

FINAL TRANSCRIPT

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HLF - Q2 2006 HERBALIFE LTD Earnings Conference Call

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PRESENTATION

Operator

Good morning and thank you for joining the second quarter of 2006 earnings conference call for Herbalife Ltd. On the call today is Michael O. Johnson, the Company's CEO; Greg Probert, the Company's President and COO; and Rich Goudis, the Company's CFO.

I would now like to turn the call over to Brett Chapman, the Company's General Counsel to read the Company's Safe Harbor language.

Brett Chapman - *Herbalife Ltd - General Counsel*

Good morning. Before we begin, as a reminder, during this conference call comments may be made, which include some forward-looking statements. These statements involve risks and uncertainty, and, as you know, actual results may differ from those discussed or anticipated. We encourage you to refer to yesterday's earnings release and in our SEC filings for a complete discussion of risks associated with these forward-looking statements and our business.

In addition, during this call, certain financial performance measures may be discussed that differ from comparable measures contained in our financial statement, prepared in accordance with U.S. Generally Accepted Accounting Principles referred to by the SEC as non-GAAP financial measures. We believe these non-GAAP financial measures assist management in evaluating

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and comparing period-to-period results of operations to more meaningful [inaudible]. 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.

Now, I'll turn it over to Michael.

Michael Johnson - Herbalife Ltd - CEO

Thanks, Brett, and good morning everyone. Thanks for joining our conference call.

Today I'm going to begin with highlights from our second quarter and provide, as usual, an update on our key initiatives. Our President and Chief Operating Officer, Greg Probert, will provide an overview of some of our recent developments, and our CFO, Rich Goudis, will walk you through our financial results and provide guidance for the balance of 2006.

Based on your feedback, we've reduced our prepared comments to about 20 minutes, but we will be more than happy to provide greater detail on specific topics of your interest during the q&a session.

Obviously, as you read yesterday, I am extremely pleased to announce that we've had another remarkable quarter, our 10th consecutive quarter of double-digit sales growth and our seventh consecutive quarter of record net sales. The passion and excitement that we, alongside of our distributors, feel that coupled with a unwavering commitment to our three 'Rs' -- recruiting, retailing and retention. This is what is fueling our growth in many of our markets worldwide.

Let's jump right into the highlights from our second quarter.

Net sales reached a record \$466 million in the second quarter, up 21% versus 2005. Operating income as a percentage of net sales increased 35 basis points to 14%. Adjusted net income increased 29% versus last year. EPS was up \$0.49, up 24% versus the second quarter of '05.

New supervisors rose 42%, up sequentially 34% from the first quarter. Total supervisors increased 23%, which marks the fifth consecutive quarter that we've accelerated our year-over-year supervisor growth. In the second quarter, we added 45 new members to our President's team, a 16% increase over 2005, bringing the total to 924. Year to date we've increased our President's team by 65 members, an average of almost three new members per week.

We've also welcomed one new distributorship into our exclusive Chairman's Club, which now has 29 members. During the first 13 years of the Chairman's Club existence we averaged less than two new members per year. Since the beginning of '03, we've averaged three, and that's a great sign for a new distributor coming into our Company.

So, as you have seen over the past few years, we've experienced a dramatic increase in the number of distributors moving up in our marketing plan, which reflects the overall vitality within this organization. This is very encouraging and it's an encouraging indicator to our distributors.

These distributors have embraced the three 'Rs' -- the retailing, the retention, the recruiting -- and are developing unique selling methods and are motivating new distributors to build their businesses worldwide.

Let me summarize for you our second quarter achievements in the context of our five strategic initiatives.

Our distributor strategy.

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We remain committed to supporting our distributors by strategically investing in initiatives that will increase recruiting, the retailing of our product, and retention of our distributors, will globalize Best Practices of these methods as a key component of our overall strategy. We believe that now there are more than 36,000 customer clubs operating in 38 markets worldwide.

Additionally, regeneration methods created by our distributors, such as the Total Plan, the first new Wellness evaluation and sampling continue to expand and they are now active in many key markets.

Continuing with our distributor strategy, our ability to leverage distributor momentum by providing events focused on business building, training, and motivation is critically important to the expansion and the penetration of our products and business opportunity worldwide. We know that some of you joined us in Las Vegas and I think you saw in action Herbalife.

During the quarter, we hosted at these events over 50,000 distributors at more than 50 local and regional events. Our Agent-Specific Extravaganza held in Bangkok Thailand attracted over 15,000 distributors from 13 countries. At our European Spring Spectaculars we hosted over 16,000 distributors with 18 mini extravaganzas spread across 17 countries.

And we held numerous leadership and trading events across our Americas region, including a World Team School in Brazil, our South American leadership development weekends and two active supervisor schools in Mexico.

Global branding continues to be a key component in supporting our distributors in the three 'Rs'. One of the ways we are branding Herbalife is through sponsorships worldwide that associate our brand with healthy, active lifestyles. We showcased our brand to hundreds of thousands of spectators at more than 20 events during the quarter, including the Florence Fitness Festival in Italy, the Beta Breakers Run in San Francisco, the Madrid Triathlon in Spain, the Nice Iron Man Triathlon in France, and two races in Mexico's leading running circuit. These were all great opportunities for our distributors to get out, sample, recruit, retail, and retain their distributors.

Our customer strategy.

We are pleased with the progress we have made in the development of our e-commerce platform. In May, we launched a limited release of our new consumer website, herbalifeshopping.com. That's herbalifeshopping.com, just to repeat that. The beta test allows customers to purchase online from our entire catalog of Herbalife products while maintaining the financial relationship with our Herbalife distributors and avoiding any channel conflict.

The limited release version was introduced as a test site to ensure optimal backend functionality. We expect to launch a two-phase marketing campaign, beginning in August, with a full rollout of the site in the U.S. expected in early October. We also plan to launch a Spanish language version of the site later this year.

Additionally, our new customer site will integrate our BizWorks distributor tools and include updates to myherbalife.com distributor site. Of course, as you would expect, I would encourage all of you to logon to herbalifeshopping.com right now, or right after this call and purchase some of our wonderful Herbalife products.

And speaking of products, our product strategy.

We continue to globalize our scientifically-based product portfolio. This expansion serves as a catalyst in maintaining excitement within our distributor organization and supports the three 'Rs'.

During the second quarter, we introduced Liffoff in Japan, as well as eight European markets. We rolled out Neurofusion in 14 new markets, including several key markets, such as Brazil, Argentina, Russia, and Turkey. We also introduced Shakeworks in five new markets, including Russia, Columbia, and Indonesia.

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As part of our commitment to distributor support and training, we've expanded our Medical Advisory Board during the quarter, naming UK's sport's medicine, Dr. Ralph Rogers. He's our 11th member.

Last month we completed the second wave of our European Liftoff launch in our Regional Extravaganza in Athens, Greece. We have received very positive feedback from our distributors and they're excited about the opportunity to have Liftoff in more markets.

We frequently talk about how our distributors and management are working more closely than ever and how this communication and coordination has created more unity within the organization. We've also begun to build more confidence amongst our distributors and leaders by listening and leveraging their knowledge about the marketplace and effective retailing methods.

At our North American Extravaganza last month this commitment was reinforced with the launch of three new products, each intended to capitalize on specific opportunities our distributors had communicated relating to improving product convenience and enhancing distributor ability to retail Herbalife products.

