

FINAL TRANSCRIPT

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HLF - Herbalife Ltd. at Jefferies Consumer Conference

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Jun. 22. 2010 / 3:15PM, HLF - Herbalife Ltd. at Jefferies Consumer Conference

CORPORATE PARTICIPANTS

John DeSimone
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Doug Lane
Jefferies - Analyst

PRESENTATION

Doug Lane - Jefferies - Analyst

Okay. Good morning, everybody. Welcome to the Jefferies Global Consumer Conference. My name is Doug Lane. I'm on the Jefferies consumer team. I am a consumer products analyst. It is my pleasure to introduce John DeSimone, the CFO of Herbalife. Amy Greene from IR is also here as well for follow-up questions, and let me turn it over to John.

John DeSimone - Herbalife Ltd. - CFO

Thank you, Doug. Good morning, everyone. I will start with the Safe Harbor language. There is a copy for those that are working on the Internet or on the webcast. There is a copy of the Safe Harbor language on our website.

We can start the presentation with four overview slides, general overview slides. This is a big picture of the story. It is a growth story. The Company has doubled in the last five years, and we expect to triple in the next 10. That is our goal. So we expect the growth rate that we have been experiencing to continue and all the drivers of the growth.

First and foremost, it starts with product. Our products, our nutrition-based products address two key megatrends, obesity and antiaging. It is funny this morning I read an article on FIFA, the World Cup. Great big world stage and catching grief for having sponsorships from McDonald's, Coke and Budweiser. Because in South Africa 29% of the men are obese and 56% of the women. So it's just amazing how what you will (inaudible) today of how important nutrition is and how unhealthy obesity is, and that awareness is accelerating. So our products fit those megatrends. That is key.

The second driver of growth is a change in the model. Our model has evolved or transformed from -- or it is in the process of transforming I should say from traditional direct selling, which will go over the characteristics of that in a few slides, to daily consumption, and daily consumption in every market that is adopted, daily consumption in the nutrition core model has had a significant growth. It has been an accelerator of growth. And there are a lot of markets that are just now getting to that stage and a lot that has not even gotten to the beginning yet. And daily consumption, which is offering our products to consumers at a daily price point and we will talk about that in a few slides, has been driving growth both in emerging markets and in established markets, which is different than most direct sellers. We will have a slide on giving you a little bit of history on that, too.

From a business model standpoint, we're a very low capital business. So our capital expenditures this year are estimated to be around 3% of net sales. That is a good run-rate going forward, and we are looking to go vertical. That 3% covers the capital requirements that go vertical. In addition, we generate strong free cash flow. Our cash flow for the last three years -- three and a half years with one exception has exceeded net income. The only exception is when we put Oracle in, and we have some details on that coming. And we have very low debt.

Our debt is 0.7 times EBITDA, and our net debt when we back out cash is 0.2 times EBITDA. So we're very conservatively levered. And then we have a disciplined return of capital, so we are not -- meaningful M&A is probably not in our future. So with cash flow equally or exceeding net income and capital expenditures equal to about 3% of net sales, we look to return cash to



Jun. 22. 2010 / 3:15PM, HLF - Herbalife Ltd. at Jefferies Consumer Conference

shareholders through a dividend and a buyback program. We have authorized a \$1 billion buyback program a couple of months ago. That extends for the next four plus years. We will talk about that in a little bit. But up until the end of the first quarter, we had returned over \$600 million to shareholders in share buyback over the last three years and \$150 million in dividends, and that is an approach that we will continue for the next four plus years for sure.

Just a slide that details our portfolio of products or how it breaks down into categories. 63% of our products -- just under 63% of our products is in daily nutrition or weight management. It's not a diet product line. That is important. It is more of a lifestyle change. We don't have the seasonality that traditional diet products have. And you will see on the next slide, we are more of a functional food company. 22% of our sales come from we call it targeting nutrition. That's condition specific products like heart health or digestive health and things like that. And then energy and sports is a relatively new product line for us. It represents a small percentage of our business, a little over 4%, and skin care we call it outer nutrition or personal care represents 5% of our sales.

This is an important slide for anybody new to the story. I think there is a perception and I had the perception before I came to the Company a few years back that we are a diet company with the typical contentious diet products, right, the ones that are, you know, take a pill, don't eat for 30 days and lose weight. It's not who we are. Herbalife doesn't -- we don't chase that.

