

# FINAL TRANSCRIPT

**Thomson StreetEvents<sup>SM</sup>**

## **HLF - Herbalife Ltd. at Goldman Sachs Global Retailing Conference**

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## CORPORATE PARTICIPANTS

**Michael O. Johnson**

*Chairman & CEO - Herbalife Ltd.*

**Rich Goudis**

*CFO - Herbalife Ltd.*

## CONFERENCE CALL PARTICIPANTS

**Simeon Gutman**

*Analyst - Goldman Sachs*

## PRESENTATION

**Simeon Gutman** - *Analyst - Goldman Sachs*

We'll get started. I'll introduce these guys. We're pleased with us today Herbalife Management represented by Chairman and CEO, Michael Johnson, CFO, Rich Goudis, and VP of IR, Andy Speller.

As many of you know, Herbalife is a [buy ready] name for us and was recently added to our retail consumers group most favorite list. And the logic when we initiated it over a year ago has more or less prevailed until today. First, the company is well positioned to take advantage of both the global health and wellness market, and the direction only market. Second, management truly understands how to capture, balance, and retain momentum. And third, with a high teens bottom line growth rate and a low teens PE multiple, this is a growth story that trades at a value multiple.

And so of course there has to be an explanation for this disconnect, at least temporarily, and that reason is most likely the general anxiety with MLM models. But with one of the company's loudest critics formally walking away from the story recently, a big overhang has been removed. Separately and what I think will make this session especially valuable, since Michael is here to present with us, is that these businesses can be fast growing and sustainable if positioned the right way. And for Herbalife, that combination has never seemed more realistic and achievable, as daily product consumption continues to grow.

So to shed some light on the company's strategy, let me turn it over to Chairman and CEO, Michael Johnson.

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**Michael O. Johnson** - *Chairman & CEO - Herbalife Ltd.*

Good morning. Sorry for being a few minutes late there. I think we've all been on the same elevators this morning. Now, if I walk around I'll grab that in a second. I just want to give you a very brief overview and then we're going to open it up to Q&A. This is, we've been public now for almost five years, four years plus, and we've been doing these presentations and spending a lot of time trying to bring people up to the model that we're in, which is multi-level marketing, direct selling, nutritional supplements, the world of nutrition.

And so we decided to take a look at this meeting, do it just a little bit differently. It's funny, when I sit with Andy, and we used to be sitting in one of your chairs, and I said to him, what do these guys really want to see, Andy? I mean, we've had tremendous growth in our company. We've had 18 quarters in a row of double digit growth, 24 quarters in a row consecutive growth in this company. We've never had more sales representatives, distributors than any time in the company's history.

We're retaining more. We're recruiting more. We're seeing more people get healthy with our products. We're building this business globally. We're about 20% of our business is in the US and it's one of our fastest growing markets right now in a pretty tough selling environment. We have one of our biggest success stories, which is here in the United States.

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We're growing globally and we're building a business in marketplaces that have tremendous opportunity in front of them. China, we would love to crack the code in India. We're not there yet and I'm cautiously optimistic about China, but we'll come back to that in a second. But I said to Andy, what do these folks want to see and what does it take to really sell your stock to them, sell an investment in your company. He said, Michael, they want to see your passion. Well, I didn't wear a triathlon suit in here today. I didn't come in here to ride my bike for you or do anything like that.

But the passion I have for these products, and I'll tell you, this morning I recruited the doorman at the Four Seasons Hotel. Yesterday, I recruited two bellman in the hotel that I was in, in Colorado just by watching them and listening to them. And I was down in the gym working out this morning and a woman was looking for another energy drink. And I happened to have a little one of our Lift Offs with me. I said, try one of these, and she said, what's this. And I said, this is an energy drink that has no calories, that has ginseng, taurine, and ginkgo in it. It has Vitamin C, all the Vitamin C you'll need for today, and it's a natural caffeine. So it's this wonderful lift for you.

And so she got done with her work out. I got done with mine. We happened to be leaving the gym the same time. She said, where can I get more of this. To me, that's the passion that this company is. It is about the products and it's a person to person selling model that's way different from selling a product on the shelf.

