

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 20-F/A
(Amendment No. 1)

(Mark One)

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934
ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 For the fiscal year ended December 31, 2005
TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 Date of event requiring this shell company report

Ciba Specialty Chemicals Holding Inc.

(Exact name of Registrant as specified in its charter)

Switzerland
(Jurisdiction of incorporation or organization)

Klybeckstrasse 141
4002 Basel
Switzerland

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act.

Table with 2 columns: Title of Each Class, Name of Each Exchange on Which Registered. Row 1: American Depositary shares, Each representing one half of one ordinary share, nominal value CHF 1 per share, Ordinary shares, par value CHF 1 per share\*, New York Stock Exchange.

Securities registered or to be registered pursuant to Section 12(g) of the Act. None

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act. None

(Title of Class)

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report, December 31, 2005.

69 064 617 Registered Shares

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

If this is the annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

\* Not for trading but only in connection with the registration of the American Depositary Shares pursuant to the requirements of the Securities and Exchange Commission.

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## **Explanatory Note**

This Form 20-F/A amends Ciba Specialty Chemicals Holding Inc.'s Annual Report on Form 20-F for the fiscal year ended December 31, 2005, which was filed on February 1, 2006. This amendment revises the originally filed Form 20-F solely to correct certain clerical errors consisting of (1) two boxes on the Cover, which were not checked correctly and (2) the third paragraph in the Introduction, which was inadvertently not deleted.

## **Introduction**

This Annual Report on Form 20-F relates to the registered shares with a nominal value of 1 Swiss franc per share (the "Shares") of Ciba Specialty Chemicals Holding Inc., the American Depositary Shares ("ADSs"), each representing one half of one Share, and the American Depositary Receipts ("ADR") evidencing the ADSs under the Deposit Agreement among the Company, Citibank, N.A. (the "Depositary"), and the registered holders and beneficial owners from time to time of the ADRs.

In this Annual Report, "Company" refers to Ciba Specialty Chemicals Holding Inc. and its consolidated subsidiaries. In certain cases, where indicated or where the context requires it, "Company" refers to Ciba Specialty Chemicals Holding Inc.

The consolidated financial information as of December 31, 2005, 2004, 2003, 2002 and 2001, and for each of the years in the five-year period ended December 31, 2005, included in this Annual Report has been taken or derived from the audited consolidated financial statements of the Company for the relevant periods. The Company's consolidated financial statements have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP"). Statements in this Annual Report with respect to such financial information, except where otherwise indicated, are based on U.S. GAAP information.

All market share data contained in this Annual Report is based on management's estimates.

## **Currency Translation**

Unless otherwise indicated, all amounts herein are expressed in Swiss francs ("CHF") or United States dollars ("U.S. dollars", "dollars", "USD", "US\$" or "\$"). Amounts stated in U.S. dollars, unless otherwise indicated, have been translated from Swiss francs at the noon buying rate in New York City for cable transfers in foreign currencies as certified for customs purposes by the Federal Reserve Bank of New York (the "Noon Buying Rate") on December 31, 2005, which was CHF 1.3148 per US\$1.00. This rate should be used solely for convenience and should not be construed as a representation that the Swiss franc amounts actually represent such U.S. dollar amounts or could be converted into U.S. dollars at the rate indicated, or at all. This rate may differ from the actual rates used in the preparation of the Consolidated Financial Statements of the Company as of December 31, 2005, 2004 and 2003, and for each of the years in the three year period ended December 31, 2005, included in Item 18 of this Annual Report, which are expressed in Swiss francs. Accordingly, U.S. dollar amounts appearing herein may differ from the actual U.S. dollar amounts that were translated into Swiss francs in the preparation of such financial statements.

## **Cautionary Statement Regarding Forward-Looking Information**

This Annual Report contains certain forward-looking statements and information with respect to the financial condition, results of operations and business of the Company and certain of such statements and information with respect to plans, objectives and market position of the Company are based on the opinions and beliefs of the Company's management as well as assumptions made by and information currently available to the Company. In particular, among other statements, certain statements in "Item 4. Information on the Company" and "Item 5. Operating and Financial Review and Prospects" with regard to trends, revenues, costs, net income, accounting policies, market size, market share, market demands, volumes, prices, margins, research and development, capital expenditures, cash flows, debt levels, patents, outlook the effect of technological developments, strategy and management objectives, opinions and beliefs and sufficiency of environmental reserves and insurance arrangements are forward-looking in nature. Such statements reflect the current views of the Company with respect to market conditions and future events and are subject to certain

risks, uncertainties and assumptions. Investors are cautioned that all forward-looking statements involve risks and uncertainty as there are certain important factors that could cause actual results, performance or events to differ materially from those anticipated including, but not limited to, the following: the timing and strength of new product offerings, pricing strategies of competitors, introduction of competing products by other companies, lack of acceptance of new products and services by the Company's targeted customers, changes in the Company's business strategy, the Company's ability to continue to receive adequate raw materials from its suppliers on acceptable terms, or at all, or to continue to obtain sufficient financing to meet its liquidity needs, the effects of the Company's reorganization and restructuring, strategic decisions and impairment charges affecting the Textile Effects Segment, and changes in the political and regulatory framework in which the Company operates or in economic or technological trends or conditions, including currency fluctuations, inflation and consumer confidence, on a global, regional or national basis and various other factors. For more information regarding some of these factors, see Item 3 — Key Information — Risk Factors. All forward-looking statements are expressly qualified in their entirety by the cautionary statements contained or referred to in this section. Furthermore, the Company does not assume any obligation to update these forward looking statements.

## PART I

### Item 1. *Identity of Directors, Senior Management and Advisors*

Not applicable.

### Item 2. *Offer Statistics and Expected Timetable*

Not applicable.

### Item 3. *Key Information*

#### Selected Financial Data

The tables below set forth selected consolidated financial data for the Company for the periods indicated and are qualified by reference to, and should be read in conjunction with, the Company's Consolidated Financial Statements and the Notes thereto, which are included elsewhere in this Annual Report, and Item 5 — Operating and Financial Review and Prospects.

The selected consolidated financial data as of December 31, 2005, 2004, 2003, 2002 and 2001, and for each of the years in the five-year period ended December 31, 2005, have been taken or are derived from the audited consolidated financial statements of the Company for the relevant periods. The selected financial data have been prepared in accordance with U.S. GAAP and are presented in millions of Swiss francs, except share and per share data.

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
<b>Results of operations</b>					
Net sales . . . . .	7 419	7 027	6 646	7 085	7 367
Operating income (loss) . . . . .	(124)	521	563	769	753
Income (loss) from continuing operations, net of tax <sup>(1)(4)</sup> . . . . .	(286)	278	345	419	375
Income from discontinued operations, net of tax <sup>(5)</sup> . . . . .	30	28	0	0	0
Cumulative effect of change in accounting principles, net of tax . . . . .	0	0	(16) <sup>(2)</sup>	0	2 <sup>(3)</sup>
Net income (loss) <sup>(1)(4)</sup> . . . . .	(256)	306	329	419	377
<b>Earnings (loss) per share, basic and diluted</b>					
Continuing operations <sup>(1)(4)</sup> . . . . .	(4.38)	4.21	5.05	6.12 <sup>(7)</sup>	5.64
Discontinued operations <sup>(5)</sup> . . . . .	0.46	0.43	0.00	0.00	0.00
Cumulative effect of change in accounting principles . . . . .	0.00	0.00	(0.23) <sup>(2)</sup>	0.00	0.04 <sup>(3)</sup>
Net income (loss) per share <sup>(1)(4)</sup> . . . . .	(3.92)	4.64	4.82	6.12 <sup>(7)</sup>	5.68
Equity per share . . . . .	58.73	62.78	62.76	63.55	59.36
Dividend per share <sup>(6)</sup> . . . . .	3.00	1.00	0.00	0.00	2.00
Capital reduction per share <sup>(6)</sup> . . . . .	0.00	2.00	3.00	3.00	1.00
<b>Weighted average number of shares outstanding</b>					
Basic . . . . .	65 288 741	66 059 479	68 361 123	68 549 964	66 419 147
Diluted . . . . .	65 288 741	66 059 479	68 361 123	72 036 457	66 419 147

**Selected Financial Data — (continued)**

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
<b>Other data — continuing operations</b>					
Net sales development percentage . . . . .	6%	6%	(6)%	(4)%	(7)%
Depreciation and amortization of other intangibles . . . . .	421	394	366	385	408
Amortization of goodwill . . . . .	0	0	0	0	61
Restructuring, impairment and other charges . . . . .	703	91	0	0	0
Adjusted EBITDA <sup>(10)</sup> . . . . .	297	915	929	1 154	1 222
Operating income margin . . . . .	(1.7)%	7.4%	8.5%	10.9%	10.2%
Adjusted EBITDA margin . . . . .	4.0%	13.0%	14.0%	16.3%	16.6%
Capital expenditures . . . . .	275	294	233	250	259
Research and development . . . . .	301	288	281	294	276
Personnel costs . . . . .	1 835	1 761	1 722	1 771	1 804
Number of employees at year end . . . . .	19 105	19 338	18 658	19 007	19 683
<b>Balance sheet data</b>					
Current assets . . . . .	4 267	4 381	4 936	5 306	4 819
Property, plant and equipment, net . . . . .	2 724	3 015	2 963	3 196	3 565
Total assets . . . . .	10 612	10 996	11 095	11 811	11 732
Short-term debt . . . . .	277	559	259	1 496	316
Long-term debt . . . . .	2 942	2 917	3 187	2 344	3 678
Common stock . . . . .	69	212	433	649	721
Shareholders' equity . . . . .	3 903	4 152	4 253	4 381	3 926

**Selected Financial Data — (continued)**

	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
<b>Business segment data<sup>(8)</sup></b>					
<b>Plastic Additives</b>					
Net sales .....	1 938	1 895	1 822	1 903	1 913
Operating income .....	260	224	165	225	256
Adjusted EBITDA .....	355	319	265	332	375
Operating income margin .....	13.4%	11.9%	9.1%	11.8%	13.4%
Adjusted EBITDA margin .....	18.3%	16.8%	14.6%	17.5%	19.6%
<b>Coating Effects</b>					
Net sales .....	1 804	1 818	1 807	1 920	1 944
Operating income .....	233	291	298	335	310
Adjusted EBITDA .....	340	394	395	434	409
Operating income margin .....	12.9%	16.0%	16.5%	17.4%	15.9%
Adjusted EBITDA margin .....	18.9%	21.7%	21.8%	22.6%	21.0%
<b>Water &amp; Paper Treatment</b>					
Net sales .....	2 394	2 014	1 616	1 718	1 837
Operating income .....	128	128	125	163	147
Adjusted EBITDA .....	288	259	228	271	261
Operating income margin .....	5.4%	6.3%	7.8%	9.5%	8.0%
Adjusted EBITDA margin .....	12.0%	12.8%	14.1%	15.8%	14.2%
<b>Textile Effects</b>					
Net sales .....	1 283	1 300	1 401	1 544	1 673
Impairment <sup>(9)</sup> .....	(583)	0	0	0	0
Operating income (loss) .....	(520)	61	68	140	180
Adjusted EBITDA .....	(468)	117	128	206	248
Operating income margin .....	(40.5)%	4.7%	4.9%	9.1%	10.8%
Adjusted EBITDA margin .....	(36.5)%	9.0%	9.2%	13.4%	14.8%
<b>Trading prices on the Swiss Exchange</b>					
	<u>2005</u>	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
	(Price per share in CHF)				
Annual highs .....	85.00	96.14	101.50	128.00	115.75
Annual lows .....	72.51	76.70	74.75	89.75	75.00
Period End .....	85.00	86.50	92.37	89.79	95.81

- (1) As of January 1, 2002, the Company adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard (SFAS) No. 142 “Goodwill and Other Intangible Assets”, which requires that goodwill no longer be amortized to earnings. The results of operations on an adjusted basis, excluding goodwill amortization, had SFAS No. 142 been applied retroactively for 2001 would have been: income from continuing operations, net of tax — CHF 436 million; basic and diluted earnings per share for income from continuing operations — CHF 6.56 net income — CHF 438 million; basic and diluted earnings per share for net income — CHF 6.60.
- (2) The Company applied FASB Interpretation No. 46(R) to a previously unconsolidated trust that leases an asset to the Company, resulting in the consolidation by the Company of the trust in 2003.
- (3) As of January 1, 2001, the Company adopted SFAS No. 133 “Accounting for Derivative Instruments and Hedging Activities” as amended.

## Selected Financial Data — (continued)

(4) Effective January 1, 2003, the Company adopted Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 123, as amended. Had the Company applied the fair value method for all periods prior to 2003, pro forma income from continuing operations, net of tax would have been — in 2002 CHF 408 million, in 2001 CHF 363 million; pro forma basic earnings per share for income from continuing operations would have been — in 2002 CHF 5.96, in 2001 CHF 5.45; pro forma diluted earnings per share for income from continuing operations would have been — in 2002 CHF 5.95, in 2001 CHF 5.45; pro forma net income would have been — in 2002 CHF 408 million, in 2001 CHF 365 million; pro forma basic earnings per share for net income would have been — in 2002 CHF 5.96, in 2001 CHF 5.49; pro forma diluted earnings per share for net income would have been — in 2002 CHF 5.95, in 2001 CHF 5.49.

(5) Income from discontinued operations for 2005 and 2004 resulted from the release of previously established reserves following the settlements of disputes that had been initiated by Vantico (now owned by Huntsman Corporation), the purchaser of the Performance Polymers business. The Performance Polymers business had been sold to Vantico in 2000.

(6) The Board of Directors proposes a cash dividend payment to the Company's shareholders in 2006 of CHF 3 per share, based on 2005 results, which is reflected in the 2005 column in the table above. The dividend is subject to shareholder approval at the Annual General Meeting to be held on March 2, 2006.

The proposed dividend per share, based on the USD exchange rate of December 31, 2005 is USD 2.28. Based on the USD exchange rate at the payment date of May 18, 2005, the 2004 capital reduction per share was USD 1.64. Based on the USD exchange rate at the payment date of March 8, 2005, the 2004 dividend per share was USD 0.86.

Based on the USD exchange rate at the payment date of May 23, 2004, the 2003 capital reduction per share was USD 2.30.

Based on the USD exchange rate at the respective payment date of the 2001 dividend, the USD equivalent of the dividend per share was USD 1.19.

(7) For 2002, the figures presented are only basic per share amounts. Diluted per share amounts for 2002 are CHF 6.11 for both income from continuing operations and net income.

(8) In 2002, the Company implemented SFAS No. 142 "Goodwill and Other Intangible Assets". As a result of adopting this standard, the Company reclassified certain goodwill and other intangible assets to the segments that were previously reported as corporate items and not allocated to the segments. In addition, the Company reclassified goodwill amortization that was previously allocated to the segments to corporate and reclassified other intangible amortization from corporate to the segments corresponding to the other intangible asset reclassification. Amounts reported for the previous periods have been restated to conform to the 2002 presentation. In addition, in 2004 the Company reorganized from five into four reporting segments and restated all segment information to reflect the new structure.

(9) The CHF 583 million impairment charge that is included in restructuring, impairment and other charges in 2005 consists of the impairment of the carrying values of certain long-lived assets of the Company's Textile Effects Segment. This impairment charge is considered a segment activity and is therefore charged to the Textile Effects Segment. All other restructuring, impairment and other charges relate primarily to Project Shape, which applies principally to the Company as a whole and therefore are included in Corporate and are not allocated to the segments.

(10) Adjusted EBITDA is a non-U.S. GAAP financial measure. See Use of Certain Supplementary Financial Indicators in Item 5 – Management's Discussion and Analysis for further discussion of the use of this measure.

### Exchange rate information

The table below sets forth, for the periods indicated, the average, high, low and period-end Noon Buying Rate for Swiss francs expressed in Swiss francs per U.S. dollar.

<u>Year</u>	<u>Average<sup>(1)</sup></u>	<u>High</u>	<u>Low</u>	<u>Period End</u>
2001 .....	1.6893	1.8185	1.5878	1.6598
2002 .....	1.5566	1.7190	1.3833	1.3833
2003 .....	1.3374	1.4181	1.2380	1.2380
2004 .....	1.2426	1.3202	1.1338	1.1412
2005 .....	1.2507	1.3255	1.1466	1.3148
Months				
2005 January .....	1.1769	1.1960	1.1466	1.1877
February .....	1.1918	1.2222	1.1585	1.1585
March .....	1.1756	1.2060	1.1501	1.1952
April .....	1.1954	1.2135	1.1788	1.1898
May .....	1.2172	1.2447	1.1927	1.2447
June .....	1.2665	1.2827	1.2456	1.2827
July .....	1.2945	1.3041	1.2754	1.2870
August .....	1.2629	1.2780	1.2487	1.2546
September .....	1.2671	1.2967	1.2287	1.2890
October .....	1.2880	1.3022	1.2731	1.2900
November .....	1.3110	1.3255	1.2780	1.3148
December .....	1.3053	1.3210	1.2788	1.3148
2006 January (through January 27) .....	1.2768	1.2938	1.2595	1.2798

(1) Represents the average of the Noon Buying Rates on the last business day of each month during the relevant year.

### Capitalization and Indebtedness (N/A)

### Reasons for the Offer and use of proceeds (N/A)

### Risk factors

Prospective purchasers and existing holders of the ADSs of the Company should consider carefully all of the information set forth in this Annual Report and, in particular, should evaluate the following risks in connection with an investment in the ADSs. Information contained or incorporated by reference in this Annual Report contains “forward-looking statements” which can be identified by the use of forward-looking terminology such as “believes”, “opinion”, “expects”, “may”, “will”, “should” or “anticipates” or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy. Such statements include, without limitation, the Company’s beliefs about trends in the global economy, in the specialty chemicals industry and its views about the long-term future of the industry and the Company. See Item 4 — Information on the Company and Item 5 — Operating and Financial Review and Prospects. We cannot assure you that the future results covered by the forward-looking statements will be achieved. The following matters constitute cautionary statements identifying important factors with respect to such forward-looking statements, including certain risks and uncertainties that could cause actual results to vary materially from the future results covered in such forward-looking statements. Other factors could also cause actual results to vary materially from the future results covered in such forward-looking statements.

The Company is subject to various changing competitive, economic, political, legal and social conditions, including the following:

***As an international business, the Company is exposed to various global economic, political, social and local business risks that may have a material adverse effect on its financial condition and results of operations.***

The Company has a small home market for its products and has for many years operated on a global basis. The Company currently has manufacturing facilities in 28 countries and sells its product in more than 120 countries. This means the Company is faced with different complex legal and regulatory requirements in many jurisdictions. These include tariffs and trade barriers, requirements relating to withholding taxes on remittances and other payments by subsidiaries and different intellectual property regimes. The Company's international operations also expose it to many different local business risks and challenges. The Company's overall success as a global business depends, in part, upon its ability to succeed in differing economic, social and political conditions. The Company may not continue to succeed in developing and implementing policies and strategies that are effective in each location where it does business.

The Company's results of operations and financial position also are affected by developments and trends in the world economy. The year 2005 was characterized by economic growth, high industrial output and renewed consumer confidence, however performance varied significantly at a regional level. The U.S. economy stabilised at 2004 growth levels during the first three quarters of 2005, however the slow down in the fourth quarter lowered real GDP growth for the year to just over 3 percent. This reflected a slow down in both federal and consumer spending, especially evident in the automotive sector. The major European economies continued with low levels of growth through 2005, with real GDP growth at below 2 percent. In Asia-Pacific, the China Region continued to grow strongly, with real GDP growth remaining close to 10 percent although economic expansion slowed down in Japan, growing at 3 percent in GDP terms in 2005.

The economic conditions in NAFTA, Europe and parts of Asia-Pacific may worsen or not continue to recover, which could have a material adverse effect on the Company's results of operations and financial position.

In addition, an adverse development in the political and social stability in the regions where the Company operates, may have a material adverse effect on the Company's results and financial condition.

***The Company currently has operations in more than 120 countries, and its results of operations may be adversely affected by currency fluctuations.***

The results of the operations and the financial position of the Company's subsidiaries outside of Switzerland are reported in the relevant foreign currencies and then translated into Swiss francs at the applicable exchange rates for inclusion in the Company's Consolidated Financial Statements. The exchange rates between these currencies and the Swiss franc may fluctuate substantially. Because the Company generates a significant percentage of its revenues and a substantially lower percentage of its operating expenses in currencies other than the Swiss franc, fluctuations in the value of the Swiss franc against other currencies have had in the past, and may have in the future, a material effect on the Company's operating margins as well as its competitive position compared with local producers in affected markets. Currency fluctuations also may significantly affect the comparability of the Company's results between financial periods. The Company's results and financial condition are particularly affected by significant changes in the value of the Swiss franc, euro, U.S. dollar, Japanese yen, and British pound relative to each other. For more information, see Item 5 — Operating and Financial Review and Prospects — Currency Trends in this Annual Report.

***Significant competition may force the Company to reduce its product prices which may adversely impact its results of operations.***

The Company faces significant competition in the markets in which it operates. Although competition in specialty chemicals is based upon a number of considerations, such as product innovation, product range and quality, relationships with customers, reliability of delivery, technical support and distribution capability, price

competition does exist in certain of the Company's markets due to factors such as industry overcapacity and low-cost local competition. Increased price competition may also occur in certain product areas due to consolidation and globalization among the Company's customers and competitors and as industry segments mature. As a result of the trends toward global expansion and consolidation by competitors, the Company anticipates that it will continue to face new competitive challenges, continued price competition as well as additional risks inherent in international operations in developing regions.

***The Company's inability to remain technologically innovative and to offer improved products and applications cost-effectively could negatively impact its operating results.***

The Company's operating results depend to a significant extent on its ability to be a low-cost producer of its core products and to continue to introduce new products and applications that offer distinct value in use for its customers. In many of the industry sectors to which the Company sells its products, products are subject to a traditional product life cycle. The Company must devote significant resources to the development of new technologically advanced products and applications, and the Company may not be successful in these efforts at all times.

***The cyclical nature in the various industries served by the Company may have a material adverse effect on the Company's business and financial condition.***

The Company's results are affected by cyclical nature in various industries served directly or indirectly by the Company, including the automotive, plastics, textiles and clothing, paper, packaging, paint and coating, electronics and construction industries. The Company's results of operations and financial position have in the past been affected adversely, for example, by slow growth in the textile and paper industries, reduced demand in the automotive industry and by declining demand in a number of industries. The cyclical nature of pricing and investment in the specialty chemicals business is likely to continue, and the Company will continue to experience periods of overcapacity, declining prices and lower profit margins. In addition, external factors beyond the Company's control, such as general economic conditions, competitors' actions, international events and circumstances and governmental regulation in the United States and in other jurisdictions, can cause volatility in raw material prices and product demand, as well as fluctuations in the Company's prices, volumes and margins.

***The Company depends upon proprietary technologies, and its competitive position may be adversely affected if it fails to protect its intellectual property rights or is subject to claims that it is infringing upon the rights of others.***

Proprietary rights are important to the success and competitive position of the Company. If the Company is unable to maintain the relative exclusivity of certain of its products following patent expiration, through manufacturing scale, technical know-how, advanced applications and service expertise, increased competition may result with consequent erosion of profit margins. Actions taken by the Company to protect its proprietary rights may be insufficient to prevent others from developing similar products to those of the Company. In addition, the laws of many foreign countries do not protect the Company's intellectual property rights to the same extent as the laws of Switzerland, other European countries, the United States and Japan.

The Company has in the past received and may continue to receive communications asserting that certain of its products or their applications infringe on the proprietary rights of others. The Company has continued to experience a significant increase in intellectual property conflicts, either initiated by the Company or by third parties. In management's opinion there is no material pending litigation against the Company regarding any intellectual property claim but there could be in the future. Such legal proceedings or claims, with or without merit, and whether initiated by the Company or another party, could subject the Company to costly and time-consuming litigation and divert its research, technical and management personnel from their regular responsibilities. Furthermore, successful legal proceedings or claims against the Company could suspend the development and manufacture of products using the contested invention, or require the Company to pay substantial penalties or royalties.

***Any disruption or deterioration in the quality of the raw materials available for the Company's products may have a material adverse effect on the results of the Company's operations.***

The Company utilizes specialty chemicals and base chemicals as its main raw material in its manufacturing process. Raw material costs represent a significant component of the Company's cost of goods sold. The prices and availability of these raw materials vary with market conditions and can be highly volatile. As a result of these factors, the Company's operating margins may decrease if it cannot pass on increased raw material prices to customers, if prices for its products decrease faster than raw material prices or if the price it pays under long-term supply contracts is above the market price.

There have been in the past, and may be in the future, periods of time during which raw material price increases cannot be passed on to customers in whole or in part. Even in periods during which raw material prices decrease the Company may suffer decreasing operating profit margins if raw material price reductions occur at a slower rate than decreases in the selling prices of its products. Historically, the Company typically has not entered into significant hedging arrangements with respect to prices of raw materials but the Company has entered into long-term supply contracts for some raw materials. Any major dislocation in the supply or price of these raw materials or any material difference between the price the Company pays under its supply contracts and market price may have a material adverse effect on its financial condition and results of operations. Additionally, the Company requires raw materials to be of a satisfactory standard for manufacturing its products. Any deterioration in the quality of the raw materials available to the Company may adversely impact the Company's ability to manufacture its products to an acceptable standard and may have a material adverse effect on the results of its operations. Even if it could obtain acceptable substitute raw materials, the Company could incur increased expenses in securing the raw materials from an alternative source and suffer reduced profit margins and an adverse impact on its business.

***Environmental laws and regulations may expose the Company to liability and result in increased costs.***

The Company's business is subject to stringent environmental laws and regulations in the various countries in which it operates. Such laws and regulations govern, among other things, air emissions, wastewater discharges, the use and handling of hazardous substances, waste disposal and the investigation and remediation of soil and groundwater contamination. As with other companies engaged in similar activities, a risk of environmental liability is inherent in its current and historical activities. See Item 4 — Information on the Company — Environmental Matters in this Annual Report.

***The EU Chemicals Policy may result in significant additional costs for the Company.***

The EU Chemicals Policy, if adopted by the appropriate EU bodies and Member States in its current draft form (as published on October 29, 2003) would require all companies to register with defined data requirements, their substances manufactured or imported in the EU at levels above 1 ton per year. Whilst presently, the Company cannot assess the complete impact of the EU Chemicals Policy, it believes that the proposed regulatory system will be highly resource intensive and therefore costly to industry and regulators alike. At present, the exact timing of the legislative process and the resulting definitive regulations cannot be estimated.

***The Company's business may be adversely affected by rigorous health and safety regulation.***

Certain of the Company's products are subject to rigorous health and safety regulations. There is a risk that key raw materials or one of the Company's products may be recharacterized as or found to have a toxicological or health related impact on the environment or on third parties, its customers or employees. Health and safety regulations are continually strengthened and relevant raw materials or products may be banned or the Company may incur increased costs in complying with new requirements.

***Liabilities arising from the development, manufacturing and use of the Company's products may adversely impact the Company's financial condition.***

The Company's operations are subject to various hazards associated with the production of chemicals, including the use, handling, processing, storage and transportation of hazardous materials. These hazards can cause personal injury and loss of life, severe damage to and destruction of property and equipment, and environmental damage, and may result in the suspension of operations and the imposition of civil and criminal liabilities. The Company has been subject to claims of injury from direct exposure to such materials and from indirect exposure when such materials are incorporated into other companies' products. As a result of past or future operations, there may be additional claims of injury by employees or members of the public due to exposure, or alleged exposure, to such materials. Furthermore, the Company also has exposure to present and future claims with respect to workplace exposure, workers' compensation and other matters arising from events both prior to and after the date of this Annual Report. The Company cannot predict the actual amount of these liabilities or the timing thereof, if any.

***Change of control provisions and limitations on shareholder voting rights may render the Company an unattractive target for any transaction in which the Company's investors could receive a premium for their Shares or ADSs.***

Certain contractual arrangements with Novartis and restrictions on the voting rights of shareholders of the Company may make an acquisition of the Company less likely, and thus may limit any opportunity for the Company's shareholders to receive a premium for their Shares or ADSs. Similarly, the Company may face adverse tax consequences if certain material parts of the business are divested. Accelerated vesting provisions and the elimination of restriction periods under one or more employee incentive plans instituted by the Company could result in a significant cost to the Company in the event of a change of control not recommended by the Company's board of directors.

Additionally, a change in control of the Company or a sale of substantially all the assets of the Company could relieve Novartis of its contractual obligation to indemnify the Company for a portion of specified environmental liabilities arising from prior activities of the predecessor of the Company in the United States.

Pursuant to the Company's articles of association, no shareholder or group of shareholders of the Company will be recognized in the Company share register as owning the voting rights of more than 2 percent of the Company's share capital. No shareholder or group of shareholders may represent more than 5 percent, by proxy or otherwise, of the Company's share capital at a shareholders' meeting.

***Under certain circumstances, the Company may not be permitted to continue to use the name "CIBA", which could adversely affect its brand name recognition and its results of operations.***

Pursuant to an agreement between the Company and Novartis, the Company is permitted to use "Ciba Specialty Chemicals" as part of its registered corporate name, while Novartis may continue to use the name "Ciba" in the Ciba Vision Group and in certain other cases. The Company is entitled to use the "Ciba" trademarks and trade names outside the core business of Novartis (pharma specialties, pharma OTC and generics, eyecare, crop protection, seeds, animal health and nutrition). Novartis remains entitled to continue to use trademarks and trade names containing the term "Ciba" as they were being used at the date of the Spin-off. In addition, Novartis is entitled to use trademarks and tradenames containing the term "Ciba" in the areas for its marketing concept for the "Ciba" line of pharmaceutical products and for products and services of the Ciba Vision Group. In addition, the Master Spin-off Agreement entered into by the Company and Novartis includes provisions which specify that upon the occurrence of certain change of control events or acquisitive transactions involving the Company or other members of the Company, or in the event any member of the Company begins to compete materially with Novartis' business as in existence as of the time of the Spin-off, the Company may be required to cease using "Ciba" as a corporate name or to pay Novartis significant liquidated damages for its continued use. The above restrictions could affect the Company's ability to conduct its business with its present and future customers. Even if the Company is able to establish brand

name recognition under a new name, it may incur significant expenses in doing so, which could adversely affect its future results of operations.

***The introduction of the euro and the replacement of currencies in which the Company presently conducts business may adversely affect the operations of the Company.***

The introduction of the euro in twelve of the twenty-five member states of the European Union may continue to have an impact on the Company's operations. These potential impacts include, but are not limited to, increased cross-border price transparency and tax and legal implications (such as easier harmonization).

***The Company's share price may be highly volatile and subject to sudden and significant drops.***

The trading price of the Shares and the ADSs has been, and could in the future continue to be, subject to significant fluctuations in response to variations in the Company's financial performance, regulatory and business conditions in the specialty chemicals and the chemicals industry, general economic trends and other factors, some of which are unrelated to the operating performance of the Company. For more information on the historical price ranges of the Company's shares and the ADSs see Item 9 — The Offer and Listing Principal Trading Market and Price Range. From time to time, following periods of volatility in the market price of a company's securities, securities litigation has been instituted against that company. The institution of any such litigation against the Company could result in substantial costs and a diversion of the Company's management's attention and resources, which could materially adversely affect its business, results of operation and financial condition.

***The Company's inability to successfully manage and integrate businesses acquired or its alliances may adversely impact the Company's results of operation and financial condition.***

The Company has made and expects to continue to make acquisitions and to enter into alliances from time to time. Acquisitions and alliances present significant challenges and risks relating to the integration of the acquired business into the existing business of the Company. There can be no assurances that the Company will manage the integration of acquisitions and alliances successfully.

Other risks we face with respect to acquisitions or alliances include:

- greater than expected costs and management time and effort involved in completing and integrating acquisitions or alliances;
- potential disruption of our ongoing business and difficulty in maintaining or upgrading our standards, controls, information systems and procedures;
- our inability to successfully integrate the services, products and personnel of any acquisition into its operations;
- the potential incurrence of a significant amount of debt and contingent liabilities; and
- realizing little, if any, return on the Company's investment.

Integration or other acquisition or alliance difficulties could have a material adverse impact on the Company's financial condition and results of operations.

***The Company is undergoing a strategic review of the Textile Effects Segment and may record additional impairment charges for that Segment.***

The evaluation of strategic options to reposition the Textile Effects Segment is well underway, with both internal and external solutions further advanced. An impairment charge totalling CHF 583 million was recorded for 2005. The review of the carrying value of the Segment determined that the Segment's overall fair value is lower than its carrying value. Therefore, were the Segment to be disposed of in the near future, further charges would occur.

#### **Item 4. Information on the Company**

##### **History and Development**

Ciba Specialty Chemicals Holding Inc.'s registered office is located at Klybeckstrasse 141, CH-4002 Basel, Switzerland, telephone +41 61 636 1111.

Ciba Specialty Chemicals Holding Inc. was first registered as a corporation in Switzerland on April 24, 1996, and began to conduct the specialty chemicals business of the former Ciba-Geigy Limited ("Ciba-Geigy") as of January 1, 1997. Until the merger of Ciba-Geigy and Sandoz Limited ("Sandoz") into Novartis AG ("Novartis"), as described below, the businesses of the Company were part of Ciba-Geigy. Ciba-Geigy was formed in 1970 through the merger of CIBA Aktiengesellschaft ("CIBA") and J.R. Geigy AG ("Geigy"), two Basel, Switzerland-based chemicals and pharmaceuticals multinationals.

The Company's roots go back to 1757 when Geigy, the oldest chemical company in Basel began trading in chemicals and dyes. In 1925, Geigy began research into textile chemicals and in the 1930s turned its attention to agrochemicals. A pharmaceuticals division was formed in 1938.

In 1970, Geigy merged with CIBA, a chemical company founded in 1884 in Basel. CIBA developed its first pharmaceutical products in 1889 and added other products such as textile auxiliaries and finishing products, cosmetics and plastics in the 1920s. It introduced epoxy resins in 1946 and began to manufacture plant protection products in 1954, followed by products for animal health and hygiene in 1959.

In 1996, Ciba-Geigy and Sandoz merged to form Novartis (the "Merger"). As part of the Merger, Ciba-Geigy's specialty chemicals business was spun off to form Ciba Specialty Chemicals Holding Inc. (the "Spin Off"), which on March 13, 1997, was listed on the Swiss Exchange.

##### **Recent acquisition and divestiture activities**

In 2003, the Company acquired additional equity interests in Diamond Dye-Chem Limited for approximately CHF 11 million, increasing its holdings to 69 percent. Also in 2003, the Company purchased additional shares in Shanghai Ciba Gao-Ciao Chemical Co. Ltd., for approximately CHF 12 million, increasing its holdings to 75 percent.

In 2004, in order to establish a stronger world-wide presence in the paper chemicals business, the Company completed three acquisitions: in June 2004 the Company acquired Raisio Chemicals from the Raisio Group, headquartered in Raisio, Finland, for approximately CHF 662 million; in July 2004 the Company acquired LPM Technologies Inc., a Canadian paper chemicals company, for approximately CHF 11 million; and in August 2004, Ciba Specialty Chemicals acquired AB CDM, a Swedish based supplier of chemicals, from Imerys SA for approximately CHF 22 million. The AB CDM acquisition also provides the Company with a direct presence in the Swedish water treatments market.

In order to enhance its Expert Services program, which provides a wide range of specialty chemicals services to customers, the Company in March 2004 acquired Pira International, based in the United Kingdom, for approximately CHF 5 million.

In December 2004, in order to expand access to Asian markets outside of Japan and build market share in pigments, the Company increased its interest in the Daihan Swiss Chemical Corporation from 50% to 100%, for approximately CHF 31 million. Daihan Swiss Chemical Corporation is a Korean manufacturer, marketer and distributor of pigments and preparations for the Korean coatings, plastics and inks markets.

In 2005, the Company continued the integration of the Raisio Chemicals business by acquiring the remaining portions of a number joint ventures acquired at the acquisition of Raisio Chemicals the previous year. In addition, in March the Company acquired for CHF 45 million, the Metasheen line of high reflectance aluminum pigments from Wolstenholmes, in order to expand the products offered in the effect pigments business within coating effects. There were also a number of minor acquisitions during the year.

## Capital expenditures

Ciba Specialty Chemicals' aggregate capital expenditures for property, plant and equipment were CHF 275 million in 2005, CHF 294 million in 2004 and CHF 233 million in 2003. In 2005, 2004 and 2003, capital expenditures have been focused primarily on efficiency and safety improvement-related items. Recent projects include investments in new production facilities for stabilizers and pigments, upgrades to water and paper treatment production facilities, and investment in emerging markets, particularly Asia.

## Business Overview

Ciba Specialty Chemicals is one of the world's leading developers and producers of specialty chemicals, which are high value-added chemical products used as key components and in a wide variety of consumer and industrial products. The Company operates on a global basis with manufacturing facilities in 28 countries and sales in more than 120 countries.

In 2005, the Company had net sales from continuing operations of CHF 7 419 million, an operating loss of CHF 124 million and a net loss of CHF 256 million.

Net sales, by geographic region of the Company for the past three years were as follows:

<u>Amounts in CHF millions, except percentages</u>	<u>2005</u>		<u>2004</u>		<u>2003</u>	
	<u>Sales</u>	<u>In %</u>	<u>Sales</u>	<u>In %</u>	<u>Sales</u>	<u>In %</u>
Europe .....	3 197	43%	3 050	44%	2 731	41%
Americas <sup>(i)</sup> .....	2 087	28%	2 046	29%	2 066	31%
Asia Pacific <sup>(ii)</sup> .....	2 135	29%	1 931	27%	1 849	28%
Total net sales .....	<u>7 419</u>	<u>100%</u>	<u>7 027</u>	<u>100%</u>	<u>6 646</u>	<u>100%</u>

(i) The Americas are comprised of North, Central and South America.

(ii) Asia Pacific is comprised of Asia, Africa, the Middle East, Australia and New Zealand.

## Organization

The Company is organized into four reporting segments ("Segments") focused on specific customer markets. The four Segments are Plastic Additives, Coating Effects, Water & Paper Treatment and Textile Effects. Each Segment is responsible for marketing, research and development, technology, production and sales. The mission of each Segment is to provide the best and most complete service to its customers' industries and strive for market leadership in its respective area.

While each Segment has a lasting role in providing for a well-balanced portfolio for the Company, they are positioned for growth and higher profitability through different approaches: innovation (Plastic Additives and Coating Effects), cost leadership (Textile Effects) and business growth (Water & Paper Treatment).

From 2001 until 2004, the Company had been organized into five Segments. However, in August 2004, the former Home and Personal Care Segment, which had not achieved a critical mass, was integrated into the Plastic Additives and Water and Paper Treatment Segments.

The Company's organizational structure also includes Group Service Units focused on providing cost efficient support services to the Segments. To ensure that innovation efforts are successfully shared across Segments, the Company has a corporate technology office under the leadership of a Chief Technology Officer. In 2004, a Chief Strategy Officer was appointed to oversee strategic development and portfolio management for the Company. All Segments share the support functions provided by the Group Service Units, which include finance and accounting, human resources, communications, information technology ("IT") infrastructure, legal and supply chain services.

In 2005, the Company adapted the structure of its Executive Committee to reflect the changing needs of its markets and created the Chairman's Committee, focusing on strategic development, and the Operations

Committee, focusing on the operational management of the Company. As part of this new structure, a Chief Operating Officer was appointed, responsible for the operational management of the Company.

## Segments

Net sales, by Segment, of the Company for the each of the past three years were as follows:

<u>Amounts in CHF millions, except percentages</u>	<u>2005</u>		<u>2004</u>		<u>2003</u>	
	<u>Sales</u>	<u>In %</u>	<u>Sales</u>	<u>In %</u>	<u>Sales</u>	<u>In %</u>
Plastic Additives . . . . .	1 938	26.1%	1 895	26.9%	1 822	27.4%
Coating Effects . . . . .	1 804	24.3%	1 818	25.9%	1 807	27.2%
Water & Paper Treatment . . . . .	2 394	32.3%	2 014	28.7%	1 616	24.3%
Textile Effects . . . . .	<u>1 283</u>	<u>17.3%</u>	<u>1 300</u>	<u>18.5%</u>	<u>1 401</u>	<u>21.1%</u>
<b>Total net sales . . . . .</b>	<u>7 419</u>	<u>100.0%</u>	<u>7 027</u>	<u>100.0%</u>	<u>6 646</u>	<u>100.0%</u>

Plastic Additives develops, manufactures and markets products and provides services to the plastic and lubricant industries. The Segment's products are additives, which are ingredients added in small quantities to polymers and lubricants that prevent aging and corrosion and help improve appearance, durability and performance of finished goods such as polyolefins and engineering plastics as well as high-performance motor oils and industrial lubricants. The Segment's service business provides customers with product application solutions.

Coating Effects is a leading global manufacturer of organic pigments and functional dyes as well as the leading supplier of photoinitiators and light stabilizers to the coatings, graphic arts and electronic industries. The Segment develops, manufactures and markets additives, pigments and functional dyes, as well as additive and pigment concentrates, for the coatings, printing, imaging, electronic, information storage, plastics and fibers industries. The end-user markets for its products and services are, among others, the automotive, packaging, publication, electronics, information storage, construction, photographic and digital printing industries.

Water & Paper Treatment serves the paper and water treatment as well as the detergents and hygiene industries. The Segment offers products and services to the global paper and board industry. Its 'effect chemicals' provide solutions to increase paper mill productivity and improve appearance, handling and performance of paper and board. The Segment also offers products and services used to treat the water streams in industrial and municipal applications and to improve the efficiency of mineral and oil processing as well as soil additives and specialty monomers. Furthermore the Segment provides whiteners and antimicrobials for detergents and hygiene effects for a variety of personal care products.

Textile Effects serves the textile industry, offering dyes and chemicals, services and integrated solutions to customers along the whole textile value chain. The Segment's products include dyes and chemicals for dyeing and printing of almost all textile fibers, optical brighteners and textile finishing products for protection and easy-care. Services offered by the Segment include color matching via the Internet and technical consultancy regarding textile color and effects management for international brand houses and retailers.

## Group Services

The Company has established a number of Group Service Units that are responsible for providing cost efficient support services to the Segments. The utilization of these centralized Group Service Units has two primary benefits to the Company: they allow the Segments to fully concentrate on serving their markets and customers and they reduce overall costs as a consequence of increased economies of scale. The functions of the Group Service Units of the Company are described in the following paragraphs.

The Supply Chain Services unit is responsible for the supply chain process from finished product stage onwards, which includes order processing, warehousing and transportation of products. The Supply Chain Services unit maintains shared order desks on a regional/country level that service all Segments with regards

to order taking, order processing, shipping and customer invoicing. Different customer service solutions are actively explored and implemented with the goal of increasing the ease with which customers are able to do business with the Company and minimizing product distribution costs. The Company, through its Supply Chain Services unit, utilizes a global network of both Company- and third-party-owned warehouses and distribution centers to ensure adequate coverage of the Company's distribution requirements. The global and regional distribution networks are actively and systemically reviewed to ensure an optimized relationship between warehousing costs, distribution costs and customer service levels.

The Company maintains Business Support Centers that provide finance and accounting services to geographic regions, instead of using numerous country organizations. The Business Support Centers, using standardized financial systems, provide control, treasury and information management services to the Company for financial and corporate applications. They are responsible for ensuring the accuracy, validity and timeliness of financial reporting. As part of its strategy to streamline administrative operations and reduce costs, the Company in 2005 consolidated the functions of its Northeast Asia and South Pacific Business Support Centers into other existing Business Support Centers, thereby reducing the number of centers from 11 to 9.

In 2005, the Company consolidated responsibility for all information technology and data processing and management functions under a newly appointed Chief Information Officer. Included in these functions is the Global Infrastructure unit, which working with outsourcing partners, has the principal objective of optimizing the Company's information technology infrastructure including its wide area networks.

Corporate functions such as legal, environmental, communications and human resources are managed through 7 Regional Presidents Offices.

Headquarters is responsible for strategy and corporate governance.

### **Equity Affiliates**

The Company, from time to time, acquires and disposes of participations in entities to help achieve strategic objectives. The Company's investments in equity affiliates resulted in total income from earnings of equity affiliates of CHF 2 million in 2005, CHF 1 million in 2004 and CHF 3 million in 2003.

The Company invests in equity affiliates to support and supplement the growth of its core business. Some of these investments are made in countries where legislation requires or custom dictates local investor control or participation. The Company holds an active interest in its equity affiliates.

The Company's most significant investment in equity affiliates as of December 31, 2005 is a 50 percent interest in CIMO Compagnie Industrielle de Monthey SA, which is a joint venture with Syngenta that provides infrastructure services and utilities to the partner's manufacturing facilities in Monthey, Switzerland.

### **Company Strategy**

The key components of the Company's strategy to drive profitable growth and to maximize value for its shareholders are to place the customer first, offer leading edge innovation, aim for best-in-class manufacturing, and attract, develop and retain the very best people. Placing the customer first involves utilizing an industry-focused organization that is closely aligned with customers' industries. A focus on leading edge innovation enables the Company to make everyday products better and makes breakthrough products possible. The Company offers its customers both significant innovation as well as steady improvements by fostering a creative culture and by sharing and leveraging its core competencies. In aiming for best-in-class manufacturing, the Company seeks lowest-cost manufacturing coupled with focused capital expenditures, while maintaining an overriding policy of 'safety first'. A single, streamlined global supply system supports both manufacturing and customer supply concerns, and increases efficiency across the Company.

## Competition

The Company competes in the global specialty chemicals market. Its major competitors include BASF, Bayer, Buckman, Clariant, Cognis, Croda, Crompton, Cytec, Degussa, Dow, DuPont, GE Water Technologies, Great Lakes, Hercules, Johnson Polymer, Kemira, Lubrizol, Nalco, Rhodia, Rohm and Haas, SNF Floerger, Songwon and Stockhausen.

## Plastic Additives

### Overview

Plastic Additives' products provide, maintain and improve the desirable properties, or suppress the adverse properties, of plastics, rubber, adhesives, lubricant materials and home and personal care products. Additives increase the stability of a variety of materials during processing and use, thereby facilitating or improving the efficiency of industrial processes or enhancing their value for home and personal use. Additives can improve quality and provide long-term stability and economical viability of final industrial and consumer products by, for example, protecting products against aging, light degradation, corrosion or wear. Specialty colors for home and personal care products deliver unique properties.

Plastic Additives' business has for many years experienced strong growth and profitability resulting from its leadership in the additives markets. The Segment is the leading supplier of stabilizers and stabilizer systems to the plastics, rubber and adhesive industries, and is a leading supplier of ashless antioxidants and extreme pressure and antiwear agents to the lubricant industry. In addition, the Segment delivers high value chemical ingredients for manufacturers of non-durable home and personal care consumer goods.

Plastic Additives is managed as an integrated global business and primarily focuses on four Business Lines: (i) Polymer Products, (ii) Base Polymers, (iii) Process and Lubricant Additives and (iv) Home & Personal Care. Plastic Additives also includes the small Business Unit Ciba® Expert Services.

The additives market is mainly related to the plastics industry, which has generally been experiencing long-term growth. However, this growth is affected by shorter-term economic and industrial cycles, particularly in the oil, automotive, construction and packaging industries. Increasing environmental and safety regulations governing the industries of the Company's customers have also affected the additives market. These regulations have resulted in an increased demand for more innovative products with lower environmental impacts. The company's products are developed for sensitive applications, such as use in contact with food and drinking water or for home and fabric care and personal care. These applications are subject to a higher degree of regulatory control. Other regulatory initiatives being introduced in the area of environmental control (for example, the removal of volatile organic chemicals) have led to the reformulation of some products and greater engineering oversight in production by the Company.

The Segment's Expert Services Business Unit provides knowledge-based services to customers seeking professional consulting, testing and information support. The Expert Services Business Unit acquired in 2004, Pira International Ltd, a leading consultancy and testing business and, in 2005, the U.S. conferencing company Intertech.

The table below sets forth certain historical combined financial information and the percentage contribution to the consolidated Company net sales from continuing operations for Plastic Additives for the years ended December 31, 2005, 2004 and 2003.

<u>Amounts in CHF millions, except percentages</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Total Segment net sales . . . . .	1 938	1 895	1 822
Operating income . . . . .	260	224	165
Capital expenditures . . . . .	72	76	64
Research and development expenditures . . . . .	97	97	107
Contribution to the consolidated Company net sales from continuing operations, in percent . . . . .	26.1%	26.9%	27.4%

## *Products*

Plastic Additives products add value to the polymer, rubber, adhesive, lubricant, and home and personal care industries. The Segment's product offerings include:

- Polymer protection products such as antioxidants, non-staining antiozonants, processing stabilizers, UV absorbers and hindered amine light stabilizers (“HALS”):
- Special effects such as antifogging agents, antistatic agents, slip agents, antimicrobials, clarifying agents, shelf life extension, flame retardants, optical brighteners and additives for degradable plastics:
- Products for polymer recycling such as PET chain extenders, antioxidants and light stabilizer systems:
- Specialized product forms and multi-component product packages, which simplify the incorporation process and improve worker hygiene and resin quality:
- Products for polymer design such as polymerization regulators:
- Products for lubricants such as antioxidants, metal deactivators, and antiwear additives:
- Light absorbers for fabric and personal care, rheology modifiers, actives for skin protection, carrier systems, conditioners, specialty colors for home and personal care products, laundry additives for comfort enhancement, and stain removers.

The Segment's leading product lines in the polymer protection category are Ciba® IRGANOX® antioxidants, Ciba® IRGAFOS® processing stabilizers, Ciba® CHIMASSORB® light stabilizers/UV absorbers, Ciba® TINUVIN® light stabilizers/UV absorbers, Ciba® IRGAMOD® additives for polyesters, Ciba® FIBERSTAB® L phenol-free processing stabilizers, Ciba® IRGASTAB® FS phenol-free processing stabilizers and Ciba® IRGAZONE™ non-staining antiozonants.

The Ciba® IRGAFOS® processing stabilizer range ensures efficiency in processing and maintenance of polymer properties across a broad range of processing conditions. Ciba® POLYAD® customer-specific blends are multi-component additive packages in easy-to-handle forms.

Ciba® TINUVIN® light stabilizers/UV absorbers constitute a complete range providing light stability to polyolefins, engineering plastics, adhesives and rubbers. Examples of new innovative products include Ciba® TINUVIN® 1577 as an innovative UV absorber for glazing, thin films and laminates, Ciba® TINUVIN® XT 833 for improved light stability and weather resistance and Ciba® TINUVIN® FR 2011/2021 providing flame retardancy and light stability.

