

FINAL TRANSCRIPT

Thomson StreetEventsSM

HLF - Herbalife Ltd. at Bank of America Merrill Lynch Consumer Conference

Event Date/Time: Mar. 11. 2010 / 6:40PM GMT



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CORPORATE PARTICIPANTS

John DeSimone
Herbalife, Ltd. - CFO

PRESENTATION

Unidentified Speaker

Next up we are pleased to have Herbalife. Here for the Company is newly appointed CFO, John DeSimone. John was appointed just this past December ahead of their Analyst Day. Now, John takes the role as a number of key markets are improving and there's a number of key initiatives for the Company. And John's going to walk us through it.

John DeSimone - *Herbalife, Ltd. - CFO*

Okay. Thank you, Chris. With me, next to Chris, is Amy Greene, our Vice President of Investor Relations.

I'll start by pointing to the safe harbor language in the presentation, which is also available on our website for those listening online. Our website is www.herbalife.com under the Investor Relations icon.

I'm going to start with an overview. We'll talk a little bit about who we are. Then we'll get into what's driven growth over the last five years and what's going to drive growth for the next five. And then we'll end with the financial review.

Herbalife is in -- we're a \$2.5 billion revenue company located in 73 countries that we've grouped into six regions. No one region is overly weighted. We have three regions -- North America which, for our purposes, excludes Mexico -- North America; EMEA, which is Europe, Middle East and Africa; and then Asia Pacific. Each range between 21 and 23% of sales. South America is around 16% of sales. And then two what we call regions, but they're really countries, Mexico and China, represent around -- Mexico's 12% of sales and China's around 6.6 or 7% of sales. It's the most -- it's the newest region for us and it's under development right now.

For the year, you can see in the boxes we have our -- this is local currency net sales growth, so it takes out translation. And for 2009 we had actually a record volume year in what was a really difficult economic challenging environment. Four of our six regions grew in terms of local currency in 2009. Specifically in the fourth quarter that growth accelerated. We had growth in five of our six regions. It was a record quarter for us, so it was the highest volume quarter in our history. So we ended 2009 with a lot of momentum.

And then, from another perspective, from an emerging market perspective, which is not how it's presented here, but more than half of our business is in countries that are classified as emerging market countries from the World Bank. So it's an important data point for some investors.

From a product standpoint we consider ourselves one of the world leaders in nutrition. We're \$2.5 billion. 62% of our business is done in what's called weight management. I think it's an important distinction between what we call weight management and what maybe people think of when they think of weight management. We are not a magic pill company. We're not about take the pill and don't eat for 30 days. Half of our weight management product is a meal replacement shake. It's our oldest product. It's what the Company was founded on in 1980. It's been around for 30 years, tried and tested, and it represents 30% of our sales.

We have another category called targeted nutrition, which is condition-specific product, such as brain health, heart health, immune health, things like that. That makes up 22% of our business. Then we have two smaller categories. One is more of a branding category for us, which is sports nutrition, which is how we build our brand around the world. And then personal care



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is really an opportunity for us. It's a relatively small percent of our sales, like 6% of sales. We haven't done a great job at growing that, but it is a strategic initiative for us, because it is an opportunity.

Little bit about the story of Herbalife, where we are. Our model has really evolved a lot from where it was 10 years ago. As I said earlier, we've doubled the Company, size of the company, in the last six years. That growth has been driven by a couple of concepts. One is our products are relevant. Our products address two megatrends. So first is obesity and our products are used as a meal replacement product that helps people maintain their weight. And second, the jobs. So, right, healthcare and jobs are two of the things you hear the most about today in the news. And we have an element of our business plan that supports jobs, kind of a countercyclical element, if you would. I don't think that we were perfectly positioned for that, but we made some changes that will help us be more countercyclical when we need to be.

The real driver of growth, for those who are unfamiliar with the story, is a transition from what was a, really a monthly purchased -- monthly purchase model, where consumers had to purchase our product at a monthly fee, a monthly base, a monthly price point to a new model where consumers can produce -- purchase the product at a daily price point. And what you'll see in a few slides is how that has dramatically increased penetration in our marketplace. Because the traditional direct-selling model can only skim the surface of consumers that can participate in the business, whereas a daily price point really digs deeper into a market as to who can participate in the business.