The first was the launch of our new flagship product, Formula One. As many of you know, prior to the launch, Formula One for many people required a blender. Last month in Las Vegas we launched a water-mixable version. This is really an instant meal on the run. It adds convenience for our consumers, offers our current Formula One users a convenient second shake daily, supports distributor retailing, and we were able to improve the nutritional value by adding antioxidants equivalent to one serving of fruit and increase the protein content to 20 grams.

Additionally, our new water-mixable version contains 24 vitamins and minerals and has zero trans fat. This is truly a great product.

Distributor research showed us that we could increase the marketing of our Garden 7 product if we were able to lower the price point and reduce the number of tablets. Therefore, our team focused our efforts on improving the formulation of the product to make it more convenient to use. And we launched a reformulated version at our extravaganza in Las Vegas. The new Garden 7 contains all the benefits of the original version, has fewer tablets, and a lower retail price with more convenient packaging. Additionally, we were able to source the new version at a cost that would not affect our profit margin.

Another launch at the extravaganza was our Neurofusion line in sample packs, which are great for our distributor sampling and lead generation activities. All 12 Neurofusion products are now available in sample sizes and we plan to aggressively expand our sample line to include more of our top-selling products.

Looking ahead, we plan additional product launches and rollouts in the second half of the year, including the introduction of new flavors of Formula One in the U.S. and Europe, globalization of our Heart Healthy Cardio line with rollouts scheduled in Japan, Canada, and several European markets.

Expansion of our products portfolio into the multibillion dollar anti-aging market, with the launch of our skin activator product in Mexico and the U.S. And we'll be launching the first product in our new Immunity Defense line at our Herbalife University event in October. Think of this as airborne in emergency, supported by Herbalife science. It's truly a wonderful product.

We will also continue the active development of high quality, differentiated products for our Sports Nutrition and Showrooms line with launches scheduled in 2007.

Our China strategy.

I'm sure most of you are aware that a few days ago one U.S. company and several foreign-based companies were granted their direct selling licenses by the Chinese Ministry of Commerce. We believe this news is positive to the direct selling industry and signals that the Chinese government is progressing in the licensing process.

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As we have stated before, we continue working very closely with the Chinese government and state officials during the licensing process. However, timeline remains uncertain. In the meantime, we continue the pragmatic execution of our Chinese strategy.

During the quarter, we opened nine new stores and expanded into eight additional provinces. We also expanded our product portfolio by introducing Herbal Aloe Shampoo, Conditioner, and Body Wash products. As of June 30, 2006, we had 28 stores operating in 17 provinces and generating \$10.2 million in net sales through the first six months of the year. We remain very optimistic about the long-term potential in this market.

Our infrastructure strategy.

Our infrastructure strategy is progressing as planned, as we would like to remind you this is the year of investment and we continue to invest our improvements to our IP platform, our facility upgrades, and the development of our direct consumer platform.

Once again, I'm very excited to report that we've got another great quarter! Reminding just once again, our 10th consecutive quarter of double-digit growth. Year-over-year net sales growth, our 7th consecutive quarter of record net sales levels, and our 18th consecutive quarter of positive year-over-year net sales growth.

Let me now turn it over to my business partner, Greg Probert, to provide further insight into organizational realignment initiative that we began last month. G-Pro, they're all yours.

Greg Probert - Herbalife Ltd - President COO

Thank you Michael. Good morning everybody.

In early July we began the first stage of important realignment initiative. When Michael and I came onboard a few years ago our first priority was to reinvigorate distributor leadership and increase confidence throughout the entire distributor organization. Based on the strong performance we've experience over the past three years, we believe we've made great strides in unifying the leadership and reinstating excitement back to the organization that quite frankly diminished when our founder died in 2000.

Our second goal was to build a strong internal management team and define the overall direction of the Company by establishing key strategic objectives and instilling [inaudible] of a five-year planning process.

And now we are embarking upon our third goal, which is to align the Company for growth and optimize the use of management's time and resources. Last month we began the first phase of this realignment initiative. Our primary objective was to transition from a purely geographic and regional organization to a structure with increasing emphasis on achieving growth in high-potential markets.

We believe this refinement of our organizational structure will create additional touch points and grow profits for our distributors, ensure future net sales growth occurs within enhanced profitability, prioritize management's time and investment, streamline internal decision making within our current major markets, support faster decision making across the entire organization due to reduced management layers and accelerates the implementation of new products essential for growth in high-potential markets. And finally, it improves the sharing of ideas and tools between our high-potential markets.

Just let me provide a quick detail of the new structure.

We have separated Mexico and Brazil from our Americas group and the management directors of each of these markets will now report directly to me. Our North American region will now consist of the U.S., Canada, and the Caribbean. Hong Kong and

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Taiwan will become part of our greater China market with headquarters in Shanghai. As a result, we are closing our regional office in Hong Kong.

Our North Asia operations will consist of Japan and Korea. Mexico and Central America will be comprised of Mexico, Costa Rica, and Panama. And our European and African region will essentially operate current geographic structure. And we have created a new reporting unit, called our 'High Potential Segment', which will be headed by the former head of our Americas region.

The segmentation of these emerging high-growth markets to our core markets represents our commitment to the proper alignment of our time and resources towards the potential in these markets. Included in this group are countries, such as India, Malaysia, Indonesia, Argentina, and Columbia. The managing directors of each of these segments report directly to me.

Over the next three to six months we will further refine our core processes organizational structure and operating model with the goal of properly aligning the organization from top to bottom-- for top and bottom-line growth.

Thank you and I'll now turn it over to Rich for our financial update.

Rich Goudis - Herbalife Ltd - CFO

Thank Greg. Let me walk you through the financial statement that we issued in our press release yesterday and our 10-Q this morning, and also provide financial guidance for the third quarter and revisions for the full year of '06.

During this session, I would remind you that all sales are net sales and volume points relate to Herbalife volume points.

Net sales in the quarter of \$466 million were up 21.1 % versus the second quarter of '05, reflecting strong volume and supervisor growth in our key markets. On a year-to-date basis, net sales increased 21.8% to \$921.8 million.

Net sales in the Americas, which comprised 49.8% of our business, were \$232.3 million, an increase of 39.2% versus the second quarter of '05. After-tax had a 1.8% favorable impact during the quarter.

Leading this growth was Mexico, up 86%, driven by 101% increase in supervisors and an expansion of our Nutrition Club Party Planning concept.

Sales in the U.S. were up 5.7% on a reported basis. On the surface, investors may be concerned that the U.S. growth rate slowed substantially from the 21% growth rate reported in the first quarter. But adjusting for the national sales transacted at the 25th anniversary extravaganza last year, the U.S. would have been up 9.5%.

Additionally, due to the timing difference of extravaganzas in the U.S., 2Q in '05 and the third quarter of this year, we faced difficult comps in the second quarter. We fully expect the U.S. will return to double-digit year-over-year growth in the third quarter of this year.

We also continue to post strong sales results in other countries within the Americas region -- Brazil, up 27.1%, and Chili and Argentina, our number 4 and 5 markets in the region, continue to have strong performance, increasing 97.4% and 83.5%, respectively.

The European net sales of \$145.2 million, which comprised 31.2% of our sales, increased 2.4% from \$141.8 million in the second quarter of '05. Excluding the impact of [FX], sales growth was 2.7%.

