition of the paper chemical business of Raisio Chemicals.

However, we were also confronted with a series of external cost increases. In particular, the cost of raw materials increased by no less than 10 percent in 2005. This was mainly due to oil prices, which reached all-time highs. In addition, certain raw materials became subject to capacity constraints which drove up prices even more. Although we purchase raw materials from the lowest-cost suppliers worldwide, the raw material prices alone resulted in additional costs of around CHF 280 million. The high oil price was also reflected in a rise in energy prices. Moreover, like all firms, Ciba Specialty Chemicals was confronted with higher pension costs. Together, these extra costs added up to nearly CHF 400 million in 2005.

We have, however, also made substantial efforts to offset these higher costs. The most important countermeasure was raising the sales prices of our products across the board, which brought in additional revenues of around CHF 160 million. Specifically, we increased our 2005 sales prices by 2.5 percent. The Plastic Additives and Water & Paper Treatment segments, in particular, raised their prices. Thus, we have achieved a clear reversal in sales price trend, considering that in the last few years we have had to accept price declines of around 3 percent per year. This makes the efforts of our sales staff in persuading customers to accept these price increases even worthier of our appreciation. Furthermore, in the current business year we will again make every effort to pass on even more of the increase in raw material costs to customers.

We realized total cost savings of CHF 60 million with Project Shape. On the one hand, as already mentioned, this project aligned the textile business with the altered market conditions. On the other hand, it covered the integration of Raisio Chemicals, acquired in 2004, into our paper chemicals business. This integration is now complete, and anticipated synergies are being realized.

Through the aforementioned price increases and cost savings, we were able to counter the additional costs. Nevertheless, our bottom line operating income before special effects declined from CHF 612 million to CHF 579 million. EBITDA remained virtually unchanged at around CHF 1 billion. However, due to the increase in turnover, the EBITDA margin edged downwards from 14.3 percent to 13.5 percent. Finally, net income before special effects fell by CHF 10 million to CHF 364 million.

The higher raw material costs are also reflected in our free cash flow. After a very weak first half of the year, cash flow did recover markedly in the second half and reached CHF 250 million before restructuring payments. The contraction of CHF 150 million was mainly due to the prices of raw materials. Although inventory volumes fell by 3 to 4 percent, values rose, resulting in a cash outflow of CHF 100 million.

I would also like to mention here that last year we were able to make further progress on the environmental front. Our performance on all five eco-efficiency indicators – energy use, water consumption, global warming contribution, ozone depletion and waste generation – improved relative to production volume. We are also pleased that the frequency of lost-time accidents decreased for the fifth time in a row.

The fact that, against a backdrop of difficult conditions, the decline in operating margins could be kept within clear boundaries is primarily thanks to the more than 19,000 employees of Ciba Specialty Chemicals. They increased prices on the sales front, improved productivity at manufacturing level and sought the most cost-effective avenues possible in the purchase of raw materials and in marketing. I would like to convey, in your name too I am sure, our sincere thanks to all these employees.

I would also like to thank you, our shareholders, for your loyalty to the company. This has probably not been easy for you in the face of share price developments over the last year. While share prices in many other sectors skyrocketed over this period, the price of Ciba Specialty Chemicals' shares declined. Neither you as shareholders nor we as responsible board members and managers of Ciba Specialty Chemicals can be satisfied with this.

However, it should also be remembered that in the last five years Ciba Specialty Chemicals' shares were able to maintain their edge on the Swiss SMI index for a long time and only lost this edge in the spring of 2005. And our company never suffered a major plunge in share prices over this period, which cannot be said for many other firms. Now the crucial task for Ciba Specialty Chemicals is to achieve further progress going forward, even if headwinds continue unabated.

As you can see from your invitations, the Board of Directors is proposing a dividend payout for the 2005 business year of CHF 3 per share. The proposed payout matches that of last year if the dividend of CHF 1 and the reduction in par value of CHF 2 are added together. In making this decision, the Board of Directors was driven by two crucial considerations. First, Ciba Specialty Chemicals succeeded in containing the effects of the difficult market conditions on the current operating results within clear limits. Second, the Board of Directors is confident in the company's future. This payout also complies with the principle of continuous dividend increases.

We are aware of the criticism that employees are not receiving any incentives while a dividend of the same high value as last year is to be paid out. It is important here to bear firmly in mind, however, that dividends are not comparable to the incentive for

employees. The shareholders receive the dividend because they have provided capital for the establishment and development of the company. This corresponds to the salary that employees receive for their committed work. And Ciba Specialty Chemicals pays good basic salaries which are being increased again this spring. It therefore makes sense to grant the shareholders a dividend in the same amount as last year's payout, especially as they bear the business risk primarily via the share price.

As mentioned, Ciba Specialty Chemicals plans to focus on its core businesses in plastics, coatings, and water and paper treatment going forward. This brings me to our strategy.

