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Documentation

Presidential Address, Annual General Meeting 2006

Armin Meyer, Chairman of the Board and CEO

Dear Shareholders,

2006 was a year of transformation for Ciba Specialty Chemicals. We divested our textile business, the historical root of our company. We refined our strategy and now have a clear focus on the core businesses Plastic Additives, Coating Effects and Water & Paper Treatment. We launched the Operational Agenda to enhance efficiency across the company and accelerate growth and innovation. And, last but not least, we improved both our sales and our underlying profitability. Based on this, the Board of Directors is again proposing a dividend of 3 Swiss francs per share.

By the end of this year, we will have implemented the essential strategic changes in the company. The Board of Directors has therefore decided that the start of 2008 will be the right time to adapt the company's management structure and to eliminate the double mandate. From early 2008, I will concentrate on my role as Chairman of the Board. The Board of Directors has appointed as the new Chief Executive Officer Brendan Cummins, who has been Chief Operating Officer since 2005. I am pleased that we are thus transferring responsibility for operational management in a gradual, orderly way.

We have also abolished so-called golden parachutes, the compensation payments to which the Executive Committee and three other executives had been entitled if dismissed in the event of a change in control of the company.

With this move, the company is underscoring its commitment to further strengthening corporate governance and adapting to the latest developments.

When Ciba Specialty Chemicals was spun off ten years ago, we had the great advantage of being able to continue to use the historic Ciba brand. As you know,

Ciba is short for **C**hemical **I**ndustry **B**asel, and this is the name by which our customers around the world know us.

I am pleased to announce that a new agreement with Novartis allows us to use the name "Ciba" without the suffix "Specialty Chemicals" with immediate effect. We will implement the change in the various national companies and then conclude the process by proposing to change the name of the holding company from Ciba Specialty Chemicals to Ciba at the 2008 Annual General Meeting.

Allow me now to take a look back at our business in the past year.

As I said at the outset, 2006 was a year of transformation. The most important change was surely the divestment of the textile business.

I explained the reasons for this move at last year's Annual General Meeting. The sale allows Ciba Specialty Chemicals to focus on its core businesses and, most important, to align and streamline its structure accordingly.

Today I can report that we successfully completed the divestment in the summer of 2006. In the space of just four months, our employees were able to separate business and support structures that were formerly closely interwoven and to establish independent processes in their place — an impressive accomplishment by everyone involved. The associated costs even came in under budget.

We also sold our masterbatch business to Clariant at the end of 2006. This regional business, with sales of 80 million Swiss francs, had a presence in only three countries. By selling it, we have further strengthened our focus on our global core businesses.

Overall, our continuing operations performed better in 2006 than in the previous year. I'm sure I also speak for you when I express our sincere thanks to Ciba's employees for their dedication and crucial contribution to the company's success.

In 2006, we succeeded in increasing our sales from continuing operations by 5 percent, to 6.4 billion Swiss francs. The segments Plastic Additives and Coating Effects contributed especially to this result.

Asia remains our most important growth driver. We increased our sales in the Asia-Pacific region by 9 percent in local currencies. Growth in the China region was 16 percent, and in India it even reached 19 percent. We intend to further expand our position in these markets accordingly.

With higher sales in 2006, we also succeeded in increasing our operating profit by 5 percent. Like last year, our operating profit margin was 8.4 percent of sales. However, the operating profit for 2005 included one-time proceeds of 68 million Swiss francs from the sale of real estate holdings that were no longer needed. Excluding these special effects, we were thus able to improve underlying profitability by about 1 percentage point.

After a sharp increase in raw material and energy costs the previous year, in 2006 we were again confronted with a 90 million Swiss franc increase in expenses. Pension and payroll costs also rose.

We were able to partially offset the increase through better capacity utilization in our production plants. But the most decisive factor was savings from Project Shape, which was launched in 2004. Shape produced savings of 95 million Swiss francs last year in our continuing operations. Other measures yielded a further 36 million Swiss francs in savings.

Project Shape, which also benefited the recently sold textile business, demonstrated our ability to implement our improvement measures systematically and achieve the intended savings.

Two of our three segments performed exceptionally well. Plastic Additives boosted its operating profit margin substantially to 14.9 percent of sales, and Coating Effects also improved its margins, to 13.6 percent.

The profitability of the Water & Paper Treatment segment, unfortunately, was unsatisfactory. I'll return in a moment to the reasons for its operating profit margin of just 3.3 percent and to the countervailing measures we are implementing.

Overall, the continuing operations generated a profit of 306 million Swiss francs in 2006 before one-time effects, 7 percent more than in the previous year. The losses from the discontinued businesses – mostly book losses – were somewhat lower than expected at around 300 million. As a result, the bottom line after restructuring costs was a consolidated loss of 41 million Swiss francs.

