

## Herbalife Ltd (Q4 2020 Earnings)

February 17, 2021

### Corporate Speakers:

- Eric Monroe; Herbalife Nutrition Ltd.; Senior Director of IR
- John Agwunobi; Herbalife Nutrition Ltd.; Chairman & CEO
- Alexander Amezquita; Herbalife Nutrition Ltd.; CFO
- John DeSimone; Herbalife Nutrition Ltd.; President

### Participants:

- Douglas Lane; Lane Research; Principal & Director of Research
- Hale Holden; Barclays Bank PLC; MD
- Sebastian Barbero; Jefferies LLC; Equity Analyst
- William Reuter; BofA Securities; MD
- Ivan Feinseth; Tigress Financial Partners LLC; Director of Research
- Karu Martinson; Jefferies LLC; Analyst

## PRESENTATION

Operator: Good afternoon, and thank you for joining the fourth quarter and full year 2020 earnings conference call for Herbalife Nutrition Ltd. On the call today is Dr. John Agwunobi, the company's Chairman and CEO; John DeSimone, the company's President; Alex Amezquita, the company's Chief Financial 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.

Eric Monroe: Before we begin, as a reminder, during this conference call, we may make forward-looking statements within the meaning of the federal securities laws. These statements involve assumptions and are subject to known and unknown risks and uncertainties that could cause actual results to differ materially from those discussed or anticipated. For a complete discussion of risks associated with these forward-looking statements in our business, we encourage you to refer to today's earnings release and our SEC filings, including our most recent annual report on Form 10-K.

Our forward-looking statements are based upon information currently available to us. We do not undertake any obligation to update or release any revisions to any forward-looking statement or to report any future events or circumstances or to reflect the occurrence of unanticipated events.

In addition, during this call, certain financial performance measures may be discussed that differ from comparable measures contained in our financial statements prepared in accordance with U.S. generally accepted accounting principles referred to by the Securities and Exchange Commission as non-GAAP financial measures.

We believe that these non-GAAP financial measures assist management and investors in evaluating our performance and preparing period-to-period results of operations in a more meaningful and consistent manner as discussed in greater detail in the supplemental schedules to our earnings release. A reconciliation of these non-GAAP measures to the most comparable GAAP financial measures is included in our earnings press release submitted to the SEC.

These reconciliations together with additional supplemental information are available at the Investor Relations section of our website, [herbalife.com](http://herbalife.com). Additionally, when management makes reference to volumes during this conference call, they are referring to volume points.

I will now turn the call over to our Chairman and CEO, John Agwunobi.

John Agwunobi: Good afternoon, everyone. Thank you for joining us on the call today. 2020 was a record year for Herbalife Nutrition. The demand for our nutrition products, combined with the tenacity and entrepreneurial spirit of our distributors, resulted in net sales of \$5.5 billion, which is a record for the company and an increase of 14% compared to the prior year. Three of our regions, Asia Pacific, EMEA and North America set annual net sales records. Fourth quarter net sales of \$1.4 billion increased 16% and represented the largest fourth quarter in company history. In fact, each quarter in 2020 set a net sales record for the respective quarter.

It was not just on the top line that we delivered notable results. 2020 net income of \$372.6 million increased 20% versus the prior year. Reported earnings of \$2.77 per diluted share and adjusted earnings per share of \$3.71 each grew by approximately 25% year-over-year. Our business continues to generate significant cash flow with 2020 cash flow from operations of \$629 million, an increase of approximately 37% versus the prior year.

Today, we also announced sales leader retention results for the last 12-month requalification period ending in January of 2021. The requalification rate was 67.9%, which increased from the prior year rate of 66.5%. There were approximately 330,000 sales leaders retained, the highest in our history. We believe this result reflects the ongoing sustainability of our business and the opportunity we offer to our distributors.

Simply put, 2020 was an amazing year, the best year ever for Herbalife Nutrition, and a testament to the strength of the company and the resilience of our distribution channel. Although 2020 was a record-setting performance year, I believe the best is still to come. In 2021, we are projecting to build off the double-digit net sales growth of 2020 and have raised our net sales guidance to be in the range of 6% to 14%. And the Board of Directors approved a new 3-year \$1.5 billion share repurchase authorization.