Leading the growth in our top ten European markets was Portugal, increasing 50.5%, followed by France, up 34.9%, Spain, up 12.9%, and Italy, our number 1 market in the region, up 17.7% versus '05. Offsetting this strong performance was softness in

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Germany and The Netherlands, down 14.9 and 21.2%, respectively, albeit at a slower rate of European decline that we experienced in the first quarter.

Net sales in Asia-Pac, which accounted for 14.9% of our sales, were \$69.6 million, an increase of 24.7% versus the second quarter of '05. Excluding [FX], sales in the region increased 22.9% versus last year. The growth in Asia-Pac was primarily attributable to a \$12.9 million incremental sales from both Malaysia and China and continued growth in Thailand and Korea, which were up 39.4% and 18.9%, respectively.

These gains were partially offset by a 4.6% decline in Taiwan. However, we were down only 2.2% in local currency. We continue to expect softness in this market, resulting from increased focus by our Taiwanese distributors towards two new markets, specifically Malaysia and China.

Sales in Japan, which represented 4.1% of our sales, were \$18.9 million, down 6.3% from \$20.2 million in the second quarter of '05. However, most of the currency in Japan sales decreased less than half a percentage point versus last year.

As Michael mentioned, we have had 10 consecutive quarters of double-digit sales growth and I'd like to point out that although Mexico has contributed robust growth over the past year or so, we are seeing strong momentum across many of our markets. In fact, if you remove Mexico entirely from our business, our net sales have grown double digit year-over-year in five of the past six quarters. These results reflect tremendous balance that we have experienced in sales growth around the globe.

Moving on to gross profit in the second quarter, was \$373.3 million, or 80.1% of sales for a year-over-year improvement of 23 basis points, primarily reflects Q1 price increases across several European and Asia-Pac markets.

Royalty expense in the second quarter of \$167.4 million, or 35.9% of sales, compares to 35.6% in the second quarter of last year. The slight increase in royalty expense as a percentage of sales was in line with our expectations and reflects the success of our active World Team School promotion. Year-to-date royalty expense increased to \$332.6 million, or 36.1% of sales.

SG&A as a percent of sales improved 40 basis points to 30.2% during the second quarter, primarily reflecting the timing of sales events. Remember that in the second quarter of '05 we incurred approximately \$9 million in costs related to the 25th anniversary extravaganza in Atlanta. This year we split our extravaganzas into six different regional events with only Asia-Pac event occurring during the second quarter.

As a result, our sales expenses were lower than during the second quarter of last year, which provided benefits on the SG&A line when comparing on a percentage basis.

Partially offsetting this benefit was high promotion expense, increased investment spending in China, and a direct consumer platform, and, of course, adoption of FAS-123R. The year-to-date SG&A expense as a percentage of net sales improved 20 basis points to 29.9%.

We've been very consistent this year, indicating that 2006 is a critical investment year for the Company. And to the extent that top-line growth exceeds our guidance, then investors should expect to see margin expansion.

On that note, operating income was \$65.1 million, up 24.3% versus '05, and more importantly, as a percentage of sales, our operating margin improved 35 basis points to 14%, primarily reflecting improved gross margin and lower SG&A margins, as I just mentioned.

Year-to-date operating income increased to \$129.2 million, or 14% of sales, a 30-basis point improvement over the prior year.

Interest expense in the quarter was \$5 million, a decrease of \$2.5 million from last year. The decline was primarily attributable to lower average debt balance during the quarter, partially offset by higher average interest rate. On a reported basis, year-to-date

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interest declined \$18.7 million to \$11 million, primarily due to the recap expenses we incurred in '05 relating to the [call back] of our 9.5% note in the first quarter. Excluding the \$14.2 million of recap charges last year, interest expense decreased \$4.5 million during the first six months of '06.

Our effective tax rate was 39.6% in the second quarter, up from 37.1% last year, adjusted to exclude the non-cash \$5.5 million charge associated with moving our China sub into our global strategies. We project the full-year effective tax rate of approximately 39.7%, excluding the first quarter '06 charge or benefit of \$3.7 million, in line with our guidance, and 72 basis points lower than the effective rate last year.

Net income on a reported basis was \$36.3 million in the quarter to \$22.8 million in the-- versus \$22.8 million in the second quarter of '05. Year-to-date income increased 108% to \$75 million.

Earnings per share, \$0.49 in the second quarter of '06, improved 54.4% compared to earnings per share of \$0.32 in the same quarter last year. Again, excluding the impact of the \$5.5 million non-cash tax charge last year, earnings per share on a normalized basis increased 24.5%.

Additionally, versus '05, our diluted share base increased from 71.9 million shares to 74.2 million, which had a diluted impact on our EPS of a little bit over a penny.

In summary, our second quarter net sales were up 21.1% and our adjusted EPS growth rate was 24.5%.

Now, turning to the balance sheet.

We ended the second quarter of '06 with \$169.3 million in cash, up \$81 million compared to the ending balance in December of '05. We increased our cash on hand in preparation for the refinancing of our credit facility, which closed in July.

Inventory increased to \$110.1 million at the end of June versus \$109.8 million at the end of 2005.

Cap-ex of \$13.5 million for the quarter reflects the continued investment in our infrastructure that Michael and Greg mentioned, primarily related to the development of our direct consumer platform, the global rollout of our Oracle ERP, additional investments in China, and the creation of our Americas regional office in Los Angeles.

As many of you are aware, in July we completed the refinancing of our former \$225 million senior credit facility with a new \$300 million facility, initiated a call on a 9.5% notes.

The total one-time after-tax charge we expect to report in the third quarter is approximately \$14 million. The debt restructuring has added a tremendous amount of flexibility to our capital structure. All the debt is now prepayable. We have improved our covenants, creating more flexibility to invest in our business and behind our distributors and lowered the margin of our borrowing from 175 basis points on our term facility to 150, and on our revolver, 225 basis points above IBOR.

Additionally, we received upgrades from both Moody's and S&P to BA1 and BD, a double D-plus, respectively. Assuming no additional borrowings under the facility, we expect this financing to be EPS accretive, a penny in the fourth quarter of this year.

We believe this refinancing will provide substantial long-term benefits as we continue to deleverage the Company and improve our cap structure. We now have the ability to optimize the use of a tremendous amount of cash flow that's generated from our business.

And lastly, let's turn to our guidance for the third quarter and full year. And please note that the guidance contained in yesterday's press release, which I believe is summarized, excludes the following one-time charges, the \$3.7 million tax benefit in Q1 of 2006 and the anticipated impact in the third quarter of \$14 million after-tax charge I just spoke about related to the debt refinancing.

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In summary, our guidance is as follows.

Net sales growth versus '05 in the third quarter, we expect 16 to 18% top-line growth, and for the full year, 17 to 20%. Note that the growth written in the third quarter would be approximately 100 basis points lower than you would normally have expected due to the quarter ending on a weekend. As many of you investors know, our distributors work their business on a royalty month, which is slightly different than a calendar month. We expect those sales to shift from Q3 into Q4 and that's why we feel confident about our full-year expectations of 17 to 20% top-line growth.

EPS in the third quarter will be in the range of \$0.43 to \$0.46, and for the full year we raised our guidance from \$1.88 to \$1.83 up to \$1.90 to \$1.96, primarily reflecting the [beat] in the second quarter, the recap benefit in the fourth quarter, and overall confidence in the momentum of the business for the back half of the year.

