

FINAL TRANSCRIPT

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HLF - Q2 2009 Herbalife Ltd. Earnings Conference Call

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PRESENTATION

Operator

Good morning, and thank you for joining the second quarter 2009 earnings call for Herbalife Ltd. On the call are Michael Johnson, the Company's Chairman and CEO, the Company's Executive Vice President, Des Walsh, Rich Goudas, the Company's CFO, and Brett Chapman, the Company's General Counsel. I would now like to turn the call over to Brett Chapman to read the Company's safe harbor language.

Brett Chapman - Herbalife Ltd. - General Counsel

Good morning. Before I begin, and as a reminder, during this conference call comments may be made that include some forward-looking statements. These statements involve risks and uncertainties, and as you know actual results may differ materially from those discussed or anticipated. We encourage you to refer to yesterday's earnings release, and our filings for a complete discussion of risks associated with these forward-looking statements and with our business. 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 US generally accepted accounting principles, referred to by the SEC as non-GAAP financial measures.

We believe that these non-GAAP financial measures assist management and investors in evaluating and comparing period to period results of operations in a more meaningful and consistent manner. Please refer to the Investor Relations section of our website, Herbalife.com, to find our second quarter press release containing a reconciliation of these measures. Additionally, when management makes reference to volume during this call, they are referring to volume points. I'll now turn the call over to Michael.



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Michael O. Johnson - Herbalife Ltd. - Chairman, CEO

I'm taking an extra sip of my Liftoff this morning because I had to put two in there after seeing the price -- good morning, everyone, and welcome to our second quarter earnings call. Believe it or not we had a stronger than expected quarter, led by higher net sales reflecting higher volume points in several of our key markets and a more favorable FX rate than projected. Our SG&A was lower. We had a lower effective tax rate, which was partially offset by higher cost of sales due to FX volatility, and a higher share base. These factors lead to a higher than expected adjusted EPS of \$0.78, and our guidance range of \$0.69 to \$0.73. As many of you know, last year's second quarter was our strongest of the year, making this year's second quarter our most difficult comp of 2009.

In addition to the April 2008 kickoff of our 30th anniversary celebration promotion, it was the final quarter before the 15% VAT went in to effect in Mexico. We also had a 2008 second quarter promotion in China that rewarded our sales employees when they achieved 10 million volume points in three sequential months.

Our volume point decline of 6% over -- in our 2009 second quarter reflects this difficult 2008 comparison, and was slightly better than our guidance of down 7% to 9%. We are pleased to report that sequential growth in volume points improved in three of our key markets.

In the US we were up 8%. Mexico was up 3%, and China was up 58%. In terms of local currency, our overall net sales were essentially flat with the second quarter last year. On a positive note, our top ten markets were up 11.3% in terms of net sales for the quarter, excluding Mexico and Venezuela, which as you know have specific issues which Des will expand upon in just a few minutes.

We are very pleased to have emerged from our most difficult quarterly comp slightly ahead of our plans in terms of volume points. Going forward in 2009, the year-over-year comps get easier.

To illustrate this point, in the first half of 2009, our volumes points declined 3.7% compared to the same period last year whereas if you assume the midpoint of our guidance for the second half of 2009, it implies a volume point growth rate of approximately 5%, versus the same period in 2008. This positive momentum is very encouraging as we head in to the back half of 2009, and finalize our growth plans for 2010. Another important point is that since December, our net debt has improved by \$68 million to \$133 million, reflecting our year-to-date net income along with the improvements in our working capital.

Herbalife has an enviable business model. We have a history of financial success, including strong free cash flow generation, a clean and under-levered balance sheet, a variable and scalable cost structure, improving brand recognition and an attractive value proposition operating in 70 countries throughout the world.

During these challenging economic times, our role is to provide strong leadership that creates confidence among our distributors, employees and, you our investors. Herbalife is at the intersection of health and wealth. We are in a unique and enviable position, our products help provide solutions to the global obesity epidemic.

More than 84% of our sales are in weight management and daily nutrition categories. And our business opportunity can provide additional income for those under-employed or out of work. Our Formula 1 meal replacement shake which is 30% of our sales provides distributors and their customers with the opportunity to trade up in nutritional value, and trade down in price when comparing a typical meal.

Today our brand is better known globally than at anytime in our 29-year history. Together with our distributors, we have tremendous opportunity to help change the lives of people throughout the world.



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This year, our team has been on the road, marketing and speaking with Team Herbalife, tens of thousands of distributors and our employees. Our message has been consistent, have confidence in our products, our business opportunity, the Herbalife brand, our Company, and yourself.

We believe our performance is directly correlated to the level of confidence that distributors and employees have in our Company, and the speed with which our distributors transition this confidence to business models that focus on daily consumption. With our better than expected results through the first half of the year, and our most difficult comp behind us, Team Herbalife is displaying a high level of confidence that should position us well for top-line growth as we close out 2009 and head in to 2010.

Our primary efforts remain focused on the areas of business that we can control to grow the top and bottom line of our business. Stimulating recruiting, which is a major catalyst for increasing volume. This quarter we hosted numerous distributor meetings, leadership development weekends, Chairman's Club and nutrition club tours, the DMO training sessions, along with our Asia-Pacific Extravaganza held in Korea. In total, we saw more than 45,000 distributors and their guests.

Our distributors take the energy, the training, the key messages from these corporate sponsored meetings to thousands of distributor -- Herbalife opportunity meetings and training sessions around the world. As a result of these efforts, during the quarter we welcomed 51,728 new sales leaders.

This figure is a sequential increase of 28.5% from the first quarter of 2009, and represents an improving trend from the declines we experienced in the past three quarters. This is the highest sequential growth rate since the second quarter of 2006. And most recently, our leadership team spent the entire month of July in Europe hosting three outstanding extravaganza events in St. Petersburg, Russia; Turin, Italy and Prague in the Czech Republic. We saw approximately 20,000 distributors during these meetings.

