

Herbalife Nutrition Ltd (Q4 & Full-Year 2022 Earnings)

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Corporate Speakers:

- Eric Monroe; Herbalife Nutrition Ltd.; Senior Director of IR
- Michael Johnson; Herbalife Nutrition Ltd.; Chairman and CEO
- Alexander Amezcuita; Herbalife Nutrition Ltd.; CFO
- John DeSimone; Herbalife Nutrition Ltd.; Vice Chairman and Chief Strategic Officer

Participants:

- Chasen Bender; Citigroup Inc.; Research Division, Assistant VP
- Jeffrey Wallin Van Sinderen; B. Riley Securities, Inc.; Research Division, Senior Analyst
- Karru Martinson; Jefferies LLC; Research Division, Analyst
- Hale Holden; Barclays Bank PLC; Research Division, MD
- Anna Jeanne Lizzul; BofA Securities, Research Division; Research Analyst
- William Michael Reuter; BofA Securities, Research Division; MD & Research Analyst

PRESENTATION

Operator^ Good afternoon and thank you for joining the Fourth Quarter and Full Year 2022 Earnings Conference Call for Herbalife Nutrition Limited. On the call today is Michael O. Johnson, the company's Chairman and CEO; Alex Amezcuita, the company's Chief Financial Officer; John DeSimone, the company's Chief Strategic Officer; Mark Schissel, the company's Chief Operating Officer; and Eric Monroe, the company's Senior Director, Investor Relations.

I would now like to turn the call over to Eric Monroe to read the company's safe harbor language. You may begin.

Eric Monroe^ Good afternoon. On today's call, we will be making some forward-looking statements. And while we are making those statements in good faith, we do not have any guarantee about the results we will achieve. Descriptions of our risk factors are included in the documents we filed with the SEC. We will also be discussing some non-GAAP financial measures.

These non-GAAP and adjusted numbers refer to measures that exclude items management believes impact the comparability for the period referenced. Please see the earnings release for additional information on our comparability items. These GAAP to non-GAAP reconciliations can be found in the earnings press release and the slides we will be reviewing on today's call, both of which can be found on the Investor Relations section of our website.

I'll now turn the call over to Chairman and CEO, Michael Johnson.

Michael Johnson^ Thanks, Eric, and welcome, everyone. And I find it a little bit ironic that I'm talking to you on Valentine's Day, my first day back with Herbalife after 2.5 years, was on Halloween. So, I'm coming to you on 2 American holidays, and now I'm going to give you a report in my first 100 days.

I started on October 31 and immediately jumped on a plane to Cairo, Egypt in November and we met with our distributor leaders, our Chairman's Club and Founder's Circle. We did a follow-up meeting with them in Los Angeles in the first part of December to take action in the lift sales and to formulate a strategic plan for growth. We listened, we learned, we made decisions. We put a plan in place to modernize and relaunch Herbalife.

We presented it to our up-and-coming distributor leaders in Lisbon, Portugal and in Dallas, Texas, to inspire, to listen to them, to energize and to present the foundation of our relaunch of Herbalife, which we call Herbalife 2.0. This is -- was and is to our next level leaders. We have launched new promotions.

Our in-person events in 2023 alone have totaled 170. We've reached 175,000 distributors face-to-face. That's a big change from our pandemic times. We set up a digital task force made up of select distributors in our internal team to speed the time to market for Herbalife ONE, our digital transformation. We have set up 2 internal committees, a volume committee to drive growth and a margin committee to manage cost.

With all that said, there's no way to get around that we are disappointed in our performance for fiscal 2022 and our last quarter. Our fourth quarter net sales of \$1.2 billion were down 10% from the prior year. On a constant currency basis, sales were down 4%. Our full year net sales of \$5.2 billion were also down 10%, but on a constant currency basis, down 5%. The strength of the dollar has obviously impacted our EPS as well. Our full year adjusted EPS of \$3.40 was impacted by a \$0.60 currency headwind. We generated significant cash flow in 2022. Our FY operating cash flow was over \$350 million. Through our cost management efforts in the fourth quarter, we maintained adjusted EBITDA flat to the fourth quarter in 2021.

Now on to the future. And here's my promise. Our sales will grow, and our results will improve. I'm fully aligned with our Board, our investors, our distributors, and our employees to usher in a new era of growth for Herbalife. Here's our vision on how we're going to deliver.

Our business is built on 2 major platforms: our content and our distribution. Our content is our product. We are going to grow our product portfolio to position Herbalife as the premier public health and wellness company.