Our top five products are mostly functional food category products. Formula 1 represents almost 30% of our sales. It is a 30-year-old product. We had Formula 1 shakes that we passed around at the last break. I hope everybody had a chance to try some. We have more coming in now that you can try, but it is a meal replacement shake. It is not a contentious product. It is very well established.

Our second largest product line are teas. Right? You know, caffeine-oriented teas, morning drinks, again not a contentious product. Aloe represents 9% of our sales. That is the third biggest. And those three products you will see in a few slides represent what we call that Corporate Nutrition Club line, that daily consumption line. And then augmenting those three products are protein powders -- again, not a contentious product line -- and then our fifth largest product is a product called Niteworks that is developed by a Nobel Laureate scientist. So it's not traditional supplements, and I want to get potential investors off that mindset.

This slide depicts our geographical diversity. We are in 73 countries, grouped into six regions. We don't need to go into all the numbers. It is available on our website. The important takeaway is we are not overly rated in any one region. North America is our largest region, representing just under 25% of our revenue. Asia-Pacific is second with a little over 20, EMEA for those who are not familiar with the Company is Europe, Middle East and Africa. That represents a little over 20%. And then it works down from there to Central America, Mexico and China. To diversify geographically is the takeaway.

This slide might take a minute to set up. This speaks about the transition from traditional direct selling to daily consumption. And this may be a five-minute slide.

Traditional direct selling -- and it is all direct selling. It was Herbalife, but it's everybody who sells direct is traditionally getting a few people to buy a lot. It is a medium to high-priced monthly purchase or every two weeks in some cases. So a distributor would go to a consumer with a new catalog or whatever it may be and say, did you put this month's order in today? That kind of model skims the surface of people that can participate in the product offering because it's an expensive price point. It's a high acquisition cost, and it is a very inefficient model for distributors because distributors have to go to their consumer. And in 2003 that is exclusively what Herbalife was. And then last year you can see that the Company over the six years from 2000 through to 2009 has almost doubled with profit up 120%.

The characteristics of the new model, daily consumption model, is that it is looking for a lot of people to buy a little, instead of a little people to buy a lot and has a daily price point. And that means the consumer comes in and buys the product they need just for that day. It is a one day serving. And that is a much more effective model that reaches much deeper into every market



Jun. 22. 2010 / 3:15PM, HLF - Herbalife Ltd. at Jefferies Consumer Conference

that has been introduced, and it makes a lot of sense, and we have a slide that I really like on the next page that talks about the power of that model.

It penetrates deeper. It has a much lower customer acquisition cost, much higher retention rate. It is a stickier model for a lot of reasons. Not only (inaudible) get consumers when they only have to spend what they need that day, but it's a forced discipline that does not exist in traditional direct selling, and traditional direct selling when a distributor comes into a business, they need to be self-motivated. So they come in that day, they are probably quite motivated. But 30 days later, what do they do? How are they successful?

When you have a club, you have a job. You have to get up every day. You have that forced discipline so the distributor knows what they have to do to be successful. Our retention rates and success rates for people doing club is much greater than people doing traditional business models, and it is a more predictable, more consistent model. And right now we estimate on 30% of our business falls into that category and it is growing.

And an additional benefit that I did forget is that in that daily consumption model, customers come to distributors instead of distributors having to go to customers. So once you have got a customer, it's much more efficient to keep it running than traditional direct selling.

I like this slide. This slide analogizes the daily consumption model to coffee. Starbucks is on here. It's a great example, I think, at \$2 a day, which is what you pay for a cup of coffee at Starbucks. Very expensive. If you had to pay \$60 at the beginning of each month for that month's supply of coffee, far fewer people could participate. But when you pay \$2 a day, it is such a low price point, people can afford it. People living hand to mouth or whatever it may be, so far more people can afford that. And that is what we have seen with our core products that are offered at a daily price point is far more people can come in and pay \$3 a day than would have paid \$100 for that month's supply. And that \$3 is sold primarily as a meal replacement. So the distributor is looking for consumers to replace what they are spending for a meal and come to Herbalife as opposed to an incremental spend. So we have it is a strategy we call "replace one meal a day from fast food." So that is what you are going after. Somebody who is eating poorly, who will benefit from good nutrition, who only has to replace the money they are already spending in terms of incremental dollars, and that has been driving the growth.

This slide depicts the opportunity, and what we have seen in markets that have adopted daily consumption.