Yet, I also know that for too many, 2020 was a year filled with loss and unimaginable challenges. And my thoughts are with everyone impacted by the pandemic. We all must do our part to ensure that everyone remains safe. Nothing is more important.

As our distributors navigated the challenges of 2020, many were able to give back to their communities, donating products and other supplies to those who needed it the most. For this, I am grateful. Let's dig a little deeper into our regional results for the fourth quarter. Starting with the U.S., where net sales grew 32% compared to the fourth quarter of 2019. During the quarter, we continue to see strength in the underlying metrics, with new distributors increasing 17% and new preferred members increasing 44%.

At the end of the year, we had over 9,000 Nutrition Clubs in the U.S. compared to approximately 7,700 clubs at the end of the prior year. The growth in Nutrition Clubs came for more rural parts of the country, such as Alabama, Tennessee and Louisiana, where Nutrition Clubs have become embedded in small town communities.

In China, net sales declined 8% compared to the fourth quarter of 2019, along with a decline in the number of new independent service providers. In addition to some macroeconomic challenges in China, we believe 1 factor contributing to these declines is a recent enhancement made to the requirements for our sales representatives to be eligible to apply to become independent service providers. While we believe this change was a contributing factor to the decline in the fourth quarter, we believe this enhancement will ultimately strengthen our business by improving the quality of our independent service providers.

The EMEA region continued its strong trajectory with net sales growth of 31%. 36 countries in EMEA experienced double-digit net sales growth in the quarter, highlighted by markets such as Italy, which grew 34%; Spain, which was up 54%; France, which increased 57%; and the U.K., which grew 129%. The accelerated growth in new members that we had in the second and third quarters is having a positive impact on our sales leader metrics. As average sales leaders with volume points increased 18% in the fourth quarter versus the prior year.

Additionally, we have launched our segmentation initiative in 9 markets in EMEA. We are encouraged by the initial adoption of the program and the distributor engagement it is driving. We are continuing to implement segmentation around the world with 21 markets scheduled throughout 2021.

Moving to India, where we saw continued success with net sales surpassing \$100 million in the quarter for the first time in the history of the country, representing an increase of 21% compared to the prior year. Strong underlying metrics support the growth with more than 120,000 new preferred customers joining the business during the fourth quarter. The growth in India contributed to a record net sales quarter for the Asia Pacific region, which increased 14% versus the prior year. We believe we have the right strategy in place to continue delivering results.

On Friday, we will provide an update on our growth strategies at our annual presentation at the virtual CAGNY conference. The presentation will be available on our IR website. I am proud of our distributors and our employees for all they have accomplished in 2020.

Their contributions to expanding access to nutrition and economic opportunities are significant, and I expect they will only continue to grow in 2021. Congratulations to the entire Herbalife Nutrition team.

I will now turn the call over to Alex to review the financials.

Alexander Amezcuita: Thank you, John. Fourth quarter net sales of \$1.4 billion represents an increase of 16% on a reported basis compared to the fourth quarter in 2019. Our net sales performance for the fourth quarter once again showed the strength of our geographic diversity. In our 5 largest markets, the U.S., India and Vietnam had net sales up double digits, while China and Mexico were down. Yet as a company, net sales were up 16%.

For the fourth quarter, we reported net income of approximately \$73.8 million or \$0.59 per diluted share and adjusted earnings per share of \$0.71. Currency continued to be a headwind and had an unfavorable impact of \$0.07. Note that our adjusted earnings now includes the impact of China grant income. For the fourth quarter, adjusted earnings includes China grant income of \$1.5 million as well as expenses related to the China growth program of approximately \$6 million. Adjusted results from all prior year periods have been updated to include China grant income.

Reported gross margin for the fourth quarter of 78.1% decreased by approximately 300 basis points compared to the prior year period. The decrease was largely driven by the unfavorable impact of foreign currency, increased inventory write-downs and the increase in freight costs related to orders being shifted to home delivery versus member pickup as a result of COVID-19, consistent with the second and third quarters of 2020. The negative impact to cost of sales from home delivery is expected to continue in 2021.

Fourth quarter 2020 reported and adjusted SG&A as a percentage of net sales were 36.5% and 36.4%, respectively. Excluding China member payments, adjusted SG&A as a percentage of net sales was 29.2%, approximately 130 basis points favorable to the fourth quarter 2019, which was largely due to a decrease in member promotion and event costs as a result of delays, cancellations and reformatting of promotions and events due to the COVID-19 pandemic.