The effective tax rate we expect to be between 39.5 and 40.5%, both in the third quarter and for the full year.

And then lastly, Cap-ex \$15 to \$20 million in the third quarter as we close our back office facilities in Englewood and move them to a new Americas headquarters in Torrance and \$50 to \$55 million for the full year.

I would also like to announce that at the beginning of '07 quarterly guidance will consist solely of net sales growth, our effective tax rate, EPS and Cap-ex.

That is our financial summary. I would now open it up for questions.

QUESTIONS AND ANSWERS

Operator

[OPERATOR INSTRUCTIONS].

Michael Lasser from Lehman Brothers.

Michael Lasser - Lehman Brothers - Analyst

Great quarter! Could you talk about the new supervisor growth, a 42% increase? How much of that is coming from new distributors who are entering the business versus an increase in the conversion rate of existing distributors who are now becoming supervisors?

Greg Probert - Herbalife Ltd - President COO

Hi, this is Greg. We don't really track that, the distributors moving up versus new people coming in, so I don't have that stat. I think what you will see is our recruiting across the board is very strong, and you also have to remember that most distributors that come in, come in as customers are using the product, and like the product so much that they move up and become supervisors. I think when you see that new supervisor count it's most indicative of strong recruiting, but also strong product usage among our distributors or discount buyers and we don't [inaudible] those two things. That bodes well, I think, for the future.

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Michael Johnson - Herbalife Ltd - CEO

Michael, what I would add is that our total distributors in the quarter reached 1.4 million distributors, which increased 16% from the end of last year, and 26% from a year ago this time.

Michael Lasser - Lehman Brothers - Analyst

Thanks, that's helpful. Net sales in Malaysia doubled versus the first quarter to the second quarter. As you look out over the next 12 months is it reasonable to expect that rate of sequential growth to continue, or how might the growth look.

Michael Johnson - Herbalife Ltd - CEO

Michael, I think what you really saw there was that Malaysia opened up during the first quarter, so the second quarter we saw a full quarter impact of that growth. I don't think you'll see sequentially the same rate of growth, albeit I think you will see sequential growth over what we did in the second quarter as our Taiwanese, our Singaporeans, and our Australians are all in Malaysia, building their businesses and down lines very successfully.

Michael Lasser - Lehman Brothers - Analyst

And then, you talked about the timing differences of new product launches this year versus last year. Has the response to the new products that were introduced just recently been similar in volumes to what you experienced with the new product last year?

Greg Probert - Herbalife Ltd - President COO

Probably too early to tell on the new products that we just launched a couple of weeks ago, that specifically being the ones Michael referred to on the call. Last year we had a very major launch. Neurofusion went to 22 markets simultaneously and Liftoff into the U.S., so too early to tell on the ones that we just launched in the second quarter.

Michael Johnson - Herbalife Ltd - CEO

Michael Johnson. Hi Michael. One of the things you've got to remember is that the sampling product fits into a business methodology for many of our distributors. So, while we will see possibly an uptick in the product itself, you're going to see an uptick in the recruiting opportunities that are associated with it.

Michael Lasser - Lehman Brothers - Analyst

And could you talk about the growth in Nutrition Clubs outside of Mexico? I may be comparing apples to oranges here, but it seemed like it only increased maybe modestly quarter to quarter.

Rich Goudis - Herbalife Ltd - CFO

Yes, I think we indicated that the amount of people we trained were 16,000 people and now it's about going deeper in the markets that we've already penetrated.

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Greg Probert - Herbalife Ltd - President COO

I would just add that I think from the start we cautioned everyone that it takes a while for these things to 1) be [inaudible] to each market and to gain some momentum. It took us years-- our distributors years to get this right in Mexico, so we've always said that this is slow growth in the initial years. We want to make sure that we get it right. We want to make sure that we're branding these clubs and that our distributors understand this.

I think from the time of the training to when it shows up in the financials, it takes a few quarters. I'll tell you the fact that we're seeing tens of thousands of distributors show up voluntarily to training is a good indicator to us that this is a concept that's been embraced by our distributors around the world and I think I've very excited as Michael about the future of the Nutrition Clubs and Customer Clubs around the world.

Michael Johnson - Herbalife Ltd - CEO

And one more data point here -- you're getting the round robin of all three of us -- is that it took three years for Mexico to get their business in Nutrition Clubs up and running. While the training takes place, I think it's going to take a little -- it's going to take six months, sometimes even a year, for these things to really get a foothold, so I'll take the slow, steady growth over a quick, rapid rise in failure rates. I would prefer a lower failure rate in a steady growth pattern.

Michael Lasser - Lehman Brothers - Analyst

Final question. If you exclude the incremental spending for China and incremental spending for events that are taking place this year, what type of SG&A leverage do you think that the business is true SG&A leverage you think those businesses are generating, or could generate this year?

Rich Goudis - Herbalife Ltd - CFO

I think what we've said, and we'll be consistent with this, is that our goal would be in a normal year to at least see a 50-basis points of operating margin expansion. This year being a significant investment year I think you're seeing just a little bit below that, about 30 basis points year to date and in the last quarter. So, we'll see the benefit of these, I think, in '07 and beyond.

Michael Lasser - Lehman Brothers - Analyst

And I think one more. Are you getting leverage from your suppliers? Given your growth rate I would imagine that you could expect some price breaks on your purchases, is that true?

Rich Goudis - Herbalife Ltd - CFO

I sure hope our suppliers are listening. Thanks, Michael. I think we're experiencing good improvement in relationships with our suppliers and I think you saw some of that in the gross profit line, albeit the pricing increases overshadowed that. But I think in the wake of a lot of other companies seeing commodities increasing, putting pressure on the gross profits, we're not experiencing that, so, I think that's a testament to how we're working well with our partners.

Michael Lasser - Lehman Brothers - Analyst

Thank you very much.

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Operator

Chris Ferrara with Merrill Lynch.

Chris Ferrara - Merrill Lynch - Analyst

Can you talk about the realignment a little bit more? I guess I missed a lot of what you said. I understand Mexico and Brazil and being stripped out and are reporting directly to you, Greg, right?

Greg Probert - Herbalife Ltd - President COO

Yes, they are, Chris. Basically, the P&L reports are Mexico, Brazil, North America, which is U.S., Canada, and the Caribbean, Amia, North Asia, which is Japan and Korea, greater China, and then the high-potential markets.

Chris Ferrara - Merrill Lynch - Analyst

And those high-potential markets, did you guys mention sort of the central and eastern European countries? I mean, is Russia in there? Is Turkey in there?

Greg Probert - Herbalife Ltd - President COO

Yes, the way Amia is going to be [inaudible] is eventually is-- [Wynn] Roberts runs it for us and he will then reorganize towards his major market -- the Italies, the Spains, and his high-potential markets, which will be Russia, CIS and eastern Europe, including probably Poland is the biggest in there.

Chris Ferrara - Merrill Lynch - Analyst

So, you're saying there will be markets that will go from Amia to your high-potential category?

Greg Probert - Herbalife Ltd - President COO

No, they'll stay under Wynn, but there will be an increased focus under Wynn to pull those up higher and then, even though they report to him, I'll be spending more of my time, as will Michael and the corporate team, on those high-potential markets in Europe.

