

FINAL TRANSCRIPT

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HLF - Herbalife Ltd. at ICR XChange

Event Date/Time: Jan. 13, 2010 / 10:40PM GMT



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PRESENTATION

Rommel Dionisio - *Wedbush Securities - Analyst*

Good afternoon. I'm Rommel Dionisio at Wedbush Securities and it's a pleasure for me to introduce our next company, Herbalife, one of the largest direct selling companies in the world. Presenting on behalf of the company is their relatively new Chief Financial Officer, John DeSimone. He's certainly not new to being a CFO, though, as well as someone who I think many of us know from her years in the [South Side], their new VP of Investor Relations, Amy Greene.

John?

John DeSimone - *Herbalife Ltd. - CFO*

I'd like to thank everybody for coming. Before we get started, I'll point to the Safe Harbor language on the screen. It's also available on our website for those who are participating in the webcast. It's under www.herbalife.com under the Investor Relations icon. And as Rommel said, with me today is Amy Greene, our Vice President of Investor Relations.

I'm going to start with an overview. We believe that our story is misunderstood and our stock is undervalued, and it starts with growth. We're a growth company. We've been a growth company for the last six consecutive years we've had growth. The last five, I won't include 2009 yet, our compound annual growth rate was 12.5%, and we think there's a lot of runway left. And the reason why there's a lot of runway left is, one, our product line fits really well into two of the biggest megatrends in the world, right, health, and jobs. I mean, that's what we hear about every day, healthcare, and jobs.

All right, we're a 60 -- two-thirds of our product are weight management products. That addresses obesity, which is the number one health epidemic in the world. There's a quote you'll see later on that speaks to how much obesity costs Americans. Second, I'll point to the business model and there's been an evolution from traditional direct selling to daily consumption, and daily consumption is the consumption of our product on a daily basis. But more specifically, it's a business model in which our distributors have daily servings sold at daily price points and daily touch points.

So we'll get into that in a little -- a little deeper in a few slides, but that's been the number one driver of our growth over the past six years and it is the number one strategy we have over the next ten years is the expansion of that model around the world. In addition, we have plans, we have aggressive plans to expand internationally into more countries. So we're in 72 countries. Our goal is to, over the next ten years, to get into 130 countries. It's a very aggressive goal. It calls for five or six new countries openings a year, but this is not a very capital intensive business and we have one operating system around the world, which we can leverage to open up these new markets. So that's an important part of our strategy.

Another area we think we're misunderstood is our financial model. Our financial model is characterized by very low capital requirements. So we generate a lot of cash, but we don't have to reinvest it back in the business. It's a high margin business and a majority of our cost structure is extremely variable. All right, it's payment to distributors that we don't have to make until the distributor buys the product. So we have a very low fixed cost base and additionally we're very conservatively levered. All right, our debt to EBITDA is one times. So we're very conservatively levered.



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And in addition, I think we are very disciplined with our use of capital. We return a lot of capital to shareholders. As I said, it's -- this is not a capital intensive business. We generate a lot of cash. We invest in the business where we can and where we can exceed our hurdle rates and where we can't, we find ways to return that money to shareholders. And that's been evident in our history.

By way of background, just for those who aren't familiar with the Company, like I said two-thirds of our Company fall into daily nutrition/weight management category. 21% of our business falls into targeted nutrition, which is products like healthy heart or healthy digestion, things like that. And then we round out the line with some sports and fitness products and personal care products.

This slide is to just further illustrate the megatrends, excuse me, that exist around the world, that our products address and our business opportunities address. It's health and jobs and so we put some Time Magazine covers on here. I don't think these are contentious points so I don't have to spend a lot of time on there, but one of the quotes I wanted to put up is, which is really difficult to see for some reason, but it's that the CDC says that obesity causes Americans \$147 billion a year. All right, and we know it's a huge topic within America right now and our product line addresses it really well.

So daily consumption, I'm going to spend a moment on this slide so you can see on the bottom our financial results from 2003 through the guidance we've given for 2009 and we've nearly doubled our sales. The way we've doubled our sales is the evolution of the business from traditional direct selling to daily consumption. Traditional direct selling is characterized by medium and high price purchases done very infrequently.

All right, so that's the way you think of direct selling. It's people buying \$50, or \$100, or \$200 at a time once a month, once every two months. Daily consumption is characterized by people spending very little money very frequently. So it's people paying \$2 or \$3 a day two, three, four, five days a week. All right, and daily consumption allows a lot more consumers to participate in the product offering than traditional direct selling does. And what we find is it penetrates deeper into a marketplace. It has much higher retention. It's stickier and it's a very efficient model for our distributors because their customers now come to them.