Let me set this slide up. It will take a minute, too. The blue bars are the penetration rates in 2003 in our top markets, and the green bars are the penetration rates in 2009. And we measure penetration rates as volume points per capita. Our volume points, to keep it simple because it is an Herbalife measurement, is the equivalent of retail sales reinstated to 2003 in US dollars. So it takes out price increases, and it takes out currency or anything else. It is just volume.

And in Mexico, which was the genesis of clubs, the volume points per capita was 1.2. So if Mexico had 100 million people, it means we get 120 million volume points. In 2009 we did 4.4. Now Mexico started clubs in 2003. It did not spread very easily because the club modeled most of the distributors within Herbalife thought the club model could only work in Mexico because it is a very social culture, and it could not expand beyond that.

But the models evolved from what was a home club to more of a commercial club. That's a much more comfortable model for various cultures. And the US Latino market adopted clubs in 2006. They went from 2.3 volume points per capita to 10.8.

Taiwan similarly in 2006 went from 2.9 to 8.7. Korea, which started in 2007, they are from 1.2 to 3. It is almost 3X. In Brazil, which even started later, has more than doubled from 0.4 to 0.9. And an important country that is not on here but will illustrate the power of daily consumption is India. It is not on here because the population is so great you cannot measure penetration yet. It does not draft well. But Herbalife entered India 10 years ago, and for 10 years it has been flat.



Jun. 22. 2010 / 3:15PM, HLF - Herbalife Ltd. at Jefferies Consumer Conference

I should not stay that. We started out strong growth because it was a new market, but after the first year, it has been flat. And then five quarters ago, they started having successful clubs, and for the last five quarters, -- India has represented either strong double or low triple digit growth, and it's all because of clubs. And you can envision if anybody has been to India, they are used to buying just that day's supply of product for whatever it may be -- consumption, cigarettes, you name it. It is what they are used to. So the traditional daily consumption model is not the right model for India whereas daily consumption fits perfectly. So we are starting to see good growth in India.

They are a little bit further ahead than China. China is starting clubs, too. They are trying to find a way, and eventually they will, but India a little further ahead. But it highlights the opportunity.

So a Company penetration rate for the countries that we are in was 0.3, a little under 0.3 in 2003. And last year it was 0.56, rounded up to 0.6. So you can see it is relatively low penetration relative to the markets that have already adopted daily consumptions, and this talks about the opportunity that exists for us. And when we start looking out and do our 10-year plan, penetration rates are where we start.

Let's talk about the club model for those who don't know. The three primary products, and they also are the three primary products in clubs, are the meal replacement shakes, herbal teas and aloe drink. And those three products in 2003 represented 37% of the Company's business. In 2009 it represented 51% of the Company's business. So it has had 2X growth for the Company because it has grown 152%, while the Company has grown 84%. So the growth of the Company has been driven by going deeper with what we have. Unlike a traditional food drug mass nutritional company that is driven by new products, ours is driven by what we take, what we have and taking it deeper into the marketplace. We have been very successful, and there is a lot of runway left.

This slide looks at our sales in established markets and emerging markets. A lot of direct sellers are in emerging markets. Sorry, we are both. We are seeing a strong growth in both markets. Emerging markets represented 53% of our sales in 2006, and from 2006 to now we have had good growth, and they still represent 53% of the sales. You will see there is also a blue pie that represents Korea. The World Bank has Korea as an established market. A lot of investors we need have it as an emerging market, so we put it here, and you can put it in whichever bucket you feel is appropriate.

Vertical strategy. We coined our vertical strategy seed to seed up until early last -- mid last year the Company only made about 5% of its products. It made products in China for China only. Everything else was outsourced. There was a strategy the company launched on a couple of years ago to self-manufacture. It's a lot of reasons they want to self-manufacture, but the first priority is protection, (inaudible) avoidance, control. We want to control the supply chain.

So, in the third quarter of last year, we bought our manufacturing operations in California, \$10 million. Relatively low capital investment. Manufacturing is not very capital intensive in this industry. So we purchased an operation for \$10 million. We have to put another \$10 million to \$15 million into that operation. That will give us enough capacity for about 40% of our worldwide needs.

When we bought that product, I mean that facility, we hired a gentleman named Gerry Holly. He is the foremost expert in manufacturing in our industry. We have since hired a gentleman named Dr. Bill Frankos who up until March was the head of Dietary Supplement Division of the FDA. He now works for us.

