

FINAL TRANSCRIPT

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HLF - Herbalife Ltd. at Morgan Stanley Global Consumer & Retail Conference

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PRESENTATION

Dara Mohsenian - *Morgan Stanley - Analyst*

So I'm Dara Mohsenian, Morgan Stanley's household products' analyst. And we're very pleased to have Herbalife with us here today, including the CFO, Rich Goudis. I'll hand it over to Rich.

Rich Goudis - *Herbalife Ltd. - CFO*

Thank you. Good afternoon, everybody. Also with me from Herbalife to my left is John DeSimone. He's our Senior Vice President of Finance & Strategy. And Amy Greene is our Vice President of Investor Relations. So if you have a chance afterwards to say hello that would be great.

As far as the presentation, we'll start off with just pointing you to the Safe Harbor language. And for those online, this is posted on the investor website at www.herbalife.com/investorrelations.

Why Herbalife and why now? This has been our theme all year. For those of you who follow direct sellers, certain characteristics of direct sellers pretty much hold. Typically a unique product line sold through independent distributors on a worldwide basis. The financial model is typically characterized by high margins, low capital investment. And Herbalife fits into all those categories.

Where we see our growth opportunity is really through our products and our reach of distribution. We currently distribute our products through 72 markets around the world. Our products, 64% of our business is done in the area of weight management. So we basically chase the global obesity epidemic around the world.

We have a successful financial track record. 5 years ago, next month, Morgan Stanley took us public at \$14. And today we're a little over \$42. We have high margins with low capital investment. Typically, our free cash flow is approximately what our net income is.

Our commitment to shareholder value I think stands for itself. Over the last few years, we've returned over \$600 million in cash to our investors either through the form of dividends or share repurchases. And we currently have a board authorized \$300 million share repurchase that's underway.

As far as some of the key themes that I want you to take away from the next 25 minutes or so is the transformation of this business from a traditional, what we call a use/wear/talk or where you might buy a month's supply of product for about \$100 to today, in many of our markets, and we'll give you examples momentarily, to one that's typified by daily consumption. So think of it as Starbucks went to market 20 years ago where you had to pay \$100 on the first day of every month and that allowed you access to Starbucks every day of the following month. That's the way Herbalife went to market.

Now, we're going to market where you can pay and it depends on the marketplace \$2.50, \$3.00 a day and you can have access to Herbalife products on a daily basis. So I think our product line allows itself to be sold on an individual basis. You won't find that with many of our peers. Very difficult to sell cosmetics on a daily use basis or plastic containers on a daily basis. Herbalife



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products are unique in that manner. And we'll walk you through some of the impact by market. But you can see overall, in the last five years, we've almost doubled the size of the business and more than doubled the size of the EBITDA.

Mexico is the litmus test. Mexico was the marketplace that first developed this model called nutrition clubs. And you can see that when in about the year 2002 was what we call the inflection point for the impact in Mexico. And Mexico is up almost five times in terms of not only revenue and volume but also from a penetration standpoint, when we think about how deep we are penetrating in that marketplace. And it's currently our number two market.

Our products, we think we're very much aligned with an open door, where many consumers are trying to lose weight. And if half the world is trying to lose weight, the other half is trying to find ways to eat more nutritious and gain some weight, especially in developing markets. So we play both sides and our product line really aligns itself to that.

As you can see here from the chart on the right, 63% of our business is in the area of weight management. And the Time covers really just again bring forward the concept and the idea that it's a global epidemic of obesity.

Trade down, that's been something you've heard a lot this past year. People, consumers trading down in price and value. We would also add trading down in calories is probably a good thing as well. For many of you, especially if you hit the snack table over here, you probably consumed about 1,000 calories if you had a coffee and a muffin without even knowing it. Herbalife typical start in the morning is less than 300 calories. And not only is it a trade down in calories, but if you look below you can see that it's a significant trade down from the standpoint of cost.

