

**Who wants to be a Millionaire?**



**Pershing Square Capital Management, L.P.**

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Source: Herbalife Independent Distributor Presentation (2012)

# Welcome to Herbalife!

**A great solution, at the right time**

'If you can dream it,  
you can do it!'  
*Walt Disney*



## Introduction to Herbalife

# Herbalife Ltd. (“HLF”)

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**HERBALIFE™**

**Ticker: “HLF”**

**Stock price: \$42.84 <sup>(1)</sup>**

**Daily Volume: ~\$100mm**

- ▶ **Herbalife sells weight-management, nutritional supplement, energy, sports and fitness, and personal care products through its network of 3 million independent distributors in 84 countries**
  
- ▶ **Capitalization:**
  - Enterprise value: \$4.6 billion
  - Equity market value: \$4.8 billion
  
- ▶ **Recent valuation multiples:**
  - Dividend Yield: 2.8%
  - ‘13e Price-to-Earnings: 9.4x <sup>(2)</sup>

1) As of 12-17-12.

2) Capital IQ consensus estimate (as of 12-17-12).



# Herbalife's Mission Statement

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***“Our Mission is to change people’s lives by providing the best business opportunity and the best nutrition and weight-management products in the world”***

# Is Herbalife a Product Company or a Business Opportunity?

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## Product Company

*Herbalife's mission is to change people's lives by providing the best nutrition and weight-management products in the world*

## Business Opportunity

*Herbalife's mission is to change people's lives by providing the best business opportunity in direct selling*

Source: Herbalife Independent Distributor Presentation (2012)

# The Products

It's all about the products!



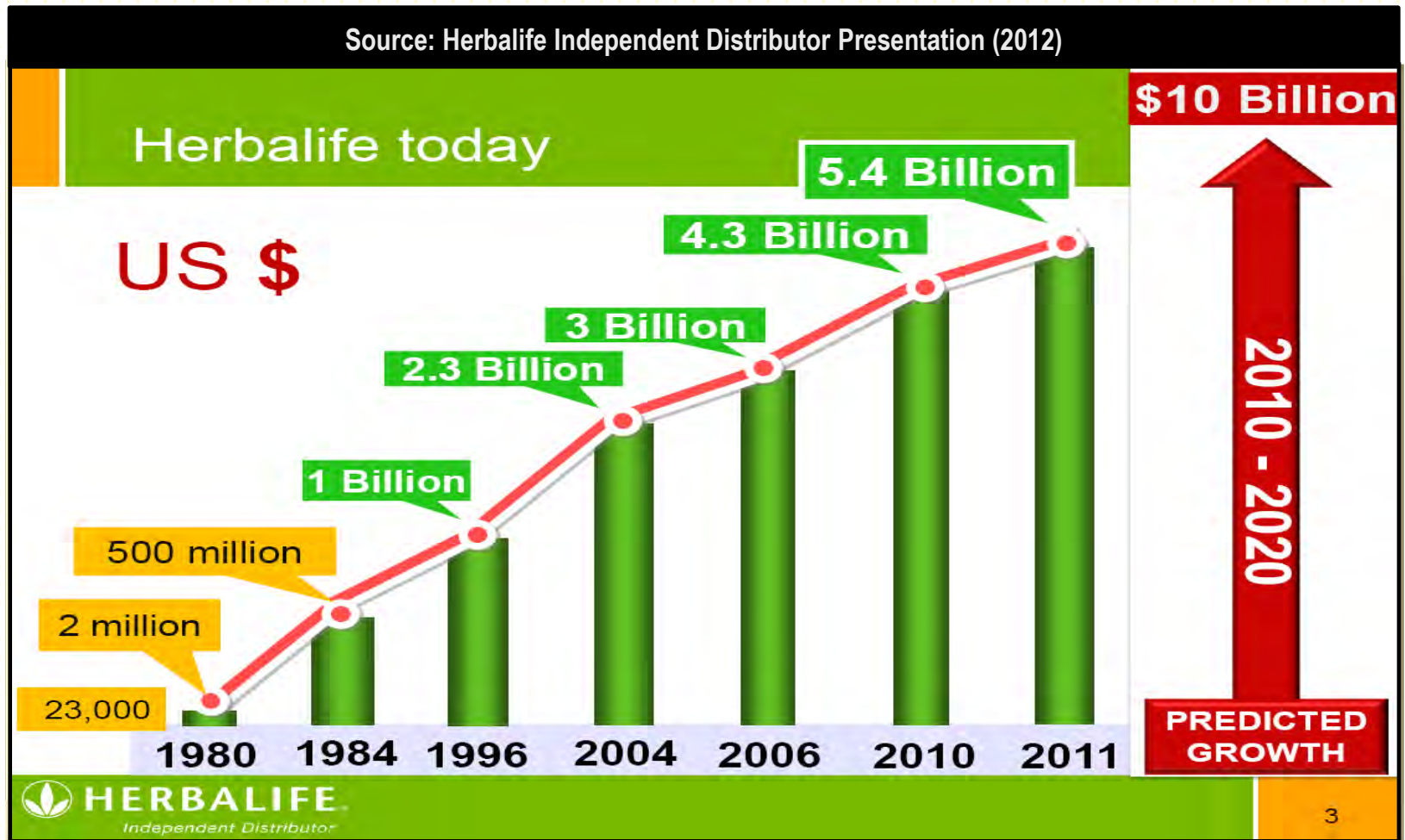
HERBALIFE

**Herbalife:  
The Product Company**

***“In the product area, which we’re very proud of, we’re continuing to develop our science-based nutritional supplements to support our mission, which is to provide the best nutrition and weight-management products in the world.”***

**– Michael Johnson, Herbalife CEO, 5/2/07**

# Herbalife has Experienced Remarkable Growth Since its Formation in 1980



Note: The chart depicts Herbalife's Retail Sales. "Retail Sales" is a Non-GAAP term defined by the Company, which represents the gross sales amount reflected on Herbalife's invoices to its distributors (at Suggested Retail Price ("SRP")).

# Herbalife Has Grown to Become One of the World's Leading Consumer Product Companies...



Ticker	NYSE:CHD	NYSE:ENR	NYSE:CLX	NYSE:HLF
Company Value <sup>(1)</sup>	\$7.2bn	\$6.7bn	\$11.7bn	\$8.1bn
Revenue <sup>(2)</sup>	\$2.8bn	\$4.6bn	\$5.5bn	\$3.9bn
Countries <sup>(3)</sup>	80+	160+	100+	80+
Year Founded	1846	1875	1913	1980
















(1) Based on Total Enterprise Value as of 4/30/12 (pre-Einhorn). Source: Capital IQ.

(2) LTM as of 9/30/12. Source: public company filings.

(3) Represents the number of countries where a portion of each company's products can be purchased. Source: public company filings.

# ... But It Is Not a Typical Consumer Product Company



Gross Margin <sup>(1)</sup>	43.9%	46.8%	42.4%	80.2%
Key Brands	   	    	    	

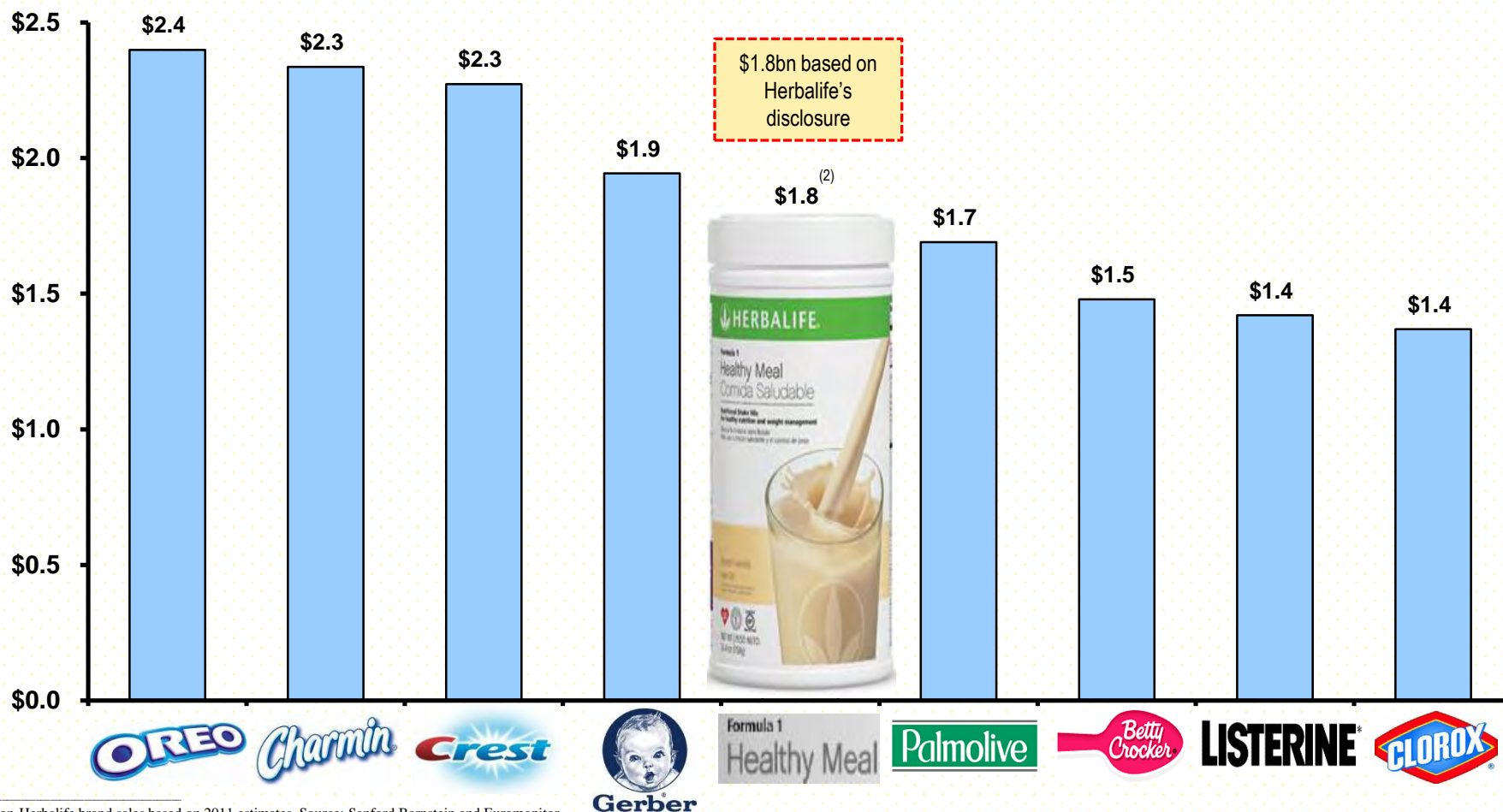
***Has anyone ever purchased an Herbalife product?***



# Herbalife's Top-Selling Product: Formula 1

*Formula 1: the only ~\$2bn brand nobody's ever heard of*

**Global Retail Sales by Brand (\$ in billions) <sup>(1)</sup>**



(1) Non-Herbalife brand sales based on 2011 estimates. Source: Sanford Bernstein and Euromonitor.

(2) Source: Herbalife 2011 10-K notes Formula 1 was 29% of net sales. To get to Retail Sales, assumes Formula 1 is also 29% of Product Sales. Product Sales were 53% of Retail Sales (excluding literature, promotional and other). Includes 29% of Shipping & handling revenue in Retail Sales as these expenses have to be passed through at retail for distributors to capture their full markup.



# What is Formula 1, Herbalife's Top-Selling Product at 29% of Sales?

Formula 1 is a nutritional shake mix like Lean Shake, Slim-Fast or Ensure



Formula 1



Lean Shake



Slim-Fast



Ensure

Company

Herbalife

GNC

Unilever

Abbott Labs

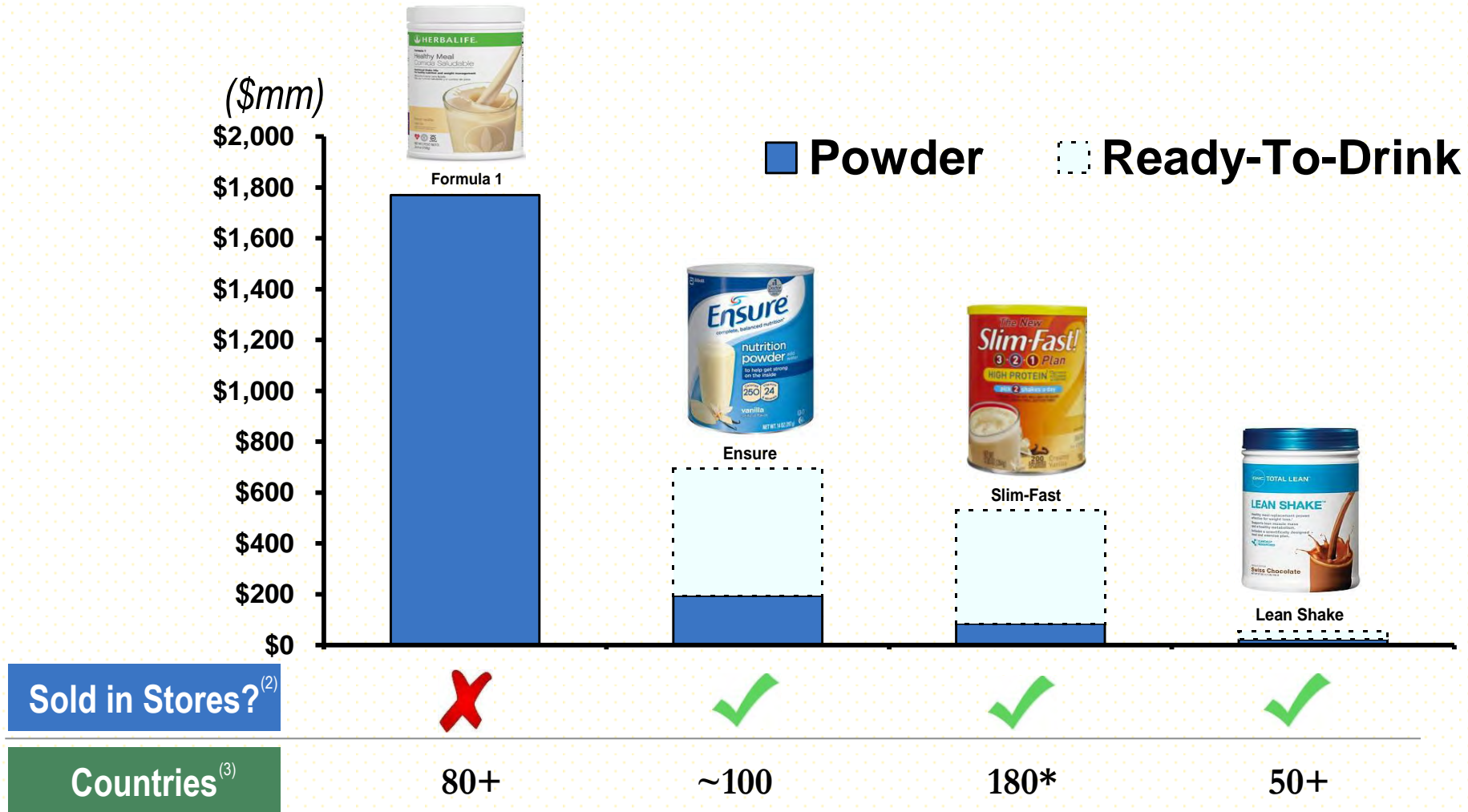
Powder Offering?



Ready-To-Drink Offering?



# Herbalife Sells ~10 to 20 Times More Nutrition Powder than its Competitors<sup>(1)</sup>



(1) Source: public company filings, Euromonitor, sell-side research and Pershing Square estimates.