So let me just go through kind of a canned presentation and then open it up to your comments and questions. Chasing the megatrends of obesity and appropriate nutrition, this is obvious. What's going on in our world today is, frankly, very, very sad. The obesity issue is not just a US phenomenon. It is a global phenomenon. I read some research recently that it's hard to believe, it's hard to fathom that by the year 2042 that 100% of America, so that means I'm dead in 2042, will be overweight, because I refuse to be one of those people.

It's a very sad statement of our times but it's also a tremendous opportunity. What we're doing at Herbalife is that we are giving people an opportunity, basically, to change out an unhealthy meal with a healthy meal. And we're doing it through a variety of methods. We're doing it on an economic basis. I gave a lift to somebody on the way over here this morning. She was out calling for a cab and she says, I'm going to the Marriott Marquis. And I said, come on, jump in with me.

And so she was explaining -- asking me about the company, and I was saying to her, we're basically a great calorie exchange. That's what our diet is. We're going to give you a meal for 220 to 240 calories depending on the fruits, or the vegetables, or the milk you mix it with, that will replace, and I love it when we talk about replacing another meal, maybe a Happy Meal or something like that. Is that really a meal we're replacing there? When you think about the ingredients, you think about the process that that food got from field to that bag that you got it in at that fast food joint.

They call it a meal. I'll put up our meal against that and say it's a healthier exchange, but it's a great economic exchange too. What our distributors have done, and this is a very creative entrepreneurial group of people, have figured out a way to make this a daily consumption model, which is driving the heck out of our business right now, and I'll go more into that in just a second, by taking this opportunity and turning it not only into a nutrition opportunity, but a social opportunity.

They've created these things called Nutrition Clubs and through Nutrition Clubs on a global basis, 5, 10, 15 people get together on a daily basis. They take a meal together. They take a tea and an aloe drink. So you've got good nutrition. You've got energy, increase your metabolic rate, and you've got a digestive aid, which is the aloe drink. And they've put a social environment around it, so people show up every day. They're very sticky customers. They might be paying anywhere from \$2 to \$4 for this experience and they're coming in droves.

And so think of this in an odd way as a Starbucks without any of the bricks and mortar. These are in people's homes. These are at no cost to the company whatsoever. It's on a royalty plan that keeps people very loyal to the product and the brand, and it builds a community and social fabric that's incredible. And if I could fly you out here on a magic carpet and fly you into some of these clubs, and to see what's taking place in Mexico, in the United States, and especially in the Hispanic market. In countries like Peru, in Taiwan where we have tremendous reach and extension of these clubs.

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And you'll see what our distributors have done with this idea because the one thing that motivates our distributors more than anything, of course, is nutrition, but it's financial. And so we have people coming to us for a financial opportunity that's unique, especially in these tough times, because we may be that extra \$100 paying that mortgage. And we may be that extra \$200 getting the kids schoolbooks, or clothes, or getting them off on the right foot at the beginning of the school year. And that's what creates this tremendous opportunity, not only the nutrition but the financial opportunity.

So they've created these clubs which creates a sticky customer. The distributors have then taken the clubs and extended them. They've come together and gone into light commercial or industrial space and they've put five or six distributorships together, and they have a social environment. They have a nutrition environment. They have a training environment. They have a recruiting environment all under one roof.

But here's the basic deal. This is the transformation of this company is to take a high calorie meal, exchange it with a low calorie meal. Put a distributor who's driven by not only the nutritional opportunity in their personal testimony, but a financial opportunity behind this company. That's what is the basis of our growth. And when we came to the company in '03, we had about 275,000 distributors who were retained on an annual basis, basically almost a 1 for 1 swap from '99 to 2003. Meaning, we were a recruiting machine. We're just recruiting people, one in, one out.

We've got 475,000 distributors now who are supervisors, who are gaining or looking to gain income from this company as a complete income for their lives or supplementary income. Here's where to me it really gets interesting, and as we start to slice and dice our marketplace, it is about penetration. And so our company average, our pro rata is about \$1.14. And that \$1.14 average right now is on a global basis, and if you look at some of our top markets, and you look at some of the kind of middle markets, and you'll see an Italy fits almost there in the middle, and France is half that, and China is a nickel. And when you look at countries like the USA which is up to \$2.17. If we took the USA average or even took the -- start to get really bold here and you start to take a Taiwan average, you're talking about doubling or six timesing the size of this company.