And that's what unique when you see the fact that we're transitioning our business to daily consumption because people now will have the ability and the affordability, more importantly, to have access to the Herbalife opportunity.

Very quickly, we're making some changes in our marketing plan. Again there's three changes that we're making, all with the intention of being able to increase our distributor base, make it easier for our distributors to earn more money earlier in their career at Herbalife and improve the retention of the business.

The chart on the left is from-- the financials are from our 10-K. The single biggest earnings opportunity at Herbalife is the wholesale to retail price differential. Last year that was \$1.8 billion. Think of that is traditional, single level marketing.

The three stacked bars on top, these are what we call collectively, royalties. These you'll find on our P&L, right below cost of sales. And collectively those were almost \$800 million last year.

So the ability to buy the product at a discount and mark it up is almost-- is more than 2X the opportunity of building an organization and earning on that online production and productivity.

So, we're making some changes not only to deal with the issues and-- the economic issues we've seen here in the US over the last year, but more importantly to address and increase the addressable population in developing markets. So we're going to create a softer approach for people to move from what we call distributor up to supervisor, going from a 25% discount to 50% discount, where they can participate in more of that discount structure below. We can improve the discount structure so that once you achieve, for example a 40% discount, you retain that for a period of 12 months. And then lastly, for the first time in Herbalife's history in 29 years, we're going to allow distributors to recruit distributors and able to earn on them if there's a differential in that commission structure.

We think the benefits will be many, three to take away. For one, it'll be an increase I think in new distributors coming in the business. And we have a chart momentarily to show that; an increase in organic supervisors, a growth; and then higher retention.

If you look at this chart on the left-hand side, we made a similar marketing plan change in 2005 where we allowed supervisors to re-qualify over a period of 12 months. Historically, the supervisor requalification was over a period of one or two months.



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When we relaxed, if you will, that requalification hurdle, we saw a significant improvement in our retention from 28% to nearly 41%. So we expect, and you can see the question marks in 2011, in January 2011, when we have our next requalification, we will have the time to see the impact of this. We believe that we will be looking at retention that will move higher from where it is today.

And then on the right-hand side, and this is a new metric that we'll start to share with investors in 2010, this is the number of new distributors coming in the business on a quarterly basis. And you can see the improving trend as we've moved through the back half of last year and through this year. But more importantly is that they go forward. By relaxing some of these hurdles, we think that this is going to increase the growth rate in new distributors.

So back to daily consumption, why that's important? This graph depicts in blue where these countries were in terms of volume points per capita. And those of you who follow Herbalife, you know that volume points is basically our internal currency. It's not FX affected and it's a constant currency, if you will, around the world.

So as an example, in the first bar is our US Latino business. Today in the US, our Latino business comprises 68% of the Herbalife business in the US. And it's our number one market in the US.

In 2003, the volume points per capita was 2.3. In 2006, when we called the inflection point where the nutrition clubs were starting to become localized and then replicated, we saw an acceleration in growth. And today the US Latino population with a volume point per capita of 9.3 is up nearly 5X. That's a wow in our books.

And if you look at Taiwan right next door to it, it's 3X. Mexico, as we said earlier, is 4X, almost 5X. Korea, the inflection point is just about a year and a half ago, up about 50%. Brazil is still going through that, up about 100%.

And India, while it doesn't even register on this scale, it's very interesting that the last three quarters India was up 90%, 95%, and last quarter 100%, and broke into our top 10 markets. And the power and the growth behind India is that they finally localized and they figured out how to make the club model work in India. So remember that Mexico chart I showed you earlier, it's our expectations and our hope that this model continues to find growth and a foundation in India and be able to grow on an ongoing basis.

And from an overall company standpoint, you can see that we've more than doubled the volume points per capita. Again, this is the theme. This is when you think about modeling and how you can do, these are the countries that have gone through this inflection point. We have 72 markets. So another 60 to 65 markets that have not yet gone through this inflection point. That's the driver of growth. This is our number one theme in our 2010 budget. It's our number one theme in our five-year strategic plan. This is what you should take away from this meeting if nothing else.