Let me comment now on the areas our business we believe which will further drive growth as we head into 2010. New country openings. We anticipate opening new two high-potential markets in the fourth quarter, Vietnam and Paraguay.

We believe that Vietnam with a population of 87 million, of which 53% were below the age of 25 at the time of the 1999 census, and which is roughly 50% larger than Korea, has the ability to be a top 10 country for us in the next few years. We made some changes in the marketing plan, one of the most important catalysts for growth in our business over the past 29 years has been improvements to our marketing plan.

We are planning to make two enhancements to our marketing plan later this year. The first change is focused on increasing new supervisor growth in developing markets. We have recently tested this change in one of our larger markets, and we are very pleased with the results. The second change is focused on improving retailing and retention, given the current economic landscape. This change will provide new distributors the opportunity to earn higher retail commissions earlier in their Herbalife career.

In the current challenging global economy, these two changes have the potential to help distributors worldwide improve their businesses. In the third quarter we expect our distributor leaders to embrace these enhancements to our marketing plan. With the exception that these changes will be -- excuse me -- with the expectations that these changes will be implemented in the fourth quarter of 2009, we believe that it can be a catalyst for growth beginning in 2010.

The third point is improving our infrastructure, to better support and grow our distributors businesses. We made a decision in 2003 to implement Oracle, and retire our legacy HB3000 system. I am pleased to report that in early July, we successfully completed the rollout of Oracle in the European, Middle East, and African territories.

This completes our Oracle rollout. With this new platform and numerous upgrades to the hardware running this software, we are now in a fantastic position to further improve online distributor experience, and open new countries at a faster pace.



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We have also worked on improving our supply chain in manufacturing. With over 95% of our products produced by contract manufacturers, we developed a strategy last year to become more vertical throughout our supply chain. By doing so, we believe we have better control of our product quality, intellectual property. And we also believe we are able to mitigate commodity cost pressures. During the quarter, we kicked off our factory expansion plans in China, and continued our evaluation for vertical integration here in the United States.

In our fifth category is product innovation. Our product innovation is focused on major product categories, supporting distributor DMO's, and entering high-growth product segments.

Within weight management and daily nutrition, which is 84% of our business, we launched a meal replacement bar in EMEA this summer. Our Formula 1 shake is our number one selling product, and is at the core of our weight management category. This new Formula 1 bar is a meal replacement qualifies as a healthy meal under EU regulations, providing a wonderful balance of protein, carbohydrates and other nutrients.

This bar will make the second Formula 1 meal much more convenient for our distributors, and of course for their customers. We continue our development work on the Satiety product, which will complement our existing product lines, and have independent clinical testing for additional substantiation. Our current plan is to introduce this new product at our 30th anniversary celebration in March 2010.

In our targeted nutrition category, we continued the global roll out of Night Works, which was developed by Nobel laureate Dr. Louis Ignarro, introducing the product in to Mexico in the second quarter. Packaging and single-serve sizing is important to us as we develop the daily consumption business models for our distributors in developing markets such as Indonesia, Brazil, India, and the Philippines.

Our goal is to make this single-size serving our top-selling products more accessible to our distributors and their customers to help drive deeper penetration into these markets. We expect the first release of these single-serve products to be introduced into the Philippines next month.

Ongoing innovation in our product formulas to incorporate the latest science and contribution from our nutrition advisory board helps keep our product line fresh. During the quarter, we introduced two new and improved products, Xtra-cal and Joint Support. Our plans to enhance the formulas of many of our top-selling products over the next year will help our distributors create excitement and interest which will help improve the retailing of our wonderful products.

We are increasing our focus on the personal care segment of our business. We are experiencing success in Brazil with our Soft Green line and are developing plans to expand that line within and outside of Brazil. With many SKUs under \$5, this product line enables distributors to upsell their customers.

We also continue to make great progress on a high antioxidant drink, which along with our new Satiety product we plan to introduce at the Company's 30th anniversary in March of 2010. Channel innovation.

Our biggest, single focus continues to be the expansion of distributor business methods that support daily consumption. As you know, in the early part of this decade, we experienced dramatic growth in Mexico, where our nutrition Club DMO was created.

As a result, Mexico's volume points increased 6 times, and volume points per capita increased to 5.4. Over the last three years our US market experienced tremendous growth as the Latin segment of the business adopted the club concept. As a result, the overall US business increased 62%, and per capita volume points increased to 2.1.



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During the past two years, we have experienced growth in Taiwan, Korea, and most recently in Brazil as the distributors in these markets embrace, train, localize and replicate the club concept in their markets. As a result, we have seen per capita volume points increase to 7.1 in Taiwan, 2.1 in Korea, just under 1 in Brazil.

You know, our Company could be six times larger if we were able to globally achieve the volume point penetration rates of Taiwan, a market we have been in for over 13 years. We are continuing to support distributor training globally on this, and other business methods that support daily consumption and recruiting, such as the weight-loss challenge in the US, road shows in Malaysia, premium Herbalife opportunity meetings in Korea, and breakfast clubs in Russia.

We believe the emerging markets should be the next countries to benefit from our focus on daily consumption DMO's. This includes markets such as India, where volume points were up 102% in the quarter, which now has more than 300 clubs. Malaysia, where volume points were up 44% in the quarter, which now has 155 clubs. And Indonesia, which is up 38% in the quarter with more than 120 clubs. We are also having initial success in the introduction of clubs in China.

