

# FINAL TRANSCRIPT

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**HLF - Herbalife Ltd. at Canaccord Adams Global Growth Conference**

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*Herbalife Ltd. - CFO*

**Amy Greene**  
*Herbalife Ltd. - VP, IR*

## CONFERENCE CALL PARTICIPANTS

**Operator**

**Scott Van Winkle**  
*Canaccord Adams - Analyst*

## PRESENTATION

**Scott Van Winkle** - *Canaccord Adams - Analyst*

Good morning, everyone. I'm Scott Van Winkle with Canaccord Genuity. Thank you for being here for the Herbalife presentation. Please look at your seminar materials for any appropriate disclosures. But Herbalife, well, I don't know what you can say, I've never seen a company put up a quarter like it was put up a couple of weeks ago, and I'm sure John will be happy to talk about it.

But I'll introduce Chief Financial Officer, John DeSimone and he'll probably introduce the rest of the team. John?

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**John DeSimone** - *Herbalife Ltd. - CFO*

Thank you, Scott. With me today are Amy Greene, Vice President of Investor Relations and Ibi Fleming, she runs our US Latino business, which represents about 16% of the Company. It's the single biggest segment we have. And under her leadership over the last six years, it's grown by a factor of five. So, a good person to come and speak to you in the breakout session if you're interested.

I need the -- is there a clicker, or I just hit the screen? Let me start with the Safe Harbor statement. This is available for those listening on the web. It's available on our website. I see some new faces, I also see some faces who sat through the presentation before. We've flip-flopped the order of the slides. We're starting with the results.

As Scott said, we had a tremendous second quarter. It's three strong quarters in a row, but second quarter has outperformed the other two. And it starts with volume, and it's -- what you'll see here is volume broken into the regions as we report them. Volume points is a unique term for Herbalife. It represents effectively the retail sales in US dollars of products, okay? And it's the same -- every product has the same volume point value around the world. So basically it's a good proxy for unit volume.

Q2, we had 837.1 million volume points, and that's up 19.9% versus the prior year. And the growth was very broad based, and very spread out throughout the quarter. April, May and June are now each in the top-three months in the Company's history. So it was a very evenly spread quarter, and the results as you see, as I go through the regions, were pretty broad based.

North America -- now we break out North America and Mexico separately, because Mexico was a genesis of daily consumption club model, which I'll talk about in a few slides. So North America, in this case, 95% of the volume is the US, and the US was up 21.1%. That's unique in our industry of any direct seller of size. And I'll get to the details later behind it, but it's really because we're addressing a segment of the population that couldn't participate in the product offering a few years ago under the traditional direct selling model.



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Mexico, Mexico was up 11%. It's been interesting ride. We learned a lot with Mexico. Mexico was the genesis of the new daily consumption model. We had a little learning curve along the way. We've had some ups and downs, but it's now double-digit growth again and it's -- the double-digit growth after five years of daily consumption speaks to the strength of the model.

South America was the only region where we had a slight decrease, almost flat. Two key markets, Venezuela, which has a lot of noise, a lot of political noise, lot of currency noise, importation controls that make the business a little challenging. I mean that was one of the key drivers for volume being down in South/Central America.

EMEA, which is Europe, Middle East and Africa, 8.6% volume growth. That's coming off of a number of quarters in a row of essentially flat sales, and that is also a result of the new daily consumption model starting to spread in Europe, and Eastern Europe starting to leverage the new marketing plan that was put in place a couple of years ago, as Russia was up 36% in the quarter.

China, which is a relatively new market for us, so you can see the volume points aren't that high, but we've had 25.7% volume growth in the second quarter after 22% plus growth in the first quarter.

And then Asia Pacific, 50% plus growth in Asia. It is now, from a net sales standpoint, our single biggest region. It surpassed North America the first time and that represents 25% of our net sales. So, the volume points is on the screen, but if you look at concentration of sales around the world, we're pretty diverse. Asia is 25% of our net sales, North America is 24%, EMEA is 20%, Mexico, and Central and South America combined to about 25% of net sales, and 7% in China. So we're diverse geographically.

