

Non-GAAP measures

Certain discussions and analyses set out in our results announcements and elsewhere on this website include measures which are not defined by generally accepted accounting principles (GAAP) such as IFRS. We believe this information, along with comparable GAAP measurements, is useful to investors because it provides a basis for measuring our operating performance, ability to retire debt and invest in new business opportunities. Our management uses these financial measures, along with the most directly comparable GAAP financial measures, in evaluating our operating performance and value creation. Non-GAAP financial measures should not be considered in isolation from, or as a substitute for, financial information presented in compliance with GAAP. Non-GAAP financial measures as reported by us may not be comparable to similarly titled amounts reported by other companies.

Measures of long-term value creation

Unilever's ambition for the creation of value for shareholders is measured by Total Shareholder Return over a rolling three year period compared with a peer group of 20 other companies. Unilever believes that the contribution of the business to this objective can best be measured and communicated to investors through the following measures:

- The delivery, over time, of Ungeared Free Cash Flow (UFCF), which expresses the translation of profit into cash, and thus longer term economic value; and
- The development, over time, of Return on Invested Capital (ROIC), which expresses the returns generated on capital invested in the company.

Unilever communicates progress against these measures annually, and management remuneration is aligned with these objectives. The UFCF over a three year period is incorporated as a performance element of Unilever's management incentive scheme.

UFCF and ROIC are non-GAAP measures under IFRS. We comment on these in detail here since they are the way in which we communicate our ambition and monitor progress towards our longer-term value creation goals and in order to:

- Improve transparency for investors;
- Assist investors in their assessment of the long-term value of Unilever;
- Ensure that the measures are fully understood in the light of how Unilever reviews long-term value creation for shareholders;
- Properly define the metrics used and confirm their calculation;
- Share the metrics with all investors at the same time; and
- Disclose UFCF as it is one of the drivers of management remuneration and therefore management behaviour.

As investor measures, we believe that there are no GAAP measures directly comparable with UFCF and ROIC. However in the tables below, we reconcile each as follows: UFCF to cash flow from operating activities and also to net profit; ROIC to net profit.

Unilever cautions that, while UFCF and ROIC are widely used as tools for investment analysis, they are not defined terms under IFRS and therefore their definition should be carefully reviewed and understood by investors. Investors should be aware that their application may vary in practice and therefore these measures may not be fully comparable between companies. In particular:

- We recognise that the usefulness of UFCF and ROIC as indicators of investment value is limited, as such measures are based on historical information;
- UFCF and ROIC measures are not intended to be a substitute for, or superior to, GAAP measures in the financial statements;
- The fact that ROIC is a ratio inherently limits its use, and management uses ROIC only for the purposes discussed above. The relevance and use of net profit for the year (being the most relevant comparable GAAP measure) is clearly more pervasive; and
- UFCF is not the residual cash available to pay dividends but represents cash generated by the business and broadly available to the providers of finance, both debt and equity.

Ungeared free cash flow

UFCF expresses the generation of profit by the business and how this is translated into cash, and thus economic value. It is therefore not used as a liquidity measure within Unilever. The movement in UFCF is used by Unilever to measure progress against our longer-term value creation goals as outlined to investors.

UFCF is cash flow from group operating activities, less capital expenditure less charges to operating profit for share-based compensation and pensions, and less tax (adjusted to reflect an ungeared position and for the impact on profit on sales of material business disposals), but before the financing of pensions.

The reconciliation of UFCF to the GAAP measures net profit and cash flow from operating activities is as follows:

	€ million 2008	€ million 2007	€ million 2006
Net profit	5 285	4 136	5 015
Taxation	1 844	1 137	1 332
Share of net profit of joint ventures/associates and other income from non-current investments	(219)	(191)	(144)
Net finance costs	257	252	725
Operating profit (continuing and discontinued operations)	7 167	5 334	6 982
Depreciation, amortisation & impairment	1 003	943	982
Changes in working capital	(161)	27	87
Pension charges in operating profit less payments	(502)	(910)	(1 038)
Movements in provisions less payments	(62)	145	107
Elimination of profits on disposals	(2 259)	(459)	(1 620)
Non-cash charge for share-based compensation	125	118	120
Other adjustments	15	(10)	8
Cash flow from operating activities	5 326	5 188	5 574
Less charge for share-based compensation	(125)	(118)	(120)
Add back pension payments less pension charges in operating profit	502	910	1 038
Less net capital expenditure	(1 099)	(983)	(934)
Less tax charge adjusted to reflect an ungeared position	(1 368)	(1 228)	(1 336)
Taxation on profit	(1 844)	(1 137)	(1 332)
Taxation on profit on material business disposals	581	-	159
Tax relief on net finance costs	(105)	(91)	(163)
Ungeared free cash flow	3 236	3 769	4 222

The tax charge used in determining UFCF can be either the income statement tax charge or the actual cash taxes paid. Our consistently applied definition uses the income statement tax charge in order to eliminate the impact of volatility due to the variable timing of payments around the year end.

For 2006 the income statement tax charge on this basis was materially impacted by the tax effect of non-cash charges for the provision for preference shares and certain other non-cash items, UFCF for 2008 based on actual cash tax paid would have been €3.6 billion (2007: €3.6 billion; 2006: €4.5 billion).

Return on invested capital

ROIC expresses the returns generated on capital invested in the Group. The progression of ROIC is used by Unilever to measure progress against our longer-term value creation goals outlined to investors.

ROIC is profit after tax but excluding net interest on net debt and impairment of goodwill and indefinite-lived intangible assets both net of tax, divided by average invested capital for the year. Invested capital is the sum of property, plant and equipment and other non-current investments, software and finite-lived intangible assets, working capital, goodwill and indefinite-lived intangible assets at gross book value and cumulative goodwill written off directly to reserves under an earlier accounting policy.

The reconciliation of ROIC to the GAAP measure net profit is as follows:

	€ million 2008	€ million 2007	€ million 2006
Net profit	5 285	4 136	5 015
Add back net interest expense net of tax	294	314	365
Add back impairment charges net of tax	38	1	15
Profit after tax, before interest and impairment of goodwill and indefinite-lived intangible assets	5 617	4 451	5 395
Year end positions for invested capital:			
Property, plant and equipment and other non-current investments	7 024	7 276	7 142
Software and finite-lived intangible assets	540	590	608
Inventories	3 889	3 894	3 796
Trade and other receivables	5 002	4 965	4 667
Trade payables and creditors due within one year	(8 449)	(8 545)	(8 513)
Elements of invested capital included in assets & liabilities held for sale	45	150	15
Goodwill and indefinite-lived intangible assets at gross book value	20 892	20 029	20 705
Total	29 843	28 359	28 420
Add back cumulative goodwill written off directly to reserves	6 343	6 427	6 427
Year end invested capital	35 286	34 786	34 847
Average invested capital for the year	35 832	35 122	36 850
Return on average invested capital	15.7%	12.7%	14.6%

(a) Excluding write-downs of goodwill and indefinite-lived intangible assets taken in connection with business disposals.

ROIC is based on total business profit, including profit on business disposals. The impact of such disposals in 2008, 2007 and 2006 was €1 609 million, €326 million, and €1 170 million respectively. ROIC excluding this impact in 2008 was 11.2% (2007: 11.3%; 2006: 11.5%).

USG and Net debt

Underlying sales growth (USG) reflects the changes in revenue from continuing operations at constant rates of exchange, excluding the effects of acquisitions and disposals. It is a measure that provides valuable additional information on the underlying performance of the business. In particular, it presents the organic growth of our business year on year and is used internally as a core measure of sales performance. We provide a reconciliation of USG to turnover growth in total and by segment in our results announcements.

Net debt is defined as the excess of total financial liabilities, excluding trade and other payables, over cash, cash equivalents and financial assets, excluding amounts held for sale. It is a measure that provides valuable additional information on the summary presentation of the Group's net financial liabilities and is a measure in common use elsewhere. The net debt definition in our 2007 reporting has not changed, in substance from previous years, however the terminology has been updated to correspond with that appearing on the balance sheet.

USG and net debt are non-GAAP measures under IFRS.