So we are on a journey to elevate ourselves above the industry. You cannot do that without self-manufacturing, and we are not working our way back. So we are starting with manufacturing. We started an ingredient sourcing company. So all ingredients in our product will come from our ingredient sourcing company. So it will have traceability, and then we are going to look to do an extraction joint venture. So an extraction is the process of taking the crop to the ingredients, and we will control that. So you can extract it through our process, and then we will have complete traceability from we will call it seed to feed.



Jun. 22. 2010 / 3:15PM, HLF - Herbalife Ltd. at Jefferies Consumer Conference

So from a government regulation standpoint, that is the huge competitive advantage. It is also a big marketing advantage. Our distributors love selling that concept that we are in control of the product from seed to feed, so there will be a big marketing advantage. And then there is an ROI. It is not a capital-intensive business. But it provides a great return, and we will look for 100 to 200 basis points improvement on COGS over the next three to five years.

Turning to some distributor metrics, our business has transformed or is transforming from traditional to daily consumption. That has required us as a company to change some of our metrics and some of our marketing plans. That top right box, that is what we call sales leaders. Those are the business builders. And traditionally that is the box we looked at. Somebody who is really building the business and what level they were doing and how engaged they were. There is a lot of activity happening below that level on the distributor side that we were not focused on. That is an important metric for us and how we went to daily consumption. So we changed the marketing plan to help people get into the business easier and then build from a distributor to a sales a little bit more slowly so they can build consumers through that daily consumption model. So when they become a sales leader, they already have a business. And we tested this idea in a market and it tested very well, and people that became sales leaders were much more productive, much more active when they became a sales leader over a long period of time than those who became a sales leader quickly. So that was an important change for us.

And also with some internal metrics and external metrics, we had to start discussing different data points than we had in the past. So we used to talk about new sales leaders, and new sales leaders was always a driver for direct selling. But new is not the most important aspect for us. The most important is active. How many people are engaged in the business. If you got somebody new coming in but then not engaged after they come in, it is an irrelevant metric.

So what is really important is how many people are ordering products from you every month, and that's a new metric for us that we started releasing just early this year.

This takes a look at two key metrics. So volume point, which again that is volumetrics for us, and then active, that is that new sales leader metric that we released. In Q4 '08 and, of course, in early '09, our volume points decreased within an economic climate that was very difficult. A lot of people sitting on their wallets. But what was important to us that Wall Street could not see was that our activity level never decreased. So we were not losing people out of the business. They were still active. They just were buying less. They were cautious. And so we knew it was going to come back, but it was kind of a disconnect with Wall Street because all they were seeing was volume points and new sales leaders, not how many people were ordering. So we decided that this was a better metric. We did regression analysis. This was much more correlated to future growth than new sales leaders. So this is a new metric that we will leave investors to focus on.

A quick financial update. I have six minutes, but most of this information is available on the website. This looks at sales growth in the first quarter, which was 13.3%. This is currency adjusted. So the first bar is Q1 '09, the second is reported Q1 2010, and then the third is currency adjusted. So if you take out currency, we have 13.3% net sales growth, 180 BPS operating margin improvement, and 33.8% EPS growth.

And this information we have currency adjusted detail on our website, full P&Ls for anybody who wants or needs that information to help model the business.

From a cash flow standpoint, I said this earlier, we are a strong cash flow generator. You can see free cash flow usually exceeds net income. 2008 was an exception. We spent far more money than we usually do because we were putting Oracle around the world. That was an investment that was long overdue. That was certainly a one-time investment. We don't expect to spend that much as a percent of sales in the future. So we generally say free net income is a good proxy for free cash flow. And from an EBITDA per share standpoint, we are at 588 last year, and if you annualize it this year, we are over 6.

Very under levered. You can see on this sheet we have a conservatively capitalized balance sheet. Our net debt is 0.2 times EBITDA. Our debt is 0.7 times EBITDA. We have two tranches. We have a revolver and a credit facility. One is due in 2012, one in



Jun. 22. 2010 / 3:15PM, HLF - Herbalife Ltd. at Jefferies Consumer Conference

2013. Not that we would pay it off, but it is nice and comforting to know that we could pay it off if we had to from cash from operations. So it's a good position to be in.

From a share buyback standpoint, so to date over the last three years, this is through the end of Q1. We returned \$600 million through a share buyback since 2007 and \$150 million through dividends. At the end of Q1, the board authorized another \$1 billion buyback through the end of 2014. As of the end of Q1, we were \$100 million into that, so we have \$900 million left. We expect to buy back a portion of that on a regular basis and another portion to keep this dry powder for an overreaction. But it is an important element of our capital strategy.