We are encouraging our sales employees to become, what we call service providers, which will allow us to train more rapidly and roll out this innovative selling method in our 11 licensed provinces, along with the provinces in which we have not yet received direct-selling licenses. At the end of June, we had approximately 278 clubs, which represents a two-fold increase in the first quarter. While we are still in a test phase, this DMO is demonstrating early success.

Before I turn the call over to Des, let me emphasize once again, that in the midst of these historically unsettling times, our Company continues to prosper. Our distributors are motivated and engaged in their businesses, and confident with their futures in Herbalife.

We will continue to focus on areas of the business that we can control, improving the distributors experience and the business opportunity, introducing innovative products and packaging, strengthening our brand and image, improving our cost structure, and prudently allocating our free cash flow to improve returns to our shareholders. As a result of our current business trends and our outlook for the balance of the year, we believe volume points will grow slightly over 2008, which is a major goal for us in 2009.

We believe if it were not for the unfavorable impact of FX, our 2009 EPS would exceed our record 2008 performance. With our most difficult comp behind us, good momentum in key markets carrying us into the third quarter, a weakening US dollar, we look at the fourth quarter run rate this year to be a good indicator for potential financial performance in 2010, after considering the timing of our major events.

We continue to be very excited about our future, our theme for the year says it all. We're proven, we're powerful, and now is the time. With that set up, let me turn it over to my fellow road warrior, Des Walsh for specific market updates. Take it away,

Des Walsh - Herbalife Ltd. - EVP

Thank you, Michael, good morning, everyone. Before speaking to specific market results, let me note that despite the difficult macro conditions around the world, the Company experienced local currency growth in seven of its top ten markets this quarter, reflecting what we believe is the company's ability to succeed in the current environment.

The net sales data for these markets have been posted on our website. I'll now review volume points and distributor results for our top markets.

Our number one market, the United States, accounted for approximately 27.8% of the Company's volume for the quarter. And while the US volume declined 1.9% versus the same quarter last year, reflective of a difficult comparison due to the kickoff of our 30th anniversary promotion in April of last year, it represents a strong 7.7% growth over the first quarter this year.

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Our business is not very seasonal, and accordingly, we believe that sequential performance can be a key indicator in the market, as long as the results have not been skewed by a promotion or major event. And in the case of the United States, we believe this sequential growth is an indicator of good momentum, supported by active and engaged distributor leadership.

New supervisors were down in the quarter by 18.8%, but sequentially, new supervisors increased 34.9% from Q1. Additionally, the number of supervisors placing orders during the month was 2.9% higher than the second quarter of last year. We believe this metric is reflective of the shift to daily consumption, as more distributors are being introduced in to the business through a model that promotes daily consumption and consistent repeat orders.

This approach also offers a lower cost entry point for new distributors wishing to participate in our business opportunity. The United States Spanish-speaking business represented 68% of the country's volume and was up 0.6% versus the prior year, comping a quarter in which we experienced 28.6% growth in this segment, and reflecting a 15.6% increase from the first quarter this year.

New supervisors were down 15.9%, compared to the second quarter last year, but the average number of monthly supervisors ordering increased by 9.8% from the same period last year. And the number of new supervisors in the second quarter increased 54.9% from the first quarter this year. Volume points in the non-Spanish-speaking market of the US market, decreased by 7.8% versus the second quarter, again, reflecting the difficult comp from the second quarter last year.

New supervisors were down 24.8%, and the average number of supervisors ordering during the quarter decreased by 8.3%. But on an encouraging note, the number of new supervisors in the second quarter increased 3.8% from the first quarter of this year. Second quarter volume for the top 25 metro areas in the US, was up 6.5% year-over-year. The top 25 metro areas for the Spanish-speaking segment also experienced volume growth of 7.1% versus a year ago while the non-Spanish-speaking segments, top 25 metro areas experienced a year-over-year volume growth of 6.1%.

Similar to the last couple of quarters, we are continuing to see growth in our largest US markets. These results support our belief that Herbalife can succeed during economically challenging times, even in our largest and oldest market.

Moving on to Mexico, our second largest market, volume for the quarter decreased by 18.7%, but increased sequentially by 3.2% compared to Q1. And while new supervisors were down 23.1% year-over-year, the number of new supervisors increased by 45.2% sequentially.

Similar to the comment I made with respect to the United States, we believe that the sequential growth in both volume and new supervisors indicates that Mexico is beginning to build momentum. As a reminder, our volume in Mexico has been impacted by both the general economic slowdown that has negatively impacted the amount of US dollars flowing back in to Mexico, and a 15% VAT that we began collecting in the third quarter of 2008. However, despite these negative influences, we expect Mexico will return to growth in the late third or early fourth quarter, after we anniversary the implementation of the VAT this month.

Now let's turn to China, our third largest market during the quarter in terms of net sales. As we mentioned during last quarter's earnings call, we expected China's volume points to be down slightly as a result of the difficult second quarter comparison caused by a special promotion during the second quarter of last year, coupled with the impact from China transitioning to a daily consumption model.

We know from experiences in other markets that have transitioned to daily consumption, that we generally see volume points slow, as our sales employees transition their sales methods. Accordingly, volume decreased by 1.8% year-over-year, which was ahead of our expectations, and very encouraging given the fact that we did not have a similar promotion this quarter.

Sequentially, China's volume points increased 57.5% from the first quarter this year, reflecting both the low Q1 volume, due to the Chinese New Year, but also due to the transition to daily consumption beginning to take hold through the introduction of clubs. As most of you are aware, in addition to introducing clubs in China, we have been launching a new service provider



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model, and are encouraging our sales employees to adopt this model through opening offices and nutrition clubs which will allow us to train more rapidly and also expand in licensed and unlicensed provinces. We have currently made this opportunity available to only our Senior level employees, and expect to expand the offer to other levels of employees during the coming months.