Although the divestment of the textile business was responsible for the consolidated loss, it also yielded cash proceeds that enabled us to reduce our net debt by about 110 million Swiss francs. An increased free cash flow of 195 million Swiss francs also helped. The 2006 free cash flow figure also includes temporary cash outflows of 50 million Swiss francs, so assuming comparable circumstances, free cash flow should be higher in the next few years.

The shareholders' equity line of our balance sheet was also affected by new US GAAP regulations concerning the reporting of pension liabilities. Under these rules, information that was previously fully disclosed in the notes to our financial statements is now included on the balance sheet, without affecting cash flow or the income statement.

Why is the Board proposing an unchanged dividend of 3 Swiss francs per share despite a consolidated loss of 41 million Swiss francs? There are several reasons.

First, we achieved higher profits in our continuing operations and have initiated key measures to continually enhance profit margins in the years to come. From the Board's vantage point, this carries greater weight than the consolidated losses of 2005 and 2006, which mainly represent book losses in the discontinued businesses.

Second, even after the proposed dividend distribution, we will have adequate funds to invest in the future of our business. Having focused on our core businesses, we are not planning any major acquisitions in the foreseeable future. At the same time, the

sale of the textile business brought a cash inflow of 200 million Swiss francs last year, and we expect to receive a further 100 million Swiss francs. This has reduced our net debt, and at year-end we still held more than 1 billion Swiss francs in cash.

Third, and not least, a stable, high dividend benefits our shareholders. We are committed to taking appropriate account of your interests as well.

We will deal with determining the dividend under agenda item number 3.

Our improved results are not yet reflected in our share price, unfortunately. Not long ago, our shares were selling at about the same price as during last year's Annual General Meeting, and the stock market slump of the last several days has led to another drop in price.

The current share price is something with which neither you as shareholders nor we as the responsible board members and managers of Ciba can be satisfied.

We know that we can ultimately influence the share price only by continuing to improve the financial results of Ciba and by decisively implementing the measures we have initiated to achieve that goal.

In the second part of my address, I would like to look at our refined strategy and certain key aspects of it in more detail.

All our main markets around the world are of considerable size, between 7 and 15 billion Swiss francs, as you can see on this chart. Most of these markets are also growing faster than the global gross national product. Both market size and market growth mean substantial future expansion opportunities for our businesses.

Our core businesses Plastic Additives and Coating Effects will take advantage of this potential through targeted investments in growth and innovation. In our core business Water & Paper Treatment, however, we are focusing first on improving profitability. Our niche businesses have a clear growth focus. We intend to expand our position primarily through organic growth and to make only small acquisitions that fill gaps in our technology base and increase our market share.

The market for plastic additives is experiencing the fastest growth. Global consumption of plastics is rising at more than 5 percent a year. With rising living standards, Asia especially is using ever more plastic. Moreover, research and development work is steadily improving the properties of plastics, expanding their uses and driving growth in mature markets as well.

Ciba already has a leading position in plastic additives. To expand this position, we are further reinforcing our global cost leadership and seizing opportunities in those regions with the fastest growth.

Just as important for growth are innovative products, such as our new generation of clarifiers for polypropylene. Packaging is by far the most important application for plastics, and consumers like being able to see package contents directly. Our new product offers outstanding transparency and does not create odors or cause degradation during processing. In developing this product, we have created a new chemical platform for our company.

A strategic focus in our second core business, Coating Effects, is to strength those market segments with the highest value generation potential, while simultaneously extending our technology lead. Ciba is already the leader in photoinitiators, which enable paint to be cured in seconds on exposure to light, without a long drying process or polluting solvent fumes. But the shadow areas on three-dimensional objects still create problems. To meet this challenge, we worked with partners to develop the new UV PlasmaCure™ technology, which we have already successfully tested together with automakers. In this process, distributed plasma particles are activated as light sources in an enclosed chamber, curing paint even in shadow areas. The process allows the production of exceptionally scratch-resistant surfaces.

Our core business Water & Paper Treatment also holds a strong market position, although as I have said this was not enough to produce commensurate performance in 2006. Although higher raw material costs and one-time factors such as the consequences of a fire in Grenzach did have an impact on our operating margin, we must also acknowledge that the strategy we have pursued until now, especially in the paper market, has not yielded the expected results. Marketing has been insufficiently differentiated, and the one-stop-shop concept of offering paper customers a broad product range from a single vendor has generated little added value.

Because of the unacceptable margin, strategic attention in the Water & Paper Treatment segment over the next few years will have to be wholly focused on improving profitability.

Our water business has already been successful in targeting high-value, high-growth markets, but there is still room for improvement.

In the paper area, a new management team is implementing additional targeted measures. This includes differentiated business models for the various market segments. For example, focused consulting can generate genuine value for customers in paper making, whereas in paper coating the offer is the product. Our paper research is being even more strongly focused on special effects, and the entire production network, including purchasing and sales, is being made more efficient.

