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Documentation

Address by Armin Meyer, Chairman and CEO

Ciba Specialty Chemicals Annual General Meeting 2003

Dear Shareholders:

Analogies should always be used with caution. But when we look around us we can say with good reason that: Ciba Specialty Chemicals stands like a rock in a stormy sea.

2002 was a difficult year – which makes it all the more gratifying for me to be able to report such a good result today. Our earnings have increased thanks to rigorous cost management and aggressive marketing. At the same time, we have again generated a very strong cash flow. We can, therefore, propose to you once again an increased payment to shareholders of 3 Swiss francs per share – which translates into a total distribution of 200 million Swiss francs.

Ciba Specialty Chemicals is well equipped for the future too, which is why we are as committed as ever to our medium-term goals:

- Sales growth averaging 6 percent per year until 2005 and
- an EBITDA margin equivalent to 20 percent of sales and a free cash flow of 1 billion Swiss francs in 2005.

These are, in summary, the most important points.

I would first like, however, to take this opportunity to thank all our employees worldwide for their hard work and to thank you, dear shareholders, for your confidence in our company.

I would like now to explain to you the results for 2002 in rather more detail. Then I will present our new program we have launched for promoting profitable growth, "Managing for Growth". The third part of my speech will then be devoted to the highly topical issue of corporate governance and sustainable corporate development, followed by an outlook for the year ahead.

1. Ciba tops last year's good results

The year 2002 was especially challenging, as was the previous year. We had to hold our own in a very difficult business environment, in which worldwide GDP rose by a paltry 2 percent, according to most estimates. The fourth quarter continued to weaken. The external influences could hardly be described as conducive to success – which also means that what we achieved was entirely the result of our own hard work. And we achieved a great deal:

In 2002, we were again able to strengthen our market position.

Many of our businesses enjoyed above-average growth, with new products having an especially important role to play – a fact that once again underscores our innovativeness. Furthermore, due to our global presence, we have been able to enjoy our share of the above-average growth that many parts of Asia and Latin America have seen. Our customers still rely on our top quality products and thanks to our “quality before volume” strategy, we have been able to limit price concessions too. All in all, we have achieved sales growth in local currencies of 3 percent, having at the same time increased our market share.

Four out of five segments were able to top last year's sales figures in local currencies. Plastic Additives and Coating Effects have been especially successful, reporting solid growth of 6 and 5 percent respectively. Even Textile Effects performed satisfactorily, bearing in mind the extraordinary difficulties in that market.

We have been able to keep profitability at a consistently high level.

Just how well we have performed given the difficult overall situation is most clearly evident from our EBITDA, or Earnings Before Interest, Taxes, Depreciation and Amortization. We have been able to keep our EBITDA margin at a good level of 16.6 percent of sales – a better result than for most of our competitors.

Our operating profit in Swiss francs increased by 4 percent and net income by 6 percent, both of these having benefited from a change in goodwill accounting required under US-GAAP. Net income, on the other hand, was affected by non-periodic write-downs of certain participations – Hexcel in particular.

Even apart from these special effects, both operating income and net income showed a healthy operational improvement and so have helped cancel out the negative impact of exchange-rate fluctuations. This improvement in our performance is a direct result of consistent cost management, the tapping of our innovative potential and decisive action we have taken to boost productivity. During the past two years, four smaller factories have been closed and the productivity of others improved significantly. Numerous improvements in our IT processes have already been implemented, and our one big project – the integration of what used to be three separate supply chains in a single system – is progressing according to plan and will be completed in the course of this year. In the last two years, Ciba Specialty Chemicals eliminated 1,300 positions to adapt its cost structure to the realities of the market. This has been done in as socially acceptable a manner as possible, making full use of natural attrition.

Taken together, all these measures implemented as part of our "Fit for Growth" program in 2002 have resulted in savings in the order of CHF 50 million. And as promised, we will achieve the annual savings target of CHF 70 million a year in 2003.

In 2002, we again produced an excellent free cash flow.

By retaining a clear cash focus throughout the year just ended, we were able to generate a free cash flow of CHF 683 million. Such a solid cash flow at such a difficult time is convincing proof of our stability and capacity for performance as a business enterprise!

We have again strengthened our balance sheet.

By no means least, thanks to this free cash flow, we have been able to reduce our net debt by CHF 888 million, bringing it below the CHF 1.5 billion mark. Meanwhile, cash is at a record high of CHF 2.4 billion so that even after the bond repayments due in mid-2003, Ciba Specialty Chemicals will still have a rock-solid balance sheet.