Our fourth largest market in terms of net sales is Brazil. During the past two years, distributors in Brazil have made the transition to the daily consumption models which has resulted in a more fundamentally sound business with increased focus on retailing and retention. As a result, volume during the quarter increased by 10.6%. And while new supervisors were down 8.9%, the number of supervisors ordering increased by 18.2%. Similar to comments I made regarding the United States, these statistics are indicative of our distributors focusing on daily consumption, where the model promotes a steady build of volume and has the potential to attract a larger percentage of the population by allowing a smaller initial investment.

The last markets I want to discuss on this earnings call are Taiwan and Korea. Both markets have adopted daily consumption methods over the past few years and it has proven to be a driver of growth.

During the second quarter, volume up is 4.2% in Taiwan, and 48.5% in Korea. We believe that a significant factor in this growth is the expansion of clubs in both markets. Since the introduction of these clubs in Taiwan, the volume points per capita ratio for this market has increased to 7.7.

While Korean distributors are following a similar path to Taiwan, their volume point per capita ratio today is just 2.2 to 1 -- 2.1. This helps illustrate the opportunity that still exists within this top market.

Before I pass the call over to Rich, I would like to add that we continue to believe that the company is positioned well to succeed during this time of economic instability. We provide a business opportunity that offers people the opportunity for financial independence, earning part-time and full-time income during one of the most uncertain economic times in recent history, and our core product line, weight management, helps address the obesity epidemic sweeping around the world. Now over to

Rich Goudis - Herbalife Ltd. - CFO

Thanks, Des. I'll assume you had a chance to review the earnings release and the 10-Q that was filed last night, so I'll start by giving you some highlights of our second quarter results compared to the guidance we provided back on May 4th.

As Michael previously mentioned from a volume perspective the second quarter represented our most difficult comp period for 2009. And the comps from this point going forward get easier as we exit 2009.

Although we finished the quarter down 5.9% in volume points versus prior year, this represented better performance than our internal expectations and from the guidance we provided of down 7% to 9%. The improvement was primarily driven by better than expected results in our Asia-Pacific region, and in particular South Korea. The favorable results in South Korea reflect the continued adoption and success of the nutrition club DMO in the form of commercial clubs, premium HMOs as well as the excitement generated by the regional extravaganza held in Seoul in June.

And in addition, we saw stronger than expected growth in markets such as Taiwan, Malaysia, and India. The growth in each of these markets has been primarily driven by successful transition to daily-consumption business models. Most importantly, our two top markets, the US and Mexico both exceeded our volume expectations contained within our guidance for the quarter. Mexico improved 3.3% sequentially from the first quarter of 2009, and the US improved 7.7% sequentially, driven by continued success within the Spanish-speaking market.

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And China also finished slightly better than our guidance expectation, while improving 57.5% sequentially from the first quarter of 2009. Again, this is a quarter we had no promotion like we had a year ago. These stable results were offset by a shortfall in several markets primarily in our EMEA region including Germany, France, and Spain.

Our largest market in the EMEA region, Italy was the exception, finishing above our expectations. Overall volume-related growth contributed approximately \$0.06 towards our favorable EPS results versus guidance.

From a net sales perspective, favorable currency fluctuations and country mix positively impacted our EPS results approximately \$0.08 compared to our guidance. Net of our FX hedging, the positive EPS impact was approximately \$0.05 versus guidance.

We experienced gross profit margin compression during the quarter, primarily reflecting higher costs of sales largely due to the impact of significant volatility of the Mexican peso early in 2009. As you may know, the peso lost approximately 50% of its value between mid 2008 and March 2009.

We expect to see a similar but declining impact in the third quarter, as gross profit returns to more normal levels by fourth quarter of 2009, assuming that the peso remains at or near its present levels. We don't believe that the second quarter or third quarter gross margins are indicative of our normal business model.

Excluding a tax audit settlement, our effective tax rate for the quarter was 30.8%, which was slightly better than our guidance range of 31% to 32%. In summary for the second quarter, we beat the high end of our second quarter EPS guidance range by \$0.05, reflecting higher volume points, \$0.06; favorable impact of currencies \$0.05 net of hedging; lower than expected operating expenses, \$0.03; and a slight improvement in our effective tax rate, \$0.01. These favorable contributions were partially offset by lower gross margins driven primarily by the cost of sales issue I just mentioned, which was \$0.09, and a higher share base reflecting increase in our stock price, which is \$0.01.

In the second quarter, our Company produced cash flow from operations of \$36.3 million, paid a quarterly dividend of \$12.3 million, and invested \$12.7 million in capital expenditures, primarily reflecting the rollout of our Oracle ERP system and the related hardware, as well as certain key strategic initiatives that we believe will add value going forward.

In early July, we added the EMEA region to our Oracle platform thereby completing the migration of all markets, except China. We reduced our net debt over \$30 million during the quarter -- excuse me -- our total debt by \$30 million, and we reduced our net debt by \$18 million sequentially to \$132.5 million. We remain conservatively capitalized during these difficult economic times at 0.9 times debt to EBITDA.

Turning to our guidance for the third quarter, we expect volume points to be 0% to 1% above prior year. Note that this is the final quarter that we will have a negative year-over-year comparison impact due to the Mexico VAT.

From a net sales perspective, despite the weakening of the US dollar from levels seen earlier this year, we expect continuing headwinds from foreign currency fluctuations, albeit at a lower level, and are projecting declines of 4% to 6% to prior year, assuming late June spot FX rates. We have hedged approximately 90% of our FX exposure in major currencies as of these late June levels.

We expect our effective tax rate to be in the 31% to 32% range and therefore our EPS guidance for the third quarter is in the \$0.66 to \$0.69 range. For our full year guidance we are maintaining guidance of our volume point growth rate at flat to 1% above our record 2008 performance.