The Board of Directors is fully confident that Ciba Specialty Chemicals can succeed as an independent chemical company. This is a clear mandate to all levels of the company's management, and we will not allow ourselves to be misled by rumors on this subject. The closing of the sale of the textile business, expected for the third quarter, will lay favorable foundations for swift implementation of the focused strategy aimed at strengthening our core businesses.

We are pursuing three key paths.

First, we already hold leading positions with our products for the plastics and coatings industries. We plan to extend this lead even further, not least by strengthening our partnerships with the customers in these areas and offering them a comprehensive product range.

The second key priority is to further develop our leading position in paper chemicals and our strong position in water treatment. We must also attain a marked improvement in profitability.

Third, we intend to take advantage of the opportunities in niche markets such as electronics, lubricants, personal care and others even more systematically.

Now I would like to offer an example of how we are extending our leading positions in the areas of plastics and coatings. As a supplier to the coatings industry, we took two important steps last year by adding effect pigments to our existing pigment range. To this end we acquired an aluminum technology and established a joint venture for pearlescent effect pigments in China. These steps have strengthened our position in this premium market appreciably. Ciba Specialty Chemicals now offers high-reflectance mirror effects for automobiles and luxury products, soft, shimmering pearlescent tones for cosmetics and printing and fluorescent tones for safety clothing and vehicles.

The water treatment area saw double-digit growth last year. Water is a vital resource. With our highly effective products and process systems, we make a significant contribution to water supply and environmental protection. Since the acquisition of Raisio Chemicals, we also offer a comprehensive range of paper chemicals; this business has now been fully integrated and we are currently exploiting the synergies created. However, we still face higher raw material costs.

We have already successfully taken the opportunity to apply our technologies in additional niche markets and plan to continue doing so in the future. Our UV filters for

sun creams, for example, have grown into an important source of revenue in the five years since their launch. Thanks to Ciba Specialty Chemicals' filters, numerous sun creams and care products today protect skin from both UVA and UVB rays. Moreover, in December the US health authority FDA gave the go-ahead to submit the documents required for approval for use in the US. FDA approval would further boost the growth potential of our UV filters.

Innovation is of particular strategic significance to the success of Ciba Specialty Chemicals. Last year, we invested over CHF 300 million in research and development. With around 1,500 researchers, we were able to file 160 new patents in 2005, mainly in the Plastic Additives and Coating Effects segments.

To achieve successful and rapid market implementation of new chemical solutions, Ciba Specialty Chemicals regularly teams up with partners. An example: Until recently, the "best before" date has been the only guarantee of freshness for meat, fish or milk. Now Ciba Specialty Chemicals has developed new Time-Temperature Indicators. As labels or printed directly onto packaging, these conspicuously indicate via a change in color when a product is past date or has been stored at too high temperatures. Ciba Specialty Chemicals produces the special pigments developed by our partner Freshpoint and contributes its know-how in UV activation, ink formulation and food packaging regulations. Consumer testing has revealed a strong desire for such products.

A promising area for the future is that of so-called white biotechnology, in which fermentation and biocatalysis are used to complement classical chemical synthesis or to make new products possible. Another direction for research is that of using nanomaterials for coatings and surface modification. Interesting, forward-looking projects are also under way in the field of organic electronic materials, for example, organic light-emitting diodes.

Besides innovation, another strategic success factor that I would like to particularly emphasize is presence in geographical growth markets. In addition to Latin America, Eastern Europe and the Middle East, Asia, in particular, offers attractive growth opportunities. Already last year, 29 percent of Ciba Specialty Chemicals' consolidated sales were generated in the Asia-Pacific region. With 11 percent growth in Swiss francs, we grew more than twice as much in Asia-Pacific as in Europe.

Within Asia, India stands out with a gain of 16 percent in local currencies; with a steadily growing middle class, this country has great potential. China also achieved above average growth once again, with 12 percent.

So much for our key strategic priorities. The crucial matter, of course, is to implement the strategy consistently and to improve operational performance in a highly focused way. I have therefore asked our new Chief Operating Officer Brendan Cummins to outline for you in a moment the operational focal points for the coming years.

I come now to the conclusion of my presentation. How do we assess the prospects for 2006?

Ciba Specialty Chemicals expects business conditions in the current year to remain essentially similar to those in 2005. Accurate forecasting for utility and raw material costs is difficult, as oil prices continue to fluctuate substantially; despite this, it is likely that the effects of these costs on Ciba Specialty Chemicals will remain significant. It will therefore be even more important to mitigate this high level of costs with further sales price increases going forward.

While sales in 2006 are expected to exceed 2005 levels in local currencies, we intend first to analyze in more detail the effects of the sale of the textile business on profitability and cash flow, and will therefore only announce our guidance for 2006 in this regard with the quarterly results at the end of April.

With our technological strengths, our global presence in growth markets and especially the expertise of our employees, I am confident that this year we will make further progress in what will remain a challenging environment.

I would like to thank you, our shareholders, for your support. Thank you.