I would like to stress here that these results were achieved in Swiss francs. If the negative impact of a strong Swiss currency is disregarded for a moment, the strength of our performance on the worldwide market becomes even more apparent. Expressed in local currencies, for example, our operating profit increased by a massive 25 percent and our EBITDA by 10 percent. In other words, the fact that the Swiss franc has risen by 8 percent against the dollar and by 3 percent against the euro has hidden much of the improvement.

Perhaps you are wondering whether it might not be better for Ciba – like others before it – to do its accounting in US dollars instead. We do not believe today, there would be anything to be gained from such a step, however.

To start with, we have a very balanced global presence, with 38 percent of our sales generated in Europe – for the most part in euros – 35 percent in North and South America and 27 percent in the Asia Pacific region, where not just the dollar, but various local currencies have an important role to play. Our costs – for raw materials, wages and the like – are incurred in various currencies all over the globe. Exchange-rate fluctuations will therefore continue to impact on our sales and earnings in the future, no matter which currency we use for our accounting. Not only that, but viewed in the long term, exchange-rate fluctuations are not a one-way street. Just a few years ago, the dollar was strong against both the euro and the Swiss franc.

The second point is that most of our shareholders live in Switzerland. For them, the Swiss franc will remain the currency of relevance. At the same time, we have succeeded in attracting a number of international investors from the USA, none of whom view our practice of doing our accounting in Swiss francs as in any way to their detriment.

Thirdly, it is important to remember that the translation of one currency into another in the annual statement is merely a conversion effect, and not a direct loss. Consequently, we confront this only if money really does have to be converted from one currency into another in order to cover costs. And it is for cross-currency cash flows such as these that our CFO Michael Jacobi and his team use modern hedging possibilities.

Today's very uncertain business environment makes a company's stability and capacity for sustainable development vitally important.

The two really decisive factors as far as shareholders are concerned are:

- First, that there be no unpleasant surprises, such as might occur if the need to restructure were not addressed, and
- Second, that a company must generate a constant cash flow so as to be able to finance its future development.

Ciba Specialty Chemicals has complied fully with both these requirements during the past few years and intends to continue doing so in the future.

Ciba's stability and sustainable development are also evident in the motions that are to be put to this annual general meeting. After raising our payout from CHF 2 to CHF 3 per share last year, this year we would again like to provide you with a payout of CHF 3 per share. We therefore propose lowering the nominal value of your shares from CHF 9 to CHF 6 each, which from a taxation perspective, is an attractive form of payment.

Just how well Ciba Specialty Chemicals is doing in comparison to other companies is also apparent from the performance of Ciba stock. Our company was the third best performer on the Swiss Market Index in 2002. Nor does it have to fear international comparisons either, given that last year, for example, it far exceeded the Dow Jones Index for specialty chemicals worldwide – as you can see on page 2 of our Annual Report.

With equity markets still languishing at record lows, however, this good performance has not, unfortunately, translated into an increase in the price of our stock. We are nevertheless well placed for the future:

- Having been among the first to adapt our corporate structure, our resources are no longer tied up internally, but rather can be pooled together and dedicated to improving our market position.
- We have a dynamic corporate culture, a motivated workforce and great innovative potential.
- Thanks to our good operating performance and strong balance sheet, we are not under any external pressure to grow, although we do have scope for acquisitions, should any attractive opportunities arise; the bearish stock market has made takeovers appealing again – at least in terms of price.

We want to make full use of what scope we have for the future development of our corporation – through both organic growth and through acquisitions. And this, Ladies and Gentlemen, is what I want to talk about in the second part of my speech.

II. Ciba wants to grow with "Managing for Growth" program

Our "Fit for Growth" program has enabled us to make significant progress during the past two years:

- Thanks to our cash focus, not only have we greatly improved our cash flow, but we have also worked steadily on the creation of an extremely solid balance-sheet structure with impressive cash resources.
- Our vision entitled "We create effects for a better quality of life", our strategy and our new structure have given our employees a clear focus for their work.
- We have adopted various measures aimed at enhancing our capacity for innovation, including – for example – the setting up of a research fund. Our Chief Technology Officer, Martin Riediker, will be explaining the role of innovation at Ciba Specialty Chemicals in more detail later on.
- We have succeeded in strengthening our market position.

If we pause to take stock, therefore, we can say that both our cash and people initiatives have achieved what they set out to achieve and in some cases have even surpassed it. There has been progress in innovation too, although there is still a lot of untapped potential there. Nor do we look bad when it comes to profitable growth. But we are certainly not going to rest on our laurels! After all, growth is a tremendous driving force for the whole group.