Taiwan is where those nutrition clubs have hit and hit in a very deep basis. So now you're looking at a company that could be six times as large as it is today. Now, are we out there preaching that? No. We're just giving you an indication to say, here's what this company can be. Here's what this model supports. Taiwan, very advanced retail system in the marketplace. Very strong growth in that market in terms of our business and the two have lived very well together. And the distributors that have taken it out there have done what we call the daily consumption model. And this is a case study on that.

In Mexico, we ramped up. This was -- the Nutrition Club model was founded in a small community called Zacatecas, Mexico by two very innovative distributors, a husband and wife. And now this model has spread throughout the world. And what happened in Mexico on this model is really phenomenal, but it outstripped our ability to service the marketplace. We grew from about a \$200 million market to a \$600 million market in three years in the marketplace. It took a while for this program to set into place.

It takes a while for people to get Nutrition Clubs, especially an older line distributor who's changing their method of operation because they used to be mostly recruiting machines. And now we're saying, think about retail more. For three hours recruit, retail, retain, retail your business, get closer with your customers, more face to face. Look for opportunities in there to recruit new distributors, but also really the opportunity of retailing, changing people's lives through a better nutritional opportunity. And what happened in Mexico was an incredible growth rate that frankly outstripped our ability to grow it.

So we saw some of the drop off there in the marketplace because it grew too fast, and now what we're doing is starting to see Mexico level and slight growth once again. The introduction of the daily message you can see in the USA has taken our business from below 1.4 up to almost 2.2 in terms of pro rata daily consumption, or consumption, excuse me, on an annual basis. It is a tremendous opportunity and it still has plenty of headroom in front of it.

It's largely been taken in by our Hispanic distributors, our Latin American distributors who are importing this idea from Mexico and from Central America, and they're starting to see these clubs work, and they're starting to see the economic opportunity

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work for them on an individual basis. We have in every metro in the United States we have a very strong Latin population out here in New Jersey. We've got a very strong group going. We've got them in Chicago, Detroit, Dallas, Los Angeles, Phoenix.

And now the next opportunity is to get this over into the Anglo community, is to show those distributors, which we'll have a large meeting with them come October here in the United States to show them how the success story can work with them. And we have some very strong what we call President's Team members who are based out of Dallas, who are Anglos, who are starting to build the Nutrition Club model in that community.

Now, we have another thing called the Weight Loss Challenge going inside the United States, which distributors have made tremendous opportunity out of, by creating these weight loss challenges inside clubs, again building that environment, that social gratification, that network of people that comes together to work together, to build the opportunity not only financially but for health.

Financial upside from improving penetration is pretty obvious for us. We believe that the average penetration would increase, it's up there, by \$1.1 billion if all of the underperforming countries except China and India just moved to the average, just moved to everybody's average. You've got your company up \$1.1 billion in volume points. An additional \$1.4 billion if China moves to average. Now, I just want to be a little careful about China. We've got new licenses there. We continue to grow there but we are a bricks and mortar company in China. We have a lot of retail fronts. We have almost 100 retail fronts at this point. We will continue to invest in that marketplace around these licenses. The bricks and mortar outer foundation of the growth there, the distributors can operate outside that, but they tend to still cluster at those bricks and mortar facilities.

I was in China two weeks ago, visited a couple of our facilities there and what you see is almost like a Sears catalog store, if you were a kid growing up and had one of those in your community. It's more or less a service center where you come in and place orders, and take orders, and you take the product out the front door of the facility itself. It's not what I would call a typical Wal-Mart or Kmart. It's more like a catalog service store in there, but there's places to hold meetings. There's place to identify and train on the product, train on the business program to understand exactly how to operate inside Herbalife.

So with that said, again this is unusual for our typical. We run you through multilevel marketing, and direct selling, and marketplace. What we'd do is we thought we'd keep what we were ordered to do as more of a fireside chat here today. No fireplace. They had them in the [PR] though. Just kidding. It's tough for Goldman this year too, I guess. But a company that we're very, very proud is Herbalife, and a company that we've seen enormous potential for growth. We see an enormous potential to continue to build our bottom and our top line in this company, attract people to a wonderful financial opportunity, but also to a health opportunity.