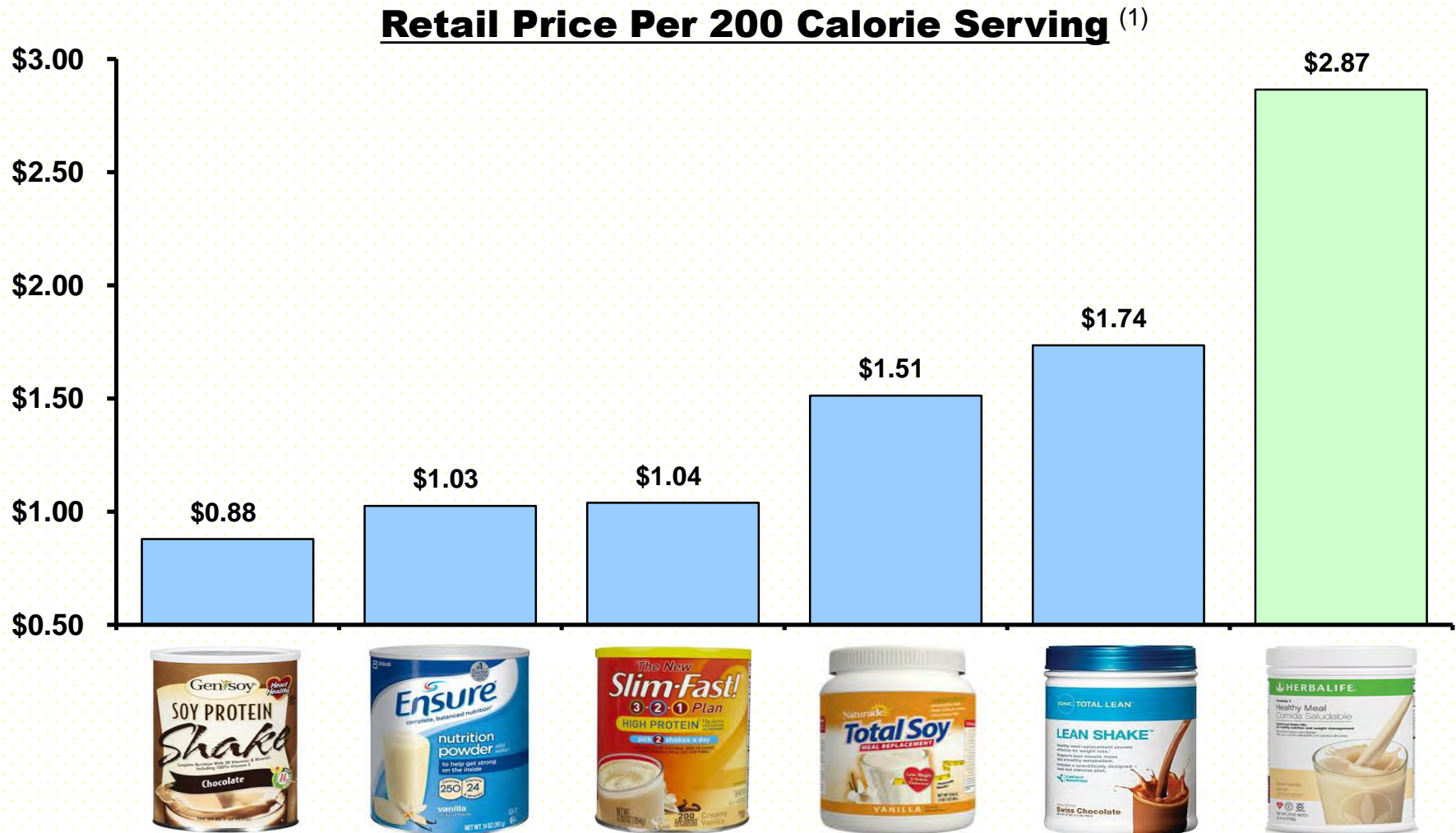
(2) Herbalife products are not sold in stores; however, they are distributed at nutrition clubs. Per the company's investor presentation disclosure, Formula 1 (along with tea and aloe, the other two products primarily distributed at nutrition clubs) accounted for ~35% of total volume in 2002 (pre nutrition clubs) and 52% in 2011. This suggests ~1/3<sup>rd</sup> of Herbalife's Formula 1 sales could be to nutrition clubs.

(3) In 2011: Herbalife distributed its products in ~80 countries. Ensure was distributed in ~100 countries (source: RBC Capital Markets research 11-12-12). Unilever does not disclose how many countries Slim-Fast is distributed in, but Unilever products are available for purchase in 180 countries (source: public filings). GNC products are available for purchase in 53 countries (source: public filings).

**How is it possible that Herbalife  
sells six times more nutrition  
powder than Abbott Labs (Ensure),  
Unilever (Slim-Fast), and GNC  
(Lean Shake), combined?**

**Perhaps it is cheaper...**

# No, Formula 1 is Materially More Expensive than Comparable Nutrition Shake Powders



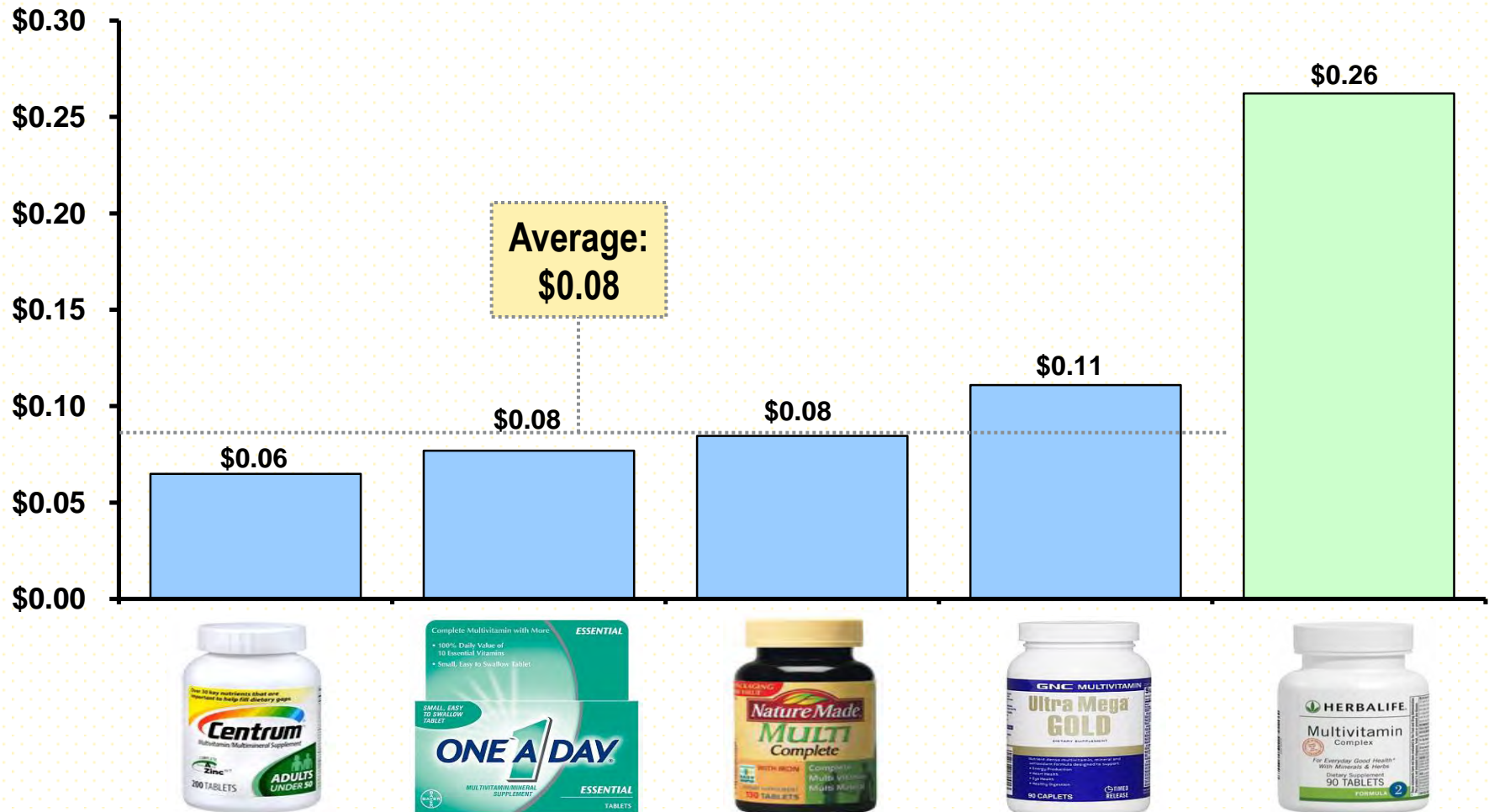
(1) Retail Price per 200 Calorie Serving includes Herbalife's 7% surcharge ("packaging and handling charge"). This charge is fixed despite quantity purchased or if distributors manually pick-up the product. To create an apples to apples comparison, prices are evaluated on a per 200 calorie serving basis and assume the product is mixed with water.

HLF Source: Herbalife Product Price List - Los Angeles (3-6-12). GNC Source: GNC website (11-19-12). Slim-Fast/Ensure/Genisoy/Naturade Source: Walmart.com (11-19-12).

**How does Herbalife price its other products?**

# Herbalife's Multivitamin is more than 3x the Price of Comparable Products

## Retail Price Per Multivitamin Tablet <sup>(1)</sup>

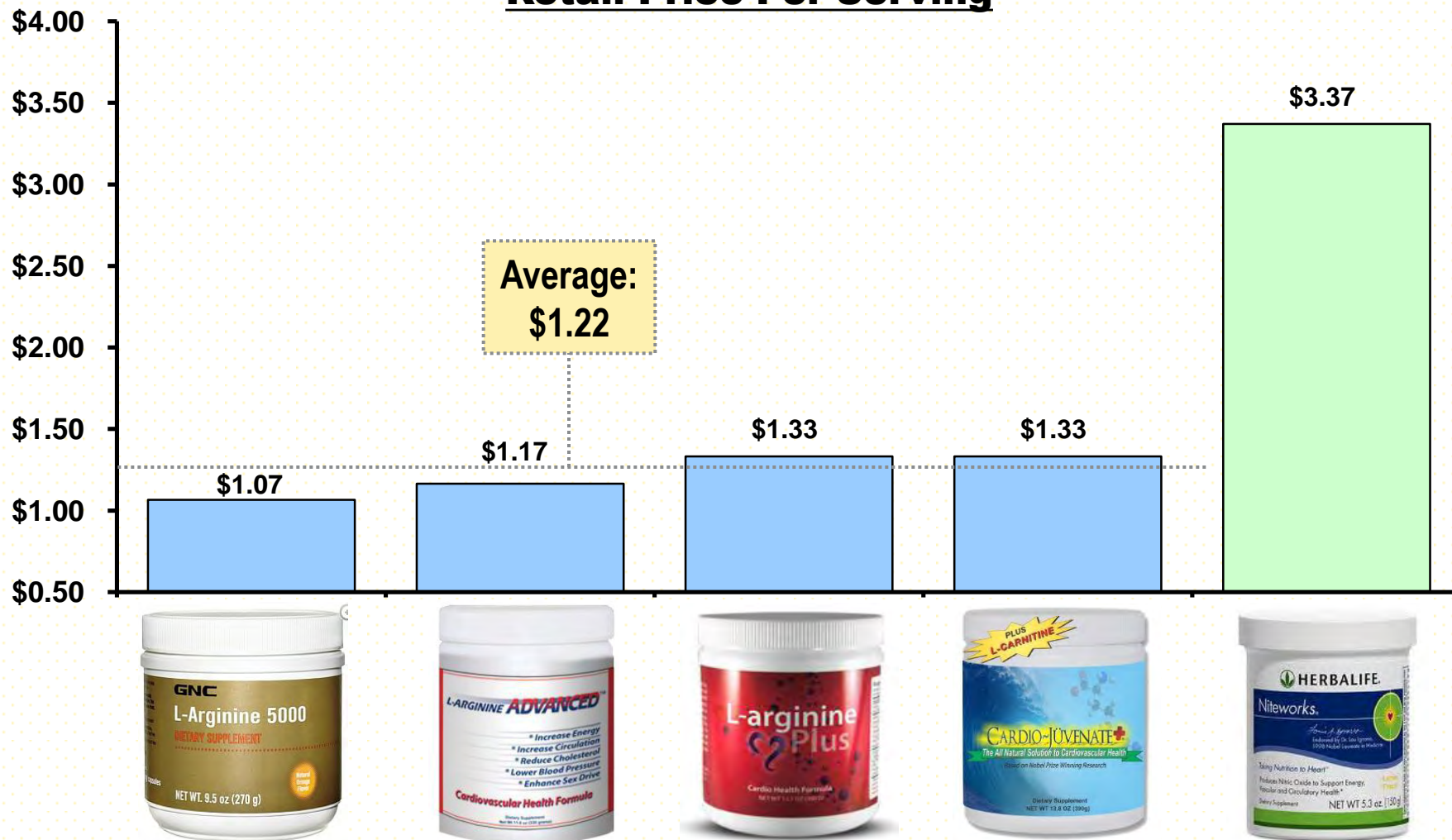


(1) Retail Price per Tablet includes Herbalife's 7% surcharge ("packaging and handling charge"). This charge is fixed despite quantity purchased or if distributors manually pick-up the product.

HLF Source: Herbalife Product Price List - Los Angeles (3-6-12). Centrum source: Walmart.com (11-20-12). GNC source: gnc.com (11-20-12). One a Day source: drugstore.com (11-20-12). Multi Complete source: CVS.com (11-20-12).

# Herbalife's Niteworks (L-Arginine Supplement) is Nearly 3x the Price of Comparable Products

**Retail Price Per Serving <sup>(1)</sup>**



(1) Retail Price includes Herbalife's 7% surcharge ("packaging and handling charge"). This charge is fixed despite quantity purchased or if distributors manually pick-up the product.

HLF Source: Herbalife Product Price List - Los Angeles (3-6-12). GNC source: gnc.com (11-24-12). L-Arginine Plus source: l-arginine.com (11-24-12). Cardio-Juvenate source: erasedisease.com (11-24-12).

L-Arginine Advanced source: advancedhealthsupplements.com (11-24-12).








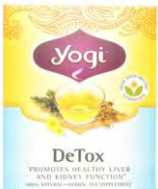

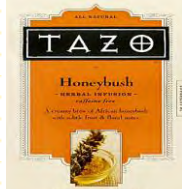














# **How Can Herbalife Justify Such a Meaningful Retail Price Premium for its Products?**

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**Is it because Herbalife has proprietary products for which there is limited competition?**



# No, Herbalife's Products are Commodities

	% of Volume <sup>(1)</sup>	Herbalife Product	Comparable Products				
Nutrition Powder	32%						
		Formula 1	Lean Shake	Slim-Fast	Ensure	Genisoy Protein Shake	Naturade Total Soy
Herbal Tea	12%						
		Herbal Tea	Yogi Herbal Tea	Lipton Herbal Tea	Tazo Herbal Tea	Twinings Herbal Tea	Celestial Herbal Tea
Protein Powder	7%						
		Protein Powder	Muscle Milk	GNC AMP	EAS Whey Protein	MET-RX Natural Whey	Optimum Nutrition
L'Arginine Powder	4%						
		Niteworks	GNC L'Arginine 5000	L'Arginine Plus	AHS L'Arginine Advanced	Cardio Juvenate	now L'Arginine Powder

(1) Source: HLF 2012 Investor Day presentation.