We started in 1980 as a weight loss company. We evolved in the 2002, a nutrition company. Today, we are launching ourselves into the future to be a public health and wellness company. New products, new services, coaching, wellness evaluations available through our distributor platform for our customers, we shall see this company grow. We have enormous opportunity to grow our company through enhancing our daily nutrition products with expanded lines such as vegan and choices and proteins. We are expanding Herbalife24 to include new product enhancing our current ingredient profile.

We've actually brought back the founder, the creator of Herbalife24, a product that expanded our distributor base to our consumers and to our distributors. We are exploring opportunities for sleep products and coaching. We will continue to build upon our weight management platform.

We have other categories we're exploring regionally. In India, which is a growth market for us, our product line is unique to that market. We are unleashing products regionally in Europe and Asia and China, and we'll look forward to synergies and opportunities to globalize some of our regional product offerings.

Our plan is to reach more consumers with more offerings through our distributors than ever before.

Our next platform is distribution. And it's our distributors that give a voice and a passion, if you will, to our product. Our distributor base, it's global, 95 markets. Our entrepreneurial distributors have a unique relationship with their consumers. Today, we're modernizing our compensation structure, including new promotions to energize and incentivize our distributors to make it easier to earn early in their journey.

Through our digital platform, we will accelerate the transference of data to better understand our consumers and our preferred customers to work alongside our distributors to enhance their sales, which brings me to our digital platform, Herbalife ONE.

This is our largest investment ever. Our digital platform, Herbalife ONE is transformational. It will accelerate data actions. Herbalife ONE will be our first-ever unified data-powered global digital platform that will enable growth by delivering best-in-class digital experience for distributors and consumers around the globe. From simplifying sign-ups to providing a best-in-class e-commerce experience with enhanced data analytics to suggested and targeted selling features, Herbalife ONE will modernize, differentiate and strengthen our leadership in the marketplace.

Data visibility is improving in Herbalife, but we want to do it better. We need better data utilization, and we know it. Where else? Our brand, we are refreshing our brand. We're relaunching it, which allows us to operate in a variety of verticals. We will roll it out at our leadership event in 1 month from today.

Our vision? It's both short term and long term. Our plan to return to growth in the near term is made up of a well-defined plan. It's growth for the short term. Let's recruit and retain customers and distributors, pretty simple; expand Nutrition Clubs, high opportunity by analyzing metrics and giving more information and data to distributors entering this highly profitable area.

Growth Preferred Customer Programs. We are enhancing data analytics to take action on the data we are collecting in order to drive growth. And we need to better maximize the usage of our data for visibility and opportunity. Distributor contribution or compensation enhancement, as I mentioned before, we are creating economic incentives and promotions to motivate, drive and reward distributor activity.

I said it before, I'll say it again, we need to improve visibility, improve our data and analytics, high-tech, high touch in this company. Herbalife ONE will be the underpinning of our operations going forward. Today, we are saying we have no guidance in our forecasting because we just launched new initiatives and need time to analyze and digest before we can accurately forecast into the future.

On margin enhancement, we have \$70 million of ongoing efficiencies identified through our Transformation Program. We are making difficult and, frankly, unpopular decisions, 7% reduction in our global workforce, price increases in 2023, zero-based budgeting, every expense to be analyzed, including our professional fees, but we are still investing for growth as you've seen in Herbalife ONE.

Personally, I'm focused on getting Herbalife (inaudible) again. It's the only Herbalife, I know, how to grow volume, build content, enhance our distribution, and create better margin opportunities. We have a shared vision with our distributors and management for building customers and building distributors' businesses stronger. This is our Herbalife of today. It's our Herbalife of tomorrow, and it's our promise to you.

So, let's take it over, Alex, and show them what we got.

Alexander R. Amezcua Thank you, Michael. Michael left you with a vision of where we are headed and the plan that will return Herbalife to growth. I'll begin my section with the key takeaways for today's call.

First, fourth quarter net sales of \$1.2 billion were down 10.4% compared to the prior year. Although currency pressure eased towards the end of the quarter, the U.S. dollar remained significantly elevated over the prior year, driving a 620-basis point currency headwind to net sales.

Second, despite the net sales decline, focused cost management efforts during the fourth quarter contributed to adjusted EBITDA that was approximately flat with the prior year.

Third, over the past 90 days through Michael's leadership, we are aligned in a well-defined plan that will focus the company's efforts to improve distributor metrics and ultimately return Herbalife to growth.

Fourth, while we are optimistic about revitalizing the top line, we are actively controlling expenses to manage margins and maximize profitability. We've expanded and accelerated our previously announced Transformation Program, which is now expected to deliver annual savings of at least \$70 million, with approximately half of these savings being realized in 2023 and the remainder being realized in 2024 and thereafter.