From a financial modeling standpoint, we're very low capital requirements. We don't have much capital needs, even to grow the business. Most of our cost structure is variable in nature, so we don't have a high fixed cost base. And we generate a lot of free cash. All right? So we've generated in excess of \$200 million in free cash the last few years each year. And it's far more cash than we can effectively spend. And we have a trend of returning that money to shareholders through -- we have a dividend.

And we have a share repurchase program. That share repurchase program started at \$300 million, went to \$600 million. Then we added another \$300 million. So our board tends to do \$300 million tranches of buyback. We'll talk a little bit about that in a few pages, but I think for analysts that -- I mean for investors that are familiar with Herbalife, they appreciate the cash flow. For those who are unfamiliar with Herbalife, that may be the most underappreciated aspect of our business model, is the amount of free cash flow we have and the cash flow yield of the Company.

Back to the evolution of the business from traditional direct selling to daily consumption. Again, traditional direct selling, distributors have to sell to their consumers -- and this is all direct selling, not just Herbalife -- at a monthly price point. And they do that through infrequent purchases. So a distributor will call up their customer once a month, once every two weeks, whatever the cycle is for that company, and they would try to get the month's order from that customer. So not very efficient for the distributor, because they have to call the customers up. And the people who could afford to buy that product is a lot smaller population than those who could afford to buy it if it was a daily price point. It's also a very low penetrating model and it's a high turnover and high acquisition cost of customers.

The shift that our distributors have done over the last five years is offered -- they've come up with a model that offers a good portion of our product at a daily price point, so just that daily use of products. For example, a program for a month of three products in Herbalife, three core products, which are the shake, the tea, and the aloe drink, would have been about \$100. So people, if they wanted to participate in the product offering, had to pay \$100 at a time, whereas now they can pay \$3.00 just for that day's supply. And that's been a big driver of growth. And we'll talk about that in a few slides.

This slide tries to analogize what our distributors have done, and what this new model has done, through coffee. And I think it's a good analogy. Coffee at \$2 a day doesn't seem expensive, because it's a low daily price point. But the reality is if you had to pay \$60 at the beginning of each month for your month's supply of coffee, you'd go buy a pound of coffee and make it at home. But a few dollars a day just doesn't seem expensive, and far more people can participate in that coffee offering under a daily price point.



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And that's really what's happened with three of our core products. And these three products you'll see in the next slide make up more than half of our company's volume. These three products can now be offered through what's called clubs -- and I'll spend a moment on clubs -- at a daily fee.

The genesis of clubs happened in Mexico. And it really happened from a distributor who is a professor at a university who loved the product, saw the need for the product with the Mexican population, but realized most people in Mexico couldn't afford to buy the product at \$100 for the month's supply. He came up with a home club concept that has now evolved to a commercial club concept, where consumers come to a fixed location. In some markets that's a home; in some markets that's a commercial club. And they pay \$3 and they get three products every day. In other words, every day they come they get a meal replacement shake -- and it's a meal replacement shake and I'll talk about what that's an important concept -- a drink of tea for caffeine and they get an aloe drink, which is digestion.

The meal replacement shake is an important component of the program in general, because if you replace a meal with a shake, first of all it's the same -- it's cheaper money, so you're trading down economically and buying a meal. But more importantly, you're trading up nutritionally. And if you trade a bagel and a muffin for a 220-calorie shake, you'll also lose weight and that creates stickiness to the product line. It's been an important element of our growth.

And we compare on this page -- this compares some of the key peer groups in our business and their model for this new model. Our product model fits well with a daily serving size, whereas a lot of our competitors do not. And we think it's a huge competitive advantage.

So the two concepts to walk away with is, we have a daily price point and now we have daily touch points, where our consumers are coming to distributors instead of distributors going to consumers. So it's a far more efficient model for distributors than traditional direct selling.

These are the three products that are sold on a daily basis in clubs. And it's really just these three products. And that's another opportunity, right, for us to offer more of our product at this daily price point. And that's a strategy for us going forward. But these three products -- you can see on the far right our volume points -- which is, call it a proxy for unit volume -- have grown 84% in the last six years, where these three products have grown 152%, so 2x. And they total a little over 50% of our business.

So the message is, our growth has been about going deeper. And we've only gone deeper in a handful of markets. And the opportunity is to deeper in additional markets, which you'll see on the next slide.