All right, so how many people here have been to a nutrition club or a commercial club with -- okay, so just a couple people. But if you're interested in this story, that's really the next step for you is to go visit a club and Amy Greene, if you contact her she'll set you up with one. But the way these clubs work is it's either a home club or a commercial club where our distributors rent commercial space and share the cost. And they invite potential consumers into that club and they give them a shake, which is our weight loss product, a tea and an aloe drink for around \$3 a day.

All right, so we have a model now where the consumers can pay just that daily fee and then the consumers come back. So instead of distributors having to go chase the consumer down, which is generally how direct selling works, you have to pick up the phone, make calls every month, schedule meetings, in our model distributors -- consumers come to distributors. So it's a much more efficient model and that's that bullet point, the fourth bullet point on the right.

To help illustrate the point of daily price points, we put this slide up. I like this slide. It talks about coffee. I think it's a good analogy. If you had to buy coffee on a monthly basis and you had to go to McDonald's and pay \$60 for your month's supply and go pick it up every day, very few people can afford to participate in an opportunity. There's a lot of people that don't have that kind of extra money. But when you have to buy coffee for \$2 a day, a lot more people participate and that's what we've been able to do with our three top products, our three core products is break it down into a daily price point and that allows more consumers to participate in the product offering.

And then we think a big competitive advantage is we have daily touch points. Our competitors can't have their customers come to them every day because they can't use the product or they can't sell it on a daily serving basis. We have the ability to sell it on a daily serving basis and that's where the growth is coming from and that allows our distributors to see their customers very often. So we call it daily price points and daily touch points and both are big competitive advantages for the company.



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And this is another slide that illustrates the power of and how deep, deeply penetrating the daily consumption is. So the three core products that support clubs are Formula One, Aloe, and Tea, and since 2003 those three products have grown 151% while the Company, this is on a volume basis, while the Company has grown 84%. So those three products have grown almost twice as fast as the Company and the Company has had great growth. Why? Because those three products have been able to penetrate deeper into the marketplace. So instead of skimming the service of consumers that can afford to buy the product, this daily fee allows it to go deep into a marketplace and this is just to illustrate that point.

So this is a little buys slide. Okay, daily -- the daily consumption concept, the daily fee concept started in Mexico with our Mexican distributors. It started in 2003. Okay, the blue bars are penetration rates in 2003. So we look at penetration as volume points per capita. All right, and for those who don't follow the Company, volume points are a proxy for volume. Okay, so in 2003 volume points per capita in Mexico was just over one. In 2008, it exceeded five. So it had almost five times growth.

Okay, and then in 2006 a few years later, so when this concept started in Mexico it didn't spread very quickly around Herbalife because a lot of distributors thought it was specific to Mexico. But then the US-Latino community adopted daily consumption and their penetration rates went from 2.3 to over nine and in 2006, Taiwan adopted daily consumption and their penetration rates doubled, and so forth.

And you see Korea and then at last you'll see India, and India doesn't register yet, but India started -- we opened India ten years ago and it had a big pop, and then it dropped. Right, that's pretty consistent with most direct sellers. And then it flattened out for a long time. And then over the last three quarters we've seen high double to low triple digit growth from India from clubs because now we've been able to go to the market in India with a daily fee, and that offers a lot more people the opportunity to participate in our product line. So there's a big opportunity in India if we're at the flush point that we think we're at. So that's on here.

And then to illustrate the opportunity around the world, we're in 72 countries. Only a handful have adopted this daily consumption. The rest is still trying to [cede] the idea and get it to work, but the penetration rates for the Company in 2008 were 5.6 -- I mean, excuse me, .56 volume points per capita. So you can just, you can see the opportunity because you can see the penetration rates that other markets that have adopted daily consumption could obtain and we think a lot of other markets can get to that point. And that's really the number one strategy behind the Company is the spreading of that concept.

Additionally, as we said, we're going to augment that strategy with the expansion into new countries. We opened up two in Q4. For those who haven't followed the story, it took us a while to implement Oracle. It took us about a year and a half into 71 of our 72 countries, we launched Oracle. We completed that in the end of the second quarter and that allowed us to build a platform or gave us the platform to open up new countries. So in Q4 we opened up two new countries. This year our goal is six new countries and over the next ten years, it's almost 60 new countries. So that's an important part of our strategy too.

So the countries we're in right now represent about 75% of the world's population. So there's still 25% of the world's population we don't address yet, and that's what this new country strategy would look to do. Manufacturing strategy, so prior to the middle of 2009, most of Herbalife's products were outsourced (inaudible) of China. We have a strategic initiative to bring most of that in-house for a couple of reasons. There is a margin opportunity.