Fifth, during the fourth quarter, we took steps to secure our balance sheet. In December, we issued a new convertible note due in 2028 using all proceeds of the transaction to repurchase a portion of convertible notes due in 2024. In addition to the refinancing, the company

strategically paid down its revolver and with scheduled amortization payments, we reduced our nominal debt by approximately \$60 million.

And sixth, we will not be providing guidance for 2023 on today's call. While we anticipate the trends, we observed in the third and fourth quarter to continue into the first quarter, there are also growth initiatives being put into place and will need to observe traction before incorporating into our forecast. Further, the macroeconomic conditions continue to create a backdrop of consumer behavior that is challenging to predict.

Reported net sales for the fourth quarter declined 10.4% compared to the prior year and down 4.2% on a constant currency basis. Reported net income of approximately \$54 million resulted in adjusted EBITDA of approximately \$131 million, which was in line with the prior year. Adjusted EBITDA margin in the quarter was 11.1%, an improvement of 110 basis points compared to the fourth quarter of 2021.

Reported EPS of \$0.55 resulted in adjusted earnings per diluted share of \$0.53. Adjusted EPS was negatively impacted by year-over-year currency headwind of approximately \$0.25.

During the fourth quarter, as previously communicated, the company strategically reduced approximately \$60 million of our outstanding debt. We ended the quarter at 3.47x gross debt to adjusted EBITDA, which is above our target leverage ratio of 3.0x. The company plans to use free cash flow generation in 2023 to reduce our overall debt as we continue to work towards our long-term target leverage.

For the full year, net sales declined 10.3% compared to the prior year. We experienced a year-over-year net sales headwind in all 4 quarters this year with a full year impact of 490 basis points. Local currency net sales declined 5.4% in 2022.

Reported net income of approximately \$321 million resulted in full year adjusted EBITDA of approximately \$694 million. Adjusted EBITDA margin for the year was 13.3%.

Reported EPS of \$3.23 resulted in adjusted earnings per diluted share of \$3.40. Adjusted EPS was negatively impacted by year-over-year currency headwind of approximately \$0.60.

The company generated over \$350 million of operating cash flow in 2022. The impact of our working capital accounts improved in 2022 over 2021 and we will continue to focus on working capital initiatives to improve cash flow generation as we move into 2023.

Drilling into fourth quarter net sales, where we benefited from 12.7 percentage points of pricing from price increases influenced throughout the year. Unfavorable country mix, primarily driven by significant outperformance in India resulted in a net sales headwind of approximately 270 basis points. Local currency net sales for the fourth quarter was down 4.2% compared to the prior year. U.S. dollar weakened towards the end of the quarter against most major currencies but were still materially elevated compared to the fourth quarter of 2021.

For the full year, volume declined 10.1%. Unfavorable country mix resulted in a net sales headwind of approximately 320 basis points. The full year average of the price increases taken over the course of the year resulted in a net sales benefit of 7.9 percentage points. The U.S. dollar strengthened significantly over the course of the year before a modest pullback towards the end. This resulted in an FX headwind to net sales of 490 basis points for the full year.

Moving to EBITDA margins, where adjusted EBITDA of \$131 million resulted in adjusted EBITDA margin of 11.1%, which was in line with the prior year despite a 137 -- despite a \$137 million reduction in net sales. EBITDA benefited approximately 400 basis points from our price increases. Despite the pricing benefit, gross profit of 77.5% was flat with the prior year as we continue to be impacted by elevated input costs in our supply chain. These cost increases to raw materials, manufacturing overhead and freight drove an EBITDA margin headwind versus prior year of approximately 170 basis points.

Consistent with the third quarter, within SG&A, we experienced an approximate 120 basis headwind related to our promotional spend. This headwind was largely due to the return of in-person events in most regions as well as the return of more normalized promotional spend.

We continue to see the positive impact of our cost-saving initiatives in labor and benefits. During the fourth quarter, we benefited by approximately 80 basis points of EBITDA margin expansion due to efficiencies and targeted strategic improvements, leading to favorable margin impact even after absorbing the impact of annual wage increases. As mentioned earlier, currency had a significant impact and led to an additional approximately 170 basis points headwind on EBITDA margins.

Full year adjusted EBITDA of \$694 million resulted in an adjusted EBITDA margin of 13.3%, which was approximately 170 basis points lower than fiscal year '21. Full year gross profit of 77.4% was approximately 120 basis points unfavorable from the prior year as approximately 210 basis points of price benefit was offset by elevated input costs in our supply chain, which negatively impacted EBITDA by approximately 130 basis points in addition to FX and other impacts such as country mix.