This slide attempts to put some perspective around the opportunity. So on the bottom you can see the year in which clubs in these various markets took hold. And these are our top five markets. The blue bar is the penetration rate back in 2003 for each of these countries. And the green bar is the penetration rate last year for each of these countries. So in Mexico, for example, on volume points, they had 1.2 volume points per capita per year, meaning, if there were 100 million in Mexico, we'd get 120 million volume points in the year.

Through -- to growth from clubs. We've been able to grow Mexico four times as big as it was before clubs started, because of that penetration. Instead of attacking just the top of each market with consumers, we've been able to go deeper in each market. In the US Latino market, where penetration rate was 2.3 volume points per capita in 2003, that jumped up to over 10 last year. Right? It's a huge, huge success story for us. And even within that 10, there are cities where we're 20 and cities where we're still 1. So there's still a lot of opportunity, even within the Latino community, to grow the business.

Taiwan -- Taiwan -- so Mexico and even the US Latino business started with home clubs. Taiwan evolved it to commercial clubs, as did Korea and Brazil. And we've had tremendous growth, similar growth to what we had in Mexico. They're just earlier in that cycle, just from clubs and the ability to sell at a daily price point instead of a monthly price point.



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It's also a very sticky model for distributors, right? There's a forced discipline with the club model that you don't get in traditional direct selling where a distributor has to get up every day and determine what they're going to do that day. And if they're not motivated they may fall out of the business. But when you have a club you have a reason to get up; you have something to do. It helps drive success with distributors that traditional direct selling doesn't necessarily do.

So we talked a little bit about daily consumption, the evolution of where it's been, where it's going. There is one country I didn't mention that's an interesting country for us. So India is not -- it's teetering on the top 10 market for us. We went into India 10 years ago. And we went in and it was a big -- it's called pop and drop. You go in. A lot of distributors come in. They recruit and you get a lot of volume. Those distributors leave the country and you get a big drop. And for 10 years we've been flat.

But for each of the four quarters we've had high-double to low-triple digit growth in India, from the introduction of clubs. Because in India there's a large percentage of the population that cannot afford to buy product at \$100 price point, that can afford to buy it at a much cheaper price point. And it's all driven from clubs right now. So that's a new -- a market that's really exciting for us. It's a huge opportunity. There's 200 million to 300 million people in India that can afford to participate in this product offering at the daily price point. So we're watching that closely.

And that may translate at some point in time to China, where they haven't figured out clubs yet. So China is not in that accelerated growth mode. It actually declined slightly in the fourth quarter, but we'll grow it this year. But generally when a country tries to launch clubs it's a learning curve. There an [enculturalization] period where they've got to figure out how to make it work with their culture, their community. And China is in that phase right now, whereas India's gone through that phase and we're starting to see those clubs duplicate. So it's an exciting opportunity.

We're in 73 markets, as I said in the opening. We don't want to stop there. Those 73 markets represent about 75% of the world's population. There's still 25% of the world's population we do not address yet. Some of those are real bid opportunities for us. And really, we haven't had the ability to go into markets too easily over the couple of years, because we were putting in a worldwide Oracle system. That system is now in in every country but China. It was completed in the middle of '09. And in the back half we opened two countries, Vietnam and Paraguay.

And we look to open five or six this year, and five or six every year. Some of those will be meaningful. Some will be small, but the point is it's not a lot of capital for us to open up markets anymore. So if we've got a small market and we can do it easily, we'll do it. And we're going after some of the bigger markets that we're still not in, like the Middle East, Egypt, countries like that.

Manufacturing - we have a strategy, we call it seed to feed. This is our strategy to elevate our company above the rest in this industry. We as a company only manufacture our product in China, for China. The rest of the world is made by third-party manufacturers. As a part of a strategy, we decided that we want to control supply chain from the fields to the consumer it goes to. So traditionally have crops. Those ingredients would then go to an extraction company and they extract the ingredients from the crop, to a broker, who sells it to a raw material supplier, who sells it to a manufacturer, who sold it to us. And there's a lot of profit layers. But more importantly, it was really difficult to have the traceability you need in this industry to figure out what field your product came from.