And that's my personal mission in this company is, when I first started at the company my brother sent me a great little quote from Ralph Waldo Emerson that said, the first wealth is health. And everything we're doing at this company to drive the product is so important to what we believe not only to today's consumers, but to the future of this company and of course to our distributors.

So with that, let me leave it open to questions. You've got Rich on the financial side and me on the business side, Andy on the investors side. So any questions?

## QUESTIONS AND ANSWERS

**Simeon Gutman** - Analyst - Goldman Sachs

We're asking all of our companies at the conference (inaudible) questions, first related to macro. What type of macro backdrop are you assuming (inaudible) your business over the next 6 to 12 months, better, worse, or the same, and why?

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**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

Well, I don't want to be a contrarian, but our company seems to be operating quite well in tough times. So when we look at the macro environment, obviously on the margin side, the cost of goods, the cost of energy, the cost of supply to our supply chain is going to be higher, and we know that. But we also believe that in our company we have some efficiencies still to manage through our supply chain. We just hired a new head of supply chain in the company we're pretty excited about. We believe there's opportunity there.

On the macro environment, on the economic side, we're not blind to what's going on in the world. There's still a financial crisis out there in many quarters, but as I said in my earlier comments that people are looking for additional financial income. And we have this model that can provide anything from \$50 a month to \$50,000 a month if you want to get super aggressive and build a huge business. But that part time income is a great inviter to our company and gives people an option to take a look at us, and to see, and to test themselves, and to test the product, and to test the ability for potentially some income.

So when I look at the grander economic scale, this company continues to grow at double digits through some pretty tough times, and we seem to be, and I want to be careful of the word countercyclical, because when the cycles are good, are we then countercyclical again. And we've been growing through the good and bad times for the last five years pretty solidly. So I don't look at it and we don't have a weekly meeting about the prime rate and what it's done to house loans. Our company just doesn't seem to be as impacted by that as others are.

**Simeon Gutman** - Analyst - Goldman Sachs

The second question is on margins, which you've somewhat addressed. But over the next 12 months, do you expect margins to stay flat, rise, or fall?

**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

Well, I expect them to rise, but this is my head of margin here. We constantly have that. I have Mr. Volume and Mr. Margin. I have the revenue side and the margin side of the company and I get to spend time with both of them, and bat the ball back over the net at them. And I'm a freak for the bottom line, I must admit.

I believe that efficiency is good in all sorts of things. It's good for the environment. It's good for our product. It's good for the company. It's good for the employees to be motivated by that. It's good for our suppliers to be looking at different ways to deliver. We're looking at new packaging concepts and ideas that will be more sensitive to landfills and to certain other areas of our company that I just don't think we operate as efficiently as we should. And I think Rich will be back me up on this one. We've set a goal for continual process improvement and continual improvement in our company, and that includes the bottom line.

So I'm going to say yes on the bottom line. We did not have a big bottom line increase in the last, what, six months. Not quite what we wanted, but in the last four years we've grown it by how many basis points?

**Rich Goudis** - CFO - Herbalife Ltd.

400.

**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

400 basis points in four years, and I think we're getting near the top of our pack in our industry, but that's not good enough for us.

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**Simeon Gutman** - Analyst - Goldman Sachs

Okay, and the third one is, has the ongoing credit crisis led you to be more guarded when it comes to capital allocations, leverage and/or buy backs?

**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

Well, the last one's an interesting one because we've returned over \$520 million to our shareholders in the last year and a half. And the value is, it's perceptive. I don't see the value as great as others do. I was not against the buybacks but I'm very much in the neutral program on that. I'd like to figure out better ways to return value to our shareholders, certainly by a higher stock price.

Buying all those shares back didn't seem to move it much. Maybe that was a condition of the market at the time. I'm not an expert there. I'm no Peter Lynch, so I can't tell you how these things move or what they do. I'm just a businessman who tries to drive a top line and a bottom line, and hopefully we get the benefits. And I listen to all these geniuses in the room. I'm just a farm boy from Michigan, and I hear them all talking to me about, well if we do this all these great things are going to happen.

And all these bankers get around me, and everybody seems to be getting a fee for all this stuff. And god bless them, but they're all doing this, and I'm going, yes, but guys we did all this and my stock didn't move. So what's up with that? Well, they all bought no cars and houses, but my stock didn't move. So the question, I don't know how to answer that. We will continue to have that discussion. We will continue to look. They will continue to educate Michael Johnson in the big ways of the marketplace, and hopefully I'll be brighter and smarter by the end of all this when I'm riding my bike off into the sunset.

