

## Disclaimer

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Certain sections of the Unilever Annual Report and Accounts 2008 have been audited. Sections that have been audited are set out on pages 81 to 136, 140 to 141, 143 to 145 and 148 to 150. The auditable part of the Directors' Remuneration report as set out on page 60 has also been audited.

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The Annual Report and Accounts does not constitute an invitation to invest in Unilever shares. Any decisions you make in reliance on this information are solely your responsibility.

The information is given as of the dates specified, is not updated, and any forward-looking statements are made subject to the reservations specified on the final page of the Report.

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## Outlook and risks

The following discussion about outlook and risk management activities includes 'forward-looking' statements that involve risk and uncertainties. The actual results could differ materially from those projected. See the 'Cautionary statement' on the inside back cover.

### Outlook

The progress Unilever has made in recent years is clear and encouraging. We have great brands, an enviable geographic reach and around 70% of our turnover comes from categories in which we have leadership positions. We have an organisation which is able to act more decisively and with greater speed. We are also benefiting from cost reduction programmes which we established well ahead of the onset of the recession and which have much further to run.

The fact remains however that the global economic climate is more difficult than many of us have ever seen. The extent of the downturn, how deep and how prolonged, is difficult to predict.

As 2008 progressed we saw recessionary conditions in most developed markets and a slowdown in D&E markets. Consumer and customer de-stocking exacerbated already weakening demand, and volumes suffered as a result.

In these circumstances it is important to focus on the things we can do in the short term to further strengthen our competitive position. So the priority for 2009 will be to re-ignite volume growth whilst protecting margins and the strong cash generating capacity of the business.

We have already announced a series of measures in support of these priorities; and have shortened the time horizon of our variable pay scheme to six months. This will ensure that we quickly align the organisation behind the new priorities.

We no longer wish to target the business to deliver an operating margin in excess of 15% in 2010. This target was set at a very different time and in very different circumstances. We need to ensure that we focus on creating long-term value for our shareholders in today's climate. Hence, the focus will be on volume growth and strengthening the competitive position of our brands.

We believe that the actions we are taking will further strengthen Unilever's competitive position. In time, we have no doubt we will be able to lift the growth profile of the business whilst steadily improving margins each year.

### Principal Risk Factors

Unilever's system of risk management is outlined on page 28. Responsibility for establishing a coherent framework for the Group to manage risk resides with the Boards. The remit of the Boards is outlined on page 44.

Risks and uncertainties could cause actual results to vary from those described in forward-looking statements made within this document, or could impact on our ability to meet our targets or be detrimental to our profitability or reputation. The risks that we regard as the most relevant to our business are identified below. We have also commented on certain mitigating actions that we believe help us manage such risks; however, we may not be successful in deploying some or all of these mitigating actions.

#### Global economic slowdown and changing consumer demand

The unprecedented economic slowdown and turmoil in the global economy has adversely impacted consumer markets, including those in which Unilever operates. Unilever's business is dependent on continued consumer demand for our products, and reduced consumer wealth may result in our consumers becoming unwilling or unable to purchase our products, with clear implications for turnover and profitability.

Unilever's strategy is aimed at delivering superior value products to consumers, through strong brands, supported by differentiated innovation and continued product improvement, and driven to market through excellent execution. We seek to build mutually rewarding relationships with customers in order to make our products available across all relevant channels.

We have a significant number of global brands and any adverse event affecting consumer confidence or continuity of supply of such a brand could have an adverse impact in many of our markets, or in some cases affect intangible asset values. We support our brands and their growth through compelling and competitive levels of investment in advertising and promotions. The breadth of both our portfolio and our geographic reach also help us mitigate general economic risks. We aim to protect the value of our brands through a rigorous approach to R&D and product quality, and by operating in accordance with relevant laws and regulations.

These measures are aimed at extending our consumer offerings, reducing the impact of falling consumer demand or of consumers switching to alternative products, and thus allowing us to compete effectively in our key categories and countries.

#### Competitive markets and consolidation of customers

We operate in competitive markets, and the actions of multinational, regional, and local customers or competitors may place our market shares or margins at risk.

Our strategy continues to focus on investing resources in markets and segments that are attractive, where we have competitive advantage, and where we can grow sales and margins competitively. Three priorities have been communicated: to invest in Vitality (expressed as offering consumers products that enable them to look good, feel good, and get more out of life); to grow the proportion of our total business that comes from Developing and Emerging (D&E) markets (currently nearly 50%); and to increase our presence in personal care markets.