At the same time, we are paying even closer attention to geographical hot spots of growth. In China, for example, per capita paper consumption is still only one-tenth that in the United States, and forecasts put the growth rate of the Chinese paper industry at 10 percent.

On a substantially more positive note, the 2006 performance of our niche businesses confirmed their long-term potential.

For example, we achieved very strong sales growth in personal care, driven by our UV filters for sunscreen creams, which benefited from higher UV-A protection standards in European markets. The process of getting approval for these products in the demanding US market is incidentally well under way.

Our oil and lubricant additives help customers meet ever more stringent environmental standards. Our focus today is on the needs of tomorrow. For example, we have introduced a new stabilizer for biodiesel. Derived from natural, renewable resources such as vegetable oils or recycled cooking oil, biodiesel is an environmentally safe alternative to petroleum-based fuels. Our stabilizer keeps biodiesel from oxidizing and producing deposits that can damage fuel injection systems and engines.

Our electronic materials niche business is profiting from the sweeping success of liquid crystal displays, in which our special color pigments and photoinitiators play an important role.

Finally, we strengthened Expert Services, our product-independent consulting business, with the acquisition of Cantox Health Sciences last year. This leading registration and consulting company in areas such as foodstuffs, healthcare and consumer goods can now benefit from our global presence and from Expert Services' established analytical and testing processes.

To implement our strategic focus, we are setting clear priorities for resource allocation.

Because innovation is of key strategic importance in our core businesses Plastic Additives and Coating Effects, we invest some three-quarters of our research and development resources in these two segments. A further 8 percent goes to corporate research, which focuses on fundamental new technologies that are relevant to all the businesses, such as biocatalysis and material science.

Collaboration with external research partners is of growing importance for innovation. We complement our own research by working with leading external research partners and building on the results in our own application areas.

For example, if simple printing processes can be developed to replace costly methods of producing electronic devices, entirely new opportunities will open up for mass production of electronic sensors, solar cells and organic LEDs, to name just a few examples. That's why we've been working with the Max Planck Institute for Polymer Research since last autumn to develop printable organic electronic materials. And six weeks ago, we announced a collaboration with the VTT Technical Research Centre of Finland to investigate roll-to-roll printing processes and compatible electronic materials.

We are setting similar priorities for investment in our production facilities. The key aim is to expand our production capacity in Asia, where our sales are also growing the fastest. We more than doubled our capital expenditures in the Asia-Pacific region last year.

At 125 million Swiss francs, our new plastic stabilizer production facility in Singapore is Ciba's biggest capital investment yet. Construction is progressing well, with production slated to begin early next year. The innovative production processes and state-of-the-art technologies in use there will further extend our cost leadership. The facility's location on major trade routes enables us to supply not only high-growth Asian markets but also the Middle East, where crude oil is increasingly being refined locally and used to produce plastics, among other products.

Implementation of our strategy is being supported by the Operational Agenda, our program to enhance the efficiency and effectiveness of all core processes. This includes not only adapting our geographical presence to our core businesses, implementing an integrated IT platform and optimizing our production network, but also enhancing our profitable growth and innovative capacity through targeted initiatives in marketing and sales and in research and development. Brendan Cummins will explain these initiatives in more detail later.

We expect the implementation of our strategy and the Operational Agenda to significantly improve our results over the next three years. Overall, our cost structure should improve by 400 to 500 million Swiss francs by 2009. At the same time, restructuring costs will be 250 to 300 million Swiss francs. Together the Operational Agenda measures will render about 2,500 jobs redundant by 2009. We are taking seriously our responsibilities to the employees affected by exploiting natural attrition and by finding new jobs inside or outside the company wherever possible.

The specific results we expect from the strategy and the Operational Agenda are:

- average annual sales growth of 3 to 4 percent in local currencies;
- a 1 percentage point increase in the operating margin in 2007 and in 2008, followed by an even larger increase;
- and significantly higher free cash flow starting in 2008.

Business conditions in 2007 are expected to remain similar to those in 2006. Accurate forecasting for utility and raw material costs is difficult, as the oil price continues to fluctuate substantially. Despite this, the company's current assumption is that the impact of these costs for Ciba will remain fairly stable at a high level.

Sales for 2007 are expected to increase over 2006 levels in local currencies. Before restructuring, impairment and other charges, operating income margin is expected to increase by 1 percent, and both net income in Swiss francs and free cash flow are expected to be above 2006 levels.

In closing, let me say that after a year of transformation, we are in the process of taking decisive steps to significantly improve our company's performance.

I know that we have not always succeeded in meeting shareholders' expectations in recent years, and I would like therefore to thank you that much more for the trust that you continue to put in our company.

I am confident that we have an effective strategy in place and are implementing the right operational measures to get Ciba fully back on track.

And with that I'll give the podium to our future CEO, Brendan Cummins.