In addition to the Segment's traditional Ciba® IRGANOX® range, Ciba® IRGANOX® HP, Ciba® IRGANOX® XP, Ciba® IRGASTAB® PUR, Ciba® IRGASTAB® PVC and Ciba® IRGASTAB® STYL are examples of how additives support the polymer industry with new, innovative products and services. Both the Ciba® IRGANOX® HP and Ciba® IRGANOX® XP ranges combine HP-136, the Company's innovative lactone technology, with established high-performance phosphites for the stabilization and protection of polyolefins, polyurethane foams and adhesives during processing. Ciba® IRGASTAB® PUR, Ciba® IRGASTAB® PVC and Ciba® IRGASTAB® STYL are new liquid, environmentally friendly solutions for the polyurethane, vinyl and styrenics markets, respectively.

The Ciba® IRGAMOD® range comprises multifunctional PET additives reducing acetaldehyde and oligomers, avoiding discoloration and acting as chain extenders by modifying the properties of PET via reactive extrusion. Recent product launches are Ciba® IRGATEC® CR 76 and Ciba® IRGAMOD® RA 20.

Ciba® FIBERSTAB® L and Ciba® IRGASTAB® FS phenol-free processing stabilizers systems set with excellent gas-fade resistance a new standard in the processing stabilization of polyolefin fibers. They also provide good long-term thermal stability and enhanced light stability. Ciba® FIBERSTAB® L is particularly suited for PP fiber applications such as carpets and hygienic non-wovens and Ciba® IRGASTAB® PVC 11 EM is an environmentally friendly antioxidant for PVC.

Ciba® IRGAZONE™ 997 non-staining antiozonant provides rubber products with very good protection against ozone, heat, flex and fatigue. Opposite to classical rubber antiozonants, it is non-staining, is not leaching from rubber vulcanizates and has various food contact approvals.

The Segment is adding to its polymer product offerings by branching out from its core polymer protection and stabilization business to take advantage of new market opportunities in the area of property enhancement. With a focus on surface modification, the Segment is improving materials with special physical effects, thereby improving surface properties and product performance. A step in this direction has been the expansion of an antistatic and antifogging product range, which modifies surfaces to temper the buildup of static charge or water as fog. The Segment's leading product lines in this special effects additives category are ATMER™ antifogging agents, Ciba® IRGASTAT® and ATMER™ antistatic agents, ATMER™ SA — slip and antisticking agents, Ciba® IRGAGUARD® antimicrobial line, including Ciba® IRGAGUARD® A — anti-algae and Ciba® IRGAGUARD® B — antibacterial, and Ciba® IRGACLEAR® F — antifungi, Ciba® IRGACLEAR® — clarifying agents, Ciba® SHELFPLUS® — shelf life extension, Ciba® FLAMESTAB® NORTM and Ciba® MELAPUR® — flame retardants, Ciba® TINUVIN® FR flame retardant/light stabilizer combinations and Ciba® UVITEX® optical brighteners. Ciba® SHELFPLUS® UV 4100 blocks a broad spectrum of UV radiation protecting package contents in food, home and pharmaceutical applications. The novel agricultural growth promoter Ciba® SMARTLIGHT™ RL100 utilizes photo-selective properties of the product to improve crop quality and productivity. Ciba® IRGASURF™ HL 560 delivers durable hydrophilicity for polyolefin fibers and nonwovens. Ciba® IRGAZONETM 997, launched in 2003 for rubber applications, represents a technology that offers protection against ozone, fatigue and oxygen, with non-staining properties and extraction resistance. Ciba® IRGAMOD® 195 is an effective catalyst and stabilizer for rosin esters and is an extraction resistant antioxidant for rubber applications, especially ones based on NBR and ECO.

The trend of plastics replacing other materials, such as glass and wood, is expected to continue. This offers the Segment opportunities to further work with customers to develop new applications for the Segment's products in, for example, the automotive industry where engineered plastics are replacing traditional materials. In addition, in the area of base polymers the Segment is continuously expanding its services business areas to provide customers with tailor-made additives blends as part of a market approach that emphasizes customer contact and quick response times.

To cope with the increased temperature stress in modern engine oils, two new high temperature antioxidant systems, Ciba® IRGANOX® L 93 and Ciba® IRGANOX® L 94 were introduced.

For the lubricant industry, the Segment offers single components for engine oils and industrial lubricants such as antioxidants, extreme pressure/antiwear additives, friction modifiers, corrosion inhibitors and metal deactivators, and additives packages for industrial lubricants.

In the Process and Lubricant Additives business, the focus is on working with customers to develop additives for lubricants, such as Ciba® IRGALUBE® F 10, that enhance the performance of engine oils while providing environmental benefits. Management is of the opinion that products such as additives for plastics recycling and ashless antioxidants for lubricants are becoming more important with increased environmental awareness and regulation.

The home & personal care products market is served by five business platforms:

*UV Protection & Actives for the personal care industry:*

Ciba® TINOSORB® UV absorbers are used to provide protection against the harmful effects of UVA (long wave-length) and UVB (short wave-length) radiation in a variety of products applied directly to the skin, including sunscreens, lotions, and day creams. Growth prospects are particularly strong in regions where concern for effective protection from sunlight is high. Ciba® TINODERM® Actives Delivery Systems facilitate the transport of actives through the skin barrier to the site of interaction. TINOCARE® GL, a Scleroglucan polysaccharide, retains skin moisture in a natural way and improves the sensory characteristic of personal care formulations.

*Polymer Systems for the personal care and home and fabric care industries:*

Rheology modifiers, conditioners, and gel thickeners allow customers to produce formulations to the highest standards of quality and consistency. Ciba® RHEOVIS® and Ciba® GLASCOL® are for the home care industry and Ciba® SALCARE® and Ciba® TINOVIS® are for the personal care industry.

*Colorants & Stabilizers for the personal care and home and fabric care industries:*

Ciba® TINOGARD® provides product stabilization against oxidation and UV induced degradation. Ciba® VIBRACOLOR® products are hair dyes. Ciba® PURICOLOR® and Ciba® VIBRACOLOR® pigments and anionic, water-soluble dyes are used in personal care as well as home and fabric care products.

*Fabric Appearance for the laundry care industry:*

Ciba® TINOFIX® dye fixatives maintain the color integrity of fabrics. Ciba® TINOTEX® Comfort & Easy Care ingredients bring easy care properties to laundered fabrics. Ciba® TINOLUX® is a unique photocatalytic system that uses sun rays to safely and effectively bleach stains. Ciba® TINOSORB® UV absorbers are applied to clothing via the laundry washing process to clothing to convert cotton fabrics into effective UV shields.

*Stain Removal for the laundry care industry:*

Ciba® TINOCAT™ oxidation catalysts enable efficient stain removal at lower wash temperatures and with shorter wash cycles and as well provide an anti-graying effect on white fabrics.

The Expert Services Business Unit delivers services in the regulatory, environmental, safety, and testing areas. It also provides extensive information services and offers strategic and technical consulting.

***Customers and End-User Markets***

In 2005, end-user markets such as the packaging industry accounted for approximately 26 percent of the Segment's sales, the construction industry for 18 percent, the durable goods industry for 9 percent, the automotive industry for 8 percent, the agricultural industry for 7 percent and the lubricants industry for 11 percent. The top ten customers of the Segment accounted for approximately 28 percent of the Segment's 2005 sales.

***Research and Development***

Plastic Additives spends approximately 5 percent of sales each year on research and development activities (CHF 97 million in 2005). The primary objective of these research and development activities is to achieve and maintain a high level of the Segment's sales of "innovative products". Innovative products are defined as patent protected products or products and applications younger than five years. Management is of the opinion that Plastic Additives has a growing product pipeline. The goal is to further improve sales with new and innovative products, and to protect product and application innovations by appropriate patents. Products currently being developed include new classes of light stabilizers, anti-static additives, process stabilizers for plastics, non-staining antioxidants for rubbers, flame retardants, process chemicals for reactive monomers, new UV absorbers for sunscreens, a new photobleach agent for laundry detergents, a new class of oxidation catalysts for use in home and fabric care applications and new nanocolloid encapsulated active ingredients for skin care products.

Research and development activities focus on new product development as well as process improvements that aim to lower costs and increase productivity, speeding time-to-market of new products and improving responsiveness to customers by increased integration of manufacturing processes with the Segment's distribution network.

## Coating Effects

### *Overview*

Coating Effects develops, manufactures and markets additives, pigments, pigment and additive concentrates for the coatings, printing, imaging, plastics, synthetic fibers, electronics and information storage industries. Coating Effects is a leading global manufacturer of organic pigments and the leading supplier of photoinitiators and lightstabilizers to the coatings, graphic arts and electronic industries.

Coating Effects is managed as an integrated global business and serves five industry-focused markets: (i) coatings, (ii) plastics, (iii) electronic materials, (iv) imaging & inks and (v) masterbatches.

Pigments, including Effect Pigments, are insoluble coloring materials used for the coloration of printing inks, paints, plastics and synthetic fibers in products such as automotive paints, transportation coatings, synthetic carpets and upholstery, printed materials and publications, building paints, packaging, cables, flooring, toys, industrial goods and equipment, furniture, consumer goods and electronics.

Additives maintain or improve the desirable properties, or suppress the adverse properties, of materials and improve the stability of these materials during processing, thereby facilitating or improving the efficiency of industrial processes. In addition, additives can improve quality and provide long-term stability and economical viability for the final product by, for example, protecting the product against aging, destruction or wear.

Growth in the global pigments market tends to track Gross Domestic Product (“GDP”) development. There is a move towards high value pigments and improved additives as customers upgrade their products and the technical performance requirements of the colorants and additives they incorporate in their formulations. Changes in technology in the customer base provide opportunities for new products, for example in the fast changing electronics industry. In recent years, environmental pressure to replace heavy metals such as cadmium and lead has led to an increased demand in organic pigments. The impact of the low volatile organic content (“VOC”) regulations is that solvent usage is being reduced in the printing ink and coatings industries with alternative technologies, such as UV-curing, powder coatings, high solid paint systems and water-based systems. With the Segment’s current portfolio and innovation projects, the Company believes the Segment is well placed to take advantage of these trends. There also is a need for products that make processing easier and more cost effective for customers in all traditionally served industries. In particular, there is a focus on ease of product handling, for example, low dusting colorants and additives. The Segment’s range of products includes liquid forms, granules, dispersions and concentrates. As pigment manufacturers have traditionally had strong market positions in particular colors (for example, the Segment has a strength in high performance, opaque red pigments used in automotive paint), color trends can benefit particular producers while negatively affecting others.

The high performance and high value pigments market are characterized by capital-intensive production facilities and demanding standards for high and constant quality. The major applications for these pigments are automotive paints, general industrial paints, decorative paints, electronics, plastics and packaging and specialty inks, with competition based mainly upon the technical properties of the products. In contrast, the classical pigments market is characterized by relatively mature products with minimal patent protection and strong competition from low cost manufacturers in emerging countries. The major application for these pigments is printing inks. The dispersions market for organic and inorganic pigments is characterized primarily by the provision of customer-specific solutions and delivery service. The major application for dispersions is the plastics industry and the major applications for inorganic pigments are plastics and industrial paint.

The additives market is affected by shorter-term economic and industrial cycles experienced by its customers, particularly in the coatings industry, which in turn is dependent on the automotive industry. Increasing environmental and safety regulations governing the industries of the Company’s customers also have affected the additives market. These regulations have resulted in an increased demand for more innovative products with lower environmental impacts. The Company’s products are developed for sensitive applications, such as use with food and drinking water. These applications are subject to a higher degree of regulatory control.

The table below sets forth certain historical combined financial information and the percentage contribution to the consolidated Company net sales from continuing operations for Coating Effects for the years ended December 31, 2005, 2004 and 2003.

<u>Amounts in CHF millions, except percentages</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Total Segment net sales . . . . .	1 804	1 818	1 807
Operating income . . . . .	233	291	298
Capital expenditures . . . . .	82	82	79
Research and development expenditures . . . . .	104	101	95
Contribution to the consolidated Company net sales from continuing operations, in percent . . . . .	24.3%	25.9%	27.2%

***Products***

The Segment’s leading colorant product lines include the high performance pigments, Ciba® IRGAZIN®, Ciba® CINQUASIA® and Ciba® CROMOPHTAL®, used in coatings, inks, plastics and synthetic fibers, the IRGAPHOR®, functional dye products used for optical information storage (CD-R and DVDR) and Ciba® IRGALITE® classical pigments used primarily in printing inks. The Segment also produces pigment dispersions and masterbatches. The Segment’s management is of the opinion that its Diketo-Pyrrolo-Pyrrol (“DPP”) technology offers distinct advantages to users of its high performance pigments for coatings and plastics. DPP pigments are currently being used in automotive paints and high performance plastics materials. Current environmental pressure on cadmium pigments opens up good growth opportunities for DPP pigments in the plastics industry. The Segment does not believe it has yet fully exploited the benefits of DPP technology in the automotive industry or in other paint, plastics or inks applications.

With the Effect Pigment product ranges of Ciba® METASHEEN® (vacuum-metalized aluminum pigments) and Ciba® XYMARATM (Mica/metal oxides), the Segment augmented its range of Pigments. These Effect Pigments offer a wide choice of shiny, sparkling, pearlescent and mirror-like effects for the coatings, plastics, imaging and inks industries.

The Segment’s leading additives products lines include, Ciba® TINUVIN® light stabilizers for coatings, inks and photographic applications, Ciba® IRGACURE® photoinitiators and photoinitiators blends for ultraviolet curing of coatings, paints, inks and electronic materials and the environmental friendly polymer specialty rheology agents and dispersants for coatings. The Segment also offers, stabilizers and process chemicals for photographic and photo-reproduction systems, algaecides for antifouling and dispersion paints. Management is of the opinion that products such as photoinitiators for solvent-free coatings are becoming more important with increased environmental awareness and regulation.

***Customers and End-User Markets***

In 2005, Coating Effects supplied pigments and additives to the paint and coatings industries, the printing ink industry, the plastics industry, the synthetic fibers industries and the electronic materials industry. The top ten customers of the Segment accounted for approximately 28 percent of the Segment’s 2005 sales.

In 2005, the end-user markets such as the automotive industry accounted for approximately 24 percent of the Segment’s sales, the imaging and publication industry for 13 percent, the packaging industry for 20 percent, the electronics industry for 8 percent and the construction industry for 18 percent of the Segment’s sales.

Consolidation and globalization have occurred in certain of the customer industries served by the Segment, particularly in the coatings and printing ink industries. The effect of such consolidation and globalization is that pricing pressure is exerted on suppliers.

### ***Research and Development***

Coating Effects spends approximately 6 percent of sales each year on research projects (CHF 107 million in 2005). The primary objective of these research and development activities is to achieve and maintain a high level of the Segment sales of “innovative products”. Innovative products are defined as patent protected products or products and applications younger than five years. Pigment products currently being developed by the Segment include high value pigments with a new standard of performance to price ratio (a novel range of polymer soluble dyes), novel granule forms of pigments, solvent-free dispersions, pigments and dyes for optical storage and color filters. The Segment is also developing colorants for digital ink jet printing on paper and plastic.

Additive products currently being developed include high performance curing catalysts for coatings, imaging and information storage, new classes of light stabilizers, UV-absorbers, sterically hindered amines for coatings as well as algacides for antifouling paints. In addition, in response to increasing environmental and safety regulations, Coating Effects is developing various additives for waterborne, powder or radiation curable systems.

### **Water & Paper Treatment**

Water & Paper Treatment is one of the leading global suppliers to the paper industry, the municipal and industrial water treatment industries and the detergents and hygiene industries, and is managed as an integrated global business. The markets in which the Segment is present have been affected by increasing environmental and safety regulations that govern the industries of the Company’s customers. These regulations have resulted in an increased demand for more innovative products with lower environmental impact.

Water & Paper Treatment products and services for the paper and board industry increase the speed, run-ability and quality of the paper making process (retention and drainage aids, deposit control aids). Furthermore, they improve the visual appearance, optical properties and printability of the paper (paper whiteners, paper coloration, starch and latex binders, coating additives and surface modifiers), impart water, oil and grease resistance (barrier effects and sizing), and provide stable images on carbonless and thermal papers. The Segment’s newly acquired Technical Centers in Finland further enhance our position as a total solution provider to the paper industry.

The products and services offered in the area of water treatment improve the separation of solids from liquids, purify water, dewater sludge for disposal, and enhance dredging applications. In extractive and process technologies, the Segment’s products improve the efficiency of all extraction and mineral processing. The Segment also serves a number of niche markets including soil additives where products improve plant nutrition and soil fertility, and performance intermediates where high purity specialty monomers are supplied by the Segment for various applications (e.g. rubbers and adhesives). The Segment’s activities in industrial water management aim to bring a service oriented approach by providing customers, initially in Europe, with complete solutions that meet all their industrial water treatment needs. Strong, local support is available through a network of partners, each providing expertise and industry leading Ciba® IRGATREAT™ product technology, equipment and services.

In the area of detergents and hygiene, the Segment’s products and services are used in the home and fabric care industries as well as the personal care market. Whiteners, used in detergents, enhance the whiteness and brightness of textiles while antimicrobial solutions are used in personal care products, promoting good hygiene by inhibiting microbial growth and contributing to personal well being.

The table below sets forth certain historical combined financial information and the percentage contribution to the consolidated Company net sales from continuing operations for Water & Paper Treatment for the years ended December 31, 2005, 2004 and 2003.

<u>Amounts in CHF millions, except percentages</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Total Segment net sales . . . . .	2 394	2 014	1 616
Operating income . . . . .	128	128	125
Capital expenditures . . . . .	89	81	55
Research and development expenditures . . . . .	48	42	33
Contribution to the consolidated Company net sales from continuing operations, in percent . . . . .	32.3%	28.7%	24.3%

**Products**

In the paper industry, there is an ongoing demand for more efficient production processes and this is where Ciba patented technologies such as the Ciba® TELIOFORM® retention and drainage aid system and Ciba® PERGAFAST™ Color Developer for the Color Former market bring value to customer. At the same time, consumers are demanding more innovative paper products and here the Company’s Grade Solutions approach to the paper and board industry provide advantages. With Grade Solutions, Ciba pulls together its complete product and service offering to the market in alignment with the major grades produced: Fine Paper, Mechanical Paper, and Packaging. For each grade, the Segment offers a full range of chemicals as part of its solution offer — Wet-End Solutions, Size Press Solutions, Water Management Solutions, and Coating Solutions. The Segment’s complete range and proximity to the customer allows the Company to be a leading innovator in meeting consumer requirements. The rapid change of technology, the globalization of the customer base and the growing importance of emerging economies are likely to shape the future direction of these markets. Of particular importance are the growing environmental regulations, which are expected to contribute to a growth in chemical demand in excess to that of the paper and board industry.

The Segment develops, produces and sells the following products to the water treatment market segment: Ciba® ZETAG®, Ciba® MAGNAFLOC® and Ciba® MAGNASOL® polyacrylamide polymers, organic coagulants, and poly acrylic acid polymers. The main usage of these products is as flocculants for the separation of solid particles from water. The recently launched Ciba® KRYSALIS® products for the dredging industry enhance solid liquid separation and the separation of contaminants from the dredging sediment. Ciba® RHEOMAX™ tailings management products for the mining industry allow minimization of water consumption and maximization of water recovery, thereby reducing disposal areas and hence generating cost savings in waste disposal. The water treatments product range also includes Ciba® IRGATREAT™ specialty formulations for the full range of water purification and conditioning applications, dispersants to reduce the viscosity and to increase the performance of inorganic pigments and fillers in water systems, monomers as building blocks used in water treatment, adhesives, synthetic fibers and antistatic finishes, as well as a range of chelates including Ciba® LIBFER® iron chelate, which correct soil deficiencies for intensively grown crops.

The leading product lines in detergents and hygiene include Ciba® TINOPAL® whiteners for detergents and Ciba® IRGASAN®, Ciba® IRGACARE® and Ciba® TINOSAN® antimicrobials providing hygiene effects for personal care products. Whiteners are supplied to the detergents industry. In detergents, the demand for whiteners has stagnated in the European, United States and Japanese markets, while the emerging markets of Asia and South America continue to show signs of growth. Hygiene effects are high value-adding antimicrobial ingredients supplied to the personal care and home and fabric care industries. Main applications include soaps, deodorants, toothpastes, dishwashing liquids, detergents and disinfectants for hospitals and medical purposes. The Segment’s antimicrobial solutions continue to be recognized as the industry standard for efficiency, performance and safety by key customers.

### *Customers and End-User Markets*

In 2005 Water & Paper Treatment supplied products and services to the paper and board, municipal and industrial water treatment as well as detergents and hygiene industries. The top ten customers of the Segment accounted for approximately 25 percent of the Segment's 2005 sales.

In 2005, end-user markets such as the paper and board industry accounted for approximately 58 percent, the detergents and hygiene industries accounted for 10 percent, the water and wastewater services industry accounted for 20 percent, the extractives and process technologies industry accounted for 7 percent, the performance intermediates accounted for 3 percent and the agricultural industry accounted for 2 percent.

### *Research and Development*

Water & Paper Treatment spends approximately 2 percent of sales each year on research and development activities (CHF 48 million in 2005). The Segment's integrated research and development philosophy is aimed at driving process/production technology improvements, development of novel targeted offerings to the industry and expansion to novel markets using existing and emerging technologies.

### **Textile Effects**

#### *Overview*

Textile Effects develops, manufactures and markets a variety of organic and inorganic synthetic dyes as well as processing and finishing chemicals for natural and synthetic fibers, focusing on cellulose, polyester, wool and polyamide and their blends.

Based on 2005 sales, management estimates that the Segment Textile Effects is one of the largest textile effects businesses in the world. The Segment is the world's second largest manufacturer of textile dyes, the largest manufacturer of dyes for wool, polyamide carpets and automotive fabrics, and the second largest manufacturer of reactive dyes. As one of the leading suppliers of textile chemicals to the textile industry it provides customers with an integrated range of products and services for fabric processing and finishing, including sizing, pretreatment, dyeing and printing auxiliaries, whiteners, comfort and easy care, UV protection, oil and water repellents, flame retardants and coating chemicals.

Demand for textile dyes and chemicals is mainly driven by consumer trends in the textile end markets such as GDP, shade and effect trends related to fashion as well as the level of personal disposable incomes. The textile industry is shifting rapidly to the lower wage countries in Asia, particularly those with fast growing internal markets (such as China, India, Pakistan, and Vietnam).

The traditional North American and European markets are experiencing a reduction in demand for traditional apparel and home textiles, however the technical segments show good growth.

The table below sets forth certain historical combined financial information and the percentage contribution to the consolidated Company net sales from continuing operations for Textile Effects for the years ended December 31, 2005, 2004 and 2003.

<u>Amounts in CHF millions, except percentages</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Total Segment net sales .....	1 283	1 300	1 401
Operating income (loss) .....	(520)	61	68
Capital expenditures .....	27	35	29
Research and development expenditures .....	29	29	32
Contribution to the consolidated Company net sales from continuing operations, in percent .....	17.3%	18.5%	21.1%

### ***Products***

The Segment's leading dyestuffs product lines include CIBACRON® reactive dyes for cellulose, Ciba® LANASET® and Ciba® LANASOL® dyes for wool, Ciba® TECTILON® acid dyes for carpet and Ciba® ERIOFAST® reactive dyes for Polyamide and Ciba® TERASIL® and Ciba® TERATOP® disperse dyes for polyester. In addition, the Segment manufactures vat and direct dyes for cellulosic fibers, and cationic dyes for polyacrylonitrile fibers.

The Segment's leading textile chemical product lines include Ciba® UVITEX® whiteners for textiles, CIBATEX® UV absorbers for the protection of textiles against ultraviolet radiation, Ciba® PYROVATEX® flame retardants, Ciba® ALCOPRINT® print thickeners, Ciba® OLEOPHOBOL® fabric protector products for protection against stains, Ciba® ULTRATEX® softeners and Ciba® ALBEGAL® Dyeing auxiliaries.

### ***Customers and End-User Markets***

Textile Effects supplies the clothing/apparel, home furnishing and industrial textile industries (including automotive textiles). In 2005, the top ten customers of the Segment accounted for approximately 9 percent of the Segment's sales. The customer base of the textile dyes and chemicals market is highly fragmented. In 2005, the end-user markets of the textile, fiber and carpet industries accounted for most of the Segment's sales with the automotive industry accounting for a small percentage. While the clothing/apparel industry is predominant in Asia, the automotive textiles and the carpet industry is focused primarily in North America and Europe.

### ***Research and Development***

Textile Effects spends approximately 2 percent of sales each year on research projects (CHF 29 million in 2005). The primary objective of these research and development activities is to achieve and maintain a high level of the Segment sales of "innovative products". Innovative products are defined as patent protected products and products and applications younger than five years. Textile dyes currently being developed by the Segment include reactive dyes with improved technical and economical performance, a range of disperse dyes with new state-of-the-art wetfast performance, metal free dyes for polyamide with unmatched wetfast and lightfast performance, alternatives to sulphur and naphthol dyes. Textile chemicals currently being developed by the Segment include ecologically improved flame retardants, more efficient UV absorbers and optical brighteners, economical oil and water repellents, range of improved products for easy care and the whole process chemicals range to increase the efficiency and simplify dyeing and printing processes. The Segment's research and development focus also includes technologies geared towards new effects, such as microencapsulation, application of nanoparticles and use of biotechnological processes.

### ***Manufacturing***

The Company has 87 manufacturing sites in 28 countries in important regions of the world. Currently, 56 of these sites are used primarily for chemical synthesis and the others are used for physical operations and to manufacture formulations that meet customer specific requirements. Europe and North America account for over 80 percent of the fixed asset base of the Company, with approximately 65 percent of the Company's assets located in Switzerland, the United States, Germany and the United Kingdom. All of the Company's major manufacturing facilities have qualified for International Organization for Standardization ("ISO") 9001 or ISO 9002 certification. The Company has also entered into several manufacturing arrangements and participates with shares of up to 50 percent in five non-consolidated joint ventures, all in Asia.

The Company's production costs, excluding raw materials, amounted to approximately 22 percent of sales in 2005, 22 percent of sales in 2004 and 23 percent of sales in 2003.

In recent years, the Company has achieved significant capacity increases at its facilities, through process and production improvements. For example, through de-bottlenecking, production capacities have been increased for high performance pigments, whiteners and antioxidants and newly developed production processes have increased capacities for hindered amine stabilizers and antimicrobials. The Company's

manufacturing facilities generally operate within a range of sixty to eighty percent of capacity. Management is of the opinion that capacity utilization provides adequate growth potential. However, improved asset utilization is a priority for the Company generally and the Company conducts an ongoing monitoring study of capacity utilization on a cross-segmental basis to improve asset utilization. In 2004, the Company announced a program entitled “Shape”, which will result in the closure of certain sites and the movement of production activities to other sites in China and in Europe.

The Company’s manufacturing strategy is to be a low cost producer, to increase productivity and to concentrate production on higher value-added products. To this end all Segments plan to dedicate considerable capital expenditure on capacity, product and process improvements spending yearly more than CHF 100 million in the next 5 years. For example, Textile Effects is spending CHF 15 million to streamline their dyestuff production facilities at Basel and Water & Paper Treatment CHF 15 million to streamline its stilbenics production facilities at Grenzach, Germany and McIntosh, USA.

Plastic Additives has invested in the Hindered Amine Stabilizer area, primarily in the NAFTA region. These projects were completed in 2004 at a total estimated cost of approximately CHF 70 million. Plastic Additives is investing CHF 8 million in a new GMP approved plant for a UV absorber for skin protection at Kaohsiung, Taiwan and approximately CHF 20 million for special Formgiving machines at Kaisten, Switzerland and in McIntosh, USA. It also plans to invest CHF 6 million in a new flame retardant production unit at Lampertheim, Germany.

Coating Effects is investing CHF 30 million in a new production unit for DPP pigments at Monthey, Switzerland and plans to invest another CHF 15 million in a new DPP plant in China. Coating Effects is also investing CHF 10 million to increase its Benzotriazol capacities at McIntosh, USA and Lampertheim, Germany and CHF 30 million for the expansion of its ink production facility at Maastricht, Netherlands.

During the period from 2002 to 2004, Water & Paper Treatment has invested more than CHF 40 million to upgrade its production sites at Bradford United Kingdom and West Memphis Arkansas, United States. Water & Paper Treatment plans to invest CHF 10 million in a new acrylamide plant at Kwinana, Australia and another CHF 15 million to expand its Latex plant at Zhenjiang, China.

Textile Effects has invested CHF 9 million to increase the capacity for textile dyes at Mahachai, Thailand. In addition, Textile Effects has expanded its Key Manufacturing Base in Panyu, China, for CHF 4 million and plans to invest another CHF 5 million for a new Liquid Disperse Polymers unit at the same site.

The Company is further strengthening its position in emerging markets, particularly Asia, by expanding its facilities in these areas. For example, Coating Effects plans to invest approximately CHF 20 million for new capacities for light stabilizers and photoinitiators at Goa, India. Plastic Additives has invested CHF 10 million for the expansion of its antioxidants production facility at Shanghai, China and is planning to invest CHF 125 million for a new integrated antioxidants plant in Singapore.

The Company is not dependent on any single production site. The five largest production sites of the Company are in Basel (Switzerland), Grenzach (Germany), McIntosh (Alabama, United States), Bradford (United Kingdom) and Monthey (Switzerland).

### **Sales, Marketing and Distribution**

The Company sells its products in more than 120 countries through a global sales network. The sales and marketing functions are decentralized within the Company, with each Segment having its own sales and marketing strategy for its products and services. The organization of these functions varies from Segment to Segment.

Sales in all Segments are generally on a purchase order basis. However, the Company has established longer-term arrangements with certain key customers or where required by customers. Such arrangements generally do not extend beyond one year. Bidding on one to three year supply arrangements has become

common in the paper and detergent whiteners markets, with contracts in the paper industry tending to be for longer periods. Such bidding has tended to increase price pressure in these product segments.

All distribution and order processing, warehousing and transportation are centrally managed by the Supply Chain Services unit on behalf of the Segments.

Shared order desks on a regional/country level service all Segments with regards to order taking and processing, shipping and invoicing. A global network of warehouses and distribution centers, both externally and internally operated, ensures adequate coverage of the Company's distribution requirements. Contracts with major transport partners are negotiated/managed centrally. The strategy is to significantly reduce the number of partners in this field with the ultimate goal to co-operate with one global lead logistics provider for all intercontinental transports.

In 2000, the Company was one of the first chemical companies to offer a comprehensive e-business service to all its customers: mybusiness@cibasc. The site is a secure, user-customized one-stop shop that lets customers place and track orders from all Segments. In addition, various complementary services are offered to customers such as on-line access to material safety data sheets, certificates of analysis and technical data sheets. Both current and potential customers also have the ability to locate the Company's products based on their industry/sub-industry/application and desired effect using a comprehensive product finder application covering all Segments' products. mybusiness@cibasc is available in 12 languages and has over 15,000 active users in 140 countries. In addition, the Company participates in Elemica, a specialized business-to-business exchange that allows the Company, in one step, to link its Enterprise Resource Planning system directly to those of major suppliers and customers, allowing the Company to achieve higher efficiency and reduce supply-chain costs.

The Company is focusing production and process development efforts on better integration of the manufacturing process with the supply chain in order to increase customer responsiveness while at the same time reducing inventories by increasing the volume of products shipped directly from the production facility to the customers.

### **Sourcing of Raw Materials**

The Company purchases a large number of raw materials and intermediates from third parties around the world for its manufacturing processes, and strives to optimize the supply chain for each Segment. Raw material costs represent a significant component of the Company's cost of goods sold. The prices and availability of these raw materials vary with market conditions and can be highly volatile. The Company has limited backward integration and has out-sourced production where economically feasible and desirable.

The increased price of crude oil and its derivatives in combination with strong demand in major downstream industries led to a significant recent increase in raw material cost. This was already noticed during the 2<sup>nd</sup> semester of 2004, and it continued well into 2005; somewhat leveling off during the 2<sup>nd</sup> semester. The Company expects the overall high price level and the high volatility to continue for the foreseeable future. To offset some of these cost increases, the Segments continue to source more raw materials and intermediates from newly-established suppliers in Asia. The Company adjusts its currency portfolio to mitigate exchange rate fluctuations.

Although the Segments purchase certain raw materials from single suppliers, management does not believe that the loss of any supplier would have a material adverse effect on the Company's business or financial condition.

### **Intellectual Property**

Where appropriate, the Company protects its new products and processes by obtaining patents and registering trademarks in selected regional markets. The Company has over 17 000 granted patents and pending applications world-wide and has trademark protection for approximately 400 product names. The Company continues to experience a constant increase in intellectual property conflicts, either initiated by the Company or by third parties. The Company relies on its know-how and technical expertise in many of its

manufacturing processes to develop and maintain its market position. Management is of the opinion that intellectual property rights as a sole measure do not create a sustainable competitive advantage in the specialty chemicals industry. The Company's ability to extract the maximum value from its patent protected products and processes is dependent upon the Company's ability to apply its technical expertise in its manufacturing processes to meet customer requirements. In general, the Company historically has not licensed or sold its intangibles to third parties. In addition, separate cash flow streams cannot, in general, be identified with intangible assets separately from the cash flows associated with the related productive assets. The value of internally developed patent and process protection is, therefore, generally inseparable from the Company's productive assets and processes.

In connection with the Spin-off, Novartis assigned to the Company certain patents relating to the specialty chemicals business. Pursuant to the Master Spin-off Agreement, Novartis also granted the Company a non-exclusive royalty-free worldwide license with respect to (i) certain patents that were originally registered by Ciba-Geigy's central research department and (ii) those patents remaining with Novartis which the Company was using, or had a specific plan to use, at the effective date of the Spin-off. The Master Spin-off Agreement also provides that Novartis and the Company may enter into other arrangements with respect to certain patents pursuant to which royalties would be payable. Although relative exclusivity can be maintained for certain products following patent expiration through know-how and technical expertise, the expiration of a basic patent can result in intense competition, including from lower cost producers, and erosion of profit margins. Prior to and following expiration of the basic patent for a key product, the Company will generally focus efforts on developing patentable enhancements to the product or new patentable formulations for which the product is used. Management is of the opinion that the loss of patent protection for any particular product or process would not have a material adverse effect on the Company's results of operation or financial condition.

The Company and Novartis also entered an "Agreement Regarding Use of Ciba as a Corporate Name". Pursuant to such agreement, the Company and its subsidiaries and affiliates may use "Ciba Specialty Chemicals" as part of their registered corporate names, while Novartis may continue to use the name "Ciba" in connection with the Ciba Vision Group and in some other special cases. The Company and its subsidiaries and affiliates are entitled to use the "Ciba" trademarks and trade names outside of the core business of Novartis (defined as pharma specialties, pharma over-the-counter and generics, eyecare, crop protection, seeds, animal health and nutrition). Novartis is entitled to continue to use trademarks and trade names containing the term "Ciba" as they were used at the of the agreement and to use new and existing trademarks and trade names containing the term "Ciba" to market the "Ciba" line of pharmaceutical products and for products and services of the Ciba Vision Group.

### **Regulatory Affairs**

National and international laws regulate production, marketing and use of chemical substances. Although almost every country has its own legal procedure for control of chemical substances, the most significant to the Company's business are the laws and regulations in the European Union, the United States and Japan. Some facets of the regulations in these regions are continuously being revised but probably none more so than the control for production and import within the European Union where a complete overhaul of the requirements is being undertaken. The Company has been actively involved in the development of the regulations and does not expect significant concerns from the final changes. Within the U.S., the Environmental Protection Agency ("EPA"), have revised the High Production Volume program and this has been evaluated by the Company. EPA and other U.S. agencies have also become increasingly active in the area of global chemical control and are taking the lead on many issues of global concern within the OECD. The Company actively supports these initiatives for more globally harmonized requirements and the effort being applied to minimize resource and cost for both industry and government.

The Company continues to actively seek approvals for their products within certain specially controlled applications. Within the U.S., the Food and Drug Administration ("FDA"), oversee the approval of specialty chemicals that will come in contact with food. For many years, the Company has been a leader in this area and is diligent in maintaining its expertise. The EPA's Federal Insecticide, Fungicide and Rodenticide Act

(“FIFRA”) controls the use of such applications as material preservation and microbial control for the manufacture of polymeric, plastics and textile products together with the protection of the finished article itself. The Company, through its expertise, regularly gains approval for its products in the area and is also supporting other companies in achieving approval for these exacting requirements.

#### **Agreements with Novartis in Connection with the Spin-off**

Novartis and the Company entered into a Master Spin-off Agreement (“MSA”) dated December 20, 1996, which governed the separation of the specialty chemicals business from Novartis. In addition, this agreement, together with certain ancillary agreements, established various interim and ongoing relationships between Novartis and the Company.

Pursuant to the MSA, Novartis and the Company provide each other with chemical products and intermediates and certain services, such as provision of utilities, waste handling and security at shared production sites. Such products and intermediates are provided at market prices or, in the absence of market prices, at full cost, and such services are provided at the lower of market price or full cost. In addition, pursuant to the MSA, the Company and Novartis agreed on the allocation of taxes relating to the transaction and past operations of the businesses. The Company is responsible for taxes relating to the past operations of entities engaged exclusively in the specialty chemicals business and Novartis is responsible for transaction related taxes and taxes relating to the past operations of entities other than those engaged exclusively in the specialty chemicals business.

Pursuant to the “Agreement Regarding Use of Ciba as Corporate Name”, the Company is permitted to use “Ciba Specialty Chemicals” as part of its registered corporate name, while Novartis may continue to use the name “Ciba” in the Ciba Vision Group and in certain other cases. See “Intellectual Property”.

Novartis and the Company have also entered into certain arrangements with respect to the responsibility for environmental liabilities associated with operation of the specialty chemicals business prior to the Spin-off. See “Environmental Matters.”

#### **Insurance**

Management is of the opinion that the Company’s insurance arrangements regarding property, liability and marine are adequate and sufficient.

#### **Organizational Structure**

Ciba Specialty Chemicals Holding Inc. is the ultimate holding company of the Ciba Specialty Chemicals group. Its Shares are listed on the Swiss Exchange, traded on virt-x, and its ADSs trade on the New York Stock Exchange (see Item 9 — The Offer and Listing).

The following table identifies the Company's significant subsidiaries, their jurisdiction of incorporation or residence, the Company's ownership interest in each subsidiary and the principal function of the subsidiary.

	<u>Group Holding %</u>	<u>Principal Function of Company</u>			
		<u>Selling</u>	<u>Manufacturing</u>	<u>Research</u>	<u>Services, Finance</u>
<b><u>AMERICAS</u></b>					
<b>Argentina</b>					
Ciba Especialidades Químicas S.A., Buenos Aires .....	100	•			
<b>Bermuda</b>					
Chemical Insurance Company Ltd., Hamilton .....	100				•
Ciba Specialty Chemicals Eurofinance Ltd., Hamilton .....	100				•
Ciba Specialty Chemicals International Finance Ltd., Hamilton .....	100				•
<b>Brazil</b>					
Ciba Especialidades Químicas Ltda., São Paulo .....	100	•	•		
Latexia Brazil Ltda., São Paulo .....	100	•	•		
<b>Canada</b>					
Ciba Specialty Chemicals Canada Inc., Mississauga .....	100	•			
<b>Chile</b>					
Ciba Especialidades Químicas Ltd., Santiago de Chile .....	100	•	•		
<b>Colombia</b>					
Ciba Especialidades Químicas S.A., Bogotá .....	100	•	•		
<b>Guatemala</b>					
Ciba Especialidades Químicas, S.A. (ACC), Guatemala .....	100	•	•		
<b>Mexico</b>					
Ciba Especialidades Químicas Mexico S.A. de C.V., Mexico .....	100	•	•		
<b>Panama</b>					
Ciba Especialidades Químicas Colon S.A., Colon .....	100	•			
<b>United States of America</b>					
Ciba Specialty Chemicals Corporation, Tarrytown, NY .....	100	•	•	•	
<b><u>ASIA PACIFIC</u></b>					
<b>Australia</b>					
Ciba Specialty Chemicals Pty. Ltd., Thomastown .....	100	•	•		
<b>Bahrain</b>					
Ciba Specialty Chemicals Middle East W.L.L., Manama (Al Seef District) ..	100	•			

	Group Holding %	Principal Function of Company			
		Selling	Manufacturing	Research	Services, Finance
<b>China</b>					
Ciba Specialty Chemicals (China) Ltd., Shanghai .....	100	•		•	•
Ciba Specialty Chemicals (Hong Kong) Ltd., Hong Kong .....	100	•			
Ciba Specialty Chemicals (Shanghai) Ltd., Shanghai.....	100	•			
Ciba Specialty Chemicals (Suzhou) Co., Ltd., Suzhou, Jiangsu.....	100	•	•		
Guangdong Ciba Specialty Chemicals Co. Ltd., Panyu, Guangdong.....	95	•	•		
Guangzhou Ciba Specialty Chemicals Co. Ltd., Guangzhou .....	80	•	•		
Qingdao Ciba Dyes Co. Ltd., Qingdao ..	94	•	•		
Qingdao Ciba Pigments Co. Ltd., Qingdao .....	91	•	•		
Shanghai Ciba Gao-Qiao Chemicals Co. Ltd., Shanghai.....	75	•	•		
Shenzhen Ciba Specialty Chemicals Co. Ltd., Shenzhen .....	85	•	•		
Xiangtan Chemicals & Pigments Co. Ltd., Xiangtan.....	49	•	•		
<b>India</b>					
Ciba India Private Ltd., Mumbai .....	100			•	•
Ciba Specialty Chemicals (India) Ltd., Mumbai <sup>(1)</sup> .....	69	•	•		
Diamond Dye-Chem Ltd., Mumbai <sup>(2)</sup> ...	69	•	•		
<b>Indonesia</b>					
PT Ciba Specialty Chemicals Indonesia, Jakarta .....	83	•	•		
PT Intercipta Kimia Pratama, Jakarta ...	60	•	•		
PT Latexia Indonesia, Jakarta .....	100	•	•		
<b>Japan</b>					
Chemipro Fine Chemical Kaisha Ltd., Kobe.....	51	•	•		
Ciba Specialty Chemicals K.K., Osaka ..	100	•		•	
Musashino-Geigy Company Ltd., Kitaibaraki .....	60	•	•		
Nippon Alkyl Phenol Co. Ltd., Tokyo ...	46	•	•		
<b>Republic of Korea (South Korea)</b>					
Ciba Specialty Chemicals Korea Ltd., Seoul .....	100	•			
Daihan Swiss Chemical Corporation, Seoul .....	100	•	•	•	
Doobon Fine Chemical Co., Ltd., Chongwon-kun .....	63	•	•		

	<u>Group Holding %</u>	<u>Principal Function of Company</u>			
		<u>Selling</u>	<u>Manufacturing</u>	<u>Research</u>	<u>Services, Finance</u>
<b>Malaysia</b>					
Ciba Specialty Chemicals (Malaysia) Sdn Bhd, Klang .....	70	•	•		
<b>New Zealand</b>					
Ciba Specialty Chemicals N.Z. Ltd., Auckland .....	100	•	•		
<b>Singapore</b>					
Ciba Specialty Chemicals (Singapore) Pte. Ltd., Singapore .....	100	•			
Ciba Specialty Chemicals Industries (Singapore) Pte. Ltd., Jurong Island ..	100	•	•		
<b>South Africa</b>					
Ciba Specialty Chemicals (Pty) Ltd., Spartan.....	100	•			
<b>Taiwan</b>					
Ciba Specialty Chemicals (Taiwan) Ltd., Kaohsiung .....	100	•	•		
<b>Thailand</b>					
Ciba Specialty Chemicals (Thailand) Ltd., Bangkok .....	100	•	•		
<b><u>EUROPE</u></b>					
<b>Austria</b>					
Ciba Spezialitätenchemie Österreich GmbH, Pischelsdorf/Zwentendorf ....	100	•	•		
<b>Belgium</b>					
Ciba Specialty Chemicals N.V., Groot-Bijgaarden .....	100	•			
<b>Denmark</b>					
A/S Alfred Gad, Lyngø.....	100	•			
<b>Finland</b>					
Ciba Specialty Chemicals Oy, Raisio....	100	•	•	•	•
Finnamyl Oy, Raisio.....	100	•	•		
<b>France</b>					
Ciba Spécialités Chimiques SA, Saint Fons .....	100	•	•	•	
Ciba Specialty Chemicals Masterbatch SA, Saint Jeoire en Faucigny .....	100	•	•	•	
<b>Germany</b>					
Ciba Spezialitätenchemie Grenzach GmbH, Grenzach-Wyhlen.....	100		•	•	
Ciba Spezialitätenchemie Holding Deutschland GmbH, Lampertheim ...	100				•
Ciba Spezialitätenchemie Lampertheim GmbH, Lampertheim.....	100	•	•	•	
Ciba Spezialitätenchemie Pfersee GmbH, Langweid/Lech .....	100	•	•	•	

	Group Holding %	Principal Function of Company			
		Selling	Manufacturing	Research	Services, Finance
<b>Hungary</b>					
Ciba Specialty Chemicals Central Eastern Ltd., Budapest . . . . .	100	•			
<b>Italy</b>					
Ciba Specialty Chemicals S.p.A., Sasso Marconi (Bologna) . . . . .	100	•	•	•	
Magenta Master Fibers S.r.l., Milano . . .	60	•	•		
<b>Luxembourg</b>					
Ciba Specialty Chemicals Finance Luxembourg S.A., Luxembourg . . . . .	100				•
<b>Netherlands</b>					
Ciba Specialty Chemicals International Nederland B.V., Maastricht . . . . .	100				•
Ciba Specialty Chemicals (Maastricht) B.V., Maastricht . . . . .	100	•	•	•	
Ciba Specialty Chemicals Heerenveen B.V., Heerenveen <sup>(3)</sup> . . . . .	100	•	•	•	
<b>Portugal</b>					
Ciba Especialidades Químicas Lda., Porto	100	•			
Raisio Portugal-Produtos Químicos, Lda., Nogueira Maia . . . . .	51	•			
<b>Spain</b>					
Ciba Especialidades Químicas S.L., Barcelona . . . . .	100	•			
Raisio Echeveste, S.A., Tolosa . . . . .	100	•	•		
<b>Sweden</b>					
Ciba Specialty Chemicals Sweden AB, Göteborg . . . . .	100	•			
AB CDM, Västra Frölunda . . . . .	100	•			
<b>Switzerland</b>					
Ciba Specialty Chemicals Holding Inc., Basel <sup>(4)</sup> . . . . .					•
Ciba Spécialités Chimiques Monthey SA, Monthey . . . . .	100		•		
Ciba Spezialitätenchemie AG, Basel . . .	100	•	•	•	
Ciba Spezialitätenchemie Finanz AG, Basel	100				•
Ciba Spezialitätenchemie International AG, Basel . . . . .	100				•
Ciba Spezialitätenchemie Kaisten AG, Kaisten . . . . .	100		•		
Ciba Spezialitätenchemie Schweizerhalle AG, Muttenz . . . . .	100		•		
Ciba Spezialitätenchemie Services AG, Basel . . . . .	100				•
CIMO Compagnie Industrielle de Monthey SA, Monthey . . . . .	50				•

	<u>Group Holding %</u>	<u>Principal Function of Company</u>			
		<u>Selling</u>	<u>Manufacturing</u>	<u>Research</u>	<u>Services, Finance</u>
<b>Turkey</b>					
Ciba Özel Kimyevi Ürünler Sanayi ve Ticaret Ltd., Istanbul . . . . .	100	•			
<b>United Kingdom</b>					
Ciba Specialty Chemicals PLC, Macclesfield . . . . .	100	•	•	•	
Ciba Specialty Chemicals Investment PLC, Macclesfield . . . . .	100				•
Pira International Limited, Leatherhead	100	•		•	

- (1) The shares of Ciba Specialty Chemicals (India) Ltd., Mumbai, (“CSCIL”) are listed on the Mumbai Stock Exchange (www.bseindia.com) under the scrip name “CIBA SPE CH”; the scrip code is 532184. The total market value of the 13 280 819 outstanding shares of CSCIL as of December 31, 2005 was approximately CHF 225 million (INR 7 741 million). As of December 31, 2005 the Company held 9 200 887 Equity Shares, representing 69.28 percent of the paid-up share capital of CSCIL.
- (2) Diamond Dye-Chem Limited is a wholly owned subsidiary of CSCIL.
- (3) This company name became effective as of January 1, 2006. Until December 31, 2005 the company’s name had been “EFKA Additives B.V.”.
- (4) Ciba Specialty Chemicals Holdings Inc. is the ultimate holding company of Ciba Specialty Chemicals Group. Its Shares are listed on the Swiss Exchange and, since August 2, 2000, the Company’s American Depositary Shares (“ADSs”) are listed on the New York Stock Exchange. Two ADSs represent one Share of the Company’s common stock.

To enhance the readability of this report and because of being less relevant, the share or quota capitals of Ciba group companies are not indicated herein, with the exception of Ciba Specialty Chemicals Holding Inc. and of Ciba Specialty Chemicals (India) Ltd., two publicly listed companies.

**Property, Plant and Equipment; Manufacturing**

The Company owns all of its principal manufacturing facilities and owns substantially all the land on which such facilities are located. In certain cases, infrastructure is either shared with Novartis or with its recent spin-off Syngenta or outsourced to third parties as in some Swiss facilities. The Company also has other properties, including office buildings, research laboratories and warehouses. The principal office buildings are the headquarters in Basel, Switzerland. The principal research and development facilities are located in Basel, Switzerland and Tarrytown, New York, USA.

The following table sets forth the Company’s principal manufacturing facilities by geographic region together with the Segment or Segments that maintain principal responsibility for the management and production at the site and the major product lines that each facility is designed to manufacture.