Within SG&A, we experienced an approximately 110 basis points headwind related to events and promotional spend. Labor and benefit cost savings initiatives, which were largely executed in the back half of '22, contributed to approximately 30 basis points of EBITDA expansion for the full year. Currency had a significant impact across the P&L and led to an approximately 70 basis points headwind on overall EBITDA margins.

For the quarter, Average Active Sales Leaders of approximately 480,000 was 6% under last year and slightly reduced from second and third quarter levels. Performance was supported by the continued outperformance of India.

While the Q4 metric followed our usual seasonality compared to second quarter and third quarter, new distributor and preferred customers joining the business declined 1% compared to the fourth quarter of 2021. New distributor and preferred customer growth is a key focus area as

we move into 2023. We have implemented new global initiatives in addition to market-specific action plans aimed towards improving this metric with several strategies underway.

Turning to our regional results for the quarter where the Asia Pacific region was flat compared to the prior year. The region was led by India, which grew 22% and Vietnam, which was up 9%. The EMEA region saw a 3% decline in local currency net sales, which was materially amplified by 12 points of currency pressure in the quarter, resulting in reported net sales of down 15%.

Within the LatAm region, Mexico returned to growth, increasing 8% compared to the prior year but was offset with declines in Chile, Colombia and Brazil.

Beginning in 2021, we initiated a Transformation Program to optimize global processes for future growth. The Transformation Program involves the realignment of infrastructure and the locations of certain functions to better support distributors and customers. In the back half of 2022, we began to see the benefits of these initiatives. We have expanded the scope and accelerated the program, which is now expected to deliver annual savings of at least \$70 million with approximately half of these savings being realized in 2023 and the other half being realized in 2024 and thereafter.

We also expect to incur total pretax expenses of at least \$60 million to realize these run rate savings. We have already incurred total pretax expenses of approximately \$25 million through the end of '22.

Turning to cash flow. And while our cash generation ability remains strong, free cash flow in 2022 was below historical run rates. For 2023, we will continue to execute on the initiatives to optimize working capital that began in late 2022. Despite a higher level of expected capital expenditures in 2023 versus 2022 through margin initiatives and working capital management, we expect to generate a higher level of free cash flow in '23 versus '22.

Turning to capital allocation. Our long-term use of cash prioritization as a company remains unchanged. As always, our #1 priority is to service our debt and as I have previously mentioned, during the fourth quarter, we strategically reduced our debt by approximately \$60 million as we remain prudent with cash given the difficult macro backdrop. We plan to use free cash flow generated in 2023 to continue to reduce our nominal debt levels.

This concludes our prepared remarks. Operator, please open up the line for questions.

+++ q-and-a

Operator^ (Operator Instructions) Our first question comes from the line of Chasen Bender with Citi.

Chasen Louis Bender^ Great. Where I'd like to start is on the Herbalife 2.0. It sounds really exciting with all the new products and offerings and tools and brandings, what have you. But I was hoping maybe you could wrap some additional commentary around that. In terms

specifically of kind of timeline and rollout and how you plan to manage the execution of all of those moving pieces without it being too disruptive? And then also specifically, in terms of any extra investment for this initiative on top of what it was the \$400 million that you called out related to Herbalife ONE?

Michael Johnson^ Okay. John, this is Michael. John DeSimone and I will [tag team here] on the answer here. One is it's going to be additive and not disruptive. Our distributors have wanted and needed a better platform in which to operate their business. We will lay out for them in March at our event here where we have the Worldwide Leadership Forum here in Los Angeles. We will roll out for them what opportunities are available when and we will timeline it as we launch Herbalife ONE, which is the digital transformation in the company.

Product wise, we are consistently and continually launching new products in regional markets as well on a global footprint. Bringing back the creator of Herbalife24 was a huge boon to us. That created new distributors. It created new consumers. It created new opportunities for distributor methods of operation inside our company. And we're looking to do the same with some of what we call the vertical rollouts by exploring new areas, some which will be successful, and some may be less successful. But we're going to look at a variety of opportunities along that line.

Now let me turn it over to John to talk about probably some of the enhancements around the marketing and compensation plan.

John G. DeSimone^ Yes. I'll take -- I shall take it on some of the initiatives that were discussed in Michael's opening. So, I think the key takeaway is a lot of the actions are, a, either staged in a way that they're manageable; or b, with making some changes internally to handle the incremental work that's needed. So, I'll see if I can hit them all at once.