In terms of net sales, what we reported this quarter was net sales of \$688.8 million in the quarter. That's 20.5% growth on -- what you saw on the prior page was 19.9% volume growth. So most of this is -- most of our sales growth is coming from volume. There's a little bit of FX benefit.

Operating margin went from 12.7% to 16.9%, a 420 basis point improvement, all driven by volume and volume gains. The contribution margin of incremental sales in our business -- on our business model in the short term is 35% to 40%. In the longer term, it's I mean 20%, maybe 25% depending on the market. So we get a big bang in the short term when our volume exceeds our expectations.

And earnings per share was up 70% from \$0.78 last year in the second quarter to \$1.32 this year, mostly driven by volume. And then guidance, this is the guidance we provided a couple of weeks ago when we did our earnings release. You can see on the volume point and net sales, which is the first box, you can see the third-quarter guidance. Volume point and net sales growth is expected to be 13% to 15%, and EPS growth is expected to be 16% to 21% in the third quarter. And then for the full year, we're looking for a EPS growth of 31% to 34% on volume growth of 12% to 14%.

Now why is Herbalife growing? So there's a couple of key reasons. This first one, we don't speak enough about, right? It's -- our products are relevant. They solve a need, okay? That need is the need for good nutrition, weight loss and then just as importantly, weight management; maintaining your weight once you've hit your goals.

It was considered though -- obesity was considered a Western problem. It's really a global problem. The World Health Organization estimates that in five years from now, there'll be 2.3 billion overweight adults in the world and that's 40% higher than it was five years ago. And China, for example, people -- a lot of investors don't think China has a weight problem, but 24% of the adult population in China was overweight. That means there's more than 200 million people in China that's overweight. That's more people overweight in China than in the US, even though the US has 64% of its population overweight. So it's a big population and it's expanding. As fast foods, Western diets expand globally, obesity expands. And we bring a solution, so our products are very relevant.

Second and equally as important is, a new model has increased consumer access to the product. Traditional direct selling and Herbalife direct selling was always selling a monthly price point, monthly quantity of products. So you'd spend \$30, \$50, \$100



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at one time and by that month supply a product depending on nutritional needs. And that worked very well for a certain segment of the population and still works well today for that segment. But this is another segment that couldn't afford to participate in that monthly price point, it didn't have \$100 at a time to buy products.

Our distributors a few years ago in one market specifically identified that problem, all right, that there's a consumer segment that couldn't afford to participate in that monthly price point and many of those consumers needed our products more than most. So they developed what's called a club model, and a club effectively allows a consumer to buy an Herbalife meal one serving at a time. So it takes the monthly price point and breaks it down to a daily price point, and that daily price point increases the affordability of the product. And I'll come to that in a little more detail in few slides.

And then branding; we spent quite a bit of money on building a strong brand to benefit our distributors. We do that through sports, soccer specifically. We do a lot of sports. Soccer fits well as a global sport, we're a global company. We sponsor over 150 teams and athletes around the world; FC Barcelona, Lio Messi, LA Galaxy. There were -- if you had listened to our conference call, you'd have heard that there were nine players on the winning Spanish soccer team, World Cup team that are -- play on teams that we sponsor.

Little bit -- just to look at our product portfolio. We are 62.5% Weight Management, so almost two-thirds of our product come from Weight Management. But non-traditional weight management, as you might think if you're new to the story. We don't chase fads. We're not coming out with a new hot product that stops people from eating to 30 days. We're a lifestyle company. We're much more a functional food company, and you'll see some of that on the next slide. Half of that 62.5% comes from Formula 1, which is the meal replacement shake and it's been around for 30 years.

Moving over to Targeted Nutrition, Targeted Nutrition are products that address a condition-specific problem, could be cholesterol, brain health, whatever it may be. And then we have two smaller categories that offer opportunity in the long term, Energy and Sports, which represents less than 5% of our sales and Personal Care, which represents less than 5% of our sales.