With that comes a change and I think in our metrics. Historically, we've disclosed on the top graph is our volume point growth. On the bottom left is our new sales leader or supervisor growth. And I think that that's why the stock was dislocated earlier in the year because a lot of investors who had been trained since we've been public, so look at new supervisors as a predictor of future volume. We're dislocated from what the company was saying that they thought they could deliver versus what the new supervisor growth, or in this case, decline was leading towards. And they couldn't do the math.

And probably a little bit around our fault in that on the right-hand side on the bottom, these are the metrics that we were looking at. Wasn't ready for what we would call prime time yet. But as we head into 2010, this will be a new added metric, which puts us probably more in line with what you hear from Tupperware and Avon and some others, which is the active average of the particular reps. And you can see here that even in the most difficult quarter, last year in the fourth quarter, we still had positive activity. That there was year-over-year, think of it as same-store sales, were up. And I think that's a very positive reflection of this business, being what we would say is economically resilient, not countercyclical.



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To take a look and see what that looks like on a correlation basis, these are our top 10 markets, which in the third quarter comprised 77% of our business. On the two right-hand columns, you can see our volume growth year over year for our top 10 markets was 9%, so pretty broad. And then the active supervisor ordering was 7%. You can see the correlation by market. And then you'll see more of this next year. This is really the beginning of our introduction of this metric and the transition for investors to start to look at this metric as something meaningful.

If you were inside our company, you'd hear us talk about deeper and wider. How are we going to grow the top line of this business? Deeper and wider. Today, if you look on the left-hand side, this is our top ten markets. And you can see the volume points per capita. And this is using 2008 data, so India's not even on this chart yet, but it will be this time next year, when it anniversaries at full year.

But the opportunity, if you look at the US, we've been in the US for 29 years at 2.38. The opportunity for the US to potentially get to Mexico as the Latinos are following the Mexico club concept, the opportunity for the India's and the China's of the world to get to not only the company average but maybe even the US average, that becomes really things that we get excited about.

On the right-hand side, this is the wider. We look at a company like Avon who has very broad reach, 110 countries. As you may know, we just finished rolling out Oracle on a global basis one instance. So it gives us finally the foundation to build and to more rapidly roll out new markets. In the past two weeks, we rolled out Vietnam and Paraguay. And we expect to roll out 8 new markets in 2010 and then going forward somewhere about 6 new markets a year, to get up to that 110, 120 country type of reach, if you will.

Looking specifically to the third quarter, as you know with the dollar weakening over the last several quarters, the third quarter for us was the last quarter of headwinds. And you can see that in the net sales on the top left. We had about 780 basis points of headwinds in the third quarter. In terms of reported net sales, we were down 0.3%. In terms of local sales, we were up 7.5%. And if you look at our top 10 countries, they were up 12.4% in local currency. So again, very broad success in our top markets, which comprises almost 75% of our business. From a margin standpoint, again in local currency, a 60 basis point improvement. And then in local currency, our EPS growth was 21%.

Back to one of the characteristics of this business is a strong balance sheet. And I think that Herbalife leads the way here in our peer group, but our-- from a leverage standpoint, we're just under now one times debt to EBITDA. Our debt is not due till 2012 and 2013. The only reason we have debt on our books right now is that over the last 2 years, we've returned over \$600 million to investors in either dividends or in stock repurchases.

Typically, free cash or excuse me, net income is a good proxy for free cash. You can see in 2008 we made significant investments as we're rolling out Oracle and start to come more in line in 2008 and 2009. And our guidance for next year is about \$65 million to \$75 million. So again, when you want to look at the performance, look at our free cash flow. Look at our ability to not only invest in our business, but have access. And that puts us in a very unique position to figure out how to most cleverly and financially reasonable return that to investors.