Michael Johnson - Herbalife Ltd - CEO

Chris, we made a real conscious decision in that regard not to break the Amia region up because of the way our distributors are organized because a lot of their business is on the European continent, so it was more important for us to take what Greg is doing on a global basis and take that same thinking into that marketplace, to be very conscious of how our distributors go to business, yet still being able to differentiate between core, emerging, and major markets in that sector of the world.

Chris Ferrara - Merrill Lynch - Analyst

So, there will be markets that you do consider to be high growth potential that will not be in the high-growth potential segment?

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Greg Probert - Herbalife Ltd - President COO

That's correct. We kind of balance the reorganization or the realignment, if you will, based on how our distributors go to market. I think that was very apparent with the greater China because both Taiwanese and Hong Kong distributors can operate businesses in China and potentially with Southeast Asia, and then South America. Our Brazilian distributors pretty much stay in Brazil. Our Central America and Mexican distributors kind of works together. And then all other South America kind of works together.

So, I think you're seeing a combination of the thought process of prioritizing the business and the investment by where we can get the biggest return and also balancing that with how our distributors go to market so we have great touch points and great communication with them.

Chris Ferrara - Merrill Lynch - Analyst

I mean, is there a chance-- obviously, you're going to be investing more behind the high growth markets and less behind the more sluggish markets. I mean, is there a chance that you guys-- how do you back out of markets? But we see some of the more marginal markets really sort of go off the screen with respect to how material they are?

Michael Johnson - Herbalife Ltd - CEO

No. This is Michael, Chris. I think what you've got -- what we've got under hand right now is a better alignment of resources of this Company to high-growth markets. There will be an operating plan in the model for the markets that have growth patterns that are less aggressive than the ones we're looking at.

A group of us are heading off to London this weekend for meetings with distributors for the London triathlon to compete and also be a part of a pretty good sized event to launch our [inaudible] Herbal Lite there. We're looking at something like that and saying, "This is a great activity for our UK market, but we should be looking at Russia in the future for something like this." This is a high-growth market, a high-potential market for us.

We would want to make sure that what resources we're putting out there are properly aligned to the real growth opportunities. And it would be very disruptive for us to ever pull out of a market. We don't see that as a sensible alternative for this Company. But we're also making sure that we're aligning resources to where real opportunities are, to make sure that we, as a management team, our distributors, and really the marketplace are all very well aligned. That's why we delayed.

We had the head of Brazil reported to someone who reported to Greg and we want to-- he actually had two reports in-between. We want to take that out to make sure that Anita [Beaning] who runs Brazil, has a direct contact to Greg, and they've all been up here for a week. We've been going through an exhaustive plan with them to put roles and responsibilities clearly defined between what's regional, what's local, and what is global in there.

So, we're going through a very thorough, disciplined approach, and basically, reorganizing our Company while we're in a good situation to do it.

Chris Ferrara - Merrill Lynch - Analyst

I guess-- I mean, it's no secret, right, that your peers can [inaudible] in Eastern Europe as the fastest growth markets and it hasn't been that way for you guys. Is there any structural reason why we wouldn't expect those to sort of take a torch in the next couple of years as some of your fastest growth markets?

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Greg Probert - Herbalife Ltd - President COO

I means, that's part of the reason that we're realigning is to maintain the growth in some of the markets where we've outstripped the market, so in some of the major markets we're ahead of the direct selling market growth. And, like you said, in Eastern Europe and Russia and some other countries we see a lot of potential that has been untapped by ourselves.

So, again, to reiterate Michael's point, it's not about cutting back investment. It's about maintaining investment in all of our markets. They're all important to us. But really getting a greater focus on where we think the -- finding the next Mexico, finding the next Brazil while maintaining growth in Mexico and Brazil, maintaining growth in the Spains and Italies. So again, all of our markets are important. We just want to make sure that we realign so that we can continue to maintain the fantastic momentum we've created over the past three years.

Chris Ferrara - Merrill Lynch - Analyst

In a country like Russia, I mean, is it simply that Herbalife is an organization really hadn't gotten to it yet, like gotten to prioritize it and you're going to try that now? Or, are there structural changes you need to make in the portfolio, or different ways to think about new products that would help you grow there?

Greg Probert - Herbalife Ltd - President COO

Well, I think it's both. I think the lack of prioritization creates a lack of focus on do we have the right product mix, are we supporting our distributors in every way we can. So, I think those things are connected at the hip. So, we believe that through greater focus, getting it, like Michael said, higher on the radar screen, cutting out the layers of management, that we'll be quicker to assess the market needs of our distributors and be able to respond to those more quickly.

Chris Ferrara - Merrill Lynch - Analyst

Great! Thanks a lot, guys.

Operator

Doug Lane of Avondale Partners.

Doug Lane - Avondale Partners - Analyst

Good morning everybody. Rich, can you go over that Cap-ex number again, what you're looking for this year?

Rich Goudis - Herbalife Ltd - CFO

Sure. We raised our Cap-ex number range to 50 to 55, up from the 40 to 45, primarily reflecting the decision to move out of the historical back office operation for us, which was down there at the LAX airport and create more of a distributor facing, high touch point facility for our Americas region in a town called Torrance, which is about eight miles south of the airport.

I have a very hands-on [inaudible] R&D lab that [inaudible] training center, customer relations center, as well as again organized around that. So, that's the primary driver of the change in the last quarter.

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Doug Lane - *Avondale Partners - Analyst*

I thought there was a change there. Michael, can you give us an update on the Internet strategy here in the U.S., how that's going?

Michael Johnson - *Herbalife Ltd - CEO*

Well, I'll do it and Greg will probably jump in. What it is, it's just in a beta test right now. We've got 200 distributors who are involved in the Herbalifeshopping.com. We are working this as we do with every key program with distributors involved. We have a strategy and planning team that help us devise and walk through to make sure the channel contents are held, to a non-existent, not to a minimum, but make it non-existent. The financial underpinnings of the transaction with the consumer are held consistent to a distributor just as they would be with a personal transaction with a distributor to a consumer.

We are posting a range of products right now. When we launch this program later in the fall it will have a complete line of our products on there. And this is an opportunity for people who may not have access to a distributor, who may be somewhat apprehensive with the channels. They have access to our great products and our great distributors.

So, obviously, we're excited about it. And one of the functionalities the business can provide is support for our existing distributors to do what we call the back office for them. Pick, pack, ship, inventory, credit and collections will be handled by the corporation and have also direct access and input with the distributor to their consumers. And it gives us ability to what we call CRM -- Customer Relation Manage that relationship in order to offer them the opportunity for more products and even an opportunity to become an Herbalife distributor or buy products at a greater discount.

So, think of it as an online buying club with the opportunity to have a personal wellness coach attached to it. It's really something we're very excited about. We've invested in and it will roll out, not only in English, but in Spanish language later this year, and in key markets globally.

Doug Lane - *Avondale Partners - Analyst*

What has been the feedback from the distributors that have been testing it? Is there apprehension, enthusiasm? Is it going to be--? I mean, I know it's all going to be good, but I really just honestly, is there a concern out there that this is going to disconnect the distributor from their end-user?

Greg Probert - *Herbalife Ltd - President COO*

Doug, it's Greg. No. The reason we've been going slow on this, and I think, as Michael mentioned, we've been working with a steering committee made up of distributors, a press team, and also Chairman's Club, to make sure that this concept is a useful tool for our distributors. And again, you have to remember this is a tool for our distributors. And if they don't embrace it and they don't feel it's the right tool and has the right functionality, then we're wasting our time building it.

