

FINAL TRANSCRIPT

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HLF - Herbalife Ltd. at Canaccord Genuity Healthy Living Conference

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PRESENTATION

Scott Van Winkle - *Canaccord Genuity - Analyst*

Hi. Good afternoon. The next presentation is Herbalife, and I'm starting a moment late, so I'm not going to give too much detail. I will let Amy do it.

From the company we have a Vice President of Investor Relations, Amy Greene. And if you haven't seen the stock chart, you haven't missed it. It is still not that expensive. And the company has an analyst day and some guidance coming from next year, coming in the beginning of November I believe.

Some I'm going to turn it over to Amy to talk about the trends at Herbalife.

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

Thanks Scott. First I will point you all to the ever wonderful Safe Harbor statement.

And then while dated, it is the best I can give you for right now, let's look at second-quarter results.

I think the important thing to look at is the fact of how broad-based our growth is and has been in the second quarter. Five of our six regions posted positive volume point growth.

North America was particularly strong in the quarter with 21% growth in volume points, which is just kind of a good volume measurement for us, instead of having the talk currency adjusted.

Mexico was up almost 11%.

EMEA is being driven by various countries through there, we -- it up almost 9%.

China, a very healthy 26%, and Asia Pac, a strong almost 53%.

Central and South America was our only soft spot in the quarter, predominantly two countries for us, Venezuela and Brazil. Anyone that owns anybody that has business in Venezuela is all too conversant in how difficult it is to do business in that market, and Brazil is in the process of transitioning to daily consumption. So we're hoping to start seeing some more growth out of that market.

Overall net sales, up almost 21% in the quarter.

Operating margin, a very strong 420 basis points of op margin expansion.



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I think the key things to know about that is the second quarter we had three record months. They were actually the three strongest months in our 30-year history. So we saw a lot of SG&A leverage in the second quarter, probably more so than is normal, and driven by the strong volume growth.

And then EPS growth of 70% to \$1.32.

Why are we growing? From a large -- when you look at the macro trends, it is not difficult to make a case for why there is a need for weight management products around the world, and that need is only growing.

The business is growing, not from new product development or anything like that, it is really just the fact that our distributors have evolved how they're selling the product. They've gone from a traditional direct selling model to one with daily price points where they are actually -- they post what are called nutrition clubs, and we will talk more about that in a minute, but where they're charging about \$4 a day on average for a daily serving of the product, and that has vastly expanded what the addressable audience for the product is.

And then the brand. We are seeing increasing brand equity or recognition of the brand around the world. We do this primarily behind the healthy active lifestyle or sports, so we do a lot of sports and soccer sponsorships.

Our first larger kind of marquee sponsorship was the LA Galaxy with -- it was the beautiful timing of David Beckham joining the Galaxy, and lots of free press. Every time he was wearing a Galaxy jersey, in People magazine and everywhere else, you saw Herbalife on the jersey. So that was good.

The one we just announced recently was FCB, or FC Barcelona. We're the nutrition sponsor for the team. And we have a personal sponsorship by Leo Messi, who is one of the top football players around the world. So -- and then various other teams around.

These are our product categories -- daily nutrition, targeted nutrition, energy sports and fitness, and personal care.

Daily nutrition is almost 63% of our business. Formula 1, which you see pictured over there, is our meal replacement shake. That alone accounts for about half of that category in its various iterations around the world.

Targeted nutrition is that, it is kind of more of a supplement or condition-specific products.

Energy sports and fitness is not a huge growth opportunity, but it's a good branding opportunity for us. It works well with the teams and the athletes that we sponsor, and so we keep that category and will look at adding products in it as it makes sense for the higher-end athlete.

And then personal care is 4.5% of our sales in the second quarter. It is not a core competency for us. It is not in our DNA. It is something we could do better, and there's a lot of opportunity there, but it is not something we have focused a lot of energy or time on.

Our top five products -- I think one of the important things about us is that four of our top five products are conceptually functional foods. Our Formula 1 shake, Herbal Tea, Aloe Concentrate, and Protein Powder -- those four together are all functional. They are not high end science. They are as caloric substitution, energy, and a digestive drink, and protein powder that can go in the shake.

Niteworks is a nitric oxide product. It's a hugely successful product, particularly in Asia, but when we talk -- people ask us a lot about regulators or about the things that are going on in the industry. I think it helps when you have very uncontentious products.



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This slide speaks to the change in the way our distributors are going to market. Traditionally direct selling is characterized by medium- to high-priced purchases done infrequently. You needed -- our distributors, for the three core products, needed to find someone that they could get \$120 a month for a 30-day supply. Those -- of kind of the rollup costs.

It has very high customer turnover cost, and it's time intensive to acquire a customer.

Under daily consumption, you're looking at getting \$4 from a person. You have a quasi-retail location. The distributors invite consumers to the clubs. They pay a daily membership fee, and for that membership fee they are served an aloe drink, a tea, and a shake.

The addressable audience that can pay \$4 a day is vastly larger than the audience that could pay \$120 a month. So while over 30 days it may roll up to the same amount, the number of people that can come out of pocket a smaller amount daily is much larger.

I liken it to Starbucks. So if in order to drink Starbucks coffee you had to go to Starbucks at the 1st of every month and prepay, preload a Starbucks card for \$60, so that you had the privilege of going every day to get a \$2 cup of coffee, there would be a lot fewer people that could do that.

Our products were not dissimilar. So it cost about \$100 to \$120 to get those three products under the old model. Now you are going into a club and you are paying \$3 to \$4.

The difference is -- has been huge. When we look at the US Latino market, five years ago it accounted for about a third of our US business. They started doing daily consumption, and they now are almost 70% of the US business.