# **How Can Herbalife Justify Such a Meaningful Retail Price Premium for its Products?**

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**Is it because Herbalife has proprietary products for which there is limited competition?**



**Is it because Herbalife spends so much on advertising its products?**

# HLF Compares its Brand Recognition to that of Disney and Nike

Source: Herbalife Investor Presentation (2010)

STRATEGIC OVERVIEW

Herbalife Decade: Brand & Image Vision



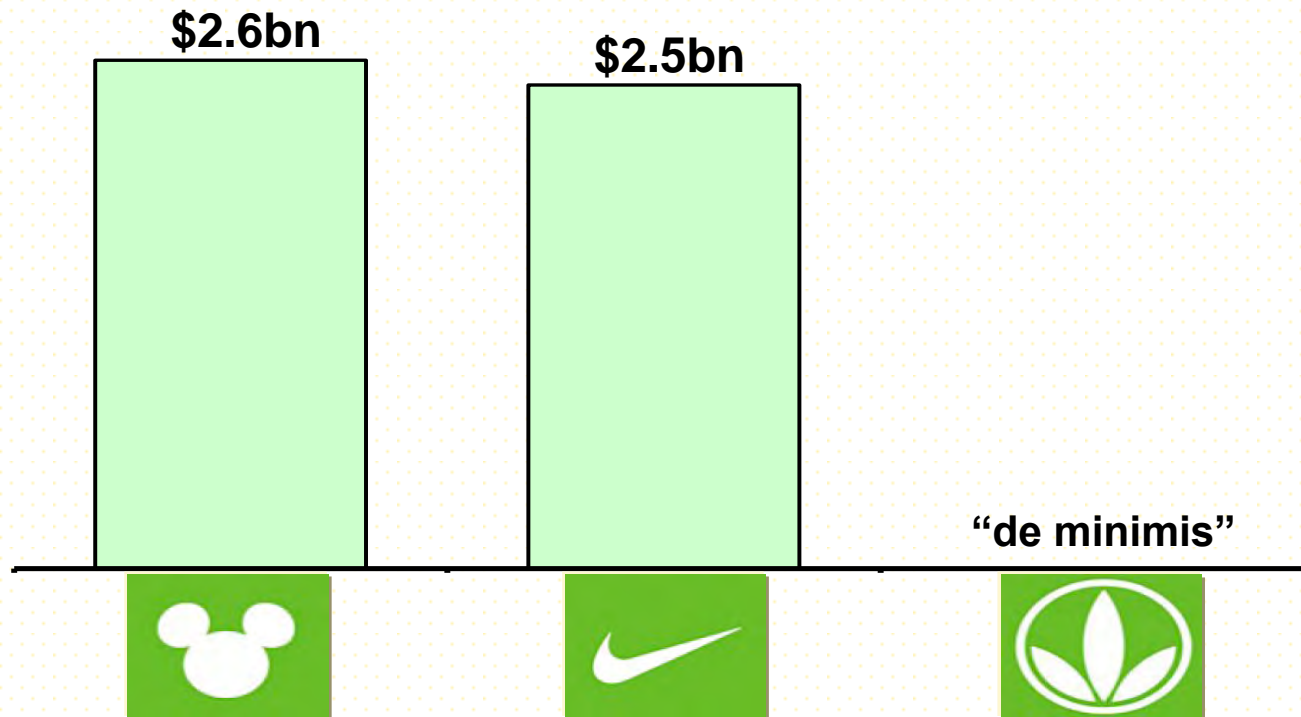
Everyone in the world knows Herbalife



129

# Yet, Herbalife Spends “de minimis” Dollars on Advertising

## Annual Advertising Spend <sup>(1)</sup>



***“The Company’s advertising costs are de minimis”*** <sup>(2)</sup>

**– HLF Letter to the SEC, November 2004**

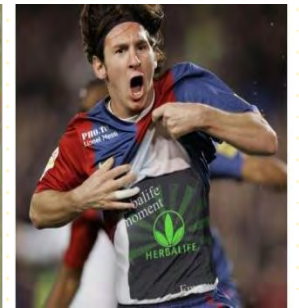
(1) Represents Disney and Nike three-year average advertising expense.

Nike ad spend represented by demand creation expense, which consists of advertising and promotion expenses, including cost of endorsement contracts.

(2) “The Company’s advertising costs are de minimis, and therefore these costs are not specifically addressed under ‘Significant Accounting Policies.’” Source: Herbalife Letter to SEC, November 2004. As of HLF’s 2011 10-K, advertising costs remain unaddressed in the Company’s Significant Accounting Policies disclosure.



# Surprisingly for a CPG Company, Herbalife Advertises and Promotes its Corporate Name and Logo, But Not its Products



***“We generally do not target promotions or advertising at any particular product or brand. Our significant promotions are generally aimed at generating increased levels of recruiting and retention of distributors.”***

**– Herbalife Annual Report 2005**

*“I think more people are seeing people walk around with Herbalife on their chest, and approaching them. And people are now asking us, and that is what I talked about the paradigm shift, what is Herbalife? And that is a new paradigm for our distributors, where someone walks up to them and says, you know, what is Herbalife? Who are you? We have become in a way a cool company like almost over night, which is very gratifying and confidence-building for our distributors.*

*When they see that name Herbalife everywhere all the time, they get excited about that, and they get less – what should I say – less cautious about saying who we are, what we are.”*

**– Michael Johnson, Herbalife CEO, Q2’07 Earnings Call (8-7-07)**

# **How Can Herbalife Justify Such a Meaningful Retail Price Premium for its Products?**

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**Is it because Herbalife has proprietary products for which there is limited competition?**



**Is it because Herbalife spends so much on advertising its products?**



**Is it because Herbalife spends so much money researching & developing its products?**

# Herbalife Claims to Have the Highest R&D Standards in the Industry

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Source: Herbalife Website (2012)



## HERBALIFE

[English](#) | [Español](#) |

United States - English



[Distributor Login](#) | [Find a Distributor](#)

### OUR SCIENCE

Everything we do starts with great products; and all our products start with proven science. Herbalife is dedicated to developing innovative, effective products that comply with the highest research, development and manufacturing standards in the industry.



# Herbalife Claims to Have the Highest R&D Standards in the Industry (Cont'd)

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Video Clip:

<http://www.pscmhflibrary.com/herbalife-ceo-on-rd/>

*“We’re doing research around the clock in this company”*

– Michael Johnson, CEO, CNBC’s *Mad Money*, February 22, 2012

## But Herbalife's R&D Spending is “Not Material”

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► From the Herbalife 2011 Annual Report:

□ *“For all periods presented, research and development costs were expensed as incurred and were not material”*

# Herbalife Claims it has “Increased R&D Expenditures Dramatically” Since 2003...

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Source: Herbalife Website (2012)



The screenshot shows the Herbalife website interface. At the top, there is a green header bar with the Herbalife logo on the left, which consists of a stylized leaf inside a circle followed by the word "HERBALIFE" in white capital letters. To the right of the logo, there are links for "English" and "Español", and a dropdown menu currently set to "United States - English". Further right, there are links for "Distributor Login" and "Find a Distributor". Below the header, the main content area has a light gray background. The first section is titled "OUR SCIENCE" in green, bold, uppercase letters. Below this title is a paragraph of text: "Everything we do starts with great products; and all our products start with proven science. Herbalife is dedicated to developing innovative, effective products that comply with the highest research, development and manufacturing standards in the industry." The second section is titled "RESEARCH & DEVELOPMENT" in green, bold, uppercase letters. Below this title is a paragraph of text: "Herbalife is committed to setting the standard by which all nutrition companies are measured. We are advancing the science of nutrition through scientific research conducted around the world. Since 2003, we've increased our research and development expenditures dramatically to advance the product-development process." The text in the second paragraph is highlighted in yellow.

**HERBALIFE**

[English](#) | [Español](#) | [United States - English](#) ▼

[Distributor Login](#) | [Find a Distributor](#)

## OUR SCIENCE

Everything we do starts with great products; and all our products start with proven science. Herbalife is dedicated to developing innovative, effective products that comply with the highest research, development and manufacturing standards in the industry.

## RESEARCH & DEVELOPMENT

Herbalife is committed to setting the standard by which all nutrition companies are measured. We are advancing the science of nutrition through scientific research conducted around the world. Since 2003, we've increased our research and development expenditures dramatically to advance the product-development process.

# **It's Not Hard to “Dramatically” Increase R&D Expenditures When they are Less than \$2mm/yr**

## **► From the Herbalife 2004 Prospectus:**

- ☐ *“The Company’s research and development is primarily performed by outside consultants and is less than \$2 million per year”  
[or less than 0.2% of GAAP Net Sales in 2004]*

# Herbalife Claims to be a Product Innovator

Herbalife highlights Niteworks, introduced in 2003, as one of its most significant product innovations

Source: Herbalife Investor Presentation (2009)

## Why HLF? Ongoing Product Innovation



# Herbalife Claims Niteworks was the First Nitric Oxide Product in the Marketplace



Endorsed by Dr.  
Lou Ignarro  
1998 Nobel  
Laureate in  
Medicine



Niteworks

*“Dr. Ignarro has basically started the world on the track of nitric oxide, has made the world understand that a healthy blood flow is a healthy body. And we are the first company to come out with a nitric oxide product in the marketplace, it was laughed at initially and now it is copied.”*

**– Michael Johnson, Herbalife CEO, 11-28-07**

***Dr. Ignarro is cited more than 100 times in Herbalife’s SEC filings since the IPO in 2004***

# But Herbalife Was Not the First Company to Develop and Market a Nitric Oxide Product

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**Unither Pharma introduced a nitric oxide product in 2000**

*“In December 2000, we expanded our cardiovascular focus when we acquired the assets and certain liabilities of Cooke Pharma, Inc., the exclusive maker of the HeartBar® line of arginine-enriched products, which operated as Unither Pharma, Inc. (Unither Pharma), our wholly-owned subsidiary. Arginine is required by the body to produce nitric oxide. Unither Pharma is the exclusive licensee of patents entitling it to claim that arginine is critical for maintaining vascular function and certain other natural functions.”*

**– United Therapeutics Corporation 2007 10-K**



# Niteworks Is Sold Under License from United Therapeutics, which Holds Patents for the Product

**Niteworks®** Herbalife teamed with Nobel Laureate in Medicine, Dr. Lou Ignarro, to develop this refreshing lemon powder mix that helps you create more life supporting nitric oxide during the night, when nitric oxide levels are naturally lowest.\* Research indicates that L-Arginine and L-Citrulline help produce nitric oxide, which can protect your cardiovascular health and helps blood vessel elasticity.\*

Helps to support healthy blood pressure levels already within a normal range.\* Rich in antioxidants natural vitamin E and vitamin C. According to the FDA, "Consumption of antioxidant vitamins may reduce the risk of certain kinds of cancer."\*\*\* Niteworks® also contains Folic Acid to protect the vascular system and Lemon Balm to soothe and relax you.\* So drink to your heart's health each night, and wake up feeling rejuvenated.\*

\*\* Some scientific evidence suggests that consumption of antioxidant vitamins may reduce the risk of certain forms of cancer. However, FDA has determined that this evidence is limited and not conclusive.

\*\*\*\* The Nobel Foundation has no affiliation with Herbalife and does not review, approve or endorse Herbalife® products.

Dr. Lou Ignarro is a member of the Scientific and Nutrition Advisory Boards, and receives compensation for his endorsement of Herbalife® products.

**DIRECTIONS:** Two scoops (two teaspoons or about 10g) in 8 fl oz of cold water. May also be mixed with sparkling water or juice. Drink at night or before bedtime.

**30-day money-back guarantee.** This exclusively formulated product is only available through Herbalife Independent Distributors.

This product is sold under license of U.S. patents 5,428,070; 5,891,459; 6,117,872; and 6,646,006.

**NOTICE:** Not recommended for use by children, pregnant or lactating women.



# Herbalife Pays United Therapeutics a Royalty to Market Niteworks

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Source: United Therapeutics Press Release (2006)

## UNITED THERAPEUTICS AND HERBALIFE INTERNATIONAL SETTLE ALL PATENT LITIGATION

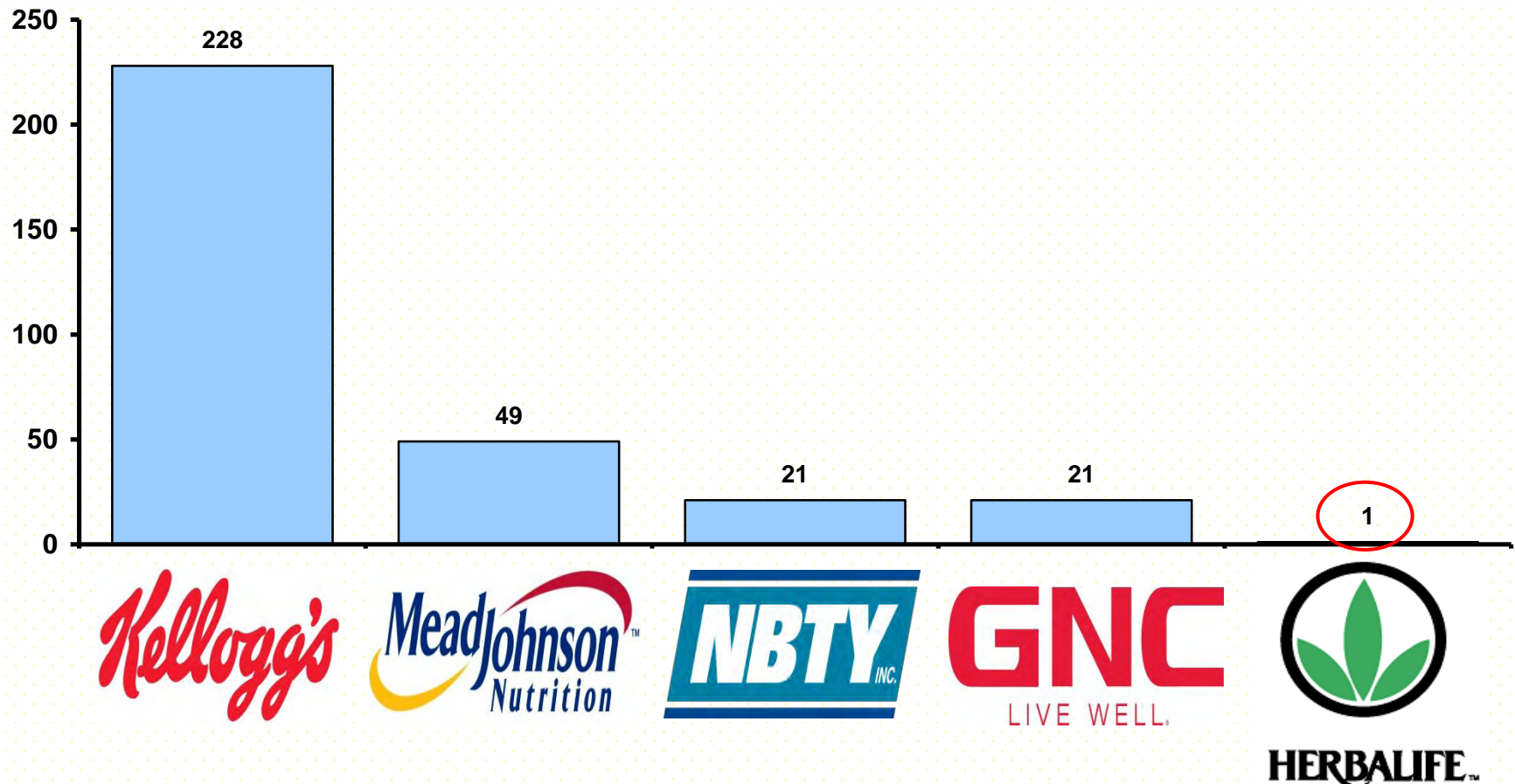
Silver Spring, MD, November 13, 2006: United Therapeutics Corporation (NASDAQ: UTHR) announced today that its wholly owned subsidiary Unither Pharma, Inc. has settled all patent litigation with Herbalife International, Inc. ("Herbalife"). The patent litigation, which began in August 2003, related to products sold by Herbalife containing the amino acid L-arginine and Herbalife's promotion of such products to support cardiovascular and vascular function.