But I think as we look at the marketplace, that capital investments, we're not a heavy capital investment company. We don't need it. The only thing that I would say that I would like to get better command of is our supply chain. I think manufacturing makes a lot of sense for us for a lot of reasons, a lot of different reasons. I'd like to put under contract fields where we get our products from. You've heard me speak about that for years and it's just something that hasn't happened.

We have better supply chain management than we've ever had, but I want the assurance of knowing what's in those fields, where it comes from, how it gets there, what the process is. And I'd love to see it blended in our own facilities. But that's a relatively small capital investment on the scale of our company. Rich, you want to add anything to that?

**Rich Goudis** - CFO - Herbalife Ltd.

Yes, I would just add that we don't see the outside forces that are effecting other companies effecting us. We're about one time debt to EBITDA. So we're pretty conservatively capitalized. We are fortunate that our business model generates a significant amount of free cash and our business does not require that free cash to be invested in the business to drive double digit growth. I mean we've had double digit growth in 18 sequential quarters here or consecutive quarters.

So it's one, like Michael said, how do we get this free cash that's accumulating back to our investors in the most efficient way. And that rewards them for being --

**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

You might have an idea on how to do that, right?

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#### Unidentified Participant

(Inaudible) Mexican Pesos been strong against the dollar. What if the Peso weakened by 5% and also your model (inaudible question - microphone inaccessible) people drive up with 7 or 8 cars. The neighbors complain and say get these people out of here in a nice way, and call the town saying, they're running a business out of that house. How does that work?

#### Michael O. Johnson - Chairman & CEO - Herbalife Ltd.

Well, we had that problem and we faced it, and we had it in suburban Los Angeles in Compton where we had some clubs there. So as these clubs expand so do unfortunately, our rules. And what we have to educate our distributors about is local rules, health rules, business rules, running a business out of your home. Each community may have its own set of doctrines, and how to park cars, and how to be a polite neighbor, and all that. And so we actually put out a cartoon book because I'm convinced people don't read. So we did a cartoon for them to show them how to live happily with their Nutrition Club in their neighborhood under the rules.

On the Peso, yes, we have a good neighbor rule. Rich just wrote that down. It's in the company, be a good neighbor, be a good citizen in your community in more ways than one, but don't get me started there. That's a whole getting them off into a social environment. The Peso, as the peso weakens or strengthens, the Euro goes one way or the other, we are in 66 markets throughout the world. So we have a continuing economic range of exchange. And right now, I think we're actually seeing the Peso go the other way a little bit. And as the Euro is strengthening a bit, we have offsets on those.

If it goes up 5%, we'll probably be impacted. I don't know to what level. Rich? 5%.

#### Rich Goudis - CFO - Herbalife Ltd.

Yes, Peter, it depends on what you're asking as far as actually bottom line. Because we hedge about 50% of our net income exposure on a rolling four quarter basis. So you might see it at the gross profit level as far as net sales and gross profit, but it probably gets mitigated both ways. We kind of neutralize that by the hedging policies that we have in place.

#### Unidentified Participant

Just wanted to ask a question before we open it up again. Related to your comments about buying stock back and not getting credit, I think this is a worthwhile discussion, the whole idea of growth versus sustainable growth. And at the (inaudible) that these models get. And I want to talk about the idea of taking an MLM model and creating a smooth trajectory, which you guys more or less have done. How do you ensure that smoothness, because I think that is the disconnect that sometimes doesn't get made up in the stock market?

#### Michael O. Johnson - Chairman & CEO - Herbalife Ltd.

Well, you're going to get a couple answers. I'm going to let Rich feast on that one too. Is that here's, I was going to say go to this slide. Here's what smooth transition is. Go deeper in your markets. Our distributors used to make their money by going to a whole bunch of markets. You talk to a very senior distributor in Herbalife and you'd say, where's your check from. And they'll lip off 30 marketplaces.