So, we've gone very, very slowly and the feedback has been very good. I think the beta test is more about do we have the right functionality, can we break the system before we roll it out to the entire field because you want it to work perfectly. You don't want it to be disruptive.

But again, like Michael said, we're giving distributors a tool to manage their customers better, take some of that administrative functions off their back so they can focus their time on the mentoring and the coaching and the education on the product, and also on the distributor side to maintain their [inaudible].

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So, if you look at as an average tool that we rolled out last year was BizWorks and it had a distribution relationship/management system in it, which has proved very useful for distributors to manage their down-line, see who is doing well, see who is not doing so well, and to do that real time online so that they can focus their energy on lifting the lower performers and maintain the performance of the high performers. And if you can take that concept now over to their customers and for the first time really give them deep visibility into their customers and their purchasing patterns, what products they like, and that data will then help us better service our distributors.

Doug Lane - *Avondale Partners - Analyst*

And lastly, I wondered if you could comment on-- I mean, we see the numbers and the supervisor growth is just really strong. And I wondered what are the one or two or three things that you can attribute to the increased just the ranks of the supervisors here, the leadership? It just seems like over the last two or three or four quarters we've seen a dramatic acceleration in the people that want to be supervisors at Herbalife. What are the two or three key things driving that, if you could drill down there a little bit?

Michael Johnson - *Herbalife Ltd - CEO*

Doug, and I know this isn't a metric you guys are going to love. Confidence. I think our distributors have a renewed confidence in Herbalife, in our products, in the business opportunity. We're seeing more people come in and get recruited and really, frankly, a very exciting effect is more people are moving up in the organization than ever before.

We're up, as we set 41% over 34% in the first quarter, the second quarter is up 41% and that means people are out there with confidence, talking about our products, getting people. It goes down to the basics of this Company. They're using the products, they're wearing some of our Herbalife clothes, they are wearing their button. They're talking to people; there's confidence in the brand. And we're seeing it. And really, this is what we call kind of a pig in a pipe down here. The more you recruit the opportunity for people to move up-line and that's why you're seeing more pricing, more Chairman's Club come in. We're getting more of our whole ladder of success. Our [inaudible] millionaire team members are all growing in this Company.

And I've got to hand it to both the distributors and the direct team. They've put in a couple of promotions that have been phenomenal. Our active world team promotion has created longer planned distributors by helping them balance the three 'Rs', to help them build their recruiting activities, their retailing activities, and therefore, resulting in retention.

So, without sounding too much of a hype meter here, it comes into, I think our distributors and our consumers have a lot of confidence in Herbalife products and our distributors have a ton of confidence in the Herbalife marketing plan because people are moving up at a greater rate than ever before.

Doug Lane - *Avondale Partners - Analyst*

I mean, there's been no change in Herbal rates to become a supervisor, or a change in the compensation system to promote becoming a supervisor, or anything more quantitative like that, or it really is just the intangibles of where Herbalife has been?

Michael Johnson - *Herbalife Ltd - CEO*

The only thing we changed a year ago was the requalification of a supervisor, not the initial qualification, but the requalification of supervisors became a 12-month process versus a one to two-month process. So, you could accumulate points over a longer period of time in order to requalify. But the initial qualification process has not changed. None of the financial metrics have changed in the marketing plan.

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Doug Lane - *Avondale Partners - Analyst*

Well, good job! Thank you.

Operator

Scott Van Winkle from Canaccord Adams.

Scott Van Winkle - *Canaccord Adams - Analyst*

When you look at the new supervisors number relative to the total supervisors number at the end of the quarter, which one looks further out? I mean, I always thought -- I always think a current supervisor at the end of the second quarter would be a good indication of what third quarter revenue is. How far out do we look as to where you really see a turn in that new -- or driven by that new supervisor number? I remember when you gave that for the U.S. probably six quarters ago. Two quarters later the U.S. took off. Is that a further looking indicator?

Rich Goudis - *Herbalife Ltd - CFO*

Yes, you're right, Scott. I mean, the total supervisor is more of a static look just at the end of the quarter. The new supervisors, I think as Michael just alluded to, is really more indicative of the future business because it's a reflection of the level of momentum and excitement and enthusiasm within the distributor organization and the level at which they are bringing new people into the business. So, I think it's more of a leading indicator.

Scott Van Winkle - *Canaccord Adams - Analyst*

And [inaudible] the economics on sampling, you do it at a gross margin, or how do you make that work out economically?

Rich Goudis - *Herbalife Ltd - CFO*

It's actually really our distributors make it work out. Up until this past couple of weeks, as you saw in Las Vegas, our distributors were creating their own sampling packet other than Liftoff, obviously. And we started with Neurofusion a couple of weeks ago and we'll extend that into other product lines to make it more easy for our distributors to sample products with new customers.

Greg Probert - *Herbalife Ltd - President COO*

In our Formula One, the Instant Formula One also comes in packets, so that's another sampling opportunity.

Scott Van Winkle - *Canaccord Adams - Analyst*

As far as the packets that you're assembling, I know the distributors can cover the costs of that with shipping often, but are you making a positive gross margin on that, or are you doing that as really more of an sampling effort and not really making money off of it?

Rich Goudis - *Herbalife Ltd - CFO*

No, Scott, we don't differentiate in our pricing, whether it's a sample size or a full size. Typically the margins are the same.

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Scott Van Winkle - *Canaccord Adams - Analyst*

And, Michael, I just made an order on herbalifeshopping.com and I happen to have a question. Are there only 200 distributors that are involved in getting the leads from this?

Michael Johnson - *Herbalife Ltd - CEO*

Today.

Scott Van Winkle - *Canaccord Adams - Analyst*

And how-- is it a lottery? I was assigned to a person in Arkansas. I wonder do you do it geographically, or is it just some kind of lottery system?

Michael Johnson - *Herbalife Ltd - CEO*

The way we're going to work this out, and we're working the final details with the distributors right now, it will be on performance and region. So we would love to have someone in your region, a high-performing distributor in your region be your distributor.

Greg Probert - *Herbalife Ltd - President COO*

What we're really looking for, Scott, is that we're going to watch it more broadly at our university in October. And what's very important is that when this does occur that distributors get up onstage and talk about the success they've had, some going as far back to the liftoff.com site that was launched last December, more since May with what you're just experiencing, so that distributors are giving comfort to other distributors that it's a great business opportunity. It's more productive for them and that there is no channel conflict.

Scott Van Winkle - *Canaccord Adams - Analyst*

Oh, and one last question. Prior to Nutrition Clubs in the Total Plan, was there ever a history of using the Party Plan concept at Herbalife?

Michael Johnson - *Herbalife Ltd - CEO*

Well, I think there was -- the Party Plan has always been in this Company at a variety of levels, because an HOM in an odd way is a Party Plan. It's an Herbalife opportunity meeting and HOMs are sometimes done in people's homes, sometimes done in small hotels, conference rooms. What we've had is we've had shake parties in this Company. There has been different types of meetings that have taken place. A lot of distributors operate their businesses, obviously, out of their home and invite people over.

So, there's been a Party Plan part of our Company forever. The Nutrition Clubs and the Customer Clubs tend to take it to a new level.

Scott Van Winkle - *Canaccord Adams - Analyst*

Thank you.