These are our top five products on the bottom, and they represent 61% of our sales. So you can -- almost all of them are what I'd consider functional food, not traditional, contentious, fat-oriented supplements.

Formula 1 shakes represent, it's a third of our business, it's our number one product. Our second product are Herbal Teas, energy teas. Aloe Concentrate is our third-largest product. Protein Powder is our fourth. And then fifth is Niteworks. Niteworks is a product designed by the only scientist ever to win a Nobel Prize for work in nutrition. He won it based on developing a molecule that's the basis for Niteworks and it's exclusive to Herbalife.

Now I'm going to speak a little bit to the transition from the traditional model to the new model, and I've said some of this already. But the traditional model, again, is that medium to high price-point purchase done infrequently. It's done once a month. It's a month supply. And it's pretty much the same way for all direct sellers. That model skims the surface of the consumers that can participate in that offering. So it's a very low penetrating model. The turnover at the customer level is pretty high, and the acquisition cost of the consumer is high.

If we transition over to daily consumption -- and the traditional model hasn't gone away. It works still for a segment of the consumers. But on the daily consumption side, it's going after small purchases. It's done frequently, regularly. It penetrates much deeper into the marketplace, because many more consumers can afford to participate. And there's a slide I like on the next page that maybe will help everybody visualize what that means. It has a much lower consumer turnover rate, higher retention and it's more efficient because it's a club model, so it's a club setting where consumers come to distributors instead of distributors going to consumers. So it allows distributors to service more consumers than they can traditionally. And you can see, that model started in 2003. It started in Mexico. It's spread pretty slowly, although it's gained a lot of traction over the last 12 to 18 months. But from 2003 to 2009, Company nearly doubled its sales and more than doubled its profits.



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This is the slide I like. If you're not new to the story, you've seen it, because I show this all the time. This analogizes the power of having a daily price point versus a monthly price point. We put coffee on the slide, because coffee at \$2 a day, very affordable, a lot of people can go in, spend their \$2, they'd buy just what they need for that day. It's very accessible. If you had a walk into a coffee shop on the first of each month and spend \$60, far fewer people could do it. And that's effectively what's happened with Herbalife, is there's a model called the club model that has daily price points that addresses a different consumer than the traditional model. And that's why, in some of the markets that we've been operating for the longest, the US, Mexico -- US has been 30 -- where we've been in for 30 years, it was the beginning of the Company, double-digit growth right now, over 20% growth; Mexico, 20 years old, double-digit growth; Korea, 15 years old, 92% growth, all because this model allows more consumers to participate in the product offering than the traditional model.

This puts a little perspective around the opportunity. The blue bar -- if I can set this slide up for a moment, the blue bar is penetration rates in 2003 for some of our top countries. And we measure penetration as volume points, which I explained earlier, per capita. Okay? And in Mexico, in 2003, there was 1.2 volume points per capita, that last year was 4.4, all because of changing from skimming the market in direct selling with that monthly price point to going deep into a market with a daily price point.

The US Latin business, as I said, Ibi (inaudible), back in 2006 the penetration rate was 2.3 volume points per capita. It's gone up by a factor of five to 10.8 last year and still growing. Taiwan went from 2.9 to 8.7. Korea -- again this is 2009 numbers. The 2010 numbers are even stronger. Korea was 1.2 in 2003. It went up by almost a factor of three through last year. Brazil, relatively low penetration still because clubs are still just getting started in Brazil, but it has double-digit penetration rates over the last five years.

And then total Company, again, there's a huge opportunity, because from a total Company standpoint, just in the countries we're in, our penetration rates are still less than 0.6 volume points per person. We can double in size just by getting the countries that are below the Company average in penetration up to the Company average. So there's a lot of opportunity by going deeper into the markets we're in.

I like this slide, too. It speaks to the power of daily consumption. This slide breaks our business into established markets and emerging markets, as defined by the World Bank. Both markets represent half our sales. So we're equally split and we are getting double-digit growth in both markets, which is unique in this industry. Most of our competitors are growing in emerging markets and struggling in established markets. But with this new model, reaching new consumers, we're actually having stronger growth in established markets and still double-digit growth in emerging markets.