And then you talk to one of our newest President's team (inaudible) club and say, where's your business, and they'll give you a city, not 30 markets. And that's the depth that we want to see this company go through. Daily consumption of the product, daily nutritional regimen that makes sense, exercise, working out, getting good nutrition and then building a customer on a daily basis. Then you start to get consistent order patterns. You start to get a consistency in your business, maybe even a

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predictability and a visibility into our business, that people complain about this business a lot. And I do too because sometimes I feel like I'm running a casino and I don't know who's hitting the tables hard.

But what we have now is enough markets in front of us to look at, to say, okay, we can go into these markets over the next couple years. Because we were held back on an IT infrastructure issue. We weren't allowed to do the things we wanted to do, go as fast into the markets. And then you've got a China sitting there, an India sitting there that are a bit wildcards, that could turn into opportunities, although nobody's really cracked the code in India in direct selling.

And then you have marketplaces here like the US that's growing at a double digit rate right now that has never shown -- well, we haven't seen other companies with that kind of growth in our space. And so what it's done is this model has created consistency. Rich, you want to add anything to that?

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**Rich Goudis** - CFO - Herbalife Ltd.

No, and where we see the consistency is in retention, and for those people that have followed our business, in 2003 the retention of our leaders, our supervisors was about 28%, really reflecting a high recruiting orientation to the business. Today, that sits at about 42% and from a predictability standpoint, it's nice to know that 42% of your business is going to be recurring, if you will, and that's the way we look at it.

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**Unidentified Participant**

Daily consumption is really taking sort of an MLM ebb and flow away from the model, and if Nutrition Club is a vehicle that is creating a daily consumption, what type of infrastructure or controls, kind of related to the earlier question about almost market growth of Nutrition Clubs. What type of things are you thinking about so that that can continue as opposed to that turning into an ebb and flow.

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**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

A pop and drop. It's very interesting, we just met with our very senior leaders. We had them in Beijing for the Olympics. When everyone else was going to the Olympics, we had two days of pretty intense meetings and this was topic number one is how to make sure that growth. How do we not get into a Starbucks situation where we're closing down 600 stores? And how do we make sure that we as a company are working in our communities, working not only with this model, but with models that are going to evolve from it.

We have an argument going on in our distributor base about, well as an individual distributor you'll allow me to do things I can't do as a Nutrition Club operator. We said yes, because there's certain things in the Nutrition Club that we don't want out there. We don't want massive advertising taking place on these. This is a person to person network of clubs, private clubs that do not have brand names on the doors and stores themselves because we still have to keep the playing field level for the new distributor.

So what are we doing to take this? We're controlling this a little more than we would control other methods of operation. We're looking at the advertising around these. We are looking at the sanitation, the health department, the good neighbor policies that we have with these clubs. We are careful to make sure that the clubs -- the Germans came over, the Germans is our heaviest recruiting place and it's one of our worst brand images in the world.

We struggle in Germany and the Germans came over to Zacatecas, Mexico and we were all excited about that. We thought, great, they're going to come over here and they're going to get daily consumption going in Germany. It's going to be fantastic. Well, the German mind went over there and saw, way to recruit. So they went back to Germany and they had these huge

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meetings, 3,000, 4,000 people all built around a business opportunity, six hour meeting. And they basically said, here you can get rich quick by opening a Nutrition Club.

Well, they all failed in Germany because the Mexicans took three years to develop these and they took the -- they trained a new distributor coming into a Mexican Nutrition Club for sometimes three months before they'll let them. Now, there's friction in our plan that way because anybody can operate any way they want as long as it falls within the rules. But the Mexicans have put more controls into the way they're doing it to make sure that the experience would be individualized.

The Germans used it purely for recruiting, opened up a bunch of Nutrition Clubs and they all closed because they didn't realize, well you've got to get up at 6 o'clock every morning and get this thing going, and prepare to see people at 8 in the morning for a couple hours. And then later in the afternoon, and this is work. And one of our distributors jumped on stage last year and said, I found a solution to Herbalife. I found something that really makes your business go. He had the whole room, they were all leaned over to hear this great man from step down mountain. He said it's called work. Work works and the Germans wanted a recruiting machine. So their clubs popped and dropped.

Now, we have some Germans who've come back to some very basic. They're in Strasburg. That's France, but they're right over the border there and they're starting to figure out a different way to do it. So that to me is the building model in there.