United Therapeutics is the exclusive licensee of five patents licensed to it by Stanford University and New York Medical College with claims relating to L-arginine and vascular function, in particular L-arginine's role in the cardiovascular system's nitric oxide pathway.

Under the terms of the settlement arrangement, all pending lawsuits will be dismissed with Herbalife, and Herbalife has entered into a royalty-bearing, non-exclusive license under United Therapeutics' patents. Financial terms of the settlement were not disclosed.

# Herbalife Has Only One U.S. Patent<sup>(1)</sup>

The companies below have received approximately the following number of U.S. patents in the healthcare / nutrition area



(1) Herbalife only has one utility patent assigned to it entitled "Herbal Supplement to Support Weight Loss" (U.S. Patent No. 7,329,419). In addition, Herbalife has one design patent for an oral supplement (which appears to be an oral tablet with the Herbalife symbol on it). Source: Sullivan & Cromwell.

# **Herbalife Claims its UCLA-led Scientific Research Drives “Meaningful Product Differentiation”...**

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## **From the 2011 Herbalife Annual Report:**

*“We believe our focus on nutrition and botanical science and our efforts at combining our internal research and development efforts with the scientific expertise of our Nutrition Advisory Board and the educational skills of the Nutrition Advisory Board and the resources of the UCLA Lab should result in meaningful product differentiation and give our distributors and consumers increased confidence in our products.”*

## **... and Frequently Cites its “Strong Affiliation” with UCLA**

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*“At UCLA, we have a strong affiliation, where we’ve established the Mark Hughes Cellular and Molecular Nutrition Laboratory at the Center for Human Nutrition.”*

**– Michael Johnson, Herbalife CEO, 11/7/07**

## ... and Frequently Cites its “Strong Affiliation” with UCLA (Cont’d)

Source: Herbalife Independent Distributor Presentation (2007)

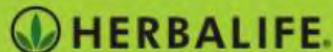


### Herbalife's Commitment to Science and Innovation

#### ***The Mark Hughes Cellular and Molecular Nutrition Laboratory***

Herbalife is dedicated to fostering the exploration of nutritional frontiers as a way to help humanity achieve its potential for optimal wellness. In 2003, Herbalife helped establish the Mark Hughes Cellular and Molecular Nutrition Laboratory at the Center for Human Nutrition at UCLA\* as a part of its mission to advance nutritional science through the most progressive research and development technologies available.

*\*The University of California does not endorse specific products or services as a matter of policy*



*Changing people's lives*

## **... and Frequently Cites its “Strong Affiliation” with UCLA (Cont’d)**

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*“Our product development stems out of our own research and development labs. It comes from UCLA where we have the Mark Hughes Cellular Lab there, University of Mississippi where we have a botanical research lab in the Thad Cochran Center down there. We have doctors placed and scientists placed throughout the world, nutrition experts.”*

– Michael Johnson, Herbalife CEO, 9/3/08

Source: Herbalife at Goldman Sachs Global Retailing Conference (9-3-08).

**Herbalife has cited its UCLA affiliation 440 times in SEC filings since its IPO in 2004**



# Yet, Herbalife has Donated Only \$1.5mm to the UCLA Research Lab

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## From the Herbalife 2011 Annual Report:

*“We have also made contributions to the UCLA Lab. We have invested in this lab since 2002 with total donations of approximately **\$1.5 million** which includes donations of lab equipment and software. UCLA agreed that the donations would be used for further research and education in the fields of weight management and botanical dietary supplements. In addition, we have made donations from time to time to UCLA to fund research and educational programs.”*



# And, Only a Fraction of HLF's Donations were Earmarked for Clinical Studies

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## From an HLF Letter to the SEC, December 2004

*Product Development, page 78*

2. *We note your response to comment 15 and the associated revisions to the prospectus. With respect to your disclosure of \$254,000 in fixed costs for the clinical studies at UCLA, please explain why such amount was given as \$420,000 in your response 78 of your previous letter of November 9, 2004.*

In response to the Staff's comment, we note that while an aggregate contribution of \$420,000 was in fact made to UCLA at year end, only \$254,000 of this amount was specifically earmarked for the clinical studies. The remainder of this contribution was an unrestricted donation to UCLA. Therefore, our revised disclosure was intended to more accurately quantify the fixed costs related to the clinicals, notwithstanding our response 78 in our previous letter of November 9, 2004.

# **How Can Herbalife Justify Such a Meaningful Retail Price Premium for its Products?**

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**Is it because Herbalife has proprietary products for which there is limited competition?**



**Is it because Herbalife spends so much on advertising its products?**



**Is it because Herbalife spends so much money researching & developing their products?**



**Why does Herbalife so heavily promote the R&D and science behind its products?**

# To Inspire Confidence and Create an Aura of Legitimacy

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*“Confidence of our distributors is paramount. It is absolutely the number one thing... We are going through a whole process of making sure that every single thing that we do inside this company has deeper and further substantiation for the distributors, for the web, for anybody in the science industry, anybody in the health community, to make sure that they understand what this company is all about and what we’re doing.*

*This is a company that’s out there at the University of Mississippi, University of Bonn, the University of California at Los Angeles, UCLA. We’re involved in research, development of products, we have our own research facility now in our offices in Southern California. We have doctors dedicated – this nutrition advisory board that’s unlike any other company in our field. We meet with experts on a global basis to review, to study, to understand, to build confidence and substantiation in our products on a global basis.”*

**– Michael Johnson, Herbalife CEO, 12/16/08**

**Herbalife has paid its Nobel Laureate spokesman, Dr. Louis Ignarro and his affiliated consulting firm more than \$15 million to help Herbalife promote its business opportunity to its distributors**

# Herbalife is Not a Product Company

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## HLF View

- Herbalife products are **truly extraordinary**
- Herbalife products are offered at a **fair price**
- “Everybody knows Herbalife”
- “We’re doing research around the clock in this company”
- Renowned scientists are employed to differentiate HLF product offering

■ **It’s all about the products**

## Reality

- Herbalife products are **commodities**
- Herbalife products are offered at a **massively inflated price**
- Herbalife’s advertising expenditures are **de minimis**
- Herbalife’s R&D expenditures are **not material**
- HLF pays PhD’s to lend credibility to HLF’s business opportunity

■ **It’s all about the business opportunity**

**How does Herbalife sell so much of its unadvertised, commodity products at an inflated price?**

**Herbalife bundles its products with a business opportunity**



Source: Herbalife Earnings Call (Q1'10)

*“What we’re doing at Herbalife, is we’re building the best business opportunity on the face of the earth”*

– Michael Johnson, CEO

**Herbalife:  
The Business Opportunity**

**What is the Herbalife business opportunity?**

# **An Opportunity To Be Your Own Boss**

---

Source: Herbalife Independent Distributor Presentation (2009)

## **Herbalife is a fantastic Business Opportunity!**

- **Start straight away** - part time, full time – flexible to fit with your life
- **Minimal start up costs**
- **No previous experience** required
- **Be your own boss** – take charge of your life
- **Anyone can do it!**

# **An Opportunity To Achieve Financial Freedom**

---

Source: Herbalife Independent Distributor Presentation (2010)

## **What are you looking for?**

**Work From Home**  
**Extra Income**  
**Own Business**  
**Financial Freedom**  
**More Spare Time**  
**Personal Development**  
**Helping Others**  
**Meeting New People**  
**Retirement / Pension**  
**Leave a Legacy**



# An Opportunity To Create a Growing Annuity

Source: Herbalife Independent Distributor Presentation (2011)

## Development of normal income



## Income with Herbalife

After build-up phase you continue to receive income even when you don't work yourself



*Making the world healthier.*

# **An Opportunity To Improve Your Lifestyle**

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Video Clip:

<http://www.pscmhflibrary.com/profile-of-an-herbalife-chairmans-club-member/>

*“You know, it’s really amazing. I step out of the Ferrari, the Bentley, or whatever, and people go – ‘what does that guy do for a living? – and I go, ‘I’m an Herbalife independent distributor,’ and people are absolutely amazed”*

**– Doran Andry, Chairman’s Club Member**





**How could a distributor of nutrition and weight-management products who is working from home possibly achieve this degree of wealth and lifestyle?**



# (Here's a Hint from an Herbalife Distributor Marketing Presentation)

Source: Herbalife Independent Distributor Presentation (2006)

## *Growing and Sustaining Royalties*

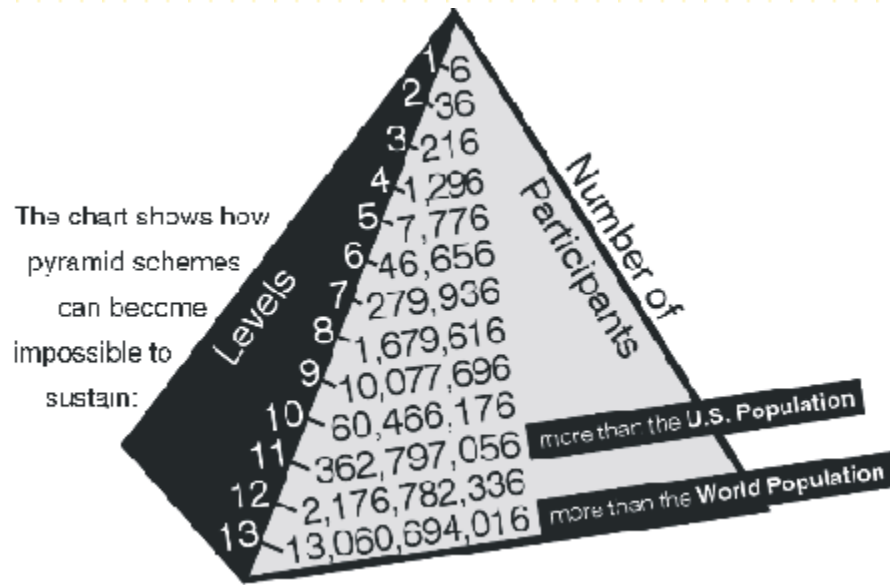
<b>You</b>		<b>Personal Sales = \$2500</b>
<b>1<sup>st</sup></b>		<b>5 supervisors</b>
<b>2<sup>nd</sup></b>		<b>25 supervisors</b>
<b>3<sup>nd</sup></b>		<b>125 supervisors</b>

**155 supervisors total**

*Each has 25 clients = TOT. \$390,000 in Sales    Royalties 5%    Production Bonus 6%*  
***\$1250 retail + \$19,500 R.O. + \$23,400 P.B. = \$44,150/month***



*Changing people's lives*



## What is a Pyramid Scheme?

Source: SEC.gov.

# What is a Pyramid Scheme?

---

**In 2002, Dr. Peter J. Vander Nat, a senior economist at the FTC, defined a pyramid scheme:**

The FTC settlement orders reached in *Equinox*, *JewelWay*, and *World Class Network* may be viewed as a certain refinement of *Webster v. Omnitrition* (1996). The FTC settlements reflect the following position: If an organization sells goods or services to the public and the participants in the organization obtain monetary benefits from (1) recruiting new members and (2) selling the organization's goods and services to consumers, the organization is deemed a pyramid scheme if the participants obtain their monetary benefits primarily from recruitment rather than the sale of goods and services to consumers (see order provisions and language in *FTC v. World Class Network Inc.* 1997; *FTC v. JewelWay International Inc.* 1997; *FTC v. Equinox International Inc.* 1999).

Vander Nat, Peter J and Keep, William W.; (2002). Marketing Fraud: An approach for differentiating Multi-level Marketing from Pyramid schemes. *Journal of Public Policy and Marketing*. Vol 21-1, 139-151.

# Herbalife Is Well Aware of the Law

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FINAL TRANSCRIPT

Sep. 03. 2008 / 9:30AM, HLF - Herbalife Ltd. at Goldman Sachs Global Retailing Conference

**Rich Goudis** - CFO - Herbalife Ltd.

Yes, 25% of our revenue is associated with bringing in new people into the business. We're very public about that and the way to look at that is in our public filings. On a quarterly basis look at the number of new supervisors coming into the business, which we use as a key statistic and we report upon. Assume that somewhere between \$2,500 net sales to \$3,000 is the value of that new supervisor coming into the business. There's very strong FTC rules that we measure ourselves against to make sure that at least the FTC rule says less than 50% of your business has to be from recruiting. So that's a real benchmark.



# Why are Pyramid Schemes Illegal?

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A.

Pyramid schemes are said to be inherently fraudulent because they must eventually collapse. See, e.g., *S.E.C. v. International Loan Network, Inc.*, 968 F.2d 1304, 1309 (D.C.Cir.1992). Like chain letters, pyramid schemes may make money for those at the top of the chain or pyramid, but “must end up disappointing those at the bottom who can find no recruits.” *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181 (1975), *aff’d mem. sub nom., Turner v. F.T.C.*, 580 F.2d 701 (D.C.Cir.1978).

Source: Webster v. Omnitrition, 79 F.3d 776, 781 (9<sup>th</sup> Cir. 1996).

**In a pyramid scheme, the money at the top is made from the losses of people at the bottom of the pyramid**

## **In the next section, we will demonstrate two facts:**

1. Participants in the Herbalife scheme, the distributors, “obtain their monetary benefits primarily from recruitment rather than the sale of goods and services to consumers.”
2. Herbalife inflates the Suggested Retail Price (“SRP”) of its products and overstates “Retail Sales” in its public filings to conceal the fact that Recruiting Rewards earned by distributors are substantially greater than the Retail Profit they generate

**And we will demonstrate that:**

**Herbalife is a Pyramid Scheme**

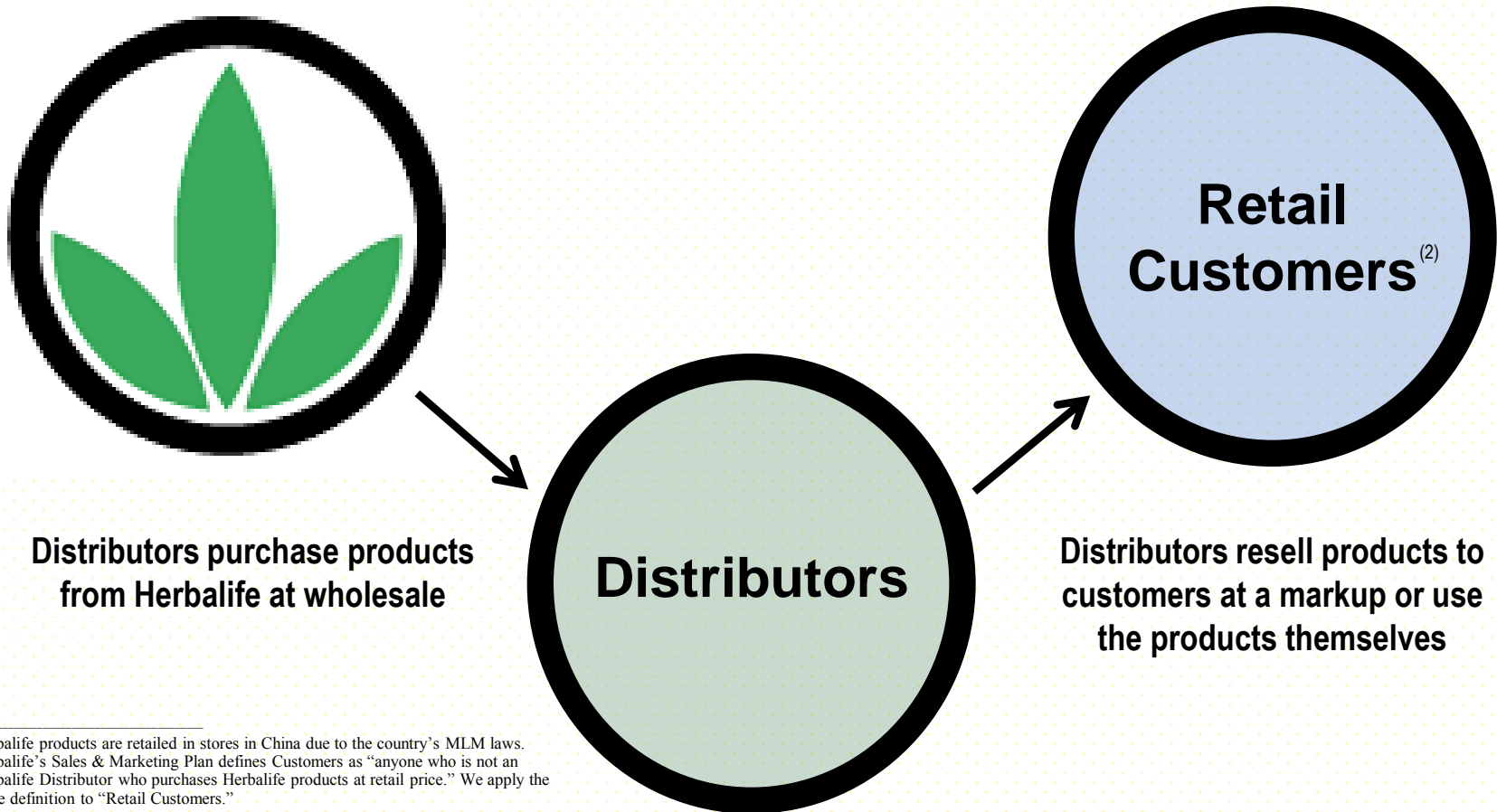




**How does Herbalife's business work?**

# Herbalife Is a Direct Seller: Its Products Are Not Sold in Retail Stores<sup>(1)</sup>

Distributors purchase products from Herbalife at what HLF deems to be “wholesale” prices and consume the products themselves (“Internal Consumption”) or resell them at retail prices thereby capturing the markup (“Retail Profit”)