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Michael Johnson - Herbalife Ltd - CEO

Only take two more questions.

Operator

Javier Escalante from Morgan Stanley.

Javier Escalante - Morgan Stanley - Analyst

Hi, good morning everyone. I have a question to-- I mean, is related to Chris' questions about the new organization, how you guys came about putting the countries together the way you guys did. Is it that you guys are trying to balance high growth and low growth markets within a single reporting unit? Is that the thinking and this is the way that you guys are going to be reporting financially going forward?

Greg Probert - Herbalife Ltd - President COO

I'll let Rich handle the financial fees. Yes, from an operational side, Javier, and good morning to you. Yes, we really want to -- I think we've said this -- is get some of the big markets. So if you look at our five major markets that [inaudible] -- Mexico, U.S., Brazil, Japan, and China, which is mostly planning now and it'll be a better mix with mainland China growing -- to really get those reporting directly to me.

So, again, those are big markets. They're not only growing, but they're all over 85 million volume points, so those are the engines that drive the Company.

We also realigned the way our distributors work the business. So, we didn't break Amia up, and one idea was we could pull up the high potentials and make one region. That's not the way our distributors -- we have the European extravaganza, the World Team Schools. Many, many of our leadership in Europe operate in western and eastern Europe, so we really want to make sure that corporately we're aligned with our distributors so that --

Again, this is all about helping the distributors, getting closer to the distributors, getting closer to the markets, making sure they have the right and the right tools and the right events and promotions. So, if we align differently than they do, it wouldn't have worked.

So, part of it was a white sheet of paper, but part of it was also looking at the way they operate. And then really again, focusing on the big major markets and the high potentials. And as Chris pointed out, you have some of those high potentials, the market is growing faster than we are and we feel that's a great opportunity for us to find the next Mexico, the next Brazil.

Javier Escalante - Morgan Stanley - Analyst

And Rich, are you guys going to be reporting this way now, or is it the same way, like Americas, et cetera?

Rich Goudis - Herbalife Ltd - CFO

No, we'll eventually move this. The question is do we do it just in the 10-K at the end of the year, or do we adopt it sooner and do it in the third quarter, so we'll debate that with our outside auditors on that, but I would assume that worse case in the 10-K it will be organized that way, and obviously going back in history as well.

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Javier Escalante - Morgan Stanley - Analyst

And I believe, Greg, again [inaudible] how you guys are going to manage the business, right? Let's say that you are a country manager, not a distributor, a country manager in a big, but low potential market, say Germany, right? So, what kind of resources these managers has in terms of keeping the local distributors motivated so the sales in these markets don't kind of like fall once you guys basically -- I wouldn't say divert resources, but emphasize resources say in Russia. So, what exactly -- if you're in Germany and you want to -- Germany basically was very weak, so what will you do to avoid Germany [inaudible] multi-years for-- for multi-year decline for a while?

Greg Probert - Herbalife Ltd - President COO

I think we have to remember, Javier, is the first phase of our organizational design that we've done over the past three years was to make sure that we had strong country managers. So, before we realigned corporate we made sure that we beefed up the resources in the local market. We're going through an exercise right now to make sure there's a clear alignment of accountability and responsibility.

So, before we can hand off responsibility to someone running a Spain or an Italy, we have to make sure we have the right person in there. We have a clear strategy; we have a clear corporate branding and marketing and product strategy. All that has been done and that's the work we've done over the past couple of years.

So, we feel now that this is a corporate realignment, but we have people in those markets, in the Italies, and the Spains, that can run their businesses, support the distributors locally, better than actually than we've ever had. And they have regional air cover or they go back to corporate. So, it's more about getting rid of corporate layers as opposed to country management changes.

Javier Escalante - Morgan Stanley - Analyst

And basically, on herbalifeshopping.com, just to-- the way that I understood it, this is more to help distributors to retain existing customers. Is there any emphasis on capturing new customers with the website?

Greg Probert - Herbalife Ltd - President COO

It's both, but I think the primary focus was really to assist our distributors to better manage and retain their existing customers. We're also looking at ways with our distributors that we can create ways to reach other customers and get them, and assist again in getting them over to our distributors. That's a touchier issue. It's also where you could potentially have channel conflict, so we're going slow on that side because we don't want to do that. We've seen historically in this business, if you create that channel conflict it is very disruptive to your business.

But, just the value of helping our distributors better manage their customers will not only affect retention and retailing, but ultimately will help recruit, because if you're successful by keeping your long-term customers, you're a better distributor and it's easier for you to go recruit the next line of distributors.

So, it's both, and I think when you see it roll out, that the early functionality will be to make sure that we're helping our distributors better manage and retain their customers. It also gives us a chance to look at that database and help distributors spread Best Practices, so if we see one organization has pickier customers or they're doing a better job of up-selling, that's available for them.

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One thing you have to remember, this is an opt-in program, so our distributors, if they feel uncomfortable, they don't have to use it. It's not a mandatory program.

Javier Escalante - Morgan Stanley - Analyst

And finally, on the Nutritional Clubs, I know that the ramp-up is something that it may take 12, 18 months, but you have been testing some of them totally within that kind of timeframe. In the places where you feel that the Nutritional Clubs have clearly [inaudible] better, what kind of changes do you guys have seen? Is the same identical concept as in Mexico, people showing up every day? Is it-- Any insight in terms of whether rural versus more urban people work better within a Nutritional Club? Is it-- does it-- anything with regards to the low income versus high income? If you guys can comment on that, that would be helpful.

Greg Probert - Herbalife Ltd - President COO

It's still a little early to say-- to talk about those macro trends. I will say that we're seeing it-- and we're the initial pushback-- this is only for lower social economic [inaudible]. We've seen it take hold in middle class and even upper class groups, so we're seeing some early indications that it can be not only a [inaudible] by a country, but also by social economic level. So, that's one thing still sort of early to tell on that.

But, we're happy with the rollout of the Clubs. The other question you asked was are they all exactly [inaudible], and the answer is clearly no. We actually talked more about Customer Clubs than Nutrition Clubs. A Nutrition Club is a type of Customer Club. The thing that -- what you see that some of those clubs meet daily, some of those clubs meet weekly, some meet even monthly.

If you look at the value of the clubs, we talk about product results, socialization, and a sense of community, and recognition, so that cornerstone can be accomplished in many, many different ways. I think we talked earlier about in some of our countries we're seeing Lunch Clubs spring up in corporate environments.

Again, it's a chance to get people together in a social setting to talk about nutrition, to share results, to be recognized for their results, and that's the common theme. The way that you carry that out, in your home, out of your home, daily, weekly, monthly, isn't as important as that you basically, the underlying concept is that you bring your customers together on a periodic basis to drive a sense of community and recognition and sharing the product and education of product.

And so, that's why we're very positive that this can be taken around the world. It's just figuring out what is that right secret sauce for each country and within each country for [inaudible] economic [inaudible].

Javier Escalante - Morgan Stanley - Analyst

And the countries where you guys think that the concept has achieved critical mass, other than Jamaica, I think that you guys mentioned Argentina when we were in Vegas. Is that the two countries where the clubs have kind of like gained more traction?