You can see net income for the three years combined, through actually three plus years combined, equals 100 -- share buyback was 112% of net income, and we paid down net in that period. So we were able to return to shareholders more than we earned and still reduced our debt. So that speaks for the fact that cash flow usually exceeds net income.

From a valuation standpoint, I don't have a lot of time. So I'm sure if you are in the room, you probably look at this already. We are undervalued in almost every metric versus our peer group, despite what we think is a growth prospect that exceeds our peer group. I think some of that is because we are misunderstood. People are not as familiar with the business, and there is a legacy issue. Old Herbalife, which is the traditional direct seller 15 years ago, is much different than who we are today. We've got much more bricks and mortar. You know, 30% of our business comes from daily consumption, which is more predictable and more consistent. And that 30% investors are an ability to channel check. We give them addresses for clubs. You want them to go clubs. Actually we would advise you to go to clubs if you are interested in this story. It will give you a good perspective on how the business is run and what the opportunity is.

And then just as interestingly, when you look at Herbalife compared to other CPT groups or diet groups versus just direct selling groups, we are very undervalued. So we think there is still a lot of opportunity. I mean it's a great return for shareholders, even if valuation does not increase just because of the buyback. I mean that's not in the long models right now. But valuation increases will actually be upside for the return.

Consensus, this was consensus -- excuse me, this was guidance that we gave to the street at the end of Q1, so it is up here. It is on our website. You can see that we looked at EPS guidance of \$0.89 to \$0.92 for the second quarter and full-year \$3.80 to \$3.90.

And the last currency -- right, currency is pretty topical for the last seven weeks. There is really a short and medium and long-term approach that we have to currency. In the short-term, very short-term, which is the current quarter we are in, always we hedge every major currency. So when we give guidance in April for Q2, we are hedged for Q2. So we take some of that short-term volatility out.

On the medium term, which is the current year, for the euro, we get hedge accounting treatments. So for the year, we had hedge out six quarters on a stair step approach. So we hedge 90% of the current quarter exposure, 75% of the subsequent quarter and so forth and work our way down, and we roll that every quarter. So there is an average effect on the euro.

So, as of the end of Q1, we were 85% hedged on the euro for the year. So the euro has moved quite a bit in the last seven weeks, but it will not impact us this year. And then longer-term we have our US dollar denominated cost structure. Most of our product is made in the US. That will change. We will look to regionalize manufacturing. That will create a natural hedge for us. So we can get more of our cost structure into the local currency that is generating the revenue and out of dollars. But that's a three to five-year process.

And this is just the same slide I showed at the introduction. It just talks again to remind everybody we are a growth story. It is driven by the fact that we've got great nutrition products, which is very topical. We have an evolution transformation of our model to daily consumption, which is the more predictable and consistent model and that that model allows us to go deeper both into established and emerging markets. And then we are in a great -- we have a great financial model, and we returned a lot of money to shareholders.



Jun. 22. 2010 / 3:15PM, HLF - Herbalife Ltd. at Jefferies Consumer Conference

I think they are holding questions for the -- I will happily answer the questions, but I was --

QUESTIONS AND ANSWERS

Unidentified Audience Member

(inaudible question - microphone inaccessible)

John DeSimone - Herbalife Ltd. - CFO

Okay. So the question is, what is the value proposition? What is the price point?

The daily price point in clubs, it varies by market and currency matters. So I will start with the US. So it starts in the US it ranges between \$3 and \$4 a day. Our clubs are -- and actually some clubs are even higher end, a very entrepreneurial business. So some clubs have exercise equipment, and they charge a little more and you get to work out, too.

But generally it is \$3 to \$4 a day. For that you get breakfast or lunch and dinner. You get a meal replacement shake, which we have outside here. So I thought they were going to bring them in. It does not look like they did, but we have samples you can try. So meal replacement shakes. You get your caffeinated drink, you get your tea, and then you get an aloe drink, so you're getting three drinks. You are getting an aloe drink which is for digestion.

And that proposition differs by market. So when you get to China or India, it competes well against fast food. Maybe not as well against street food because street food is pretty inexpensive. So it is a little different proposition in every market. But it is generally sold as a meal, and it tries to compete against fast food.

All right. Thank you.

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