<u>Location</u>	<u>Size in hectares<sup>(1)</sup></u>	<u>Major Product Lines</u>
<b>EUROPE</b>		
Basel, Switzerland . . . . .	14	Textile Effects (reactive dyes for cellulose and wool, disperse, vat and acid dyes)
Bradford, United Kingdom . . . . .	28	Water & Paper Treatment (water treatment and paper chemicals, inks, soil additives, intermediate monomers, rheology modifiers and textile chemicals)
Clayton, United Kingdom . . . . .	22	Water & Paper Treatment (specialty chemicals for paper coating)

<u>Location</u>	<u>Size in hectares<sup>(1)</sup></u>	<u>Major Product Lines</u>
Grenzach, Germany . . . . .	52	Water & Paper Treatment (whiteners, specialty colors, antimicrobials, new businesses, cationic and solvent soluble dyes) Coating Effects (high performance pigments)
Grimsby, United Kingdom . . . . .	19	Water & Paper Treatment (water treatment chemicals)
Guturrybay, Spain . . . . .	2	Water & Paper Treatment (latex production)
Heerenveen, Netherlands . . . . .	2	Coating Effects (defoamers, slip and leveling, high molecular weight dispersants, wetting and dispersing agents)
Huningue, France . . . . .	12	Coating Effects (high performance pigment preparations, imaging and coating additives) Plastic Additives (polymer additives and process and lubricant additives)
Kaipiainen, Finland . . . . .	—	Water & Paper Treatment (latex production)
Kaisten, Switzerland . . . . .	59	Plastic Additives (polymer additives)
Kokemaeki, Finland . . . . .	10	Water & Paper Treatment (starch production)
Lampertheim, Germany . . . . .	80	Plastic Additives (polymer additives, imaging and coating additives and process and lubricant additives)
Langweid/Lech, Germany . . . . .	29	Textile Effects (fabric finishing and dyeing and printing auxiliaries)
Lapua, Finland . . . . .	23	Water & Paper Treatment (starch production)
Maastricht, Netherlands . . . . .	11	Coating Effects (dispersions and inorganic pigments)
Mietoinen, Finland . . . . .	8	Water & Paper Treatment (starch production)
Monthey, Switzerland <sup>(2)</sup> . . . . .	11	Water & Paper Treatment (whiteners) Coating Effects (high performance pigments)
Mortara & Trivolzio, Italy . . . . .	17	Coating Effects (imaging and coating additives)
Paisley, United Kingdom . . . . .	17	Coating Effects (classical pigments)
Pischelsdorf, Austria . . . . .	—	Water & Paper Treatment (latex production)
Pontecchio Marconi, Italy . . . . .	12	Plastic Additives (polymer additives and production of insecticides for a third party)
Raisio, Finland . . . . .	1	Water & Paper Treatment (sizing agents and additives for the paper industry)
Ribecourt, France . . . . .	—	Water & Paper Treatment (latex production)
Saint Fons, France . . . . .	9	Textile Effects (metal-complex and acid dyes)
Saint Jeoire, France . . . . .	5	Coating Effects (masterbatches)
Schweizerhalle, Switzerland . . . . .	1	Coating Effects (polymer additives, Imaging and coating additives) Textile Effects (standardization)
Toulouse, France . . . . .	1	Water & Paper Treatment (sizing agents and additives for the paper industry)
Veurne, Belgium . . . . .	1	Water & Paper Treatment (starch production)
<b>AMERICAS</b>		
Atotonilquillo, Mexico . . . . .	43	Textile Effects (disperse, basic and acid dyes, textile chemicals) Water & Paper Treatment (whiteners, photobleach)
Berwick, USA . . . . .	10	Water & Paper Treatment (sizing agents and additives for the paper industry)

<u>Location</u>	<u>Size in hectares<sup>(1)</sup></u>	<u>Major Product Lines</u>
Camaçari, Brazil . . . . .	14	Plastic Additives (polymer additives)
Charlotte, North Carolina USA . . . . .	6	Textile Effects (dyeing and printing auxiliaries)
Estrada do Colégio, Brazil . . . . .	4	Water & Paper Treatment (whiteners, fabric finishing)
McIntosh, Alabama, USA . . . . .	637	Plastic Additives (polymer additives and imaging and coating additives) Water & Paper Treatment (whiteners)
Medellin, Colombia . . . . .	4	Water & Paper Treatment (sizing agents and additives for the paper industry)
Newport, Delaware USA . . . . .	15	Coating Effects (high performance pigments)
Paulinia, Brazil . . . . .	—	Water & Paper Treatment (latex production)
Puebla, Mexico . . . . .	22	Plastic Additives (polymer additives and process and lubricant additives)
St. Gabriel, Louisiana USA . . . . .	81	Textile Effects (reactive and acid dyes)
Suffolk, Virginia USA . . . . .	89	Water & Paper Treatment (water treatment chemicals)
West Memphis, Arkansas USA . . . . .	60	Water & Paper Treatment (water treatment chemicals)
<b>ASIA-PACIFIC</b>		
Ai-oi, Japan <sup>(3)</sup> . . . . .	—	Plastic Additives (polymer additives and imaging and coating additives)
Ankleshwar, India . . . . .	2	Water & Paper Treatment (whiteners)
Candra Sari, Indonesia . . . . .	5	Textile Effects (textile chemicals)
Chiba, Japan <sup>(4)</sup> . . . . .	—	Plastic Additives (polymer additives)
Goa, India . . . . .	14	Plastic Additives (polymer additives)
Isohara, Japan <sup>(5)</sup> . . . . .	8	Plastic Additives (polymer additives)
Kaohsiung, Taiwan . . . . .	4	Plastic Additives (polymer additives)
Mahachai, Thailand . . . . .	4	Textile Effects (reactive dyes for cellulose)
Merak, Indonesia . . . . .	6	Water & Paper Treatment (latex production)
Panyu, China <sup>(6)</sup> . . . . .	5	Textile Effects (textile chemicals)
Perth, Australia . . . . .	2	Water & Paper Treatment (water treatment chemicals)
Qingdao, China <sup>(7)</sup> . . . . .	1	Coating Effects (classical pigments)
Qingdao, China <sup>(8)</sup> . . . . .	1	Textile Effects (wool and disperse dyes)
Serang, Indonesia . . . . .	—	Water & Paper Treatment (sizing agents and additives for the paper industry)
Shanghai, China <sup>(9)</sup> . . . . .	6	Plastic Additives (polymer additives)
Ulsan, South Korea . . . . .	7	Coating Effects (classical pigments)
Zhenjiang, China . . . . .	10	Water & Paper Treatment (latex production)

(1) One hectare is equal to 2.471 United States acres.

(2) Most of the infrastructure facilities are shared with Syngenta and Huntsman through a joint venture in which the Company holds a 50 percent interest.

(3) Joint venture with Chemipro Kasai Kaisha, Ltd., in which the Company holds a 51 percent interest.

(4) Joint venture with Mitsui Petrochemical and Musashino-Geigy, in which the Company holds a 40 percent interest.

- (5) Effective January 2001, the Company acquired a controlling interest in Musashino-Geigy Co. Ltd., increasing its holdings from 50 percent to 60 percent in this joint venture with Musashino Chemical Laboratory Co. Ltd.
- (6) Venture with Panyu City Shilou Town Economical Development Company Limited, in which the Company holds a 95 percent interest.
- (7) Venture with Qingdao Double Peach, in which the Company holds a 91.4 percent interest.
- (8) Venture with Qingdao Double Peach, in which the Company holds a 94 percent interest.
- (9) Joint venture with Shanghai Gao-Qiao Petrochemical Company, in which the Company holds a 75 percent interest.

The Company's management is of the opinion that its principal manufacturing facilities and other significant properties are in good condition and that they are adequate to meet the Company's needs. Except as disclosed in this Annual Report, the Company does not currently plan to construct, expand or improve facilities significantly.

### **Environmental Matters**

Operating in the chemical industry, the Company is subject to stringent environmental, health and safety laws and regulations. It is the Company's policy to continuously develop and improve the environmental performance of key manufacturing processes through an active program to address environmental matters. In addition to process improvements, the Company uses advanced waste treatment and disposal facilities at all major manufacturing sites that allow the sites to comply with laws and regulations applicable to waste streams. In management's opinion, the Company substantially complies with all such laws.

For outstanding environmental matters that are currently known and estimable by the Company, provisions of approximately CHF 506 million as of December 31, 2005 and CHF 509 million as of December 31, 2004 have been recorded in the accompanying Consolidated Balance Sheets. The Company anticipates that these provisions will be spent generally over the next 30 years or longer. The decrease in the provision of CHF 3 million in 2005 compared to 2004 relates to usage of provisions of CHF 28 million and a decrease of CHF 2 million in provisions, offset in 2005 by an increase related to currency effects of CHF 27 million. The Company's environmental protection and improvement cash expenditures were approximately CHF 43 million in 2005 (CHF 54 million in 2004), including investments in construction, operations and maintenance and usage of the provision.

Under the Company's agreement with Novartis, Novartis agreed to reimburse the Company 50 percent of United States environmental liabilities arising from past operations of the Company in excess of the agreed reserves. Outside the United States, environmental liabilities are allocated between Novartis and the Company based on the ownership of the site or, if environmental liabilities do not relate to production sites or these are not owned by either entity, according to the polluter pays principle. If causation between the parties cannot be determined, costs are shared equally. The agreement with Novartis is not subject to any time or amount limits but could terminate for certain liabilities in the United States (i) upon a sale of substantially all of the Company's assets, (ii) upon a change in control of the Company, or (iii) for individual facilities, upon the sale of the facility (unless the Company retains responsibility for any clean-up at such site).

The contractual terms of the sale of the Performance Polymers business stipulate that, in general, the Company will retain responsibility for environmental claims relating to the operations of the Performance Polymers business prior to May 31, 2000, whereby damages for remediation in connection with sites outside the United States shall cover only 80 percent of the respective costs. The responsibility with respect to any non-United States sites covers environmental liabilities incurred within fifteen years from May 31, 2000 and is limited to CHF 75 million. With respect to any such environmental liabilities in the United States, the Company's obligation to indemnify is unlimited in time and/or amount. Novartis' environmental indemnification obligations to the Company described above are not affected by the sale of the Performance Polymers business.

The Company continues to participate in environmental assessments and clean-ups at a number of locations, including operating facilities, previously owned facilities and United States Superfund sites. The Company accrues reserves for all known environmental liabilities for remediation costs when a clean-up program becomes probable and costs can be reasonably estimated. Clean-up of the most significant sites has been or is nearly completed, except as described in the following paragraphs.

At its Toms River, New Jersey remediation site, the Company's subsidiary in the United States is engaged in a large bio-remediation project that is estimated to take up to another five years to complete. Based on management's current estimates, the Company's environmental provisions are adequate to cover the expected costs to complete this remediation plan.

In 2005, the Company's subsidiary in the United States received a demand from local authorities to remove the Cell 1 landfill at the Toms River site. Environmental experts have been consulted and extensive discussions have been held with the local authorities. The removal of the Cell 1 landfill is not probable, however certain additional remediation is reasonably possible. The magnitude of the loss contingency relating to possible additional remediation of the Cell 1 landfill cannot be reasonably estimated at this time.

The planning for the total remediation of the waste disposal site in Bonfol, Switzerland, which was closed in 1976, is expected to conclude in the near future. The responsibility for the remediation lies with eight chemical enterprises including among others the Company. The responsible companies cooperate with the governmental authorities to define the necessary measures in view of a final remediation of the site. The remaining planning and remediation effort could require up to ten years to complete. In management's opinion, based on the current remediation plans, the Company's environmental provisions are adequate to cover the Company's share of the expected costs to complete the remediation at this site.

In the Basel region, several landfills (Switzerland, France and Germany) contain chemical waste besides other industrial and household wastes. Presently, eleven landfills are the subject of investigations carried out with the authorities by the 'Interessengemeinschaft Deponiesicherheit Regio Basel', an association of the involved pharmaceutical and chemical enterprises (including the Company). As of December 31, 2005, no remedial actions have been defined or required in a legally binding form.

In management's opinion, the environmental reserves accrued are sufficient to meet all currently known and estimable environmental claims and contingencies. Because of the nature of the Company's operations, however, there can be no assurance that significant costs and liabilities from ongoing or past operations will not be incurred in the future. In addition, environmental clean-up periods are protracted in length and environmental costs in future periods are subject to changes in environmental remediation regulations. As a result, the Company is unable to estimate the amount or range of reasonably possible losses in excess of provisions recorded in the accompanying consolidated balance sheets.

See Item 3. Key Information — Risk Factors — Environmental laws and regulations may expose the Company to liability and result in increased costs.

## ***Item 5. Operating and Financial Review and Prospects.***

### **Management's Discussion and Analysis of Financial Condition and Results of Operations.**

The discussion in this Management's Discussion and Analysis of Financial Condition and Results of Operations (Management's Discussion and Analysis) is based on, and should be read in conjunction with Item 3 — Key Information and the Consolidated Financial Statements and the Notes thereto, which are prepared in accordance with United States Generally Accepted Accounting Principles (U.S. GAAP) and are included in Item 18 — Financial Statements. For a definition of certain financial terms used herein, see Glossary of Financial Terms at the end of this Management's Discussion and Analysis. Except for percentages, share, per share data or exchange rate data and except as otherwise stated, all numbers in tables are in millions of Swiss francs (CHF).

**Year in review — 2005 compared to 2004**

<u>Results of operations</u>	<u>2005</u>	<u>2004</u>
Net sales .....	7 419	7 027
Gross profit .....	2 117	2 171
Operating income (loss) .....	(124)	521
Income (loss) from continuing operations .....	(286)	278
Income from discontinued operations, net of tax .....	30	28
Net income (loss) .....	(256)	306
<i>Earnings (loss) per share, basic and diluted</i>		
Continuing operations .....	(4.38)	4.21
Discontinued operations .....	0.46	0.43
Net income (loss) per share .....	(3.92)	4.64
<b>Other data</b>		
Depreciation and amortization of other intangible assets .....	421	394
Restructuring, impairment and other charges .....	(703)	(91)
Adjusted EBITDA <sup>(1)</sup> .....	297	915
Net cash provided by operating activities .....	410	631
Net cash used in investing activities .....	(292)	(1 051)
Net cash used in financing activities .....	(526)	(304)
Free cash flow <sup>(1)</sup> .....	168	390
Net debt <sup>(1)</sup> .....	1 946	1 840
Shareholders' equity at year-end .....	3 903	4 152
Dividend per share <sup>(2)</sup> .....	3.00	1.00
Capital reduction per share <sup>(2)</sup> .....	0.00	2.00
<b>Key performance ratios</b>		
Net sales development .....	6%	6%
Net sales development in local currencies .....	4%	8%
<b>Expressed as a percentage of sales</b>		
Gross profit .....	28.5%	30.9%
Operating income (loss) .....	(1.7)%	7.4%
Income (loss) from continuing operations .....	(3.9)%	4.0%
Net income (loss) .....	(3.4)%	4.4%
Adjusted EBITDA <sup>(1)</sup> .....	4.0%	13.0%

(1) Adjusted EBITDA, free cash flow and net debt are non-U.S. GAAP financial measures. See Use of Certain Supplementary Financial Indicators in this Management's Discussion and Analysis for further discussion of the use of these measures.

(2) The Board of Directors proposes a cash payment to the Company's shareholders in 2006 totaling CHF 3 per share, based on 2005 results, which is reflected in the table above. The per share amounts presented above for 2004 reflect the dividend that was paid in 2005, based on 2004 results, as well as the capital reduction approved by the Company's shareholders in 2005, based on 2004 results. For further information see the Operational Review section of this Management's Discussion and Analysis and Item 6. Directors, Senior Management and Employees — Dividends and Dividend Policy.

## Summary

Ciba Specialty Chemicals (the “Company”), despite very challenging business conditions, was able to increase sales prices in 2005 by 2 percent after several years of price declines. As a result, the Company was able to partially mitigate the effect of raw material price increases, which were mainly oil-price driven.

Sales grew by 4 percent in local currencies and 6 percent in Swiss francs. The increase was principally due to the inclusion of a full year of sales from Raisio Chemicals, which the Company acquired in mid-2004. Excluding these sales, the Company was able to increase sales by 2 percent in Swiss francs and maintain them at 2004 levels in local currencies. Favorable currency effects contributed to higher sales as the U.S. dollar, in particular, strengthened against the Swiss franc in the second half of the year.

In 2004, the Company implemented Project Shape to assure the achievement of synergies from the integration of Raisio Chemicals and to address the continuing shift in the textiles market to Asia. The project is progressing on track with cost benefits being achieved. In line with the project’s objectives, the Company continues to focus on innovation, improving profitability and optimizing operations.

Project Shape has already contributed to the slightly improved results of the Company’s Textile Effects Segment during the year. However, the acceleration of the market shift to Asia has made it apparent that the Segment would still not be able to achieve its targeted profit levels without further cost saving measures. This triggered a review of the carrying values of certain of the segment’s assets, which resulted in an impairment charge of CHF 583 million. The evaluation of strategic options to reposition the Textile Effects business is well underway, with both internal and external solutions further advanced.

### *Operational review*

The global economy in 2005 was characterized by economic growth, high industrial output and renewed consumer confidence, however performance varied significantly at a regional level. The Asian economies continued to deliver strong growth, driven by China, and this was reflected in the Company’s performance in the region. Company performance in the Americas was better in the second half of the year due to increasing demand in the plastics industry and the first signs of recovery in production rates in the automotive industry. Results in the Americas also benefited from the relative strengthening of the U.S. dollar. The European markets were quite mixed with the U.K. and Germany especially weak, but good growth in Eastern Europe. Demand was good for electronics, housing/construction and plastics, however the economic environment for automotive and paper was mixed. The textile and imaging and inks industries had another challenging year, although there were some signs of stabilization of textile margins following the implementation of new trade agreements between China and the U.S. and China and the European Union.

Gross profit decreased in absolute terms in 2005 to CHF 2 117 million from CHF 2 171 million last year. Gross profit margin for 2005 was 28.5 percent, compared to 30.9 percent for 2004. Increased sales prices were unable to fully counter the effects of higher raw material and energy costs. Also contributing to the decline in gross profit was the inclusion of a full year of operations of Raisio Chemicals, which the Company acquired in mid 2004 and has a different cost structure. Selling, general and administrative expenses were 4 percent lower than 2004 levels and also decreased as a percentage of sales from 17.4 percent in 2004 to 15.9 percent in 2005. Improvements in the Company’s cost structure resulting from Project Shape and income from property disposals offset higher pension expenses.

In 2004, the Company announced Project Shape, which is primarily designed to adapt and optimize the production and support organizations of Segment Water & Paper Treatment following the acquisition of Raisio Chemicals, and to accelerate the shift of focus in Segment Textile Effects to growth regions in Asia by reducing its European presence. The Segment Water & Paper Treatment portion of the project is well on track and the Company is realizing benefits according to expectations. During 2005, Project Shape cost saving measures and sales price initiatives resulted in slightly improved Segment Textile Effects profitability compared to 2004, however it became evident that significant improvement would not be able to be achieved without additional cost saving measures. For further discussion, see Textile Effects Impairment below.

Project Shape continues to focus on the phased closure of the Clayton manufacturing facility towards 2007, the closure of smaller production and administrative facilities and rightsizing initiatives across the Company's global production base, mainly in Water & Paper Treatment. During the year the project was expanded and some of the timings accelerated. The project is progressing as planned. Overall benefits achieved in 2005 from Project Shape are estimated by management to be more than CHF 60 million. Operating income in 2005 includes CHF 116 million of charges in relation to Project Shape. Project Shape charges in 2004 were CHF 80 million. In addition, in 2004 there were charges of CHF 11 million for expensing of acquired in-process research and development costs from the Raisio Chemicals acquisition.

Operating income decreased to a loss of CHF 124 million from income of CHF 521 million in 2004 and operating income margin declined to minus 1.7 percent of sales in 2005 compared to 7.4 percent of sales in 2004 primarily due to the Textile Effects Segment impairment charge. Operating income in 2005 excluding these impairment and restructuring charges would have been CHF 579 million and in 2004 would have been CHF 612 million.

#### ***Cash flow and balance sheet review***

Cash flows from operating activities in 2005, were CHF 221 million lower than 2004, at CHF 410 million. This resulted primarily from the lower operating results and also from higher restructuring payments.

Net cash flows from investing activities was an outflow of CHF 292 million in 2005, a decrease in outflow of CHF 759 million from CHF 1 051 million last year. The decrease primarily consisted of the cash paid in 2004 for the acquisition of Raisio Chemicals. Capital expenditures decreased by CHF 19 million to CHF 275 million in 2005 from CHF 294 million last year. Such expenditures remain focused primarily on productivity improvement projects and maintenance of existing capacity.

Net cash flows used in financing activities were CHF 526 million in 2005 primarily consisting of a further capital reduction payment to shareholders totaling CHF 130 million and the repayment of long term debt totalling CHF 275 million.

Net debt increased by CHF 106 million to CHF 1 946 million in 2005. Although total debt decreased due to scheduled repayments, net debt increased due to the lower levels of cash inflow from operating activities.

#### ***Significant other events***

In connection with the Company's divestment of the Performance Polymers Business in 2000, Vantico (now owned by Huntsman Corporation) initiated a pension-related lawsuit. The supreme court ruled in the Company's favor in June 2005 resulting in the release of previously established reserves totaling CHF 30 million, net of income taxes of CHF 10 million.

The Company continues to progress on its project to harmonize business processes and implement a company-wide, unified system structure with new software. This project is expected to be completed in three years.

#### **Critical accounting policies**

The consolidated financial statements of the Company are sensitive to accounting methods, assumptions and estimates that form the basis of these financial statements and accompanying notes. Critical accounting policies, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered in conjunction with reviewing the Company's financial statements and the discussion in this Management's Discussion and Analysis.

Note 1 to the consolidated financial statements in Item 18 — Financial Statements describes the significant accounting policies and methods used in the preparation of the Company's consolidated financial statements. Following are the Company's critical accounting policies impacted by judgments, assumptions and estimates.

### ***Impairment testing of property, plant and equipment, goodwill and other intangible assets***

As discussed in Note 1, Summary of Significant Accounting Policies, in the Company's consolidated financial statements in Item 18 — Financial Statements, the Company periodically evaluates property, plant and equipment, goodwill and other intangible assets for potential impairment. If such assets are considered to be impaired, they are written down to fair value as appropriate.

The impairment review process requires management to make significant estimates and judgments regarding the future cash flows expected to result from the use and, if applicable, the eventual disposition of the respective assets as well as other factors to determine the fair value of the respective assets. The key variables that management must estimate in determining these expected future cash flows and fair values include sales volumes, sales prices, sales growth, production and operating costs, capital expenditures, market conditions, and other economic factors. Significant management judgment is involved in estimating these variables, and such estimates are inherently uncertain; however, the assumptions used are consistent with the Company's internal planning. Management periodically evaluates and updates the estimates based on the conditions that influence these variables.

The assumptions and conditions for determining impairments of property, plant and equipment, goodwill and other intangible assets, reflect management's best assumptions and estimates, but these items involve inherent uncertainties as described above, many of which are not under management's control. As a result, the accounting for such items could result in different estimates or amounts if management used different assumptions or if different conditions occur in future accounting periods.

### ***Environmental compliance and expenditures***

The measurement of environmental liabilities is based on an evaluation of currently available facts with respect to each individual site and considers factors such as existing technology, presently enacted laws and regulations and prior experience in remediation of contaminated sites. Inherent uncertainties exist in such evaluations primarily due to unknown conditions, changing governmental regulations and legal standards regarding liability, the protracted length of the clean-up periods and evolving technologies. Environmental operations and maintenance as well as remediation costs are accrued when environmental assessments and the need for remediation are probable and the costs can be reasonably estimated. The recorded liabilities are adjusted periodically as remediation efforts progress or as additional technical or legal information becomes available.

The assumptions and conditions for determining the level of the environmental liabilities reflect management's best assumptions and estimates, but these items involve inherent uncertainties as described above, many of which are not under management's control. As a result, the accounting for such items could result in different amounts if management used different assumptions or if different conditions occur in future accounting periods.

For further discussion related to environmental matters, see Note 21 to consolidated financial statements in Item 18 — Financial Statements and Item 4 — Information on the Company — Environmental Matters.

### ***Pension and other postretirement benefits***

Many of the amounts recognized in the consolidated financial statements related to pension and other postretirement benefits are determined from actuarial valuations. Inherent in these valuations are assumptions including discount rates, expected return on plan assets, rates of increase in future compensation levels, mortality rates and health care cost trend rates. These assumptions are updated annually based on current economic conditions and, if required, also for any changes to the terms and conditions of the pension and postretirement plans. These assumptions can be affected by (i) for the discount rate, changes in rates of return on high-quality fixed income investments currently available in the markets and those expected to be available during the period to maturity of the pension benefits; (ii) for the expected return on plan assets, changes in the pension plans' strategic asset allocations to various investment types or to long-term return trend rates in the capital markets in which the pension fund's assets are invested; (iii) for future compensation levels, changes in

labor market conditions; and (iv) for health care cost trend rates, the rate of medical cost inflation in the regions of the world where these benefits are offered to the Company's employees.

The weighted average actuarial assumptions used to compute the Company's pension and postretirement benefit obligations for 2005 and 2004, as well as the U.S. GAAP requirements for accounting for the differences between actual results that differ from the assumptions used in calculating the annual retirement benefit liabilities and costs, are disclosed in Note 18 to the consolidated financial statements in Item 18 — Financial Statements. While management believes that the assumptions used are appropriate, differences in actual experience or changes in assumptions may affect the Company's pension and other postretirement obligations and expenses in future accounting periods.

***Income taxes***

Deferred tax assets and liabilities are determined using enacted tax rates for temporary differences between the book and tax bases of assets and liabilities, as well as the effects of tax losses carried forward in certain tax jurisdictions in which the Company operates that may be utilized to offset future taxable income and similar tax credits carried forward that may be utilized to reduce future taxes payable. The Company records valuation allowances on deferred tax assets when appropriate to reflect the expected future tax benefits to be realized. In determining the appropriate valuation allowances, certain judgments are made by management relating to recoverability of deferred tax assets, use of tax loss and tax credit carryforwards, levels of expected future taxable income and available tax planning strategies.

The assumptions involved in making these judgments are updated periodically by management based on current business conditions that affect the Company and overall economic conditions. These management judgments are therefore subject to change based on factors that include, but are not limited to (i) changes in the profitability of the Company's subsidiaries, as well as for the Company as a whole, (ii) the ability of the Company to successfully execute its tax planning strategies and (iii) the accuracy of the Company's estimates of the potential effect that changes in tax legislation, in the jurisdictions where the Company operates, may have on the Company's future taxable profits. Failure by the Company to achieve forecasted taxable income or to execute its tax planning strategies may affect the ultimate realization of certain deferred tax assets. Factors that may affect the Company's ability to achieve sufficient forecasted taxable income or successfully execute its tax planning strategies include, but are not limited to, increased competition, general economic conditions, a decline in sales or earnings, loss of market share, delays in product availability or changes in tax legislation.

In addition, the Company operates within multiple taxing jurisdictions and is subject to audits in these jurisdictions. These audits can involve complex issues that may require an extended period of time for resolution. In management's opinion, adequate provisions have been made for any additional taxes that may result from any tax audits of historical periods that are currently ongoing or that may occur.

**Financial review**

***Total sales higher, comparable sales also higher in Swiss francs and stable in local currencies***

Sales increased by 6 percent overall to CHF 7 419 million. This includes 4 percent due to the inclusion of a full year of Raisio Chemicals activities in 2005 compared to seven months in 2004. This is incorporated within volume/product mix. Excluding acquisition effect, sales grew by 2 percent in Swiss francs and were flat in local currencies. Sales development in 2005 compared to 2004 resulted from the following factors:

<u>Consolidated sales development</u>	<u>2005 compared to 2004</u>
Volume/product mix/acquisition . . . . .	2%
Price . . . . .	2%
Currency . . . . .	<u>2%</u>
<b>Total in Swiss francs . . . . .</b>	<b><u>6%</u></b>

Sales price increases were implemented in most areas, primarily in the first half of the year to counter rising raw material costs. Volume developments were mixed, reflecting mostly differentiated demand growth patterns in end-user industries and a competitive industry environment. Sales growth was achieved in process and lubricant additives and water treatments but this was offset by a continued decline in textile dyes and sales into the optical information storage market.

In **Europe** sales increased, however this was predominantly due to the inclusion of a full year of Raisio Chemicals sales, compared to seven months for 2004. The underlying sales development remained mixed, with the U.K. and Germany in particular down from prior year. However, the region did improve towards the end of the year. In the **Americas**, the North American markets were similarly down, with demand particularly weak in the automotive sector and the textile industry. The aftermath of the hurricanes in the U.S. resulted in some supply problems and increased prices, but many of the lost sales were regained later in the year. **Asia Pacific** continued to grow strongly, especially in mainland China and India undoubtedly aided by the end of the WTO export quotas, which seemed to further accelerate the movement of sales from Europe and the Americas to Asia.

Sales levels were positively impacted by the movements of certain major currencies against the Swiss franc, particularly the U.S. dollar in the fourth quarter of 2005. There were no large movements in the relationships between the Swiss franc and the euro or the British pound, although both currencies were slightly stronger in the second semester compared to the first. Coupled with increased sales prices, the currency movements resulted in comparable sales (after accounting for the additional Raisio Chemicals sales) being 2 percent higher in Swiss francs and stable in local currencies.

Sales movements in Europe were similar in Swiss francs and local currencies. In the Americas, increases of sales in Swiss francs were currency driven with sales in local currencies in almost all locations being slightly lower. Sales growth in Asia Pacific was strong both in Swiss francs and in local currencies. Asia Pacific now accounts for 29 percent of the Company's total sales, having moved ahead of the Americas.

<u>Geographic sales distribution</u>	<u>2005</u>	<u>2004</u>
Europe . . . . .	43%	44%
Americas <sup>(i)</sup> . . . . .	28%	29%
Asia Pacific <sup>(ii)</sup> . . . . .	29%	27%

(i) The Americas are comprised of North, Central and South America.

(ii) Asia Pacific is comprised of Asia, Africa, the Middle East, Australia and New Zealand.

***Gross profit reductions due to higher raw materials and utility costs***

In absolute terms gross profit levels decreased by 3 percent to CHF 2 117 million and decreased to 28.5 percent of sales compared to 30.9 percent in prior year. Raw material prices started to increase at the end of 2004 and continued to rise rapidly during the first half of 2005. In addition, energy costs rose significantly during the year, primarily due to significantly higher costs of oil and natural gas. The decrease in gross margin in absolute and percentage terms has resulted mainly from sales price increases not fully covering these cost increases and higher pension costs. The inclusion of a full year of Raisio Chemicals activities had a dilutive effect on margins due to the different cost structure and volume declines have caused lower levels of plant utilization and consequently higher levels of unabsorbed fixed costs.

***Selling, general and administrative costs decrease***

Selling, general and administrative expenses in Swiss francs decreased by 4 percent to CHF 1 178 million in 2005 from CHF 1 224 million last year. As a percentage of sales, selling, general and administrative expenses decreased to 15.9 percent of sales in 2005 from 17.4 percent in 2004. Cost structure improvements resulting from Project Shape and other initiatives mitigated the effects of increased costs due to the inclusion

of a full year of Raisio Chemicals activities and increased pension costs. Selling, general and administrative also includes CHF 68 million income resulting from the sale of certain assets.

***Investment in research and development sustained***

Research and development expenses as a percentage of sales were 4.1 percent in 2005, in line with 2004. In absolute terms, research and development expenses increased by CHF 13 million to CHF 301 million in 2005 from CHF 288 million in 2004.

The Company has historically invested and plans to continue to invest approximately 4 percent of sales in research and development activities. In addition, pursuant to its commitment to innovation, the Company maintains a Research Fund for high risk/high reward projects, allowing up to CHF 15 million additional research and development expenses annually for such projects.

***Textile Effects impairment***

Project Shape, upon full implementation, was expected to restore Segment Textile Effects to acceptable profitability levels. However, the shift of the textile market and customers to Asia was further accelerated in 2005 by the ending of WTO quotas. It became evident that significant profitability improvement for the Segment would not be able to be achieved without additional cost saving measures. This triggered a requirement to test the carrying value of certain of the Segment's long-lived assets for impairment. The test determined that the carrying values of these assets are impaired. Consequently, an impairment charge totaling CHF 583 million was recorded. The impaired assets consist of property, plant and equipment, goodwill and other intangible assets. The basis and calculation methodology used for the impairment charge recorded in 2005 is described in note 23 to the consolidated financial statements in Item 18 — Financial Statements. The test also determined that the Segment's overall fair value is lower than its carrying value. Therefore, were the Segment to be disposed of in the near future, further charges would occur.

***Operating income and adjusted EBITDA lower due to impairment of Textile Effects Segment***

	<u>2005</u>	<u>2004</u>
<b>Operating income (loss)</b> .....	(124)	521
Adjusted EBITDA .....	297	915
Operating income margin .....	(1.7)%	7.4%
Adjusted EBITDA margin .....	4.0%	13.0%
<b>2005 compared to 2004</b>		
Operating income .....	(124)%	9%
Adjusted EBITDA .....	(67)%	8%

Operating income decreased by 124 percent to a loss of CHF 124 million in 2005 from income of CHF 521 million in 2004. The major change to operating income and adjusted EBITDA was the impairment of the Textile Effects Segment of CHF 583 million. There were also additional charges incurred in relation to Project Shape of CHF 116 million and other charges of CHF 4 million. 2004 included Project Shape charges of CHF 80 million plus CHF 11 million for expensing in-process research and development activities connected with the acquisition of Raisio Chemicals. See Note 23 to Consolidated Financial Statements in Item 18 — Financial Statements.

Without these items, in 2005 operating income would have been CHF 579 million, or 7.8 percent of sales compared to 2004 operating income of CHF 612 million, or 8.7 percent of sales. Adjusted EBITDA in 2005 would have been CHF 1 000 million, or 13.5 percent of sales, compared to 2004 adjusted EBITDA of CHF 1 006 million, or 14.3 percent of sales.

## Plastic Additives results

Sales increased to CHF 1 938 million in 2005 or by 2 percent in Swiss francs and by 1 percent in local currencies. Sales development in 2005 compared to 2004 resulted from the following factors:

<u>Sales development</u>	<u>2005 compared to 2004</u>
Volume/product mix .....	(4)%
Price .....	5%
Currency .....	1%
<b>Total in Swiss francs</b> .....	<u>2%</u>

Sales across the Segment were above 2004 in both local currencies and Swiss francs. Base polymers, home and personal care and process and lubricant additives exceeded prior year whereas only in polymer products were sales below previous year.

In response to the ongoing upward trend in raw material prices, significant sales price increases were implemented during the year. In addition, the Segment discontinued sales of low margin products resulting in some volume declines. Despite this decline, operating margins improved. After a challenging first semester, base polymers sales growth recovered strongly from June onwards across all of its core markets. For polymer products the strong sales growth achieved in 2004 faltered in early 2005 due to further contraction of the plastic converting industry in which customers are struggling with polymer price increases. Despite the competitive market, prices remained stable and some recovery was experienced in the second half of the year. Sales growth was achieved in process and lubricant additives, with most regions performing well. Following the trend of raw material prices, sales prices have been significantly increased. Home and personal care sales were significantly higher. Growth was mainly driven by higher sales of UV absorbers.

Geographically, sales in the **Americas** were slightly below 2004 in local currency. Due to positive currency effects, Swiss franc sales were above last year. In **Europe** sales were below last year both in Swiss francs and local currencies mainly as a result of the generally weak economy. **Asia Pacific** continued to deliver strong sales growth, especially in China and Japan.

<u>Operating income and adjusted EBITDA</u>	<u>2005</u>	<u>2004</u>
Operating income .....	260	224
Adjusted EBITDA .....	355	319
Expressed as a percentage of sales:		
Operating income .....	13.4%	11.9%
Adjusted EBITDA .....	18.3%	16.8%

Operating income and adjusted EBITDA increased both in absolute terms and as a percentage of sales. The increases in raw material costs were compensated with increases in selling prices during the year. The higher level of demand allowed the Segment to discontinue sales of low margin products, thereby accepting lower volumes of low margin products. Gross margins were slightly higher than 2004. The lower volumes resulted in lower plant utilization levels. Production costs increased slightly as higher utilities prices could only partly be offset by productivity improvements. Selling, general and administration expenses were lower, both in local currencies and in Swiss francs. This is mainly the result of cost savings resulting from the integration of a portion of the Home and Personal Care Segment, which occurred in the latter part of 2004, into the Plastic Additives Segment. The Segment maintained its investment level in research and development activities at approximately 5 percent of sales.

<u>Asset management</u>	<u>2005</u>	<u>2004</u>
Net current operating assets:		
Absolute in CHF . . . . .	453	393
As a percentage of sales . . . . .	23%	21%
Capital expenditures in CHF . . . . .	72	76
Invested capital in CHF . . . . .	1 441	1 321
Total assets in CHF . . . . .	1 692	1 603

Net operating assets increased from 2004 levels. This was due to higher inventory values and lower levels of payables, both in absolute terms and as a percentage of sales. Inventory values increased due to the impact of higher raw material prices and both inventory and receivables increased due to the higher U.S. dollar exchange rate. Capital expenditures decreased by CHF 4 million and continued to remain below the level of depreciation, focusing principally on de-bottlenecking and productivity improvement programs. Both invested capital and total assets increased over prior year.

The Company announced in 2005 the decision to invest approximately CHF 125 million in a new production plant for antioxidants for plastics in Singapore. The new plant will ensure continuous supply to growing markets in Asia Pacific and the Middle East. Start-up of the new plant is expected to occur in early 2008.

### Coating Effects results

Sales in Swiss francs decreased to CHF 1 804 million in 2005 or by 1 percent and decreased by 2 percent in local currencies. Sales development in 2005 compared to 2004 resulted from the following factors:

<u>Sales development</u>	<u>2005 compared to 2004</u>
Volume/product mix . . . . .	(1)%
Price . . . . .	(1)%
Currency . . . . .	1%
<b>Total in Swiss francs . . . . .</b>	<b>(1)%</b>

The Segment's key businesses experienced a challenging year, particularly in the first semester. However, most businesses improved significantly during the second half of the year. In 2005, electronic materials was negatively impacted by the further decline in the optical information storage business, which ultimately impacted the Segment's overall sales and profitability. The Segment was able to mitigate this decline in business volume with a combination of organic growth in other business lines and small acquisitions, although the competitive environment remained tough with increasing pressure from Asia.

The coatings business experienced increased demand for some industrial and decorative coatings products. The business also experienced decreased demand from the transportation sector, which nevertheless showed signs of recovery in the second half of the year. Electronic materials experienced strong growth in sales to the displays and microelectronics market, but not enough to compensate for the aforementioned decline in sales to the optical information storage market. The imaging and inks sector has seen some competitor consolidation as a result of higher levels of commoditized products and strong competition from Asia. In this sector, packaging and specialty products continues to grow, but the publications and, to a lesser extent, digital and photo markets remain under significant pressure. Despite the sluggish business environment and hostile market conditions affecting the thermoplastic sector, masterbatch maintained 2004 sales levels. The plastics market remains highly competitive and although sales to the agriculture sector increased strongly, sales to plastics and fibers declined.

Geographically, in **Europe** sales levels were slightly below 2004 in both Swiss francs and local currencies. Germany and Italy maintained prior year levels, however the U.K. once again had a difficult year with significant sales decreases in both Swiss francs and local currency. In the **Americas** sales also decreased in

both local currencies and Swiss francs, with sales stronger in South and Central America than in North America. Although the U.S. has suffered some supply problems and increasing prices following hurricane Katrina, the markets appeared to be improving later in the year. In **Asia Pacific** sales were basically equal to prior year, with little currency effect overall. 2005 was another good sales year for Japan and Korea. Region China, however, did not meet expectations but started to pick up in the latter part of the year with the development of the transportation market. The other countries in the region performed very well.

<u>Operating income and adjusted EBITDA</u>	<u>2005</u>	<u>2004</u>
Operating income . . . . .	233	291
Adjusted EBITDA . . . . .	340	394
Expressed as a percentage of sales:		
Operating income . . . . .	12.9%	16.0%
Adjusted EBITDA . . . . .	18.9%	21.7%

Operating income and adjusted EBITDA decreased both in absolute terms and as a percentage of sales. Margins deteriorated due to sales price erosion, the end of the life cycle for a high margin product and increased raw material costs, higher utilities and pension costs. Investment in research and development was approximately 6 percent of sales.

<u>Asset management</u>	<u>2005</u>	<u>2004</u>
Net current operating assets:		
Absolute in CHF . . . . .	579	501
As a percentage of sales . . . . .	32%	28%
Capital expenditures in CHF . . . . .	82	82
Invested capital in CHF . . . . .	2 028	1 843
Total assets in CHF . . . . .	2 275	2 090

Net operating assets increased from prior year levels. Both receivables and inventory levels were higher in absolute terms as well as in percentage of sales. Inventory values increased due to the impact of higher raw material prices and both inventory and receivables increased due to the higher U.S. dollar exchange rate. Payable levels were lower than in prior year. Capital expenditures remained level with prior year and below the level of depreciation. Due to the current available capacity, expenditures were focused on maintenance and process improvements rather than on adding capacity. Both invested capital and total assets increased as a consequence of some minor acquisitions.

### **Water & Paper Treatment results**

Sales increased to CHF 2 394 million in 2005 or by 19 percent in Swiss francs and by 17 percent in local currencies. Sales development in 2005 compared to 2004 resulted from the following factors:

<u>Sales development</u>	<u>2005 compared to 2004</u>
Volume/product mix/acquisition . . . . .	12%
Price . . . . .	5%
Currency . . . . .	<u>2%</u>
<b>Total in Swiss francs . . . . .</b>	<b><u>19%</u></b>

Sales of products that were previously marketed by Raisio Chemicals, which the Company acquired effective May 31, 2004, account for 15 of the 19 percent increase in sales. In order to provide more meaningful comparability, all comments regarding sales that follow exclude this acquisition effect other than where specifically indicated.

Segment sales performed well during the year in both Swiss francs and in local currencies. Water treatment sales growth was driven by substantial price increases, reduced by some consequent volume declines later in the year. The Segment's key market centers performed well except for the intermediates and agriculture sector. Paper sales suffered in the second quarter due to the lockout in the paper industry in Finland, but lost sales were able to be partially recovered in the second half of 2005. Despite the tough operating environment for paper makers, sales exceeded prior year levels. Market stagnation and competition contributed to difficult market conditions for detergents and hygiene, however sales were maintained at prior year levels as the result of a stronger second half driven by the strengthening U.S. dollar. A fire occurred at the Segment's Grenzach, Germany production site, however supplies to customers in the paper industry were not disrupted as the Segment was able to source these products from other Company production sites.

Geographically, sales in **Europe**, had a better second half, but over the whole year sales were flat in both Swiss francs and local currencies. Performance in the **Americas** was better, especially in the second half as the economies are now stabilizing and growing. Markets remain competitive with price increases not always being matched by competitors. The strengthening U.S. dollar has benefited the Segment, as some of the major sales and raw materials contracts are denominated in U.S. dollars. Central America delivered sales growth in both local currencies and in Swiss francs. **Asia Pacific** continues to be a growth area, particularly Region China for paper.

Including acquisition effects, sales development was positive across all regions in both local currencies and Swiss francs.

<u>Operating income and adjusted EBITDA</u>	<u>2005</u>	<u>2004</u>
Operating income . . . . .	128	128
Adjusted EBITDA . . . . .	288	259
Expressed as a percentage of sales:		
Operating income . . . . .	5.4%	6.3%
Adjusted EBITDA . . . . .	12.0%	12.8%

Operating income decreased as a percentage of sales. Adjusted EBITDA increased in absolute terms but decreased as a percentage of sales. Margins decreased mainly due to the dilutive effect of Raisio Chemicals (different cost structure) and higher raw material and energy costs not being fully recovered through sales price increases. Plant utilization decreased at the main sites due to volume losses triggered by the Segment's price increases and raw material shortages earlier in the year, as well as the impact of the Finnish lockout. Selling, general and administrative costs were higher in both Swiss francs and in local currencies due primarily to the acquisition effect of Raisio Chemicals added costs and some minor acquisitions during 2005. Investments in research and development remained at the prior year level of approximately 2 percent of sales.

<u>Asset management</u>	<u>2005</u>	<u>2004</u>
Net current operating assets:		
Absolute in CHF . . . . .	539	458
As a percentage of sales . . . . .	23%	23%
Capital expenditures in CHF . . . . .	89	81
Invested capital in CHF . . . . .	3 283	3 164
Total assets in CHF . . . . .	3 644	3 508

The Segment's operating assets were higher than prior year levels both in absolute and intensity terms. Both inventories and receivables increased in absolute terms driven primarily by currency developments as well as increased raw material and selling prices. Receivables in intensity to sales improved due to continued credit management efforts. Capital expenditures increased from prior year but were below depreciation expense and were again targeted primarily on productivity improvement projects. These factors and further minor acquisitions led to an overall increase in both invested capital and total assets.

## Textile Effects results

For comparability with prior year, the following discussion of the Segment's results excludes the effect of the impairment charge discussed earlier.

Sales decreased to CHF 1 283 million in 2005 or by 1 percent in Swiss francs and by 2 percent in local currencies. Sales development in 2005 compared to prior year resulted from the following factors:

<u>Sales development</u>	<u>2005 compared to 2004</u>
Volume/product mix .....	(1)%
Price .....	(1)%
Currency .....	<u>1%</u>
<b>Total in Swiss francs</b> .....	<b>(1)%</b>

Sales remained almost flat in an extremely challenging market. Textile chemicals sales developed positively, however not enough to offset the decline in textile dyes. The earlier months of the year were particularly difficult with price erosion and many competitors not increasing their prices. However in the second half prices became more stable and sales pricing policies started to have a positive impact.

Geographically, sales in **Europe** decreased from prior year levels both in Swiss francs and in local currencies. The region improved towards the end of the year, with higher demand but also because of agreements on the levels of Chinese imports. In the **Americas**, sales declined in Swiss francs and in local currencies across North America. However, Brazil delivered good sales growth in local currencies. In the **Asia Pacific** region, strong sales development, undoubtedly aided by the end of WTO quotas supports the decision to structurally realign the business to Asia. The main growth areas were China, Hong Kong and India, with other areas improving or at least remaining stable.

<u>Operating income and adjusted EBITDA</u>	<u>2005</u>	<u>2004</u>
Impairment .....	(583)	0
Operating income .....	(520)	61
Adjusted EBITDA .....	(468)	117
Expressed as a percentage of sales:		
Operating income .....	(40.5)%	4.7%
Adjusted EBITDA .....	(36.5)%	9.0%

Excluding the effect of the aforementioned impairment, operating income and adjusted EBITDA remained comparable with 2004 on absolute terms and as a percentage of sales, despite the difficult environment. The impact of the shift to lower margin business in Asia has been mitigated by personnel expense savings achieved through the Shape program. Selling, general and administrative costs declined as higher pension costs were more than offset by cost savings from Project Shape and other gains. As demand picked up during the second half of the year, the Segment also realized better capacity utilization. Investment in research and development remained stable at approximately 2 percent of sales.

<u>Asset management</u>	<u>2005</u>	<u>2004</u>
Net current operating assets:		
Absolute in CHF .....	411	393
As a percentage of sales .....	32%	30%
Capital expenditures in CHF .....	27	35
Invested capital in CHF .....	561	1 158
Total assets in CHF .....	785	1 361

Net current operating assets increased due to higher levels of receivables, although inventories were below prior year levels despite the impact on inventory values of higher raw material prices and the higher

U.S. dollar exchange rate. The latter also contributed to the higher receivables values. Payable levels were the same as last year. Capital expenditures decreased from last year, and remain well below depreciation expense for the period. Both invested capital and total assets decreased significantly due to the impairment.

### Consolidated balance sheets

<u>Selected balance sheet data as of December 31,</u>	<u>2005</u>	<u>2004</u>
Cash and cash equivalents and short-term investments .....	1 273	1 636
Total assets .....	10 612	10 996
Total shareholders' equity .....	3 903	4 152

Cash and cash equivalents and short-term investments decreased by CHF 363 million from 2004 to 2005 primarily due to the repayment of debt. Total assets were lower by CHF 384 million compared to prior year mainly as a consequence of the impairment of assets of the Segment Textile Effects. The Company further continued in 2005 its practice of maintaining total investments in property, plant and equipment at less than the annual depreciation cost.

The decrease of CHF 249 million in shareholders' equity in 2005 was principally due to the reported net loss in 2005 and the payment of the capital reduction and dividend to the Company's shareholders, partially offset by changes between December 31, 2004 and 2005 in year-end currency exchange rates, which are used to translate the Company's various non-Swiss franc denominated balance sheet items located around the world into Swiss francs. During 2005, the U.S. dollar appreciated by 14 percent, the Chinese renminbi by 16 percent and the British pound by 3 percent from prior year against the Swiss franc.

### Liquidity and capital resources

In recent years, the Company's sources of liquidity have primarily been provided by operations and funds from capital markets. Management of the Company is of the opinion that the funding available to it from these sources will be sufficient to satisfy its working capital and debt service requirements for the foreseeable future.

#### *Treasury management*

The international financial markets remained volatile in 2005. The major trends in the markets, which were the focus of the Company's treasury management initiatives, included movements in global interest rates as well as a strengthening of the U.S. dollar against the Swiss franc and the euro, whereas the exchange rate of the Swiss franc to the euro remained relatively stable.

As a consequence of the strong economic growth particularly in Asia and the U.S., global interest rates continued to rise during 2005. Through the effective anticipation of market conditions and the use of financial instruments available in the financial markets, the Company was able to keep the average cost of its total borrowings almost constant at 4.05 percent in 2005 compared to 4.03 percent in 2004. The Company's net interest cost, which is interest expense less interest income, increased slightly to CHF 114 million as compared to CHF 108 million in 2004.

During 2005, the U.S. dollar fluctuated against the Swiss franc from a high of approximately CHF 1.33 to a low of approximately CHF 1.15. The Swiss franc balance sheet year-end rate was at CHF 1.31 against the U.S. dollar in 2005 versus CHF 1.15 at the end of 2004. During 2005, the euro fluctuated against the Swiss franc from a high of approximately CHF 1.56 to a low of approximately CHF 1.53. At the end of 2005, the Swiss franc was at a level of CHF 1.56 against the euro versus CHF 1.54 at the end of 2004.

The Company, in accordance with its stated risk management policy, continues to monitor its currency exposures and, where appropriate, enters into transactions to minimize its overall exposures to volatility in the currency markets. The Company selectively executes foreign currency transactions, when considered cost effective, to protect the cash flows of its operating companies against unfavorable foreign currency movements.

In 2005, other financial expense, net which includes foreign currency exchange gains and losses, net hedging expenses, and losses on financial investments, was CHF 23 million, a decrease of CHF 16 million from CHF 39 million in 2004. The decrease in 2005 is mainly due to reduced losses from adverse foreign currency exchange rates, partially offset by gains from hedging activities. Otherwise, other financial expenses, net were relatively stable between the two periods.

### *Capital resources*

The Company's policy is to maintain a high degree of flexibility in its funding process by using a broad variety of financial instruments and currencies depending on market conditions. The Company enters into derivative financial instruments in the ordinary course of business to mitigate its exposure to adverse changes in foreign exchange rates and to manage its interest rate exposures. Various risk exposures, arising from existing assets and liabilities, from future transactions in which the Company is firmly committed and from future anticipated transactions, are assessed and managed centrally by the Company's treasury group based on the Company's aggregate exposure.