This is consistent with the previous guidance we issued in May. While we are very pleased with the second quarter volume results, we remain cautious in several markets as we monitor the transition to more balanced DMO's, and continue to watch the global economic situation unfold. Implicit in our volume guidance is a much stronger fourth quarter than we experienced



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in 2008. We believe that the economic factors which contributed to the sales declines in last year's fourth quarter will not repeat this year.

From a net sales perspective, we've revised our guidance upwards to reflect current rates as of the end of June, and therefore a negative 4% to negative 5% compared to the previous guidance of negative 7% to negative 9%. The upward revision reflects FX assumptions we are currently using which are the spot rates as of June 25th, which have improved since our previous guidance, and for that matter, since late June, as the dollar continues weaken against most major currencies.

We expect our effective tax rate to be in the 31% to 32% for the full year, excluding any adjusting items which is consistent with our previous guidance. In terms of EPS we are providing new guidance in the range of \$2.97 to \$3.03 which reflects a tightening of both the low and the high from the previously announced full-year EPS guidance of \$2.90 to \$3.10.

At the low end, the improvement primarily reflects the beat in the second quarter. At the high end, we have lowered our EPS by \$0.07, reflecting the impact of our higher stock price, approximately \$0.04, and \$0.03 of FX impact to cost of goods sold, which will be 66% lower than the impact we experienced in the second quarter.

This new guidance, reflects very little FX hedging in the fourth quarter, and does not assume any share repurchase by the Company during the second half of the year. If the dollar stays at its current level or gets weaker, and if we buy back stock, this will represent a potential upside to our fourth quarter and therefore full year guidance. And finally we believe our capital spending for 2009 will be in the range of \$55 million to \$60 million. This concludes our prepared remarks. We'll now open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Our first question comes from Tim Ramey with D.A. Davidson.

Tim Ramey - *D.A. Davidson & Co. - Analyst*

Good morning. Just key off the very last sentence, if the dollar stays where it is, or you buy back stock in the remainder of the year, that represents upside. What possible reason would there be to not buy back stock?

Rich Goudis - *Herbalife Ltd. - CFO*

I think go back to what we said over the last couple of quarters, Tim. We are looking to get more vertical in our US manufacturing operations. We are narrowing it down to a few targets, and last quarter, quite honestly, we ran out of time.

Our ability, our open period ended on June 10th, and we were not far enough into our evaluation to determine whether we could or could not buy back stock in the second quarter. I think we're further along in that analysis, and I'll leave it at that, that we potentially can do both in the third quarter.

Tim Ramey - *D.A. Davidson & Co. - Analyst*

And the -- the 90% currency hedged figure you threw out, that related to the third quarter only; is that correct?



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Rich Goudis - Herbalife Ltd. - CFO

That's correct.

Tim Ramey - D.A. Davidson & Co. - Analyst

Okay. Thanks, Rich.

Rich Goudis - Herbalife Ltd. - CFO

You are welcome, Tim.

Operator

Our next question comes from Doug Lane with Jefferies & Company.

Doug Lane - Jefferies & Company - Analyst

Yes, hi, good morning, everybody. Just a follow-up on the free cash flow issue, can you go over what your strategy had been for free cash flow up until now? And what you think it will be going forward?

Rich Goudis - Herbalife Ltd. - CFO

Sure, as we have said consistently, our number one objective is to invest in growth initiatives in this business. Oracle has been a big catalyst for that, opening new markets, investing behind tools and technology that will improve our distributor experience, that's number one.

Beyond that, it's things of looking at getting vertical in our manufacturing. And we have been pretty clear over the past couple of quarters that we are getting closer to finalizing those plans, and beyond that it's either pay down debt, build cash on the balance sheet, or buy back stock if it remains dislocated from what we believe is fair value.

Doug Lane - Jefferies & Company - Analyst

Assuming either -- well, maybe you can help us out by giving us an order of magnitude? Would there be EPS accretion right off of the bat if you were to move in to manufacturing?

Rich Goudis - Herbalife Ltd. - CFO

Depending on which target we move on, there could be some accretion right away. There could be a little dilution, but I would say it's -- it's minimal, Doug. We bring a lot to the table, being able to move our production in to a facility should create absorption rather quickly, and there's no license barriers to move our US production into a US facility. So we're pretty optimistic about that.

Doug Lane - Jefferies & Company - Analyst

I understand near term dilution, but you should be able to scale that and that would be accretive, right? You are capturing the manufacturing margin?

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Rich Goudis - Herbalife Ltd. - CFO

Absolutely.

Doug Lane - Jefferies & Company - Analyst

Okay. So the whole strategy there is really -- if I remember right was to improve gross margins. Did you give us -- I can't remember if you gave us a potential gross margin target if you were to vertically integrate? Did you say you could capture 120 basis points there?

Rich Goudis - Herbalife Ltd. - CFO

I think your strategy has been pretty consistent. Number one is to improve our speed to market, and protect our intellectual property, number one. Number two, improve and standardize our quality of our products on a global basis, and number three is to mitigate cost pressures from commodity shifts, and if there's margin improvement beyond that, that's upside, Doug.

Doug Lane - Jefferies & Company - Analyst

Okay. I didn't know if you had given a goal there or not. And then lastly, I know you haven't really talked about 2010 yet, but with the Oracle system implemented, do you have a preliminary, at least, range for capital spending next year?

Rich Goudis - Herbalife Ltd. - CFO

We do not. And we haven't guided obviously for 2010. When people ask that question, we usually say use a placeholder of \$50 million to \$55 million. Because hopefully, we'll always have projects like new-country openings, like other investments in technology, or potentially even manufacturing that have good ROIs associated with them, and makes it prudent for us to make those investments.