So, we talked about growing Nutrition Clubs. That's really data analysis on our side and providing that data to our distributors, providing best practices to our distributors and the work is on their end to open it. So, we provide the information, but that's -- the efforts are much more in (inaudible).

When we look at Preferred Customer Program and the enhancement of the Preferred Customer Program, in a way that generates more sales for our distributors, that's data analytics. That comes in 2 phases. There's the manual phase that we're doing now and then there's the AI phase, and that's going to happen as Herbalife ONE comes on board. So that's going to be staged with Herbalife ONE as that gets implemented.

When we talk about product content, there is going to be a lot of work on product content and launching new products. One of the initiatives we've initiated with the help of our distributors is a SKU rationalization program to free up resources to be able to do that. The SKU [rat] program will have a minimal impact on sales. We've got plenty of SKUs that I think we can roll off in a planned way without impacting our distributor sales.

And then it goes to the marketing plan, which is the one that we call a marketing plan, it's the distributor compensation plan. I think that's maybe a better choice of words. And it's what -- how our distributors get rewarded. And one of the things that we've done is we've made our bonus plan, part of the distributor compensation plan is a bonus, and we made that bonus more accessible to more distributors. And we think that's something we can do immediately. That was in programming. That's already been done. That's the beginning of trying to optimize the compensation plan regionally and maybe even our country level. But a lot of that work has been done. And that's something that we'll be able -- that we could do immediately, and we think it's going to drive activity and engagement at the distributor level. And so, it's all done in a very planned phased-in approach with mostly current resources.

Chasen Louis Bender^ Got it. Super helpful color. And then maybe one for you, Alex. Just in terms of not providing guidance, obviously, I get that you roll through all of these new initiatives, and you need time to digest them. But when I think back when you pulled guidance last quarter, one of the reasons you highlighted was essentially KPIs changing at the same rate or simultaneously as sales. And I think in the press release, you called out seeing some stabilization on a global basis in terms of KPIs and business trends.

So, the question is, how do I balance those 2 ideas? And maybe is it something in key geographies where you're still seeing that rate of change happening at the same time? And then kind of, 2, ultimately, what does it take for you to get to a place where you can issue guidance?

Alexander R. Amezcua^ Well, I'll start with the end, right? So, there's been long periods of times where we have been able to provide guidance and our business has been predictable enough that we largely were able to meet those guidance that we provided. Over the past couple of years, whether it be the pandemic environment, coming out of the pandemic environment or going into the sort of global situation that we're going now from an economic standpoint, it created an environment where that long history of predictability is not present in a moment.

You couple that with all of the initiatives that we're launching from a growth perspective, and you just create a situation where right now, providing guidance isn't something that we're able to do. We don't have the traction, the observable traction of how those initiatives are going to take place in the marketplace. We have a lot of confidence that they will be additive, and they will help return us to growth. But the timing, the rate of change, all of these types of behaviors in this backdrop, we don't have a lot of models to be able to go to it and say, this is -- we're confident enough to give you investor or you analyst guidance that this is our path. We're confident in the strategy. We're confident that we'll get to the endpoint, but the timing of that right now, we need some time to see how that's going to progress.

Operator^ Our next question comes from the line of Jeff Van Sinderen with B. Riley.

Jeffrey Wallin Van Sinderen^ Multipart question for Michael, if you can bear with me. Now that you've had some time to assess, Michael, analyze, formulate a plan to reinvigorate the business, what do you believe were the primary mistakes that were made under the prior regime? And given that you've laid out some high-level initiatives here, how much of the turnaround plan is around product content? I know you mentioned SKU rationalization, but

how do new products play into the plan? Where is the emphasis there? And then additionally, how much of the turnaround elements are around distribution? Maybe you can kind of weigh that for us?

Michael Johnson^ So on the first part of your question, I had a mentor say to me a long time ago, you're never going to get anywhere looking in the rearview mirror for too long. Look out the windshield, see where you're going. So everybody in this company has worked incredibly hard. Our distributors have worked incredibly hard through a very tough time, macroeconomic headwinds. Those are the favorite words of everybody.

I tend to look forward. And so to answer the second part of your question is our product is vital to us. It's our content. And it is the underpinning of the success in our marketplace with distributors and consumers. What we need to do now and be better with our content is a couple of things. We have to look at our ingredient profile and be more in tune with the times. We have great product. Our product today is one of the best meal replacements there is out there. We want to shift people from a fat, salt and sugar diet to a healthy diet of proteins and carbohydrates and branched-chain amino acids, and I could get going with all of the molecular structure of nutrition (inaudible), but I'm going to spare you that discussion right now.