Our fourth quarter reported effective tax rate was approximately 34.8%, and our adjusted effective tax rate was 28.8%, which was higher than our year-to-date tax rate due to unfavorable changes in our country mix for the fourth quarter and was within our expectations.

Turning to the full year. Reported net sales of \$5.5 billion increased 14% on a reported basis. Adjusting for foreign exchange impact in Venezuela, net sales for the year increased 17%. 2020 reported net income was \$372.6 million or \$2.77 per diluted share compared to reported net income of \$311 million or \$2.20 per diluted share for the full year 2019. 2020 adjusted diluted EPS was \$3.71 and includes China grant income of

\$14.5 million and expenses of approximately \$13.7 million related to the China growth program.

The full year was negatively impacted by approximately \$0.28 per share from foreign currency fluctuation. On a constant currency basis, adjusted earnings per share grew approximately 34% compared to 2019. Our full year adjusted tax rate of 22.7%, which improved approximately 280 basis points from our 2019 adjusted tax rate of 25.5%.

We are issuing guidance for the first quarter 2021 as well as updating our full year 2021 guidance. For the first quarter, we estimate net sales to be in the range of 8.5% to 16.5% growth, which includes an approximate 200 basis points currency tailwind versus the prior year. First quarter reported diluted EPS is estimated to be in a range of \$0.95 to \$1.10 and adjusted diluted EPS to be in a range of \$1 to \$1.15. Reported and adjusted diluted EPS include a projected currency benefit of \$0.06 compared to the first quarter of 2020.

For the full year, we are increasing our net sales estimates to be in a range of 6% to 14% growth on a reported basis, which includes an approximate 340 basis point tailwind due to currency. Constant currency net sales are slightly increased to a range of 2.6% to 10.6% growth from the previous range of 2.2% to 10.2%.

We are raising full year 2021 guidance for reported diluted EPS to a range of \$4.05 to \$4.55, along with adjusted diluted EPS to a range of \$4.25 to \$4.75. The \$0.60 raise versus prior adjusted EPS guidance is primarily driven by favorable currency movement along with the impact of share repurchases, including the \$600 million share repurchase we completed in early January.

EPS guidance excludes the impact of any future China grant income and expenses related to the China growth program, future share repurchases and excess tax benefits from equity exercises.

Turning to cash flow, capital structure and our share repurchase activity. Our business continues to generate substantial cash flow. Operating cash flow of \$629 million grew 37% compared to 2019. This contributed to a little over \$1 billion of cash on hand at the end of 2020. Adjusting for share repurchase completed in January and the drawdown on our revolver, we currently have approximately \$600 million in cash. As John mentioned, the Board approved a new 3-year \$1.5 billion share repurchase authorization.

Related to the balance sheet. Earlier this month, we announced an amendment to our existing \$733 million term loan B credit facility that reduces the interest rate by 25 basis points. Excluding the cost of the transaction and future principal payments, the lower interest rate will save the company approximately \$8 million in interest costs through maturity.

Continuing to improve our capital structure remains a key focus as part of our overall strategy to deliver value to our shareholders. This concludes our prepared remarks. Operator, please open the line for questions.

## QUESTIONS AND ANSWERS

Operator: (Operator Instructions) Our first question will come from Doug Lane with Lane Research.

Douglas Lane: Staying on the China growth program. And just could you give us your thoughts on why the change there in the adjusted EPS for that line.

Alexander Amezquita: Sure. So it's a change from our adjusted EPS. Effectively, as we've been dealing with the China growth program now for a number of years, we had a contract renegotiation this year. And as we reevaluated the treatment of that income, it was determined now that we're a few years into this, that it is recurring in nature. We can't simply say that it's nonrecurring. We have an expectation that we may receive these funds in the future.

So it's simply treatment, a few years of more knowledge or renegotiation of a contract and an expectation that, that China grant income would be -- we can no longer say it's nonrecurring.

Douglas Lane: Okay. I mean that's fair. Now if you do spend that money -- and the spending of that money was included in your results previously, correct?

Alexander Amezquita: Correct. So it feels like we're now matching the income with the expenses, albeit, the China grant income is unpredictable. We don't know when we will exactly get it, and we have more control on how we can spend it. So we may have some volatility in matching the income with the expense. With that said, over a long period of time, you would see matching of the expense with the income.