While on the one hand we are growing faster than the market as a whole and our strategy of "quality before volume" is indeed bearing fruit, we still need a growth rate that is significantly higher than the market average – not just to offset the price-cost gap, but also to ensure long-term our growth and expansion.

When it comes to the price-cost gap, I have already pinpointed the various factors that together conspire to create a downward spiral. While the pressure on product prices has effectively eroded many of the gains to be had from volume growth, we are at the same time facing rising wages and costs that in turn will force us to adopt more and more cost-cutting measures, including job cuts – unless we can generate the vigorous growth we need.

How can we reverse this downward spiral? Only by achieving a much higher growth rate than we have now, only by pursuing a more expansive strategy. If we grow by 6 percent a year on average – this being the medium-term goal we have set ourselves until 2005 – but our costs rise by only 2 to 3 percent, then we can turn the downward spiral into an upward spiral instead. This can be summed up in the following equation: sales growth + increased productivity = profitable growth

For this reason we started our "Managing for Growth" program.

This new program builds on the four initiatives of the "Fit for Growth" program. With "Managing for Growth", however, we will be concentrating on growth itself and on getting our innovations onto the market as fast as possible. We want to seize every

opportunity for growth there is. We want to be among the very best companies when it comes to creating and making full use of opportunities for growth.

The new program comprises two main activities.

To start with, all 19,000 Ciba employees will attend a "Managing for Growth" workshop. The teams will take a step-by-step approach to such subjects as the importance of and opportunities posed by growth. They will also identify what scope for action there is in their own particular field and will commit themselves to a concrete plan of action. The decision to invest some 80,000 hours of our employees' valuable time in these workshops was inspired by our conviction that everyone must contribute to "Managing for Growth". Not just sales and marketing, but purchasing, production and logistics, research and development and even our specialists in such fields as legal, EHS and communications.

The second "Managing for Growth" activity consists of over 20 key projects, spread over six areas of growth:

- We have identified technologies and products that could be taken over and sold by other segments and on other markets.
- We want to make better use of the specific potential of each of our geographic growth markets. This means not only such Asian growth markets as China and India, but also Eastern Europe, the Gulf states and Latin America.
- We want to continue expanding our service solutions so that our customers can buy service packages independent of chemicals.
- We have identified those innovations we want to get onto the market as fast as possible – thanks to a concerted effort on the part of our development and marketing teams. Our Chief Technology Officer, Martin Riediker, will be talking to you about the importance of innovation later on.
- Education is to be focused more specifically on enabling our employees to make better use of every opportunity for growth.
- Finally, we intend to continue the systematic pursuit of our strategy of growing by acquisitions.

To illustrate this strategic focus, I would like to cite various examples of our past successes:

There are countless examples of technologies and product groups that can be used in not just one, but in several segments.

- The light-stabilizers originally developed for plastics applications, for example, have long since been used to prevent the yellowing of paints and coatings as well. Now they are also being used in sunscreens and textiles to protect people against UV radiation from the sun.
- Acrylates, which are fundamental to the flocculants we manufacture for wastewater treatment and paper production, can also be used as additives in textile manufacture or to make paints thinner and cosmetic products creamier.

- The competence we have acquired in soluble pigments for use in textiles can be applied to paper, plastics and even hair dyes too.
- The optical brighteners added to detergents as a means of retaining the original brightness of clothes can also be used to enhance the whiteness of paper or plastics as well.

During the past 10 years, Ciba Specialty Chemicals has set up a network of factories throughout China. Today, all five segments are now producing there – and not just for the Chinese market, but for customers throughout Asia as well. At the same time, we have gradually built up our sales organization as well as opening a number of technical service centers. Last year, sales in local currencies in the China region were up by no less than 13 percent – making it our third largest market after the USA and Germany. Not only that, but the People's Republic of China's admission to the World Trade Organization or WTO has increased its growth potential still further.

Ciba Specialty Chemicals' range of integrated solutions combining both products and services, which has been built up and expanded in recent years, is already producing impressive sales figures. The offer includes dye and additive concentrates for the plastics industry, dispersion solutions to the paint and printing-ink industry and integrated solutions for certain processes in paper production and wastewater treatment.

During the past few years, however, we have also developed a wide range of services that are services in their own right – even if I have time to mention only two of these here:

- Since the fall of last year, Ciba Textile Services™ has been able to offer customers all along the textile chain integrated solutions for color and effect management, tests at color sampling centers and online support and training worldwide.
- January saw the launch of our electronic color matching system, Ciba® COLIBRI™ QuickMatch, which permits customized, precision formulae for the manufacture of plastics, paints and printing inks. We also provide consultancy in colorimetry.