Here's a shot if you invest in the space of direct sellers. This would be our resume to say consider Herbalife. When you look at what we think are some of the most important metrics to follow on companies, the checkmarks indicate where we have a leadership position. Unfortunately, from a P/E standpoint, we are trailing the peer group. So we're out here working hard. We've been in the Mid-Atlantic States the last couple days, New York today. We were in Boston and New York last week, trying to get the message out and trying to get investors to understand this transition to daily consumption.

And we'll have an investor day on December 17th. We'll be back in New York to try to continue to further that education process.

Looking at our guidance, if you look at the fourth quarter, our return to growth in terms of not only volume but net sales. As again we anniversary the significant strengthening of the dollar a year ago. For the full year, volume growth of 1% to 1.5%. That was our goal as we entered the year was to have a growth at the very top line, unaffected by currency. And then next year again,



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as we expect a tailwind for most of the year, you can see very strong currency growth when you look at the difference between volume growth of 5% to 6% versus the net sales growth of 11% to 13%. The majority of that difference is currency and then some pricing.

Our track record-- we've been public now almost five years. We've had a very good track record of giving you guidance in November of the preceding year for the following year. And we've had a very good track record of delivering on that promise if you will.

2009 was a challenging year. 2009, right after we gave guidance in November, the world was sort of falling apart. And we found ourselves in February having to lower that guidance a little bit. The stock significantly was disrupted. Myself, I bought over \$1 million worth when-- of stock when it hit bottom around \$13. And that kind of started to provide a floor. Investors started to understand that maybe we were significantly undervalued. And the stock's recovered very nicely since.

And our guidance and our outlook for this year has recovered as well as a lot of the seeds that we planted in Q4 and Q1 is in response to the economic meltdown, started to take hold and the dollar started to recover throughout the course of the year. And we found ourselves now, guiding at the very high end and even above the initial guidance range.

Next year, in our guidance and as we spend some time in our last investor-- earnings call, there are some key assumptions in the 2010 guidance that we should really put out in front of you. Number one is that we are treating Venezuela effectively as a breakeven market. Venezuela, as you know, has very strict currency controls. We believe that the SEC is very close to deeming Venezuela as a hyperinflationary market, which will effectively mean for you that the financial records, the financial statements of the company and all companies doing business in Venezuela will be translated at the effective rate that people can get cash out of the marketplace, which is probably 3X different than what the official rate is.

We started to take cash out pretty aggressively over the last month or so. And our expectation is we'll get all of our excess cash out in the fourth quarter. Next year, in these numbers includes about a \$0.20 impact. So our guidance would have been \$3.70 to \$3.85 had we not treated Venezuela the way we did. But we think we're a leader in this regard. And when news does come from the SEC on how to treat this market, our geography on the P&L might change, but the bottom line we don't believe will. And then second, a key assumption, we're assuming at least \$50 million as being used from our free cash to repurchase shares. So the key assumptions for 2010.

And lastly, looking at our brand. Where we were? Where we're going to? And hopefully you'll have a chance to tune in on Sunday and watch the Galaxy and David Beckham lead triumphant Galaxy team over a team from Salt Lake City in the MLS finals up in Seattle. We're trying to put Herbalife on the big stage. And the company has done a very good job, but more importantly our distributors are activating that and taking that branding and that image to a lower and more local level.

For example, we now are the nutrition sponsor for the Valencia soccer team in Spain, which is a very big club and AC Milan in Italy and on and on around the world. I could give you multiple, multiple different teams and individuals, Olympians that are trying to get the Herbalife brand associated with, so we can move that Herbalife brand into that healthy active lifestyle mindset from our-- not only our distributors and the (inaudible) but also consumers.