Douglas Lane: Okay. Fair enough. Shifting gears, Alex, I think on the third quarter call, you mentioned there would be more advertising and promotion spending in the fourth quarter because you acknowledged an underspend there, obviously, with COVID earlier in the year, and it doesn't sound like that happened. So can you just update us on where you think advertising and promotion -- why it didn't really expand in the fourth quarter, what we should look for that going into 2021.

Alexander Amezquita: Well, actually, Doug, we did spend more this fourth quarter than we did in the fourth quarter of 2019. So I think that you did still have some of that spend that we thought would have in Q2 and Q3 did hit in Q4. It was still an underspend relative to our expectation. That still the nominal dollar amount in Q4 2020 was significantly higher than Q4 of 2019.

Douglas Lane: And that should continue, right? So I mean we should view 2021 as having a higher SG&A as a percent of sales than 2020, correct?

Alexander Amezcua: That's right. So as we go into 2021, the biggest issue with 2020 was in reacting to the COVID-19 situation. We couldn't mobilize fast enough. We did get some promotion in. We did do some virtual events. But there wasn't enough time to reappropriate all of the funds that we normally would for ROI-positive promotions and events.

Now that we have the benefit of more time, now that we have the benefit of stabilization in this COVID-19 world, we do anticipate being able to fully spend the advertising and promotion event-type spend that we would normally do, we feel like we have the necessary lead time to make sure that we could put those monies to work.

Douglas Lane: Okay. Good. And just lastly, looking at the numbers in the second and third quarter, there was a huge spike in new members that I don't remember those kind of numbers in the recent past anyway. So could you update us on -- now that we're a couple of quarters into it. How is the behavior of the new members from last summer as far as advancing the leadership, productivity, all those kind of things and trying to think about how your sales leaders' numbers will evolve this year.

John DeSimone: Yes. Doug, it's John. I'll take this one. So the performance of the new members coming in, in Q3 and Q4 were not materially different than the new members coming in, in Q3 and Q4 of 2019 or really the recent history of any new members in any quarter, which we view as a good sign.

I think it's an opportunity for us as we focus on better improving customer retention, which is one of our long-term objectives, there's lots of opportunity. But if you're looking for the quality of the new members coming in now versus what we had seen kind of pre-COVID, they're about the same.

Operator: Our next question will come from Hale Holden with Barclays.

Hale Holden: I had 2. I was wondering in the market segmentation rollout that you're doing in EMEA, and you've done in a couple of other markets. If there is a way to kind of tease out the benefit you've seen there from the overall benefit the company is having on COVID -- or post-COVID this year, year-to-date?

John DeSimone: Yes, this is John. I'll take that, although it isn't going to be much of a tease because it's pretty early, right? Most of the European markets that launch segmentation did so in December of 2020. We had a few in Russia -- in the Russian-speaking markets that did in August. So it's early.

But what we've seen from the markets that have launched it prior to 2020, of course, is it's a big advantage. And I think it's created a lot of demand from our distributors to launch it in a lot of other countries. So we're in 13 countries right now. We're going to do

another 21 in this year in 2021, ironically. And so that will give us 34 markets out of our 95, but it will give us coverage of a little over 80% of our sales.

And so the benefit ultimately there's direct interaction between the customer and the company, a transaction, which the system can then help leverage for improved productivity on behalf of the distributor. To be clear, it's still distributors' customers. So we've seen a lot of good utility from the program so far, and we're expecting a lot from it in the future.

Hale Holden: Great. And then my second question is, if you can give us a little bit of color on the change in requirements in China in the fourth quarter for your independent distributors there. And how that results in a little bit of churn down, I guess, in the number.

John Agwunobi: Yes. Look, it's not the only thing. Let me just be clear, right? I mean China has got a handful of initiatives now that we're launching this year in 2020 or have just launched that are in the really early phases to overcome really a changing landscape in China, right? That changing landscape is really the reduction in meetings that we thought were much more temporary than they turned out to be. And we needed some strategies in technology and product and Nutrition Clubs. And I'll go through each of those, if you'd like.

But specifically to the ability of a distributor to qualify to become a service provider. A portion of their sales, or a portion -- a little less than 40% of their sales has to come with customer transactions through the company's system with the customer visibility. So think of it as just almost a promotion of the segmentation that's going on everywhere else.