So we're working backwards. We bought a manufacturing facility in the middle of 2009. And we've hired a guy, a gentleman named Gerry Holly. Gerry Holly's the foremost manufacturing expert in the US in this category. We augmented that with a new hire, a gentleman called Dr. -- named Dr. Francos. He is the head of dietary supplements for the FDA. He is retiring from the FDA this month and coming to work for us next month. That's a critical hire for us too.

And then we pushed it back. We started a sourcing company. We hired a gentleman named Jim Barton from Pfizer. He ran worldwide strategic sourcing for Pfizer's nonpatented business. And he now works for us in a sourcing company. So all -- and we'll work our way back and we'll get into the extraction business. So we will know where our extraction company purchased the product from, so we'll know the fields. Our company will extract the ingredients the proper way, sell it to our ingredient



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company, who will either sell it to us if we manufacture it, or sell it to our co-packers if they manufacture it for us. So we will be in control of the product from the beginning to the end.

It's not a capital intensive process. We purchased the manufacturing facility in Orange County, California. Very expensive real estate, right -- market in general. We purchased the operation for \$10 million. We have to put another \$10 million to \$15 million into it. And that will still give us 35% to 40% of our worldwide capacity needs. So it's not a capital intensive business. But what it does do, is gives us a leg up from a credibility standpoint in the industry, both with the FDA, regulators, government officials and our distributors. It's a great selling proposition for our distributors. So it's an important element for us.

That is just the first factory. We will look to regionalize manufacturing over the next five years for a couple of reasons. Most of our product around the world is made in the US. It's not very efficient from a shipping standpoint or from a duty standpoint to ship it around the world. And it gives us a lot more of our expenses denominated in dollars, where a lot of our revenue is denominated in other currencies. So it gives us more exposure to currencies.

So long term, as we push manufacturing out into regions, we'll create a natural hedge and an ability to ship product into certain countries with lower duty rates by taking advantage of trade agreements regionally. So we're going to look to be in five or six regions with manufacturing over the next five years. And the total cost of being into manufacturing around the world, \$75 million to \$100 million over five years. It's -- in our capital expenditure projections, I wouldn't expect CapEx as a percent of sales in the future to be any different from what we're projecting for this year. And that includes the manufacturing component. So it's not a capital intensive business.

We made a couple of changes in our marketing plan and we've added a test of what we call extended payments to help take advantage of the countercyclical opportunity that exists. So we grew the company by 100% from '03 to '08 during great economic times. There's a countercyclical aspect to direct selling that weren't positioned perfectly for. We have distributors that can get in for very little money, no barrier to entry, right? But, to become a supervisor, which is to get the maximum discount, and to earn royalties, you had to spend \$3,000 in one or two months, effectively. And that was difficult to do a year ago, during difficult economic times. People weren't willing to make that investment.

We've changed our marketing plan and I'll talk about that in the next slide. But really to give the people the ability to grow in this marketing plan over 12 months by doing those purchases over 12 instead of 1 or 2 months. But equally I think opportunistically is to offer extended payment terms just to new distributors. So when a new distributor comes into the business, they will be able to buy product on terms with the Company for their first six months of their life within Herbalife. This is just reducing a barrier to entry for new distributors. They can buy product on terms. They pay the terms -- they pay that off in 30 days and they get it again. If they pay it off in 10, they also get it again. It allows them to turn enough inventory to make enough profit to run the business on their own and have enough working capital.

Our investment risk is really low, because all we are investing is the inventory component, because our biggest expense is our payment to other distributors, which we will not make until we get paid. So it's a ver- -- put it in perspective it might be \$30 to \$50 of inventory cost per new distributor. That's what's at risk. And then we have 2 million distributors in our system right now. If it was 100,000 new a month that went on this program, that would be \$3 million to \$5 million of an investment. I mean, it's de minimis investment for what is a good selling opportunity to take advantage of countercyclical opportunities.

So we're going to test this idea in Brazil. It tests -- it begins at the end of this month. I think it's a really big opportunity for us. It makes the sales pitch from a distributor much simpler than it is today. And we'll shortly have some stats to validate the tests.

I've covered this page a little bit already. We had distributors. There's a couple aspects that are important on this page, right? And one of them is how our stats weren't necessarily appropriate for the evolution of the business. So you have new distributors. Those are the guys that come in, or people that come in relatively inexpensively. They get a 25% discount. And then they work their way up to supervisor or sales leader; they're synonymous. And that was an expensive proposition for them. And they can get a 50% discount and they can earn royalties.