By concentrating our resources on areas where we have leading category and brand positions we seek to strengthen our overall competitive position. We also seek in-fill acquisitions to support our category and geographical ambitions.

In the current climate, we also face counterparty risk with customers. The Group establishes limits for key customers, reviews these regularly and takes necessary action to manage this risk.

In respect of our route to market, further consolidation among retailers and the continued growth of discounters could adversely impact our rate of sales growth and our profit margins. Our success depends on our ability to manage successfully our trading relationships with our key customers. We tackle this by developing and adapting our customer-facing strategies and plans, by optimising the return on the investment we make in customers, and by continually improving our customer development capabilities. A specific focus for us at the moment is to improve our level of customer service.

#### **Financial risks – liquidity, currency, interest, pensions, taxation**

Turbulence in the financial markets and the downturn in the economic environment have heightened financial risks. As Unilever operates on a global basis it is affected in a variety of ways by such instability.

Several factors could affect liquidity management. A material and significant shortfall in cash flow could undermine our credit rating, impair investor confidence and hinder our ability to raise funds, whether through access to credit markets, commercial paper programmes, long-term bond issuances or otherwise. During 2008, Unilever benefited from its strong single-A Balance sheet 'active financial management', and the coming year will see the continuation of the same policy. Maintaining our strong single-A rating will remain a key priority.

To manage financial risks, the Group aims to concentrate cash in the parent and finance companies in order to ensure maximum flexibility in meeting changing economic needs. We finance our operating subsidiaries through a mixture of retained earnings, third-party borrowing and loans from parent and group companies, with the mix determined by what is most appropriate to the country concerned. We seek to manage our liquidity requirements by maintaining access to global debt markets through an infrastructure of short-term and long-term debt programmes. In addition to this, Unilever has committed credit facilities in place to support its commercial paper programmes and for general corporate purpose. We plan on increasing liquidity by reducing the outstanding commercial paper through the issuance of long-term bonds, extending the maturity profile of the remaining commercial paper and through continued active management of our working capital positions.

Because of the breadth of our international operations, we are subject to risks from changes in the relative value of currencies. We intend to continue our policy whereby operating companies manage trading and financial foreign exchange exposures within prescribed exposure limits and the use of forward foreign exchange contracts. On a case-by-case basis, companies may decide whether or not to apply cash flow hedge accounting. Regional groups monitor compliance with this foreign exchange policy.

In addition, as Unilever conducts business in many foreign currencies but publishes its financial statements and measures its performance in euros, it is subject to exchange risks associated with the translation of the underlying net assets of its foreign subsidiaries. We aim to minimise our foreign exchange exposure in operating companies by borrowing in local currencies, except where inhibited by local regulations, lack of local liquidity or local market conditions. For those countries that in the view of management have a substantial retranslation risk, we may decide to hedge such net investment through the use of foreign currency borrowing or forward exchange contracts on which hedge accounting is applied.

Increases in benchmark interest rates could increase the interest cost of our debt and increase the cost of future borrowings. These rates are susceptible to market fluctuations and volatility, and any inability to manage this effectively could impact our cash flows and profits. Our interest rate management policy aims to achieve an optimal balance between fixed and floating rate interest exposures on expected net debt levels for the next five calendar years. The objective of the policy is to minimise annual interest costs and to reduce volatility. We achieve this through a combination of issuing fixed rate long-term debt and by modifying the interest rate exposure of debt and cash positions through the use of interest rate swaps.

In the current climate, we also face significant counterparty risk from banks. The Group regularly reviews these and where necessary tightens counterparty limits and reduces the maturity profile of deposits to provide for maximum flexibility. The Group actively manages its banking exposures on a daily basis.

Certain Unilever businesses have defined benefit pension plans. Falling interest rates and market values of investments coupled with increasing life expectancy could result in the cost of funding these schemes increasing substantially.

Our pension investment policies are such that investments are well diversified, and the failure of any single investment would not have a material impact on the overall level of assets. The plans seek to invest the largest proportion of the assets in equities, which the Group believes offer the best returns over the long term commensurate with an acceptable level of risk. The pension funds also have a proportion of assets invested in property, bonds, hedge funds and cash. The majority of assets are managed by a number of external fund managers, with a small proportion managed in-house. Unilever has a pooled investment vehicle (Uninvest) which it believes offers its pension plans around the world a simplified, externally managed investment vehicle to implement their strategic asset allocation models currently for equities and hedge funds.