Now we did something a little deeper but similar in the U.S. a few years back when we implemented the segmentation that was required as part of our settlement. And when you implement a shift with a distributor base, there's just time it takes to overcome and implement. In the U.S., it was 6 to 8 months. I don't know what China will be, but kind of think in that same time frame.

But that's not the only thing that's happened. That was just one of a handful of things. I think from a technology standpoint, we launched the personal store last year, and that's more of an online transaction system. But that's 1 of 4-step digital transformation process. What we didn't launch -- or we just now launched was a beta of distributed hub, which is the distributor's business tools that will -- things like live streaming, for example.

Distributors can have live streaming events, except we have a very limited number of SPs that can use that tool because our system can't handle the number of transactions that come in with people trying to buy product during those live streaming events. So we have work to do there.

We also have signed a deal with Alibaba to provide the middleware. So the middleware will sit underneath this customer -- excuse me, the personal store for our distributors that



will interact with all of our systems. It will give us abilities to do customer promotions and loyalty programs and things like that, and that should launch in May. And then lastly, of course, is the data infrastructure piece that is out for bid right now that will turn all of these systems into AI capable by the end of this year as our goal. So there's a lot of technology-based initiatives in China.

China is a really high-end technology tool region. Consumers are used to high-end tools, and that's where we're putting a lot of our money this year. There's a handful of other strategies that I could talk about. But those -- that's the key point.

Operator: Our next question will come from Sebastian Barbero with Jefferies.

Sebastian Barbero: I was wondering if you can give us a little more details on your digital initiatives for 2021 outside of China.

John DeSimone: Yes, this is John. I'll take that, too. So the digital transformation of this company falls into a couple of buckets. So one is we've got some very easy-to-use high-end tools in a handful of markets, and we're rolling them out. And by the end of this year, most of our markets will have those high-end tools. That's step one. So that's more just creating a level playing field with the top-of-the-line tools that we have today.

We're also building more of a middleware program now that will allow us similar to what I just explained in China. We're doing that globally, too, that allow us to create even state-of-the-art tools going forward. And so those are the 2 of the key areas that we're going to invest in technology in 2021.

Sebastian Barbero: Okay. And your gross margin in Q4 was a bit more pressure than we anticipated. Wondering if you could perhaps talk about where your e-comm penetration is today versus where it was a year ago. And also talk about this penetration rate in some of the larger markets.

Alexander Amezcua: Sebastian, let me make sure I heard the question right. Are you talking about our e-commerce penetration rates?

Sebastian Barbero: Yes. In terms of shipping to -- your home delivery versus member pickup.

Alexander Amezcua: Sure, sure. Why don't I talk about home delivery. So yes, so margins continue to be pressured by home delivery. Again, given that we have a distribution network in terms of getting our product into the hands of customers and distributors that were really geared for a lot of access points that require in-person delivery, that flipped on its head this year, right, because of the lack of in-person because of COVID and lockdown.

So home delivery has become -- we've had to layer on home delivery on top of our infrastructure. And those margins, you've seen it in our gross margin continue to pressure

gross margin. We're still in a COVID-19 situation. So it's still too early for us to react in any meaningful way to be able to reoptimize our distribution network to know is our current home delivery rate here to stay? Or would we revert back to what were optimized for more of an in-person delivery once COVID-19 settles.

So you're going to see in 2021, this continued, probably at the same rate that we've seen in Q4 see that margin pressure from that aspect in 2021. It's probably somewhere around 1 point of margin, I would say, as we think of 2021.

With that said, overall gross margins should be about the same, maybe even slightly improved, as we think of other types of benefits that we can get out of our cost of goods sale online. So a point of pressure from home delivery, but hopefully, we can offset that with other benefits.

Sebastian Barbero: Got it. Okay. And want to shift gears a little bit and talk about the performance of the product portfolio. I think your growth was the strongest for the year in your sports nutrition, and wondering that has to do with a younger member base. And also talking about that, how do you think about the growth by category in 2021. And then what should we expect from the portfolio extension, I think, over the next 12 months.

John DeSimone: Yes. This is John. I'll take the beginning of that question, which is the performance of the different categories. And really, there's 3 core, right? So there's weight management, and targeted nutrition and sports. And just by way of -- for everybody else on the call, weight management grew in 2020. I'm talking volume here by -- I'm assuming net sales by 10%, targeted nutrition by 20% and sports nutrition by 25%.