India -- similar. We've been in India for 10 years. It has been a very flat business until they started opening nutrition clubs. And India for the last five or six quarters has been growing between 80% and 115%. Not a new product, just a new way to distribute the products.

This is what has happened in markets where we've seen daily consumption take root.

This is looking at per capita consumption by country. The blue bar represents what per capita consumption was in that country in 2003. The green bar is per capita consumption in 2009.

All -- it's not -- all we've done is take the volume points done in that country in that year and divide it by that country's population.

What you can see is that in the markets that have had daily consumption the longest, we've tended to see somewhere between 3 and 5 X growth in the market, to justify the ability to go deeper into the market instead of going wider.

So if you look at 2003, Mexico was the first country to start opening clubs. Then the US Latino market took it from -- learned from Mexico, copied it. Taiwan, from US Latino, and on.

What we're seeing and what has been driving our growth is just that more countries with more distributors are opening more clubs, and that is the key to the story.

Established versus emerging markets -- often in direct selling a lot of growth comes from emerging markets. We love emerging markets, and a hugely important thing for Herbalife is the fact that a lot of our growth is coming in both GDP established markets but also our oldest market, so a 20% growth in the US.

Korea, Mexico -- lots of growth coming from the established markets and the emerging. It's a pretty good balance.



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These are the key metrics that we look at and that we point the street at to look at the health of the business.

Average active sales leaders looks at the average number of sales leaders that ordered during a given period. And we look at the new distributors too. So you see the new people coming into the business, but you also see the productivity measurement to actually see how many sales leaders are engaged in the business during a given period.

You can see during the trough in the middle -- that was during the economic collapse of late 2008, early 2009. I think the important thing to see is that while the business slowed, the number of sales leaders that were engaged in the business and purchasing product never turned negative.

And the reason is, if you're operating a nutrition club, you still have to buy product to service that club. You may not order extra product or more products, but you still have consumers showing up every day to pay their \$3 or \$4 to have their shakes. So the engaged distributors were still ordering.

New distributors slowed but has rebounded nicely to almost that early 2008 level.

We're often asked about margins, and while a lot of our margins, there's not a lot of wiggle room in a lot of our margins, one of the things we are doing right now is called a seed to feed strategy, and that is our desire to become more vertically integrated.

We have historically, for the last five years -- at least since going public -- have predominantly used contract manufacturing. But governments around the world, from a regulatory standpoint, we like the protection that is provided by being vertical.

We bought a manufacturing facility in third quarter of 2009 in California, and so we are beginning to self manufacture domestically. We have a Chinese manufacturing facility that manufactures for China. We've started an ingredient sourcing company, and we just broke ground -- and you may have seen the press release this week -- for an extraction JV in China.

So the way this will work is the extraction JV will purchase crops from the farmers. They will extract the active ingredients. It goes to the sourcing company, and our manufacturer -- manufacturing company or our contract manufacturers will have to purchase their ingredients from our sourcing company.

This will give us line of sight and traceability from actual field to bottle. So if we're talking to governments, it is a huge differentiating point for our distributors.

But another thing is that governments want to know, how is the active ingredient extracted? Was it solvents or water? What was the method used?

It's very difficult when you're using contract manufacturers and your ingredients have changed agent hands four or five times, to have absolute line of sight on what happened to the product.

So while it's great and we're excited about it, it was -- and protection risk avoidance was our number one reason for doing it, the derivative is that there will be 100 to 200 basis points of margin benefit over the next three to five years.

Most of you are probably aware of this, but we do generate a lot of cash. Net income is a good proxy for free cash for us, and it is a pretty low capital business.

We return a lot of it through dividends or share repurchase. We have a \$1 billion share repurchase authorization. By the end of the second quarter, we had \$850 million remaining on it. We increased our dividend last quarter. Our goal is to keep a dividend yield between 1.5% and 2.0%.



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So from a uses of cash standpoint, which is very important to all of you, number one, we will obviously look at debt, but we have very little of it, so there's not a lot to repay there. Secondly, we will look at internal investments where we can exceed our hurdle rate. And then thirdly, pay the dividend, and what is left over goes back to buy stock.

We have a very under-levered balance sheet, net debt to EBITDA, and to last 12 months EBITDA, 0.7, or 0.2 times. Our debt is due in '12 and '13. We can repay it from cash from operations if we were to choose to, and so it's very -- it's a pretty enviable position to be in these days.

From a valuation standpoint, the stock has gone up a lot, but we're still pretty undervalued, particularly when you look at the growth side coupled with cash generation.

And that is pretty much the wrap-up.

So we will -- as Scott mentioned, we will report our earnings, our third-quarter earnings, on November 1st after the close. November 2nd is our analyst day, so we will do the quarterly earnings call on the front end and then proceed into the analyst day. It's in New York at the St. Regis. The press release one out this morning, so if any of you-all want to go, please just send me an e-mail or give me your business card before you leave, and I'll be sure to put you on the attendance list.

QUESTIONS AND ANSWERS

Scott Van Winkle - *Canaccord Genuity - Analyst*

(Inaudible question - microphone inaccessible)

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

Okay. Well, good question. Scott was asking about currency.

So what we do is, when we give guidance, we're essentially hedged for a greater majority of any exposure we have for the quarter in which we give you guidance, for the major currencies.

The only currency we get hedge accounting treatment on is the euro, so we have a longer staged hedge on the euro. We go out 18 months in a stair-step approach. So we'll be essentially fully hedged on the euro in the given quarter, and then stair-step it out over the next several.

So while if currency changes mid quarter don't benefit, there is no way to really see a meaningful benefit in that quarter because we will essentially be hedged, you can look at it as a forward benefit or expect it to be a forward benefit in -- when we give -- when we true-up guidance and give it to you for the next period.

Any other questions?

Thanks.



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