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**Simeon Gutman** - Analyst - Goldman Sachs

Let's open it up because I know we had a couple questions.

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**Unidentified Participant**

(Inaudible question - microphone inaccessible)

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**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

What is MLM?

It's going that direction where I'm sure you've encountered many times through the typical investor concerns with the multilevel marketing model. I won't ask you to repeat them all back now. I think one that is often thrown about is the portion of profits that are associated with the bringing in of new members versus growing sales from existing distributors. I don't know to what extent you've addressed that or are comfortable addressing it in terms of specifically maybe why it comes from starter kits or so forth. Is that on the table?

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**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

Oh, sure. Rich?

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**Rich Goudis** - CFO - Herbalife Ltd.

Yes, 25% of our revenue is associated with bringing in new people into the business. We're very public about that and the way to look at that is in our public filings. On a quarterly basis look at the number of new supervisors coming into the business, which we use as a key statistic and we report upon. Assume that somewhere between \$2,500 net sales to \$3,000 is the value of that new supervisor coming into the business. There's very strong FTC rules that we measure ourselves against to make sure that at least the FTC rule says less than 50% of your business has to be from recruiting. So that's a real benchmark.

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There's a lot of FTC rules and a lot of best practices established by basically dissent decrees with most formally Amway and most of the attorney generals around the US that give us as an industry, and through the direct selling association, our best practices. There's a 10 person resale rule. There's a 70% consumption rule. There's a lot of rules.

#### Unidentified Participant

Understood. So let me flip over and ask one that's on a more positive note. Clearly, you've made tremendous strides in driving up the retention rate as you pointed out. Could you talk to us a bit about going -- I guess what were the key drivers of that, why that's sustainable, and what you're going to do going forward to continue to make progress there.

#### Michael O. Johnson - Chairman & CEO - Herbalife Ltd.

So I'll handle some of that and let Rich pick up where I miss. The key driver net is that there's a requalification to be a supervisor in the company, and it used to be over basically a one month period on the annual basis of your subscription into the company when you came in. What we did is we lengthened that to 12 months and it flattened out, or increased the retention, which has now plateaued on us around 41%, which is pretty good, 41%, 42%. That's pretty good for just about any business to return 40% of their customers to them is not too bad.

And what we did is we put in 12 month requalification period. So if you hit the volume required to requalify over a 12 month period, which retains again a whole new group of distributors who had left because they just didn't want to re-up to that level. So now we've created a new class, if you will, of distributor. If you requalify from that method, you have certain benefits that you gain and certain benefits that you lose by doing that. But you still have a tremendous opportunity at business.

Now, there's a flip side to that, a flip side on the up side to that, which is what we don't do at this company, which we think is a great opportunity for us is we don't talk to customers who've come and gone in our business. And I say customers. We have a lot of people who sign up and this is where some of the attacks that came at this company a while ago were so mathematically incorrect. Not everybody is signing up to be a business opportunity participant.

A lot of people sign up to lose weight. They want to get on a program to lose weight and they get a 25% discount, and we call them a distributor. Well, that distributor may just be a customer. It may be a Costco customer. He's paid \$49 or she's paid \$49 to get a 24% discount or 25% discount on a product. And we have a large group of those people who come and go, and we never say hello to them or goodbye to them.

And now with our new IT infrastructure we'll be able to farm that group of people to directly contact them. Our distributors are okay with that because they're already in the financial pipeline. They're already signed up by another distributor. And so we're not out recruiting around them. We're not taking anyone away. What we're going to do is try to keep more customers just like we're keeping more distributors. And we think that's a great initiative for us in '09 and beyond. We'll be prepared to go into that.

#### Simeon Gutman - Analyst - Goldman Sachs

We've run out of time.

#### Unidentified Participant

We can take one more and then break. So we can go over a little bit.

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**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

I was late, so maybe they'll give me a minute. Yes, sir? But your hand was up there so nicely.

#### Unidentified Participant

Could you talk about your new product pipeline, and in particular what are your thoughts on the antioxidant juices that so many other network marketers have?

**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

Any antioxidant is a good deal for you. It prolongs cell life. Antioxidation is really what it's all about. It's at the base of it. I think a lot of our competitors have good products. It's their claims that I get wary of. In this business, we are given to people with hyperbole and that's what really I know. I know the category I live in. I know the business I live in. I love a lot of things about it.