And if you've seen our -- any of our prior investor presentations, there was a focus on expanding into targeted nutrition and the sports category, and that's what's driving the growth being outweighed in those 2 categories. A lot of that is coming from the expansion of certain SKUs we have in the U.S. into other markets because sports and nutrition went into China, it went into India. And I expect that sports will outgrow the other 2 categories both in 2021 and in the next few years. And I also expect that targeted nutrition will outgrow weight management over that same time period.

Alexander Amezquita: Yes. And to add on to that, Sebastian. So if you look at -- we talked about the growth rates. We talked about the growth rates of sports nutrition and targeted nutrition being accelerated from our weight management.

And if you look at our overall product mix, particularly as you compare it from 2018 to 2019 to 2020, you continue to see the diversification of our product portfolio. Weight management in 2018 represented just over 63% of our product sales. It's now under 60%. And that has been taken -- targeted nutrition now represents an incremental just over 2%, and sports and fitness represents another incremental 1.5.

So it's little bites each year as those areas of focus that we've highlighted in our investor presentations, et cetera, continue to outpace the rest of the portfolio. And we're hoping to continue to take advantage of taking share and making share in those categories.

Operator: Your next question will come from William Reuter with Bank of America.

William Reuter: In 2020, I think that your SG&A was down based upon lower event costs, less promotional activity, et cetera. So I guess the outlook for 2021, do you expect that those expenses are going to come back? Or given continued high cases, et cetera, are you still going to be posting less of those events in person?

Alexander Amezcua: Good question. So I think the large buckets of expense will be coming back. So our advertising, promotion, sales events, those types of spends, that are consistent. Historically, if you go back to 2019 and before, as a percentage of our net sales will be returning. So there will be some margin pressure as compared to 2020. Actually, I would say it the other way around 2020 was a bit of an anomaly because we didn't have that spend.

With that said, some spend like T&E, we don't anticipate that coming back right away. But I don't think that's not as big of a needle mover as our advertising promotion spend, et cetera.

So on a margin basis, I think the way that I would look at it, William, is looking at 2019 as the reference year, and approaching margin levels that are more consistent with 2019 on a constant currency basis.

William Reuter: Okay. And then just my other one, in terms of how you're going to continue -- you should continue to produce a lot of free cash flow this year. How you're thinking about uses of that free cash flow if you think you're going to pay some sort of a large dividend. I guess what are your thoughts there?

Alexander Amezcua: Yes. I don't think a dividend strategy is something that the Board has been contemplating. I think it's still the same story that we have been espousing and that our excess cash flow will return to shareholders, and the most efficient way to do that is through share repurchases. So as we sort of move into 2021, consistent cash flow generation. We'll return that consistent cash flow through share repurchases as we generate the excess cash flow. So I guess I'll leave it at that. It's our consistent strategy that we've had, and we'll continue to do so.

Operator: Our next question will come from Ivan Feinseth with Tigress Financial.

Ivan Feinseth: Congratulations on another great quarter and a great year. What were some of the leading products in the quarter and the year that drove a lot of the sales growth? And also, if -- did you experience any shortages in products because of the pandemic and issues with supply chain that if you had more of you would have sold more.

John DeSimone: Yes. Those are 2 unique questions. So first one, I'll take -- this is John. We launched a lot of new products this year. I think the ones that outpaced the normal performance of the company were sports nutrition and targeted nutrition, as we've already said. The growth rates in sports and nutrition were 140% higher than growth in weight management; and in targeted nutrition, it was 100% higher.

So that's where our focus is and has been. There is no one product launch that makes up a material part of our growth product launches generally -- I know a lot of direct sellers do it differently. Some people have big pipeline fills. We don't. We are slow builds, and you do not see material growth coming from a product launch, and we expect -- that's the way the model will continue to work. So I can't point you to any one product.

I'll just let you know, the new products are important to drive growth long term. It drives distributor engagement, right? It's something to distributors to call customers about, and that's important.

With respect to out of stock, look, we had a number of out-of-stocks earlier, first half of the year, second quarter, Q3 a little bit. I think we're pretty much caught up at this point. Q3 may had the most impact. And that was for a couple of reasons, of course, when sales growth dramatically exceeds expectations, that puts pressure on supply.