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Traditionally, before daily consumption, all the metrics in the Company were all focused on sales leaders and up. Right? Yet there's a lot of activity going from distributor to sales leader, especially in the daily consumption model, where it's a slower, more steady build of business. Secondly, as I said, sales leaders were more difficult to recruit a year ago when the economic times were difficult. So we made a change where you could become a sales leader over 12 months, as I said, instead of one or two. And I'll talk a little bit about this on this slide. So the changes we made improves the earning opportunities, lower the barriers to entry, really increases the selling proposition for distributors.

On the left, for your perspective, there's the big bar on the bottom and that is the way distributors make money from retail. Right? So they get a discount and they retail the product. That's how much money they make. And then the three bars above it are the other components people can earn as they duplicate their clubs, or as they bring in more people into the business, they have a chance to earn more money besides just the retailing component.

From a retention standpoint, in 2002 our retention was in the mid-20's, for supervisors, for that middle box that we saw on the prior page. So that meant 75% of the people that came in left. Last year that was 43%. That's a huge improvement. It's been driven by two changes in the business. The first is this -- the shift to daily consumption, which is a sticky and more profitable model for distributors.

And equally as important is to requalify every year, we allowed people to buy their volume over 12 months, which is similar to the change we just made for qualification. I know that kind of gets confusing, but you can qualify now over 12 months and you can requalify over 12 months. And that requalification kept more people in the business. So we expect similar results from this change of qualification. I know it's confusing, but we can talk about that in breakout session.

Key nonfinancial statistics -- I think this probably where our stock got dislocated earlier in 2009. We had two statistics that we released -- volume points, which is unit volume, and you can see in Q4 2008 that was our first decrease in volume in six years. But more importantly, I think, for investors, were new sales leaders, or supervisors, on the bottom, where it declined 19% -- 19.5%. And people are used to in direct selling when your recruiting goes down your sales are going to go down and they'll be no growth.

However, we have access to a lot more statistics and on the right -- and I'll point you first to the bottom right, because that's the most important box. That's the number of the supervisors or sales leaders that have been actively ordering each month. And you can see, that never went negative, even in the worst quarter we had, which was in Q4 2008. It was still slightly up. And then we saw that trend increasing. So we were comfortable in our guidance, but it was difficult for Wall Street to have that visibility because this is a statistic they weren't aware of.

So average supervisor is probably the most important nonfinancial statistic that we release. It just means how many people at the supervisor level are participating, engaged, ordering product. I would call it a quality-of-supervisor, quality-of-new-sales-leader metric. And that's something we look at internally. And we've done our regression analysis and it offers the most correlation between this statistic and three-month growth.

Financial update -- obviously, all of this information is available on our web site. The first bars are 2008 performance for the fourth quarter. The second bar is our 2009 performance and the third bar is currency-adjusted. So you can see how we would do on a constant currency basis. Net sales would have grown 15.8%. We did report 210 basis point operating margin improvement. It would have been 280 basis points. And we had 39% improvement in EPS.

Of course it was an easy comp. Q4 you saw was difficult for everybody. But more importantly, it was a record quarter, both from an adjusted earnings standpoint, taking out Venezuela, and from a volume standpoint. So we left 2009 with the best quarter the Company's ever had.

Probably one of my favorite slides -- this is our cash flow. We're a strong cash flow generator. It starts with net income. Then it looks at other items like working capital, which gets you cash from operations. Capital expenditure -- we have an anomaly in



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2008 where we put Oracle in. That was a huge expense for us. So that's higher than it would traditionally be. But every year we generate, if you can normalize '08 for Oracle, excess of \$200 million of free cash.

And you'll see on the next slide, or maybe it's two slides from now, where you'll see our cash flow yield far exceeds that of our competitors. And this is just an opportunity to me, from an investment standpoint. Because what's probably not -- traditionally, we buy back stock with our excess cash. We only have \$225 million left of the current authorization, so I think that may be what's built in to some analysts' models right now. But if you were to build in our excess cash over the next five years of stock buyback, you'd see there's a big opportunity for return, even without multiple expansion and we think there's a big opportunity for multiple expansion.