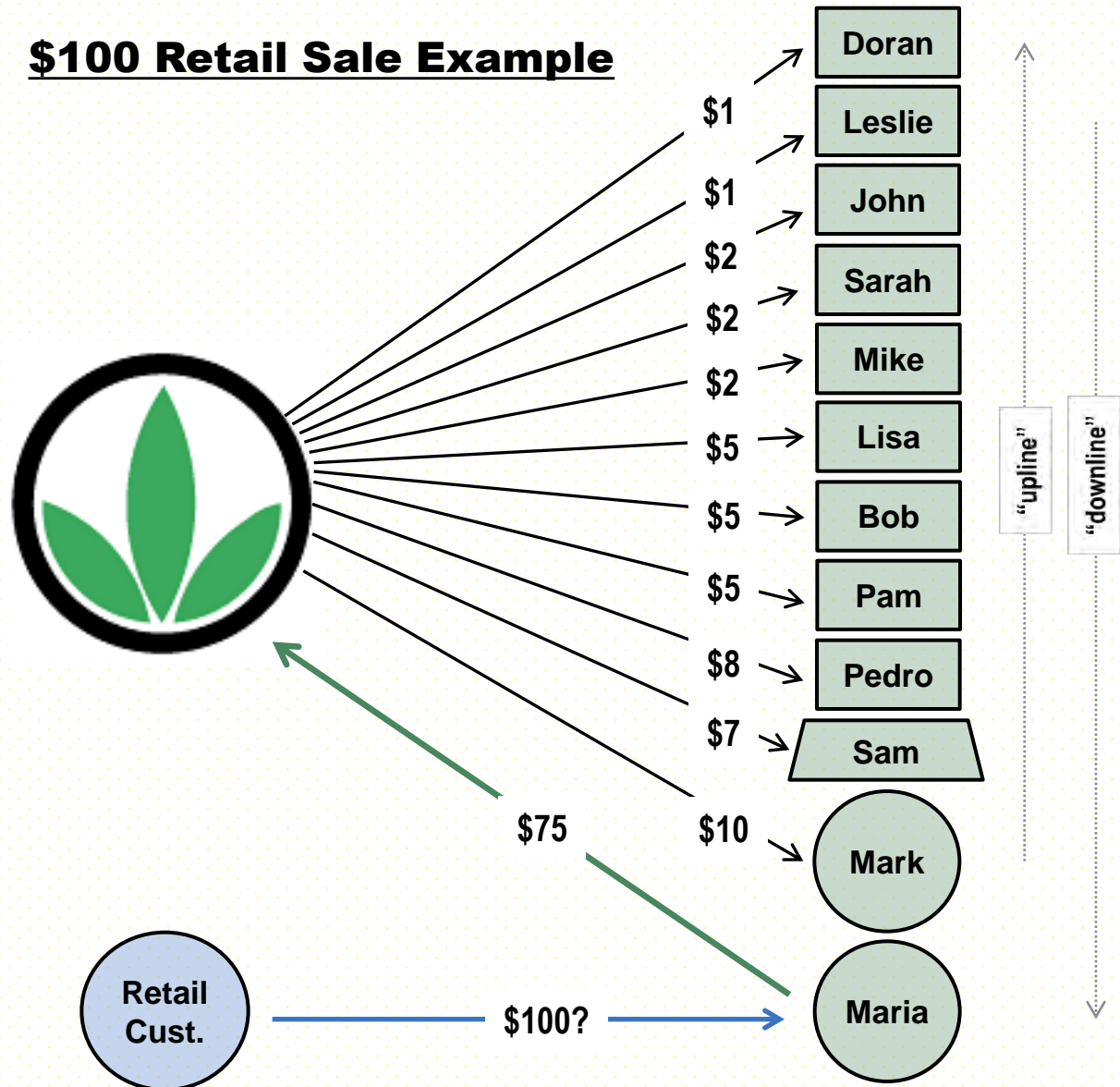
(1) Herbalife products are retailed in stores in China due to the country's MLM laws.  
(2) Herbalife's Sales & Marketing Plan defines Customers as "anyone who is not an Herbalife Distributor who purchases Herbalife products at retail price." We apply the same definition to "Retail Customers."

# Herbalife is a Multi-Level Marketer (“MLM”)

This means when Doran recruits Leslie who recruits John who recruits Sarah who recruits Mike who recruits Lisa who recruits Bob who recruits Pam who recruits Pedro who recruits Sam who buys \$75 of product from Herbalife:

Multiple levels of people above Maria receive commissions from Herbalife

## \$100 Retail Sale Example



# How To Become An Herbalife Distributor

---

## ▶ Distributors must buy their way in

- *All independent Herbalife distributors must purchase an International Business Pack (“IBP”) to enroll*
- *Cost: \$55 to \$91*



## ▶ Distributors must sign a Distributor Agreement

- *Herbalife’s Distributor Agreement has 124 pages, 48,000 words and 215 rules*
- *Herbalife’s non-compete restricts senior distributors from soliciting alternative multi-level marketing opportunities (e.g., senior distributors can work part-time at GNC but not Avon)*

# Distributors Have Two Ways to Earn

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## Retail Profit

*Profit derived from sales  
to Retail Customers*

*(paid by Retail Customers)*

## Recruiting Rewards

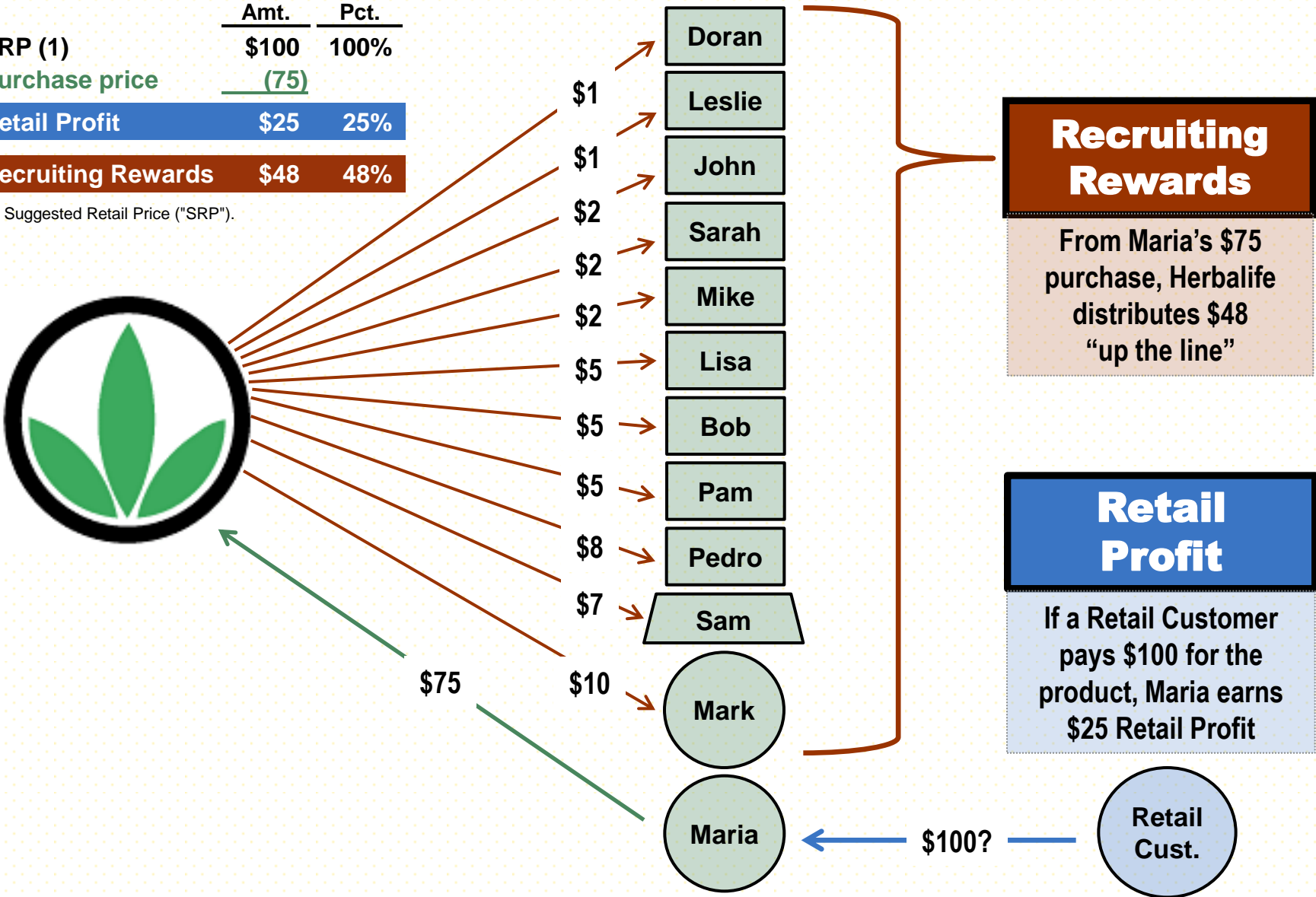
*Rewards derived from the  
purchases of other distributors*

*(paid by the company)*

# Distributors Have Two Ways to Earn (Example)

	Amt.	Pct.
SRP (1)	\$100	100%
Purchase price	(75)	
Retail Profit	\$25	25%
Recruiting Rewards	\$48	48%

(1) Suggested Retail Price ("SRP").





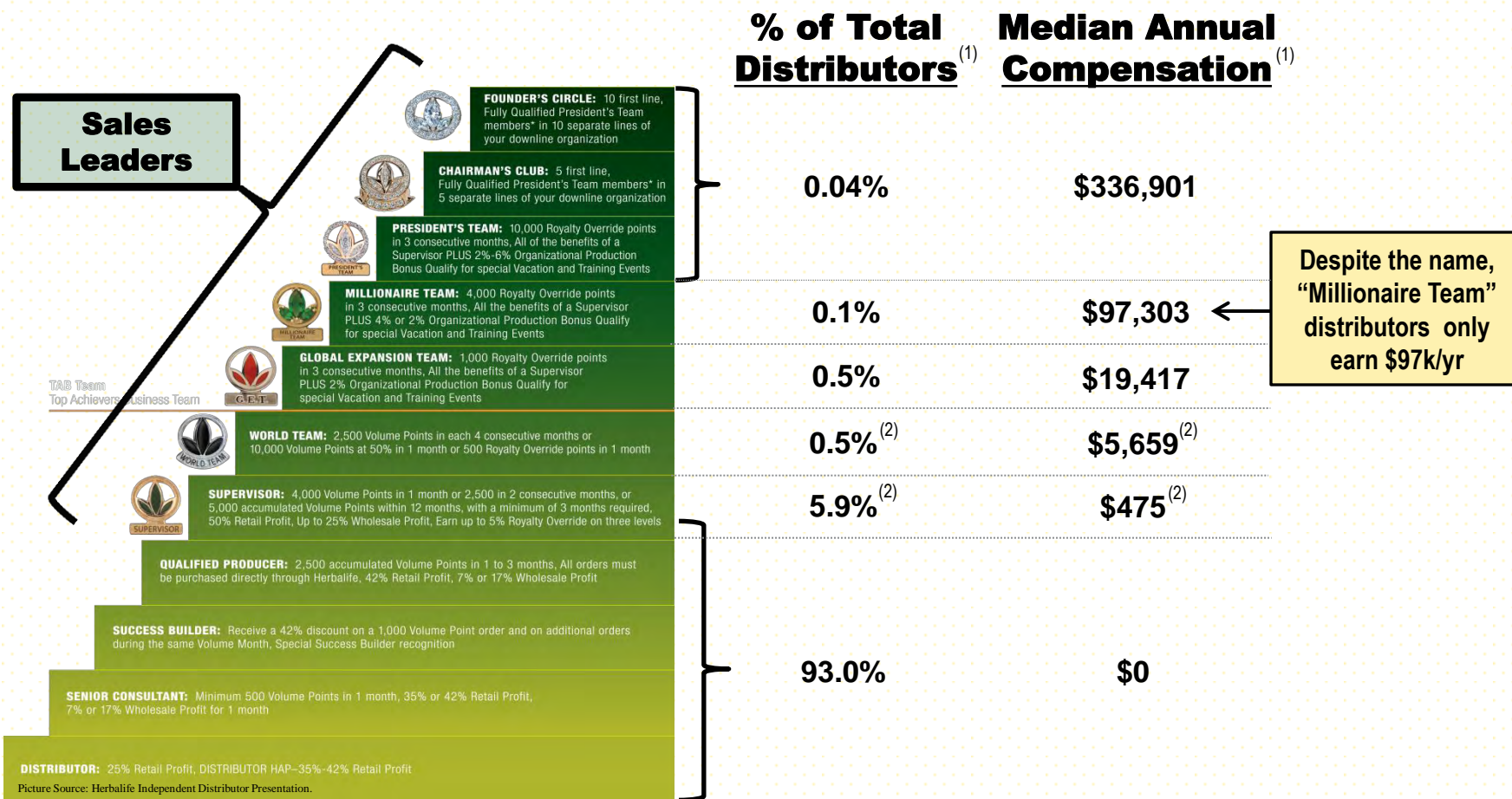
# Two Primary Types of Distributors

	Non-Sales Leaders ("NSLs")	Sales Leaders ("SLs")
Retail Profit	Purchase product at a 25%, 35%, or 42% discount	Purchase product at a 50% discount
Recruiting Profit	Not eligible to receive Recruiting Rewards <i>(except 35% and 42% NSLs who are eligible for Wholesale Commissions)</i>	Eligible to receive Recruiting Rewards
Minimum Volume Requirement <sup>(1)</sup>	25%: Must purchase IBP  35%: 500 Volume Points (~\$360)  42%: 1,000 Volume Points (~\$650)	50%: 4,000 Volume Points (~\$2,600)

(1) Assumes 1 Volume Point = \$1 Retail Sales for simplicity (the actual ratio is a little higher). Cost to achieve the Volume Points includes Herbalife's 7% surcharge (e.g., 500 Volume Points \* 1 VP / RS = \$500 Retail Sales;  $(1 - 35\% + 7\%) * \$500 = \$360$ ).