And then with workforce being a little bit limited during some of the COVID -- height of COVID, production was challenging more with third parties than with Herbalife Nutrition itself. But there was definitely some impact to sales from out of stocks, but much more of a Q3 than Q4 issue.

John Agwunobi: Ivan, this is John Agwunobi here. Thank you for your question. Just a reminder that at the category level, as was mentioned earlier by Alex, we continue to see significant growth in sports nutrition, in general, and we're very pleased to see that and in targeted nutrition as well. So the strategy for our product portfolio at a category level continues to deliver the way we hoped it would, and we expect to see more of that in the future.

The other part that I think is notable. But to John's point, no one item would be called out is the fact that we are increasingly moving to new flavors and new products at the regional level as designed by product development teams in each region. So flavors in India and particular categories of products like [diabetic] products in India are launching. We're seeing flavors in China, the new products in South America that are unique to those regions as well. Overall, I think at the category level, we're seeing significant growth.

Ivan Feinseth: Very good. All right. As far as support tech investments, what kind of demands are your distributors are looking for? Like what would they say? And what kind of investments are you going to be making in support tech? And what type of initiatives?

John DeSimone: Again, so I'll break into I'll break it into China and everything else, although they're related, but they're coming in different platforms. So like I said, in China, these high-end tools started with the personal store, but to get better functionality out of the personal store. We need that set of business tools and the middleware that ties it all together.

The middleware is almost like a -- think of the old days of a receiver, when you had all these things plugged into your receiver and your receiver plugged into the [splitters], right? Well, we don't have that. So every time you've got a personal store, you got to plug into all our different databases, and you can't run promotions that way, and you can't run a customer loyalty program. So there's a lot of functionality that will get enhanced with this middleware that goes into May.

But that is a next step to a bigger strategy, which is AI. How to use artificial intelligence to make our distributors more effective and more productive because a distributor's single most constraining asset is their time. They're almost all single-person entities. And so what you'll see -- that's a China comment, but that -- it's also a global comment is how do we make our distributors more effective and more productive with technology. And that falls into 2 buckets. One is ease of use, okay? So that's -- there's a whole focus on rolling out our best tools to every market, ease of use.

Second is then scale, is creating the technology to help our distributors service multiple customers at the same time. If the distributors had a training event, how are they also recruiting customers and servicing their customers. If they're servicing one customer, how can they also service another customer.

And so how can we give our distributors the information they need to be more effective and efficient and, therefore, retain their customers longer through artificial intelligence that happens automatically. That's the way that's coming in technology.

Ivan Feinseth: Okay. Well, how would you incorporate artificial intelligence trying to match up like additional products that somebody would use when they favor certain products? Or how would you...

John DeSimone: Yes. There's lots of ways, but what you're talking about is kind of the -- maybe the easiest way to visualize it, right? So it's almost -- people that buy -- I, as a consumer, buy product A. And then the system says, people who buy product A also liked product B and C, do you want to add it to your basket, right?

That's -- it's a lot more complex than that because we are also in the business of helping distributors generate more from their whole organization, and that can also be tied into AI. So there's lots of opportunities with AI. But what you just mentioned is one that a lot of people can understand and it is part of what we're trying to accomplish.

Ivan Feinseth: What about, let's say, population demographics of your customer base to target either product launches or potential interest...

John DeSimone: Yes, of course. Right. So we're getting -- that's fair. We're getting younger, right, as an organization, which is rare for direct seller, right? When you look at almost 60% of our new members are millennials or gen Z. And we're trying to now incorporate their views into our strategies, which include product strategy and technology strategies. So of course, that will be an important component.

Ivan Feinseth: The fact then that your client base is getting younger, is that that's why it's skewing to the growth of sports nutrition because younger people would just generally be more active?

John DeSimone: Yes. Look, it's chicken and egg, though, right? So -- but yes, and that might be also why the sports nutrition line like we're attracting younger, right? So it goes hand in hand.

Ivan Feinseth: And as we come out of the pandemic, what type of opportunities do you see with people reengaging in the economy with that -- what type of consumer demand for products. And what type of new products do you envision coming out in 2021 and beyond.

John Agwunobi: Yes, Ivan, let me jump in with a few thoughts here. So I think clearly, it's hard to predict on a country-by-country basis what the longer-term impacts of COVID might be on the economy, on people's behaviors. There are some, I think, obvious patterns that will carry forward.