Under the Company's written hedging policy, treasury management continuously monitors and reports the results of its risk management programs to senior management and may choose to partially or fully hedge exposures. In accordance with its hedging policy, the Company primarily utilizes foreign exchange currency forwards, swaps and options contracts. The Company's risk management policies do not permit the utilization of financial instruments for speculative or trading purposes.

For further information see note 9 to consolidated financial statements and Item 11 — Quantitative and Qualitative Disclosures About Market Risks.

Throughout 2005, the Company continued to maintain its long-term debt rating of 'A' from Standard & Poor's. However, in August 2005 Standard & Poor's changed the outlook for the rating from "stable" to "negative". In May 2005 Moody's changed the Company's rating from 'A2' to 'A3' and in December 2005 changed the outlook for the rating from "stable" to "negative". Management believes that the Company will continue to be able to access global capital markets to meet its capital requirements as required.

The Company's capital requirements are primarily dependent on management's business plans regarding the levels and timing of capital expenditures and investments. The Company announced in 2005 the decision to invest approximately CHF 125 million in a new production plant for antioxidants for plastics in Singapore. Start-up of the new plant is expected to occur in early 2008. Subject to developments affecting the Company, which cannot be predicted or controlled, management for the next one to two years intends to maintain the Company's capital expenditure levels, including the new production plant in Singapore, generally in the range of the past three years. Other than described above, the Company is not currently subject to any commitment for capital expenditures that individually is material to the Company.

For further information on capital resources available to the Company, see notes 12 and 13 to consolidated financial statements in Item 18 — Financial Statements.

### *Net debt*

The table below shows the components of net debt at December 31, 2005 and 2004:

<u>December 31,</u>	<u>2005</u>	<u>2004</u>
Short-term debt . . . . .	277	559
Long-term debt . . . . .	<u>2 942</u>	<u>2 917</u>
<b>Total debt</b> . . . . .	3 219	3 476
Less: cash and cash equivalents . . . . .	(1 259)	(1 614)
Less: short-term investments . . . . .	<u>(14)</u>	<u>(22)</u>
<b>Net debt</b> . . . . .	<u>1 946</u>	<u>1 840</u>

The Company maintains short-term debt facilities, including commercial paper programs and bank overdraft and credit line facilities to finance its working capital requirements, which are described in note 12 to the consolidated financial statements in Item 18 — Financial Statements.

The Company's long-term debt in 2005 and 2004 consisted primarily of Euro Medium-Term Notes (EMTN Program) and straight bonds, which are described in note 13 to the consolidated financial statements in Item 18 — Financial Statements. The current portion of long-term debt totaled CHF 4 million at December 31, 2005 and CHF 258 million at December 31, 2004.

Total debt decreased by a net CHF 257 million principally as the result of the decrease in the short-term portion of long-term debt that resulted from the repayment of CHF 275 million of debt. Net debt, however, increased by CHF 106 million in 2005 due in part to the strengthening of the USD at year-end. Long-term debt, net of current portion, was similar to prior year levels. See note 13 to consolidated financial statements in Item 18 — Financial Statements.

The Company's commercial paper program is uncommitted and the availability of future funds thereunder depends to a large extent on market conditions. The Company may, if and when it is economically advantageous, issue new debt.

### *Cash flows*

The net decrease in cash and cash equivalents of CHF 355 million from year end 2004 to year end 2005 resulted from cash flows provided by or used in the Company's operating, investing and financing activities.

<u>Cash flows from operating activities</u>	<u>2005</u>	<u>2004</u>
Net income (loss) . . . . .	(256)	306
Deduct net income from discontinued operations, net of tax . . . . .	(30)	(28)
Depreciation and amortization . . . . .	421	394
Net change in operating assets and liabilities . . . . .	(134)	(226)
Other, net . . . . .	<u>409</u>	<u>185</u>
<b>Net cash provided by operating activities . . . . .</b>	<b><u>410</u></b>	<b><u>631</u></b>

Cash flows provided by operating activities of CHF 410 million were CHF 221 million lower than 2004 primarily due to the Company's lower overall operating result and higher restructuring payments, which increased by CHF 71 million from CHF 11 million in 2004 to CHF 82 million in 2005.

The Company continues to prioritize cash flow generation and is satisfied that operating cash flow levels are sufficient to satisfy both short-term and mid-term funding requirements.

<u>Cash flows from investing activities</u>	<u>2005</u>	<u>2004</u>
Capital expenditures . . . . .	(275)	(294)
Sale (acquisition) of businesses, net of cash . . . . .	(50)	(810)
Proceeds from sale of assets and changes in loans and other long-term assets . . . . .	<u>33</u>	<u>53</u>
<b>Net cash used in investing activities . . . . .</b>	<b><u>(292)</u></b>	<b><u>(1 051)</u></b>

Cash flows used in investing activities decreased by CHF 759 million in 2005 to CHF (292) million from CHF (1 051) million in 2004 due primarily to decreased cash outflows for acquisitions of businesses, which in 2004 included CHF 662 million for the acquisition of Raisio Chemicals. The remaining decrease is

attributable to higher cash proceeds from sales of fixed assets, which in 2005 increased to CHF 95 million from CHF 21 million in 2004.

<u>Cash flows from financing activities</u>	<u>2005</u>	<u>2004</u>
Increase (decrease) in short-term and long-term debt, net .....	(341)	55
Dividends paid .....	(66)	0
Capital reduction paid .....	(130)	(197)
Treasury stock transactions and other .....	<u>11</u>	<u>(162)</u>
<b>Net cash used in financing activities</b> .....	<u>(526)</u>	<u>(304)</u>

For discussion of cash flows from short-term and long-term debt, see the Net Debt section of this Management's Discussion and Analysis and notes 12 and 13 to consolidated financial statements in Item 18 — Financial Statements.

At the Company's Annual General Meeting on March 3, 2005, the shareholders approved the Board of Directors' proposal for a dividend payment of CHF 1 per share, based on 2004 results, and a payment to the shareholders in the form of a capital reduction of CHF 2 per share. The capital reduction was in the form of a reduction in the nominal value of each common share from CHF 3 per share to CHF 1 per share. The dividend payment, which totaled CHF 66 million, was made on March 8, 2005, and the capital reduction payment was made on May 18, 2005, totaling CHF 130 million.

At the Company's Annual General Meeting on February 26, 2004, the shareholders approved the Board of Directors' proposal for a payment to the shareholders in the form of a capital reduction of CHF 3 per share. The capital reduction was in the form of a reduction in the nominal value of each common share from CHF 6 per share to CHF 3 per share. The Company paid the capital reduction on May 14, 2004, which totaled CHF 197 million.

In connection with its share buy-back program initiated in 2004, the Company purchased 1.8 million treasury shares in 2004 for CHF 162 million. The shareholders approved the cancellation of these shares at the Company's Annual General Meeting on March 03, 2005; consequently, the shares were cancelled on May 18, 2005. For further details, refer to Note 16 to Consolidated Financial Statements in Item 18 — Financial Statements.

<u>Free cash flow</u>	<u>2005</u>	<u>2004</u>
Net cash provided by operating activities .....	410	631
Less: net cash used in investing activities .....	(292)	(1 051)
Add: (sale) acquisition of businesses, net of cash .....	<u>50</u>	<u>810</u>
<b>Free cash flow<sup>(i)</sup></b> .....	<u>168</u>	<u>390</u>

(i) In financial statements published prior to 2005, the Company deducted a pro-forma CHF 2 per share dividend from the calculation of free cash flow. The 2004 free cash flow figure presented above and in the year in review — 2005 compared to 2004 table in this Item 5 — Operating and Financial Review and Prospects has been adjusted to correspond with the 2005 calculation.

The Company historically has utilized free cash flow to maintain short-term debt at stable levels, to repay long-term debt according to payment terms or earlier when economically advantageous to the Company, for acquisitions of businesses or treasury shares, and to pay distributions to shareholders.

Free cash flow was lower by CHF 222 million in 2005 compared to prior year. This was mainly due to lower cash from operating activities in 2005, which resulted from the Company's lower overall operating result.

### Long-term obligations, commitments and contingencies

The Company has various purchase commitments for materials, supplies and items of permanent investment incident to the ordinary course of business. Management believes that these commitments are not in excess of current market prices and reflect normal business operations. The Company had outstanding at December 31, 2005, various long-term obligations that will become due in 2006 and beyond. These various purchase commitments and long-term obligations will have an effect on the Company's future liquidity and capital resources. The table below shows, by major category of commitment and long-term obligations outstanding as of December 31, 2005, the Company's current estimate of their annual maturities.

#### Payments by year, as from December 31, 2005

	<u>Total</u>	<u>Less than 1 year</u>	<u>1 to 3 years</u>	<u>3 to 5 years</u>	<u>More than 5 years</u>
Long-term debt, including current <sup>(i)</sup> . . . . .	2 916	4	1 021	310	1 581
Long-term obligations, including current portion <sup>(ii)</sup> . . . . .	1 474	87	173	170	1 044
Raw material purchase commitments . . . . .	618	245	311	48	14
Fixed assets and other purchase commitments	478	293	164	7	14
Lease commitments . . . . .	<u>134</u>	<u>36</u>	<u>46</u>	<u>25</u>	<u>27</u>
<b>Total</b> . . . . .	<u>5 620</u>	<u>665</u>	<u>1 715</u>	<u>560</u>	<u>2 680</u>

- (i) Long-term debt shown is the face amount of the debt obligations. The amounts reported on the consolidated balance sheets and in note 13 to consolidated financial statements in Item 18 — Financial Statements are net of discounts and premiums, in accordance with U.S. GAAP.
- (ii) Estimated payments for long-term obligations have been determined by the Company based on payment schedules for those long-term obligations where set payments exist. For long-term obligations with no set payment schedules, estimates have been made by the Company based on the most likely timing of cash payments based on the facts and circumstances that exist as of December 31, 2005. The ultimate timing of these future cash flows may differ due to events and circumstances that are out of the direct control of the Company. Also included are liabilities related to environmental matters, which are further discussed in note 21 to consolidated financial statements in Item 18 — Financial Statements.

In addition to the long-term obligations and commitments disclosed above, the Company, in the normal course of business, provided guarantees to third parties. The Company estimates that the fair value of these guarantees is not material and does not expect to incur material losses as a result of these guarantees. As of December 31, 2005, the Company has provided guarantees to third parties for indebtedness of others of approximately CHF 3 million of which CHF 1 million expire in 2006 and CHF 2 million in 2007 or thereafter.

#### Effective income tax rate

The Company reported a significantly lower effective income tax rate in 2005 than in 2004. The primary unique events impacting the 2005 rate are the impairment of Segment Textile Effects, additional tax loss carryforwards in certain of the Company's subsidiaries and higher tax deductions in certain of the Company's subsidiaries that are not recognized for financial reporting purposes. The specific tax-related impacts resulting from these events are described in note 14 to consolidated financial statements in Item 18 — Financial Statements.

## Year in review — 2004 compared to 2003

<u>Results of operations</u>	<u>2004</u>	<u>2003</u>
Net sales .....	7 027	6 646
Gross profit .....	2 171	2 067
Operating income .....	521	563
Income from continuing operations .....	278	345
Income from discontinued operations, net of tax .....	28	0
Cumulative effect of change in accounting principles .....	0	(16)
Net income .....	306	329
<i>Earnings per share, basic and diluted</i>		
Continuing operations .....	4.21	5.05
Discontinued operations .....	0.43	0.00
Cumulative effect of change in accounting principles .....	0.00	(0.23)
Net income per share .....	4.64	4.82
<b>Other data</b>		
Depreciation and amortization of other intangible assets .....	394	366
Restructuring and special charges .....	91	0
Adjusted EBITDA .....	915	929
Net cash provided by operating activities .....	631	1 033
Free cash flow .....	259	728
Net debt .....	1 840	1 049
Shareholders' equity at year end .....	4 152	4 253
Dividend per share <sup>(1)</sup> .....	1.00	0.00
Capital reduction per share <sup>(1)</sup> .....	2.00	3.00
<b>Key performance ratios</b>		
Net sales development .....	6%	(6)%
Net sales development in local currencies .....	8%	0%
<b>Expressed as a percentage of sales:</b>		
Gross profit .....	30.9%	31.1%
Operating income .....	7.4%	8.5%
Income from continuing operations .....	4.0%	5.2%
Net income .....	4.4%	5.0%
Adjusted EBITDA .....	13.0%	14.0%

- (1) The per share amounts presented above for 2004 reflect the CHF 1 per share dividend and CHF 2 per share capital reduction payments made in 2005, based on 2004 results. The per share amounts presented above for 2003 reflect that no dividend was paid in 2004, based on 2003 results, as well as the CHF 3 per share capital reduction payment made in 2004, based on 2003 results. For further information see the Operational Review section of this Management's Discussion and Analysis and Item 6. Directors, Senior Management and Employees — Dividends and Dividend Policy.

## Summary

### *Highlights*

Ciba Specialty Chemicals (the "Company") experienced in 2004 generally favorable market conditions, particularly in certain areas of the world, and unfavorable currency effects from the continued weakening of the U.S. dollar against the Swiss franc and the euro. Organic growth during 2004 resulted in net sales,

excluding those of businesses acquired during the year, matching 2003 levels in Swiss francs despite negative currency effects and increasing by 2 percent in local currencies.

During 2004, the Company completed the acquisition of Raisio Chemicals Oy in addition to a number of other minor acquisitions. Comments relating to acquisition effects throughout this Management's Discussion and Analysis refer to these acquisitions in totality, other than where specifically indicated. Acquisitions contributed 6 percent to sales growth in 2004, mainly from Raisio Chemicals. Including acquisitions, net sales in 2004 of CHF 7 027 million increased over 2003 levels by 8 percent in local currencies and by 6 percent in Swiss francs.

The Company implemented in 2004 Project Shape, a restructuring program to assure that synergies resulting from the integration of Raisio Chemicals are achieved and to address the continuing shift in the textiles market to Asia. Project Shape will take until 2007 to complete and is expected to result in after tax charges totaling CHF 125 million, the reduction of approximately 950 positions worldwide and annualized after tax earnings improvement of approximately CHF 90 million, once fully implemented.

### *Operational review*

The global economy regained momentum to varying degrees during 2004, therefore providing the Company with opportunities for further growth in certain markets. Geographically, solid sales growth was achieved in Asia, particularly in China and Japan. In the Americas, sales benefited from stronger demand, particularly for specialty applications in market sectors such as polymers, industrial and decorative coatings and transportation. Sales in European markets were mixed, with Continental European sales flat to slightly improved and U.K. sales declining from prior year levels. Additional sales from acquired companies, mainly Raisio Chemicals, contributed strongly to sales growth in 2004. The acquisition of Raisio Chemicals enables the Segment Water and Paper Treatment to expand its already broad product range into its existing core markets and strengthen its presence in the Nordic regions and in Asia.

Gross profit increased in absolute terms in 2004 to CHF 2 171 million from CHF 2 067 million last year, benefiting from higher sales volumes and productivity improvements resulting from higher capacity utilization. Despite higher volumes, underlying production costs, excluding acquisition effects, were stable. Gross profit margin for 2004 was 31 percent, the same as prior year. Selling, general and administrative expenses, while higher than 2003 levels due to acquisition effects, decreased as a percentage of net sales due to continued cost control efforts.

Under Project Shape, the Company will close its Clayton manufacturing facility in the U.K. in a phased shutdown until 2007 and transfer production capacity mostly to Asia. The program also involves the closure of several smaller production and administrative facilities, primarily from the former Raisio Chemicals, and various other rightsizing initiatives across the Company's global production base. This will enable the Company to optimize regional productive capacities within growing markets, particularly in textile effects, and to further balance the currency impact between the location of sales and cost generation.

Operating income decreased to CHF 521 million from CHF 563 million in 2003. Operating income margin was also lower in 2004 at 7.4 percent of sales compared to 8.5 percent in 2003. These decreases were primarily attributable to the CHF 80 million of restructuring expenses incurred in 2004 in connection with Project Shape, in addition to the expensing of acquired in-process research and development costs of CHF 11 million resulting from the Raisio Chemicals acquisition.

### *Cash flow and balance sheet review*

Cash flows from operating activities in 2004 were, as expected, substantially lower than 2003, which had benefited by CHF 229 million from reductions in inventories and receivables. During 2004, approximately CHF 46 million of cash outflows were attributable directly to specific events at Raisio Chemicals, consisting of the build up of current assets for two new plants in China, higher receivables following the cessation of factoring and seasonal cash flow patterns in the starch business. In addition, the Company had higher payments for taxes, interest and contributions to certain of its pension plans. These factors, together with a

combined CHF 107 million of higher capital expenditures and lower proceeds from sales of assets, resulted in lower free cash flow of CHF 259 million compared to CHF 728 million in 2003.

Net cash flows from investing activities was an outflow of CHF 1 051 million in 2004, an increase in outflow of CHF 812 million from CHF 239 million last year. The increase primarily consisted of the cash paid for the acquisition of Raisio Chemicals. Capital expenditures increased by CHF 61 million to CHF 294 million in 2004 from CHF 233 million last year. Such expenditures remain focused primarily on productivity improvement projects and maintenance of existing capacity.

Net cash flows used in financing activities were CHF 304 million in 2004 primarily consisting of a further capital reduction payment to shareholders totaling CHF 197 million and treasury stock purchases, net of sales, of CHF 162 million.

***Significant other events***

As a result of a dispute, Vantico International SA (now owned by the Huntsman Group) had initiated arbitration proceedings against the Company. The dispute and related arbitration proceedings were settled during 2004 resulting in the release of previously established reserves totaling CHF 28 million, net of tax. During 2004, the Company released CHF 15 million of previously established reserves following the settlement of certain outstanding tax matters.

To streamline the Group structure, the Company in 2004 integrated the Home & Personal Care Segment into two other existing segments. In recent years, the Company has evaluated numerous potential acquisitions in the home and personal care market, however none met the Company's strict criteria for strategic fit and return on investment. This left the segment with a lack of critical mass and the Company therefore decided to save the cost of the segment support structure. The segment information presented herein reflects the new segment structure and all current and prior period segment information has been restated accordingly.

**Financial review**

***Total sales higher, comparable sales also higher in local currencies and stable in Swiss francs***

Sales increased by 6 percent overall to CHF 7 027 million including acquisition effects. Comparable sales excluding acquisition effects increased by 2 percent in local currencies and were stable in Swiss francs. Sales development in 2004 compared to 2003 resulted from the following factors:

<u>Consolidated sales development</u>	<u>2004 compared to 2003</u>
Volume/product mix .....	5%
Price .....	(3)%
Currency .....	<u>(2)%</u>
<b>Total in Swiss francs excluding acquisitions</b> .....	0%
Acquisitions .....	<u>6%</u>
Total in Swiss francs .....	<u>6%</u>

Market conditions mostly improved in 2004 across the majority of the Company's core businesses, as an overall more favorable economic environment led to a pick-up in industry activity and underlying demand levels. Consequently, higher sales volumes resulted in most segments reporting higher sales in local currencies. The ongoing impact of a strongly competitive sales environment particularly in the first half of the year resulted in further downward pressure on selling prices. However, the Company was successful in abating this trend in the second semester. These factors, in addition to adverse currency development and a slightly weakening sales trend in the last quarter resulted in stable sales in Swiss francs, excluding acquisition effects.

In Europe, the major economies failed to gain momentum in 2004, particularly in the second half of the year, which was characterized by generally weak business months towards the year-end. Conditions were more favorable across the NAFTA regions, where good sales development in the U.S. was generally in keeping with

an improved economic environment. Consequently sales increased in local currency. Further economic growth in Asia enabled another good performance in the region.

Sales levels were adversely impacted by the continued appreciation of the Swiss franc against the U.S. dollar in particular. This was partially offset by the strengthening of the euro and the British pound against the Swiss franc. Volume gains compensated for further price erosion resulting from the strongly competitive sales environment. As a result, comparable sales were 2 percent higher in local currencies and were stable in Swiss francs. Sales including acquisition effects were 6 percent higher than prior year in Swiss francs.

Sales in local currencies excluding acquisition effects were lower in Europe. However the appreciation of the euro resulted in slightly higher sales in Swiss francs. Most major sales territories experienced slow market conditions to varying degrees, although both Germany and France posted slight increases in local currencies. Sales including acquisition effects were higher in all major territories, with the exception of the U.K., where sales declined after a difficult year across the major businesses. In the Americas, sales in the U.S. increased in local currency but were lower in Swiss francs, both excluding and including acquisition effects. Sales in South America were well ahead in local currencies and to a lesser extent in Swiss francs. In Asia Pacific, sales again increased in local currencies and to a lesser extent also in Swiss francs. Region China again achieved double-digit growth in local currencies, and Japan also reported strong sales increases in both local currency and in Swiss francs.

<u>Geographic sales distribution</u>	<u>2004</u>	<u>2003</u>
Europe .....	44%	41%
Americas <sup>(1)</sup> .....	29%	31%
Asia Pacific <sup>(2)</sup> .....	27%	28%

(1) The Americas are comprised of North, Central and South America.

(2) Asia Pacific is comprised of Asia, Africa, the Middle East, Australia and New Zealand.

*Gross profit benefits from sales growth and acquisition effects*

In absolute terms gross profit levels increased by 5 percent to CHF 2 171 million but decreased to 30.9 percent of sales compared to 31.1 percent in prior year. The increase in absolute terms resulted from sales volume gains and positive acquisition effects that offset both selling price reductions and adverse currency impact. Higher sales volumes in turn generated productivity improvements leading to lower levels of unabsorbed fixed costs that combined with further savings in base production costs to positively affect margins. Raw material costs were relatively stable overall but showed an increasing trend towards year-end. Gross margins however decreased slightly as a percentage of sales, mainly due to the effect of relatively higher variable to total cost ratio of Raisio Chemicals that was partially offset in operating income.

*Selling, general and administrative costs increase; lower in sales terms*

Selling, general and administrative expenses in Swiss francs increased by CHF 32 million to CHF 1 225 million in 2004, an increase of 3 percent from CHF 1 193 million last year. This was mainly due to acquisition effects. However as a percentage of sales selling, general and administrative expenses decreased to 17.4 percent of sales in 2004 from 18.0 percent in 2003, partially due to the relatively lower fixed to total cost structure of Raisio Chemicals. Underlying costs on a comparable basis were stable.

*Investment in research and development sustained*

Research and development expenses as a percentage of sales were 4.1 percent in 2004, a slight decrease from 4.2 percent last year. In absolute terms, research and development expenses increased slightly by CHF 7 million to CHF 288 million in 2004 from CHF 281 million in 2003.

The Company has historically invested and plans to continue to invest approximately 4 percent of sales in research and development activities. In addition, pursuant to its commitment to innovation, the Company maintains a Research Fund for high risk/high reward projects, allowing up to CHF 15 million additional research and development expenses annually for such projects.

*Operating income and adjusted EBITDA lower due to acquisition and restructuring effects*

	<u>2004</u>	<u>2003</u>
<b>Operating income</b> .....	521	563
Adjusted EBITDA .....	915	929
Operating income margin .....	7.4%	8.5%
Adjusted EBITDA margin .....	13.0%	14.0%
<b>2004 compared to 2003</b>		
Operating income .....	(7)%	(27)%
Adjusted EBITDA .....	(2)%	(20)%

Operating income decreased by 7 percent to CHF 521 million in 2004 from CHF 563 million in 2003. Expressed as a percentage of sales, operating income fell to 7.4 percent in 2004 from 8.5 percent in the prior year. Despite higher sales volumes and positive acquisition effects that helped offset price erosion and adverse currency development, operating income decreased due to restructuring charges totaling CHF 80 million incurred in connection with Project Shape and special charges totaling CHF 11 million consisting of the expensing of the fair value of acquired in-process research and development activities in connection with the acquisition of Raisio Chemicals. Without these items, in 2004 operating income would have been CHF 612 million, or 8.7 percent of sales. See Note 23 to Consolidated Financial Statements in Item 18 — Financial Statements.

As a result of the decline in operating income as described above, adjusted EBITDA in 2004 decreased to CHF 915 million, a decrease of CHF 14 million from CHF 929 million in the prior year. Currency adjusted adjusted EBITDA increased by CHF 29 million from 2003. Adjusted EBITDA margin decreased to 13.0 percent of sales in 2004 from 14.1 percent in 2003.

**Segments results**

*Plastic Additives results*

Sales increased to CHF 1 895 million in 2004 or by 4 percent in Swiss francs and by 7 percent in local currencies. Sales development in 2004 compared to 2003 resulted from the following factors:

<u>Sales development</u>	<u>2004 compared to 2003</u>
Volume/product mix .....	9%
Price .....	(2)%
Currency .....	<u>(3)%</u>
<b>Total in Swiss francs</b> .....	<u>4%</u>

Sales development across the Segment was generally positive both in local currencies and to a lesser extent in Swiss francs. In base polymers an upturn in the final quarter of the year helped to offset an intentional reduction in low-margin businesses.

Strong sales growth was achieved in polymer products, with all core markets performing well. Process and lubricant additives sales were well above prior year levels, with good market conditions evident across all major territories. Home and personal care sales were significantly higher, with new product launches in colors and stabilization applications and further gains in UV absorbers as the main growth drivers. The effect on sales of ongoing downward pressure on selling prices was fully offset by increased sales volume.

Geographically, sales in **Europe** increased in Swiss francs and to a lesser extent in local currencies. Sales performance was mixed, with a good result in Germany contrasting more sluggish conditions elsewhere across the region. In the **Americas**, sales levels increased in both Swiss francs and in local currencies. Sales levels rebounded in the U.S. benefiting from the gradual economic recovery there, and were much higher in local currency and to a lesser extent in Swiss francs. Sales in South America were higher in both local currencies and Swiss francs. Further sales growth was also achieved in **Asia Pacific**, with China and Japan again achieving excellent results in both local currencies and in Swiss francs. Sales development in local currencies was generally positive across the remainder of the region, and to a lesser extent also in Swiss francs.

<u>Operating income and adjusted EBITDA</u>	<u>2004</u>	<u>2003</u>
<b>Operating income:</b>		
Absolute in CHF . . . . .	224	165
As a percentage of sales (operating income margin) . . . . .	11.9%	9.1%
<b>Adjusted EBITDA:</b>		
Absolute in CHF . . . . .	319	265
As a percentage of sales (adjusted EBITDA margin) . . . . .	16.8%	14.6%

Operating income and adjusted EBITDA increased both in absolute terms and as a percentage of sales. Despite an increase in raw material costs in the latter part of the year, gross margins improved due to the combined effects of positive sales volume mix development and also productivity gains that resulted from higher plant utilization levels. Selling, general and administration expenses were higher, both in local currencies and to a lesser extent in Swiss francs. The Segment maintained its investment level in research and development activities at approximately 5 percent of sales.

<u>Asset management</u>	<u>2004</u>	<u>2003</u>
Net current operating assets:		
Absolute in CHF . . . . .	393	362
As a percentage of sales . . . . .	21%	20%
Capital expenditures in CHF . . . . .	76	64
Invested capital in CHF . . . . .	1 321	1 247
Total assets in CHF . . . . .	1 603	1 514

Net operating assets increased from 2003 levels. This was due to higher levels of receivables and inventories, both in absolute terms and as a percentage of sales. Payable levels were higher than prior year levels. Capital expenditures were mainly focused on debottlenecking and productivity improvement programs, and were well below the level of depreciation. Both invested capital and total assets increased slightly over prior year.

***Coating Effects results***

Sales in Swiss francs increased to CHF 1 818 million in 2004 or by 1 percent and increased by 3 percent in local currencies. Sales development in 2004 compared to 2003 resulted from the following factors:

<u>Sales development</u>	<u>2004 compared to 2003</u>
Volume/product mix . . . . .	6%
Price . . . . .	(3)%
Currency . . . . .	(2)%
<b>Total in Swiss francs . . . . .</b>	<b>1%</b>

Strong volume gains across most of the Segment's key businesses contributed to overall sales growth in both Swiss francs and in local currencies. In the coatings business, sales increased in both Swiss francs and in

local currencies, benefiting from strong demand for new product applications in the industrial and decorative coating markets, coupled with higher sales in the transportation market despite downward pressure on automobile sales. The Segment again managed to increase sales into the highly competitive plastics market and also posted higher sales in electronic materials due to further gains in the fast-growing displays sector, although demand slowed in the latter part of the year. Sales of Optical Information Storage products deteriorated throughout the year due principally to overcapacity in the CD-R market. The imaging and inks business continued to experience tougher conditions particularly in the publications market, although this was partially offset by a positive mix effect resulting from sales of higher margin pigments in packaging.

Geographically, in **Europe** sales levels were stable in Swiss francs and were slightly lower in local currencies. Of the major sales regions, France and Italy delivered positive sales growth both in local currencies and in Swiss francs, as did Germany to a lesser extent. This was contrasted by a difficult year in the U.K. where sales decreased markedly both in Swiss francs and in local currency. In the **Americas** in general and in the USA in particular, sales levels increased in local currencies but were lower in Swiss francs. Sales in Central and South America increased both in local currencies and in Swiss francs. **Asia Pacific** sales grew in local currencies and to a lesser extent in Swiss francs, enabled by an excellent result in Japan. Sales in Region China were stable in local currencies, but decreased in Swiss francs. Of the remaining sales territories in the region, growth was generally positive in local currencies and to a lesser extent in Swiss francs.

<u>Operating income and adjusted EBITDA</u>	<u>2004</u>	<u>2003</u>
<b>Operating income:</b>		
Absolute in CHF . . . . .	291	298
As a percentage of sales (operating income margin) . . . . .	16.0%	16.5%
<b>Adjusted EBITDA:</b>		
Absolute in CHF . . . . .	394	395
As a percentage of sales (adjusted EBITDA margin) . . . . .	21.7%	21.8%

Operating income and adjusted EBITDA decreased both in absolute terms and as a percentage of sales. Margins deteriorated due to sales price erosion, higher production costs that resulted mainly from higher personnel costs, and adverse currency development. These were partially offset by positive volume mix gains and lower residual capacity costs resulting from increased capacity utilization. Selling, general and administrative costs increased due to higher personnel costs. Investment in research and development was approximately 6 percent of sales.

<u>Asset management</u>	<u>2004</u>	<u>2003</u>
Net current operating assets:		
Absolute in CHF . . . . .	501	520
As a percentage of sales . . . . .	28%	29%
Capital expenditures in CHF . . . . .	82	79
Invested capital in CHF . . . . .	1 843	1 762
Total assets in CHF . . . . .	2 090	2 009

Net operating assets decreased from prior year levels. Both receivables and inventory levels were lower, in absolute terms as well as in percentage of sales. Payable levels were higher than in prior year. Capital expenditures increased slightly; these remain focused primarily on enhancement of existing capacity and were below the level of depreciation. Both invested capital and total assets increased slightly.

### *Water & Paper Treatment results*

Sales increased to CHF 2 014 million in 2004 or by 25 percent in Swiss francs and by 27 percent in local currencies. Sales development in 2004 compared to 2003 resulted from the following factors:

<u>Sales development</u>	<u>2004 compared to 2003</u>
Volume/product mix .....	6%
Price .....	(4)%
Currency .....	(2)%
<b>Total in Swiss francs before acquisitions</b> .....	<b>0%</b>
Acquisitions .....	25%
<b>Total in Swiss francs</b> .....	<b>25%</b>

The acquisition effect of Raisio Chemicals is included from June 1, 2004; all comments regarding sales that follow are on a comparable basis with 2003 thereby excluding acquisition effects other than where specifically indicated.

Sales in water treatments exceeded prior year levels both in Swiss francs and in local currencies, driven by good performances across most major markets despite further competitive downward pressure on selling prices in the sector. Business line paper reported sales growth in local currencies with most markets outperforming the prior year, although sales remained stable in Swiss francs. Sales in detergents and hygiene suffered from the adverse competitive impact of the weak U.S. dollar, especially in whiteners, resulting in sales decreases both in local currencies and in Swiss francs.

Geographically, sales in **Europe** increased in Swiss francs and were stable in local currencies. Germany achieved sales growth in both Swiss francs and local currency, benefiting from slightly improved economic conditions. Performance was more muted across the remainder of the region amid tighter markets. In the **Americas**, sales increases in local currencies were achieved in all regions to varying degrees. Sales in the U.S. were slightly higher than prior year in local currency, but were much lower in Swiss francs. Canada posted growth in both local currency and in Swiss francs, while Central America delivered sales growth in local currencies but sales were stable in Swiss francs. Sales increased in **Asia Pacific**, particularly in Region China where sales were once again well ahead in both Swiss francs and in local currency, augmented by another good performance in Africa and Middle East where sales increased in both local currency and in Swiss francs.

Including acquisition effects, sales development was positive across all regions in both local currencies and to a lesser extent in Swiss francs.

<u>Operating income and adjusted EBITDA</u>	<u>2004</u>	<u>2003</u>
<b>Operating income:</b>		
Absolute in CHF .....	128	125
As a percentage of sales (operating income margin) .....	6.3%	7.8%
<b>Adjusted EBITDA:</b>		
Absolute in CHF .....	259	228
As a percentage of sales (adjusted EBITDA margin) .....	12.8%	14.1%

Operating income decreased both in absolute terms and as a percentage of sales. Adjusted EBITDA increased in absolute terms but decreased as a percentage of sales. Gross profit was higher in absolute terms, benefiting from higher capacity utilization levels in addition to favorable acquisition and volume mix gains that compensated for sales price reductions and higher costs for raw materials. Gross margins overall however decreased as a percentage of sales due to relatively higher variable to total cost ratio of Raisio Chemicals' sales. Selling, general and administrative costs were much higher in both Swiss francs and in local currencies,

chiefly due to acquisition effects, leading to a further reduction in net margins. Investments in research and development remained at the prior year level of approximately 2 percent of sales.

<u>Asset management</u>	<u>2004</u>	<u>2003</u>
Net current operating assets:		
Absolute in CHF . . . . .	458	346
As a percentage of sales . . . . .	23%	21%
Capital expenditures in CHF . . . . .	81	55
Invested capital in CHF . . . . .	3 164	2 411
Total assets in CHF . . . . .	3 508	2 640

The Segment's operating assets were higher than prior year levels both in absolute and intensity terms. Both inventories and receivables increased in both absolute and intensity terms. The increase in intensities was mostly due to acquisition effects that did not include a full year's sales. Payables were higher than in prior year. Capital expenditures increased from prior year but were well below depreciation expense and were again targeted primarily on productivity improvement projects. These factors led to an overall increase in both invested capital and total assets.

### *Textile Effects results*

Sales decreased to CHF 1 300 million in 2004 or by 7 percent in Swiss francs and by 5 percent in local currencies. Sales development in 2004 compared to 2003 resulted from the following factors:

<u>Sales development</u>	<u>2004 compared to 2003</u>
Volume/product mix . . . . .	(2)%
Price . . . . .	(3)%
Currency . . . . .	(2)%
<b>Total in Swiss francs</b> . . . . .	<u>(7)%</u>

The textiles market remained difficult in 2004 and continues to present the Segment with many challenges. Textile dyes sales were lower both in local currencies and in Swiss francs, characterized by heavy competitive pressures and slow core markets. Sales in textile chemicals were stable in local currencies, where most key markets held up reasonably well, notably sizing and pretreatments.

Geographically, sales in **Europe** decreased from prior year levels both in Swiss francs and in local currencies. All major sales territories suffered sales declines in local currencies, particularly in the second half of the year, with the exception of Turkey where sales increased both in local currencies and in Swiss francs. In the **Americas**, sales declined in Swiss francs and in local currencies across all regions. In the **Asia Pacific** region, sales remained stable in local currencies but were lower in Swiss francs. A strong result in both China and in India in local currencies and to a lesser extent in Swiss francs helped to offset sales declines across the remainder of the region.

<u>Operating income and adjusted EBITDA</u>	<u>2004</u>	<u>2003</u>
<b>Operating income:</b>		
Absolute in CHF . . . . .	61	68
As a percentage of sales (operating income margin) . . . . .	4.7%	4.9%
<b>Adjusted EBITDA:</b>		
Absolute in CHF . . . . .	117	128
As a percentage of sales (adjusted EBITDA margin) . . . . .	9.0%	9.2%

Operating income and adjusted EBITDA decreased in both absolute terms and as a percentage of sales, mainly due to the difficult sales environment. The Segment again managed to partially mitigate this effect

through further cost reductions in the production area combined with lower raw material costs. Selling, general and administrative costs were also lower in Swiss francs and in local currencies compared to the prior year. Investment in research and development remained stable at approximately 2 percent of sales.

<u>Asset management</u>	<u>2004</u>	<u>2003</u>
Net current operating assets:		
Absolute in CHF . . . . .	393	439
As a percentage of sales . . . . .	30%	31%
Capital expenditures in CHF . . . . .	35	29
Invested capital in CHF . . . . .	1 158	1 111
Total assets in CHF . . . . .	1 361	1 300

The Segment managed to reduce net operating assets below prior year levels. Both receivables and inventory levels decreased in absolute terms and were stable in intensity terms compared to prior year. Payable levels were higher than last year. Capital expenditures increased slightly from last year, but remain well below depreciation expense for the period. Both invested capital and total assets increased slightly.

***Treasury management***

The international financial markets remained volatile in 2004. The major trends in the markets, which were the focus of the Company's treasury management initiatives, included movements in interest rates as well as the continued weakening of the U.S. dollar against the Swiss franc, and the further strengthening of the euro against the U.S. dollar.

As a consequence of the improving economic recovery especially in the U.S. and receding political instability in 2004, global interest rates started to rise during 2004. Through the effective anticipation of market conditions and the use of financial instruments available in the financial markets, the Company was able to keep the average cost of its total borrowings almost constant at 4.03 percent in 2004 compared to 3.84 percent in 2003. The Company's net interest cost, which is interest expense less interest income, was stable at CHF 108 million in 2004 as for 2003.

During 2004, the U.S. dollar fluctuated against the Swiss franc from a high of approximately CHF 1.32 to a low of approximately CHF 1.13. The Swiss franc balance sheet year-end rate was at CHF 1.15 against the U.S. dollar in 2004 versus CHF 1.25 at the end of 2003. During 2004, the euro fluctuated against the Swiss franc from a high of approximately CHF 1.59 to a low of approximately CHF 1.50. At the end of 2004, the Swiss franc was at a level of CHF 1.54 against the euro versus CHF 1.56 at the end of 2003.

In 2004, other financial expense, net which includes foreign currency exchange gains and losses, net hedging expenses, and losses on financial investments, was CHF 39 million, an increase of CHF 15 million from CHF 24 million in 2003. The increase in 2004 is mainly due to the fact that in 2003, the Company sold its remaining shares in Hexcel Corporation realizing a CHF 16 million gain. Otherwise, other financial expenses, net were relatively stable between the two periods.

### *Cash flows*

The net decrease in cash and cash equivalents of CHF 772 million from December 31, 2003 to December 31, 2004 resulted from cash flows provided by or used in the Company's operating, investing and financing activities.

<u>Cash flows from operating activities</u>	<u>2004</u>	<u>2003</u>
Net income . . . . .	306	329
Deduct net income from discontinued operators, net of tax . . . . .	(28)	0
Depreciation and amortization . . . . .	394	366
Net change in operating assets and liabilities . . . . .	(226)	302
Other, net . . . . .	<u>185</u>	<u>36</u>
<b>Net cash provided by operating activities . . . . .</b>	<b><u>631</u></b>	<b><u>1 033</u></b>

Cash flows provided by operating activities of CHF 631 million did not reach the same high levels of recent years, which was partially due to higher working capital requirements necessary to fund higher sales volumes. Also in 2004, the Company had higher cash payments for interest, taxes and pensions that together resulted in an adverse development of CHF 144 million compared to the prior year. Together, these factors contributed to the decline in operating cash flows.

The Company continues to prioritize cash flow generation and is satisfied that operating cash flow levels are sufficient to satisfy both short-term and mid-term funding requirements.

<u>Cash flows from investing activities</u>	<u>2004</u>	<u>2003</u>
Capital expenditures . . . . .	(294)	(233)
Sale (acquisition) of businesses, net of cash . . . . .	(810)	(71)
Proceeds from sale of assets and changes in loans and other long- term assets . . . . .	53	65
Cash flows used in investing activities, discontinued operations . . . . .	<u>0</u>	<u>0</u>
<b>Net cash used in investing activities . . . . .</b>	<b><u>(1 051)</u></b>	<b><u>(239)</u></b>

Net cash used in acquisition and divestment activities in 2004 consisted primarily of the cash used for the acquisition of Raisio Chemicals, of CHF 662 million. In addition, the Company completed a number of other minor acquisitions during 2004 for an aggregate consideration of CHF 91 million. Also included in cash flows from investing activities in 2004 was the receipt of a long-term note receivable of CHF 42 million in connection with the sale in 2000 of the Company's investment in Hexcel Corporation.

Net cash used in acquisition and divestment activities in 2003 consisted primarily of a CHF 71 million payment for separation costs attributable to the past divestment of the Performance Polymers business. Also included is an aggregate CHF 23 million for the acquisition of additional interests in two equity affiliates in Asia, where the Company is experiencing significant sales growth. These cash outflows were partially offset by proceeds of CHF 21 million from the sale of the Company's remaining Hexcel shares.

<u>Cash flows from financing activities</u>	<u>2004</u>	<u>2003</u>
Increase (decrease) in short-term and long-term debt, net . . . . .	55	(394)
Dividends paid . . . . .	0	0
Capital reduction paid . . . . .	(197)	(206)
Treasury stock transactions and other . . . . .	<u>(162)</u>	<u>(142)</u>
<b>Net cash used in financing activities . . . . .</b>	<b><u>(304)</u></b>	<b><u>(742)</u></b>

For information regarding short-term and long-term debt, see Notes 12 and 13 to consolidated financial statements in Item 18 — Financial Statements.

At the Company's Annual General Meeting on February 26, 2004, the shareholders approved the Board of Directors' proposal for a payment to the shareholders in the form of a capital reduction of CHF 3 per share. The capital reduction was in the form of a reduction in the nominal value of each common share from CHF 6 per share to CHF 3 per share. The Company paid the capital reduction on May 14, 2004, which totaled CHF 197 million.

At the Company's Annual General Meeting on March 6, 2003, the shareholders approved the Board of Directors' proposal for a payment to the shareholders in the form of a capital reduction of CHF 3 per share. The capital reduction was in the form of a reduction in the nominal value of each common share from CHF 9 per share to CHF 6 per share. The Company paid the capital reduction on May 23, 2003, which totaled CHF 206 million.

In connection with its share buy-back program initiated in 2004, the Company purchased 1.8 million treasury shares in 2004 for CHF 162 million. In 2003 in connection with the share buy-back program, the Company purchased 1.3 million treasury shares for CHF 118 million. The shareholders approved the cancellation of these shares at the Company's Annual General Meeting on February 26, 2004; consequently, the shares were cancelled on May 7, 2004. For further details, refer to Note 16 to consolidated financial statements in Item 18 — Financial Statements.

<u>Free cash flow</u>	<u>2004</u>	<u>2003</u>
Net cash provided by operating activities .....	631	1 033
Less: net cash used in investing activities .....	(1 051)	(239)
Add: (sale) acquisition of businesses, net of cash .....	810	71
Less: dividends <sup>(1)</sup> .....	<u>(131)</u>	<u>(137)</u>
<b>Free cash flow</b> .....	<u>259</u>	<u>728</u>

<sup>(1)</sup> The Company considers CHF 2 per share to be the normal annual per share dividend amount expected by its shareholders. As a result, this amount is used in the Company's calculation of free cash flow. Actual per share dividends or other distributions to shareholders may differ from this per share amount (see the Operational Review section of this Management's Discussion and Analysis above).

The Company historically has utilized free cash flow to maintain short-term debt at stable levels, to repay long-term debt according to payment terms or earlier when economically advantageous to the Company, for acquisitions of businesses or treasury shares, and to pay distributions to shareholders.

Free cash flow was lower by CHF 469 million in 2004 compared to prior year. This was mainly due to lower cash from operating activities in 2004, as the Company's investment in working capital increased due to sales growth.

### **Effective income tax rate**

The Company reported an effective income tax rate of 24 percent in 2004, an increase of 5 percent compared to 19 percent reported in 2003. The 2004 rate is reduced by 4 percent due to a non-recurring release of previously established tax reserves following the settlement during 2004 of certain outstanding tax matters. The 2003 effective income tax rate of 19 percent had been reduced by 10 percent from different non-recurring releases of previously established tax reserves, consisting principally of 9 percent resulting from the settlement in 2003 of a dispute with Novartis. See Note 14 to consolidated financial statements in Item 18 — Financial Statements.

### **Change in accounting policy and new accounting standards**

There were no new accounting standards issued by the Financial Accounting Standards Board (FASB) or other authoritative standard setters that became effective during 2005 and that had a material effect on the Company's financial statements. In addition, several other new accounting standards were issued

by the FASB as of December 31, 2005 that were not required to be adopted during 2005, but will require adoption in 2006 or later. None of these issued but not yet adopted new accounting standards is expected to have a material effect on the Company's results of operations or financial position when adopted in the future. See note 1 to consolidated financial statements in Item 18 — Financial Statements.

### **Environmental matters**

Operating in the chemical industry, the Company is subject to stringent environmental, health and safety laws and regulations. It is the Company's policy to continuously develop and improve the environmental performance of key manufacturing processes through an active program. In addition to process improvements, the Company uses advanced waste treatment and disposal facilities at all major manufacturing sites that allow the sites to comply with recent laws and regulations applicable to waste streams. Management believes that the Company substantially complies with all such laws. For further information, see note 21 to consolidated financial statements in Item 18 — Financial Statements and Item 4. — Information on the Company — Property, Plant and Equipment; Manufacturing Environmental Matters.

### **Use of certain supplementary financial indicators**

The key financial indicators used by the Company's management to monitor overall performance and liquidity, as well as to provide incentives for employees to produce high-quality results with a goal of enhancing shareholder value include certain non-U.S. GAAP financial measures. Such non-U.S. GAAP financial measures are derived from financial measures prepared in accordance with U.S. GAAP and include adjusted EBITDA, free cash flow and net debt. The way these non-U.S. GAAP financial measures are derived, as well as definitions of other financial terms used in this Management's Discussion and Analysis, is shown in the Glossary of Financial Terms.

The Company uses adjusted EBITDA margin (adjusted EBITDA divided by net sales) and free cash flow as two of the three components of its annual incentive compensation program. The third component of the program is net sales growth. Under the Company's annual incentive compensation program, employees receive annual payments if target net sales growth, adjusted EBITDA margin or free cash flow levels are achieved. The combination of these three indicators focuses management and employees on the profitable (adjusted EBITDA margin) growth (sales growth) of the Company without the utilization of unnecessary capital (free cash flow). In addition, the Company uses net debt as an indicator of the strength of its capital structure, as well as certain currency adjusted figures that permit it to evaluate its performance from period to period without such comparisons being impacted by the effects of currency exchange rate movements during these periods. For the same reasons, management believes investors may find the non-U.S. GAAP measures useful.

As with any supplementary financial indicator, these supplementary financial indicators should be considered in addition to, not as a substitute for, operating income, net income, cash flows from operating, investing and financing activities, total assets, total debt, operating income margin and other measures of financial performance and liquidity reported in accordance with U.S. GAAP.

### ***Adjusted EBITDA***

Adjusted EBITDA, and adjusted EBITDA margin derived therefrom, provide management with additional quantitative measures of the quality of sales growth as well as the results of past and current actions taken to manage costs.

More importantly, the Company operates in a multinational environment and competes with companies in different countries. In some of these countries, very significant differences in accounting have existed with regard to depreciation as some companies with which the Company competes have calculated and reported their depreciation expense based on tax considerations. As a result, it historically has been very difficult to meaningfully compare operating income data of such competitors in other countries with that of the Company. In order to adequately evaluate the Company's performance in the markets as well as to compare and benchmark performance with that of the Company's competitors, adjusted EBITDA was determined to be a

key performance measure because it eliminates the above-described major differences. For these reasons, management believes adjusted EBITDA also provides useful information to investors.

The material limitations associated with using adjusted EBITDA as a performance measure as compared to net income are that adjusted EBITDA:

- does not include interest expense which, because the Company has borrowed money in order to finance its operations, is a necessary element of costs and ability to generate revenue. Therefore, any measure that excludes interest expense has material limitations. Management believes it compensates for this limitation by including net income, which includes interest expense, as another of its key financial indicators,
- does not include depreciation and amortization expense which, because the Company uses capital assets is a necessary element of costs and ability to generate revenue. Therefore, any measure that excludes depreciation and amortization expense has material limitations. Management believes it compensates for this limitation by including net income, which includes depreciation and amortization expense, as another of its key financial indicators,
- does not include taxes, the payment of which is a necessary element of the Company's operations. Therefore, any measure that excludes tax expense has material limitations. Management believes it compensates for this limitation by including net income, which includes tax expense, as another of its key financial indicators, and
- provides a measure of the Company's current performance without consideration of the amount of capital that has been historically invested in order to produce the Company's results. Management believes it compensates for this limitation by including free cash flow as another of its key financial indicators, as discussed above.

The reconciliation of adjusted EBITDA to net income is below.

<u>Year ended December 31,</u>	<u>2005</u>	<u>2004</u>
Adjusted EBITDA . . . . .	297	915
Depreciation and amortization . . . . .	<u>(421)</u>	<u>(394)</u>
Operating income (loss) . . . . .	(124)	521
Financial income and expense, net . . . . .	(137)	(147)
Provision for income taxes . . . . .	(18)	(92)
Minority interest . . . . .	(7)	(4)
Income from discontinued operations, net of tax . . . . .	<u>30</u>	<u>28</u>
Net income (loss) . . . . .	<u>(256)</u>	<u>306</u>

In financial statements published prior to June 30, 2005, the Company referred to adjusted EBITDA as EBITDA.

As a result of the continued harmonization of different global financial reporting practices with U.S. GAAP, the Company will in 2006 discontinue using adjusted EBITDA as one of its key performance measures and instead will focus on operating income.

***Free cash flow***

Free cash flow as defined by the Company provides the amount of net cash flow produced that is available for required or discretionary debt principle payments, reinvestment in the Company's businesses, or distributions to shareholders and, as such, is limited to being used for this consideration only. Free cash flow should not be used to measure the residual cash flow that may be available for discretionary expenditures because of mandatory debt service requirements and other non-discretionary expenditures that are not deducted from the measure.

The reconciliation of free cash flow to net cash provided by operating activities is included in the Liquidity and Capital Resources section of this Management's Discussion and Analysis.

***Net debt***

The reconciliation of net debt to the Company's total debt is included in the Liquidity and Capital Resources section of this Management's Discussion and Analysis.

***Invested capital***

The reconciliation of invested capital to total shareholders' equity is included in the Business Segment Data section of the consolidated financial statements in Item 18 — Financial Statements.