These projects and others like them are part of our drive to increase the share of our total sales generated by integrated solutions and services from 5 to 10 percent in the next few years.

As you can see, we have not had to start from scratch, but rather have already acquired wide-ranging experience, from which all the aforementioned projects stand to gain.

"Managing for Growth" is largely an investment in the future. We will, for the most part, start to reap what we now sow from 2004 onwards.

Permit me to make just one more comment on the topic of acquisitions – which is also part of "Managing for Growth"

As I announced in my letter to the shareholders, Ciba Specialty Chemicals is looking at acquisitions in 2003.

We are well aware of the associated risks and to keep these risks to the minimum, intend to consequently maintain our own stringent criteria:

- An acquisition must provide a meaningful extension of our business.
- It must provide positive earnings profit contributions by the second year.

I can tell you today that during the past few months, we have examined a number of potential takeovers that either did not fit in well with our existing portfolio or failed the profitability test.

Having said that: We obviously don't want to let any good acquisition opportunities pass us by, our main aim being to reinforce the Plastic Additives and Coating Effects segments by the addition of complementary technologies and to increase our market share in the segments Water & Paper Treatment and Home & Personal Care.

III. Sustainability and Corporate Governance – Securing the Future

Which brings me to the third part of what I have to say. Three weeks ago, the media gave extensive coverage to a recent survey showing that Swiss confidence in the economy had sunk to an all-time low. The collapse of renowned corporations, exposure of corporate malpractice, stock market doldrums have all left their scars. Public mistrust grows – and at the same time so do demands and expectations.

To an outside observer Ciba must indeed appear to be, as mentioned at the outset, like a rock in a stormy sea. Nonetheless, we too must continue to ask ourselves: Are we living up to our corporate responsibilities? Will what suffices today be adequate tomorrow as well? What should we be doing now to stay fit and healthy in the future?

I do not want to analyze here general problems or their causes. But I would like to explain to you the approach Ciba Specialty Chemicals is taking when it comes to honoring its corporate responsibilities so as to secure its sustainable corporate development in the years to come.

Sustainable corporate management follows prudent corporate governance. As I explained to you last year, the establishment of our corporation was geared to the principles of modern management and corporate governance right from the start and has further developed this approach, step-by-step, ever since.

We have therefore had no trouble complying with the latest corporate governance guidelines. In fact, we actually surpass some of today's standards. We follow the Swiss Code of Best Practice – which incidentally our own experts helped draft – also the Swiss Stock Exchange's Corporate Governance Guidelines and those parts of America's new Sarbanes-Oxley Act that can be applied in Switzerland too.

Corporate Governance at Ciba Specialty Chemicals rests on three supporting pillars:

- Checks and balances: The structures and processes we have defined also provide us with appropriate control mechanisms: With the exception of the Chairman, all members of our Board of Directors are non-executive and independent of the company. Our Vice Chairman and Lead Director, Kurt Feller, is an experienced CEO

and, both the Auditing and the Compensation Committees are chaired by external directors.

- Across-the-board transparency. The comprehensive information contained both in our three-part annual report and in the 20F Report - signed by CFO Michael Jacobi and by me personally - will enable you, as our shareholders, to form your own opinion of how our businesses are faring, of our financial situation and our structure – right down to executive salaries.
- Clear guidelines and consistent implementation. We have defined clear standards to serve both as a base for all our actions and as a yardstick by which to measure our results. These standards include the stringent criteria that all potential acquisitions now have to meet. They include our carefully coordinated, mid-term goals and they also include an appropriate system of incentives. The Board of Directors has therefore decided to pay out the long-term incentive component of Ciba's executive salaries in shares instead of options. This is because we view stock with a lock-up of several years' duration to be preferable to options when it comes to ensuring sustainable, profitable growth.

The principle of sustainability is enshrined in our corporate values. Sustainability here stands for a long-term strategy that is broad in scope, yet focused on one comprehensive goal – that of creating value for all our stakeholders.

What this means in concrete terms is:

- Strive for profitable growth,
- Care for people and the environment,
- Strive for safety and quality in all processes,
- Apply the same high standards worldwide, and
- Build credibility with open communications.

For Ciba Specialty Chemicals, living up to its social and environmental responsibilities is just as important as economic performance. We are convinced that profitability and sustainability are not a contradiction in terms. On the contrary: A long-term management strategy pays off in economic terms too –and not least for you, our shareholders.