Greg Probert - Herbalife Ltd - President COO

I think Argentina still is at the very beginning. I think what we indicated was that one of the very successful Mexican Chairman's Club members actually is sending one of his press team and [inaudible] into Argentina to really accelerate the traction on Nutrition Clubs. So, --

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Michael Johnson - Herbalife Ltd - CEO

I think the U.S. In the U.S. we're seeing tremendous traction here in the U.S. It's a big country, so it's going to take a while for that to show up in the financials, but we see it working in LA, we see it working across in many, many states. I'm very encouraged. I think, as a concept in the U.S., it's starting to take hold in Brazil. I think a couple of our Chairman's Club, especially Pedro [Cordoza] down there is very enthusiastic about the clubs, so I think they're starting to really take hold in Brazil.

Have we reached critical mass? No. I mean, Jamaica is really probably the only other country where it's reached critical mass. It's defined by it's really big enough to really start moving the top line of the country.

Javier Escalante - Morgan Stanley - Analyst

Thank you very much.

Michael Johnson - Herbalife Ltd - CEO

Angie, we'll take two more questions and that's it.

Operator

Connor [McLaughlin] from JLF.

Connor McLaughlin - JLF Financial - Analyst

Hey guys and congrats on another great quarter! I really appreciate the hard work. I'd like to see if you could talk a little bit about the potential for leveraging the investments in the out years because when you step back and look at the business from a high level, you're growing your earnings 25, 30%, ballpark, in an investment year, which is pretty incredible. And when I go back and look in 2005, the last time we had a non-investment year, we basically grew operating margins from 10% to 14%, which, when you step back, [inaudible] a sustainable 80% gross margin business and after an investment year we're only going to be at the 14% operating margin and you're talking about reaping the benefits of the investments. It gets pretty exciting, especially first [inaudible]. So I was just wondering if you could talk a little bit about the leverageability of the business in the out years and the potential for that accelerating the growth rate.

Rich Goudis - Herbalife Ltd - CFO

Well, Connor, let me just be cautious that we have not provided any guidance beyond '06, so what I would go back to at this point is, your observations are right. We had substantial margin expansion over the last couple of years, but I would remind you that some of that was the clipping of amortization and the removal of sponsor fees. So, probably half of that was, I'll say, non-operating leverage, just to be fair.

Beyond that, I think our commitment here is to balance very strong top-line growth and ongoing investments with at least a 50-basis point improvement in operating margin. We think that that's just a very good disciplined way to run the business. To the extent that our growth rate outpaces our investments going forward, I think you'll see more margin expansion.

Michael Johnson - Herbalife Ltd - CEO

Now, Connor, that's the very conservative Rich and I'm going to step outside just a little bit here.

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I have challenged our organization, and everybody has now got their head in their lap because they don't want me to say this, but I have challenged our organization to become world class in margin in our industry. And part of our realignment is to look at where and how we're spending money, how and where we're putting resources, and to look at the most effective use of those resources.

That means that no stone is going to be left unturned in this Company over the next year. We're going to look at every single thing we do for its effective reach into the marketplace to see and make sure that we are spending money adequately, properly, and focused on distributor activity to drive top-line sales growth, and to make we have a stronger margin.

Connor McLaughlin - JLF Financial - Analyst

I understand you're not giving guidance, but with Wilcox Marketing Company, get high teens operating margins in the long run, obviously? Can you just address the thought process there?

Michael Johnson - Herbalife Ltd - CEO

Well, I would love to be able to say it, but the high teens is not achievable for this type of business, I don't believe. We pay a lot out to our distributors in terms of margin of what we do. So, we're not Proctor and Gamble. We are Herbalife and we are in a direct sales model here, which is a little different economic model.

Greg Probert - Herbalife Ltd - President COO

I think we'll be cautious and that we'll maybe have this conversation a little bit more detailed on our next call when we give '07 guidance. How's that?

Connor McLaughlin - JLF Financial - Analyst

Sounds good. Congratulations again, guys!

Greg Probert - Herbalife Ltd - President COO

One last question and then we'll turn it over to Michael.

Operator

Michael Lasser from Lehman Brothers.

Michael Lasser - Lehman Brothers - Analyst

Hi guys. Real quickly. Could you characterize the frequency of which you're having discussions with the Chinese government? Are they occurring more often more recently, or has there been any change there?

Greg Probert - Herbalife Ltd - President COO

Yes, I would say probably an increase. Percy [Inaudible] who runs China was here, as Michael said, with all of our international management team going through the reorg and focusing on priorities for the remainder of this year and next year. And Percy

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flew back yesterday straight into Beijing. As you know, it's not only the central government, but it's meeting with provincial governments.

One of the reasons that we built the infrastructure that we did and we have regional management was so that that regional management team can meet with the provincial governments, Percy can meet with the Central. He can also meet with the regional, so I would say, because we built out the infrastructure, that has allowed us to increase the number of meetings and strengthen the relationships, both at a state and provincial level.

Michael Lasser - *Lehman Brothers - Analyst*

Have you altered your spending patterns in China due to any change in your expectation on when you might receive the license?

Greg Probert - *Herbalife Ltd - President COO*

No.

Michael Lasser - *Lehman Brothers - Analyst*

Last question, promise. The capital structure outlook for next year, do you feel it's appropriate to carry some amount of leverage on the business? Or will you look to be completely clean?

Rich Goudis - *Herbalife Ltd - CFO*

I think by the end of this year we'll probably be net debt free and the reason for the recap was to put all our debt in a position where we could use our attractive cash flow from our business and pay down debt and accelerate the bottom-line earnings.

Beyond that I think our Board will do the right thing and evaluate other alternatives and options for the right use of cash.

Michael Lasser - *Lehman Brothers - Analyst*

Thanks very much.

Rich Goudis - *Herbalife Ltd - CFO*

Adrian, why don't we just pass it over to Michael for closing comments?

Michael Johnson - *Herbalife Ltd - CEO*

It's always good to talk to you all. You actually had some questions that spur us on a little bit and we've had a great quarter. Everyone of us at Herbalife, and that includes distributors and employees, are pleased and excited about the performance in the first half of this year.

As I said earlier, what it does is it builds confidence and confidence is the underpinning of keeping this Company growing and strong and vital. But as I've said many times before, we're just getting started in this Company. Our distributors know it; our employees know it; all of our suppliers know it; everybody who is involved in this Company knows we're just getting started.

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There is a lot more to be done and there is a lot of opportunity ahead. The organizational realignment that Greg spoke about earlier is just the first step in ensuring that we are supporting our distributors and have the right people in the right places to execute the objectives that we have set up for ourselves and communicated to all of you, and hopefully, very clearly communicated.

In the midst of everything we do, our distributors remain our number 1 focus. And let me repeat that, they are our number 1 focus. In fact, last month alone we saw nearly 30,000 distributors at our North American and European extravaganza. And in the last four weeks, many of us have traveled as far as Bangkok Thailand, to Athens, Greece, to Las Vegas, and some of us even in Berlin for a distributor event at the World Cup final.

We're traveling, we're out there. We're with our distributors and we will continue to make prudent investments, prudent investments that will provide a great business opportunity for part and full-time income, that will develop high-quality science-based products for our consumers, that will continue to support our three 'Rs' and deliver on creating world class customer service experience while reinforcing our commitment to changing people's lives.

Jump on herbalifeshopping.com. Thank you for joining us on today's call and we'll see you in three months.

Operator

Ladies and Gentlemen, thank you for participating in today's conference. This concludes the program. You may now disconnect.

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