***Currency exchange rates***

Amounts "in local currencies" or "currency adjusted" are determined by adjusting current period amounts reported in Swiss francs, which is the Company's reporting currency under U.S. GAAP, using prior period exchange rates to remove the effects of fluctuations in foreign currency rates against the Swiss franc that occurred from the prior period to the current period. The exchange rates of principle currencies to the Swiss franc, which form the basis of the Company's disclosures of currency adjusted figures, are presented in note 2 to consolidated financial statements in Item 18 — Financial Statements.

## Glossary of financial terms

**Adjusted EBITDA** is calculated as operating income plus depreciation and amortization, and is reconciled to net income in the Financial Review section of Management's Discussion and Analysis.

**Adjusted EBITDA Margin** is adjusted EBITDA expressed as a percentage of net sales.

**Basic Earnings per Share** is defined as net income divided by the weighted average number of common shares outstanding during the reporting period.

**Cash Flows from Operating Activities** is the net cash provided from the principal revenue-producing activities of the business. It excludes financing and investing activities.

**Cash Flow Hedges** are hedges of the exposure to variability in expected future cash flows that is attributable to a particular risk associated with a recognized asset or liability or a forecasted transaction.

**Commercial Paper** are short-term borrowings in the capital markets that are typically due within 30 to 270 days from the date of issuance and are issued by companies with good credit ratings.

**Comprehensive Income** is the change in equity of the Company during the year from transactions and other events, other than dividends paid, treasury stock and common stock transactions. It includes (i) net income for the year; (ii) the current year's currency translation adjustment; (iii) the current year's unrealized gains and losses on available-for-sale securities, net of tax; (iv) the changes in the effective portion of derivative financial instruments' fair value, net of tax, that qualify and that are designated as cash flow hedges and (v) the change in the minimum pension liability, less the corresponding intangible asset, net of tax.

**Convertible Bonds** are debt instruments that may be converted into shares based on predefined conditions as stipulated in the debt agreement.

**Defined Benefit Pension Plan** is a pension plan that provides employees at their date of retirement, a predefined payment. The payment is, depending on the benefit plan, a function of one or more factors such as age, years of service or compensation level of the employee.

**Defined Contribution Pension Plan** is a pension plan that provides employees, at the date of their retirement, benefits based on the amount of capital paid-in by the participant or the Company, plus returns earned on the investment of those contributions.

**Derivatives, Derivative Financial Instruments** are financial contracts or agreements, the value of which is linked to current or future interest rates, exchange rates, prices of securities, or financial or commodity indices. Derivative financial instruments used by the Company include forward exchange contracts, options and interest and currency swaps. The Company uses these instruments to reduce its exposure to adverse fluctuations in interest and exchange rates and other market risks.

**Diluted Earnings per Share** is similar to basic earnings per share (net income divided by the weighted average number of common shares outstanding) except that it reflects the potential dilution that could occur if dilutive securities, such as stock options and convertible debt, were exercised or converted into common shares or resulted in the issuance of common shares that then shared in the earnings of the Company. Antidilutive effects are not considered.

**Equity per Share** is calculated by dividing total shareholders' equity by the number of outstanding common shares (total common shares issued less treasury shares) at the balance sheet date.

**Fair Value Hedges** are hedges of the exposure to changes in the fair value of a recognized asset or liability, or an identified portion of such asset or liability, (the hedged item) that is attributable to a particular risk.

**Free Cash Flow** is cash flows from operating activities from continuing operations less net cash from investing activities before sale (acquisition) of businesses, net of cash.

**Goodwill** is recognized in an acquisition of a business if the amount of the consideration paid by the Company is in excess of the fair value of the acquired entity's tangible and identifiable intangible net assets.

**Gross Profit Margin** is gross profit expressed as a percentage of net sales.

A **Hedge** is an economic relationship between a hedged item and a derivative financial instrument whereby losses or gains are expected to offset each other in whole or in part.

A **Hedged Item** is specifically identified as either all or a specific portion of a recognized asset, a liability, a forecasted transaction or of an unrecognized firm commitment.

**Hedge Effectiveness** is the portion of the derivative financial instrument's change in fair value that offsets the change in the fair value or cash flows of the hedged item.

**Hedge Ineffectiveness** is the amount by which the derivative financial instrument's change in fair value does not equal the change in fair value or cash flows of the hedged item.

**Intensity** is an amount expressed as a percentage of net sales. Intensity of inventories is equal to the inventories divided by net sales. Intensities of accounts receivables and accounts payable are calculated correspondingly.

**Invested Capital** is calculated as total assets less non-interest bearing current liabilities (i.e. accounts payable, income taxes payable, accruals and other current liabilities, except the current portion of deferred tax liabilities) and less deferred tax assets.

**Net Cash Provided by Operating Activities** has the same meaning as Cash Flows from Operating Activities.

**Net Current Operating Assets** is the sum of inventories and accounts receivable less accounts payable.

**Net Debt** is the sum of short-term debt and long-term debt less cash and cash equivalents and short-term investments.

**Net Sales Development** percentage is the change in the current period's net sales in Swiss francs over the previous period's sales in Swiss francs expressed as a percentage.

**Net Sales Development percentage, in local currencies** is the change in the current period's net sales in local currencies over the previous period's net sales in local currencies expressed as a percentage.

**Operating Income Margin** is operating income expressed as a percentage of net sales

**Other Intangible Assets** are assets (excluding financial assets) that lack physical substance, not including goodwill. They may include, but are not limited to, such assets as trademarks; trade names; patented and unpatented developed technology and know how; trade secrets, including processes and formulations; certain agreements such as licensing, royalty, not-to-compete, supply contracts, and operating permits; and customer relationships, lists, and contracts.

## **Item 6. Directors, Senior Management and Employees**

### **Corporate Governance**

*Numbers in square brackets refer to the Directive on Information Relating to Corporate Governance ("DCG") of the SWX Swiss Exchange. An overview of major differences between the Swiss and the U.S. corporate governance practices can be found at: <http://www.cibasc.com/investors>*

### **The Board of Directors and its Committees**

The Board of Directors of Ciba Specialty Chemicals ("Board") defines the strategic direction and supervises the overall affairs of the Company. The Board also reviews the Company's key plans and objectives, identifies external risks and opportunities and initiates required activities. The Executive Committee consists of the Chairman's Committee under the leadership of the CEO and the Operations Committee, chaired by the Chief Operating Officer ("COO"). The Chairman's Committee is responsible for the implementation of the strategies and the Operations Committee for the day-to-day management of the Company [DCG 3.6].

The Members of the Board are elected by the General Meeting of Shareholders for a term of between one and four years to allow for a staggered board [DCG 3.4.1]; a re-election is possible [DCG 3.4.1]. For an overview of the individual election terms, see the table on the next page [DCG 3.4.2]. A Board Member may tender his or her resignation during the term of his or her office. The Shareholders' Meeting may vote to remove a Board Member.

The Board continues to commit itself to maintaining the highest standards of integrity and transparency in its governance of the Company. The Board and Board Committee charters reflect recent developments in corporate governance principles including the Swiss Code of Best Practice and the Sarbanes-Oxley Act of 2002. The Board believes that it is in compliance with well recognized corporate governance standards, in particular with regard to:

- a Lead Director (to counterbalance the combined mandates of Chairman and CEO) who chairs meetings of the Board which only the non-executive members of the Board are attending. He also leads the non-executive members of the Board in all matters that require a separate discussion and decision making process. In addition, the Lead Director chairs the Compensation Committee. Based on interviews with other Board members, he prepares a review of the performance of the Chairman and CEO. He may act as a liaison between the Board and the Chairman and CEO in delicate matters
- broad supervisory and reviewing powers for the Board, directly supported by Internal Audit
- independence of Board Members who are all non-executives of the Company, with the exception of the Chairman
- independence of Board Committee Members who are equally all non-executives, with one exception being the Chairman serving on the Human Resources and Nomination and the Finance Committees
- having Audit Committee Members who are all non-executives with significant expertise particularly in the area of finance
- having Compensation Committee Members who are all non-executives with broad practical experience in the area of employee and executive compensation
- an annual self-assessment of the Board
- receiving and providing continuous and comprehensive information including periodic and yearly reports prepared by management on finances, strategies, research and development, production planning and risk management [DCG 3.7].

### **Topics of the Board in 2005**

Apart from the ongoing overall supervision of the Company's affairs, corporate governance and the preparation of the annual accounts and the Annual General Meeting ("AGM") of the Shareholders, the Board put particular emphasis for the financial year 2005 on the following topics: group business strategy, M&A, repositioning of segments, investments in Asia, developments in China, improvements in the chemical technologies, legislation in the area of registration and authorization of chemicals (REACH), structure of the Executive Committee.

### **Board Committees [DCG 3.5]**

Four standing Board Committees in the areas of audit, finance, compensation and human resources/nomination provide guidance and support to the full Board:

#### ***Audit Committee***

*Mission:* Evaluates the independence, objectivity and effectiveness of external and internal auditors, approves and pre-approves auditing and other services to be provided by the external auditors, evaluates business risk assessment, scope and overall audit plan, assesses the quality of financial accounting and reporting, reviews audit results and monitors compliance with specific laws and regulations governing the

preparation and filing of financial statements. In addition, the Audit Committee proposes the nomination of the external auditors to the full Board. The Audit Committee reviews complaints regarding accounting, internal accounting controls or auditing matters. To facilitate the submission of such complaints, the Company has set up webpages both in its intranet (under: “Corporate Governance”) and on its internet site (<http://www.cibasc.com/> — About Us — Corporate Governance). The Board has determined that the chairman of the Audit Committee, Erwin W. Heri, is the Audit Committee’s financial expert as per the requirements of Item 16A of Form 20-F filed with the U.S. Securities and Exchange Commission (“SEC”).

#### ***Finance Committee***

*Mission:* Develops principles for financial planning, accounting and reporting, disclosure and control, reviews concepts of financial objectives to optimize shareholder value, develops finance policy, is regularly briefed on application/implementation of principles of finance policy, approves financial transactions, investments and acquisitions and supports the preservation and enhancement of the Company’s reputation in the financial markets.

#### ***Compensation Committee***

*Mission:* Develops, recommends and reviews the group compensation principles in accordance with the overall Company objectives. Proposes compensation of the Members of the Board and of the Executive Committee to the full Board for approval [DCG 5.1]. The Lead Director is the chairman of the Compensation Committee.

#### ***Human Resources and Nomination Committee***

*Mission:* Develops the principles for the selection of candidates for election or re-election to the Board by the AGM and prepares a selection of candidates in accordance with these criteria. In addition, the Human Resources and Nomination Committee recommends and reviews the objectives and principles of the human resource policy and its implementation. The Chairman of the Board is the chairman of the Human Resources and Nomination Committee.

## Members of the Board [DCG 3, 3.1, 3.2, 3.4.2]

<u>Name</u>	<u>Date of birth</u>	<u>Nationality</u>	<u>Year appointed to board</u>	<u>Year term expires</u>	<u>Significant positions and political mandates outside the Company [DCG 3.2.a/b/c]</u>
Armin Meyer <i>Chairman and CEO</i>	July 25, 1949	Swiss	1997	2008	Member of the Board of Directors, Zurich Financial Services, Zurich Member of the Board, CEFIC (European Chemical Industry Council), Brussels Member of the Foundation Board IMD — International Institute for Management Development, Lausanne
Kurt Feller <i>Vice-Chairman, Lead Director</i>	August 31, 1937	Swiss	1999	2007	Chairman of the Board of Directors, Rieter Holding Ltd., Winterthur Vice-Chairman of the Board of Directors, Geberit Ltd., Jona Member of the Board of Directors, Scintilla Ltd., Solothurn
Erwin W. Heri	March 6, 1954	Swiss	1997	2007	Chairman of the Board of Directors, OZ Bankers AG, Pfäffikon Chairman of the Board of Directors, OZ Holding AG, Pfäffikon Member of the Board of Directors, Losinger AG, Berne Member of the Board of Directors, Hilti AG, Schaan/Liechtenstein, Trustee, Hilti Family Trust, Schaan, Liechtenstein, Chairman of the Investment Committee of State Pension (Publica), Berne
Gertrud Höhler	January 10, 1941	German	1997	2008	Management Consultant Member of the Board of Directors, Bâloise-Holding, Basel Member of the Board of Directors, Georg Fischer Ltd., Schaffhausen
Jean-Marie Pierre Lehn	September 30, 1939	French	1997	2006(i)	Professor of Chemistry, Nobel Prize Winner Member of the Scientific Board of the Novartis Venture Fund, Basel
Peter Littmann	December 21, 1947	German	1997	2006(i)	Member of the Advisory Board, Nijenrode University, The Netherlands Member of the Harvard University Art Museum's Visiting Committee, Cambridge, Massachusetts
Uli Sigg	April 29, 1946	Swiss	1999	2007	Vice-Chairman of the Board of Directors, Ringier Group Member of the Advisory Board of China Development Bank, Beijing
Thomas Koch <i>Secretary (not member of the Board)</i>	November 21, 1954	German	2004	—	None

## The Chairman of the Board and CEO [DCG 3.5.1]

The Chairman of the Board is elected by the Board from its Members. As such, Armin Meyer is responsible for the invitation to and the agenda of the Board meetings. He is responsible for the implementation of the Group strategy as defined by the Board, for optimizing shareholder value and for safeguarding the

interests of other stakeholders. He represents the overall interests of the Company, ensures close cooperation between the Board and the Executive Committee and supervises the implementation of the resolutions adopted by the Board.

The Company has opted to combine the functions of Chairman and CEO. In the Board’s view the advantages of having fast decision making processes as well as the timely, complete and accurate information flow between the Board and the management of the Company, complemented by a strong Lead Director outweigh the potential risk the combination of the functions may have.

The CEO is appointed by the Board. In this function, Armin Meyer is responsible for the strategic management and the overall financial results of the Group. He chairs the meetings of the Chairman’s Committee and ensures the information flow inside and outside the Company. For more details, see “The Executive Committee” below.

**The Vice-Chairman and Lead Director [DCG 3.5.1]**

As Vice-Chairman, Kurt Feller represents the Chairman in the latter’s absence. As Lead Director, Kurt Feller’s primary function is to provide for effective checks and balances in the governance of the Company. He may convene and chair meetings without the Chairman being present. In addition he is, together with the Compensation Committee, responsible for the performance review of the Chairman and CEO and may act as a liaison between the Board and the Chairman in delicate matters.

**Additional Information**

With the exception of Armin Meyer, who is also CEO of Ciba Specialty Chemicals, all other Board Members are both non-executive directors and independent from the Company [DCG 3.1.b]. The term “independent” satisfies the criteria of the Swiss Code of Best Practice and of Section 303(A)(6) of the New York Stock Exchange (“NYSE”) Listed Company Manual, as approved by the SEC on November 4, 2003. None of the non-executive Members of the Board has ever been a member of the management of the Company or any of its subsidiaries and none of them has or had a substantial business relationship with the Company or any of its subsidiaries in the last four financial years [DCG 3.1.c].

More biographical details of the Board Members are available at the Company’s website (<http://www.cibasc.com/bod-cv>) [DCG 3.1.a].

There is no cross-involvement among the Board Members and the boards of directors of other listed Swiss companies [DCG 3.3]. Other than as disclosed under “Change of Control Provisions” hereunder, there is no service contract between any Member of the Board and the Company providing for benefits upon termination of employment.

**Board Committee Memberships [DCG 3.5.2]**

<u>Name</u>	<u>Audit Committee</u>	<u>Finance Committee</u>	<u>Human Resources and Nomination Committee</u>	<u>Compensation Committee</u>
A. Meyer .....		▲	▲	
K. Feller .....	●	●	●	▲
E.W. Heri .....	▲	●		
G. Höhler .....			●	●
J.-M. P. Lehn.....				
P. Littmann .....			●	●
U. Sigg .....	●			

- ▲ = Chairman
- = Member

The Board Committees generally meet six times per year, usually immediately before the full Board meets. The duration of such meetings generally is between two and four hours. The full Board usually meets eight times per year. Normally, the duration of these meetings ranges between four and eight hours [DCG 3.5.3].

The Company's "Rules Governing the Organization" and Committee charters set out in detail the powers and responsibilities of the Board and its Committees. In order for the Board or any of its Committees to pass resolutions, at least half of their Members must be personally present, which may be deemed satisfied if simultaneous communication is ensured, such as by telephone or video conference.

#### **The Executive Committee [DCG 4, 4.1, 4.2]**

Effective October 1, 2005, the Board of Directors decided to adapt the structure of the Executive Committee to the changing needs of the Company to strengthen its strategic and operational leadership. A new position of Chief Operating Officer, responsible for the operational management of the businesses was introduced. Brendan Cummins, then Head of the Plastic Additives segment was appointed to this position. The Company is now led by the Executive Committee with two dedicated teams — the Chairman's Committee, focusing on strategic development, consisting of the Chairman and CEO, the COO, the Chief Financial Officer ("CFO") and the Chief Technology Officer ("CTO") and the Operations Committee, focusing on the operational management of the business, consisting of the COO, the CFO and the Segment Heads.

<u>Name</u>	<u>Date of birth</u>	<u>Nationality</u>	<u>Function</u>	<u>Significant positions and political mandates outside the company [DCG 4.2.a/b/c]</u>
Armin Meyer	July 25, 1949	Swiss	Chief Executive Officer (CEO)	Member of the Board of Directors, Zurich Financial Services, Zurich Member of the Board of CEFIC (European Chemical Industry Council), Brussels Member of the Foundation Board IMD — International Institute for Management Development, Lausanne
Brendan Cummins	May 18, 1951	Irish	Chief Operating Officer (COO)	None
Michael Jacobi	January 30, 1953	German	Chief Financial Officer (CFO)	Member of the Board of Phonak Holding AG, Stäfa
Martin Riediker	June 28, 1952	Swiss	Chief Technology Officer (CTO)	Member of the Board, American Chemistry Council, Arlington Member of the Board, CIIT Centers for Health Research Member of the Advisory Board, Xintec inc, Research Triangle Park, North Carolina
Hermann Angerer	December 23, 1947	Swiss	Head Segment Coating Effects	None
Eric Marohn	June 3, 1959	American	Head Segment Textile Effects	None
Mark Garrett	May 11, 1962	Australian and Swiss	Head Segment Water & Paper Treatment	Member of the Board of TEGEWA Industry Association, Frankfurt am Main
Giordano Righini	December 3, 1949	Italian	Head Segment Plastic Additives	None

*Armin Meyer* became Chairman of the Board of Ciba Specialty Chemicals in autumn 2000. Starting January 1, 2001, he in addition took over as Chief Executive Officer. He streamlined the Company structure and shifted priority targets to innovation and highly qualified people. He has been a Member of the Board of the Company since its spin-off in 1997.

Previously, Armin Meyer was Head of the global Building Technologies Segment of ABB Ltd. As of 1995, he was a member of the Executive Committee of ABB, a global technology Group.

Armin Meyer started his career in 1976 when he joined the former Brown Boveri Ltd. (BBC) as development engineer. In 1980 he became Head of Research and Development for industrial motors and took over as Head of the international business unit for electrical power generators in 1984. Further steps included the presidency of ABB Drives Ltd. as well as of ABB Power Generation Ltd. In 1995, he became Head of the Power Generation Segment. In 1998, he took over as Head of the Building Technologies Segment.

Armin Meyer, born 1949 in Zurich, Switzerland, holds a Ph.D. in electrical engineering from the Swiss Federal Institute of Technology (ETH) in Zurich.

In addition to his responsibilities at ABB, Armin Meyer was also Professor for Electrical Engineering and Drives at ETH, Zurich for twelve years.

**Brendan Cummins** became Chief Operating Officer on October 1, 2005. Brendan Cummins joined Ciba-Geigy in Ireland in 1971 as an Accountancy Student. In 1974, he assumed the position of Planning and Information Manager in Ireland. In 1979, he moved to Ciba-Geigy Singapore as Treasury Head and, in 1981, was appointed Head of Finance and Administration South East Asia. In 1984, he transferred to Hong Kong as Head of Finance and HR North Asia with project responsibility for China. In 1990, he moved to the Philippines as Head of Pharmaceutical Division and later was appointed, in combination, Group Company Head. In 1994, he transferred to the U.K. as Head of Finance and HR of Ciba-Geigy Horsham. In 1995, he returned to the Far East as Group Company Head China and, in 1997, assumed the position of Regional President Greater China for Ciba Specialty Chemicals. In 1999, he moved to Basel and was appointed Global Head of Whiteners and, in 2000, he established and headed the Global Business Unit Home & Personal Care. In 2001, he worked for Irish Fertilizer Industries as Managing Director. In December 2001, he joined Ciba Specialty Chemicals as a Member of the Executive Committee. From 2001 to 2004, he was Executive Vice-President, International Coordination and Human Resources. He was Head of the Plastic Additives Segment from April 2004 until October 2005. He has a degree in accounting and is a Fellow of The Association of International Accountants.

**Michael Jacobi** joined Ciba-Geigy's finance area in 1978. In 1980, Michael Jacobi moved to Brazil as Corporate Controller and later was appointed Treasurer. In 1986, he moved to the United States where he led the financial department at the Toms River plant in New Jersey. After further management training at Harvard, he returned to the Finance department in Basel, Switzerland in 1987 as Head of Management Accounting. He became Group Controller of Ciba-Geigy in 1990, and was responsible for the Company's overall corporate financial accounting and reporting. In 1997, he was appointed Chief Financial Officer for Ciba Specialty Chemicals, and is responsible for Treasury, Mergers and Acquisitions, Investor Relations and Control. He has a Doctorate in Economics from the University of St. Gallen.

**Martin Riediker** was appointed Chief Technology Officer in 2001. Martin Riediker joined Ciba-Geigy in 1982 as a photochemist in central research at Ciba-Geigy in Basel. In 1988, he moved to the United States as Vice President, Research and Development (R&D) for the Polymers Division and was later appointed Vice President and General Manager of the North American Resins Business Unit in 1991. He was named Head of Ciba's U.S. Polymers Division in 1994. Mr. Riediker was named as Global President of the Consumer Care Division in 1995. He also took direct charge of the Detergents and Cosmetics Business Units. In 1997, he was named Global President of the Consumer Care Division and became a member of the Executive Committee of Ciba Specialty Chemicals. Mr. Riediker has a Doctorate in Chemistry and did Post-Doctoral Studies at Princeton University.

**Hermann Angerer** was appointed Head of the Coating Effects Segment in 2001. He joined Ciba-Geigy in 1981 as a development chemist in the Additives Division in Basel. In 1985, he assumed the global marketing responsibility for radiation curing additives in the Business Unit Imaging and Coating Additives. In 1990, he was appointed Head of the Business Unit Additives for Lubricants. In 1996, he moved to Japan as Head of the Additives Division, responsible for the markets in Japan and South Korea. In 1999, he moved to Germany, responsible for the German holding company of Ciba Specialty Chemicals and the Additives Division in the Central Europe region. Mr. Angerer holds a Ph.D. in Chemical Engineering from the Swiss Federal Institute of Technology (ETH) in Zurich.

**Eric Marohn** was appointed Head of the Textile Effects Segment effective as of April 1, 2004. He joined Ciba-Geigy in 1988 in the United States. He held a number of positions in the U.S. and in Basel, Switzerland, as Manager of Production Cost Accounting, Manager of Planning and Reporting and as Controller. In 1997, he took on the role of Global Marketing Head of the Business Segment Whiteners in the Consumer Care Division at Ciba Specialty Chemicals' headquarters in Basel. In 2000, he returned to the U.S. where he was responsible for the Business Unit Textile Chemicals for North and Central America. Starting in 2001, he was Regional Head for the Business Line Paper and the Segment Representative for Water & Paper Treatment in NAFTA. From 2003 until becoming Head of the Textile Effects Segment, he headed Marketing and Sales for the Textile Effects Segment in North and South America. Eric Marohn has a B.S.B.A. degree from Appalachian State University and holds an MBA from the University of North Carolina at Greensboro.

**Mark Garrett** was appointed Head of the Water & Paper Treatment Segment in 2001. He joined Ciba-Geigy in Australia in 1986 and worked there as Information and Planning Manager. In 1989, he moved to the Swiss headquarters in Basel, working in Finance and as Marketing Center Manager and Business Development Manager. In 1995, he became head of the Business Unit Paper and in 1996 he was appointed Global Head of the Business Segment Whiteners. In 1998, Mark Garrett became Global Head of the Textile Chemicals business unit where he successfully integrated three textile chemical businesses into one business unit that became a worldwide leader in its field. Mark Garrett joined DuPont from Ciba Specialty Chemicals in 2000, initially as Director Corporate Plans before becoming the Global Business Director Tyvek/Typar. He rejoined Ciba in 2001. Mark Garrett holds the following degrees: Bachelor of Arts, Economics, University of Melbourne, Melbourne, Australia and Master of Applied Information Systems, Royal Melbourne Institute of Technology, Melbourne.

**Giordano Righini** was appointed Head of the Plastic Additives Segment in 2005. Giordano Righini joined Chimosa Chimica Organica in Bologna, Italy in 1968, initially in the Research and Development Department, and later in the Production Department, as Group Leader. In 1979, Chimosa was taken over by Ciba-Geigy and became part of the Additives Division. In 1988, he was the Head of Production for the Pontecchio Marconi facility and in addition, responsible for Process Development and Technical Services. In 1991, Giordano Righini became Site Manager and in 1992, he became Head of the Additives Division for Italy. In 1997, after the establishment of Ciba Specialty Chemicals, he was promoted to Regional President of Southern Europe, as well as Managing Director of the Italian subsidiary. In 2004, he became global Head of the Business Line Coatings in Ciba Specialty Chemicals' headquarters in Basel, Switzerland. Giordano Righini holds a diploma in Chemistry from the Forli Technical College, Italy and an honorary degree in chemistry for achievements in the industry from the University of Bologna, Italy.

There are no management agreements or other agreements between the Company or its management bodies and any third parties [DCG 4.3] providing for any persons referred to above to be elected a Member of the Company's Executive Committee.

#### **Changes since December 31, 2004**

Brendan Cummins, then Head of Plastic Additives, became Chief Operating Officer effective October 1, 2005 and was succeeded in his former role by Giordano Righini, previously Head of the Business Line Coatings and Regional President of Southern Europe. On October 1, 2005, Christoph Biedermann, Head of International Coordination and Human Resources, left the Company. In the same period, no Member of the Board left the Company [DCG 5.2.3].

#### **Business behavior**

So as to promote honest and ethical conduct, legal compliance, prompt internal reporting, accountability, and full, fair, accurate, timely and understandable disclosure in public reports, the Company relies on its "Code of Conduct" which applies to all Ciba employees world-wide and on its "Financial Code of Ethics" which applies to about 300 individuals playing a major role in the financial reporting process. Both documents can be downloaded (<http://www.cibasc.com/index/cmp-index/cmp-about/cmp-abo-corporategovernance/cmp-abo-cog-codes.htm>). In 2005, the Company did not grant any waiver, whether implicit or explicit, from

any provision of its Code of Conduct or its Financial Code of Ethics to the CEO, the CFO, or the Group Controller.

## Compensation

### *Principles of allocation [DCG 5.1]*

Base salaries of the Members of the Board and of the Executive Committee are established according to a comparative analysis of base salaries paid within selected peer groups of international companies. Annual short term bonuses are based on corporate financial performance, i.e. on free cash flow, adjusted EBITDA and sales growth measured against relevant targets that are established at the beginning of the year. Long term incentives are awarded primarily based on how individual and personal performances contribute to the overall success of the Company. The allocation of these compensatory elements is discussed in the Compensation Committee of the Board of Directors, which makes its recommendations to the full Board. The latter takes the ultimate decision with respect to such allocation. For a more detailed description of the Share and option based compensation plans, see note 17 to Consolidated Financial Statements.

### *Deviation from accrual principle [DCG 5]*

The official commentary to the Directive on Information Relating to Corporate Governance requires the disclosure of management compensation according to the accrual principle. Adherence to this principle would entail that payments received and payments made are not to be accounted for at the time of their receipt or transfer, but rather allocated to the specific periods to which they are attributable in economic terms. As the Company reports its financial results in early February and holds its AGM in early March, there is not enough time for all the performance reviews to be conducted with the Company's top executives. These reviews are a pre-condition for the determination of the incentive payments. The Company therefore reports amounts effectively paid in the reporting period, irrespective of the period to which they are economically attributable.

### *Non-executive Members of the Board [DCG 5.2.2.b]*

In 2005, the non-executive Members of the Board in the aggregate received as gross remuneration, bonuses and other benefits a total of CHF 702 538 [DCG 5.2.1]. In addition, they were granted 7 779 Shares by the Company [DCG 5.4.b] and held a total of 28 518 Shares as at December 31, 2005 (including those allocated in 2005) [DCG 5.5.b].

In addition, these persons were granted the following options by the Company [DCG 5.6.b]:

<u>Year of Allocation</u>	<u>Term (years)</u>	<u>Subscription ratio</u>	<u>Number</u>	<u>Strike price (CHF)</u>
2001 .....	5	1:1	6 892	109.20
2002 .....	5	1:1	9 280	109.00

As from 2003, the Company ceased to grant any options to non-executive Members of the Board.

### *Executive Member of the Board and Members of the Executive Committee [DCG 5.2.2.a]*

In 2005, the executive Member of the Board and the Members of the Company's Executive Committee in the aggregate received as gross salaries, bonuses and other benefits, inclusive of any voluntary Company pension contributions, a total of CHF 7 392 412 [DCG 5.2.1]. In addition, they were granted 63 776 Shares by the Company (of which most are restricted) [DCG 5.4.a] and held a total of 148 063 Shares as at December 31, 2005 (including those allocated in 2005) [DCG 5.5.a].

In addition, these persons were granted the following options by the Company [DCG 5.6.a]:

<u>Year of Allocation</u>	<u>Term (years)</u>	<u>Subscription ratio</u>	<u>Number</u>	<u>Strike price (CHF)</u>
2001 .....	5	1:1	65 672	109.20
2001 Supplementary grant .....	4 years and 10.5 months	1:1	19 572	109.20
2002 .....	5	1:1	135 640	109.00

As from 2003, the Company ceased to grant any options to the executive Member of the Board and to the Members of the Company's Executive Committee.

#### ***Highest total compensation [DCG 5.9]***

In 2005, the Member of the Board with the highest total compensation received as salary, bonus and other benefits inclusive of any voluntary Company pension contributions a total of gross CHF 2 378 414. In addition, in 2005, this person was allocated 16 539 restricted Shares and 3 027 unrestricted Shares. This compensation includes the bonus for 2004 paid in 2005.

#### ***Additional fees and loans***

None of the above mentioned persons has received any fees or any compensation for services rendered to the Company during 2005 other than as disclosed in this report [DCG 5.7], nor have they been extended any loans [DCG 5.8].

#### ***Former Members [DCG 5.3]***

In 2005, one former Member of the Executive Committee who had left the Company in 2004 has received total compensation of gross CHF 384 300 [DCG 5.3.2.a]. This amount includes voluntary Company pension contributions. In 2005, the Company did not make any payments to former non-executive Members of the Board [DCG 5.3.2.b].

#### ***Closely Linked Persons***

The Company has not made any Share [DCG 5.4], option [DCG 5.6] or any cash contribution [DCG 5.2] to any Closely Linked Person, i.e. to a third party that is closely linked to Members of the Board or to Members of the Company's Executive Committee. However, they may have acquired Shares of the Company or options on their own. Also, the Company has not paid any fees [DCG 5.7] to such persons nor has it granted them any loans [DCG 5.8].

Shareholdings of Closely Linked Persons, if any, are included in the figures reported above [DCG 5.5].

#### **Labor relations**

Membership of the Company's employees in trade unions varies from country to country and the Company has entered into various collective bargaining agreements. It is the Company's practice to renew or replace its various labor arrangements relating to continuing operations as and when they expire and the Company is not aware of any material arrangements whose expiry is pending and which are not expected to be satisfactorily renewed or replaced in a timely manner. The Company has not experienced any material work stoppages or strikes in the past three fiscal years. The Company's management is of the opinion that relations with the Company's employees are good.

The Company requires a number of highly skilled technology, chemical and other specialists. The supply of such employees is highly limited, and competition to hire and retain them is consequently increasingly intense. Competition raises the cost of hiring and retaining these employees and increases employee turnover as competitors seek to lure away employees with particularly rare or sought-after skills. The Company is continually seeking to recruit skilled high-technology, chemical and other specialized workers and manage-

ment is of the opinion that the Company offers compensation, benefits and opportunities for development and advancement which will attract and retain a sufficient number of such employees.

### *Europe*

A significant number of the Company's employees in Europe are represented by employee representative groups or trade unions. The Company's labor relations in Europe have been good and the Company has not experienced any material work stoppages in recent years, other than as a result of the lock-out by the Finnish paper industry which had an impact on the business in 2005.

Wages and general working conditions are generally the subject of negotiated collective bargaining agreements. Within the limits established by these agreements, operating companies negotiate directly with unions and other labor organizations representing the Company's employees. Collective bargaining agreements relating to remuneration typically have a term of one year.

In addition to local and national trade unions and employee representation groups, the Company also meets at least once per year with its European representatives at the Ciba Euroforum. The Euroforum meeting is a platform of information and dialogue whilst negotiation rights are at a country level.

### *Other regions*

The Company's employees in the Western and Eastern Hemispheres are often represented by trade unions or employed pursuant to other collective bargaining agreements. This includes some of the Company's United States sites. In Japan, approximately one half of the employees are represented by labor unions. Labor relations in all of these regions have been good and the Company has not experienced any material work stoppages in recent years.

### **Employees**

The Company employees worldwide totaled 19 105 in 2005, 19 337 in 2004 and 18 658 in 2003. The following table shows the number of employees at the end of December 31, 2005, 2004 and 2003.

<u>2005</u>	<u>Europe</u>	<u>Americas</u>	<u>Asia-Pacific</u>	<u>Total</u>
Plastic Additives .....	1 901	1 181	601	3 683
Coatings Effects .....	2 821	402	827	4 050
Water & Paper Treatment .....	2 512	897	719	4 128
Textile Effects .....	1 746	547	1 052	3 345
Non-Segment .....	<u>2 194</u>	<u>874</u>	<u>831</u>	<u>3 899</u>
Total Company.....	<u>11 174</u>	<u>3 901</u>	<u>4 030</u>	<u>19 105</u>
<u>2004</u>	<u>Europe</u>	<u>Americas</u>	<u>Asia-Pacific</u>	<u>Total</u>
Plastic Additives .....	1 927	1 127	655	3 709
Coatings Effects .....	2 956	409	543	3 908
Water & Paper Treatment .....	2 569	995	626	4 190
Textile Effects .....	2 007	586	935	3 528
Non-Segment .....	<u>2 274</u>	<u>930</u>	<u>798</u>	<u>4 002</u>
Total Company.....	<u>11 733</u>	<u>4 047</u>	<u>3 557</u>	<u>19 337</u>

<u>2003</u>	<u>Europe</u>	<u>Americas</u>	<u>Asia-Pacific</u>	<u>Total</u>
Plastic Additives .....	1 821	1 179	639	3 639
Coatings Effects .....	3 000	407	511	3 918
Water & Paper Treatment .....	2 136	1 019	474	3 629
Textile Effects .....	2 087	550	899	3 536
Non-Segment .....	<u>2 235</u>	<u>923</u>	<u>778</u>	<u>3 936</u>
Total Company.....	<u>11 279</u>	<u>4 078</u>	<u>3 301</u>	<u>18 658</u>

## Organizational and capital structure

Ciba Specialty Chemicals Holding Inc. is the ultimate holding company of the Ciba Specialty Chemicals group. Its Shares are listed on the Swiss Exchange, traded on virt-x, and its American Depositary Shares (“ADSs”) trade on the New York Stock Exchange. For further information see Item 9 — The Offer and Listing. As at December 30, 2005, the Company’s market capitalization amounted to CHF 5 648 879 170 (66 457 402 Shares at a price of CHF 85.00 each).

<u>Security</u>	<u>Stock exchange</u>	<u>Ticker symbol</u>	<u>Security number</u>	<u>ISIN code</u>
Share with CHF 1 nominal value .....	SWX/virt-x	CIBN	581 972	CH 000 581972 4
ADS .....	NYSE	CSB	CUSIP: 17162 W206	N/A

The Company’s nominal Share capital amounts to CHF 69 064 617 and is divided in 69 064 617 Shares with a nominal value of CHF 1 each. On May 23, 2003, the nominal value per Share was reduced from CHF 9 to CHF 6, giving effect to a resolution of the Company’s shareholders taken on March 6, 2003. On May 7, 2004, the nominal value per Share was further reduced to CHF 3, giving effect to a resolution of the Company’s shareholders taken on February 26, 2004. On May 17, 2005, the nominal value per Share was further reduced to CHF 1, giving effect to a resolution of the Company’s shareholders taken on March 3, 2005 [DCG 2.1/2.3].

The Company only has one class of Shares and has no bonus certificates [DCG 2.4/2.5]. Each Share is entitled to any dividends proposed by the Board and approved by the shareholders, and has one vote, subject to the limitations set out below. The Shares do not have any preferential rights attached to them. The Company had and has the following ordinary, authorized and conditional capitals [DCG 2.2/2.3]:

<u>Date of Articles of Association</u> <u>Article in Articles of Association</u>	<u>Nominal value of Shares</u>	<u>Ordinary Share capital</u>	<u>Authorized capital</u>		<u>Conditional capital</u>		<u>Conditional capital for employee participation</u>	
	<u>4 Para. 1</u>	<u>4 Para. 1</u>	<u>4 Para. 3</u>		<u>4 Para. 4</u>		<u>4 Para. 5</u>	
	<u>(CHF)</u>	<u>(CHF)</u>	<u>Number of Shares (million)</u>	<u>Nominal value (CHF) (million)</u>	<u>Number of Shares (million)</u>	<u>Nominal value (CHF) (million)</u>	<u>Number of Shares (million)</u>	<u>Nominal value (CHF) (million)</u>
April 20, 1998 .....	10	721 301 170	4	40	4	40	2	20
March 22, 2002.....	9	649 171 053	4	36	4	36	2	18
March 6, 2003.....	6	432 780 702	4	24	4	24	2	12
February 26, 2004.....	3	212 479 851	4	12	4	12	2	6
March 3, 2005.....	1	69 064 617	4	4	4	4	2	2

For additional information please refer to article 4 of the Company’s Articles of Association (“Articles”), which can be downloaded (<http://www.cibasc.com/index/cmp-index/cmp-about/cmp-abo-corporate-governance.htm>). The German version, which is legally binding, can be downloaded from the same internet address.

For information about the Company’s major shareholders see Item 7 — Major Shareholders and Related Party Transactions [DCG 1.2]. Updated information can be retrieved from the SWX Swiss Exchange

([http://www.swx.com/admission/being — public/disclosure — en.html](http://www.swx.com/admission/being—public/disclosure—en.html)). The Company has no cross holdings [DCG 1.3] nor has it executed any pooling or management agreements [DCG 4.3].

### **Group structure [DCG 1.1]**

For the Company's major subsidiaries, including listed companies and group structure, see 20-F — Item 4 — Information on the Company [DCG 1.1.2 and 1.1.3]. For the description of the operational structure of the Company, see Description of Segments in Business Segment Data [DCG 1.1.1].

### **Voting cap and registration restrictions, nominees [DCG 2.6]**

No shareholder may be registered as a shareholder with voting rights for more than 2 percent of the Company's Share capital. A shareholder purchasing more than 2 percent of the Company's Share capital will be recorded in the Company's Share register for the Shares in excess of 2 percent of the Company's Share capital as a shareholder without voting rights. The Board or a committee designated by the Board may, however, on a case-by-case basis allow some or all of the excess Shares to be registered with voting rights. In 2005, the Board granted no such exception and currently no shareholder has the benefit of any such exception [DCG 2.6.2]. For purposes of the 2 percent rule, individuals and/or legal entities acting in concert are considered to be one shareholder [DCG 2.6.1].

Nominees may be entered with the right to vote for more than 2 percent of the voting stock if the nominee discloses the names, addresses and number of Shares of those persons for which it holds the Shares [DCG 2.6.3].

For information about the Company's treasury stock, see Form 20-F — Note 16 to the Consolidated Financial Statements and the Consolidated Balance Sheets.

At the Company's general meeting, no person may vote more than 5 percent of the Company's stock, with the exception of depositaries, corporate bodies, independent proxies or nominees complying with their duty to disclose the names, addresses and number of Shares of those persons for which they hold the Shares [DCG 6.1.1]. In 2005, the Board granted no exception with regard to voting cap restrictions [DCG 6.1.2]. In addition to those proxies, a shareholder may also be represented by another individual at a general meeting, but this individual is required to be a shareholder of the Company [DCG 6.1.4]. A resolution on the restriction to vote and on the removal of such a restriction is subject to the approval of two-thirds of the Shares represented at a shareholders' meeting [DCG 6.1.3].

### **Annual General Meeting and extraordinary shareholders' meetings**

Any shareholder may demand that an item be put on the agenda of the AGM if she or he holds Shares representing a nominal value of at least CHF 100 000. This equals 0.145 percent of the Company's total Shares. A demand to have an item put on the agenda must be made in writing at least 60 days before the AGM [DCG 6.4]. For the AGM to be held on March 2, 2006, the Company published the deadline date (January 1, 2006) on its website on December 15, 2005. The record date for participation at the AGM is usually fifteen days before the AGM while persons who have subsequently become shareholders may register their voting rights at the AGM Office if the shareholder can prove that he or she is the owner of the Shares and that these Shares are not being voted otherwise [DCG 6.5]. The Articles do not contain any provisions with regard to calling the AGM that differ from the provisions of the Swiss Code of Obligations [DCG 6.3].

There is no provision in the Articles or under Swiss law requiring a presence quorum for the holding of shareholders' meetings. Resolutions generally require the approval of the "majority" of the Shares represented at a shareholders' meeting (i.e. a simple majority of the Shares represented at the shareholders' meeting, with abstentions having the effect of votes against the resolution). A resolution passed at a shareholders' meeting

with the affirmative vote of at least two-thirds of the Shares represented at such meeting is required for [DCG 6.2]:

- (i) any change to the Company's business purpose,
- (ii) the creation of Shares with privileged voting rights,
- (iii) the creation of restrictions on the transferability of registered Shares, or the elimination of transfer restrictions [DCG 2.6.4],
- (iv) an authorized or conditional increase in the Company's Share Capital,
- (v) an increase in the Company's Share Capital by way of capitalization of reserves (Kapitalerhöhung aus Eigenkapital), against contribution in kind, for the acquisition of assets, or involving the grant of special privileges,
- (vi) the restriction or elimination of preemptive rights of shareholders,
- (vii) a relocation of the domicile of the Company, or
- (viii) the dissolution of the Company other than by liquidation (for example, by way of a merger).

In addition, any provision in the Articles for a greater voting requirement than is prescribed by law or the existing Articles must be adopted in accordance with such greater voting requirements.

**Dividends and dividend policy**

The amount of dividends to be paid by the Company to its shareholders depends on general business conditions, the Company's financial performance and other factors. Under Swiss law, dividends may be paid out only if approved at a shareholders' meeting. The Board may propose that a dividend be paid out, but cannot itself set the dividend. In practice, the shareholders usually approve the dividend proposal of the Board.

Since its inception in 1997, the Company has paid or proposed to pay the following amounts per Share:

<u>AGM Year</u>	<u>Dividend payment (CHF)</u>	<u>Capital reduction payment (CHF)</u>
1998 .....	2	0
1999 .....	2	0
2000 .....	2	0
2001 .....	2	0
2002 .....	2	1
2003 .....	0	3
2004 .....	0	3
2005 .....	1	2
2006 <sup>(i)</sup> .....	3	0

(i) For the financial year 2005, the Board proposes to the shareholders to pay a dividend of CHF 3 per Share. The shareholders will vote on this proposal at the Company's AGM of shareholders on March 2, 2006. If the shareholders approve this proposal, the dividend payment is expected to be made on March 8, 2006.

**Convertible bonds and warrants/options [DCG 2.7]**

With the exception of the Company's employee participation programs, the Company had no equity linked debt outstanding.

## Additional information

### *Change of control provisions [DCG 7]*

If a shareholder acquires securities of a listed Swiss company and thereby exceeds the threshold of 33 $\frac{1}{3}$  percent of the voting rights, it has to offer to acquire the remaining shares (“mandatory offer obligation”). By shareholders’ resolution, this threshold may be raised to 49 percent (“opting up”). A company may also opt out of the mandatory offer obligation. In its Articles, the Company has no opting out or opting up provisions [DCG 7.1].

According to employee retention agreements with the Company, all members of the Executive Committee plus three senior managers are entitled to payments for severance resulting from a change of control. For ten executives, such payments would on average amount to less than twice that of a total annual compensation. One member of the Executive Committee has a contractual provision according to which he would be entitled to receive somewhat less than two and a half times that of his total annual compensation [DCG 7.2].

### *Auditors [DCG 8]*

The Company’s auditors are Ernst & Young Ltd, Zurich. They have been elected by the shareholders at the 2005 AGM until the AGM 2006 [DCG 8.1.1]. The Board, which bases its proposal upon a recommendation made to it by the Audit Committee, will propose that Ernst & Young Ltd be re-elected for another year. At the Company’s AGM to be held on March 2, 2006, the shareholders will vote on this proposal.

Ernst & Young Ltd’s lead audit partner, Cherrie Chiomento, has supervised the Company’s audit since 2004 [DCG 8.1.2].

Fees paid by the Company in 2005 and 2004 to its auditors were as follows [DCG 8.2/8.3]:

	2005		2004	
	Thousand CHF	In % of total fees	Thousand CHF	In % of total fees
Audit fees .....	6 210	59	5 704	93
Audit-related fees .....	3 836	36	2	0
Tax fees .....	514	5	381	6
All other fees .....	28	0	44	1
<b>Total fees</b> .....	<u>10 588</u>	<u>100</u>	<u>6 131</u>	<u>100</u>

Audit-related work includes Sarbanes-Oxley Act 404 implementation services, audit-related services in connection with the possible disposition of the Segment Textile Effects, and services in connection with the Company’s pension plans. Tax services include tax filings, transfer pricing studies and tax advice, including with regard to VAT. Other services include assistance with translation and capital reduction matters. The Audit Committee maintains a policy for the pre-approval of audit and of non-audit services. A copy of this policy can be downloaded (<http://www.cibasc.com/investors>). The Audit Committee has not approved a single service pursuant to the de minimis exception according to paragraph (c)(7)(i)(C) of Rule 2-01 of SEC Regulation S-X.

The auditors of the Company are present at those Board meetings during which the annual accounts of the Company are discussed and the items and proposals to the AGM of the shareholders of the Company are decided upon. They are also present at one of the Company’s Disclosure Committee meetings and at the meetings of the Audit Committee where audit mandate and audit planning are discussed. Any other participation is as required. In such meetings, the Board and the Audit Committee also assess and discuss the findings of the auditors and evaluate the quality of their services [DCG 8.4].

### ***Information policy [DCG 9]***

The Company's policy is to openly, clearly and regularly inform its stakeholders of all relevant developments. As a primary tool, the Company communicates through its internet site (<http://www.cibasc.com>) and by email. The Investor Relations homepage (<http://www.cibasc.com/investors>) contains comprehensive information on the Company, including Corporate Governance, the Code of Conduct, the Financial Code of Ethics and Social Policy. Interested parties may also subscribe to a news release email service (<http://www.cibasc.com/index/med-index/med-subscription.htm>).

As the Company is listed on the SWX Swiss Exchange (<http://www.swx.com>); ticker symbol = CIBN and on the New York Stock Exchange (<http://www.nyse.com>); ticker symbol = CSB, it regularly files news and reports with these exchanges. The reports furnished or filed by the Company with the U.S. stock exchange supervision authority, the SEC, can be downloaded (<http://www.sec.gov/cgi-bin/browse-ed-gar?action=getcompany&CIK=0001035497&owner=include>).

The Company's official means of communication is the Swiss Official Gazette of Commerce (<http://www.shab.ch>), while the invitation to the Company's AGM is also sent to the registered shareholders by mail. In addition, the Company publishes the AGM meeting notice in several newspapers in Switzerland. The site <http://www.cibasc.com/agm> contains all AGM relevant information, including the AGM minutes.

For publication dates of the Company's financial reports, please consult the Investor Relations sub-page (<http://www.cibasc.com/investors>).

Enquiries by telephone may also be made to: Investor Relations +41 61 636 5081 and to Group Communications +41 61 636 4444.

### ***Share ownership***

The Company applies the fair value method of accounting as defined in SFAS No. 123(R) "Share-Based Payment" as amended, for its stock-based compensation plans. Descriptions of the terms of the Company's plans are presented in the following paragraphs.

In connection with the capital reduction of CHF 3 per share in 2003 (see note 16), the Company reduced the exercise price of its then outstanding stock options and reflected this reduction in the exercise prices disclosed herein. No compensation expense was recorded as a result of this capital reduction repricing. In connection with the capital reduction of CHF 2 per share in 2005 and CHF 3 per share in 2004, the exercise price of outstanding stock options was not changed.

LTIP — The Company has a Long-Term Incentive Plan (LTIP), which grants restricted shares of common stock of the Company to senior management and other key employees. Shares granted are restricted from being sold by the grantee for three years from the date of grant.

In connection with the LTIP 2005, the Company granted 197 455 restricted shares of common stock with a market value of CHF 78.60 per share to 697 participants and recognized compensation expense of approximately CHF 16 million in 2005 related to these grants. In connection with the LTIP 2004, the Company granted 154 996 restricted shares of common stock with a market value at date of grant of CHF 95.30 per share to 705 participants and recognized compensation expense of approximately CHF 15 million in 2004 related to these grants. In connection with the LTIP 2003, the Company granted 186 503 restricted shares of common stock with a market value at date of grant of CHF 85.30 per share to 720 participants and recognized compensation expense of approximately CHF 16 million in 2003 related to these grants.

The LTIP until 2005 also provided for the granting of options to participants to purchase shares of common stock. Accordingly, in 2005 no options were granted. In 2004 and 2003, option grants were made with vesting and the right to exercise occurring over three years and expiration dates of ten years from date of grant. Options granted in years prior to 2003 expire either five years or ten years after the date of grant. As a result of the adoption by the Company in 2003 of SFAS No. 123 as amended, compensation expense of approximately

CHF 2 million in 2005 (CHF 3 million in 2004 and CHF 5 million in 2003) was recorded comprising the unvested portion of prior year awards.