Last year, the Executive Committee approved a social policy to supplement the code of conduct passed in the year 2000. These two documents reflect the standards of social responsibility upheld by such international organizations as the United Nations and the Organization for Economic Cooperation and Development or OECD. We want to ensure that Ciba Specialty Chemicals meets only the very highest standards – by cultivating open and transparent relations with its neighbors and indeed with all stakeholders both inside and outside the enterprise. After all, these are also the ones who support our varied and now firmly established training initiatives in the chemical industry.

Our contribution to the Swiss Expo 02 (Swiss national exhibition) – the largest youth project at the event, entitled "14 to 19. Shape your Future" – had the same objectives.

The highlight was a "Day of the Future", which was held at the Arteplage in Bienne on September 4 and was attended by Swiss President Kaspar Villiger in his capacity as project patron. The "Day of the Future" was above all an opportunity for some 400 young people to meet with decision-makers from the world of politics, business, research, arts & culture and to discuss with them the 32 projects on "Switzerland 20 Years From Now and How to Get There", which they themselves had developed. I, too, was among those present at this event and could not help but be impressed by the quality of the dialogue with our young generation.

We are convinced that all our efforts in the environment, health and safety have a direct and positive impact on our financial results – which is why these aspects form an integral part of our business planning and are critical to our success as a business enterprise. 2002 saw us making progress here too. Although we have always taken responsibility for the entire life-cycle of our products, last year we decided to formalize this practice in our new Product Stewardship principles. These cover the environmental, health and safety aspects of our products throughout their entire life-cycle, from product development to manufacture and sale, product application by our customers and consumers and, ultimately, disposal.

We are now well on the way to achieving the three goals we set ourselves for the environment, health and safety in the years 2000 to 2003:

- First, to eliminate all loss of time accidents. When visiting Ciba sites all over the globe, my message is always the same: Safety first!
- Second, to reduce energy consumption by 10 percent, irrespective of changes in production;
- Third, to increase efficient use of materials by 10 percent.

IV. Outlook 2003

A long-term corporate strategy is absolutely vital. Long-term goals, however, can be achieved only if you work towards them every single day. That's why I would like to close with my outlook for the current year.

Forecasts are especially difficult at present. The current environment, however, makes it all the more important for us to continue lowering our costs by streamlining our operations and keeping a tight rein on expenditure. This should enable us to absorb the higher spending in the order of CHF 60 million that will be needed primarily for pension provisions and insurance.

It goes without saying that we are following geopolitical developments very closely at present. We have prepared ourselves for various different scenarios so that we can initiate the appropriate measures as and when required. As most of our raw materials are several value added steps from crude oil, another price hike would affect us only after a certain time lag and then only in diluted form. We are of course trying to keep prices in check by procuring what we need from the cheapest suppliers worldwide. We will continue hedging – whenever and wherever this makes sense – as a means of protecting ourselves against any further deterioration in exchange rates. Should the

economy decline still further as a result of the geopolitical situation, we will still be in a comparatively good starting position – thanks largely to our lean cost base.

And what would be the outlook for 2003 if we did not have the shadow of war and all its possible repercussions hanging over us? In the upcoming quarters, Ciba Specialty Chemicals does not expect substantial changes in the current difficult trading conditions. Our sales in January and February don't allow us to conclude that there is either a worsening or an improvement in market conditions.

Despite the anticipated challenging first two quarters of the year, for the full year the Company expects sales in local currencies, the EBITDA margin and net income in Swiss francs to be above the levels of 2002. With the continuous strong focus on cash generation, the Company is striving to achieve a free cash flow for 2003 in excess of CHF 600 million.

These forecasts are based on the assumption of an economic recovery later in the year in the United States and, afterwards, in Europe, as well as reasonably stable currency exchange rates vis-à-vis the Swiss franc, and, as usual, the effects of potential acquisitions are not included. In addition, the Company continues to monitor developments in the geopolitical climate globally and is prepared to react accordingly.

Which brings me to the end of what I have to say.

Ciba Specialty Chemicals has again been successful.

Above all, there are three success factors that distinguish it from many of its competitors

- That we possess a focused portfolio, are well placed on the market and have our costs firmly under control;
- That we have a rock-solid balance sheet;
- That the potential for growth is there, has been identified and will be realized in a worldwide program.

Ciba Specialty Chemicals is and will remain a healthy and successful company.

Ladies and Gentlemen, Shareholders – thank you very much.