I don't like a few things about it and the claims part is the part that drives me crazy. When I pick up the USA Today and I see some of the print material that's out there around supplements, it makes us a target. It puts a huge target on our chest and on our back with the governments, with the FDA, and that's what we're working real hard with our distributors. And that's part of this education process that we're doing right now is to make sure that not only the health claims but the financial claims are in a realm of relative science and relative clinicals that we're doing.

Product development, real quickly. We have a team of doctors and scientists in research. We have 10 PhDs on staff. We have a medical advisory board, a nutrition advisory board with another 9 PhDs. We're doing clinical studies throughout the world. We launch our first substantiated clinical study at the National Obesity Conference in Phoenix this October. We have a Nobel prize winning scientist who helps us with our product discovery and development, a guy name Lou Ignarro who brought the Niteworks line to us, which is nitric oxide.

When we first came out with the product, we were roundly condemned. A couple people called it voodoo science. There's over 130,000 papers now written about nitric oxide. Almost every pharmaceutical company, every skincare company, every health company is out there now researching nitric oxide, and we had the first product in the marketplace with it. Our product development stems out of our own research and development labs. It comes from UCLA where we have the Mark Hughes Cellular Lab there, University of Mississippi where we have a botanical research lab in the Thad Cochran Center down there. We have doctors placed and scientists placed throughout the world, nutrition experts.

We are also looking outside the realm. In fact, when I get back I have a presentation with a small outside company looking at another line of products. We constantly entertain new ideas through our pipeline. Suppliers come to us. Different companies come to us. We look at their intellectual property to see if it makes sense for us, because ultimately what our company boils down to is content and distribution. So on the content side, we are very heavily invested and we continue to invest an increasing amount of money in that, and an increasing amount of time and energy into that.

#### Unidentified Participant

What percentage of revenue tends to be from new products introduced in a given year?

**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

Well, it's funny. New products roll out through 66 markets. So when you roll out a product in one market, it doesn't make much of an impact, but Niteworks is now a top 5 product for us, and we rolled it out four years ago. And as we roll it out globally, it'll become a stronger product for us. We will not get that product in current state into Latin America because it contains the

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substance called Arginine in there, which is disallowed by Latin American authorities. So it's only allowed to be sold through pharmacies. A lot of rules and laws to control distribution in different parts of the world.

**Simeon Gutman** - Analyst - Goldman Sachs

One more.

**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

This gentleman in the red tie up here with the blue shirt. Keep going, there you go.

#### Unidentified Participant

Since it's a consumable, do you guys have sort of automatic shipment that people can get on, establishing basically an ongoing revenue stream? Or do they have to place orders every period?

**Michael O. Johnson** - Chairman & CEO - Herbalife Ltd.

How's this for an embarrassing answer? No, we do not and yes we are going to. We are one of the few companies in our space that does not. Our senior distributors were against that initially. Well, here's the deal. The founder of the company died in 2000. I came to the company in 2003 a completely unknown entity. I was the fifth CEO in three years inside the company. Distributors were extremely wary of management when I hit the door of this company.

Each year the trust in the relationship has grown and it's enhanced, and we're taking bigger, bolder steps together with the distributors. They were worried about channel conflict. They were worried that the company was going to come in and steal customers from them, and directly communicate with them, and have an auto ship program, and go around them. Because they can come up with just about anything. Conspiracy theorists leave nothing to decide when it comes to some of our distributors.

And so now we are in a much different trust situation. Channel conflict is a minor subject, not a major. We're testing in Argentina a direct ship program right now working with distributors on that. I've always believed it's really important that they are our business partners in this business, not just independent Herbalife distributors, but we work together with them, still maintaining that independence but also working together with them on business ideas. You don't want to upset the apple cart.

Some of our competitors have tried retail. They've tried kiosks. They've gone through a variety of direct programs and it hasn't seemed to work, but the auto ship definitely works. And many of our competitors, in fact all of our competitors except us have that. So we'll be there. We're still figuring out the wheel on the wheel on that one.

#### Unidentified Participant

So Herbalife will be hosting a breakout. There is a break right now in this part of the conference (inaudible) 10 minutes. The breakout is (inaudible) right behind us. It starts at 10:55. Thank you.

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