The following table summarizes option activity under the LTIP for the three year period ended December 31, 2005 and from January 1, 2006 through January 27, 2006:

	<u>Weighted average exercise price</u>	<u>Stock options outstanding</u>
<b>Balance at December 31, 2002</b> .....	117.53	2 195 339
Options granted .....	82.60	176 627
Options exercised .....	0	0
Options canceled/forfeited .....	105.02	(26 989)
Options expired .....	<u>160.00</u>	<u>(264 355)</u>
<b>Balance at December 31, 2003</b> .....	<u>109.34</u>	<u>2 080 622</u>
Options granted .....	95.30	81 024
Options exercised .....	82.60	(2 762)
Options canceled/forfeited .....	114.48	(72 239)
Options expired .....	<u>109.60</u>	<u>(314 888)</u>
<b>Balance at December 31, 2004</b> .....	<u>108.32</u>	<u>1 771 757</u>
Options granted .....	0	0
Options exercised .....	0	0
Options canceled/forfeited .....	108.60	(23 647)
Options expired .....	<u>104.48</u>	<u>(243 860)</u>
<b>Balance at December 31, 2005</b> .....	<u>108.77</u>	<u>1 504 250</u>
Options exercised .....	0	0
Options canceled/forfeited .....	0	0
Options expired .....	<u>109.20</u>	<u>271,557</u>
<b>Balance at January 27, 2006</b> .....	<u>108.68</u>	<u>1 232 693</u>

The following table summarizes the status of stock options outstanding and exercisable at January 27, 2006:

<u>Exercise price range</u>	<u>Weighted average exercise price- outstanding/ exercisable</u>	<u>Stock options outstanding</u>		<u>Stock options exercisable</u>	
		<u>Number of outstanding options</u>	<u>Weighted average remaining contractual life (in years)</u>	<u>Number of outstanding options</u>	<u>Weighted average remaining contractual life (in years)</u>
82.60 — 111.40 .....	103.66/105.11	1 122 793	3.9	1 022 068	3.5
160.00 .....	160.00/160.00	<u>109 900</u>	1.9	<u>109 900</u>	1.9
		<u>1 232 693</u>		<u>1 131 968</u>	

MAB — The Company has a “Mitarbeiterbeteiligungsplan” (Employee Investment Plan) which grants annually to most employees in Switzerland (as an enhancement to their pension plan arrangements) the right to purchase 30 shares (prior to 2006, 25 shares) of common stock at CHF 10 per share (prior to 2006, CHF 15) as long as the share price is not greater than CHF 150, at which level the Employee Investment Plan price may be adjusted. The rights vest at the grant date and become exercisable at the date of the employees’ retirement or termination. The following table summarizes rights activity under the MAB for the three year period ended December 31, 2005 and from January 1, 2006 through January 27, 2006:

	<u>Weighted average exercise price</u>	<u>Rights outstanding</u>
<b>Balance at December 31, 2002</b> .....	15.00	370 280
Rights granted .....	15.00	105 275
Rights exercised .....	<u>15.00</u>	<u>(20 005)</u>
<b>Balance at December 31, 2003</b> .....	<u>15.00</u>	<u>455 550</u>
Rights granted .....	15.00	104 200
Rights exercised .....	<u>15.00</u>	<u>(22 955)</u>
<b>Balance at December 31, 2004</b> .....	<u>15.00</u>	<u>536 795</u>
Rights granted .....	15.00	102 475
Rights exercised .....	<u>15.00</u>	<u>(57 055)</u>
<b>Balance at December 31, 2005</b> .....	<u>15.00</u>	<u>582 215</u>
Rights granted .....	10.00	114 750
Rights exercised .....	<u>14.25</u>	<u>(6 955)</u>
<b>Balance at January 27, 2006</b> .....	<u>14.18</u>	<u>690 010</u>

Compensation expense is recorded in the year the rights are granted and, in 2005, CHF 7 million (2004: CHF 9 million; 2003: CHF 9 million) of compensation expense was recorded under this plan.

***Change in control and reserve of shares***

Upon a change in control of the Company as defined, the vesting and restriction periods for the plans stated above will cease to apply and a cash or share payment for the value of the outstanding plans and related taxes and duties will be due to the participants.

At December 31, 2005, the Company had approximately 1.4 million shares (2004: 2.0 million shares; 2003: 2.2 million shares) of treasury stock reserved for issuance under the various stock based compensation plans.

For further information see Item 18 — Financial Statements and pages F-1 through F-43

**Item 7. *Major Shareholders and Related Party Transactions.***

**Major Shareholders**

According to the Share Registrar of the Company and other publicly available information (Database on Disclosure of Shareholdings maintained by SWX Swiss Exchange). As of January 27, 2006 the following

persons in the table below were known by the Company to be the owner of 2 percent or more of the Company's Shares. These shareholders may use their voting rights up to 2 percent of the common stock.

	<u>January 27, 2006</u>	<u>January 28, 2005</u>	<u>January 30, 2004</u>
Chase Nominees Ltd, London* . . . . .	4.8%	4.8%	5.6%
Mellon Bank N.A., Everett* . . . . .	3.76%	—	2.6%
Putnam Group, Boston . . . . .	—	2.0%	—
Nortrust Nominees, London* . . . . .	2.18%	—	—

(\*) Registered as nominees.

As of January 27, 2006, according to the Share Register, there were 135 registered holders of ordinary shares in the United States. These ordinary shareholders in the United States collectively held 4 135 234 ordinary shares, or approximately 5.99 percent of the Company's total issued and outstanding Shares as of that date. Also as of January 27, 2006, there were 242 registered holders of American depositary receipts under an ADR program (including Cede & Co., the DTC's nominee). Each ADR issued under the program represents one American Depositary Share, which in turn, represents one-half of one share of the common stock of the Company. All these registered ADR holders have addresses in the United States. They collectively held 3 666 106 ADRs, or approximately 2.65 percent of the issued and outstanding ordinary Shares as of such date.

To its knowledge, the Company is not owned or controlled, directly or indirectly, by another corporation, by any government or by any other natural or legal person, severally or jointly.

**Related party transactions**

The Company and its subsidiaries have not entered into any material transactions in the last three years in which any director, officer or any associate of any director or officer of the Company has or had any interest. No director, officer or associate of any director or officer is or was during the last three years indebted to the Company or any of its subsidiaries. For further information see Item 18 — Financial Statements and pages F-1 through F-43.

The Company has a number of joint ventures with, and other equity investments in other companies. It has relationships with many of these entities in the ordinary course of business whereby it buys and sells a wide variety of products and services.

**Item 8. Financial Information.**

**Consolidated financial statements**

See Item 18 — Financial Statements and pages F-1 through F-43

**Other financial information**

*Export sales*

The Company's products and services are primarily sold outside of its home market, Switzerland. In 2005, approximately 99 percent of the Company's sales of products and services produced in Switzerland were exported to other countries.

*Legal, administrative and arbitration proceedings*

The Company operates in countries where political, economic, social, and regulatory developments could have a significant impact on its operational activities. The effects of such risks on the Company's results, which arise during the normal course of business, are not foreseeable and are therefore not included in the accompanying Consolidated Financial Statements of this Annual Report.

In the ordinary course of business, the Company is involved in lawsuits, claims, investigations and proceedings, including product liability, commercial, environmental, and health and safety matters. Although the outcome of any such proceedings cannot be predicted, management is of the opinion that there are no such matters pending which would be likely to have any material adverse effect in relation to its business, financial position or results of operations.

In connection with its Toms River, New Jersey site in the United States, the Company was named as a defendant in several actions, most of which were settled by the end of 2002. See Item 4 — Information on the Company — Environmental Matters.

### ***Dividends and dividend policy***

The amount of dividends to be paid by the Company to its shareholders depends on general business conditions, the Company's financial performance and other factors. The Board has adopted a policy on the proposal of dividends, which is to provide shareholders with dividend growth in line with the underlying growth in the earnings of the Company. Under Swiss law, dividends are paid out only if approved at the shareholders' meeting. The Board may propose that a dividend be paid out, but cannot itself set the dividend. In practice, the shareholders usually approve the dividend proposal of the Board.

For 2001, the shareholders approved the Board's proposal to pay a dividend of CHF 2 per share at the Company's Annual General Meeting held on March 22, 2002. The Company paid the dividend on March 27, 2002, which totaled CHF 134 million. At this meeting, the shareholders also approved the Board's proposal to pay an extraordinary payment to the shareholders in the form of a capital reduction of CHF 1 per share. The capital reduction was in the form of a reduction in the nominal value of each common share from CHF 10 per share by CHF 1 per share to CHF 9 per share. The Company paid the capital reduction on June 28, 2002, which totaled CHF 69 million.

For 2002 the Board of Directors proposed to carry forward the entire retained earnings of Ciba Specialty Chemicals Holding Inc. and not to pay a dividend. The Board of Directors, however, proposed a cash payment to its shareholders resulting from a capital reduction of CHF 3 per share. The capital reduction found shareholder approval at the Annual General Meeting on March 6, 2003. The capital reduction was effected by a reduction in the nominal value of each share from CHF 9 per share by CHF 3 per share to CHF 6 per share. The Company made the payment of the capital reduction on May 23, 2003.

For 2003 the Board of Directors proposed to carry forward the entire retained earnings of Ciba Specialty Chemicals Holding Inc. and not to pay a dividend. The Board of Directors, however, proposed a cash payment to its shareholders resulting from a capital reduction of CHF 3 per share. The capital reduction found shareholder approval at the Annual General Meeting on February 26, 2003. The capital reduction was effected by a reduction in the nominal value of each share from CHF 6 per share by CHF 3 per share to CHF 3 per share. The Company made the payment of the capital reduction on May 14, 2004.

For 2004 the Board of Directors proposed to pay a dividend of CHF 1 per share and to make an additional cash payment to its shareholders resulting from a capital reduction of CHF 2 per Share. Both the dividend payment and capital reduction were approved by the Company's shareholders at the Annual General Meeting on March 3, 2005. The capital reduction was effected by a reduction in the nominal value of each share from CHF 3 per Share by CHF 2 per Share to CHF 1 per Share. The Company made the payment of the capital reduction on May 18, 2005. Dividend payment occurred on March 8, 2005.

For 2005, the Board of Directors proposes to pay a dividend of CHF 3 per Share. The dividend payment is subject to shareholders' approval at the Annual General Meeting on March 2, 2006. If approved, the dividend payment will be made to the shareholders on March 8, 2006.

For additional information on dividends, see Item 6 — Directors, Senior Management and Employees.

### *Significant changes*

Except as otherwise disclosed in this Annual Report, no significant change has occurred since the date of the Consolidated Financial Statements included in this Annual Report.

### **Item 9. *The Offer and Listing***

#### **Principal trading market and price range**

The Shares are listed on the Swiss Exchange and principally traded on London based virt-x, a Recognized Investment Exchange supervised by the Financial Services Authority (FSA) in the U.K. and are also quoted on International Retail Service, the London Stock Exchange's automated quotation system for non-U.K. equity securities. The prices for Shares as quoted in the official list of the Swiss Exchange are expressed in Swiss francs. As of August 2, 2000, the ADRs, each representing one-half of one ordinary share of the Company's common stock, have been listed on the New York Stock Exchange.

The information presented in the table below represents, for the periods indicated, (i) the reported high and low closing sales prices quoted in Swiss francs for the Shares on the Swiss Exchange and (ii) the U.S. dollar equivalent of the price per Share based on the Noon Buying Rate on the last trading day of the periods presented. The Shares began trading on the Swiss Exchange on March 13, 1997, at a price of CHF 116.25 per share.

<u>Trading prices on the Swiss Exchange</u>	<u>Price per Share</u>			
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
	<u>In CHF</u>		<u>In USD</u>	
<b>Annual highs and lows</b>				
2001 .....	115.75	75.00	69.74	45.19
2002 .....	128.00	89.75	92.53	64.88
2003 .....	101.50	74.75	81.99	60.38
2004 .....	96.14	76.70	81.81	59.77
2005 .....	85.00	72.51	64.65	55.15
<b>Quarterly highs and lows</b>				
2004				
First Quarter .....	96.14	82.24	75.84	64.87
Second Quarter .....	90.70	82.05	72.44	65.54
Third Quarter .....	89.70	76.70	71.93	61.50
Fourth Quarter .....	86.50	78.00	75.80	68.35
2005				
First Quarter .....	84.24	75.38	70.48	63.07
Second Quarter .....	79.23	72.51	61.77	56.53
Third Quarter .....	80.50	74.00	62.45	57.41
Fourth Quarter .....	85.00	72.75	64.65	55.33
<b>Monthly highs and lows</b>				
2005				
July .....	77.50	74.00	60.22	57.50
August .....	80.50	76.10	64.16	60.66
September .....	78.60	74.65	60.98	57.91
October .....	77.40	72.75	60.00	56.40
November .....	77.50	74.05	58.94	56.32
December .....	85.00	77.90	64.65	59.25
2006				
January (through January 27) .....	84.95	81.20	66.38	63.45

The information presented in the table below represents, for the periods indicated, the reported high and low closing sales prices quoted in USD on the New York Stock Exchange. The Shares began trading on the New York Stock Exchange on August 2, 2000 at a price of USD 29.50 per ADR.

<u>Trading prices on the New York Stock Exchange</u>	<u>Price per ADR<sup>(1)</sup></u>	
	<u>High</u>	<u>Low</u>
	<u>In USD</u>	
<b>Annual highs and lows</b>		
2001 .....	35.44	24.00
2002 .....	40.60	30.83
2003 .....	38.75	28.25
2004 .....	40.61	30.10
2005 .....	37.73	32.20
<b>Quarterly highs and lows</b>		
2004		
First Quarter .....	40.61	33.80
Second Quarter .....	36.35	31.92
Third Quarter .....	36.58	30.10
Fourth Quarter .....	38.23	31.25
2005		
First Quarter .....	37.73	32.20
Second Quarter .....	33.94	29.05
Third Quarter .....	32.00	28.50
Fourth Quarter .....	32.30	28.08
<b>Monthly highs and lows</b>		
2005		
July .....	30.20	28.50
August .....	32.00	29.97
September .....	31.74	28.86
October .....	29.79	28.32
November .....	29.57	28.08
December .....	32.30	29.69
2006		
January (through January 27) .....	33.18	31.72

(1) One ADR represents one half of one share of the Company.

On January 27, 2006, the last reported sale price was for Shares on the Swiss Exchange CHF 84.30 and for ADRs on the New York Stock Exchange USD 32.80. According to ShareComm Service AG, as of December 31, 2005, there were 140 United States resident shareholders holding 4 142 314 Shares, representing approximately 6.0 percent of the issued and outstanding Shares as of such date, and there were 242 registered United States resident holders of American Depositary Receipts holding 3 787 326 ADRs, representing approximately 2.74 percent of the issued and outstanding Shares as of such date.

The information presented in the table below represents, for the periods indicated, the approximate average daily volumes of the Shares traded on the Swiss Exchange:

	<u>First quarter</u>	<u>Second quarter</u>	<u>Third quarter</u>	<u>Fourth quarter</u>
2005 .....	425 936	402 477	365 419	405 860
2004 .....	380 762	342 204	287 579	289 824

The information presented in the table below represents, for the periods indicated, the average approximate daily volumes of the ADRs traded on the New York Stock Exchange:

	<u>First quarter</u>	<u>Second quarter</u>	<u>Third quarter</u>	<u>Fourth quarter</u>
2005 .....	17 756	13 988	15 778	17 990
2004 .....	4 287	2 511	5 353	3 073

The above information was supplied by the Swiss Exchange via the Swiss Market Feed, Citibank N.A., and Reuters, all of which supply such data to their customers, subscribers and other information providers.

### **Trading practices and procedures on the Swiss Exchange/virt-x**

The Swiss Exchange is a private organization, which is supervised by the Swiss Federal Banking Commission. Securities traded on the Swiss Exchange include shares, investment funds, exchange traded funds, bonds and derivatives. In 2005, the exchange turnover achieved in a total of 17.95 million transactions amounted to CHF 1 449 billion.

The Company is included in the SMI®, the Swiss Market Index, an index that as at December 31, 2005, comprised shares of the 27 largest most liquid stocks in the Swiss equity market. At the same date, the market capitalization of the SMI® issuers amounted to CHF 916 billion.

With the creation of virt-x in London in 2001, the SWX Group put in place a securities exchange approved by the UK authorities and based on existing SWX technology. The value-added chain already established in Switzerland was thus extended to cross border trading. The virt-x market is based on an integrated trading, clearing and settlement model, which not only simplifies the process of trading pan-European blue chips but also significantly reduces the costs associated with trading cross border at every stage of the process. The volume of trades in Swiss blue chips has been expanded since virt-x was opened.

### **Item 10. Additional Information**

#### **Memorandum and Articles of Incorporation (“Articles”)**

Set out below is a summary of certain provisions of the Company’s Articles and of the Swiss Code of Obligations relating to the Shares. This description does not purport to be complete and is qualified in its entirety by reference to the Articles, which are an exhibit to this Annual Report, and Swiss law.

#### ***Purpose of the Company***

Section 2 of the Company’s Articles establishes that the purpose of the Company is the acquisition, holding and disposition of enterprises which are also active in the area of specialty chemicals. The Company may acquire, mortgage, liquidate or sell real estate and intellectual property rights in Switzerland or abroad and finance other companies.

#### ***Conflict of interest***

Swiss law does not have a general provision regarding conflicts of interest. However, the Swiss Code of Obligations requires directors and members of senior management to safeguard the interests of the Company and, in this connection, imposes a duty of care and a duty of loyalty on directors and officers. The breach of these provisions may result in personal liability for the directors and officers towards the Company or its shareholders. Swiss law also provides that payments made to a shareholder or a director or any person(s) associated therewith other than at arm’s length must be repaid to the Company if the shareholder, director or associated person(s) has or have acted in bad faith. In addition, the by-laws of the Company provide that the Members of the Board of Directors are required to abstain from voting on matters that relate to their own personal interests or to the interests of legal or natural persons with whom they are associated.

### ***Directors***

According to Section 25 of the Articles, the Board of Directors can pass resolutions with respect to all matters that are not reserved to the authority of the General Meeting of Shareholders, by law or by the Articles. The power to borrow falls within the competencies of the Board of Directors, which has delegated part of this power to the Finance Committee. Exercise of this power does not require shareholder approval. Neither Swiss law nor the Articles restrict in any way the Company's power to borrow or otherwise raise funds.

Members of the Board retire upon their 70th birthday. The retirement is effective on the date of the next Ordinary Shareholders Meeting. Under special circumstances the Board can make exceptions to this rule. Both Swiss law and the Articles require that the Directors be shareholders of the Company. Ownership of one Share is sufficient to satisfy this condition.

### ***Shares and Transfer of Shares***

For information on the Shares, see also Item 6 — Directors, Senior Management and Employees.

The transfer of shares (for as long as they are book-entry shares) is effected by an entry in the books of a bank or depository institution following an assignment in writing by the selling shareholder and notification of such assignment to the Company. In the event that the shares are printed, the transfer is effected by delivery of the endorsed share certificate. The right to exercise voting rights with regard to the shares further requires that the name of the purchaser be registered in the share register (Aktienbuch) of the Company. Failing such registration, the purchaser may not vote at shareholders' meetings.

There are no restrictions on the transfer of shares. However, no shareholder may be registered as a shareholder with voting rights for more than 2 percent of the Company's share capital. A shareholder purchasing more than 2 percent of the Company's share capital will be recorded in the Company's share register for the shares in excess of 2 percent of the Company's share capital as a shareholder without voting rights. The Board or a committee designated by the Board may, however, on a case-by-case basis allow some or all of the excess shares to be registered with voting rights. For purposes of the 2 percent rule, natural persons and/or legal entities acting in concert are considered to be one shareholder.

A purchaser of shares will be recorded in the Company's share register if the purchaser discloses its name, citizenship and address and gives a declaration that it has acquired the shares in its own name and for its own account. The Articles provide that shareholders may register their shares in the name of a nominee approved by the Company, including Euroclear Bank S.A./N.V. as operator of the Euroclear System ("Euroclear"), Clearstream Banking, société anonyme ("Clearstream Luxembourg"), and the Depository, and may exercise their voting rights by giving instructions to such nominee to vote on their behalf. However, the Company has agreed to exempt the Depository and the custodian and their respective nominees, if any (but no individual Holder or Beneficial Owner of ADSs), from the 2 percent limitation in respect of Deposited Securities held in connection with the ADR facility created by the Deposit Agreement (as defined therein) to the extent that (a) the Depository requires each Holder who provides voting instructions to the Depository upon the terms of the Deposit Agreement to certify (the "Voter Certification") that (i) such Holder does not beneficially own, directly or indirectly, more than 2 percent of the share capital of the Company in the form of Shares or ADSs and (ii) neither such Holder nor any of its affiliates has filed, or is under any obligation to file, a Schedule 13D or 13G under the Exchange Act in respect of the Shares or the ADSs (if any such Holder fails to provide such Voter Certification to the Depository, the Depository will disregard any voting instructions received from such Holder unless otherwise instructed by the Company), and (b) the Deposited Securities held in the ADR facility do not exceed the 5 percent limitation.

### ***Annual General Meetings***

For information on annual general meetings, see also Item 6 — Directors, Senior Management and Employees.

Under Swiss law, an annual, ordinary shareholders' meeting must be held within six months after the end of the Company's business year. Shareholders' meetings may be convened by the Board or, if necessary, by the

statutory auditors. The Board is further required to convene an extraordinary shareholders' meeting if so resolved by a shareholders' meeting or if so requested by holders of Shares holding in aggregate at least 10 percent of the nominal Share capital of the Company.

The shareholders at a shareholders' meeting also have the power to vote on amendments to the Articles, to elect the members of the Board and the statutory auditors, to approve the annual report and the annual Company accounts, to set the annual dividend, to grant the Members of the Board and management discharge from liability for matters disclosed to the shareholders' meeting, and to order an independent investigation into the specific matters proposed to the shareholders' meeting (Sonderprüfung).

At shareholders' meetings, shareholders can be represented by proxy but only by another shareholder, a proxy appointed by the Company, an independent representative nominated by the Company or a depository institution. Proxy may also be given to the legal representative of the shareholder. Subject to certain exceptions set forth in the Articles, no shareholder (or group of shareholders acting in concert) may represent more than 5 percent of the Company's Share capital at any shareholders' meeting. For purposes of this 5 percent limit, natural persons and/or legal entities acting in concert are considered to be one shareholder. The 5 percent limit does not apply to banks exercising proxies granted by their customers, to shareholders' representatives acting under statutory rules or to nominees, provided such nominees comply with the disclosure requirement discussed above. See Shares and Transfer of Shares. Votes are taken on a show of hands unless it is resolved at the shareholders' meeting to have a ballot or such ballot is ordered by the Chairman of the meeting.

### ***Liquidation***

According to Swiss Law, each shareholder is entitled to receive the part of the assets of a company remaining after its liquidation which is proportional to its paid in shareholding.

### ***Redemption Provision***

Swiss law limits the number of Shares that the Company may hold or repurchase. The Company and its subsidiaries may repurchase shares only if (i) the Company has sufficient free reserves to pay the purchase price and (ii) the aggregate nominal value of such shares does not exceed 10 percent of the nominal Share capital of the Company. Shares held by the Company and its subsidiaries do not have any voting rights. Furthermore, the Company must create a reserve on its balance sheet in the amount of the purchase price of the acquired shares. Share buy-backs by the Company may be subject to certain adverse tax consequences in Switzerland.

### ***Sinking Fund Provision***

If liabilities exceed assets, the Board of Directors must notify the competent court at the registered office of the Company thereof.

### ***Further Capital Calls by the Company***

Since all of the Company's issued and outstanding shares have been fully paid in, the Company has no further capital calls.

### ***Mandatory Bid Rule***

For information on the mandatory bid rule, see Item 6 — Directors, Senior Management and Employees.

### ***Preemptive Rights***

Under Swiss law, any share issue, whether for cash or non-cash consideration, is subject to the prior approval at the shareholders' meeting. Shareholders of the Company have certain preemptive rights to subscribe for new issues of shares in proportion to the nominal amount of shares held. A resolution adopted at

a shareholders' meeting with a two-thirds majority may, however, limit or suspend preemptive rights in certain limited circumstances.

At the 1998 shareholders' meeting, the shareholders of the Company authorized the Board to issue from time to time up to two million shares for the purpose of accommodating options and conversion rights granted to the Company's employees and excluded the subscription rights of the holders of the Shares regarding thereto.

At the same meeting, the shareholders of the Company also authorized the Board to issue from time to time up to four million additional shares at its discretion and to allot preferential subscription rights relating thereto to third parties in the event that the additional shares are used by shareholders to takeover a business, in whole or in part, or to participate in or finance such takeover. According to article 651 of the Swiss Code of Obligations, this authorization was only valid for two years. At each Annual General Meeting held on April 13, 2000, March 22, 2002, and February 26, 2004, the shareholders consented to extend this authorization for another two years. The Board of Directors proposes to the Company's shareholders at the Company's Annual General Meeting to be held on March 2, 2006 to renew this authorization for another two years.

In addition to the above, the shareholders also authorized the Board to issue from time to time up to four million additional Shares in connection with the execution of option and conversion rights and to exclude the subscription rights of the holders of Shares regarding thereto.

#### *Notices*

Notices to shareholders are validly made by publication in the Swiss Official Gazette of Commerce. The Board may designate further means of communication for publishing notices to shareholders.

#### *Duration and Liquidation*

The Articles do not limit the Company's duration.

The Company may be dissolved at any time by a shareholders' resolution which must be passed by (i) a simple majority of the shares represented at the meeting if the Company is being dissolved by way of liquidation and (ii) two-thirds of the shares represented at the meeting if the Company is being dissolved for other reasons (for example, in a merger where the Company is not the surviving entity).

Under Swiss law, any surplus arising out of a liquidation (after settlement of all claims of creditors) is distributed to shareholders in proportion to the paid-up nominal value of shares held.

#### *Disclosure of Principal Shareholders*

Under the applicable provisions of the Swiss Stock Exchange Act, shareholders (and groups of shareholders acting in concert) who own shares or other securities representing more than 5 percent, 10 percent, 20 percent, 33 $\frac{1}{3}$  percent, 50 percent or 66 $\frac{2}{3}$  percent of the voting rights of a company incorporated in Switzerland of which at least one class of equity securities is listed on the Swiss Exchange are required to notify the company and the Swiss Exchange of such holdings, whether or not the voting rights can be exercised. Following receipt of such notification, the company is required to inform the public. The same disclosure obligation applies to subsequent reductions in the holding of voting rights below the thresholds described above.

An additional disclosure obligation exists under Swiss corporate law pursuant to which the Company must disclose the identity of all of its shareholders (or related groups of shareholders) who hold more than 2 percent of its voting rights (i.e. shareholders owning shares in excess of the limit set forth in the Articles. See Shares and Transfer of Shares. Disclosure of shareholders owning more than 2 percent but less than 5 percent of the voting rights in the Company must only be made once a year in the notes to the financial statements published in the annual report. See Item 7 — Major Shareholders and Related Party Transactions.

## **Material Contracts**

### ***ADR Deposit Agreement***

Pursuant to the Second Amended and Restated Deposit Agreement (including all exhibits thereto, the “Deposit Agreement”) dated as of August 2, 2000 among the Company, Citibank, N.A., and the registered holders and beneficial owners from time to time of the ADRs of the Company, ADRs evidencing ADSs are issuable by Citibank on behalf of the Company. Each ADS represents the right to receive one-half of one share deposited under the Deposit Agreement. Shares are deposited to an account maintained by Citibank, N.A., Zürich Branch, as the custodian and agent of the Depositary in Switzerland. Only persons in whose names ADRs are registered on the books of the Depositary are treated by the Depositary and the Company as the absolute owners of such ADRs.

### ***EMTN Program***

In 1997, the Company set up a Euro Medium Term Notes program under which certain specified subsidiaries of the Company may issue bonds up to an aggregate amount of USD 2 billion. The program documentation, among Ciba Specialty Chemicals Corporation, Ciba Specialty Chemicals Eurofinance Ltd., Ciba Specialty Chemicals PLC, Ciba Spezialitätenchemie Holding Deutschland GmbH, the Company and the Dealers named thereon, includes an offering circular, a program agreement, a deed of covenant and a guarantee by the Company. As of December 31, 2005, approximately CHF 547 million (USD 417 million) of indebtedness was outstanding under the program. The Company currently has no plans to utilize this program in the future.

### ***Exchange Controls***

There are no legislative or other legal provisions currently in force in Switzerland or arising under the Articles restricting the export or import of capital, including, but not limited to, the availability of cash and cash equivalents for use by the Company’s group, or that affect the remittance of dividends, interest or other payments to nonresident holders of securities of the Company. Cash dividends payable in Swiss francs on Shares and ADSs may be officially transferred from Switzerland and converted into any other convertible currency. There are no limitations imposed by Swiss laws or the Company’s Articles on the right of non-Swiss residents to hold or vote the Shares or ADSs, as described above under Memorandum and Articles of Incorporation (“Articles”).

## **Taxation**

### ***Swiss Taxation***

#### ***Swiss Tax Consequences of Holding Shares or ADSs***

The following is a summary of the material Swiss tax consequences of the ownership of Shares or ADSs, in particular by United States holders (as defined below; see United States Taxation). The summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase Shares or ADSs, and prospective investors should consult their professional advisors as to the tax consequences of their purchase, ownership and disposition of shares and ADSs. In particular, the summary does not address the tax treatment of holders subject to special tax rules, such as banks, insurance companies and dealers in securities, investors liable for alternative minimum tax or investors who hold shares or ADSs as part of a straddle or hedging or a conversion transaction, some of which may be subject to special rules. This summary should not be read as extending by implication to matters not specifically discussed herein. Additional rules may apply to holders of 10 percent or more in voting power or value of the Shares and ADSs. With respect to United States holders, this discussion generally applies only to such holders who hold Shares or ADSs as a Portfolio investment.

The description of the Swiss and United States tax laws and practices set forth below is based on the statutes, regulations, rulings, judicial decisions and other authorities as in force and as applied in practice on

the date of this Annual Report and is subject to changes to those laws and practices, subsequent to that date, which changes could be made on a retroactive basis.

It is assumed for purpose of this summary that a United States holder is entitled to the benefits of the Swiss-American Treaty on Double Taxation (the “Treaty”). A United States holder would generally be eligible for the benefits of the Treaty. However, certain exceptions apply, including (a) United States citizens or residents that do not have a substantial presence, permanent home or habitual abode in the United States, and (b) United States corporations that fail to satisfy the “limitations on benefits” provisions of Article 22 of the Treaty because of the nature of their activities in the United States and the nature of their shareholders.

#### *Swiss Withholding Tax on Dividends and Distributions*

Dividends paid and similar cash or in kind distributions made by the Company to a holder of Shares or ADSs (including dividends on liquidation proceeds and stock dividends) are subject to a Swiss federal withholding tax (the “withholding tax”) at a rate of 35 percent. The withholding tax must be withheld by the Company from the gross distribution and be paid to the Swiss Federal Tax Administration. The withholding tax is refundable in full to a Swiss resident who receives a distribution if such resident is the beneficial owner of the payment and duly reports the gross distribution received on his tax return. However, the Company might be entitled to settle its withholding tax obligations by simply notifying the Swiss Federal Tax administration if the distribution is paid to a Swiss resident company holding at least 20 percent of the Company’s equity. An individual or corporation that is a resident of a country other than Switzerland and that owns or is deemed to own Shares or ADSs will be subject to the 35 percent withholding tax. The withholding tax, however, is a final charge for non-residents unless, such an individual or corporation could be eligible for an exemption or refund of the withholding tax if a tax treaty is in effect between such individual’s or corporation’s country of residence and Switzerland. Switzerland has concluded such treaties with the United States, Canada, Japan, all European Union member states and certain other countries.

The Depository intends to make use of informal procedures under which it will submit a certificate to the Swiss tax authorities in respect of all United States holders who have provided certifications of their entitlement to treaty benefits. So long as these procedures remain available it generally should be possible for qualifying United States holders to recover on a timely basis withholding tax in excess of the 15 percent rate as provided in the Treaty. There can be no assurance that these informal procedures will remain available.

Alternatively, a United States holder that qualifies for Treaty benefits (a “United States resident”) may apply on an individual basis for a refund of the withholding tax withheld in excess of the 15 percent Treaty rate. The claim for refund must be filed with the Swiss Federal Tax Administration, Eigerstrasse 65, 3003 Berne, Switzerland (<http://www.estv.admin.ch>). The form used for obtaining a refund is Swiss Tax Form 82I for individuals, Form 82C for corporations, Form 82 E for other United States citizens, and Form 829 for Swiss citizens resident in the United States, which may be obtained from any Swiss Consulate General in the United States or from the Swiss Federal Tax Administration at the address above. The form must be filled out in triplicate with each copy duly completed and signed before a notary public in the United States. The form may be filed no earlier than July 1 or January 1 following the dividend date but no later than December 31 of the third year following the calendar year that includes the dividend date. The form must be accompanied by evidence of the deduction of withholding tax withheld at the source.

#### *Stamp Duties upon Transfer of Securities (Umsatzabgabe)*

The sale of Shares may be subject to a Swiss securities transfer stamp duty of 0.15 percent calculated on the sale proceeds if it occurs through or with a Swiss bank or other Swiss securities dealer as defined in the Swiss Federal Stamp Tax Act.

#### *Summary of Swiss Tax Consequences*

A non-resident holder of Swiss Shares will not be liable for any Swiss taxes other than the withholding tax described above and the Swiss Securities transfer stamp duty if the transfer occurs through or with a Swiss

securities dealer. If, however, the Shares can be attributed to a permanent establishment or fixed place of business maintained by such person within Switzerland, the Shares may be subject to Swiss taxes generally.

### *United States Taxation*

The following is a general summary of certain United States federal income tax consequences of the purchase, ownership, and disposition of Shares and ADSs. The summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase Shares or ADSs, and prospective investors should consult their professional advisors as to the tax consequences of their purchase, ownership and disposition of Shares and ADSs.

For purposes of this discussion, a “United States holder” means any individual, citizen or resident of the United States for United States federal income tax purposes, corporations created or organized under the laws of the United States or any state thereof or the District of Columbia, or estates or trusts which are residents in the United States for United States federal income tax purposes, in each case who:

- is not also resident of, or ordinarily resident in Switzerland for Swiss tax purposes;
- is not engaged in a trade or business in Switzerland through a permanent establishment; and
- does not own, directly, indirectly or by attribution, 10 percent or more of the Shares (by vote or value).

This summary is of a general nature only and does not discuss all aspects of United States and Swiss taxation that may be relevant to a particular investor. This summary deals only with Shares and ADSs held as capital assets and does not address special classes of purchasers, such as dealers in securities, United States holders whose functional currency is not the U.S. dollar and certain United States holders (including, but not limited to, insurance companies, tax-exempt organizations, financial institutions and persons subject to the alternative minimum tax) who may be subject to special rules. In particular, the following summary does not address the adverse tax treatment of United States holders who own, directly, or by attribution, one or more of the Company’s outstanding classes of voting stock in the event that the Company were to be classified as a “Controlled Foreign Corporation” for United States federal income tax purposes. The Company was not classified as a Controlled Foreign Corporation at December 31, 2004. There can, however, be no assurance that it will not be a Controlled Foreign Corporation in the future.

Owners of ADSs are advised to consult their own tax advisors with respect to the United States federal, state and local tax consequences, of the ownership of ADSs and Shares applicable to their particular tax situations.

For purposes of tax treaties and United States tax laws, United States holders will be treated as the owners of the Shares represented by ADSs.

### *United States Income Tax on Dividends*

The gross amount of any dividends received with respect to the ADSs or Shares (including amounts withheld in respect of the Withholding Tax) generally will be subject to United States federal income taxation as foreign source dividend income, and will not be eligible for the dividends received deduction allowed to corporations. For this purpose, a “dividend” will include any distribution paid by the Company with respect to the ADSs or Shares, as the case may be, but only to the extent such distribution is not in excess of the Company’s current and accumulated earnings and profits as defined for United States federal income tax purposes. Any distribution that exceeds the Company’s earnings and profits will be treated as a nontaxable return of capital to the extent of the United States holder’s tax basis in the ADSs or Shares and thereafter as capital gain. Dividends paid in Swiss francs will be includable in the income of United States holders in a U.S. dollar amount calculated by reference to the exchange rate in effect on the date of receipt by the holder, or in the case of Shares held in ADS form, by the Depositary. If dividends paid in Swiss francs are converted into U.S. dollars on the date of receipt, holders generally should not be required to recognize foreign currency gain or loss in respect of the dividend income.

Subject to generally applicable limitations under United States tax law, the non-recoverable portion of the Withholding Tax (at the 15 percent rate as provided in the Treaty) will be treated as a foreign income tax that is eligible for credit against a holder's United States federal income tax liability or, at the holder's election, may be deducted in computing taxable income.

United States residents that receive a Treaty refund may be required to recognize foreign currency gain or loss to the extent the amount of the refund (in U.S. dollars) received by the United States resident differs from the U.S. dollar equivalent of the Treaty refund on the date the dividends were received by the United States resident or (in the case of ADSs) the Depository.

#### *United States Capital Gains Tax upon Disposal of ADSs or Shares*

Gains realized by a United States holder on the sale or other disposition of ADSs or Shares generally will be subject to United States federal income taxation as capital gain, and generally will be treated as United States source income. A United States holder will recognize capital gain or loss on the disposition of ADSs or Shares equal to the difference between the amount realized upon the disposition and the United States holder's tax basis in the ADSs or Shares. Such capital gain will be long-term capital gain if the ADSs or Shares were held for more than one year. Deposits and withdrawals of Shares in exchange for ADSs will not result in the realization of gain or loss for United States federal income tax purposes.

#### *United States Information Reporting and Backup Withholding Obligations*

Dividends paid on ADSs or Shares to a United States person are generally subject to information reporting and may be subject to backup withholding at the rate of 28 percent for payments made after 2002, unless the holder (i) is a corporation or other exempt recipient or (ii) provides a taxpayer identification number and certifies that no loss of exemption from backup withholding has occurred.

Dividends paid on ADSs or Shares to a holder that is not a United States person are generally exempt from information reporting and backup withholding under current law. However, such a holder may be required to provide a certification to ensure such exemption.

#### *Documents on Display*

The documents referred to herein can be obtained from the Company at its registered office at Klybeckstrasse 141, 4002 Basel, Switzerland.

### **Item 11. *Quantitative and Qualitative Disclosures About Market Risk***

#### **Market risk due to fluctuating foreign currency exchange rates and interest rates**

As a result of its global operating and financial activities, the Company is exposed to market risk from changes in foreign currency exchange rates and interest rates. The Company actively manages the resulting exposure through its regular operating and financing activities and, when deemed appropriate, through the use of derivative financial instruments. In accordance with the written policies of the Company, such instruments are used only as risk management tools and not for speculative or trading purposes. The Company's written policy with respect to the use of risk management tools has been updated in 2005.

The Company collects global cash flow information on a monthly basis and, based on these cash flows, prepares a consolidated exposure forecast by currency and determines to what extent these consolidated currency exposures will be hedged. Foreign currency forwards and swaps as well as options may be used to reduce the Company's exposure that results from the market risk arising from the fluctuation of foreign currency exchange rates. To reduce the cost of such activities, the Company may sell covered options. Potential losses, if any, on these sold options would be substantially offset by gains on the underlying transactions that are hedged. The Company's primary net foreign currency market exposures include the U.S. dollar, the euro, the British pound and the Japanese yen. In 2005, the Company's hedging activities have to a large extent focused on the U.S. dollar. However, hedging activities on the other major currencies as well as on selected minor currencies have also been undertaken.

The fair value of foreign currency exchange contracts is sensitive to changes in foreign currency exchange rates. As of December 31, 2005, a 10 percent appreciation in foreign currency exchange rates against the Swiss franc, with all other variables held constant, would have resulted in a decrease in the fair value of the Company's financial instruments of CHF 66 million. Conversely, a 10 percent depreciation in these currencies would have resulted in an increase in the fair value of the Company's financial instruments of CHF 81 million as of December 31, 2005. As the impact of offsetting changes in the fair value of the underlying positions is not included in the sensitivity model, these results are not indicative of an increase or decrease in the Company's actual exposure to foreign currency exchange risk. Consistent with the nature of the economic hedge of such foreign currency exchange contracts, such unrealized gains or losses would be compensated by the corresponding decreases or increases of the underlying transaction being hedged. The fair value of foreign currency forwards and swaps is calculated by separating the two components and applying the forward rate and the balance sheet rate as well as a discount factor. The discount factor is composed of the respective yield curves as well as the number of days until maturity. The fair value of options is calculated by applying the Black-Scholes model.

The Company is exposed to market risks due to fluctuating interest rates primarily through its borrowing activities and less so through its investments. The Company utilizes borrowings denominated in Swiss francs and in foreign currencies to fund its working capital and investment needs. The majority of short-term borrowings are in foreign currencies and floating interest rate instruments whereas the majority of long-term borrowings are in fixed interest rate instruments. The Company manages its ratio of fixed to floating interest rate instruments with the objective of achieving a mix which is appropriate both in terms of risk and cost. To manage this mix effectively, the Company, selectively, enters into interest rate swaps and forward rate agreements, in which it agrees to exchange various combinations of fixed and variable interest rates based on agreed-upon nominal amounts.

There is inherent roll-over risk for borrowings as they mature and are renewed at current market rates. Based on the short-term and long-term debt balance outstanding at December 31, 2005, a hypothetical one percentage point increase in interest rates for a one-year period would have reduced net income by CHF 8 million. The assumption is that the floating rate debt would be impacted by this hypothetical one percentage point increase but not fixed rate agreements.

**Item 12. *Description of Securities Other than Equity Securities***

Not applicable.

**PART II**

**Item 13. *Defaults, Dividend Arrearages and Delinquencies***

None.

**Item 14. *Material Modification to the Rights of Security Holders and Use of Proceeds***

None.

**Item 15. *Controls and Procedures***

Based on management's evaluation (with the participation of the Chief Executive Officer and Chief Financial Officer), the Chief Executive Officer and Chief Financial Officer have concluded that as of December 31, 2005, the disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act")) are effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms and to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to its management, including its

principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Since the last evaluation by the Company of the Company's internal controls there have not been any significant changes in the internal controls, or in factors that could significantly affect the internal controls.

**Item 16A. *Audit Committee Financial Expert***

For information related to the Audit Committee Financial Expert see Item 6 — Directors, Senior Management and Employees.

**Item 16B. *Code of Ethics***

For information related to the Company's Code of Ethics see Item 6 — Directors, Senior Management and Employees.

**Item 16C. *Principal Accountant Fees and Services***

For information with regard to pre-approval procedures and fees paid to the Company's auditors, see Item 6 — Directors, Senior Management and Employees — Auditors.

**Item 16D. *Exemptions from the Listing Standards for Audit Committees***

Not applicable

**Item 16E. *Purchases of Equity Securities by the Company***

<b>Period</b>	<b>(a) Total number of Shares purchased</b>	<b>(b) Average price paid per Share</b>	<b>(c) Total number of Shares purchased as part of publicly announced plans or programs</b>	<b>d) Maximum number (or approximate dollar value) of Shares that may yet be purchased under the plans or programs</b>
<b>January</b> .....	0	N/A	0	0
<b>February</b> .....	252,927	80.55	0	0
<b>March</b> .....	257,171	78.88	0	0
<b>April</b> .....	145,280	76.47	0	0
<b>May</b> .....	579,327	74.82	0	0
<b>June</b> .....	0	N/A	0	0
<b>July</b> .....	19,920	75.08	0	0
<b>August</b> .....	111,583	77.78	0	0
<b>September</b> .....	102,838	75.54	0	0
<b>October</b> .....	0	N/A	0	0
<b>November</b> .....	2,580	72.56	0	0
<b>December</b> .....	0	N/A	0	0
<b>Total</b> .....	<u>1,471,626</u>	<u>76.95</u>	<u>0</u>	<u>0</u>

The Company's Share buy-back program over the second trading line began on August 27, 2003 and ended on August 26, 2004. Until the end of 2003, the Company had repurchased 1 303 500 shares. Its Annual General Meeting approved the cancellation of these Shares. From January 1, 2004 until the end of the Share buy-back program, the Company purchased another 1 762 000 Shares, which were proposed to be cancelled. The shareholders approved this proposal at the Company's Annual General Meeting on March 3, 2005. In 2005, the Company did not repurchase any Shares under a Share buy-back program.

Under Swiss law (art. 659 para. 1 Swiss Code of Obligations), a company is allowed to purchase and to hold a maximum of 10 percent of its own shares, subject to certain exceptions. As the total number of issued and outstanding Shares amounts 69 064 617, the Company would be allowed to hold a maximum of 6 906 461 own Shares.

Shares purchased but not cancelled are held as treasury stock and may be sold back to the market.

### PART III

#### Item 17. *Financial Statements*

The Company is furnishing financial statements pursuant to the instructions of Item 18 of Form 20-F.

#### Item 18. *Financial Statements*

See pages F-1 through F-43

#### Item 19. *Exhibits*

(a) The following consolidated financial statements, together with the auditors' reports of Ernst & Young Ltd, are filed as part of this Annual Report:

<u>Index to consolidated financial statements</u>	<u>Page</u>
Report of Independent Public Accounting Firm — Ernst & Young Ltd.....	F-2
Consolidated Statements of Income for the Years ended December 31, 2005, 2004 and 2003 .....	F-3
Consolidated Balance Sheets at December 31, 2005 and 2004 .....	F-4
Consolidated Statements of Cash Flows for the Years ended December 31, 2005, 2004 and 2003...	F-5
Consolidated Statements of Shareholders' Equity for the Years ended December 31, 2005, 2004 and 2003 .....	F-6
Business Segment Data .....	F-7
Geographic Data .....	F-12
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All schedules are omitted because they are not applicable or because the required information is contained in the Consolidated Financial Statements or Notes thereto.

(b) Documents filed as exhibits to this registration statement:

- +1.1 Articles of Association of Ciba Specialty Chemicals Holding Inc. dated March 3, 2005
- \*\*1.2 Specimen share certificate of Ciba Specialty Chemicals Holding Inc.
- \*2.1 Second Amended and Restated Deposit Agreement dated as of August 2, 2000, between Ciba Specialty Chemicals Holding Inc., Citibank, N.A., and the additional parties named therein.
- \*2.2 Form of American Depositary Receipt of Ciba Specialty Chemicals Holding Inc.
- \*\*\*4.1 EMTN Programme Agreement in respect of a USD 2 billion Euro Medium Term Note Programme dated March 27, 2003, among Ciba Specialty Chemicals PLC, Ciba Specialty Chemicals Corporation, Ciba Specialty Chemicals Eurofinance Ltd., Ciba Spezialitätenchemie Holding Deutschland GmbH, Ciba Specialty Chemicals Holding Inc., Credit Suisse First Boston (Europe) Limited and the additional parties named therein.
- \*\*\*4.2 EMTN Deed of Covenant in respect of a USD 2 billion Euro Medium Term Note Programme dated March 27, 2003, by each of Ciba Specialty Chemicals Corporation, Ciba Specialty Chemicals Eurofinance Ltd., Ciba Specialty Chemicals PLC, Ciba Spezialitätenchemie Holding Deutschland GmbH, Ciba Specialty Chemicals Holding Inc., in favor of the account holders of Clearstream Banking, société anonyme and the additional beneficiaries named therein.

- \*\*\*4.3 EMTN Deed of Guarantee in respect of a USD 2 billion Euro Medium Term Note Programme dated March 27, 2003, by Ciba Specialty Chemicals Holding Inc.
- \*\*\*4.4 EMTN Agency Agreement in respect of a USD 2 billion Euro Medium Term Note Programme dated March 27, 2003, among Ciba Specialty Chemicals PLC, Ciba Specialty Chemicals Corporation, Ciba Specialty Chemicals Eurofinance Ltd., Ciba Spezialitätenchemie Holding Deutschland GmbH, Ciba Specialty Chemicals Holding Inc., The JP Morgan Chase Bank and J.P. Morgan Bank Luxembourg S.A. The total amount of long-term debt securities of the Company or of its subsidiaries authorized under any other instrument does not exceed 10 percent of the total assets of the Company on a consolidated basis. The Company hereby agrees to furnish to the Commission, upon its request, a copy of any instruments defining the rights of holders of long-term debt of the Company or of its subsidiaries for which consolidated or unconsolidated financial statements are required to be filed.
- \*\*4.8 Master Spin-off Agreement dated December 20, 1996, between Novartis AG and Ciba Specialty Chemicals Holding Inc.
- \*\*4.9 Transaction Agreement re: Sale of the Performance Polymers division to Morgan Grenfell Private Equity dated December 14, 1999, by and between Ciba Specialty Chemicals Holding Inc. and Avanti N03.
  - 8.1 List of Certain Subsidiaries.
  - 12.1 Certification Pursuant to Rule 13a-14(A)/15d-14(A)
  - 12.2 Certification Pursuant to Rule 13a-14(A)/15d-14(A)
  - 13.1 Certification Pursuant to 18 U.S.C. Section 1350
  - 23.1 Consent of Ernst & Young Ltd.

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+Incorporated by reference from the Form 6-K of Ciba Specialty Chemicals Holding Inc., furnished May 17, 2005. (File No. 333-56040)

\*Incorporated by reference to Post-Effective Amendment No. 1 to the Registration Statement of Ciba Specialty Chemicals Holding Inc. on Form F-6, filed August 2, 2000. (File No. 082-04541)

\*\*Incorporated by reference to the Registration Statement of Ciba Specialty Chemicals Holding Inc. on Form 20-F

\*\*\* Incorporated by reference to the Annual Report of Ciba Specialty Chemicals Holding Inc. on Form 20-F filed on February 1, 2005.

**Signature**

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, Ciba Specialty Chemicals Holding Inc. certifies that it has reasonable grounds to believe that it meets all requirements for filing on Form 20-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Ciba Specialty Chemicals Holding Inc.,

By: /s/ Michael Jacobi

Name: Michael Jacobi

Title: Chief Financial Officer

Date: February 2, 2006

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## **Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Shareholders of Ciba Specialty Chemicals Holding Inc.

We have audited the accompanying consolidated balance sheets of Ciba Specialty Chemicals Holding Inc. (the "Company") as of December 31, 2005 and 2004, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Ciba Specialty Chemicals Holding Inc. at December 31, 2005 and 2004, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

As discussed in Note 17 to the consolidated financial statements, the Company changed its accounting principles to adopt, as of January 1, 2003, the provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation". As discussed in Note 17 to the consolidated financial statements, the Company changed its accounting principles to adopt, as of July 1, 2005, the provisions of Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment".

As discussed in Note 1 to the consolidated financial statements, in 2003 the Company adopted Financial Accounting Standards Board Interpretation No. 46 "Consolidation of Variable Interest Entities".