In view of the current economic climate and deteriorating government deficit positions, tax legislation in the regions in which we operate may be subject to change, which may have an adverse effect on our profits and on our ability to remit dividends or service fees. We intend to continue with high quality tax compliance and documentation, to execute prudent tax planning strategies and to make proper provision for current and deferred taxation. Deferred tax assets are reviewed regularly for recoverability.

Further information about these, including sensitivity analysis to changes in certain of the key measures, is given in note 17 on pages 108 and 110 and note 20 on page 115.

#### **Exposure to Developing and Emerging (D&E) markets**

Unilever has significant international operations, with close to half its business in D&E markets, and whilst its diverse geographical spread helps ensure it is not reliant on a single region or country, it is continually exposed to changing economic, political and social developments outside its control. D&E markets are typically more volatile than those in the developed world, and any broad-based downturn in these markets could reduce our sales and adversely affect our cash flow and profits. In mitigation, Unilever has long experience and understanding of D&E markets and how to manage effectively at times of economic turbulence.

#### **Input costs, supplier and supply chain reliance**

Manufacturing our products is dependent on obtaining adequate supplies of production materials in a timely and cost effective manner. The prices of these, which are significantly influenced by global economic conditions, can fluctuate and could have an impact on our margins and cash flows. Our management of these fluctuations is important in terms of our overall cost competitiveness and management of margins and cash flows.

We are also dependent on suppliers and global supply chains as a means of producing and supplying our products. As a result of our reliance on these global supply chains, we are exposed to business interruption from natural disasters or catastrophes and through additional risks of changes in local legal and regulatory schemes, labour shortages and disruptions from environmental and industrial incidents.

In the current climate we also face a counterparty risk from our suppliers. Active monitoring of our suppliers and supply chain is in place, and regular supplier counterparty risk analysis is carried out to assess exposure limits. We plan to continue to work closely with our key suppliers in mitigating the impact of the lack of liquidity in the market. We intend to continue to purchase forward contracts for raw materials and commodities as appropriate.

Unilever actively monitors its external environment, reviews and revisits its business continuity and disaster recovery plans, and continues to adapt its internal cost structures to deliver products at competitive costs. We continue to actively manage fluctuations in input costs and are accelerating our cost reduction programmes.

#### **Safety, sustainability and environment**

Unilever has created a strong corporate reputation over many years for its focus on social and environmental issues, including sustainable development and utilisation of renewable sources. The Unilever brand on our products increases our exposure, and should we fail to meet high product safety, social, environmental and ethical standards in all our operations and activities it could impact our reputation.

We seek to demonstrate our commitment to our people and the communities that we operate in through compliance with our Code of Business Principles and other operational and business policies.

We continue to recognise the importance of social and environmental issues in our operations, and have established indicators to track performance in these areas. We regard safety as an essential element of a successful and sustainable business and take seriously our responsibility to provide a safe workplace. We aim to improve continuously the health, safety and well-being of everyone working for, or on behalf of, Unilever.

We continue to be committed to meeting the needs of consumers in an environmentally sound and sustainable manner. The environmental measures that we regard as the most significant in relation to our business are those relating to the amounts of CO<sub>2</sub> emissions from energy that we consume for manufacturing, the water that we consume in our production processes, and the amount of waste that we generate.

The Corporate Responsibility and Reputation Committee oversees Unilever's conduct as a responsible corporate citizen. For the report of the committee please see page 75.

#### **Restructuring and changes to the way we operate**

Restructuring is an integral part of remaining competitive, and this can involve changes to internal structures, the rationalisation of the asset base, and the use of third parties to deliver business services.

Restructuring and outsourcing programmes have been particularly intense over the last few years, and the continuing implementation of these will require significant effort and attention in order to deliver the expected benefits on time and in full. Delays, ineffective management of third-party suppliers, or employee disruption of restructuring programmes could all lead to increased cost, a delay in realising benefits, and damage to corporate reputation. We continue to mitigate these risks through strong project management, clear governance mechanisms, an agreed approach to change management, and by ensuring we treat employees in line with our internal standards and in accordance with all legal and regulatory requirements.

#### **People and talent**

Attracting and retaining talented employees is essential to the successful delivery of our strategy and success in the marketplace. Shortfalls in recruitment or retention could adversely affect our ability to operate successfully, grow our business and win against competition.

To counter the risk, we believe in providing an environment where individuals can achieve their goals, both professionally and personally, and by seeking to ensure that Unilever has the right resources and capabilities to compete effectively. We have fully integrated processes of appraisal against skill profiles, capabilities, and achievement of business objectives, and we also make investments in training and development which are aimed at equipping our people for the challenges in their roles. We constantly review external candidates to ensure we enrich and augment our home-grown talent.