And if Michael were here, our CEO, as you know Michael spent 18 year at the Walt Disney Company, last in the position of President of Disney International. Michael does see the day where the Herbalife brand, that leaf and Herbalife are in the minds of consumers the way today Disney and Nike are. So this is kind of more of where Michael paints that picture for our distributors, he paints it with a very, very big brush.

With that, that's our prepared remarks. We have about nine minutes left here. I'll be happy to take open questions. And then we have breakout following. Just please raise your hand and they'll walk the mike over to you.



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QUESTIONS AND ANSWERS

Unidentified Participant

You mentioned you plan to move into a number of new markets in 2010. Can you talk about the margin structure as you move in the new markets? And if that takes a number of years to ramp up? Or how quickly margins ramp up as you do that?

Rich Goudis - Herbalife Ltd. - CFO

The question is, is when we enter new markets, what does the margin structure look like and how quickly do we breakeven? And for most of the countries, it's almost an immediate breakeven. Our capital structure is typically opening an office in a warehouse. As you know in our model, distributors pay a fee to join the Herbalife distributor network. The only outlying country to that was when we opened China. That required a lot more infrastructure investment of factory and the like and 90 stores in 29 provinces. But, the markets we're looking at next year are several in the Middle East, several in Eastern Europe. We would expect that within probably three to six months, they are breakeven and contributing profitability.

Yes, in the back.

Unidentified Participant

I still don't understand how your sales leaders fell so much but your average active supervisors were still positive. Was that because people stayed in the network longer?

Rich Goudis - Herbalife Ltd. - CFO

That's exactly right. The people who were-- more importantly, the people who were staying in the business were active. Okay, it's looking at, if you look at same-store sales, the average was more indicative of the same-store sales. The new sales leader was saying are we opening up new stores at the same pace? And what that chart suggests is that we significantly slowed down adding new stores but the stores that were open, year over year were actually more productive and contributing.

Unidentified Participant

And why did you slow down new sales?

Rich Goudis - Herbalife Ltd. - CFO

New sales leaders-- I think it's a multiple of factors. Some is specific to countries. So, for example, Mexico we passed along a 15% VAT last August of '08. That was a significant headwind for that marketplace. Venezuela, last June we started to take significant steps to correct the economic model in that marketplace for number one, inflation with some significant price increases; and number two, to correct the distributor commission structure to more closely reflect the ability and our ability to get cash out of that marketplace. Those are two of our top ten markets. And if you look at our numbers last year, those were two very much significant headwinds.

And then lastly, aside from the economy and put that one across every market, but the transition to daily consumption. What we see when markets transition to daily consumption, there's less of a focus on bringing new people in as immediate supervisors. There's more of a focus on developing and grooming nutrition clubs and then trying to localize those and replicate that. So the build is a lot slower and the companies are, in our case countries, transition you see a slow down in that new supervisor recruiting. That's why we tried to show you that new distributor number. You start to see the new distributors are still improving while the new sales leaders were declining.



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Unidentified Participant

And then lastly, given that you're holding on to supervisors longer or doing a better job on that, why would you then now increase their commission structure percentage versus keeping it the same?

Rich Goudis - Herbalife Ltd. - CFO

That's a good question and maybe it didn't come across correctly. But we're not improving the supervisor commission structure. In fact, through the changes, the supervisor is at a most significant discount level. The distributor is at the-- I'll say the minimum discount level. And what we're doing is actually cutting up that pie a little bit differently and trying to push some of that supervisor retail earnings down to the distributor earlier in their career. So, it's no change to the company and, in fact, potentially viewed as a reduction at the supervisor level but an increase at the distributor level.

Unidentified Participant

Could you please elaborate on this daily consumption model a little bit more and tell us what the key difference is and how it works? And second question is why is the personal care part of your business not picking up any stronger?

Rich Goudis - Herbalife Ltd. - CFO

I'd say the first one was explain the daily consumption model?

Unidentified Participant

Yes.

Rich Goudis - Herbalife Ltd. - CFO

And the second one--

Unidentified Participant

The second one is the personal care products-- why they're not gaining share?