/s/ ERNST & YOUNG LTD

Zurich, Switzerland  
January 31, 2006

## Consolidated Statements of Income

(In millions of Swiss francs, except share and per share data)

<u>Year ended December 31,</u>	<u>Notes</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Net sales .....		7 419	7 027	6 646
Cost of goods sold .....		<u>(5 302)</u>	<u>(4 856)</u>	<u>(4 579)</u>
<b>Gross profit</b> .....		2 117	2 171	2 067
Selling, general and administrative .....		(1 178)	(1 224)	(1 190)
Research and development .....		(301)	(288)	(281)
Amortization of other intangible assets .....	8	(59)	(47)	(33)
Restructuring, impairment and other charges .....	23	<u>(703)</u>	<u>(91)</u>	<u>0</u>
<b>Operating income (loss)</b> .....		(124)	521	563
Interest expense .....		(135)	(141)	(142)
Interest income .....		21	33	34
Other financial expense, net .....		<u>(23)</u>	<u>(39)</u>	<u>(24)</u>
<b>Income (loss) from continuing operations before income taxes and minority interest</b> .....		(261)	374	431
Provision for income taxes .....	14	(18)	(92)	(81)
Minority interest .....		<u>(7)</u>	<u>(4)</u>	<u>(5)</u>
<b>Income (loss) from continuing operations</b> .....		(286)	278	345
Income from discontinued operations, net of tax .....	21	30	28	0
Cumulative effect of change in accounting principles, net of tax ...		<u>0</u>	<u>0</u>	<u>(16)</u>
<b>Net income (loss)</b> .....		<u>(256)</u>	<u>306</u>	<u>329</u>
<b>Earnings (loss) per share, basic and diluted</b> .....	19			
Continuing operations .....		(4.38)	4.21	5.05
Discontinued operations .....		0.46	0.43	0.00
Cumulative effect of change in accounting principles .....		<u>0.00</u>	<u>0.00</u>	<u>(0.23)</u>
<b>Net income (loss) per share</b> .....		<u>(3.92)</u>	<u>4.64</u>	<u>4.82</u>
<b>Weighted average shares outstanding</b>				
Basic and diluted .....		<u>65 288 741</u>	<u>66 059 479</u>	<u>68 361 123</u>

See notes to consolidated financial statements

## Consolidated Balance Sheets

(In millions of Swiss francs, except share and per share data)

<u>December 31,</u>	<u>Notes</u>	<u>2005</u>	<u>2004</u>
<b>ASSETS</b>			
<b>Current assets</b>			
Cash and cash equivalents .....		1 259	1 614
Accounts receivable, net .....	4	1 149	1 064
Inventories .....	5	1 439	1 292
Prepaid and other current assets .....		<u>420</u>	<u>411</u>
<b>Total current assets</b> .....		4 267	4 381
Property, plant and equipment, net .....	6	2 724	3 015
Goodwill .....	7	1 495	1 561
Other intangible assets, net .....	8	831	823
Financial investments .....	9	132	180
Other assets .....	10	<u>1 163</u>	<u>1 036</u>
<b>Total assets</b> .....		<u>10 612</u>	<u>10 996</u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>			
<b>Current liabilities</b>			
Accounts payable .....		608	634
Short-term debt .....	12	277	559
Income taxes payable .....		106	116
Accruals and other current liabilities .....	11	<u>900</u>	<u>831</u>
<b>Total current liabilities</b> .....		1 891	2 140
Long-term debt .....	13	2 942	2 917
Deferred income taxes .....	14	404	413
Other liabilities .....	15	<u>1 392</u>	<u>1 306</u>
<b>Total liabilities</b> .....		6 629	6 776
Minority interest .....		80	68
<b>Shareholders' equity</b> .....	16		
Common stock <sup>(i)</sup> .....		69	212
Additional paid-in capital .....		3 993	4 146
Retained earnings .....		520	843
Accumulated other comprehensive loss .....		(409)	(575)
Treasury stock, at cost <sup>(ii)</sup> .....		<u>(270)</u>	<u>(474)</u>
<b>Total shareholders' equity</b> .....		<u>3 903</u>	<u>4 152</u>
<b>Total liabilities and shareholders' equity</b> .....		<u>10 612</u>	<u>10 996</u>

(i) Par value CHF 1 per share (December 31, 2004: CHF 3 per share), 79 064 617 shares authorized and 69 064 617 shares issued as of December 31, 2005 (80 826 617 shares authorized and 70 826 617 shares issued as of December 31, 2004).

(ii) December 31, 2005: 2 607 215 treasury shares; December 31, 2004: 4 686 272 treasury shares.

See notes to consolidated financial statements

## Consolidated Statements of Cash Flows

(In millions of Swiss francs)

<u>Year ended December 31,</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Cash flows from operating activities</b>			
Net income (loss) .....	(256)	306	329
Deduct income from discontinued operations, net of tax .....	<u>(30)</u>	<u>(28)</u>	<u>0</u>
Income (loss) from continuing operations .....	(286)	278	329
<i>Adjustments to reconcile income from continuing operations to net cash provided by operating activities:</i>			
Depreciation and amortization .....	421	394	366
Deferred income taxes .....	(64)	24	30
Restructuring, impairment and other charges .....	703	91	0
Restructuring payments .....	(82)	(11)	0
Gain on sale/disposal of assets, net .....	(68)	(2)	(7)
Realized gain on available-for-sale securities .....	(2)	0	(12)
Minority interest and other non-cash items, net .....	(78)	83	25
<i>Changes in operating assets and liabilities:</i>			
Accounts receivable, net .....	14	(60)	56
Inventories .....	(17)	(45)	173
Accounts payable .....	(59)	34	(9)
Other operating assets and liabilities .....	<u>(72)</u>	<u>(155)</u>	<u>82</u>
<b>Net cash provided by operating activities .....</b>	<b><u>410</u></b>	<b><u>631</u></b>	<b><u>1 033</u></b>
<b>Cash flows from investing activities</b>			
Capital expenditures .....	(275)	(294)	(233)
Proceeds from sale of assets .....	95	21	67
Sale (acquisition) of businesses, net of cash <sup>(i)</sup> .....	(50)	(810)	(71)
Loans and other long-term assets .....	<u>(62)</u>	<u>32</u>	<u>(2)</u>
<b>Net cash used in investing activities .....</b>	<b><u>(292)</u></b>	<b><u>(1 051)</u></b>	<b><u>(239)</u></b>
<b>Cash flows from financing activities</b>			
Increase (decrease) in short-term debt, net .....	(71)	51	(25)
Proceeds from long-term debt .....	5	31	715
Repayments of long-term debt .....	(275)	(27)	(1 084)
Dividends paid .....	(66)	0	0
Capital reduction paid .....	(130)	(197)	(206)
Treasury stock transactions .....	<u>11</u>	<u>(162)</u>	<u>(142)</u>
<b>Net cash used in financing activities .....</b>	<b><u>(526)</u></b>	<b><u>(304)</u></b>	<b><u>(742)</u></b>
<b>Effect of exchange rate changes on cash and cash equivalents .....</b>	<b><u>53</u></b>	<b><u>(48)</u></b>	<b><u>(27)</u></b>
<b>Net (decrease) increase in cash and cash equivalents .....</b>	<b>(355)</b>	<b>(772)</b>	<b>25</b>
Cash and cash equivalents, beginning of year .....	<u>1 614</u>	<u>2 386</u>	<u>2 361</u>
Cash and cash equivalents, end of year .....	<u>1 259</u>	<u>1 614</u>	<u>2 386</u>
<b>Supplemental cash flow information</b>			
Cash paid for interest .....	(139)	(144)	(103)
Cash paid for income taxes .....	(92)	(108)	(60)

(i) Sale (acquisition) of businesses, net of cash, includes cash paid for acquisitions and cash payments attributable to the divestment in 2000 of the Performance Polymers business. See note 21.

See notes to consolidated financial statements

## Consolidated Statements of Shareholders' Equity

(In millions of Swiss francs, except share and per share data)

	Notes	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive loss	Treasury stock		Total
						Unreserved shares	Reserved shares	
<b>Balance at December 31, 2002</b> . . . . .		649	4 205	208	(362)	(78)	(241)	4 381
Net income . . . . .				329				329
Currency translation adjustments . . . . .					(135)			(135)
Realization of previously unrealized gain on available-for-sale securities, net of tax of CHF 4 . . . . .	9				(4)			(4)
Unrealized gain on available-for-sale securities, net of tax of CHF 4 . . . . .					5			5
Minimum pension liability adjustment, net of tax of CHF 1 . . . . .					(2)			(2)
Other . . . . .					(1)			(1)
Comprehensive income (loss) . . . . .				329	(137)			192
Capital reduction paid <sup>(i)</sup> . . . . .		(216)	10					(206)
Treasury stock transactions . . . . .	16		3			11	(138)	(124)
Other . . . . .			11	(1)				10
<b>Balance at December 31, 2003</b> . . . . .		433	4 229	536	(499)	(67)	(379)	4 253
Net income . . . . .				306				306
Currency translation adjustments . . . . .					(76)			(76)
Comprehensive income (loss) . . . . .				306	(76)			230
Capital reduction paid <sup>(i)</sup> . . . . .		(213)	16					(197)
Share cancellation . . . . .	16	(8)	(110)				118	0
Treasury stock transactions . . . . .	16		2			(3)	(143)	(144)
Other . . . . .			9	1				10
<b>Balance at December 31, 2004</b> . . . . .		212	4 146	843	(575)	(70)	(404)	4 152
Net loss . . . . .				(256)				(256)
Currency translation adjustments . . . . .					189			189
Minimum pension liability adjustment, net of tax of CHF 16 . . . . .					(25)			(25)
Other . . . . .					2			2
Comprehensive income (loss) . . . . .				(256)	166			(90)
Capital reduction paid <sup>(i)</sup> . . . . .		(138)	8					(130)
Cash dividends declared and paid <sup>(ii)</sup> . . . . .				(66)				(66)
Share cancellation . . . . .	16	(5)	(157)				162	0
Treasury stock transactions . . . . .	16		(13)			(105)	147	29
Other . . . . .			9	(1)				8
<b>Balance at December 31, 2005</b> . . . . .		69	3 993	520	(409)	(175)	(95)	3 903

(i) Capital reduction paid in 2005 was CHF 2.00 per share (2004 and 2003: 3.00 per share).

(ii) Cash dividend declared and paid in 2005 was CHF 1.00 per share.

See notes to consolidated financial statements

**Business Segment Data**

(In millions of Swiss francs, except percentages)

<u>Year ended December 31,</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Net sales</b>			
Plastic Additives .....	1 938	1 895	1 822
Coating Effects .....	1 804	1 818	1 807
Water & Paper Treatment .....	2 394	2 014	1 616
Textile Effects .....	<u>1 283</u>	<u>1 300</u>	<u>1 401</u>
<b>Total net sales</b> .....	<u>7 419</u>	<u>7 027</u>	<u>6 646</u>
<b>Operating income (loss)</b>			
Plastic Additives .....	260	224	165
Coating Effects .....	233	291	298
Water & Paper Treatment .....	128	128	125
Textile Effects <sup>(ii)</sup> .....	(520)	61	68
Corporate and other expenses <sup>(ii)</sup> .....	<u>(225)</u>	<u>(183)</u>	<u>(93)</u>
<b>Total operating income (loss)</b> .....	<u>(124)</u>	<u>521</u>	<u>563</u>
<b>Restructuring, impairment and other charges<sup>(ii)</sup></b>			
Plastic Additives .....	0	0	0
Coating Effects .....	0	0	0
Water & Paper Treatment .....	0	0	0
Textile Effects .....	583	0	0
Corporate .....	<u>120</u>	<u>91</u>	<u>0</u>
<b>Total restructuring, impairment and other charges</b> .....	<u>703</u>	<u>91</u>	<u>0</u>
<b>Adjusted EBITDA<sup>(i)</sup></b>			
Plastic Additives .....	355	319	265
Coating Effects .....	340	394	395
Water & Paper Treatment .....	288	259	228
Textile Effects <sup>(ii)</sup> .....	(468)	117	128
Corporate <sup>(ii)</sup> .....	<u>(218)</u>	<u>(174)</u>	<u>(87)</u>
<b>Total adjusted EBITDA</b> .....	<u>297</u>	<u>915</u>	<u>929</u>
<b>Depreciation and amortization</b>			
Plastic Additives .....	95	95	100
Coating Effects .....	107	103	97
Water & Paper Treatment .....	160	131	103
Textile Effects .....	52	56	60
Corporate .....	<u>7</u>	<u>9</u>	<u>6</u>
<b>Total depreciation and amortization</b> .....	<u>421</u>	<u>394</u>	<u>366</u>

See notes to consolidated financial statements

**Business Segment Data — (continued)**

(In millions of Swiss francs, except percentages)

<u>Year ended December 31,</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Operating income margin</b>			
Plastic Additives .....	13.4%	11.9%	9.1%
Coating Effects .....	12.9%	16.0%	16.5%
Water & Paper Treatment .....	5.4%	6.3%	7.8%
Textile Effects .....	<u>(40.5)%</u>	<u>4.7%</u>	<u>4.9%</u>
<b>Operating income margin</b> .....	<u>(1.7)%</u>	<u>7.4%</u>	<u>8.5%</u>
<b>Adjusted EBITDA margin</b>			
Plastic Additives .....	18.3%	16.8%	14.6%
Coating Effects .....	18.9%	21.7%	21.8%
Water & Paper Treatment .....	12.0%	12.8%	14.1%
Textile Effects .....	<u>(36.5)%</u>	<u>9.0%</u>	<u>9.2%</u>
<b>Adjusted EBITDA margin</b> .....	<u>4.0%</u>	<u>13.0%</u>	<u>14.0%</u>
<b>Research and development</b>			
Plastic Additives .....	97	97	107
Coating Effects .....	104	101	95
Water & Paper Treatment .....	48	42	33
Textile Effects .....	29	29	32
Corporate .....	<u>23</u>	<u>19</u>	<u>14</u>
<b>Total research and development</b> .....	<u>301</u>	<u>288</u>	<u>281</u>
<b>Capital expenditures</b>			
Plastic Additives .....	72	76	64
Coating Effects .....	82	82	79
Water & Paper Treatment .....	89	81	55
Textile Effects .....	27	35	29
Corporate .....	<u>5</u>	<u>20</u>	<u>6</u>
<b>Total capital expenditures</b> .....	<u>275</u>	<u>294</u>	<u>233</u>

See notes to consolidated financial statements

**Business Segment Data — (continued)**

(In millions of Swiss francs, except percentages)

<u>Balance at December 31,</u>	<u>2005</u>	<u>2004</u>
<b>Net assets</b>		
Plastic Additives .....	1 441	1 321
Coating Effects .....	2 028	1 843
Water & Paper Treatment .....	3 283	3 164
Textile Effects .....	561	1 158
Shared operating net assets not allocated to segments <sup>(iii)</sup> .....	91	37
Non-operating net assets <sup>(iv)</sup> .....	<u>1 253</u>	<u>1 636</u>
<b>Invested capital<sup>(v)</sup></b> .....	8 657	9 159
Items not included in invested capital .....	<u>(4 754)</u>	<u>(5 007)</u>
<b>Total shareholders' equity (total net assets)</b> .....	<u>3 903</u>	<u>4 152</u>
<b>Components of items not included in invested capital</b>		
Net deferred tax liabilities .....	(63)	(157)
Short-term debt .....	(277)	(559)
Long-term debt .....	(2 942)	(2 917)
Other liabilities .....	(1 392)	(1 306)
Minority interest .....	<u>(80)</u>	<u>(68)</u>
<b>Total items not included in invested capital</b> .....	<u>(4 754)</u>	<u>(5 007)</u>
<b>Total assets</b>		
Plastic Additives .....	1 692	1 603
Coating Effects .....	2 275	2 090
Water & Paper Treatment .....	3 644	3 508
Textile Effects .....	785	1 361
Shared operating assets not allocated to segments <sup>(iii)</sup> .....	440	357
Non-operating assets <sup>(iv)</sup> .....	<u>1 776</u>	<u>2 077</u>
<b>Total assets</b> .....	<u>10 612</u>	<u>10 996</u>

- (i) Adjusted EBITDA is calculated as operating income plus depreciation and amortization. In financial statements published prior to June 30, 2005, the company referred to adjusted EBITDA as EBITDA.
- (ii) The CHF 583 million impairment charge relating to the impairment of the carrying value of the Company's Textile Effects Segment described in note 23 is considered a segment activity and is therefore charged to the Textile Effects Segment. All other restructuring, impairment and other charges apply principally to the Company as a whole and therefore are included in Corporate and are not allocated to the segments.
- (iii) Shared operating net assets not allocated to segments and shared operating assets not allocated to segments include certain net assets and shared assets of Group Service Units and Headquarters. Group Service Units provide services to the segments.
- (iv) Non-operating net assets and non-operating assets include primarily cash and cash equivalents and certain financial investments. Also included in non-operating net assets are certain Group Service Units' current liabilities.
- (v) Invested capital equals total assets less non-interest bearing current liabilities (i.e., accounts payable, income taxes payable as well as accruals and other current liabilities, except the current portion of deferred tax liabilities) and less deferred tax assets.

See notes to consolidated financial statements

## **Business Segment Data — (continued)**

The Company is organized into four reporting segments: Plastic Additives, Coating Effects, Water & Paper Treatment and Textile Effects. The Company's reporting segments develop, manufacture and market different products, services and solutions. They are managed separately because each segment has different customer markets and requires different technology and marketing strategies. The same accounting policies are consistently applied to reportable segments across the Company and all segments generate revenue in the same manner. Reported sales reflect only sales to third parties. Intersegment sales are not material.

The Company evaluates the performance of its reportable segments based on operating income as well as Earnings Before Interest, Taxes, Depreciation, Amortization and Minority Interest (adjusted EBITDA). Segment operating income includes all operating items relating to the segments and excludes restructuring and other charges that principally apply to the Company as a whole. Segment adjusted EBITDA and adjusted EBITDA margin together provide management with additional quantitative measures of the quality of sales growth as well as the results of past and current actions taken to manage costs. Management is therefore of the opinion that these financial indicators are an important measure of comparative operating performance for the businesses of the Company.

Invested capital is a non-United States Generally Accepted Accounting Principles ("U.S. GAAP") supplementary financial indicator. As with any supplementary financial indicator this supplementary financial indicator should be considered in addition to, not as a substitute for, operating income, net income, cash flow from operating activities, total assets, operating income margin and other measures of financial performance and liquidity reported in accordance with U.S. GAAP. The Company derives invested capital from financial measures prepared in accordance with U.S. GAAP.

### **Description of Segments**

The segment Plastic Additives develops, manufactures and markets products and provides services to the plastic and lubricant industries. The Segment's products are additives, which are ingredients added in small quantities to polymers and lubricants that prevent aging and corrosion and help improve appearance, durability and performance of finished goods such as polyolefins and engineering plastics as well as high-performance motor oils and industrial lubricants. The Segment's service business provides customers with product application solutions.

The segment Coating Effects is a leading global manufacturer of organic pigments and functional dyes as well as the leading supplier of photoinitiators and light stabilizers to the coatings, graphic arts and electronic industries. The Segment develops, manufactures and markets additives, pigments and functional dyes, as well as additive and pigment concentrates, for the coatings, printing, imaging, electronic, information storage, plastics and fibers industries. The end-user markets for its products and services are, among others, the automotive, packaging, publication, electronics, information storage, construction, photographic and digital printing industries.

The segment Water & Paper Treatment serves the paper and water treatment as well as the detergents and hygiene industries. The Segment offers products and services to the global paper and board industry. Its "effect chemicals" provide solutions to increase paper mill productivity and improve appearance, handling and performance of paper and board. The Segment also offers products and services used to treat the water streams in industrial and municipal applications and to improve the efficiency of mineral and oil processing as well as soil additives and specialty monomers. Furthermore the Segment provides whiteners and antimicrobials for detergents and hygiene effects for a variety of personal care products.

See notes to consolidated financial statements

**Business Segment Data — (continued)**

The segment Textile Effects serves the textile industry, offering dyes and chemicals, services and integrated solutions to customers along the whole textile value chain. The Segment's products include dyes and chemicals for dyeing and printing of almost all textile fibers, optical brighteners and textile finishing products for protection and easy-care. Services offered by the Segment include color matching via the Internet and technical consultancy regarding textile color and effects management for international brand houses and retailers.

See notes to consolidated financial statements

## Geographic Data

(In millions of Swiss francs)

<u>Net sales to customers</u>	<u>Year ended December 31,</u>		
	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Europe</b>			
Germany .....	615	635	584
United Kingdom .....	286	297	293
Italy .....	333	355	340
France .....	393	353	304
Rest of European Union <sup>(i)</sup> .....	1 290	1 140	933
Switzerland .....	77	80	99
Rest of Europe .....	<u>203</u>	<u>190</u>	<u>178</u>
<b>Total Europe</b> .....	<u>3 197</u>	<u>3 050</u>	<u>2 731</u>
<b>Americas</b>			
United States of America .....	1 360	1 366	1 415
Canada .....	219	212	199
Central America .....	165	154	167
South America .....	<u>343</u>	<u>314</u>	<u>285</u>
<b>Total Americas</b> .....	<u>2 087</u>	<u>2 046</u>	<u>2 066</u>
<b>Asia Pacific</b>			
Japan .....	431	406	381
Region China .....	545	482	440
Rest of Asia .....	752	641	627
Australia and New Zealand .....	162	158	159
Africa and Middle East .....	<u>245</u>	<u>244</u>	<u>242</u>
<b>Total Asia Pacific</b> .....	<u>2 135</u>	<u>1 931</u>	<u>1 849</u>
<b>Total net sales to customers</b> .....	<u>7 419</u>	<u>7 027</u>	<u>6 646</u>

Net sales to customers are based on the final destination of the sale.

See notes to consolidated financial statements

**Geographic Data — (continued)**

(In millions of Swiss francs)

<u>Long-lived assets</u>	<u>December 31,</u>	
	<u>2005</u>	<u>2004</u>
<b>Europe</b>		
Germany.....	287	366
United Kingdom.....	415	453
Italy.....	170	171
France.....	121	161
Rest of European Union <sup>(i)</sup> .....	223	232
Switzerland.....	435	593
Rest of Europe.....	<u>0</u>	<u>1</u>
<b>Total Europe</b> .....	<u>1 651</u>	<u>1 977</u>
<b>Americas</b>		
United States of America.....	669	663
Canada.....	5	3
Central America.....	81	86
South America.....	<u>27</u>	<u>24</u>
<b>Total Americas</b> .....	<u>782</u>	<u>776</u>
<b>Asia Pacific</b>		
Japan.....	21	20
Region China.....	154	165
Rest of Asia.....	91	52
Australia and New Zealand.....	17	18
Africa and Middle East.....	<u>8</u>	<u>7</u>
<b>Total Asia Pacific</b> .....	<u>291</u>	<u>262</u>
<b>Total long-lived assets</b> .....	<u>2 724</u>	<u>3 015</u>

(i) Rest of European Union includes all other European Union member countries as of December 31, 2005, that are not specifically listed. Amounts for 2004 and 2003 have been adjusted to include the same member countries.

Long-lived assets represent property, plant and equipment, net and are shown by the location of the assets.

See notes to consolidated financial statements

## **Notes to Consolidated Financial Statements**

(In millions of Swiss francs, except share and per share data)

### **1. Summary of significant accounting policies**

#### ***Company operations***

Ciba Specialty Chemicals Holding Inc. and its consolidated subsidiaries (the “Company”) is a global leader in the discovery and manufacture of innovative specialty chemicals that provide color, performance and care for plastics, coatings, textile, paper and other products. The Company’s products and services are also used to provide clean water and to treat water streams in industrial and municipal applications.

#### ***Basis of consolidation and presentation***

The accompanying consolidated financial statements of the Company have been prepared in accordance with United States Generally Accepted Accounting Principles (“U.S. GAAP”). The assets, liabilities and results of operations of entities in which the Company has a controlling financial interest have been consolidated. Investments in which the Company exercises significant influence (generally 20-50 percent ownership interest), but does not control, are accounted for under the equity method of accounting. All significant intercompany accounts and transactions have been eliminated in consolidation.

#### ***Use of estimates***

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management’s best knowledge of current events and actions the Company may undertake in the future, actual results ultimately may differ from those estimates.

#### ***Foreign currency translation***

The Company’s financial statements are prepared in millions of Swiss francs (CHF million). For most operations outside Switzerland, where the functional currency is the local currency, income, expense and cash flows are translated at average exchange rates during the period, and assets and liabilities are translated at period-end exchange rates. The translation adjustments are included as a component of accumulated other comprehensive income in shareholders’ equity. The financial statements of subsidiaries that operate in economic environments that are highly inflationary maintain financial information for reporting purposes in U.S. dollars or Swiss francs and include gains and losses from translation in income. For foreign currency transactions, changes in exchange rates that arise between transaction, reporting and settlement dates result in both realized and unrealized exchange gains and losses. These amounts are included in net income for the period.

#### ***Cash equivalents***

All highly liquid investments with original maturities of three months or less are considered to be cash equivalents.

#### ***Accounts receivable***

Accounts receivable are recorded at their net realizable value after deducting an allowance for doubtful accounts. Such deductions reflect either specific cases or estimates based on historical incurred losses. This also includes an allowance for country specific transfer risks.

## **Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

### ***Inventories***

The Company values its inventories at the lower of cost, determined principally on a first-in, first-out (FIFO) method, or market. Costs include all costs of production, including applicable portions of plant overhead. Allowances are made for obsolete and slow-moving inventory.

### ***Property, plant and equipment***

Property, plant and equipment are recorded at cost less accumulated depreciation. Depreciation is provided on a straight-line basis over the estimated useful lives of the assets ranging from approximately 20 to 50 years for buildings, 5 to 20 years for machinery and equipment, and 3 to 10 years for office furniture and fixtures and other equipment. The Company assesses its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. In such cases, if the sum of the asset's expected future undiscounted cash flows is less than the carrying amount of the asset, a loss is recognized for the excess of the asset's carrying amount over its fair value.

Property, plant and equipment acquired through finance lease arrangements are recorded as assets at the lesser of the present value of the minimum future lease payments or their fair value at the date of acquisition and depreciated over the useful life of the asset or, if the lease does not provide for the transfer of ownership of the assets to the Company, the lease term if it is shorter than the useful life of the asset. The corresponding obligation is recorded as a liability in the consolidated balance sheets.

### ***Goodwill and other intangible assets***

#### ***Goodwill***

Goodwill acquired in business combinations is capitalized at acquisition cost and annually evaluated at the reporting unit level for impairment using a two-step impairment test. In the first step, the book value of the reporting unit's assets, including goodwill and other intangibles, and liabilities (the "net assets") is compared to the fair value of the reporting unit. If the fair value of the reporting unit exceeds the book value of its net assets, goodwill is deemed not impaired and the second step is not required. If, however, the fair value of the reporting unit is less than the book value of its net assets, the second step is required to measure the amount of impairment loss, if any.

In the second step, the current fair value of the reporting unit is allocated to all of its tangible assets, other intangible assets (including unrecognized intangible assets but excluding goodwill) and liabilities (the "assets and liabilities"). This fair value allocation to the assets and liabilities is made as if the reporting unit had been acquired as of the impairment testing date in a business combination and the fair value of the reporting unit was the price that would have been paid to acquire the reporting unit. The excess, if any, of the total current fair value of the reporting unit over the sum of the individual fair values assigned to its assets and liabilities is considered to be the current implied goodwill value of the reporting unit. If the book value of the reporting unit's goodwill exceeds this implied goodwill value, that excess is an impairment loss, which is recorded as a component of operating income in the consolidated statements of income. If the book value of the reporting unit's goodwill is less than the implied goodwill value, goodwill is not impaired.

During 2005, 2004 and 2003, the Company completed the annual impairment test of goodwill and determined that its reported goodwill is not impaired except that in 2005 it was determined that the carrying amount of goodwill for the Textile Effects Segment is fully impaired. See notes 7 and 23.

#### ***Other intangible assets***

Purchased identifiable intangible assets ("other intangible assets") are capitalized at acquisition cost. Other intangible assets with finite lives are amortized on a straight-line basis over the estimated periods that

## **Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

such assets are expected to contribute to the cash flows of the Company (5 to 36 years). Other intangible assets with indefinite lives are not amortized.

The Company assesses other intangible assets with finite lives for impairment whenever events or changes in circumstances indicate that the carrying amounts may not be recoverable. For such assets that are tested for impairment, if the sum of the asset's expected future undiscounted cash flows is less than the carrying amount of the asset, a loss is recognized for the excess of the asset's carrying amount over its fair value.

Other intangible assets with indefinite lives are reviewed annually for impairment, or on an interim basis if indications of possible impairment are present. For such assets, if the carrying amount exceeds its fair value, an impairment loss is recognized in an amount equal to that difference. Intangible assets with indefinite lives are reviewed annually to determine whether their useful lives remain indefinite. If such an asset is then determined to have a finite life, the asset is tested for impairment. The carrying amount of the intangible asset after recognition of an impairment charge, if any, is then amortized over the asset's remaining useful life and further accounted for in the same manner as other intangible assets with finite lives.

### ***Financial investments***

Financial investments comprise primarily investments in equity affiliates that are not controlled by the Company, but in which the Company maintains a significant equity ownership or other interest, and investments in unconsolidated companies (less than 20 percent ownership and not otherwise controlled by the Company).

Investments in equity affiliates are accounted for using the equity method under which the Company originally records these at cost and subsequently adjusts the carrying amount to reflect its share of earnings less any dividends received.

Investments in unconsolidated companies are designated as available-for-sale securities and, where quoted market prices are available, are recorded at fair value. Unrealized gains and losses on these securities, net of tax, are included as a component of shareholders' equity in accumulated other comprehensive income (loss). Where quoted market prices do not exist and where it is not cost beneficial to estimate fair value, such investments are accounted for at cost. For financial investments where the Company deems a loss in value to be other than temporary, such loss is recorded in the consolidated statements of income.

### ***Derivative financial instruments***

For derivative financial instruments designated and that qualify as fair value hedges, changes in the fair values of the derivative financial instrument and the hedged item are recognized currently in earnings. The changes in fair value of the hedged item are recorded as adjustments to its carrying amount on the balance sheet. If the derivative financial instrument in a subsequent period is no longer designated or no longer qualifies as a fair value hedge, then the changes in fair value of the hedged item are not recognized in income. The previous changes in fair value that had been recorded as adjustments to the carrying amount of the hedged item are generally amortized to earnings as the hedged item affects earnings.

For derivative financial instruments designated and that qualify as cash flow hedges, changes in the effective portion of the derivative financial instrument's fair value are recorded in accumulated other comprehensive income in the balance sheet until the hedged item is recognized in earnings. The ineffective portion of the change in fair value of the derivative financial instrument is immediately recognized in the income statement as a component of financial income/expense. If the hedged item is a forecasted transaction that later is not expected to or will not occur, then the derivative financial instrument no longer qualifies as a cash flow hedge. As a result, fair value changes that were previously recorded in accumulated other comprehensive income are immediately recognized in earnings as a component of financial income/expense. In all other instances, when a derivative financial instrument ceases to be designated or to qualify as a cash

## **Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

flow hedge, the previously recorded changes in fair value remain in accumulated other comprehensive income until the hedged item affects earnings.

For derivative financial instruments that are not designated or that do not qualify as accounting hedges, the changes in the fair value of the derivative financial instruments are recognized currently in income as a component of other financial expense, net.

### ***Revenue recognition***

Revenue is recognized upon shipment of goods to customers. Provisions for discounts and rebates to customers, product returns and other adjustments are provided for in the same period the related sales are recorded.

### ***Income taxes***

The provision for income taxes has been determined using the asset and liability approach and consists of income taxes currently paid or payable to taxing authorities in the jurisdictions in which the Company operates plus the change in deferred taxes for the current year. Deferred taxes represent the estimated future tax consequences of temporary differences between the amounts of assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a future tax benefit will not be realized.

Provision has also been made for taxes that would be levied upon the remittance to the parent company of currently unremitted earnings of foreign operations. However, no such provision is made for unremitted earnings of foreign operations that are intended to be reinvested indefinitely or that can be remitted substantially free of tax. The provision for income taxes also includes income taxes from earnings of equity affiliates.

### ***Environmental compliance and expenditures***

The measurement of environmental liabilities is based on an evaluation of currently available facts with respect to each individual site and considers factors such as existing technology, presently enacted laws and regulations and prior experience in remediation of contaminated sites. Environmental operations and maintenance as well as remediation costs are accrued when environmental assessments and the need for remediation are probable and the costs can be reasonably estimated. The estimated liability is not discounted. Actual costs to be incurred at identified sites in future periods may vary from the estimates given the inherent uncertainties in evaluating environmental exposures.

### ***Earnings per share***

Basic earnings per share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share is similar to basic earnings per share except that it reflects the potential dilution that could occur if dilutive securities, such as stock options and convertible debt, were exercised or converted into common shares or resulted in the issuance of common shares that then shared in the earnings of the Company.

### ***Restructuring***

Costs associated with exit or disposal activities that do not involve discontinued operations are included in Restructuring, impairment and other charges in the Company's consolidated statements of income. Liabilities for costs associated with exit or disposal activities are initially recognized and measured at fair value in the period in which the liability is incurred. Liabilities for one-time termination benefits provided to employees that are involuntarily terminated are recognized and measured at their fair value at the communication date

## **Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

unless the employees are required to render service beyond a minimum retention period in order to receive the termination benefits. If employees are required to render service beyond a minimum retention period, liabilities for the termination benefits are measured initially at the communication date based on the fair value of the liabilities as of the termination date and recognized ratably over the future service period.

Liabilities for costs to terminate contracts before the end of their term are recognized and measured at their fair value when the contracts are terminated. Liabilities for costs that continue to be incurred under contracts for their remaining term without economic benefit to the Company are recognized and measured at their fair value when the Company ceases using the rights conveyed by the contracts. Liabilities for other costs associated with exit or disposal activities are recognized and measured at their fair value in the periods in which the liabilities are incurred.

### *New accounting standards*

#### *Consolidation of Variable Interest Entities*

In 2003, the FASB issued Interpretation No. 46, as revised (“FIN No. 46(R)”) “Consolidation of Variable Interest Entities, an interpretation of Accounting Research Bulletin No. 51”. FIN No. 46(R) introduced a variable interests model to determine control and consolidation of variable interest entities (“VIE”). A VIE is an entity that, by design, lacks sufficient equity or is structured such that the decision-making ability of its equity holders is limited. FIN No. 46(R) generally requires consolidation of a VIE by its primary beneficiary. A VIE’s primary beneficiary is the enterprise that, as a result of its interest in the VIE, absorbs a majority of the VIE’s expected losses, receives a majority of the VIE’s expected residual returns, or both. FIN No. 46(R) became fully applicable for financial statement reporting periods ending after March 15, 2004.

The Company participated in a leasing arrangement with a trust that was a VIE where the Company was the primary beneficiary. Prior to the implementation of FIN No. 46(R), the trust had appropriately not been consolidated consistent with then existing requirements. The leasing arrangement was entered into in 1995 by Ciba-Geigy, a predecessor of the Company and had been accounted for as an operating lease. The trust was created to issue debt and interest-bearing equity to fund the acquisition of land and construction of a facility thereon that it leased to the Company. The Company had not modified the leasing arrangement since its inception and was utilizing the facility in its business operations. The lease provided the Company the option to purchase the facility in 2005 for a termination value of CHF 91 million (USD 68 million), which the trust would use to repay its debt.

The Company applied the provisions of FIN No. 46(R) to the trust effective July 1, 2003 resulting in the consolidation of the trust in the Company’s consolidated financial statements and the recording of a charge to 2003 net income of CHF 16 million (CHF 26 million pre-tax less CHF 10 million income taxes) for the cumulative effect of the change in accounting principle.

The Company is not involved with any other significant entities in which it has ownership or other financial interests and that it currently does not consolidate, that are considered to be VIEs under FIN No. 46(R). Therefore, except as described above, the adoption of FIN No. 46(R) has not had a material effect on the Company’s results of operations or financial position.

#### *Disclosures about pensions and other postretirement benefits*

In December 2003, the FASB issued SFAS No. 132 (revised 2003), Employers’ Disclosures about Pensions and Other Postretirement Benefits, which requires additional disclosures to those in the original SFAS No. 132 about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other defined benefit postretirement plans. The Company fully adopted the revised standard in 2003 (see Note 18).

## Notes to Consolidated Financial Statements — (continued)

(In millions of Swiss francs, except share and per share data)

### Other

There were no new accounting standards issued by the Financial Accounting Standards Board (FASB) or other authoritative standard setters that became effective during 2005 and that had a material effect on the Company's financial statements. In addition, several other new accounting standards were issued by the FASB as of December 31, 2005 that were not required to be adopted during 2005, but will require adoption in 2006 or later. None of these issued but not yet adopted new accounting standards is expected to have a material effect on the Company's results of operations or financial position when adopted in the future.

### Reclassifications

Certain reclassifications to the 2004 financial statements and related footnote amounts have been made to conform to the 2005 presentation.

## 2. Exchange rates of principal currencies

		Statement of Income Average Rates			Balance Sheet Year-End Rates		
		2005	2004	2003	2005	2004	
1	U.S. dollar	(USD)	1.24	1.24	1.35	1.31	1.15
1	British pound	(GBP)	2.26	2.27	2.20	2.28	2.21
1	Euro	(EUR)	1.55	1.54	1.52	1.56	1.54
100	Japanese yen	(JPY)	1.13	1.15	1.16	1.12	1.11

## 3. Acquisitions

There were no significant acquisitions during 2005.

Effective May 31, 2004, the Company completed the acquisition of Raisio Chemicals Oy, from Raisio Group Oy, for a gross purchase price of approximately CHF 755 million comprising primarily of cash paid of CHF 662 million (EUR 436 million) and debt assumed of CHF 62 million.

See note 6.

## 4. Accounts receivable

	2005	2004
Accounts receivable	1 224	1 145
Allowance for doubtful accounts	(75)	(81)
<b>Total</b>	<b>1 149</b>	<b>1 064</b>

## 5. Inventories

	2005	2004
Raw materials	216	196
Work in process and finished goods	1 223	1 096
<b>Total</b>	<b>1 439</b>	<b>1 292</b>

Work in process and finished goods are shown after deducting allowances for obsolete, slow-moving and lower of cost or market adjustments of CHF 45 million as of December 31, 2005 and CHF 46 million as of December 31, 2004.

**Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

**6. Property, plant and equipment**

Changes in the components of property, plant and equipment and accumulated depreciation for the years ended December 31, 2005 and 2004 were as follows:

	2005				2004	
	Land	Buildings	Machinery and equipment	Construction in progress	Total	Total
<b>Cost at January 1, .....</b>	112	1 881	5 490	195	7 678	7 553
Additions .....	1	4	42	228	275	294
Retirements/disposals .....	(4)	(25)	(89)	(5)	(123)	(134)
Changes in consolidation scope <sup>(i)</sup> .....	6	22	25	1	54	264
Currency adjustments .....	6	93	280	10	389	(207)
Other <sup>(ii)</sup> .....	<u>0</u>	<u>(215)</u>	<u>(941)</u>	<u>(253)</u>	<u>(1 409)</u>	<u>(92)</u>
<b>Cost at December 31, .....</b>	<u>121</u>	<u>1 760</u>	<u>4 807</u>	<u>176</u>	<u>6 864</u>	<u>7 678</u>
Accumulated depreciation at						
January 1, .....	—	(946)	(3 717)	—	(4 663)	(4 590)
Depreciation .....	—	(64)	(298)	—	(362)	(347)
Accumulated depreciation on						
retirements/disposals .....	—	13	79	—	92	92
Currency adjustments .....	—	(36)	(181)	—	(217)	121
Other <sup>(ii)</sup> .....	<u>—</u>	<u>155</u>	<u>855</u>	<u>—</u>	<u>1 010</u>	<u>61</u>
<b>Accumulated depreciation at</b>						
<b>December 31, .....</b>	<u>—</u>	<u>(878)</u>	<u>(3 262)</u>	<u>—</u>	<u>(4 140)</u>	<u>(4 663)</u>
<b>Net book value at December 31, .....</b>	<u>121</u>	<u>882</u>	<u>1 545</u>	<u>176</u>	<u>2 724</u>	<u>3 015</u>

(i) In 2005, changes in consolidation scope result from several minor acquisitions. In 2004, changes in consolidation scope result primarily from the acquisition of Raisio Chemicals.

(ii) In 2005, amounts in other for buildings and machinery and equipment consist primarily of the impairment of the Textile Effects Segment. See note 23. Amounts in other for construction in progress reflect the capitalization to buildings and/or machinery and equipment of construction projects that were completed during the year.

The insurance value of the property, plant and equipment was approximately CHF 11 258 million at December 31, 2005 and CHF 10 452 million at December 31, 2004.

## Notes to Consolidated Financial Statements — (continued)

(In millions of Swiss francs, except share and per share data)

### 7. Goodwill

Changes in the carrying amount of goodwill by Segment from December 31, 2004 to December 31, 2005 were as follows:

	<u>December 31, 2004</u>	<u>Acquisitions</u>	<u>Impairment<sup>(i)</sup></u>	<u>Foreign currency translation adjustments</u>	<u>December 31, 2005</u>
Plastic Additives . . . . .	62	2	0	3	67
Coating Effects . . . . .	189	32	0	2	223
Water & Paper Treatment . . . . .	1 154	14	0	37	1 205
Textile Effects . . . . .	<u>156</u>	<u>0</u>	<u>(161)</u>	<u>5</u>	<u>0</u>
<b>Total</b> . . . . .	<u>1 561</u>	<u>48</u>	<u>(161)</u>	<u>47</u>	<u>1 495</u>

<sup>(i)</sup> Relates to the impairment of the Textile Effects Segment. See note 23.

### 8. Other intangible assets

Other intangible assets by major class consist of the following:

<u>December 31, 2005</u>	<u>Gross carrying value</u>	<u>Accumulated amortization</u>	<u>Net carrying value</u>
Developed technology and know-how . . . . .	776	(191)	585
Patents . . . . .	87	(25)	62
Trademarks and tradenames . . . . .	25	(2)	23
Minimum pension liability — intangible asset . . . . .	6	—	6
Other . . . . .	<u>185</u>	<u>(30)</u>	<u>155</u>
<b>Total</b> . . . . .	<u>1 079</u>	<u>(248)</u>	<u>831</u>
 <u>December 31, 2004</u>			
Developed technology and know-how . . . . .	782	(179)	603
Patents . . . . .	84	(15)	69
Trademarks and tradenames . . . . .	11	(1)	10
Minimum pension liability — intangible asset . . . . .	8	—	8
Other . . . . .	<u>145</u>	<u>(12)</u>	<u>133</u>
<b>Total</b> . . . . .	<u>1 030</u>	<u>(207)</u>	<u>823</u>

The intangible asset related to the minimum pension liability is not subject to amortization. For the remaining other intangible assets, 2005 amortization amounted to CHF 59 million (2004: CHF 47 million and 2003: CHF 33 million). Based on the other intangible assets values at December 31, 2005, the estimated future annual other intangible assets amortization expense is expected to be as follows: 2006: CHF 60 million; 2007: CHF 61 million; 2008: CHF 59 million; 2009: CHF 57 million; 2010: CHF 49 million; 2011 and thereafter CHF 539 million.

**Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

**9. Financial investments and instruments**

*Fair value of financial investments and instruments*

The Company determines that, due to their short-term nature, financial assets and liabilities such as cash equivalents, accounts receivable, accounts payable and short-term debt, have book values approximating their fair values.

The book value and fair value of the Company's long-term debt is as follows:

	2005		2004	
	<u>Book value</u>	<u>Fair value</u>	<u>Book value</u>	<u>Fair value</u>
Long-term debt, including current portion .....	2 946	3 027	3 175	3 256

The fair value of publicly traded long-term debt is estimated using quoted market prices. The fair value of other long-term debt is estimated by discounting future cash flows using interest rates currently available for similar debt with similar terms, credit ratings and remaining maturities.

The fair value of financial investments for which quoted market prices are available are based on such market prices. Financial investments for which quoted market prices do not exist and where it is not practical to estimate fair value are reflected at their book value. Quoted market prices are not available for investments in equity affiliates.

*Financial investments*

	<u>2005</u>	<u>2004</u>
Investments in equity affiliates .....	117	147
Investments in unconsolidated companies .....	<u>15</u>	<u>33</u>
<b>Total financial investments</b> .....	<u>132</u>	<u>180</u>

The most significant investments in equity affiliates are Compagnie Industrielle de Monthey SA (investment interest maintained at 50 percent for 2005, 2004 and 2003) and, until December 2004, Daihan Swiss Chemical Corp (investment interest maintained at 50 percent for 2003 and until December 2004). In December 2004, Daihan Swiss Chemical Corp (Daihan Swiss) acquired the 50 percent of its shares that were not held by the Company and immediately cancelled such shares, which resulted in the Company obtaining ownership of 100 percent of Daihan Swiss. Daihan Swiss obtained the financing for this share repurchase with funds borrowed from the Company. The results of Daihan Swiss were consolidated within the Company's financial statements effective January 1, 2005.

The following table presents as of December 31, 2005, 2004 and 2003, summarized financial information on a 100 percent basis for investments in companies accounted for using the equity method.

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Sales .....	89	149	127
Income before taxes .....	4	1	4
Net income (loss) .....	3	(1)	2
Total assets .....	90	178	110
Shareholders' equity .....	219	273	259

## **Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

### *Derivative financial instruments*

The Company enters into derivative financial instruments in the ordinary course of business to mitigate its exposure to adverse changes in foreign exchange rates and to manage its interest rate exposures. Various risk exposures, arising from existing assets and liabilities, from future transactions in which the Company is firmly committed and from future anticipated transactions, are assessed and managed centrally by the Company's treasury function based on the Company's aggregate exposure. Under the Company's written hedging policy, treasury management continuously monitors and reports the results of its risk management programs to senior management and may choose to partially or fully hedge exposures. The Company's risk management policies do not permit the utilization of financial instruments for speculative or trading purposes.

The Company has procedures to monitor the credit exposure amounts and manages exposure to counterparty credit risk through specific minimum credit standards and diversification of counter-parties. The counter-parties to financial instruments generally are financial institutions with a minimum 'A' credit rating or its equivalent and with significant experience with such instruments.

### *Foreign currency risk management*

A substantial portion of the Company's cash flows is denominated in foreign currencies. The Company collects global expected cash flow information on a monthly basis and, based on these cash flows, prepares a consolidated exposure forecast by currency and determines to what extent these consolidated currency exposures will be hedged. To hedge the balance sheet and income exposure associated with diminution in value of foreign currency cash flows (principally U.S. dollars, euro, British pounds and Japanese yen), the Company primarily utilizes foreign currency forwards and swaps as well as options, which generally expire within twelve months. In order to lower the overall hedging costs, the Company may issue derivatives on existing or future positions.

Generally, the Company does not designate foreign exchange contracts as accounting hedges. For specific anticipated transactions, the Company may designate the foreign exchange contract as a cash flow hedge. For specific firm purchase or sale commitments or for recognized foreign currency denominated assets and liabilities, the Company may designate the foreign exchange contract as a fair value hedge.

### *Interest rate risk management*

The Company is exposed to market risks due to fluctuating interest rates primarily through its borrowing activities and to a lesser extent through its investments. The Company issues debt using the most efficient capital markets and products to fund its working capital and investment needs, which can result in a currency or interest rate mismatch with the underlying assets. Some short-term borrowings are in foreign currencies and mostly floating interest rate instruments, whereas the majority of long-term borrowings are in fixed interest rate instruments. The Company manages its ratio of fixed to floating interest rate with financial instruments and the objective of achieving a mix that is appropriate both in terms of risk and cost. To manage this mix effectively, the Company selectively enters into interest rate swaps and forward rate agreements, in which it agrees to exchange various combinations of fixed and variable interest rates based on agreed-upon nominal amounts.

Interest rate swaps that qualify and are designated as a hedge against the change in the fair value of the Company's fixed-rate debt obligations are recorded as fair value hedges. Interest rate swaps and forward rate agreements that qualify and are designated as a hedge against the variability of cash flows associated with Company's variable-rate long-term debt are recorded as cash flow hedges.

**Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

*Information with respect to fair value hedges*

In 2005 the Company had no fair value hedges. In 2004 and 2003 there was no hedge ineffectiveness for the Company's fair value hedges.

*Information with respect to cash flow hedges*

The Company has entered into natural gas forward contracts that are designated as cash flow hedges of price risk related to a portion of the Company's forecasted natural gas purchases in the United States. The Company used natural gas forward contracts to minimize its exposure to increases in natural gas prices in 2005, 2004 and 2003. During these periods, the fair value of open natural gas forward contracts as well as realized gains and losses on such contracts was not significant.

*Information with respect to other derivative financial instruments*

At December 31, 2005, the fair value of other derivative instruments not designated as accounting hedges was a net liability of CHF 11 million (2004: net asset of CHF 15 million), consisting of CHF 22 million included in prepaid and other current assets (2004: CHF 19 million) and CHF 33 million included in accruals and other current liabilities (2004: CHF 4 million).

**10. Other assets**

	<u>2005</u>	<u>2004</u>
Prepaid pension costs .....	822	762
Deferred taxes .....	278	203
Loans to third parties and equity affiliates .....	19	19
Other .....	<u>44</u>	<u>52</u>
<b>Total</b> .....	<u>1 163</u>	<u>1 036</u>

**11. Accruals and other current liabilities**

	<u>2005</u>	<u>2004</u>
Payroll and employee benefits .....	159	178
Taxes other than income taxes .....	75	77
Interest .....	82	85
Rebates .....	45	44
Restructuring provisions .....	56	31
Environmental remediation and compliance .....	35	32
Retirement and postemployment benefits .....	33	35
Deferred income taxes .....	76	70
Other .....	<u>339</u>	<u>279</u>
<b>Total</b> .....	<u>900</u>	<u>831</u>

## Notes to Consolidated Financial Statements — (continued)

(In millions of Swiss francs, except share and per share data)

### 12. Short-term debt

	<u>2005</u>	<u>2004</u>
Bank overdrafts .....	14	8
Loans .....	80	139
Other <sup>(i)</sup> .....	179	154
Current portion of long-term debt .....	<u>4</u>	<u>258</u>
<b>Total</b> .....	<u>277</u>	<u>559</u>

(i) Other includes employee and retiree deposits totaling CHF 137 million at December 31, 2005 and CHF 141 million at December 31, 2004.

The Company maintains certain commercial paper programs. The principle programs are in the United States and provide for short-term borrowings up to USD 1 000 million. At December 31, 2005 and 2004, no amounts were outstanding under these programs in the United States.