# Herbalife's Multiple Levels: The Only Way to Make Money is to Get to the Top

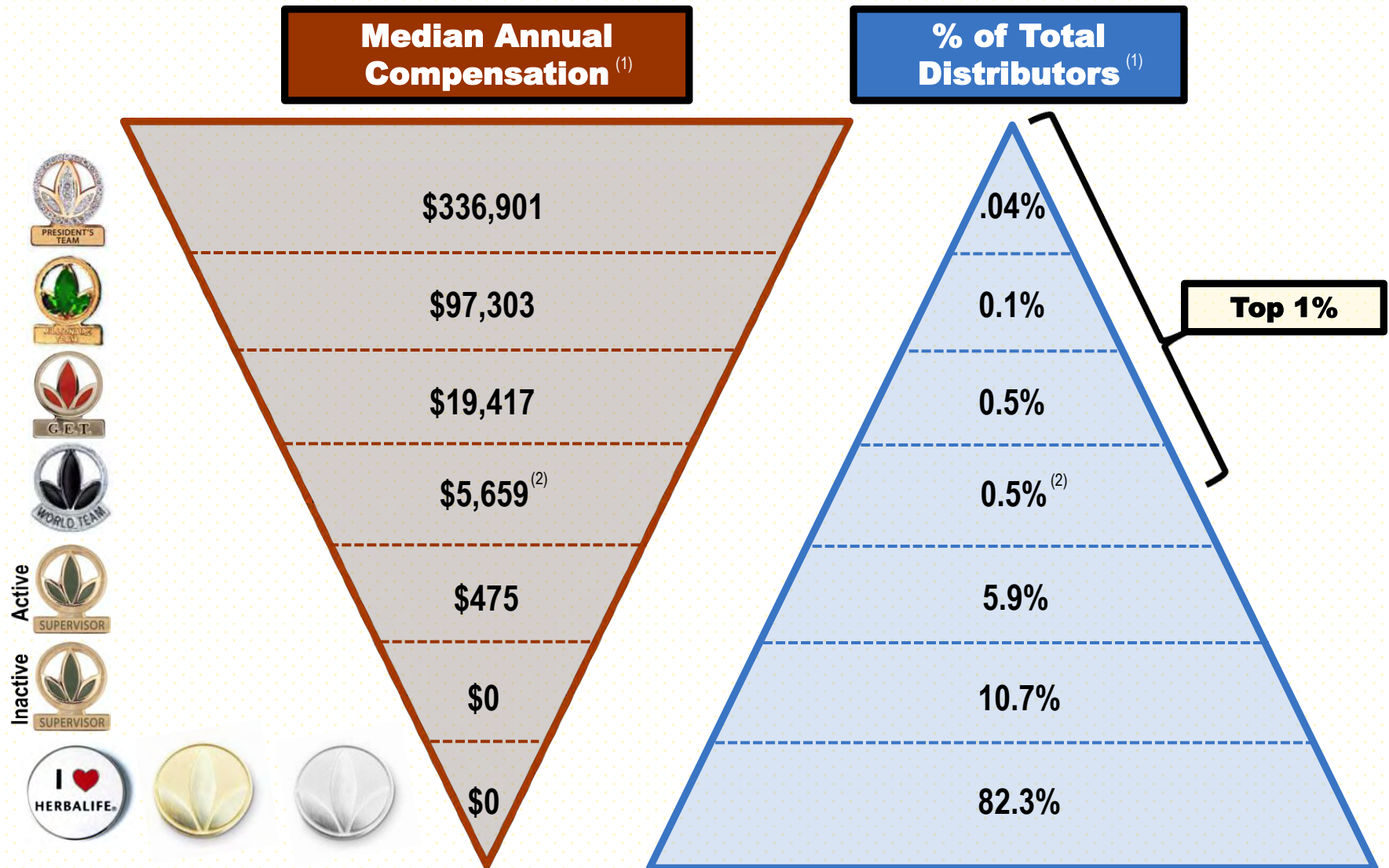
A de minimis fraction of Herbalife distributors earn enough to achieve the wealth and lifestyle depicted in distributor recruiting presentations



(1) The figures above refer to U.S. distributors. "Compensation" is an Herbalife term and does not include income earned by distributors from Retail Profit or from Wholesale Commissions. "Compensation" is gross, not net of expenses or taxes. Percentages vary from Herbalife's Statement of Gross Compensation because not all distributors are included. Source: Herbalife Statement of Average Gross Compensation of U.S. Supervisors (2011).

(2) Only includes "Active" World Team and Supervisors as defined by the Company in its Statement of Gross Compensation of U.S. Supervisors (only 39% of Sales Leaders are "Active").

# The Top 1% of Herbalife Distributors Receive 88% of the Rewards<sup>(1)</sup>

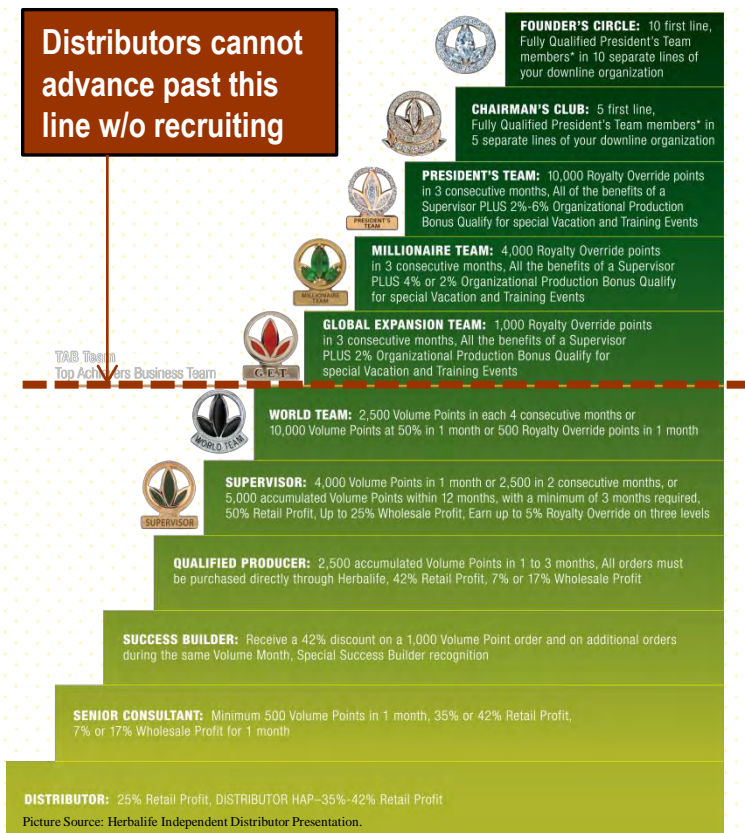


(1) The figures above refer to U.S. distributors. "Compensation" is an Herbalife term and does not include income earned by distributors from Retail Profit or from Wholesale Commissions. "Compensation" is gross, not net of expenses or taxes. Source: Herbalife Statement of Average Gross Compensation of U.S. Supervisors (2011).

(2) Only includes "Active" World Team and Supervisors as defined by the Company in its Statement of Gross Compensation of U.S. Supervisors (only 39% of Sales Leaders are "Active").

# How Distributors Move Up the Chain: Volume Points

In order to advance in the Marketing Plan, distributors must accumulate Volume Points (“VPs”), a form of “currency” created by Herbalife



- One VP is approximately equivalent to \$1 of “Retail Sales”
  - Over time this ratio has increased to greater than 1:1, which is a way for Herbalife to “increase price” to its distributors
- Distributors accumulate Volume Points by purchasing product or by recruiting others who purchase product
- To get to the upper levels of the Herbalife chain, distributors must accumulate a special kind of volume known as Royalty Override Points (“ROPs”)
- Royalty Override Points can be generated only when a Sales Leader recruits other distributors who also become Sales Leaders
- It is impossible for a distributor to get to Active World Team or above without recruiting other Sales Leaders – no matter how much they sell at retail

# Top Earning Distributors are “Recruiters”

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**Rich Goudis** - *HERBALIFE LTD - CFO*

No, that's their income. So then you're looking at now our retail sales, because the single biggest opportunity for those supervisors is their 50% off list discount. That's the biggest component of their income. They get a small piece on their royalties, because they really haven't started building a sales organization yet to get rewards down below. Whereas someone up in the very top, they're \$2+ million, they're probably working on very little retail margin, because they're not really retailers.

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**Michael Johnson** - *HERBALIFE LTD - CEO, Chairman*

They're recruiters.

---

**Rich Goudis** - *HERBALIFE LTD - CFO*

They're building their sales organization, so more of their compensation or income is based on the commission structuring in their multiple level marketing.

Source: Herbalife at Goldman Sachs 14<sup>th</sup> Annual Retailing Conference (9-5-2007).



# Senior Distributors Encourage Other Distributors to Recruit if they Want to Make “Lifestyle Money”

The screenshot shows a presentation slide with a yellow and white background. In the top right corner, the text 'Online Business Systems' is visible. A red dashed box highlights two lines of text: 'If you want some money today' followed by the word 'RETAIL' in blue, and 'If you want Lifestyle money' followed by the word 'RECRUIT' in blue. Below this, the text 'Be prepared to Roll your Cash Flow 9 – 12 months straight! – Foundation for life!!!' is displayed in orange. Further down, the text 'Retail 1-2 Starter Program Customers/Week' is shown in green, and 'Recruit 25 – 40 Decision packs per month' is shown in blue.

Online Business Systems

If you want some money today **RETAIL**  
If you want Lifestyle money **RECRUIT**

Be prepared to Roll your Cash Flow  
9 – 12 months straight! – Foundation for life!!!

Retail  
1-2 Starter Program  
Customers/Week

Recruit  
25 – 40 Decision packs per  
month

*“If you want some money today, perfect, put together a retail plan. But if you want lifestyle money, if you want to build that financial independence, you want to lock in that security for life, you need to recruit. And the other thing you need to do to, be prepared to roll that cash flow for straight 9 to 12 months. Because you know what, in that short space of time, by making that commitment, you are going to create a foundation for life. Absolutely. Not just for yourself, but a legacy, a legacy for your family, for your children, and their children’s children.”*

– Herbalife Independent Distributor

# Senior Distributors Encourage Other Distributors to “Team Build” if they Want a Growing Income Stream

## 4 Income Streams

### Active / Retail - Customers

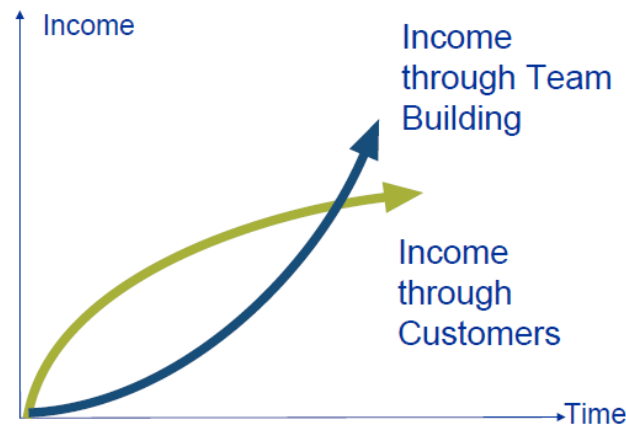
Retail Profit = 25%-50%

Wholesale Profit = 8%-25%

### Passive / Residual – Team Building

Royalties = 5% on 3 Levels

Bonuses = 2%-7% to Infinity





# Senior Distributors Encourage Other Distributors to “Teach to Teach”

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Source: Herbalife Independent Distributor Presentation (2008)

## Teach to Teach









- First step: Teach others what you've learned.
- **Second step:** Teach others to teach others what you've learned.



## Query:

**What company's goal is to recruit as many inexperienced sales-people as possible (on full commission with limited oversight) without regard for the ultimate demand for its products?**

# Top Distributors Earn More Because They Are Eligible To Receive Additional Recruiting Rewards

		Retail Profit	Recruiting Rewards				
		Discount	Wholesale Commission	Royalty Overrides	Production Bonus	Mark Hughes Bonus	Vacations/ Promotions
Sales Leaders		50%	8-25%	5% (3x)	7%	>1%	Yes
		50%	8-25%	5% (3x)	6%	<1%	Yes
		50%	8-25%	5% (3x)	4%		Yes
		50%	8-25%	5% (3x)	2%		Yes
		50%	8-25%	5% (3x)			Yes
Non-Sales Leaders		42%	7-17%				
		35%	10%				
		25%					

# Herbalife's Compensation Plan: Two Ways to Earn, Six Different Names

The simplest way to understand the various income streams available to Herbalife distributors is by way of example (next page)

Retail Profit	Discount
	Wholesale Commission
	Royalty Overrides
	Production Bonus
	Mark Hughes Bonus
	Vacations/ Promotions

Distributors may earn profits by purchasing the company's products at wholesale prices (which are discounted 25% to 50% from SRP depending on the distributor's level within the company's distributor network) and selling the products to Retail Customers

Distributors receive commissions when other distributors in their Non-Sales Leader organizations purchase product directly from the Company at lower discounts (25%/35%/42%)

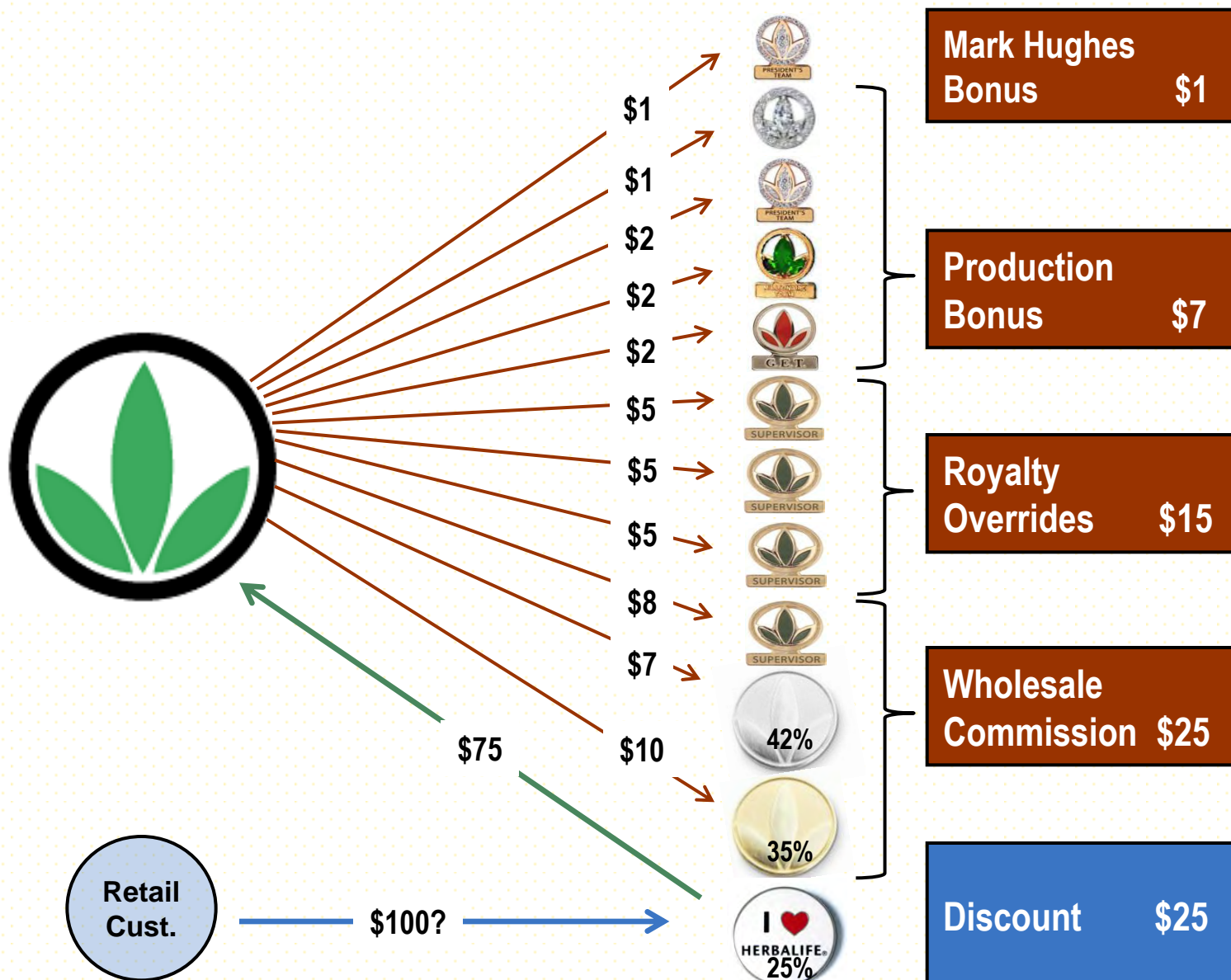
Distributors who sponsor other distributors and establish their own Sales Leader organizations ("downlines") may earn royalties of up to 15% (three active levels, up to 5% each) on the SRP of product purchased by their downline