Most of our product cost is in materials and we haven't been able to go after that bucket. There's also a protection opportunity to control our IP. There's also a -- most of our products are made in the US and shipped around the world. That's very inefficient so we'll look to, over time, develop manufacturing capabilities around the world where we can both reduce the freight costs, but also take advantage of trade agreements to lower duties and get our product costs into markets at a lower cost. So that's a strategy. We think over the next three to five years we'll have 100 basis point improvement in gross margin from this strategy.

So what I'd like to add to that is so we bought our first manufacturing facility in early, excuse me, mid-2009. It's not a capital intensive business. It's not a capital intensive investment. We bought the business for \$10 million. We have to put another \$10 million to \$25 million, I mean, excuse me, \$10 million to \$13 million in. So we're in the \$20 million to \$25 million total investment



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range for a facility that gives us the capacity to product 30% of our worldwide product. So for us to get to 80% you can see it's not that big of an investment. If we were to acquire five to seven more manufacturing facilities around the world over the next five to seven years, it might be, on the really conservative side, \$100 million. So that's coming to somewhere between \$10 million and \$20 million a year. It's a very small piece of our free cash flow to implement this strategy and there's a good payback for it.

Another key initiative and I think this is a really important part of our future is we're going to test a concept, we call it extended payments. It's similar to credit. It's for new distributors that come into the business. For those that follow Herbalife you know that there's lower level distributors and then there's business builders. The business builders are, it's a pretty high price point to get to a business builder, and in this economic time, it's difficult to get people to invest that kind of money. So what we're going to look to do when new distributors come in is finance a certain amount of product for them, give them the product and finance is the wrong word because we're not going to charge interest.

So we'll give them the product. They turn the product and then they pay for it and they'll have up to 30 days to pay for it. It'll be a very limited time they can use it. It might be six months. So if a new distributor comes into the business they can buy product on credit, sell it, then pay for it so they're not out of working capital. And it does a couple things that's important for us. One is it ties the distributor to their up line because their up line as part of this program will not get paid until the distributor pays us. All right, so our investment is very small because our biggest cost is distributor payments and we don't have to pay until we get paid.

So if I'm a distributor and I've gotten Amy into the business and she's got product on credit then I'm going to help her develop that business. Otherwise, I'm not going to get paid on it. So it ties the distributor to their up line. So that's one big benefit. And the other is, it's an easy sell to have somebody who's out of work start into this business without much capital investment. All right, and the risk to us is very small because it's just the product cost. Like I said, this is a complex subject so again, there's a breakout session this afternoon if you want -- have more questions on this.

This is more education for those who don't know. We have distributors. Distributors come in the business for \$50. They get a 25% discount on product and then they have to work their way up to supervisor and supervisor is where you begin to earn royalties and commissions and you get a 50% discount. Traditionally, the Company has always discussed new supervisors as the most important metric for the Company, okay, because that was the sign of recruiting. Okay, but the shift to daily consumption and a change that I'll talk about in the marketing plan, what we're seeing is that the growth from distributor to supervisor is taking longer and it actually works better for us.

What we found is people who have come into the business as a distributor and became a supervisor over time had a more fundamentally sound business after they became a supervisor because they already had customers, whereas people who became a supervisor more quickly, they had a lot of product but didn't have the customer base to fulfill it so they weren't as successful. So the activity level between distributor and supervisor has grown so our metrics have to change.

So instead of talking just about new supervisors you'll begin to see us talk about, formally, new distributors, and most importantly, active supervisors. So it doesn't matter how many new ones you have, it's how many are engaged in the business, how many have ordered this quarter on an average basis. And when we did a regression analysis that was the metric that was most closely related to future growth. Okay, it wasn't perfectly related, by the way. None of these are, but individually it was the closest one.

The new marketing plan change, this is a complex slide so -- and I have four minutes, so I'll try and go through it quick, but we made a marketing plan change that allows a distributor to become a supervisor over a 12-month period instead of a one or a two-month period. So in the past you had to spend \$3,000 over one or two months to become a supervisor. What we tested in Russia was extending that so you can spend that \$3,000 over 12 months and become a supervisor. And like I said in the last slide, those supervisors, those distributors who became supervisors over a longer period of time were much more successful, more active and more productive after becoming a supervisor than those who became more of an instant supervisor because they already had a customer base as they were building up to supervisor.