Total debt -- we're very conservatively capitalized. Our total debt is 0.7x EBITDA. Net debt is 0.3x EBITDA. We have a term note and we have a revolving credit facility. One expires in 2012; one will expire in 2013. And we'll -- debt for us is a capital structure decision, not a need. So we'll determine based on the capital markets at that time what the right debt level should be. But we're in a position that if we had to pay it off or wanted to, we could -- enviable position.

This just looks at what we returned to shareholders. We returned \$720 million to shareholders over the last three years, 117% of our net income, as free cash flow is effectively the same in this company as net income. And that's been our trend for the last couple of years and it's my philosophy to continue that. It's a board-level decision, but that's what we've done. This industry does not lend itself to significant M&A. So if you generate more cash than you can effectively spend in the business and you're not going to do M&A we have to find ways to return that money to shareholders. And our preferred approach currently is through buyback, because we think our stock is cheap.

Valuation perspective -- from P/E and cash flow yield, EV to EBITDA, everything but P/E we're the lowest valued in the peer group. In P/E we're the second lowest valued. And, again, I point to CSE yield. I think it's -- we're dramatically higher than many of our competitors and certainly higher than all of our competitors. And that's the big opportunity, I think, from an investment standpoint, to -- our cash flow -- our stock has been volatile; our cash flow has not.

Guidance -- we provided guidance for both Q1 and the full year. For the full year we're looking to have 9 to 13% EPS growth. Based on what was \$3.28 this year, we're looking -- we have a range of \$3.58 to \$3.70 on sales growth of 8.5 to 9.5% and volume growth of 5 to 6%. There is some currency benefit in most currencies in that guidance, with one impact negatively from Venezuela. Well, I don't need to get into Venezuela, but just know we're in Venezuela. There's a one-time impact for implementing hyperinflationary accounting. But going forward we have Venezuela in our model at worst case, at the parallel rate. If we get access to [official rate] dollars, that's upside for us.

And then hedging -- obviously, 80% of our business is done outside the US, so we're exposed to currency. We have a hedging policy on currencies where we get hedge accounting. The euro is that -- the one accounting where we get hedge accounting. And we hedge out 18 months on a stair-step approach. 70% of our currency exposure to the euro for 2010 is hedged at 1.45. For all other currencies, we just hedge the current quarter. We don't hedge out beyond the current quarter, because we cannot get hedge accounting treatment, which means we'd have to mark to market that hedge instrument in one period, where the offset would be in another. We'd be economically hedged, but you'd have huge volatility as you mark to market those hedge instruments. So we don't do that.

And last slide is just a repeat of the summary that you heard at the beginning, which is the Company's doubled in the last five years. We still consider ourselves a growth company. We think we can double in the next five. It's driven by a product line that's relevant, by a business model that goes deeper into markets, and backed by a financial model that's very strong and shareholder-friendly.

That's prepared comments. So I guess we're going to go to Q&A and we have a microphone.



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QUESTIONS AND ANSWERS

John DeSimone - Herbalife, Ltd. - CFO

[They'll come] with the microphone so everybody can hear the question.

Unidentified Audience Member

Yes. Would you do a little bit of a compare-and-contrast with the competitors that were listed on that last slide? What do you think are the main differences between you and the various others?

John DeSimone - Herbalife, Ltd. - CFO

Well, from a perception standpoint I think there's a difference. I think Herbalife is a much different company today than it was 10 years ago. So we have a legacy issue. When you think of Herbalife people tend to think of how we sell. When you think of Avon and Tupperware, I think people tend to think of a product. So I think the more investors we see, the more we tell the story, the more investors go visit clubs and understand the business model better, the more that perception will change.

That perception is really -- it's much more of a US Anglo and maybe Western Europe perception. It's not -- we don't have a perception issue with most of the markets we're growing in. The US Latino markets there's not a perception issue -- Mexico, Taiwan, Korea, South America. So I think there's a perception issue with investors that is changing. I think it's changing. I think that more people are visiting clubs and they're understanding the nature of the business and who Herbalife is today. But that's one of the challenges we've had with valuation.

Now, if you want to talk products, we can do a contrast on products. But I think you were talking more --

Unidentified Audience Member

No. Let's talk products, too.

John DeSimone - Herbalife, Ltd. - CFO

Well, the people you see are mostly [out of] nutrition or skin care. There isn't any nutrition with some, but mostly it's out of nutrition, whereas ours is [in.] Their products are sold -- it's different by product line. So Avon and Tupperware -- Tupperware's got two models, right? They've got a direct selling that's the traditional direct selling and then they've got another business they've acquired. We think our business opportunity is better. We think distributors can earn money quick and more money with Herbalife's marketing plan than you can with the competitors.