But we have to get more in tune with what's going on out there in the sleep horizon and the anxiety horizon. How can we, as a company, better address the needs of consumers across the platform. As I said in my little opening there that we started out as a weight loss company. We shifted to a high-performance nutrition company. Now we're going to even take it further and deeper and wider with our verticals, and we'll use the digital platform to enhance all that and get tools of selling to our distributors and give an opportunity to our consumers to have a general wellness in their life.

I'm sure that sounds like a sales pitch, but ultimately, I'm a salesman. And I'm here to see this company grow through its content. I'm here to see it grow through its distributor opportunity and its consumer uptake of our products into the future. So we will expand those content lines. We will expand those product lines. We will figure out better opportunities for distributor preferences and consumer preferences and find the way that our distributors best sell to our customers and enhance that with content that delivers on that promise.

Jeffrey Wallin Van Sinderen^ Okay. And then just sort of as a follow-up to that, the new product content, fair to assume that, that will be all internally developed?

Michael Johnson^ That's not fair statement right now because I think we need to widen our approach a little bit in here. Our distribution is global. And I'm sure there's people out there that would love to have their product on a global platform. So we're not going to shy away from talking to other people. Herbalife24 was actually an acquisition on our part. It was a small company called Prolong headed up by the gentleman who's coming back to join us now. I actually met him at a bike event and saw him selling the product or sampling the product out of the back of his car. It's an amazing story. It was like a young Mark Hughes there.

And when we started to get close to them, we tested this product through our science and our laboratories here through our [MNRI] machine. And we realized it was a very strong product. We purchased the company. Brought him in. It was an acquisition. And then grew that to be, I don't know, what an \$800 million product line, Alex? From a \$20,000 locally sold product. We're going to open the door to attract more people like that into our company and say, we can give you a global platform on your product and work with our distributors to best figure out the compensation model to enhance their business and then use our digital platform to reach out to more consumers for suggestive selling. This is the Herbalife for the future. This is the one we're excited about.

Jeffrey Wallin Van Sinderen^ Okay. And then, Michael, since you came on, have you evolved the Herbalife ONE initiative?

Michael Johnson^ I don't think I've evolved it. I may have sped it up a little bit much to the (inaudible) few folks. The one thing we did do is we took a -- we had a very large distributor group involved, almost 40 people involved in biasing the company. We shrunk that down to 6, is that (inaudible)? We shrunk that down to 6 distributors who have really super mindsets in the area of data, social media, how to best use the opportunity of the digital platform to sign up distributors and build that opportunity throughout their framework of their business. And so, we're speeding it up. And we're going to be launching and testing that out in a couple of markets very soon. We'll have that data for you on the next earnings call, and we'll be -- we're pretty excited about it.

Operator^ Our next question comes from the line of Karru Martinson with Jefferies.

Karru Martinson^ It was nice to see the trend stabilize here in the fourth quarter and getting some traction, it seems from what the turmoil in the first half of the year. When you say that those have continued into the first quarter, should we be looking at the first quarter similar to the fourth quarter results? Or how should we think about the cadence of that going forward?

Alexander R. Amezcuita^ Yes. So, thanks, Karru. Thanks for the question. I think we're just making a general comment that we have a lot of initiatives in our plan where we're suggesting returning to growth. We just don't want there to be confusion that, hey, we're returning to growth in the first quarter. We still see some of the trends that we're seeing in the third and fourth quarter, which obviously is top line decline, generally speaking, with distributor metrics that we still want to improve off of where they are.

So, what we're suggesting is that the first quarter probably has seeds planted for that return to growth but probably financial results that are more consistent with the second half (inaudible).

Karru Martinson^ Okay. And then when we look at the cash flow generation for the year, where will we be kind of applying that? Is that still kind of revolver pay down or should we be addressing those '24 converts that are remaining? How do you feel about the '25 that are outstanding? What's the big picture there for you guys?

Alexander R. Amezcuita^ Yes. So, cash flow generation, as I mentioned, will be going towards either nominally paying down our debt or we'll be parking it for the 2024 -- for the sub-piece of the 2024 converts that are due in the beginning of next year. It will be going to things to improve our overall gross leverage ratio. So, whether that be top line reduction in nominal debt or parking for future optimization of our debt capital structure. That's what cash flow generation in 2023 will be going to.

Karru Martinson^ Just lastly, from a long-term picture here, when you implemented Herbalife ONE and Herbalife 2 and you put in the new compensation structures and the new product and executed on the cost saves here, do you think that long term, your growth -- gross margin should be at their historical levels? Or is there a new kind of level that we should be thinking about from a long-term perspective for you guys?