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So we've changed the entire marketing plan around the world to add that opportunity to become a supervisor over time into the marketing plan. And we've launched that in October and we expect to have, to be very well received and it has been so far by the distributor base. There's been a couple other changes but we'll get into it in the breakout session when we have more time.

To kind of put the opportunity in perspective, to become a supervisor you had to do so much volume in one or two months. Then to requalify every year as a supervisor you had to do the same thing. Well, in 2004, we changed that requalification to allow you to do that volume over 12 months and that took our retention from 28% to 40%. So we had much more retention by giving people a longer time to requalify and there's the opportunity that we may see the same results by now giving people that longer opportunity to qualify instead of just to requalify.

Quickly on the metrics, volume points in new supervisors in on the left side. That's what we've traditionally have released and you can see new sales leaders, which is the equivalent of new supervisors were down in 2009 and that was one of the reasons we believe that the stock was dislocated. People didn't believe the growth when one of the underlying indicators were negative, but we were trying to educate and really difficult to do until the results were there that new supervisors are not necessarily a good indicator of future growth, and that active supervisors, which is the bottom right box, is more indicative. And you can see we never were negative in terms of the number of people ordering product from us during the year despite the fact that new people in the business was negative.

And up top, you see new distributors which ticked up in Q3 and that's another metric that we'll begin to disclose. Financial update, 80% of our business is done outside the US. The dollar was very much a headwind for the first three quarters of 2009. This slide looks at our results with constant currency. This is also available on our website in much more detail. Net sales on constant currency in the third quarter grew 7.5%. Our operating margins went up to 15.3% on a currency basis or 60 [basis points] improvement, and EPS would have been 21% higher on a constant currency basis.

You'll see, again, we'll save this for the breakout, but we have a hedging strategy that will help us on some of the volatility in foreign exchange. Strong cash flow generator. I like this slide. This talks to how much cash we generate and basically, our net income is a proxy for free cash. It's not a capital intensive business. Our EV to EBITDA is extremely discounted compared to our peer group, it's 8.2 and we think there's a lot of opportunity to grow as people understand, investors better understand that this is a growth story and how that growth story is fundamentally sound and built on consumption.

Under levered. Again, we have debt that's equal to one times EBITDA. Our debt is not a necessity. It's a capital structure choice. It doesn't -- it's not due until 2012 and 2013 and we're in the enviable position of being able to pay it off if we chose to, to our free cash. Return to shareholders, I said this on the opening slide, we have a very shareholder friendly repurchase program where we take our excess cash that we can't invest in the business and achieve a return in excess of a hurdle rate and we return it to shareholders. And we'll continue to do that. We've done \$670 million over the last three years.

Leading financial metrics against our competitors and this slide says opportunity to me. Hopefully it says opportunity to all of you. This looks -- our performance compared to the peer group and that we're trading at a big discount compared to our peer group and we think that is just more education on the story. And that's what we're going to work hard on this year is getting out, getting in front of people, telling the story better, telling it more succinctly.

Venezuela just for those who have followed Venezuela, it's been an issue in the industry or anybody who does business in Venezuela. There's multiple exchange rates. Without getting into the details because I have 35 seconds left, our approach to our guidance next year with Venezuela is very conservative. It assumes that everything happens at the curb rate. Venezuela just had a formal devaluation with two official rates. If we have access to any of those official rate dollars that's upside for us. So we view the announcement last week as good news, not negative news.

Hedging, we have two hedge strategies. One is if we get hedge accounting. For some currencies, we do and some we don't. Okay, hedge -- the currency exposure for us sits with two key currencies. The peso is about a third of our exposure and the euro



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is about a third of our exposure and all the other currencies combined make up the difference. On the euro, we get hedge accounting, in which case we hedge in a step approach, which you'll see on the left, which is hedging 90% of our exposure one quarter out, reducing it to 75% two quarters out and we just keep stepping it along the way as quarters roll in.

Where we don't get hedge accounting, we can't hedge that far out because it creates too much volatility to our P&L because if you don't get hedge accounting you have to mark to market your hedge instrument at the end of each quarter, even though might be hedging something 12 months from now when you get the offset. So we try not to put that volatility into our forecasting.

And the last slide, this is just a -- it's just a summary, the same page you saw at the beginning of the slide that says if you take nothing away from here, take away that this is a growth story driven by daily consumption and if you don't fully follow, please come to the breakout and then go visit a club because that'll give you a good perspective on what we're talking about. And that is the driver behind our growth. Okay, and then the financial model, very envious financial model, and as I said we return a lot of cash to shareholders and we'll continue to do that.

So with that, my 20 minutes I'm told is up. We have a breakout at 3:30. Please come see us if you have any questions. Thank you.

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