And we think our product has a stickiness that theirs doesn't, because our products -- when you lose weight on a product, there's a testimonial to it. There's a testimonial aspect. It's before and after. If it worked for you, you're passionate about the product and it helps you sell from a direct selling standpoint. So person-to-person product line, weight management's a great product, whereas cosmetics -- I mean, there's a business opportunity for people who use cosmetics, but there's no -- they don't have the same passion for the product line as people in our business have if the product's worked for them.

Unidentified Audience Member

Could you talk a little bit about your going deeper chart, penetration? Taking Mexico and perhaps US Latino as examples, those are the longest out there. Is that 4.8% and 10.8%, are those continuing to rise or have they peaked in the earlier years and are coming down a little bit or stabilized?



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John DeSimone - Herbalife, Ltd. - CFO

I'll have to answer it two ways, because there's a different answer for each of those two models.

So Mexico was the first market that started daily consumption. And it had gotten up over 5 from penetration. And then it started to slow. And it -- there was a learning curve for the Company to understand the needs of this model and how they're different than the needs of traditional direct selling. You'll find there's far more orders and they're smaller orders to the Company in this model than the traditional model where there's larger orders but fewer orders. And we didn't have the infrastructure appropriate for Mexico.

So there were -- that was one issue with Mexico and the second is Mexico was hit with the 15% -- our products were hit with a 15% VAT tax in August of 2008. Can't imagine a worse time, right, for a VAT tax. So there was a 15% price increase in Mexico that we've annualized now and we're starting to see growth again. But it took away from the business.

But even in Mexico, we have states in Mexico where our penetration where it's 15, with other states where it's negligible.

Unidentified Audience Member

But generally speaking, are you saying that you haven't seen kind of, just on an overall basis, it continues to increase the penetration over time? It doesn't --

John DeSimone - Herbalife, Ltd. - CFO

We have not seen --

Unidentified Audience Member

After five years or --

John DeSimone - Herbalife, Ltd. - CFO

So the US Latino market hit its record penetration in the fourth quarter of 2009 and we're still seeing growth. So we don't know, to your point, we don't know where that caps out. All right? So even in the US Latino, the way we're addressing the opportunity in the Latino market is by city. Because you'll have cities like Chicago where we have a penetration rate of 19 and many other cities where it's nonexistent. So there's still opportunities.

Unidentified Audience Member

And then the other question was, you said you recently hired, you are hiring a previous head of the FDA. He's going to come over to you shortly. Is there an issue or -- you are not covered by the FDA at this point, or are you?

John DeSimone - Herbalife, Ltd. - CFO

Well, we're not covered in the pharma sense, I mean, the tradi- -- how some people think of it, whereas we're not limited as to what we can launch based on FDA approval. But there are FDA standards for manufacturing and things like that so --



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Unidentified Audience Member

Are you concerned, though, then that perhaps in the future, the near-term future, that may be an issue? I understand where you stand now, but going forward is there -- might you or is there any concern that that -- you might be covered by the FDA more closely or require --

John DeSimone - Herbalife, Ltd. - CFO

Well, there's a lot of improvements that we would support with the FDA. Okay? Right now, that would raise the credibility of the industry and increase the barrier to entry. There's a lot of companies out there that chase that. We don't chase that. Right? And those are the companies that really the FDA's concerned about, somebody that launches the next new hot product that's not scientifically tested. Right? Again, our number one product is a functional food shake. Right? So we would be supportive of raising the bar. And the only way we could do that was both to be manufacturer, so we could control the process, and then we went out and hired people that can help us do it in the right way.

So it's an opportunity I think more -- not that it's not a risk, but I think there's more opportunity here than risk.

Unidentified Speaker

John, can I just jump in here for a second? I just want to ask, obviously daily consumption is a big push for you guys, right? It's a big source of your growth. Can you just talk about what percentage of the overall business is daily consumption, I guess where it was two years ago and where it might be two or three years from now?