This slide looks at some of our non-financial key metrics. And what you'll see is that at the beginning of 2008, the graphs start in Q1 of 2008 and of course, there was the economic crisis in middle of Q3 2008. And you can see from an active average sales leader and a new distributor, we're actually back to the pre-economic crisis levels of growth, as we are with volume points. I'll explain average active sales leaders for a moment and then new distributors.

Average active sales leaders are senior distributors that are engaged in the business. It's engagement level, it's a quality measurement of people in the business. And despite the economic crisis, that number never went negative, which means we still had more people ordering product even in Q4 of 2008 than we did in Q4 2007. So there was still growth in the engagement level, they just weren't buying as much during the economic crisis. So we knew the business is going to come back and it started to come back really in Q1 of 2009. Now we're back up to again pre-crisis levels in last quarter.

And then new distributors are the lower level, people that can get in the business for \$50, how many people are being attracted to the business for a number of reasons. That could be just consumers that are trying to buy at a discount, or they could be interested in the business opportunity. And we've made a marketing plan change that helps distributors be more engaged, to be more successful. It's a little complicated. If you're interested, come to the breakout session, we can talk about the marketing plan change, but we're seeing good results from that change. It's allowing distributors to be more successful. It's allowing them to earn money earlier and they're staying in the business.



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Seed to feed. This is our strategy to become vertical. It's an important component of our growth strategy. We want to be a leader in the category, a leader from a compliance standpoint and a leader from a GMP or cGMP, which is current Good Manufacturing Practice standpoint.

We went out and hired the best in both categories. We hired Dr. Bill Frankos who was formerly with the FDA, and we've hired Gerry Holly who has been a manufacturing icon in this business for more than three decades. So we went out and hired the best people to lead the strategy. And the strategy is to be in control of our product from the fields, even if they're not our fields, but be in control of the product from the fields to the consumer. It's a huge competitive advantage that we have all that traceability. Our distributors will activate around that and it's a risk mitigation strategy and that we will be in control from beginning to end unlike any of our competitors.

So -- and it's a low-capital project, okay? This is not a capital-intensive business, manufacturing [driven]. We expect -- we purchased -- I mean our first -- we have a factory in China just for China. We've had that since we opened China, but we don't export out of China. But our first factory outside of China we purchased in the third quarter of last year. We start moving product in this year, in a bigger way at the end of the third quarter this year and then we'll look to globalize manufacturing.

The factory we purchased, we purchased for a small amount of money, \$10 million and then we're going to put another \$10 million to \$15 million into it and that will represent -- that will have enough capacity to produce 40% of our worldwide needs. So it's not a capital-intensive business, but it is an important strategy for us.

Another slide I like, this looks at cash flow for the business. It starts with net income and you can see -- I've circled two key numbers here to show that our free cash flow is effectively net income, all right, since 2007, so for 3.5 years, they almost equal each other. All right? That speaks for the strength of this model. We have negative working capital, CapEx that equals -- pretty close to depreciation, so net income equals free cash.

And then, what do we do with that free cash? I mean we've invested a lot in our business, almost \$300 million in the last 3.5 years, a lot in our infrastructure. Again, another \$400 million over the last three years and we've been able to do that to hit the growth targets that we've laid out and at the same time, provide a handsome return to investors through a dividend and a share repurchase. We returned to shareholders over \$800 million in the last 3.5 years, that's a 110% of net income. So net income equals cash flow, free cash flow, and free cash flow equals our return to investors.

I mean we're not a big M&A company, we might buy small product companies that have good science, but limited distribution, but we're not going to go buy another big direct seller. So once we've invested in our business internally, we'd look to return excess cash to our shareholders. That's something that's going on since 2007 and we've made a strong commitment to continue that over the last two quarters. Last quarter, we announced a \$1 billion buyback program that expires in 2014. It's about \$200 million a year, not that it has to be equally spread, but it's a good ballpark figure. And then we've increased our dividend from \$0.80 to \$1.25 a quarter, because we have a dividend yield goal of 1.5% to 2% return.