Doug Lane - Jefferies & Company - Analyst

Okay. Thank you.

Rich Goudis - Herbalife Ltd. - CFO

You're welcome.

Operator

Your next question comes from Scott Van Winkle with Canaccord Adams.

Scott Van Winkle - Canaccord Adams - Analyst

Thanks. My question is around the compensation plan change you mentioned. Really just kind of three pieces to it. One, what is the change in the comp plan you mentioned, kind of more front-end loading or earlier payment for distributors? Second, how do you expect -- or what do you expect to change in distributor behavior? And then finally how are you going to communicate it?

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Des Walsh - Herbalife Ltd. - EVP

Good morning, Scott, this is Des. So there's two essential changes. The first is the introduction of a 5,000 volume point, 12-month cumulative supervisor qualification.

So as you know today, the majority of our supervisors qualify as supervisors, either by doing one month of 4,000 volume points, or 2 months of 2500 volume points. Somebody can qualify as a supervisor by accumulating 5,000 volume points over a rolling 12-month period.

What that means is effectively, it is an awful lot easier now for somebody to qualify as a supervisor. And the second thing is, that as you know we have a significant number of distributors who effectively are part-time sellers. And for them to qualify as a supervisor may seem a lofty goal.

Now what they will be able to do, is they will be able to readily achieve that by making minimal purchases and sales over a 12-month period. And most importantly, their upline becomes very actively engaged in helping them achieve that goal, so that's the first change.

The second change relates to a change which makes it easier for people to do it -- to earn higher margins. So what we're doing is introducing seeing a level in -- called a qualified producer, which effectively gives somebody a 42% discount in the marketing plan. But it becomes what we're referring to as a permanent 42% until they have to re-qualify again, and they achieve that simply by accumulating 2500 volume points over a three-month period. So two impacts of that.

First of all, obviously, a key driver of retention is when a distributor is making more money, for the time and effort they are putting into the business. By achieving this 2500 volume points over a period of three months, they now retain a 42% discount. Whereas historically in order to achieve that 42%, they would have had to achieve 1,000 volume points each month. So now once I achieve that qualified producer level, I continue at a 42% level, which means my business is fundamentally more profitable for me.

The other thing, of course is this, you couple that with our new cumulative supervisor level of 5,000, if I have already done 2500 volume points, it's very easy for me to see that over another nine month's period, how I can accumulate another 2500 and become a fully qualified supervisor. So it's very important in terms of one, their immediate profitability, but secondly, their engagement in the business, and their enthusiasm and excitement as they go on to become a fully qualified supervisor. And the other thing to mention, of course, is that these changes have actually no impact in terms of -- financial impact from our perspective. They are all changes within the existing marketing plan and so they only have an upside benefit for us.

And the third part of your question was how do we communicate it? What we are doing is, we just sent out a communication to our worldwide President's team. We have been working with our Chairman's club on developing a training DVD, where we fill in segments of it at our recent EMEA extravaganza, as we always had several of our Founders circle, and [Chairmen of] members here in our studio at LA Live.

And essentially beginning in September, we begin a worldwide communications and training program that will go out around the world. This will be followed up with individual phone calls by -- at a TAB team level, and then individual in-country trainings to support a Q4 launch.

Scott Van Winkle - Canaccord Adams - Analyst

So, Des, is -- kind of how you mention it, I mean, this is a stair-step type of model -- where you get them over the first bogey, and then push them toward the second one, which is a 5,000 volume point cumulative, and do you start really with going to

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the 42% discount? Is that kind of what you articulate first, and kind of push them towards that? And then by the way, you have got another goal on top of that?

Des Walsh - Herbalife Ltd. - EVP

Sure. Sure. And push isn't the term that I'd use. But obviously what we are doing, we're highlighting the benefits, because essentially this is a complement to our existing marketing plan. So if literally, if I was talking to you, Scott, about coming in to the business today, what I would explain to you is our discount structure as a distributor. I would explain the benefits of being a supervisor in that it enables you effectively to earn royalties.

But what I would say is, Scott, why don't we start you as a distributor, and then let's get you to the highest discount level that we can, and let's develop your circle of influence, get you a stable customer base, and let's get you to that qualified producer level, because that's what is going to give you a margin of 42% until such time as you are ready to become supervisor or have to requalify. So you are exactly right.

It's a method of showing you how you can maximize your profit for your time and effort and then most importantly show you are on that road to that supervisor level, where you are going to be serious about being in the business, developing royalties, developing organizations, and so on.

Rich Goudis - Herbalife Ltd. - CFO

And that's of course, Scott, after we start you on the products.

Scott Van Winkle - Canaccord Adams - Analyst

Of course. Des, is the 5000 volume point cumulative qualification, is that only apply to new distributors, or is that now the new qualifications for all distributors?

Des Walsh - Herbalife Ltd. - EVP

No. It applies to all existing distributors as well.

Scott Van Winkle - Canaccord Adams - Analyst

What do you expect to be the effect on existing distributors? So, do you end up with kind of less loading in the month of January, and kind of spread it out, or is this an easier qualification, and maybe productivity might fall a little bit? I'm wondering what the impact would be on those -- not to new people, but the people who are already in and already meeting the existing requirements for requalification.

Des Walsh - Herbalife Ltd. - EVP

Yes. Two things. So we actually tested this in Russia, Scott, to address the very questions that you raised, and to see what the impact would be, and here is what we saw.

We have a huge number of people who are part-time in the business, who are doing a relatively small -- just a few hundred volume points a month. And so for them to aspire to be a supervisor, historically, which is very challenging, and particularly in

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emerging markets and lower-income markets, because as you know, a 4,000 volume point order just generically on average costs a little over \$3,000 in the US and comparable in the world.