Alexander R. Amezcuita^ Yes. I mean, fundamentally, the -- our current gross profit level, where we ended 2022 is probably 3 points away from our run rate. That's a way from where we want to get this company back to. Now with -- even though that input costs, the rise of that, whether that be through ingredients, freight or factory floor wages, while there has been some modest improvement versus where we were in 2021, and I really mean improvement in the rate of change or the rate of increase, it still is at levels that is sort of commensurate to where CPI is today.

So, as we move into 2023, even with pricing action, we think that the near term is largely we're going to be treading water on a gross profit line. There still needs to be things that happen structurally in the supply chain and things that are happening structurally for us to be able to take price in and above where our input costs are before we start making progress on the gross profit line.

So long answer to simply say, we're doing what we can to improve the gross profit line, but there are structural limitations and consumer demand limitations right now that are not necessarily allowing us to recover all of that in the near term, but our long-term plan is to recover that gross profit margin loss.

Operator^ Our next question comes from the line of Anna Lizzul with Bank of America.

Anna Jeanne Lizzul^ I understand that you're not providing guidance for 2023 currently, but I was wondering if you can comment on just how the business is performing so far this year in the various geographic markets? It also looks like there was some continued weakness in China in the fourth quarter, if you can touch on the volume and sales trends that you're seeing there so far this year.

Alexander R. Amezcuita^ Thanks, Anna. Thanks for the question. So we're not providing guidance for this year. We normally don't read out results that are sort of post the reporting period. Right now, we're reporting for the fourth quarter in 2022. So we'll leave our comments to what we're reporting today.

As for the performance in China in the fourth quarter, clearly, that was still impacted by zero COVID. China has come out of that zero-COVID policy near the end of 2022. And as we move into 2023, we're looking to see some of the business transformation initiatives that we began probably at the end of 2021, which was really sort of hamstrung by the zero-COVID policy of 2022. We're looking to see some of those transformation initiatives take place and take hold in 2023. So more to come on that as 2023 opens up and we see sort of how the market receptivity is to that -- to those strategic initiatives.

Operator^ Our next question comes from the line of William Reuter with Bank of America.

William Michael Reuter^ So my first question, when you were discussing the new bonus program, it sounds -- you mentioned it's more accessible to more distributors. So I guess, I would assume that, that implies that if we don't see sales growth based upon this, if it doesn't encourage greater numbers of distributors to perform better, EBITDA margins will come under pressure with the new compensation program. Is that fair?

John G. DeSimone^ No, no, it's not. This is John. It is an allocation of the dollars that we already spend on the bonus program. It's how our distributors access those dollars. So it doesn't impact margins, sales go up or down.

William Michael Reuter^ Great. Okay. Good to hear. And then I think your price increase in the third quarter was 13% on a year-over-year basis. Are we at a point now where future or further price increases are not needed? Or do you expect additional ones to be implemented in '23?

Alexander R. Amezcuita^ So this sort of dovetails on my commentary that I was giving a moment ago on where our gross profit margin is. We still haven't been able to recover the full input costs that we have been receiving in our cost to manufacture. So we're trying to be very mindful of how to recover that lost profit margin. But we're also trying to be mindful of the impact that those price increases are having in the market with respect to consumers and distributors. So it's really -- we do anticipate continuing to execute on price increases into 2023, but we're trying to do that in a very mindful way as we move through the year.

William Michael Reuter^ Okay. That makes sense. I understand. And then lastly, with regard to the capital allocation, you spoke to the fact that this year, you're going to allocate all cash towards debt reduction in one form or another. Is there some sort of target that you're hoping to achieve in terms of your leverage target had been 3x on a total gross basis? I guess I'm wondering at what point will you look to change your capital allocation policy to a more balanced one, whether it has to do with the outlook for the '24 and '25, whether it has to do with leverage? How are you guys thinking about that?

Alexander R. Amezcuita^ Right. So the target leverage at 3x is obviously our target. So when will we change out of sort of this current mode, which is really excess cash to reduce our nominal debt level? A couple of things will likely have to happen, and it's not necessarily a crystal ball, and it certainly isn't guidance for 2023. But what are the conditions that would have to be in place. Well, first, we would have to be at or near our target leverage. And secondly, I think we would have to be comfortable at that point that we have clear line of sight that we are

returning to growth that are top line. And our EBITDA, ultimately our EBITDA is on an upward trajectory where we have a denominator growth issue in our leverage ratio. So I think those conditions need to be present before we would think of changing sort of our current strategy in our capital allocation plan.

Operator^ Our next question comes from the line of Hale Holden with Barclays.