#### **Other risks**

In common with other businesses, the Group is exposed to a number of other risks, some of which may have a material impact on its turnover, operating profit, net assets and liquidity. It is not possible to identify or anticipate every risk that may affect the Group, some of which may currently not be known or may have been assessed as not material.

### **Risk Management, Internal Controls and Disclosure Controls and Procedures**

The identification and management of risk is integral to Unilever's strategy and to achieving its long-term goals. The Boards have overall responsibility for the risk management process, which incorporates risk management, internal control procedures and disclosure controls and procedures (including the operation of the Audit Committee – see page 48 – and Disclosure Committee – see page 49).

Unilever's procedures, which are documented and regularly reviewed throughout the organisation, are designed to provide reasonable, but not absolute, assurance that our assets are safeguarded, the risks facing the business are being addressed, and all information required to be disclosed is reported to the Group's senior management, including where appropriate the Chief Executive Officer and Chief Financial Officer, within the required timeframe.

The Boards have established a clear organisational structure which includes a delegation of authorities. The day-to-day responsibility for implementation of our procedures (financial, operational, social, strategic and environmental risks and regulatory matters) and ongoing monitoring of risk and the effectiveness of controls rests with the Group's senior management at individual operating company and regional level. Regions review, on an ongoing basis, the risks faced by their group and the related internal control arrangements, and provide written reports to the Chief Executive Officer.

The Group's risk, control and disclosure procedures are supported through:

#### **Business Risk Assessment (BRA)**

The Audit Committee reviews the key risks affecting the business four times a year and the Boards review the risks as a part of the forecast and annual financial plan. The regions, category and functions provide inputs to this process and actions are put into place to mitigate the identified risks. Risk reporting covers the perceived risk, assessed impact and the effectiveness of controls to mitigate these risks.

#### **The Code of Business Principles (CoBP)**

The Code of Business Principles, which sets standards of professionalism and integrity for its operations worldwide, is Unilever's statement of values and represents the standard of conduct we require from all of our employees. Our Code of Ethics applies to the senior executive, financial and accounting officers, and comprises the standards prescribed by the US Securities and Exchange Commission (SEC). The CoBP Hotline is a confidential way for employees to submit concerns regarding accounting and auditing issues anonymously and handles all alleged violations of the CoBP. Copies of the CoBP, the Code of Ethics and the Share Dealing Code are posted on our website at [www.unilever.com/investorrelations/corp\\_governance](http://www.unilever.com/investorrelations/corp_governance)

### **Policy compliance**

The implementation of and compliance with our governance structure is facilitated through a business-orientated policy framework. Unilever policies are universally applicable within the Unilever Group. They are mandatory and have been developed to ensure consistency in all material respects amongst worldwide operations in key areas. They cover operational and functional matters, and govern how we run our business, to help ensure we comply with applicable laws and regulations. Key Unilever policies include the Compliance Manual for the Listing Rules and Disclosure and Transparency Rules (including the Unilever Share Dealing Code), the Risk Management Policy, the Corporate Pensions Policy and the Accounting and Reporting Policy.

### **Operational Controls Assessment (OCA)**

Operational Controls Assessment requires the senior management in each business unit to assess the effectiveness of financial controls. At our major units, financial controls are subject to a comprehensive risk-based assessment annually, with controls in the remaining units being reviewed over a one-to three-year cycle.

### **Annual Positive Assurance**

Senior management provides an annual Positive Assurance letter addressed to the Chief Executive Officer confirming compliance of their business unit with BRA, CoBP, Policy compliance and OCA. Exceptions, if any, together with remedial actions, form part of these written communications. A consolidated version is presented to the Disclosure Committee and the Board for their review.

### **Internal audit**

The Corporate Audit function plays a key role in providing to both operating management and the Boards an objective view and reassurance of the effectiveness of the risk management and related control systems throughout Unilever.

It is Unilever's practice to bring acquired companies within the Group's governance procedures as soon as is practicable and in any event by the end of the first full year of operation.

The Boards, through the Audit Committee (see page 74 for report of the Audit Committee), have reviewed the assessment of risks, internal controls and disclosure controls and procedures that operate in the Group and have considered the effectiveness and remedial actions where applicable for the year covered by this report and up to the date of its approval by the Board of Directors.

### **Boards' assessment of compliance with the Risk Management frameworks**

Reference is made to the requirements sections in the Corporate governance statement for Unilever's compliance with the UK Combined Code, the Dutch Corporate Governance code and the US Securities Exchange Act 1934 and the US Sarbanes-Oxley Act 2002.