I think Alex mentioned one of them, potentially home delivery could become a bigger portion of the way that we fulfill our product deliveries on a go-forward basis. It's also quite likely to expect that there'll be more physical activity, fitness, sports as people come out of their homes and reengage them in the environment around them. And the need for sports nutrition hopefully will follow that as well.

I do think that there's a general awareness of health that in our surveys and our interaction with distributors and with customers, it would appear that, that awareness is going to stick with a large portion of the populations as they come out of their COVID lockdowns. It's hard to be precise, obviously, because we're kind of looking at human behavior here.

I do think that technology is an important and powerful change that is not going to reverse. People have learned the importance of digital technology. Many of our distributors have -- who were not online, have now moved online. I think it's unlikely that they will reverse that behavior pattern. And our customers kind of -- the whole technology revolution was accelerated, and continues to be accelerated by COVID.

So I hope that answers your question. There's a lot coming. Thank you, Ivan.

Ivan Feinseth: Congratulations and wishing you a great 2021.

Operator: And our next question will come from Karru Martinson with Jefferies.

Karru Martinson: Just the changes to the China distribution model with the segmentation. Should that be a headwind, recognizing that there are other factors there at play. But how should that headwind kind of play out through the next couple of quarters until we anniversary that in the next fourth quarter. What would be the drag from that?

Alexander Amezquita: Yes, sure. So it's a change in how SPs get qualified, just to be clear, and it is a headwind. It's not the only headwind, by the way, right? So we have a headwind in the next few months in China. But that is one of the headwinds, which is the change in qualification takes time to implement and distributors take time to acclimate such change. And we've seen that in the past. So yes, I think you're looking at some headwinds for a little while.

Karru Martinson: Okay. And then just when you referenced the kind of a point of margin -- gross margin pressure with the shipping and home delivery and freight. What is the ability to push through prices? We're seeing a lot of food companies starting to talk about rising inflation for input materials and also the freight and taking pricing where appropriate. Is that something that is available to you at this point in time of the year?

Alexander Amezquita: Yes, absolutely. And let me clarify because maybe the context was taken out of context or I wasn't clear enough. So I'm not saying that there's a point in the final number of gross margin or even operating margin. What I'm saying is the home delivery impact is about a point of margin.

We have other levers that we're going to pricing being one of those to counteract the impact of home delivery such that we can deliver an operating margin that is consistent with 2019 operating margin on a constant currency basis. And referring specifically to gross margin, a gross margin consistent with what we delivered in 2020.

So the home delivery is, I guess, an impact, but I didn't mean that to represent that is going to be the final answer. Does that make sense?

Karru Martinson: Yes. Thank you very much for the clarification.

Alexander Amezquita: And speaking of pricing, it is something worth noting because we are able to take pricing. We generally have a philosophy of pricing with local inflation in the markets around the world. And if you look at our pricing, we're generally, I think, for 2020, it's been pretty consistent on a quarterly basis, but we're getting about 2.5 to 3 points of pricing on average. So we are taking price where it's responsible and where it's consistent with the inflation in that market.

Operator: Ladies and gentlemen, thank you for participating in today's question-and-answer session. I would now like to turn the call back over to Dr. John Agwunobi for any closing remarks.

John Agwunobi: Thank you. I'll keep this quick, keep it brief. First of all, 2020, a record net sales year for us as a company. Looking back on it, I think all of us are very proud of the work that our distributors and our employees put into delivering that result.

But I would note that we've seen volume growth now in 2020, in 2019, the year before that and in 2018. So there's a run here that we're pleased to see as well. Our strategy is working. It's still a very simple and focused strategy. It's -- I think -- we sometimes move the items around in terms of how we rank them. I think this year, as we look to the future, technology is going to be a big focus for us as a company.

But looking back on 2020, I think product came through for us in a big way, as has been described. And particularly, and I think it's important that we note this, that it was delivered during what I think society will recognize historically was a particularly tough year with COVID.

And I do want to just point out in closing here that many of our distributors lost loved ones this year. A number of our employees have been impacted sadly by COVID, and around the world. And that particular issue, COVID, is still here. So we're adapting on the fly. And I think it's important that I just end by saying how very proud I am of the entire team for delivering an amazing year during tough circumstances. And with that, I'll close.

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