During 2005 the Company canceled the existing Syndicated Loan Facility maturing January 2006 and entered into a new multicurrency revolving loan facility expiring 2010 that provides for borrowings in U.S. dollars up to CHF 200 million equivalent as back-up support for the Company's commercial paper program in the United States, and aggregate borrowings in multiple currencies up to CHF 500 million. A commitment fee of 30 percent of the applicable margin per annum, at 0.057 percent, is paid on the unused portion of the facility. The loans bear interest at a rate of LIBOR plus 19 basis points. As of December 31, 2005 and 2004, there were no borrowings outstanding under these facilities.

The weighted average interest rate for short-term debt (excluding the current portion of long-term debt) calculated at December 31, 2005 was 3.3 percent and at December 31, 2004 was 3.7 percent. Unused short-term credit lines totaled CHF 1 005 million at December 31, 2005 and CHF 655 million at December 31, 2004.

### 13. Long-term debt

	<u>2005</u>	<u>2004</u>
Bonds and Euro Medium-Term Notes .....	2 881	3 036
Amounts owed to credit institutions .....	19	95
Other long-term debt .....	<u>46</u>	<u>44</u>
<b>Total</b> .....	2 946	3 175
Less: current portion of long-term debt .....	<u>(4)</u>	<u>(258)</u>
<b>Total long-term debt</b> .....	<u>2 942</u>	<u>2 917</u>

## Notes to Consolidated Financial Statements — (continued)

(In millions of Swiss francs, except share and per share data)

<u>Bonds and Euro Medium-Term Notes</u>	<u>2005</u>	<u>2004</u>
CHF 1 000 3.25% Straight Bonds, principal due 2008 .....	1 035	1 052
EUR 500 4.875% Unsecured Notes, principal due 2018 .....	778	771
CHF 300 3.25% Straight Bonds, principal due 2009 .....	302	302
USD 178 U.S. pollution control and industrial development bonds, principal due between 2008 and 2028 (weighted average interest rate of 3.60%) .....	<u>219</u>	<u>206</u>
<b>Total Bonds</b> .....	<u>2 334</u>	<u>2 331</u>
EUR 114 <sup>(i)</sup> 4.875% Euro Medium-Term Note, principal due 2005 .....	0	176
GBP 243 6.50% Euro Medium-Term Note, principal due 2013 .....	<u>547</u>	<u>529</u>
<b>Total Euro Medium-Term Notes</b> .....	<u>547</u>	<u>705</u>
<b>Total Bonds and Euro Medium-Term Notes</b> .....	<u>2 881</u>	<u>3 036</u>

(i) The underlying note was denominated in German Marks (DEM 223 million).

In June 2005, the Company repaid EUR 114 million, 4.875 percent Euro Medium-Term Notes at their scheduled maturity date.

The annual maturities of long-term debt outstanding at December 31, 2005 are as follows: 2006 CHF 4 million; 2007 CHF 4 million; 2008 CHF 1 017 million; 2009 CHF 305 million; 2010 CHF 5 million; 2011 and thereafter CHF 1 581 million.

### 14. Income taxes

Income from continuing operations before income taxes and minority interest consists of the following:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Domestic .....	35	194	222
Foreign .....	<u>(296)</u>	<u>180</u>	<u>209</u>
<b>Total income from continuing operations before income taxes and minority interest</b> .....	<u>(261)</u>	<u>374</u>	<u>431</u>

The provision for income taxes in 2005, 2004 and 2003 from continuing operations consists of the following:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Domestic .....	(5)	24	47
Foreign .....	<u>86</u>	<u>42</u>	<u>48</u>
<b>Total current provision</b> .....	<u>81</u>	<u>66</u>	<u>95</u>
Domestic .....	(5)	1	(3)
Foreign .....	<u>(58)</u>	<u>24</u>	<u>(12)</u>
<b>Total deferred provision</b> .....	<u>(63)</u>	<u>25</u>	<u>(15)</u>
Share of taxes from earnings of equity affiliates .....	<u>0</u>	<u>1</u>	<u>1</u>
<b>Total provision for income taxes</b> .....	<u>18</u>	<u>92</u>	<u>81</u>

**Notes to Consolidated Financial Statements — (continued)**

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The Company's current income taxes for 2005 were reduced by approximately CHF 18 million resulting from the utilization in certain countries of prior years' tax loss carryforwards to reduce current year taxes payable.

The Company is incorporated in Switzerland, but operates in numerous countries with differing tax laws and rates. Consequently, substantial portions of the Company's income before income taxes and provision for income taxes are generated outside of Switzerland. The Company's expected tax rate consists of the weighted average rate applicable in the countries in which the Company operates. The expected tax rate for 2005 is a negative percent due to pre-tax losses normally being expected to result in a tax benefit rather than a tax expense. The main factors causing the effective tax rate to differ from the expected tax rate are:

<u>In percent</u>	<u>2005<sup>(i)</sup></u>	<u>2004</u>	<u>2003</u>
<b>Expected tax rate</b> .....	(30)	30	30
Non-deductible items .....	34	6	5
Tax free income .....	(5)	(2)	(1)
Income taxed at reduced rates .....	(7)	(4)	(8)
Changes in valuation allowance .....	88	0	1
Other .....	<u>(73)</u>	<u>(6)</u>	<u>(8)</u>
<b>Effective tax rate</b> .....	<u>7</u>	<u>24</u>	<u>19</u>

(i) The expected tax rate for 2005 is a negative percent due to pre-tax losses normally being expected to result in a tax benefit rather than a tax expense.

"Non-deductible items" include the tax effect of amortization of other intangible assets in 2005, 2004 and 2003. The increase in 2005 is attributable to the non-deductible impairment of goodwill and other intangible assets in connection with the impairment of Segment Textile Effects. See note 23.

"Income taxed at reduced rates" includes the tax effect of certain subsidiaries of the Company that operate in countries having lower tax rates.

"Changes in valuation allowance" reflect increases in valuation allowances for deferred tax assets, primarily loss carryforwards in certain tax jurisdictions, the future realization of which is uncertain and decreases resulting from the release of previously established valuation allowances when realization of the related deferred tax asset occurs or becomes likely to occur in the future. The increase in 2005 is attributable primarily to additional valuation allowances on certain tax loss carryforwards and on additional deferred tax assets created as a result of the Segment Textile Effects impairment. See note 23.

In 2005, "Other" includes (74) percent for deferred tax credits resulting from additional tax loss carryforwards in certain of the Company's subsidiaries, 27 percent for the remaining effects on expected taxes of the impairment of Segment Textile Effects, (17) percent for the effect of tax deductions in certain of the Company's subsidiaries that were not recognized for financial reporting purposes and (9) percent for a variety of other adjustments, none of which is individually significant.

In 2004, "Other" includes (4) percent for the release of previously established reserves following the settlement of certain outstanding tax matters. In addition, 2004 "Other" also includes the following items: (4) percent for the effect of tax deductions in certain of the Company's subsidiaries that were not recognized for financial reporting purposes, 5 percent for taxes not based on profit such as franchise taxes and tax risk accruals and (3) percent for a variety of other adjustments, none of which is individually significant.

In 2003, "Other" includes (10) percent for the release of previously established reserves, mostly the reserve released due to the settlement of a dispute between Novartis and the Company. In addition, 2003 "Other" also includes the following items: (4) percent for the effect of tax deductions in certain of the

**Notes to Consolidated Financial Statements — (continued)**

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Company's subsidiaries that were not recognized for financial reporting purposes, 6 percent for taxes not based on profit such as franchise taxes and tax risk accruals, 2 per cent for taxes related to the sale of financial investments and (2) percent for a variety of other adjustments, none of which is individually significant.

The significant components of activities that gave rise to deferred tax assets and liabilities on the balance sheet at December 31, 2005 and 2004, were as follows:

<u>Deferred tax assets</u>	<u>2005</u>	<u>2004</u>
Pensions and other employee compensation .....	132	105
Inventory .....	27	29
Restructuring, impairment and other charges .....	8	10
Environmental reserves .....	135	135
Tax loss carryforwards .....	330	133
Other .....	<u>83</u>	<u>176</u>
<b>Gross deferred tax assets</b> .....	715	588
Valuation allowances .....	<u>(339)</u>	<u>(110)</u>
<b>Net deferred tax assets</b> .....	<u>376</u>	<u>478</u>
<b>Deferred tax liabilities</b>		
Property, plant and equipment .....	(184)	(311)
Other .....	<u>(255)</u>	<u>(324)</u>
<b>Gross deferred tax liabilities</b> .....	<u>(439)</u>	<u>(635)</u>
<b>Net deferred tax liabilities</b> .....	<u>(63)</u>	<u>(157)</u>
<b>Included in</b>		
Prepaid and other current assets .....	139	123
Other assets .....	278	203
Accruals and other current liabilities .....	(76)	(70)
Deferred income taxes .....	<u>(404)</u>	<u>(413)</u>
<b>Net deferred tax liabilities</b> .....	<u>(63)</u>	<u>(157)</u>

In management's opinion, the majority of deferred tax assets other than certain tax loss carryforwards will be realized because of the depletion of certain significant tax deductions and anticipated future taxable income resulting from the Company's operations. Valuation allowances have been established for certain tax loss carryforwards and certain long-term deferred tax assets of the Company.

For tax return purposes, the Company has available tax loss carryforwards of approximately CHF 1 101 million, of which CHF 36 million will expire in the next five years and CHF 989 million will expire between five and twenty years. The remaining carryforwards do not expire.

At December 31, 2005, unremitted earnings of subsidiaries outside of Switzerland of approximately CHF 410 million were deemed to be permanently invested. Therefore, no deferred tax liability has been recognized for taxes that might be incurred if such earnings were remitted to Switzerland.

## Notes to Consolidated Financial Statements — (continued)

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### 15. Other liabilities

	<u>2005</u>	<u>2004</u>
Environmental remediation and compliance .....	471	477
Retirement and postemployment benefits.....	747	665
Other .....	<u>174</u>	<u>164</u>
<b>Total</b> .....	<u>1 392</u>	<u>1 306</u>

The environmental remediation and compliance accrual, including the current portion, decreased in 2005 by a net CHF 3 million as a result of a CHF 28 million usage of the accrual (see note 21) and a decrease of CHF 2 million in provisions, offset in 2005 by an increase related to currency effects of CHF 27 million. In 2004 the accrual decreased by a net CHF 48 million as a result of a CHF 43 million usage of the accrual and a CHF 18 million reduction related mainly to currency effects, offset in 2004 by additional reserves established in connection with the acquisition of Raisio Chemicals.

### 16. Shareholders' equity

The Company's shareholders have approved the creation of authorized and conditional capital of the Company. The approval allows for the issuance of an additional 10 million registered shares with a par value of CHF 1 per share (2004: 3 CHF per share; 2003: 6 CHF per share). Of these 10 million shares, 6 million may be issued only through the exercise of option or conversion rights and the remaining 4 million may be issued until February 2006, but would be subject to certain transfer restrictions.

At the Company's Annual General Meeting on March 3, 2005, the shareholders approved a dividend payment of CHF 1 per share, based on 2004 results (2004 and 2003: no dividend payment), and a payment in the form of a capital reduction of CHF 2 per share. The capital reduction was in the form of a reduction in the nominal value of each common share from CHF 3 per share to CHF 1 per share. The dividend payment, which totaled CHF 66 million, was made on March 8, 2005, and the capital reduction payment was made on May 18, 2005, totaling CHF 130 million (2004: CHF 197 million paid on May 14, 2004; 2003: CHF 206 million paid on May 23, 2003).

The Annual General Meeting also approved the cancellation of 1 762 000 shares of treasury stock that were purchased in 2004 (2004: 1 303 500 shares cancelled that were purchased in 2003) under the Company's share buyback program. These treasury shares were cancelled on May 18, 2005.

According to the Swiss Code of Obligations, the Company may under certain conditions, as defined, acquire up to 10 percent of its own shares. In 2005, 2004 and 2003, the Company effected the following treasury stock transactions:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
<b>Treasury stock at January 1</b> , .....	4 686 272	4 363 901	3 192 087
Purchased at market prices .....	1 471 626	3 589 462	2 374 611
Sold at market prices .....	(1 788 683)	(1 963 591)	(1 202 797)
Cancelled .....	<u>(1 762 000)</u>	<u>(1 303 500)</u>	—
<b>Treasury stock at December 31</b> , .....	<u>2 607 215</u>	<u>4 686 272</u>	<u>4 363 901</u>

The Company designated a total of 1 369 972 shares in 2005 (3 751 972 shares in 2004) of its treasury stock as reserved shares primarily for satisfaction of future share requirements under its various outstanding employee stock option plans and, for 2004, also for cancellation under the Company's share repurchase

## Notes to Consolidated Financial Statements — (continued)

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program. The remaining 1 237 243 shares in 2005 (934 300 shares in 2004) of treasury stock have been designated as unreserved shares.

The after-tax components of accumulated other comprehensive loss are as follows:

	<u>2005</u>	<u>2004</u>
Currency translation adjustment.....	(308)	(497)
Minimum pension liability, net of tax.....	(103)	(78)
Other, net of tax.....	<u>2</u>	<u>0</u>
<b>Accumulated other comprehensive loss.....</b>	<b><u>(409)</u></b>	<b><u>(575)</u></b>

The deferred tax effect on the unrealized gains/(losses) on available-for-sale securities is an expense of CHF 2 million in 2005 (2004: no deferred tax effect). The deferred tax effect on cash flow hedges is a deferred tax benefit of CHF 1 million in 2005 (2004: no deferred tax effect). The deferred tax effect on the minimum pension liability adjustment is a deferred tax benefit of CHF 65 million in 2005 (2004: CHF 49 million). The currency translation adjustment is not adjusted for income taxes as it relates primarily to indefinite investments in non-Swiss subsidiaries.

### 17. Stock based compensation plans

The adoption by the Company effective July 1, 2005 of SFAS No. 123(R) “Share-Based Payment” under the modified prospective transition method did not have a material impact because the Company had elected to adopt the fair value method of accounting for its stock-based compensation plans in 2003 in accordance with SFAS 123 “Accounting for Stock-Based Compensation”. Descriptions of the terms of the Company’s stock-based plans are presented in the following paragraphs.

In connection with the capital reduction of CHF 3 per share in 2003 (see note 16), the Company reduced the exercise price of its then outstanding stock options and reflected this reduction in the exercise prices disclosed herein. No compensation expense was recorded as a result of this capital reduction repricing. In connection with the capital reduction of CHF 2 per share in 2005 and CHF 3 per share in 2004, the exercise price of outstanding stock options was not changed.

LTIP — The Company has a Long-Term Incentive Plan (LTIP), which grants restricted shares of common stock of the Company to senior management and other key employees. Shares granted are restricted from being sold by the grantee for three years from the date of grant.

In connection with the LTIP 2005, the Company granted 197 455 restricted shares of common stock with a market value of CHF 78.60 per share to 697 participants and recognized compensation expense of approximately CHF 16 million in 2005 related to these grants. In connection with the LTIP 2004, the Company granted 154 996 restricted shares of common stock with a market value at date of grant of CHF 95.30 per share to 705 participants and recognized compensation expense of approximately CHF 15 million in 2004 related to these grants. In connection with the LTIP 2003, the Company granted 186 503 restricted shares of common stock with a market value at date of grant of CHF 85.30 per share to 720 participants and recognized compensation expense of approximately CHF 16 million in 2003 related to these grants.

The LTIP until 2005 also provided for the granting of options to participants to purchase shares of common stock. Accordingly, in 2005 no options were granted. In 2004 and 2003, option grants were made with vesting and the right to exercise occurring over three years and expiration dates of ten years from date of grant. Options granted in years prior to 2003 expire either five years or ten years after the date of grant. As a result of the adoption by the Company in 2003 of SFAS No. 123 as amended, compensation expense of approximately CHF 2 million in 2005 (CHF 3 million in 2004 and CHF 5 million in 2003) was recorded comprising the unvested portion of prior year awards.

**Notes to Consolidated Financial Statements — (continued)**

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The following table summarizes option activity under the LTIP during 2005, 2004 and 2003:

	<u>Weighted average exercise price</u>	<u>Stock options outstanding</u>
<b>Balance at December 31, 2002</b> .....	117.53	2 195 339
Options granted .....	82.60	176 627
Options exercised .....	0	0
Options canceled/forfeited .....	105.02	(26 989)
Options expired .....	<u>160.00</u>	<u>(264 355)</u>
<b>Balance at December 31, 2003</b> .....	<u>109.34</u>	<u>2 080 622</u>
Options granted .....	95.30	81 024
Options exercised .....	82.60	(2 762)
Options canceled/forfeited .....	114.48	(72 239)
Options expired .....	<u>109.60</u>	<u>(314 888)</u>
<b>Balance at December 31, 2004</b> .....	<u>108.32</u>	<u>1 771 757</u>
Options granted .....	0	0
Options exercised .....	0	0
Options canceled/forfeited .....	108.60	(23 647)
Options expired .....	<u>104.48</u>	<u>(243 860)</u>
<b>Balance at December 31, 2005</b> .....	<u>108.77</u>	<u>1 504 250</u>

The following table summarizes the status of stock options outstanding and exercisable at December 31, 2005:

<u>Exercise price range</u>	<u>Weighted average exercise price- outstanding/ exercisable</u>	<u>Stock options outstanding</u>		<u>Stock options exercisable</u>	
		<u>Number of outstanding options</u>	<u>Weighted average remaining contractual life (in years)</u>	<u>Number of outstanding options</u>	<u>Weighted average remaining contractual life (in years)</u>
82.60-111.40	104.73/105.97	1 394 350	3.2	1 293 625	2.9
160.00	160.00/160.00	<u>109 900</u>	2.0	<u>109 900</u>	2.0
		<u>1 504 250</u>		<u>1 403 525</u>	

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MAB — The Company has a “Mitarbeiterbeteiligungsplan” (Employee Investment Plan) which grants annually to most employees in Switzerland (as an enhancement to their pension plan arrangements) the right to purchase 25 shares of common stock at CHF 15 per share (as long as the share price is not greater than CHF 200, at which level the Employee Investment Plan price may be adjusted). The rights vest at the grant date and become exercisable at the date of the employees’ retirement or termination. The following table summarizes rights activity under the MAB during 2005, 2004 and 2003:

	<u>Exercise Price</u>	<u>Rights Outstanding</u>
<b>Balance at December 31, 2002</b> .....	15	370 280
Rights granted .....	15	105 275
Rights exercised .....	<u>15</u>	<u>(20 005)</u>
<b>Balance at December 31, 2003</b> .....	<u>15</u>	<u>455 550</u>
Rights granted .....	15	104 200
Rights exercised .....	<u>15</u>	<u>(22 955)</u>
<b>Balance at December 31, 2004</b> .....	<u>15</u>	<u>536 795</u>
Rights granted .....	15	102 475
Rights exercised .....	<u>15</u>	<u>(57 055)</u>
<b>Balance at December 31, 2005</b> .....	<u>15</u>	<u>582 215</u>

Compensation expense is recorded in the year the rights are granted and, in 2005, CHF 7 million (2004: CHF 9 million; 2003: CHF 9 million) of compensation expense was recorded under this plan.

***Change in control and reserve of shares***

Upon a change in control of the Company as defined, the vesting and restriction periods for the plans stated above will cease to apply and a cash or share payment for the value of the outstanding plans and related taxes and duties will be due to the participants.

At December 31, 2005, the Company had approximately 1.4 million shares (2004: 2.0 million shares; 2003: 2.2 million shares) of treasury stock reserved for issuance under the various stock based compensation plans.

**18. Retirement benefits**

The Company sponsors pension and other postretirement benefits in accordance with the applicable laws and customs in the countries in which the Company operates. The Company has both contributory and non-contributory defined contribution and defined benefit pension plans.

***Defined contribution pension plans***

In countries in which employees are covered by defined contribution plans, employer contributions charged to income from continuing operations were CHF 15 million in 2005, CHF 11 million in 2004 and CHF 14 million in 2003.

***Defined benefit pension plans***

Benefits to participants in the Company’s defined benefit pension plans are generally based on employees’ years of service, levels of compensation or stated amounts for each year of service.

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The majority of the defined benefit pension plans are funded, whereby contributions made by the Company and plan participants are invested, and the resulting assets necessary to fund future benefit obligations are held by independent trustees for the benefit of plan participants. Accordingly, the assets acquired and maintained by these plans are not included in the Company's consolidated balance sheets. These plans are referred to as funded plans in this note.

In certain countries in which the Company operates, principally Germany, local practice is that pension plans are not funded. In accordance with this practice, the Company does not fund these plans. The Company charges income from continuing operations for benefits earned in each period with a corresponding increase in pension liability. Benefit payments made each period to retirees are charged against this liability. These plans are referred to as unfunded plans in this note.

Each year, the projected benefit obligation (PBO), which is the present value of projected future benefits payable to current plan participants allowing for estimated future employee compensation increases, is calculated for each plan. The measurement date for the Company's pension plans that make up the majority of plan assets and benefit obligations is December 31st for each year presented.

The following table provides a reconciliation from beginning of year to end of year of the changes in PBO and the changes in the fair value of plan assets, as well as the PBO funded status of the plans. The PBO funded status consists of the excess (deficit) of the fair value of plan assets over (under) PBO.

	2005			2004		
	Funded plans	Unfunded plans	All plans	Funded plans	Unfunded plans	All plans
<b>Change in benefit obligation (PBO)</b>						
<b>PBO, beginning of year</b> .....	3 419	522	3 941	3 110	525	3 635
Service cost .....	86	9	95	79	9	88
Interest cost .....	152	28	180	149	27	176
Participant contributions .....	24	0	24	24	0	24
Actuarial (gain) loss <sup>(i)</sup> .....	510	69	579	190	(8)	182
Plan amendments .....	(103)	0	(103)	(6)	0	(6)
Benefits paid .....	(183)	(26)	(209)	(133)	(26)	(159)
Foreign currency translation .....	92	6	98	(41)	(4)	(45)
Other .....	26	3	29	47	(1)	46
<b>PBO, end of year</b> .....	<u>4 023</u>	<u>611</u>	<u>4 634</u>	<u>3 419</u>	<u>522</u>	<u>3 941</u>
<b>Change in plan assets</b>						
<b>Fair value of plan assets, beginning of year</b> .....	3 109	0	3 109	2 936	0	2 936
Actual return on plan assets .....	335	0	335	221	0	221
Employer contributions .....	114	26	140	97	26	123
Participant contributions .....	24	0	24	24	0	24
Benefits paid .....	(183)	(26)	(209)	(133)	(26)	(159)
Foreign currency translation .....	76	0	76	(30)	0	(30)
Other <sup>(i)</sup> .....	185	0	185	(6)	0	(6)
<b>Fair value of plan assets, end of year</b> .....	<u>3 660</u>	<u>0</u>	<u>3 660</u>	<u>3 109</u>	<u>0</u>	<u>3 109</u>
<b>PBO funded status</b> .....	<u>(363)</u>	<u>(611)</u>	<u>(974)</u>	<u>(310)</u>	<u>(522)</u>	<u>(832)</u>

**Notes to Consolidated Financial Statements — (continued)**

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- (i) Includes the addition to plan assets and PBO resulting from the merger of one of the Company's defined contribution plans into an existing defined benefit plan.

For both years presented, substantially all of the Company's funded pension plans had PBO in excess of plan assets.

***Accumulated benefit obligation (ABO) status of defined benefit pension plans***

Accumulated benefit obligation (ABO) is less than PBO because ABO excludes assumptions as to future increases in employee compensation when calculating the present value of the future benefit obligation.

***ABO status of funded pension plans***

The table below shows the ABO status at December 31, 2005 and 2004 of the Company's funded pension plans separated between those having plan assets that are greater than or equal to ABO (fully-funded) and those having plan assets that are less than ABO (under-funded):

<u>Funded plans</u>	<u>2005</u>			<u>2004</u>		
	<u>Fully-funded</u>	<u>Under-funded</u>	<u>Total funded plans</u>	<u>Fully-funded</u>	<u>Under-funded</u>	<u>Total funded plans</u>
Accumulated benefit obligation (ABO) . .	3 061	362	3 423	2 580	458	3 038
Fair value of plan assets . . . . .	<u>3 397</u>	<u>263</u>	<u>3 660</u>	<u>2 743</u>	<u>366</u>	<u>3 109</u>
<b>ABO status — fully (under) funded . . . . .</b>	<u>336</u>	<u>(99)</u>	<u>237</u>	<u>163</u>	<u>(92)</u>	<u>71</u>

***Minimum pension liability***

For funded plans with ABO in excess of the fair value of plan assets, SFAS No. 87 requires that the Company record on its consolidated balance sheets a minimum pension liability amount such that the Company's net pension liability is at least equal to the amount of the under-funded ABO. Net pension liability is the excess of pension liabilities over prepaid pension assets on the Company's balance sheet.

When recording a minimum pension liability, SFAS No. 87 requires the Company to record a corresponding intangible asset equal to the amount of any unrecognized prior service cost, with the remainder, if any, charged to other comprehensive income in shareholders' equity. The recording of this additional minimum pension liability has no impact on the Company's income from operations.

The following table shows the components of the additional minimum pension liability as of December 31, 2005 and 2004 for those plans where such a liability was required to be recorded, mainly in the

**Notes to Consolidated Financial Statements — (continued)**

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United States; together with a reconciliation to the ABO status of all of the Company's under-funded pensions plans:

	<u>2005</u>	<u>2004</u>
Unrecognized prior service cost recorded as intangible asset .....	4	8
Recorded as other comprehensive income .....	119	127
Currency adjustments .....	<u>(18)</u>	<u>(30)</u>
<b>Additional minimum pension liability</b> .....	<b>(105)</b>	<b>(105)</b>
Prepaid pension asset already recorded .....	<u>12</u>	<u>19</u>
ABO status, plans where additional minimum liability required .....	(93)	(86)
Other under-funded plans, no additional minimum liability required .....	<u>(6)</u>	<u>(6)</u>
<b>ABO status — All under-funded plans</b> .....	<b><u>(99)</u></b>	<b><u>(92)</u></b>

*ABO status of unfunded pension plans*

For the Company's unfunded plans, the accrued pension liability exceeds the amount of existing unfunded ABO, therefore no additional minimum pension liability is required. The table below shows the ABO and related liabilities recorded at December 31, 2005 and 2004 for the Company's unfunded defined benefit pension plans:

	<u>2005</u>	<u>2004</u>
<b>Unfunded plans</b>		
Accumulated benefit obligation .....	566	489
Accrued pension liability .....	<u>574</u>	<u>505</u>
<b>Liability recognized in excess of ABO</b> .....	<u>8</u>	<u>16</u>

*Defined benefit pension related assets and liabilities*

For each of its defined benefit pension plans, the Company records a pension-related asset (liability) based upon the excess (deficit) of the fair value of plan assets over (under) PBO. However, excluded from the net pension asset (liability) are unrecognized gains and losses that arise as a result of using long-term expected rates of return on plan assets rather than actual returns as a component of net pension expense. Instead, such gains and losses are amortized over the average remaining service life of active employees only where they exceed 10 percent of the greater of the fair value of beginning plan assets or PBO. Additionally, where pension plan amendments result in changes to employees' future benefits and therefore PBO, the resulting unrecognized prior service costs are amortized as a component of future net pension expense over the average remaining service life of active employees.

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Accordingly, the following table shows the components of the Company's net pension asset (liability) and the reconciliation of these amounts to the PBO as of December 31, 2005 and 2004:

	2005			2004		
	Funded plans	Unfunded plans	All plans	Funded plans	Unfunded plans	All plans
Prepaid benefit cost <sup>(i)</sup> .....	824	0	824	764	0	764
Accrued benefit liability <sup>(i)</sup> .....	(112)	(574)	(686)	(108)	(505)	(613)
Minimum pension liability — intangible asset ...	4	2	6	8	0	8
Accumulated other comprehensive income, pre tax.....	119	49	168	127	0	127
Currency adjustments <sup>(ii)</sup> .....	(18)	0	(18)	(30)	0	(30)
<b>Net pension asset (liability) on consolidated balance sheets</b> .....	817	(523)	294	761	(505)	256
Unrecognized net gain (loss) .....	(1 272)	(90)	(1 362)	(1 068)	(19)	(1 087)
Unrecognized prior service cost .....	92	2	94	(3)	2	(1)
<b>PBO funded status</b> .....	<u>(363)</u>	<u>(611)</u>	<u>(974)</u>	<u>(310)</u>	<u>(522)</u>	<u>(832)</u>

(i) Current and long-term portion

(ii) Currency effect on the prior year additional minimum pension liability

***Net defined benefit plan pension expense***

The components of net pension expense for the Company's defined benefit pension plans during the years ended December 31, 2005, 2004 and 2003 were:

	Funded plans			Unfunded plans			All plans		
	2005	2004	2003	2005	2004	2003	2005	2004	2003
Service cost .....	86	79	76	9	9	8	95	88	84
Interest cost .....	152	149	143	28	27	28	180	176	171
Expected return on plan assets .....	(195)	(208)	(211)	0	0	0	(195)	(208)	(211)
Amortization of prior service cost .....	1	2	2	0	0	0	1	2	2
Other (gains), losses and amortization, net .....	35	1	0	0	0	1	35	1	1
<b>Total net pension expense</b> .....	<u>79</u>	<u>23</u>	<u>10</u>	<u>37</u>	<u>36</u>	<u>37</u>	<u>116</u>	<u>59</u>	<u>47</u>

***Key assumptions***

The weighted average key actuarial assumptions used to determine the Company's pension benefit obligations were as follows:

	2005	2004
Discount (interest) rate .....	4.0%	4.6%
Rate of increase in compensation levels .....	2.4%	2.3%

**Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

The weighted average key actuarial assumptions used to determine the Company's net periodic benefit cost were as follows:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Discount (interest) rate .....	4.6%	4.9%	5.1%
Rate of increase in compensation levels .....	2.3%	2.3%	2.4%
Expected long-term rate of return on plan assets .....	5.8%	6.2%	6.2%

The determination of the overall expected long-term rate of return on plan assets for the Company's funded plans is based on the following parameters: long-term expected inflation rates, long-term inflation-adjusted interest rates, and long-term risk premium of equity investments above risk free rates of return. In addition, long-term historical rates of return adjusted, where appropriate, to reflect more recent developments, are used.

***Funded defined benefit pension plan assets***

The investment policies and strategies for plan assets held by funded defined benefit pension plans are directed toward the overriding target of achieving, on a long-term basis, the necessary return on plan assets to meet benefit obligations as they become payable. Factors included in the investment strategy for plan assets include achievement of consistent year-over-year results, effective risk management based on the level of each plan's funding status, and effective plan cash flow management. Further, the investment policies generally exclude direct investments in the Company's equity or debt securities.

For the Company's funded defined benefit pension plans, the weighted average actual plan asset allocation percentages as of December 31, 2005 and 2004, and the range of weighted average target plan asset allocation percentages in effect as of December 31, 2005, are as follows:

<b>Asset category</b>	<b>Actual plan asset allocation percentages at</b>		<b>Target plan asset allocation percentages at</b>
	<b>December 31, 2005</b>	<b>2004</b>	
Equity securities .....	38%	36%	35% - 45%
Debt securities .....	41%	48%	40% - 50%
Real estate .....	17%	12%	10% - 20%
Other .....	<u>4%</u>	<u>4%</u>	0% - 10%
<b>Total</b> .....	<u>100%</u>	<u>100%</u>	

At December 31, 2005 and 2004, the Company's pension plans did not own any Company common stock.

The following table shows the undiscounted benefit amounts expected to be paid for each of the next five successive fiscal years and for the aggregate next five years thereafter:

<u>Undiscounted Expected Benefit Payments</u>	<u>Funded plans</u>	<u>Unfunded plans</u>	<u>All plans</u>
2006 .....	133	27	160
2007 .....	132	28	160
2008 .....	142	29	171
2009 .....	147	29	176
2010 .....	158	30	188
Aggregate for 2011 through 2015 .....	1 047	165	1 212

## Notes to Consolidated Financial Statements — (continued)

(In millions of Swiss francs, except share and per share data)

The amount expected to be contributed by the Company to its defined benefit pension plans during 2006 is CHF 160 million.

### *Other postretirement benefits*

The Company's net liability for other postretirement benefits at December 31, 2005 was CHF 68 million (December 31, 2004: CHF 63 million) resulting principally from the postretirement healthcare plan in the United States. The Company's other postretirement plans are not funded by the Company, did not require significant amounts to be recognized in the consolidated statements of income for 2005, 2004 or 2003, and are not expected to require significant future annual benefit payments.

## 19. Earnings per share

In 2005, 2004 and 2003, there was no difference between basic and diluted earnings per share for income from continuing operations. In 2005 the basic and diluted weighted average number of shares outstanding were 65 288 741 (2004: 66 059 479 and 2003: 68 361 123).

In 2005, 2004 and 2003, the calculation of diluted earnings per share did not include any stock options as their inclusion would have been antidilutive, that is, diluted earnings per share would be higher than basic earnings per share. For purposes of calculating basic and diluted earnings per share in 2005, 2004 and 2003 there was no required adjustment to the reported income from continuing operations or net income.

The calculation of diluted earnings per share in 2005 excluded 1 504 250 stock options outstanding with exercise prices between CHF 82.60 and CHF 160.00, in 2004 excluded 1 783 225 stock options outstanding with exercise prices between CHF 82.60 and CHF 179.30, and in 2003 excluded 2 092 090 stock options outstanding with exercise prices between CHF 82.60 and CHF 179.30, as their inclusion would have been antidilutive. For the year ended December 31, 2003, the calculation of diluted earnings per share excluded the convertible bonds issued in July 1998 and repaid in July 2003, as their inclusion would have been antidilutive.

## 20. Related party transactions

### *Transactions with associated companies*

Investments in equity affiliates of CHF 117 million in 2005 and CHF 147 million in 2004 are included in financial investments and are described in note 9.

Loans receivable from equity affiliates of CHF 10 million in 2005 and CHF 11 million in 2004 are included in other assets. Included is a loan to Compagnie Industrielle de Monthey SA, of CHF 10 million in 2005 and 2004, which bears interest at 3 percent in 2005 (2004: 3 percent).

The Company had payables and accrued expenses to equity affiliates of CHF 10 million in 2005 and CHF 12 million in 2004, and short-term debt to equity affiliates of CHF 1 million in 2005 and CHF 2 million in 2004.

## 21. Commitments and contingencies

### *Lease commitments*

The Company leases certain facilities under operating leases. The future minimum lease commitments required under fixed term leases are: 2006 CHF 36 million; 2007 CHF 26 million; 2008 CHF 20 million; 2009 CHF 14 million; 2010 CHF 11 million; 2011 and thereafter CHF 27 million. Rental expense amounted to CHF 48 million in 2005, CHF 57 million in 2004 and CHF 64 million in 2003.

## **Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

### ***Purchase commitments***

The Company has various purchase commitments for materials, supplies and items of permanent investment incident to the ordinary course of business. In the aggregate, these commitments are not in excess of current market prices and reflect normal business operations.

### ***Guarantees***

In the normal course of business, the Company has provided certain trade and other guarantees to third parties. The Company estimates that the fair value of these guarantees is not material and does not expect to incur losses as a result of these guarantees. As of December 31, 2005, the Company has provided guarantees to third parties for indebtedness of others of approximately CHF 3 million of which CHF 1 million expire in 2006 and CHF 2 million expire in 2007 or thereafter.

In connection with past divestments of businesses, the Company has issued certain indemnifications to the purchasers of those businesses related to the past actions of the Company in the area of compliance with environmental and tax regulations. At December 31, 2005 the Company had issued CHF 30 million of environmental indemnifications that decrease to CHF 24 million in 2008 and which expire in 2009. In addition, the Company has outstanding environmental indemnifications that were issued to the purchaser of its Performance Polymers business, which was sold in May 2000. These environmental indemnifications are further discussed in the “Environmental Matters” section below. The Company has issued certain tax indemnifications in connection with divestments of businesses and in connection with certain debt financing arrangements of the Company, that are unlimited in amount and, in certain instances, in time. As of December 31, 2005, the Company has recorded a liability related to the environmental indemnifications in the amount of CHF 12 million (December 31, 2004: CHF 12 million).

### ***Contingencies***

The Company operates in countries where political, economic, social, legal and regulatory developments can have an impact on the operational activities. The effects of such risks on the Company’s results, which arise during the normal course of business, are not foreseeable and are therefore not included in the accompanying financial statements.

In the ordinary course of business, the Company is involved in lawsuits, claims, investigations and proceedings, including product liability, intellectual property, commercial, environmental, and health and safety matters. Although the outcome of any legal proceedings cannot be predicted with certainty, management is of the opinion that there are no such matters pending which would be likely to have any material adverse effect in relation to its business, financial position, cash flows or results of operations.

In connection with the Company’s divestment of the Performance Polymers Business in 2000, Vantico (now owned by Huntsman Corporation) initiated a pension-related lawsuit. The supreme court ruled in the Company’s favor in June 2005 resulting in the release of previously established reserves totaling CHF 30 million, net of income taxes of CHF 10 million.

In connection with its Toms River, New Jersey site in the United States, the Company’s subsidiary in the United States received a claim from the New Jersey Department of Environmental Protection for alleged natural resource damages (see “Environmental Matters” below). In connection with certain polyacrylamide products, the Company’s subsidiary in the United States has been named as one of the defendants in two class action lawsuits in West Virginia (see “Litigation Matters” below).

### ***Environmental Matters***

Operating in the chemical industry, the Company is subject to stringent environmental, health and safety laws and regulations. It is the Company’s policy to continuously develop and improve the environmental

## Notes to Consolidated Financial Statements — (continued)

(In millions of Swiss francs, except share and per share data)

performance of key manufacturing processes through an active program to address environmental matters. In addition to process improvements, the Company uses advanced waste treatment and disposal facilities at all major manufacturing sites that allow the sites to comply with laws and regulations applicable to waste streams. In management's opinion, the Company substantially complies with all such laws.

For outstanding environmental matters that are currently known and estimable by the Company, provisions of approximately CHF 506 million as of December 31, 2005 and CHF 509 million as of December 31, 2004 have been recorded in the accompanying consolidated balance sheets. The Company anticipates that these provisions will be spent generally over the next 30 years or longer. The decrease in the provision of CHF 3 million in 2005 compared to 2004 relates to usage of provisions of CHF 28 million and a decrease of CHF 2 million in provisions, offset in 2005 by an increase related to currency effects of CHF 27 million. The Company's environmental protection and improvement cash expenditures were approximately CHF 43 million in 2005 (CHF 54 million in 2004), including investments in construction, operations and maintenance and usage of the provision.

Under the Company's agreement with Novartis, Novartis agreed to reimburse the Company 50 percent of United States environmental liabilities arising from past operations of the Company in excess of the agreed reserves. Outside the United States, environmental liabilities are allocated between Novartis and the Company based on the ownership of the site or, if environmental liabilities do not relate to production sites or these are not owned by either entity, according to the polluter pays principle. If causation between the parties cannot be determined, costs are shared equally. The agreement with Novartis is not subject to any time or amount limits but could terminate for certain liabilities in the United States (i) upon a sale of substantially all of the Company's assets, (ii) upon a change in control of the Company, or (iii) for individual facilities, upon the sale of the facility (unless the Company retains responsibility for any clean-up at such site).

The contractual terms of the sale of the Performance Polymers business stipulate that, in general, the Company will retain responsibility for environmental claims relating to the operations of the Performance Polymers business prior to May 31, 2000, whereby damages for remediation in connection with sites outside the United States shall cover only 80 percent of the respective costs. The responsibility with respect to any non-United States sites covers environmental liabilities incurred within fifteen years from May 31, 2000 and is limited to CHF 75 million. With respect to any such environmental liabilities in the United States, the Company's obligation to indemnify is unlimited in time and/or amount. Novartis' environmental indemnification obligations to the Company described above are not affected by the sale of the Performance Polymers business.

The Company continues to participate in environmental assessments and clean-ups at a number of locations, including operating facilities, previously owned facilities and United States Superfund sites. The Company accrues reserves for all known environmental liabilities for remediation costs when a clean-up program becomes probable and costs can be reasonably estimated. Clean-up of the most significant sites has been or is nearly completed, except as described in the following paragraphs.

At its Toms River, New Jersey remediation site, the Company's subsidiary in the United States is engaged in a large bio-remediation project that is estimated to take up to another five years to complete. Based on management's current estimates, the Company's environmental provisions are adequate to cover the expected costs to complete this remediation plan.

In 2005, the Company's subsidiary in the United States received a demand from local authorities to remove the Cell 1 landfill at the Toms River site. Environmental experts have been consulted and extensive discussions have been held with the local authorities. The removal of the Cell 1 landfill is not probable, however certain additional remediation is reasonably possible. The magnitude of the loss contingency relating to possible additional remediation of the Cell 1 landfill cannot be reasonably estimated at this time.

## **Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

The planning for the total remediation of the waste disposal site in Bonfol, Switzerland, which was closed in 1976, is expected to conclude in the near future. The responsibility for the remediation lies with eight chemical enterprises including among others the Company. The responsible companies cooperate with the governmental authorities to define the necessary measures in view of a final remediation of the site. The remaining planning and remediation effort could require up to ten years to complete. In management's opinion, based on the current remediation plans, the Company's environmental provisions are adequate to cover the Company's share of the expected costs to complete the remediation at this site.

In the Basel region, several landfills (Switzerland, France and Germany) contain chemical waste besides other industrial and household wastes. Presently, eleven landfills are the subject of investigations carried out with the authorities by the 'Interessengemeinschaft Deponiesicherheit Regio Basel', an association of the involved pharmaceutical and chemical enterprises (including the Company). As of December 31, 2005, no remedial actions have been defined or required in a legally binding form.

In management's opinion, the environmental reserves accrued are sufficient to meet all currently known and estimable environmental claims and contingencies. Because of the nature of the Company's operations, however, there can be no assurance that significant costs and liabilities from ongoing or past operations will not be incurred in the future. In addition, environmental clean-up periods are protracted in length and environmental costs in future periods are subject to changes in environmental remediation regulations. As a result, the Company is unable to estimate the amount or range of reasonably possible losses in excess of provisions recorded in the accompanying consolidated balance sheets.

### ***Litigation Matters***

Two class action lawsuits were filed in 2002 and 2003 against the Company's subsidiary in the United States and other chemical suppliers in two separate state courts in West Virginia relating to the sales of certain products to coal preparation plants. The major claim in both cases is a request for medical monitoring on behalf of a class of workers in coal preparation plants due to exposure to residual acrylamide in products manufactured by the Company and several other defendants. There are also a few personal injury allegations. The Supreme Court of West Virginia recently issued a decision ordering that all future proceedings in the two cases be coordinated and remanded both cases to the same judge. The judge was given discretion on how best to coordinate those proceedings. Both cases are currently in discovery.

Based on knowledge and use of acrylamide in its own manufacturing operations for several years, the Company does not believe that these claims have merit. However, if any liability were found, there most likely would be a sharing of the liability among many of the defendants, although it is too soon to assess what share any defendant would have of that liability, if any. The Company has established adequate reserves for legal expenses related to these claims, and is confident that these reserves are sufficient to prevent the claims from having any material adverse effect on its financial position or the results of its operations.

## Notes to Consolidated Financial Statements — (continued)

(In millions of Swiss francs, except share and per share data)

### 22. Valuation and qualifying accounts and reserves

#### *Allowance for doubtful accounts*

<u>For the year ended December 31,</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Balance at beginning of year . . . . .	81	85	96
Additions charged to cost and expenses . . . . .	33	24	22
Deductions credited to cost and expenses . . . . .	(28)	(15)	(13)
Use of allowance and other, net <sup>(i)</sup> . . . . .	(16)	(10)	(18)
Currency adjustments . . . . .	<u>5</u>	<u>(3)</u>	<u>(2)</u>
<b>Balance at end of year . . . . .</b>	<b><u>75</u></b>	<b><u>81</u></b>	<b><u>85</u></b>

#### *Allowance for obsolete and slow moving inventory*

<u>For the year ended December 31,</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Balance at beginning of year . . . . .	46	50	58
Additions charged to cost and expenses . . . . .	19	17	20
Deductions credited to cost and expenses . . . . .	(18)	(16)	(22)
Use of allowance and other, net <sup>(i)</sup> . . . . .	(5)	(3)	(4)
Currency adjustments . . . . .	<u>3</u>	<u>(2)</u>	<u>(2)</u>
<b>Balance at end of year . . . . .</b>	<b><u>45</u></b>	<b><u>46</u></b>	<b><u>50</u></b>

#### *Deferred income tax valuation allowance*

<u>For the year ended December 31,</u>	<u>2005</u>	<u>2004</u>	<u>2003</u>
Balance at beginning of year . . . . .	110	121	131
Additions charged to cost and expenses . . . . .	296	11	22
Deductions credited to cost and expenses . . . . .	(75)	(20)	(19)
Other, net . . . . .	0	3	0
Currency adjustments . . . . .	<u>8</u>	<u>(5)</u>	<u>(13)</u>
<b>Balance at end of year . . . . .</b>	<b><u>339</u></b>	<b><u>110</u></b>	<b><u>121</u></b>

(i) Use of allowance and other, net is primarily amounts written-off, additions applicable to acquisitions and miscellaneous other adjustments.

### 23. Restructuring, impairment and other charges

Restructuring, impairment and other charges consists principally of the following:

#### *Project Shape*

In 2004, the Company implemented Project Shape, which is primarily designed to adapt and optimize the production and support organizations of Segment Water & Paper Treatment following the acquisition of Raisio Chemicals, and to accelerate the shift of focus in Segment Textile Effects to growth regions in Asia by reducing its European presence. The project involves the closure of manufacturing facilities in the UK and Italy and the rightsizing of plants in Europe and the U.S.

During 2005, the Company expanded the scope of Project Shape and also accelerated the timing of certain elements of the project resulting in expected costs increasing by CHF 87 million from CHF 174 million to CHF 261 million before taxes. Of these amounts, employee severance costs increased by CHF 54 million from CHF 93 million to CHF 147 million due to the number of reductions of positions having increased by 320 to approximately 1 270. In addition, Project Shape asset impairment charges increased by

**Notes to Consolidated Financial Statements — (continued)**

(In millions of Swiss francs, except share and per share data)

CHF 18 million from CHF 55 million to CHF 73 million and other costs increased by CHF 15 million from CHF 26 million to CHF 41 million. The CHF 73 million expected asset impairment charges, linked to Project Shape, are net of anticipated gains on assets to be disposed of in connection with the project. The planned project completion date is 2007.

	<u>Employee severance</u>	<u>Other costs</u>		
<b>Project Shape restructuring provisions</b>				
<b>Balance at December 31, 2003</b> .....	0	0	<u>0</u>	
Charged to operating income .....	17	13	30	
Payments/settlements .....	<u>(2)</u>	<u>(7)</u>	<u>(9)</u>	
<b>Balance at December 31, 2004</b> .....	15	6	21	
Charged to operating income .....	73	24	97	
Payments/settlements .....	<u>(41)</u>	<u>(29)</u>	<u>(70)</u>	
<b>Balance at December 31, 2005</b> .....	<u>47</u>	<u>1</u>	<u>48</u>	
	<u>Employee severance</u>	<u>Other costs</u>	<u>Impairment</u>	<u>Total</u>
<b>Restructuring charged to operating income</b>				
Incurred during 2004 .....	17	13	50	80
Incurred during 2005 .....	<u>73</u>	<u>24</u>	<u>19</u>	<u>116</u>
<b>Total incurred at December 31, 2005</b> .....	<u>90</u>	<u>37</u>	<u>69</u>	<u>196</u>

***Impairment of Textile Effects Segment***

Upon full implementation, Project Shape was expected to restore the Segment to acceptable profitability levels. However, the shift of the textile market and customers to Asia was greatly accelerated in 2005 by the ending of WTO quotas.

In 2005, cost reductions in connection with Project Shape and other sales price and cost control measures resulted in the Segment's profitability improving slightly over prior year. However, it remained at very low levels and it became evident that significant profitability improvement would not be able to be achieved without additional cost reduction. These developments triggered the testing of certain of the Segment's long-lived assets for impairment of their carrying values. For purposes of this testing, the asset group to which the long-lived assets were attributed consisted of the entire Segment.

The Segment fair value was estimated using an expected discounted cash flow technique that incorporated various probability-weighted scenarios including estimates as to future market growth, revenue development and profitability levels for the Textile Effects business. The resulting overall Segment fair value is below its carrying value. As a result, an impairment charge of CHF 583 million has been included in restructuring, impairment and other charges in the consolidated statements of income. The impairment amounts to CHF 377 million of property, plant and equipment, CHF 161 million of goodwill and CHF 45 million of other intangible assets.

***Other***

Also included in restructuring, impairment and other charges are, in 2004, CHF 11 million resulting from expensing the fair value of Raisio Chemicals' in-process research and development activities that were acquired and, in 2005, CHF 4 million of other charges.

**Section 302 Certification**

**CERTIFICATIONS**

**I, Armin Meyer, certify that:**

1. I have reviewed this annual report on Form 20-F of Ciba Specialty Chemicals Holding Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: February 2, 2006

/s/ Armin Meyer

\_\_\_\_\_  
Armin Meyer  
Chairman of the Board and  
Chief Executive Officer

**Section 302 Certification**

**CERTIFICATIONS**

**I, Michael Jacobi, certify that:**

1. I have reviewed this annual report on Form 20-F of Ciba Specialty Chemicals Holding Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the company as of, and for, the periods presented in this report;
4. The company's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Evaluated the effectiveness of the company's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (c) Disclosed in this report any change in the company's internal control over financial reporting that occurred during the period covered by the annual report that has materially affected, or is reasonably likely to materially affect, the company's internal control over financial reporting; and
5. The company's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the company's auditors and the audit committee of the company's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the company's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the company's internal control over financial reporting.

Date: February 2, 2006

/s/ Michael Jacobi

\_\_\_\_\_  
Michael Jacobi  
Chief Financial Officer

**Certification Pursuant to  
18 U.S.C. Section 1350**

**As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

In connection with the Annual Report on Form 20-F of Ciba Specialty Chemicals Holding Inc., a corporation organized under the laws of Switzerland (the "Company") for the period ending December 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), each of the undersigned officers of the Company certify pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

- 1.) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2.) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: January 31, 2006

/s/ Armin Meyer

Armin Meyer  
Chairman of the Board and  
Chief Executive Officer

Date: January 31, 2006

/s/ Michael Jacobi

Michael Jacobi  
Chief Financial Officer

**Consent of Independent Registered Public Accounting Firm**

We consent to the incorporation by reference in the Registration Statements on Form S-8 (File Nos. 333-82698 and 333-56040 pertaining to employee benefit plans of Ciba Specialty Chemicals Holding Inc.) of our report dated January 31, 2006 with respect to the consolidated financial statements of Ciba Specialty Chemicals Holding Inc. included in the Annual Report (Form 20-F) for the year ended December 31, 2005.

/s/ ERNST & YOUNG LTD

Zurich, Switzerland  
January 31, 2006