So now effectively what it means is that -- that lower-level distributor can see that even though historically to become a supervisor might have been a challenging threshold for them, now what they can see is that through consistently working their business, through consistently building their customers that they can achieve that 4,000 -- 5,000 volume points over a 12-month period. So it really drives three things.

First of all it drives retention, because now they can see that they can get to that level. Secondly, it increases the average order size, because what they can see is they are now going to benefit from that, not just in terms of the impact on their business, through getting more customers because it's a stair step. And lastly what it does is that it helps new supervisor growth because it drives our organic growth to supervisor level.

Scott Van Winkle - *Canaccord Adams - Analyst*

Okay. And just a -- a last question, you have got a lot of different DMOs being developed in different regions. You went through it call in detail but can you kind of sum it up, what the difference is right now driving performance in the Asia-Pacific region, relative to the rest of the world? Are you full -- more fully developed or can you just give us an idea of what the difference is, because that's obviously a region that is performing exceptionally well.

Des Walsh - *Herbalife Ltd. - EVP*

Sure. It's really actually a perfect storm of a number of things, Scott, but primarily it is a factor of, one, more people coming in to the business. So we have got some very strong methods of bringing people in to the business, but coupled with once those people come in to the business focusing them on daily consumption models. So essentially you look at what some of the things that we spoke of, the road shows, the premium HOMs as methods of bringing people into the business.

And you look at things like the weight-loss challenges, and the nutrition clubs, the office clubs, all of these things that are really helping. And then the last thing that I would say is that we have got a group of distributor leaders in the Asia-Pacific regions that are very active, involved in what we call cross-pollination. So it is just a wonderful sign us to, that, for example, our Korean leadership just had a very large group in Taiwan.

Taiwan where as you know, we now have the largest per capita consumption of any major market in the world, their leadership just went on a tour to see the road shows in Malaysia, to see the variations on the clubs in Korea. So what we have is an engaged and active distributor leadership that frankly is always looking for ways to enhance their business. So those are sort of the three elements of the perfect storm that we see in Asia-Pacific, and obviously we are vigorously engaged in exporting that storm to other regions in the world.

Rich Goudis - *Herbalife Ltd. - CFO*

Let me add one thing, Scott to that -- I'm going to take one step back further in the history time line here. When we have these meetings, such as the bonus awards here, and the Mark Hughes awards that we have here, people get presented checks on stage. And the bigger the check, the more interest from the crowd.

And the Taiwanese, the Asians, the Koreans, all took notice when a lot of Latin checks were growing, both Latin and US checks, and Latin checks in Mexico, and they explored. They went to Mexico, just as Des said, the cross-fertilization is one thing, but the first investigation of why are their checks up, and what are they doing that we can adapt to our marketplace? And so it is the



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basic daily consumption model that is driving the business. The Asians have been very aggressive in, as Des -- and I won't repeat everything he said, but the cross-fertilization, but it is these meetings that inspire people.

Sometimes we're asked what is the real purpose of these meetings, and what do they do? They get to see in a larger forum, and sometimes very intimately in the size of the incomes that some people are getting, success models, and they want that, they want a part of that, they want to understand that, and then they adopt these and adapt them to their market place. So we have different models.

What happened in Zacatecas, Mexico is not being repeated identically, it's being homogenized into its own market and adapted for the use and the consumption levels and the typical consumer patterns that take place, and they are rocking it in Asia, you are absolutely right. And it gives us a lot of inspiration and a lot of excitement about what can be in this Company.

Des Walsh - Herbalife Ltd. - EVP

And Scott, what I would add in terms of financial, because of this ability, especially the clubs, the ability for distributors and supervisors to essentially realize the retail profit that's within our business model. If you look at last year the gross to net in this business was about \$1.4 billion, that's commissions, discounts earned, versus royalties which was about \$750 million.

So the ability for people to buy at wholesale, and get that realization of the full retail profit when they charge \$3 to come into a nutrition club or 20 pesos, or whatever it might be, it's two times the ability of what they can achieve in royalties. So I think that's why it becomes very sticky, that's why in these emerging markets where we breakdown that barrier, and breakdown that access point to something that people can afford on a daily basis, that's the catalyst of this growth.

Scott Van Winkle - Canaccord Adams - Analyst

Thanks, everyone.

Rich Goudis - Herbalife Ltd. - CFO

Thanks, Scott.

Operator

Our next question comes from Chris Ferrara with Banc of America.

Chris Ferrara - BAS-ML - Analyst

Hey, guys, I just want to follow up on the comp plan, I guess. I guess is the idea that you get a volume lift and that offsets the cost of these? Because I just want to understand what the impact to margin might be, right? Because obviously you guys are going to be essentially pushing your selling price -- your net selling price down a little bit. You are going to be sending your commission structure up a little bit. So I guess what it is a slightly lower margin and higher volume running through the system?

Rich Goudis - Herbalife Ltd. - CFO

Let me start and I'll pass it over to Des -- from the way you look at our P&L, Chris, there is no change. Basically the give is today, I'm your upline, and I get a 50% discount, and you are my distributors 25% discount. Now the difference is, what -- I'm allowing

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you to earn -- you are able to earn up to a 40% to 42% discount. So it's no impact to the company. It's just between the distributor and their upline. Is that pretty clear?

Chris Ferrara - *BAS-ML - Analyst*

Yes, I guess. I mean the money is coming from somewhere -- they're earning a bit -- it means you are selling them at a bigger -- you are selling product to them at a bigger discount, right so it's an effect to your sales? Right?

Rich Goudis - *Herbalife Ltd. - CFO*

Our company always sells at that 50% discount. The question is what is the upline sale to their downline, or what does the distributor sell to their customer, right?

Chris Ferrara - *BAS-ML - Analyst*

Right.