John DeSimone - Herbalife, Ltd. - CFO

So right now it's about 30% of our business, all right? We don't have the best methods to track clubs. And we're putting that in place right now. And so it's all done through statistical analysis. We think that can invert, that 70% of our business can be clubs or daily consumption models over the next five years. When we look at the US Latino business, or US business in general, the Latino business is two-thirds of the US business. Five years ago it was inverted. And all that growth has come from clubs. And we can see that happening around the world. So I think that answers the question.

Unidentified Speaker

Yes.

Unidentified Audience Member

Just a simple question. Back, you said that you had kind of old metrics and then new metrics that you thought people were getting confused. And now it appears as if people are less confused. When you're running the business or managing the business internally, which of those two concepts of metrics do you focus on?

John DeSimone - Herbalife, Ltd. - CFO

Well, we focus on all those metrics. Not -- one alone isn't good enough, right? So the most important is average active. That's how many people are engaged in the business. But that alone is not a good enough metric for us. So we look at -- we have almost three dozen metrics that we look at that's key for us that you don't have access to. So we look at how many people are new in the business; how much they order the first month after they come in. I mean, there's a lot of other statistics that we look at.



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The most relevant but simple, without complicating the formula, would be average active.

Unidentified Audience Member

And so you didn't change kind of what you were looking at internally? That was just a cosmetic --

John DeSimone - Herbalife, Ltd. - CFO

Oh, so over time we've changed. So average active has always been calculated at the Company, but was not a focus. But as daily consumption has come on, it's become a focus. And then add, of course, we had difficult economic challenges at the beginning of the year that made it difficult to recruit that \$3,000 supervisor, then that just became more relevant.

Unidentified Audience Member

First, to follow up on the regulatory scrutiny front, are there any specific FDA initiatives or bills pending that you're focused on?

John DeSimone - Herbalife, Ltd. - CFO

Well, McCain's bill -- he repealed that bill. So right now there's nothing that's -- I mean, we're constantly active in Washington. And that's how we met Dr. Francos, is through our proactivity with the FDA. So we were the first nutrition company to support adverse events legislation for dietary supplements. So that has elevated us I think with regulators. We had a senator on The Tan Sheet the other day highlight Herbalife as leading the way and that more people in dietary supplements should be like Herbalife, which is what we're trying to create, is to try and make us leaders in the category.

Unidentified Audience Member

So is the FDA looking to do anything with that legislation? Or should we just keep an eye on the legislative front and we're kind of covered?

John DeSimone - Herbalife, Ltd. - CFO

I'm not going to comment, I guess, on what the FDA --

Unidentified Audience Member

My one other question was about the --

John DeSimone - Herbalife, Ltd. - CFO

-- agenda is.

Unidentified Audience Member

-- daily consumption model. For a constant mix of product, how does the profitability differ between \$3 a day or \$100 a month to you?



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John DeSimone - Herbalife, Ltd. - CFO

For -- it doesn't differ at all.

Unidentified Audience Member

Not at all?

John DeSimone - Herbalife, Ltd. - CFO

Not at all.

Unidentified Audience Member

Okay. Thanks.

John DeSimone - Herbalife, Ltd. - CFO

We still sell it to the distributor at the same price. It's what they do with it when they get it.

Unidentified Speaker

I have one. When you bring manufacturing in house, I guess the bigger question is, what do you bring to the table, right, and how much of it is -- I guess your gross margin's over 80%, right? I mean, what's the margin opportunity there? And what can -- maybe just what can you bring to the table, right? I mean, because presumably your co-packers have more scale in this and on a plant-by-plant basis, and more experience in doing it?

John DeSimone - Herbalife, Ltd. - CFO

Well, I don't know if they have more experience. We have some of the best people in the industry now on our team. So we think there's between 100 and a 200 basis point opportunity in gross profit for manufacturing over the next three to five years. Most -- 70 to 75% of the cost of supplements are in raw material. And we think we've got some of the best people to go out and negotiate those deals. I mean, we've got Gerry Holly, like I said, and Jim Barton. And these people have done this before.

And Herbalife effectively has been in manufacturing for a long time. 100% of its products were manufactured in the South California facility up until Mark Hughes death in 2000. And it was a dedicated Herbalife facility run by Herbalife managers even though it wasn't owned by Herbalife. So we've been in it for a while.

Unidentified Speaker

Thank you very much for being here.

John DeSimone - Herbalife, Ltd. - CFO

Thank you.



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