Senior Sales Leaders may earn Production Bonuses of up to 7% ("infinitely deep" in the chain) on the SRP of product purchased by their downline

A discretionary bonus paid to the most senior Sales Leaders in the aggregate amount of 1% of Retail Sales

Sales Leaders are eligible to qualify for promotions including vacations and other perks

# Herbalife's Compensation Plan: Two Ways to Earn, Six Different Names (Example)



**Query:**

**What is the business purpose or necessity of paying commissions to 11 different upline distributors to make a \$100 Retail Sale of commodity products?**

# Herbalife's Compensation Plan: Two Ways to Earn, Six Different Names (Cont'd)

	<u>Amt.</u>	<u>Pct.</u>
<b>Suggested Retail Price</b>	<b>\$100</b>	<b>100%</b>
<b>Purchase price</b>	<b>(75)</b>	
<b>Retail Profit</b>	<b>\$25</b>	<b>25%</b>
<b>Wholesale Comm.</b>	<b>25</b>	<b>25%</b>
<b>Royalty Overrides</b>	<b>15</b>	<b>15%</b>
<b>Production Bonus</b>	<b>7</b>	<b>7%</b>
<b>Mark Hughes Bonus</b>	<b>1</b>	<b>1%</b>
<b>Recruiting Rewards</b>	<b>\$48</b>	<b>48%</b>
<b>Total Payout</b>	<b>\$73</b>	<b>73%</b>





Source: Herbalife Independent Distributor Presentation (2011)

## Herbalife Compensation Plan

- 50% is the largest discount/profit in the industry
- Paid in 7 different ways!
- WORLDWIDE, Herbalife has created:
  - More people making \$100,000 per year AND
  - More Millionaires than any other company!

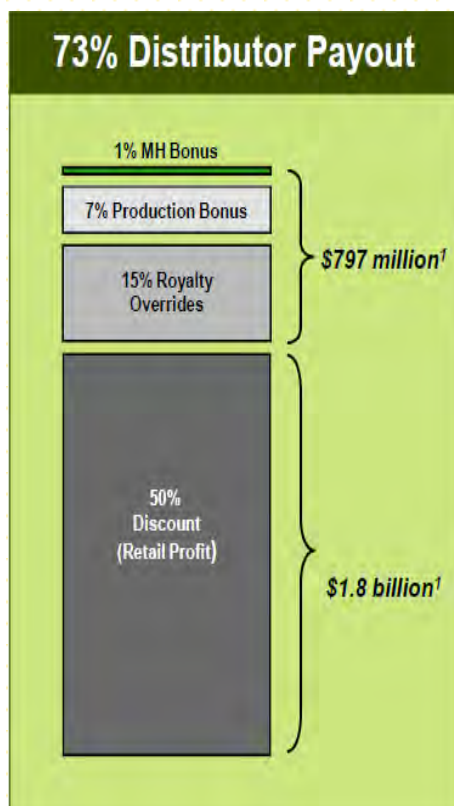
Highest Payout In  
The Industry Up  
To:

**73%**

**Herbalife's "73%"  
Payout Ratio**

# Herbalife's "73%" Payout Ratio (in Theory)

The Company claims that retail represents two-thirds of the profit opportunity for Herbalife distributors (50% of 73%)



(1) Actual results referenced in Herbalife's 2008 10K, not including China.

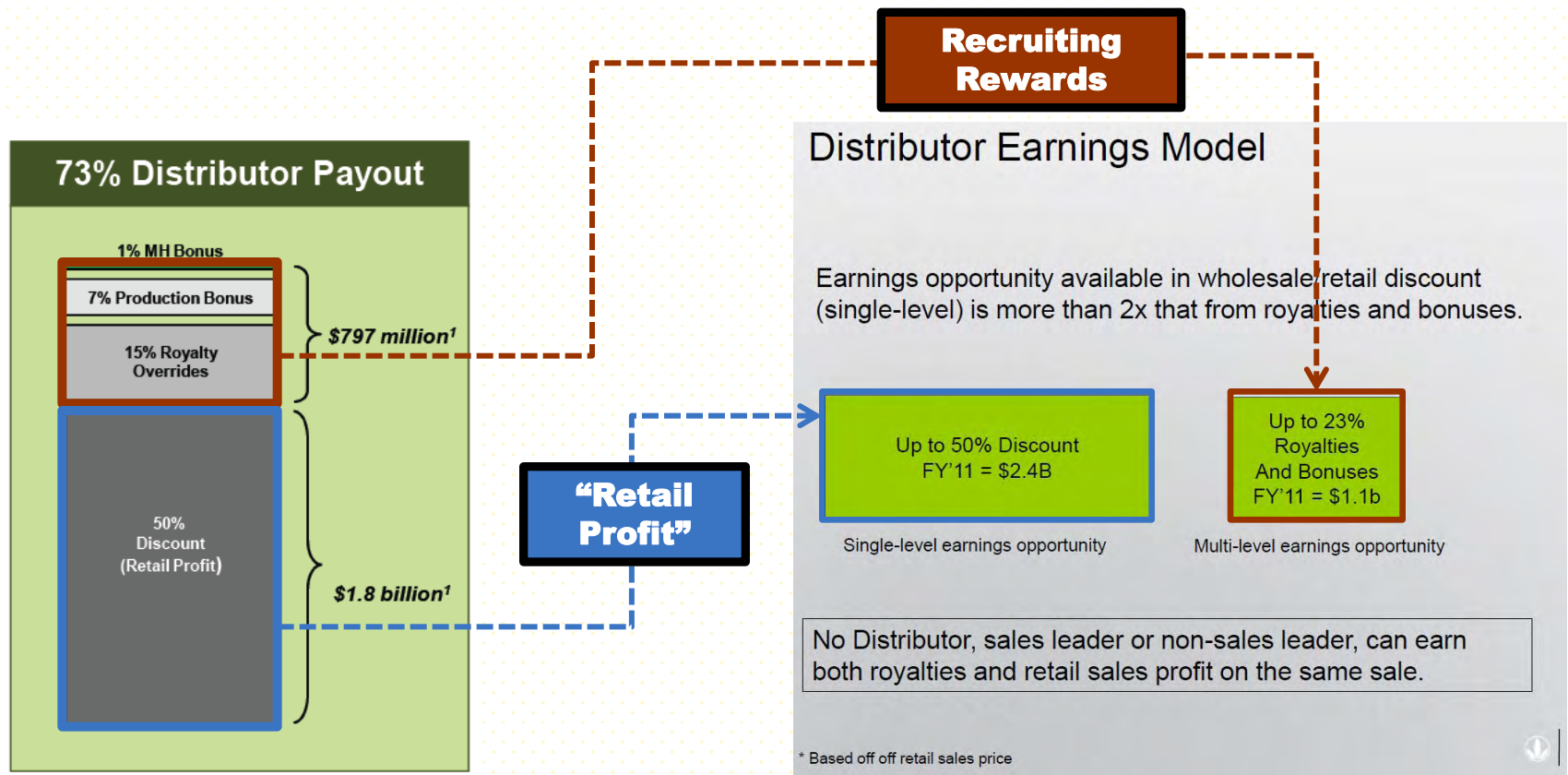
Source: Herbalife Investor Day (2009).

*"There are two ways to make profit as a distributor within Herbalife. It's the retail component, right? So you distribute it, buy the discount and that represents about two-thirds of the profit opportunity. And then there is a royalty component and that royalty component allows a distributor to earn on other distributors they bring into the business."*

**– John DeSimone, CFO of Herbalife, Bank of America Conference (9-14-2010)**

# Herbalife's Perception: Retail Profit is Greater than Recruiting Rewards

Herbalife makes this claim in an attempt to convince the public and regulators that the opportunity for Retail Profits is greater than that for Recruiting Rewards



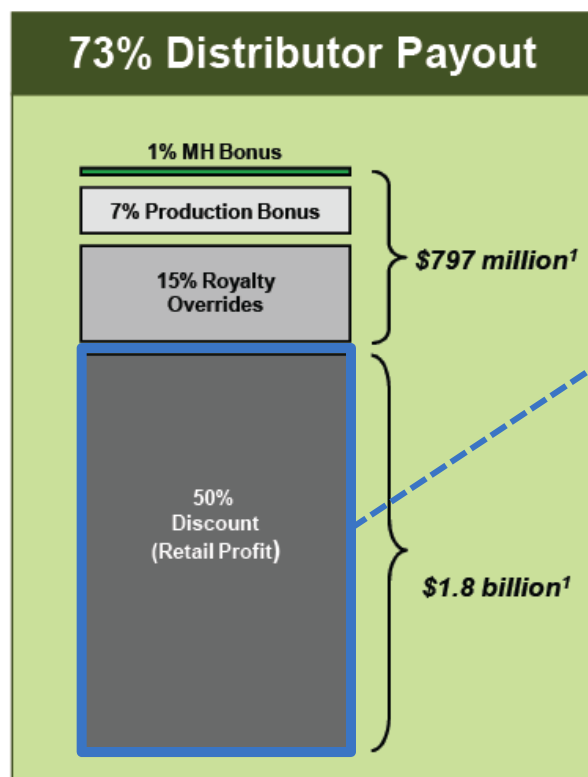
(1) Actual results referenced in Herbalife's 2008 10K, not including China.

Source: Herbalife Investor Day (2009).

Source: Herbalife Investor Update presentation (5-22-2012).

# Reconciling Herbalife's "73%" Payout Ratio to the P&L

Herbalife records "Retail Profit" as Distributor Allowances, which represents a ~50% discount to Retail Sales<sup>(1)</sup>



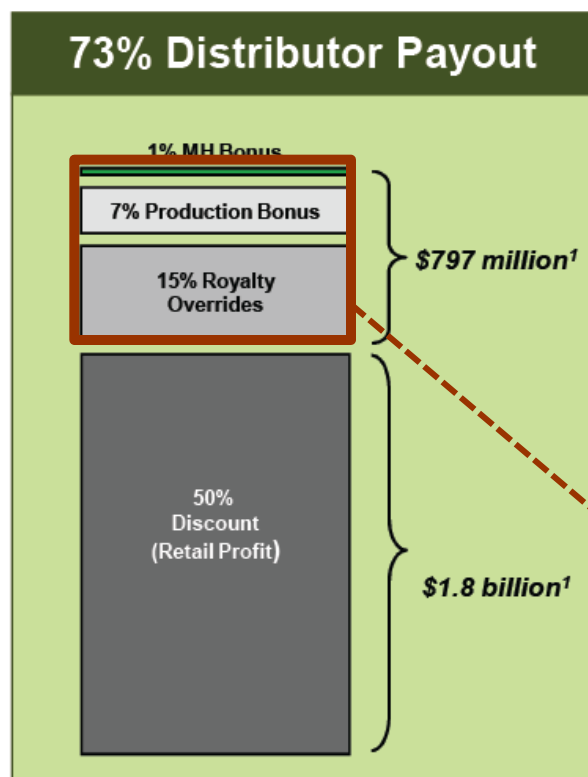
(1) Actual results referenced in Herbalife's 2008 10K, not including China.

<b>Herbalife P&amp;L</b>		
(\$ mms)	2008a	2011a
Retail Sales	\$3,811	\$5,428
<b>Distributor Allowances</b>	<b><u>(1,779)</u></b>	<b><u>(2,483)</u></b>
Product Sales	\$2,032	\$2,945
Shipping & handling revenues	<u>327</u>	<u>510</u>
Net Sales	\$2,359	\$3,455
Cost of sales	(458)	(680)
<b>Royalty overrides</b>	<b><u>(797)</u></b>	<b><u>(1,138)</u></b>
SG&A	<u>(772)</u>	<u>(1,075)</u>
EBIT	\$332	\$562

(1) In 2011, Distributor Allowances represented ~47% of Retail Sales in Herbalife's consolidated P&L. This is because in some markets Sales Leaders purchase product for less than a 50% discount to SRP.

# Reconciling Herbalife's "73%" Payout Ratio to the P&L (Cont'd)

Herbalife records Recruiting Rewards in "Royalty overrides," which includes Royalty Overrides, Production Bonuses, and the Mark Hughes Bonus, but excludes Vacations / Promotions



(1) Actual results referenced in Herbalife's 2008 10K, not including China.

<b>Herbalife P&amp;L</b>		
(\$ mms)	2008a	2011a
Retail Sales	\$3,811	\$5,428
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SG&A	(772)	(1,075)
EBIT	\$332	\$562

**Vacations / Promotions are here**

# Herbalife's So-Called "Retail Sales"

Herbalife determines its so-called "Retail Sales" by assuming all sales made by distributors are at 100% of Herbalife's inflated Suggested Retail Prices

Source: Herbalife 10-K (2011)

- (2) Retail sales represent the gross sales amount reflected on our invoices to our distributors. We do not receive the full retail sales amount. "Product sales" represent the actual product purchase price paid to us by our distributors, after giving effect to distributor discounts referred to as "distributor allowances," which total approximately 50% of suggested retail sales prices. Distributor allowances as a percentage of sales may vary by country depending upon regulatory restrictions that limit or otherwise restrict distributor allowances. "Net sales" represents product sales and shipping & handling revenues.

The following represents the reconciliation of retail sales to net sales for each of the periods set forth above:

	Year Ended December 31,				
	2011	2010	2009	2008	2007
			(In thousands)		
Retail sales	\$ 5,427,844	\$ 4,306,262	\$ 3,690,061	\$ 3,811,159	\$ 3,511,003
Distributor allowance	(2,483,122)	(1,968,769)	(1,696,444)	(1,778,866)	(1,658,569)
Product sales	2,944,722	2,337,493	1,993,617	2,032,293	1,852,434
Shipping & handling revenues	509,815	396,733	330,960	326,920	293,405
Net sales	\$ 3,454,537	\$ 2,734,226	\$ 2,324,577	\$ 2,359,213	\$ 2,145,839

*Distributor Allowances are based on this fictitious representation of "Retail Sales"*

# How Would Herbalife's P&L Look If "Retail Sales" were Recorded Based on Actual Retail Prices?

Herbalife P&L (2011a)			
(\$ mms)	As Reported (100% SRP)	As Adjusted (65% SRP) <sup>(1)</sup>	
"Retail Sales"	\$5,428	\$3,528	Decreases
Distributor Allowances ("Retail Profit") <sup>(2)</sup>	(2,483)	(583)	Decreases
Product Sales	\$2,945	\$2,945	
S&H revenues	510	510	
Net Sales	\$3,455	\$3,455	
Cost of sales	(680)	(680)	
Royalty overrides	(1,138)	(1,138)	Unchanged
SG&A	(1,075)	(1,075)	
EBIT	\$562	\$562	

(1) Illustratively assumes actual retail price is 35% off Suggested Retail Price.