Hale Holden^ I had 2 questions. The first one on China. China has become a much, much smaller part of the business over the last couple of years, and there's been a lot of reasons for that. But I was wondering, as you talked about stabilizing and potentially growing from here, if you can grow it without margin dilution or if you have to add cost or people back in to get back to your growth profile. I'm just not sure how linear the margin opportunity there is on growth?

Alexander R. Amezcua^ Yes. I mean, Hale, you raised a good point. I mean, China now is obviously a much less significant part of our overall net sales profile. From a profitability standpoint, as we think of the Transformation Program, China is one of the components of that Transformation Program. And so we think that we can execute on margin initiatives in that market specifically while still maintaining the opportunity that we see in China. China is one of the largest consumer markets in the world. We are a global company, and we still see tremendous opportunity in that market. So while we're going to be prudent from a margin perspective and get that market rightsized for the top line that it now represents, I don't think we're giving up on the opportunity in terms of what we think we can do on the top line.

Hale Holden^ And my second one, I guess, for Michael, the number of in-person meetings you guys have held and people you've touched since the beginning of the year was pretty [startling]. And I was wondering if you could give us some examples of how people leave those meetings and then get fired up to sell because hopefully, that's the goal. But any sort of tangible on the ground feel you get back from the distributors [post]. That would be helpful.

Michael Johnson^ The best example I can give you is that when we met with our leadership in Cairo and then brought them back here to Los Angeles, there have been a group of distributors, leaders with pretty sizable businesses who what I call had kind of retired, if they're successful. They built homes in the mountains and along the oceans and were stepping away from the business. And I basically have got a promise from them to come back all in and to rebuild their organizations.

The meetings that are taking place inside of their businesses are just amazing. And it is really something to take behold of. It's hard to explain in metrics. Alex will probably have a hard time explaining it until we get the numbers back up to where we want them, get the top line up. But they're sending me videos constantly of here's a meeting in Tennessee. Here's one in Texas. Here's one in France. Here's one taking place in Asia. We've got a rallying cry for the company called LGH.

So let's go Herbalife, and they've all embraced it, it's on their sweatshirt. It's in their programs. It's in their scenery behind their Zoom calls. And we -- sometimes it takes a little spark to get a fire going. And if I'm providing that spark, fantastic, but I really think it's the distributors who

are providing that spark. They're reenergized. They're excited about where are they in. We've got a promotion. It's called -- I'm all in with Michael. I don't want to use my ego here, but it's got a pretty good uptake on it.

We're going to have all those distributors here in March to reward them for their efforts with our bonus program. But I think -- I don't know if you're here for that, but you'll see an excited and energetic distributor leadership that is going to translate into a more revitalized field sales force. And that's what we need to do. I mean I'm a sales guy. And so building the sales in this company and getting us up and building distributor opportunity, that's the name of the game right now. All the other things for content, the digitalization, we feel can build sales without those, not without content, obviously, but they will enhance, and they will grow our business and grow our consumer opportunity, our data management, all these things. I'm trying to give you my closing right now, but you asked me to -- it's hard to put a finger on. You can see the smiles on the faces, you can read the texts that are coming in, you can feel the energy in the field. Now it's got to translate to top line.

Operator^ I'm showing no further questions in the queue. I would now like to turn the call back to Chairman and CEO, Michael Johnson for closing remarks.

Michael Johnson^ Thank you very much, and thanks, everyone, for being on the call. I know we have some new voices on the call today, and we hope you take the time to understand our company in depth. Come visit us, come spend time with us, understand the metrics of our distributors, the emotion of our marketplace, the opportunity of our digitalization as we go forward.

As I said in my last answer and thank you for that question. Our distributors are energized, and we're embarking on a new and exciting Herbalife. It's time. It's the -- we're out of this pandemic malaise, and we're on to a brighter, bigger future. Our customer base is expanding. Our opportunity for those customers is only going to grow bigger. Our distributor -- distribution methodologies will get more exciting at any time in the company's history.

And kind of finally, I came back because I'm passionate about Herbalife. I didn't come back for the salary because I think you're pretty aware that my compensation is tied to the success of Herbalife, the success of our employees, our customers, our distributors, our investors, our shareholders and our Board. I'm fully aligned with all of you. And I can't wait for us to get stronger, bigger, better and report back to you on those. It may not be in the next quarter, but we're going to get there. You'll see.

All right. Thank you very much for being with us today. Deeply appreciate it. Let's go Herbalife.

Operator^ Ladies and gentlemen, this concludes today's conference call. Thank you for your participation. You may now disconnect.