Rich Goudis - *Herbalife Ltd. - CFO*

So from a company -- from Herbalife standpoint, no effect to our margins, no effect to our business model. The real question is -- is the upline -- is the supervisor willing to give a little bit more of a discount on a consistent basis to ensure somebody is going to stay engaged and active in the business, and possibly organically become a supervisor. And remember, they are earning royalties on this person, and that's a -- that's I think a unique change, is that historically, you couldn't earn royalties until you are a supervisor with this change, a distributor can now earn on a person below them.

Des Walsh - *Herbalife Ltd. - EVP*

And, Chris, in terms of the impact on the business, obviously it impacts a number of things. This business as you know is driven by a number of things, confidence and excitement being two of them. And what we anticipate that is that these enhancements were really developed by our Chairman's club, based on needs they saw in particular marketplaces. And certainly, the initial feedback that we have had in recent months in discussing these with our Chairman's club with our senior leadership, our 30K and now with our President's team shows that they believe this will have a huge impact in terms of the excitement level. One, in terms of people coming into the business, and the amount of profit they can earn, and secondly as a retention driver. So essentially two things, one is keeps more people in the business, and it helps us attract more people into the business. Obviously key focal points for us.

Chris Ferrara - *BAS-ML - Analyst*

Okay. I don't want to take up all of your time on getting it through my dense head, so I will follow up later. I guess I'll move on to something less structural. You guys sound like -- obviously volume was ahead of your expectations. You sound pretty happy about the sequential trends. Can you talk at all about what you have seen into July from a volume perspective?

Michael O. Johnson - *Herbalife Ltd. - Chairman, CEO*

Chris, no, that's something we couldn't disclose at this point. Suffice it to say, that our guidance reflects what we have been seeing on those business trends through the course of July.

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Chris Ferrara - BAS-ML - Analyst

Got it. And then, hey, just finally on -- on Mexico, and I know you talked a little bit about this, Des, but I guess what -- I mean, besides simply comping the VAT, and I guess some new products running through, I mean, what is really the driver of Mexico long term? I guess, as you take a step back, what is the long-term growth rate? And is it a slower growth market from here, just because of the sheer scale that you have. And I understand that there's still room for per capita consumption base -- how do you guys frame long-term growth, and what gets it going besides just comping -- comping the VAT?

Des Walsh - Herbalife Ltd. - EVP

Sure, so one key issue for us in Mexico is obviously access to product. So as you know -- and that's something that actually we're very heavily engaged with. We have a number of tests going on that are showing very promising results. Secondly, obviously is distributor leadership, their engagement, their partnership with us, and I'm happy to say that I don't think things have ever been better in that respect. The leadership in Mexico very heavily engaged.

I think many of you may know when we had our honors celebration that we had in March, that Michael referenced the Mexican leadership had a meeting literally 8:00 one evening, in which they all got together, the group that were at the Beverly Hilton in Los Angeles, and made that commitment to return Mexico to number one. We're heavily engaged in achieving that growth. We're addressing access issues. We are also heavily addressing some of the ethical issues that had become a distraction in Mexico. So basically what we are doing is we're solving each of those issues, and working with them to get back. But you can clearly see, Chris, that what we're seeing, the confidence is back, the momentum is building just in the numbers, and we believe we're going to see the impact of that in the months to come.

Chris Ferrara - BAS-ML - Analyst

Thanks, guys.

Rich Goudis - Herbalife Ltd. - CFO

Okay. Why don't we take one more question, and then Michael will wrap it up with closing comments.

Operator

That actually was our last question.

Rich Goudis - Herbalife Ltd. - CFO

Okay. Michael?

Michael O. Johnson - Herbalife Ltd. - Chairman, CEO

I want to thank everybody for being on the call, and I want to thank Des and Rich for handling all of the questions today, which makes it a lot easier on me, which is great. Now our goal for 2009 continues to be is to have a better year than we did in 2008. As you heard today the some point performance in the second quarter, we're beginning point performance in the second quarter, we're beginning to feel a bit more optimistic that we'll have volume point growth in 2009. And with the change in FX rates over the past year, our EPS rate will most likely result in our second-most profitable year in the Company's history, and that's a goal we have had since day one. We want to make this year a little bit better at the top line. If we can get the FX to work

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for us, we'll come up on the bottom line. It will squeeze. It will get better for us, and we're excited about it. You heard about the marketing (inaudible) changes. This is a huge impact in our Company.

Huge is a relative word, but we know that over time what is going to take place, is there is going to be more attention paid to a brand new distributor than any time in the Company's past. We have seen in this Russia, that all of the distributors now are potential qualifiers. And so it isn't just one distributor who -- that an upline will focus on, it will be every distributor. We're seeing this in Russia. We were just there. We talked to a lot of lower-level distributors, it We talked to a lot of lower-level distributors, it was very, very positive in terms of what we are seeing in terms of the upline focus on them. We're going to nurture these positive volume point trends in our key markets. And we are going to invest in our business, support the globalization of successful distributors DMOs, and improve our cost structure, and to improve our profitability. And that's what you want to hear. And we're going to improve free cash flow right along -- next to it as we develop plans for 2010.

We got a tremendous business here. You know we got the tough comps behind us, we got great momentum in key markets.. The US dollar is weakening, so, it's an upside in our guidance for the fourth quarter. So with this business model, lead by these entrepreneurial distributors in 70 countries around the world, we move to 2009. We'll continue to focus on the areas of the business that we can favorably impact, to improving our products, our business opportunity, our brand, and our image position us for a stronger top-line growth in 2010. We appreciate you guys supporting us, and we appreciate your participation in the call. It's time to get back to work. Thank you very much.

Operator

Ladies and gentlemen, that does conclude today's presentation. You may now disconnect.

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