And debt, we have a very little debt. At a gross level, debt is seven times trailing 12 months EBITDA. On a net basis, net of cash, it's 0.2 times. We don't need to have debt, we have it as a capital structure choice. That debt -- there's two tranches to the debt, half of it's due in 2012, the other half is due in 2013. We're in a position to retire that debt if we want to, but we don't have to. We'll make the right capital decision based on the facts and circumstances between now and 2012.

This slide, we've always thought our stock is undervalued and we still think it's undervalued. So we've put some statistics up here. You all are probably better at this than we are, but we thought we'd lay it out for -- this all comes from Thomson and First Call. Our expected growth is 16% for the year on revenue. EPS growth, a little over 30%. That leads our direct selling peer group and a few CPG companies that we put up here. Despite that, we have the second lowest P/E. And then from an EBITDA per share, we're in the range of the CPG companies, but we're getting a discounted P/E relative to them. Our free cash flow yield is top of the class at 9.2% and our PEG ratio is, I mean, under 0.5. So there's still a lot of runway left for Herbalife and its stock and investors.



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I've got two minutes left on the clock, but this is a good summary page. Just to recap, we're a growth company. We've doubled in the last five years. We have a goal of tripling in the next 10 years. How do we do that? We have relevant products, they'll continue to be relevant. We have a new distribution model that dramatically improves accessibility to the product. And we have a brand that's continuing to grow and strengthen and getting -- it's getting a lot of visibility. We have an attractive business model, very low capital requirement, both -- including our manufacturing strategy, it's very low capital requirements. Very strong cash flow, and we certainly have a conservative balance sheet.

And we have a disciplined return of capital to shareholders. We have three years of consistent returns through dividend and buyback, and we expect that to continue. And then again, to recap the last slide, we still see us as being dramatically undervalued to see this as an investment opportunity.

And that's -- do we do Q&A here or we have time?

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**Scott Van Winkle** - Canaccord Adams - Analyst

Yes, [until] we get to the breakout session, yes.

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## QUESTIONS AND ANSWERS

**Unidentified Audience Member**

(Inaudible question - microphone inaccessible).

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**John DeSimone** - Herbalife Ltd. - CFO

Well, it doesn't -- they don't come to us, they go to distributors. And it's still a -- this is a person-to-person business, okay, and that works really well for nutritional supplements. Distributors make that first contact and tell customers where the club is, okay? So the club has no signage, it's not retail, it's a private club, and distributors through their personal contact drive consumers there.

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**Unidentified Audience Member**

(Inaudible question - microphone inaccessible).

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**John DeSimone** - Herbalife Ltd. - CFO

Well, it started in the house in Mexico. That model expanded to the US Latin business, but didn't work very well outside of that community, right? They're a very social culture, they were very comfortable inviting people to their house. Not every culture is that comfortable inviting people to their house. So that's evolved to a number of different club models. Commercial clubs, central clubs that are at rental, commercial establishments, small commercial establishments and they share the expenses.

Four or five distributors will share the burden of that club, so though somebody might open and close on Mondays, somebody else on Tuesdays. So it helps both share the human capital requirements and the financial capital requirements through a commercial club. And that's really where the model has now evolved to, is the commercial club. Still not retail, still no signage, so that initial person-to-person contact is required to get you to the club the first time. But once the consumer knows the club is there, they start coming back.



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**Amy Greene** - Herbalife Ltd. - VP, IR

(inaudible) we're in the process of doing a nutrition club tour in cities around the country. So if you would like to go see a club, Ibi and I just took some people to spend Philadelphia, Boston and New York in the last couple of days. Please let Scott know or stop me afterwards and we'll make arrangements to get you in one.

**John DeSimone** - Herbalife Ltd. - CFO

Yes. There's nothing we can say here that will make it as tangible as going to a club.

**Scott Van Winkle** - Canaccord Adams - Analyst

There'll be a breakout down the hall. Thank you, John.

**John DeSimone** - Herbalife Ltd. - CFO

Thank you.

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