Rich Goudis - Herbalife Ltd. - CFO

Okay. First on the daily consumption. Go back in time when the turn of 1999, 2000 and the only way that you could buy Herbalife product was to buy a monthly supply of a canister, a canister of Formula 1, which is a meal replacement and whatever supplement or personal care product. It was always in a canister if you will. And what our distributors in Mexico were arguing, give us the ability to sell on an individual basis, much like if you follow other consumer good companies, Anheuser Busch or Coke and Pepsi, they all sell single bottles or cans at a much faster rate than six packs or case lots, right? From just the affordability. So the company wasn't listening. So the distributors innovated. And what they did was they created a home club where they invited people into their home and at the time it was like 18 pesos a day. And for 18 pesos, you were able to get the Herbalife aloe drink for digestion, the Herbalife meal replacement and the Herbalife tea for energy. Those three products became the suite of products offered in the nutrition club.



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In addition, what you got was acceptance into a community. Think of it like a Weight Watchers or a Jenny Craig or maybe even an AA where everybody had a story. Everybody had a goal. And you became part of that community. It was very, very sticky.

So, the numbers I showed you from Mexico, it was extremely impactful because we were going after when he was trying to sell a monthly supply, you're going after the A customer. Someone who has the affordability. When you break that access point down to a daily basis, now you're going after the-- down to the C and D customers and the addressable population increased significantly.

That's what we're seeing and that's what those other graphs were indicating. When we've been fortunate to have leaders embrace that concept and localize it to their market, you see a significant impact in those before and after. And that's what we're trying to get distributor leaders all around the world to embrace and localize in their markets.

I don't know if that helps but again I go back to the Starbucks concept. Can you imagine if Starbucks, when it came to market, only sold you a monthly membership? We wouldn't have Starbucks on every corner. We wouldn't have-- probably they wouldn't have a sale. And then, you know, some Wharton MBA goes to Starbucks and says hey, what if we broke it down so you could have it on a daily basis for \$2.50? Wow and the sales would explode, right. That's what we see today.

That's what we're going through. And that's what most of Wall Street misses. It's hard to get on a little bus with us in the morning and go out to Newark to Staten Island or Bronx or Queens and see the nutrition clubs. They're up in Boston, up in Chelsey and it takes some time on your part. But when you see these, you can see how sticky this business is. Clubs that are open year after year, customers coming back year after year. It's very, very sticky. And it's unique to Herbalife because Herbalife can be broken down on a beverage, on a per-serving basis, where many of our peers don't have that ability. So I think there's a chemistry there between weight loss. I think between breaking down on a daily basis. That's and you can see in a month, it's been very explosive.

As it relates to personal care, because of the phenomenon of the nutrition clubs and the transition of daily consumption, when I started in the business 5 years ago, Formula 1, which is our meal replacement shake, was 22% of our business. Today, it's 30% of our business. Maybe a new flavor, but really not a significant amount of innovation beyond that. What's moved it from 22% to 30% is the delivery form. Is by breaking it down into a daily access if you will.

So what's suffered is the other mix of products. And primarily from us is personal care. Now, strategically and John heads up the strategic planning group at Herbalife. You know strategic we see a day when maybe personal care will be 20% to 25% of our business. And that's a journey for us. But as long as we're growing say high single or double digits, the mix of product is less relevant to us. The margins are pretty equal across the product lines, slightly different but pretty equal. And for us, our competitive advantage right now is daily consumption. And it's very difficult to apply cosmetics or personal care on a daily basis. So we think we have a really exciting opportunity.

What we are looking at is providing personal care items below let's say a \$5 retail price so that people in the club can up sell. So that's something you will see. We're testing on in Brazil right now. They're having some success. That will be awhile I think when that occurs.

Maybe one, actually no more questions. We'll go to the breakout room now I guess. Thank you.



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