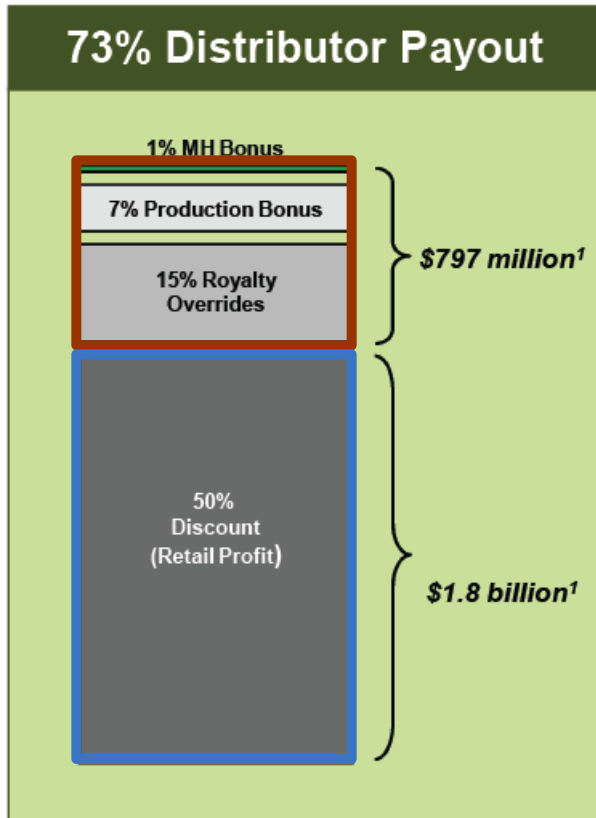
(2) Herbalife refers to Distributor Allowances as "Retail Profit" in its 2009 Investor Day presentation.



**Retail Profit varies depending on the ultimate sale price for the product achieved by distributors**

**Royalty overrides paid by Herbalife are unrelated to the ultimate sale price for the product achieved by distributors**

# A Misleading Chart...



(1) Actual results referenced in Herbalife's 2008 10K, not including China.

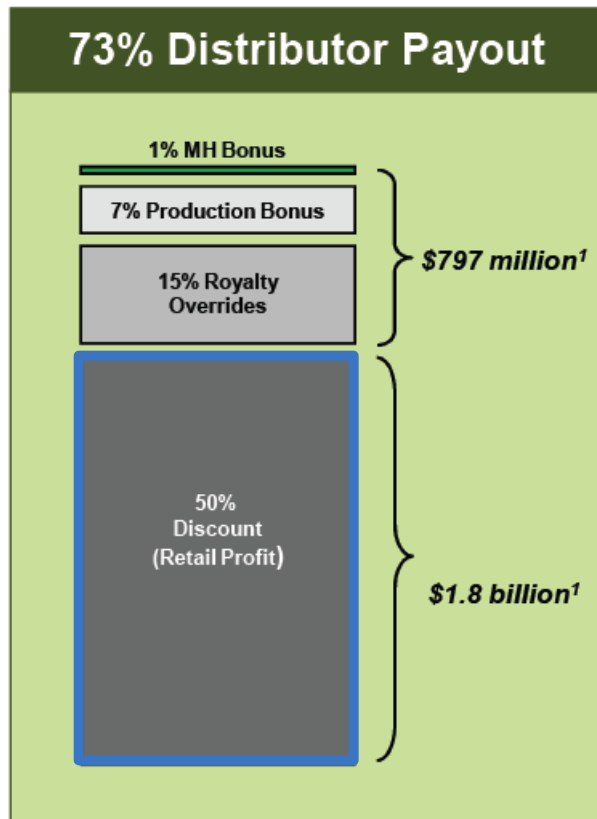
Source: Herbalife Investor Day (2009).

## Herbalife's Representation of 50% "Retail Profit"

- ▶ Assumes product is sold at SRP
- ▶ Assumes 100% of product purchased by distributors is resold to Retail Customers
- ▶ Treats Wholesale Commissions as Retail Profit

## Herbalife's Representation of 23% Recruiting Rewards

- ▶ Excludes Wholesale Commissions
- ▶ Excludes Recruiting Rewards in SG&A



**Adjustment #1:**  
**Suggested Retail Price  $\neq$**   
**Actual Retail Price**

# Herbalife's 7% “Surcharge”

---

- ▶ In order for distributors to sell Herbalife products and receive their full markup (“Retail Profit”), they must pass through surcharges and other expenses to Retail Customers<sup>(1)</sup>
- ▶ All Herbalife distributors must pay a 7% packaging and handling charge (“Surcharge”) on the Suggested Retail Price for products ordered directly from the Company
  - The Surcharge was instituted in the early 1990s at 5% as a way for the Company to fund the roll out of the Production Bonus. Over time, it has increased to 7%
  - Until 2001, Herbalife accounted for the revenue from the Surcharge as an offset to royalty override expenses

(1) In most markets the surcharge is 7%, but in some countries it is in excess of 20%.


## **Herbalife's 7% “Surcharge” (Cont'd)**

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- ▶ This charge is in addition to the ~4% expense distributors must pay (of SRP) to have the product shipped if they do not pick up the product from one of the limited number of Herbalife's distribution centers
- ▶ Unlike the shipping expense which varies depending on the quantity of product ordered and whether or not distributors pick up the product, the 7% Surcharge is fixed

# Herbalife's 7%+ “Surcharge” (Paraguay)

- ▶ In some markets, Herbalife has added even more Surcharges

 **HERBALIFE.**

**Key Points – Paraguay**

**Orders & Shipping**

- The methods to place orders are: Phone-in and E-mail.
- International orders are not allowed.
- Distributors need to submit their RUC (tax registration form) to Herbalife Paraguay. Distributors who are not tax registered in Paraguay will have a 7,500VP per year purchasing limit.
- Packaging and Handling fees will be 7% on retail price.
- There will be a 7% administrative fee.
- VAT: 10% of value added tax.
- The shipping fee varies depending on the order volume and area to be delivered.

Area		Scale	Area		Scale
Gran Asunción	Gs 0 a Gs 2.500.000	22.000	Interior	Gs 0 a Gs 2.500.000	27.000
Gran Asunción	Gs 2.501.000 a Gs 6.000.000	1,6%	Interior	Gs 2.501.000 a Gs 6.000.000	1,8%
Gran Asunción	Gs 6.000.001 a Gs 10.000.000	1,2%	Interior	Gs 6.000.001 a Gs 10.000.000	1,4%
Gran Asunción	Gs 10.000.001 o superior	1%	Interior	Gs 10.000.001 o superior	1,2%

7% “Packaging & Handling”

7% “administrative fee”

# Herbalife's 7%+ “Surcharge” (Bolivia)



HERBALIFE®

## DISTRIBUTOR KEY POINTS – BOLIVIA

### Rules

- **No** 30-day money back guarantee
- Weight Loss claims are permitted.

### Orders & Shipping

- International Orders (both inbound and outbound) are not available through Miclar
- 12% Freight Charge on Full Retail Price of Order to make product available local
- VAT 19.05 %
- 7% Packaging & handling on Full Retail
- All Orders can be placed directly at the Sales Center (Miclar) in Bolivia
- Methods to place orders are: Walk-In, Mail-In, Fax-In, and E-mail
- Freight charge is 2.5% of Full retail
- Payment methods
  - Cash – Dollars or Bolivian Pesos
  - Credit Card (Visa/MasterCard)
  - Wire Transfer
- All prices will be Tax Inclusive

**12% “Freight Charge”**

**7% “Packaging & handling”**

**2.5% “Freight charge”**



# Herbalife's 7%+ "Surcharge" (Zambia)



## Herbalife Zambia

### Rules

- New Herbalife Distributor Applications with addresses in Zambia can be accepted as of 9 July 2007. Proof of residency is required in the form of a Zambian National Identity document, and should be attached to your Herbalife Distributor Application Form.
- Any current Herbalife Distributor wishing to change their current address to a Zambian address is required to attach their Zambian National Identity document to the Herbalife change of Address form.
- Non-resident Distributors are allowed to sponsor Zambian residents in Zambia by selling them a Mini-HBP. No product sales may be generated in Zambia by non-residents of Zambia unless they have obtained a non-resident trading permit.
- The legal age in Zambia is 21 years. No persons under the age of 21 years can become a Herbalife Distributor in Zambia.
- IBP's for Zambia will be for sale as of 9 July 2007.
- 30-day money back guarantee for customers applies. These will be processed through the Johannesburg Sales Centre.
- Repurchase policy applies for distributors.
- Weight management claims are permitted.
- Notification of all public gatherings needs to be advised to the Zambian police at least seven days prior to the event.
- Any party wanting to display the Zambian National flag at its function must obtain the approval of the Permanent Secretary, Ministry of Commerce, Trade and Industry.
- Distributors need to apply for a hawkers licence from the municipality within 30 days of signing up as a Herbalife Independent Distributor.
- Prospective Nutritional Club operators must first contact the appropriate local or national government agencies in order to acquire all necessary business, tax and health permits and/or licenses. Distributors can request a copy of the Herbalife Distributor Nutrition Club Manual from their Sponsor or the Herbalife Distributor Relations Department in South Africa.
- Distributors need to register with the Tax Authority.

### Orders & Shipping

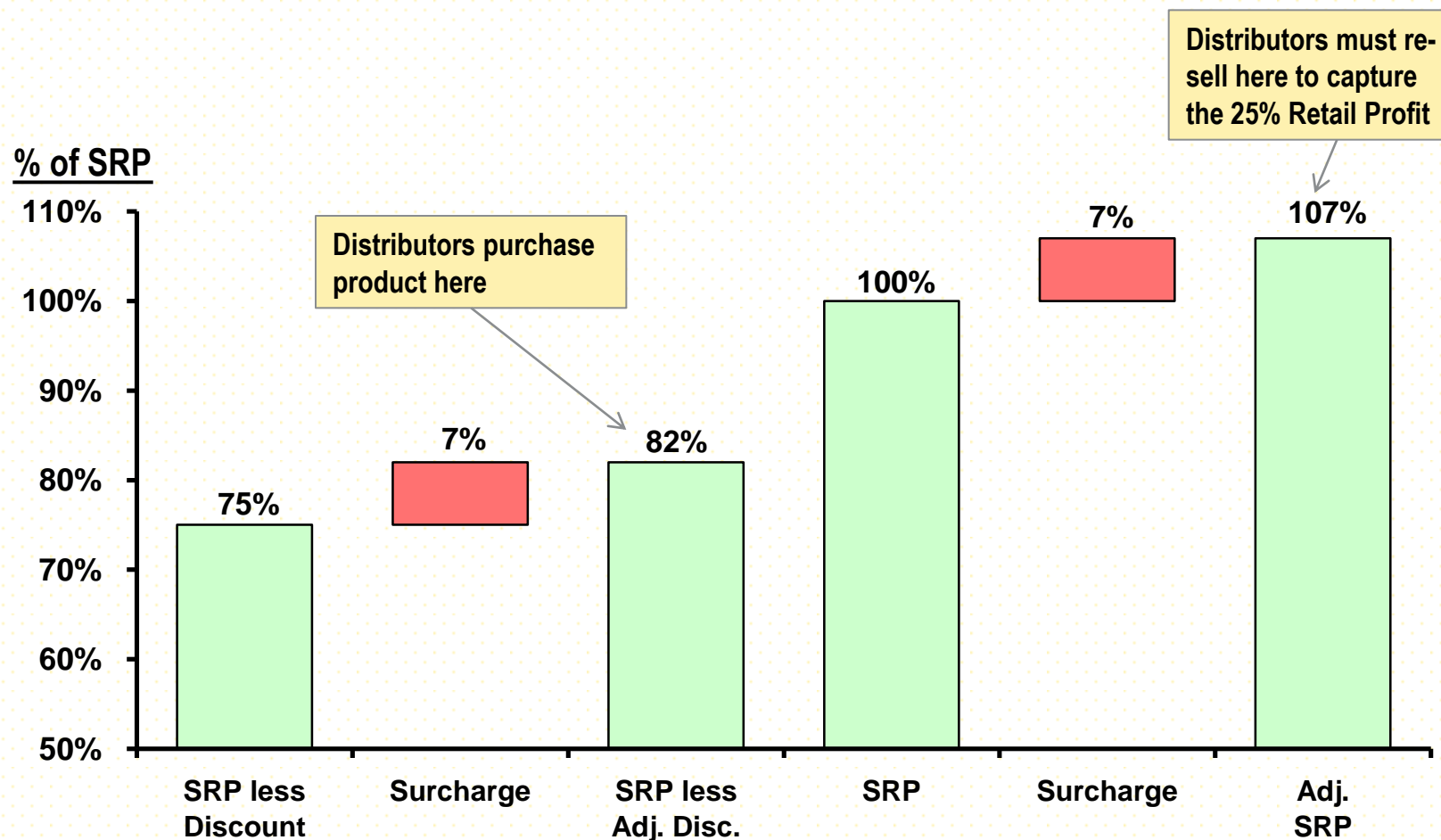
- International orders, both inbound and outbound, are limited to IBP's only.
- 7% Packaging & handling on Full Retail will apply.
- 17.5% on Full Retail will apply to cover cross border duties and cross border V.A.T.
- 15% freight on full Retail will apply.
- Walk-in, Phone-In Orders, Fax-in orders and E-mail orders can only be placed directly through the Johannesburg Sales Centre.
- E-mail Orders may be sent to [sorderline@herbalife.com](mailto:sorderline@herbalife.com).
- Payment Methods - Credit cards (Visa/Mastercard/American Express/Diners) and Wire Transfer.
- EOM rules apply - All orders MUST be received on or before the designated "EOM" day in order to count for that month's volume.
- Orders will need to be shipped directly from Herbalife to an address in Zambia and with the Herbalife designated courier company only.

### Earnings

7% "Packaging & handling"

15% "freight"

# In Order to Realize their Full Markup, Distributors Must Pass the Surcharge through to Retail Customers



# Sales Taxes Must Be Passed Through at Retail

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- ▶ In Canada, distributors must pass through 14% of sales taxes in addition to the Surcharge to capture full Retail Profit

## HERBALIFE'S NEW SALES TAX PROCEDURES QUESTIONS AND ANSWERS

Herbalife Canada has entered into pre-collection agreements with the federal and provincial governments to simplify and streamline the collection of GST/HST, QST and provincial retail sales taxes ("PST") (collectively, "sales taxes") effective January 1, 2007. Further details are available in the Sales Tax Simplification Fact Sheet.

### 5. Do Distributors still charge Sales Tax to their Customers?

Yes. Distributors will still charge an amount for sales tax on their customer invoices based on their selling price (usually SRP). The Distributors will keep the amount shown as sales taxes as reimbursement for the sales taxes that they pre-paid to Herbalife at the time of ordering.

For example, when an Ontario Distributor purchases products from Herbalife for sale to their customers, the GST and PST will be calculated as follows:


Where a product has a wholesale price of \$75 and a resale price of \$100, the Distributor will be required to pay \$75 (wholesale price) + \$6.00 (6% GST on the SRP) + \$8.00 (8% PST on the SRP) for a total of \$89.00. When the Distributor sells those products to their consumers they will charge the SRP \$100 + \$6.00 GST and \$8.00 PST. Thus the Distributor will be reimbursed from their customer for the \$14 GST/PST that was pre-paid to Herbalife, thereby realizing the same \$25 profit margin they did before.

Source: Google.

- ▶ In California, where Herbalife is headquartered, sales tax is 8.75%

# VAT Charges Must Be Passed Through at Retail

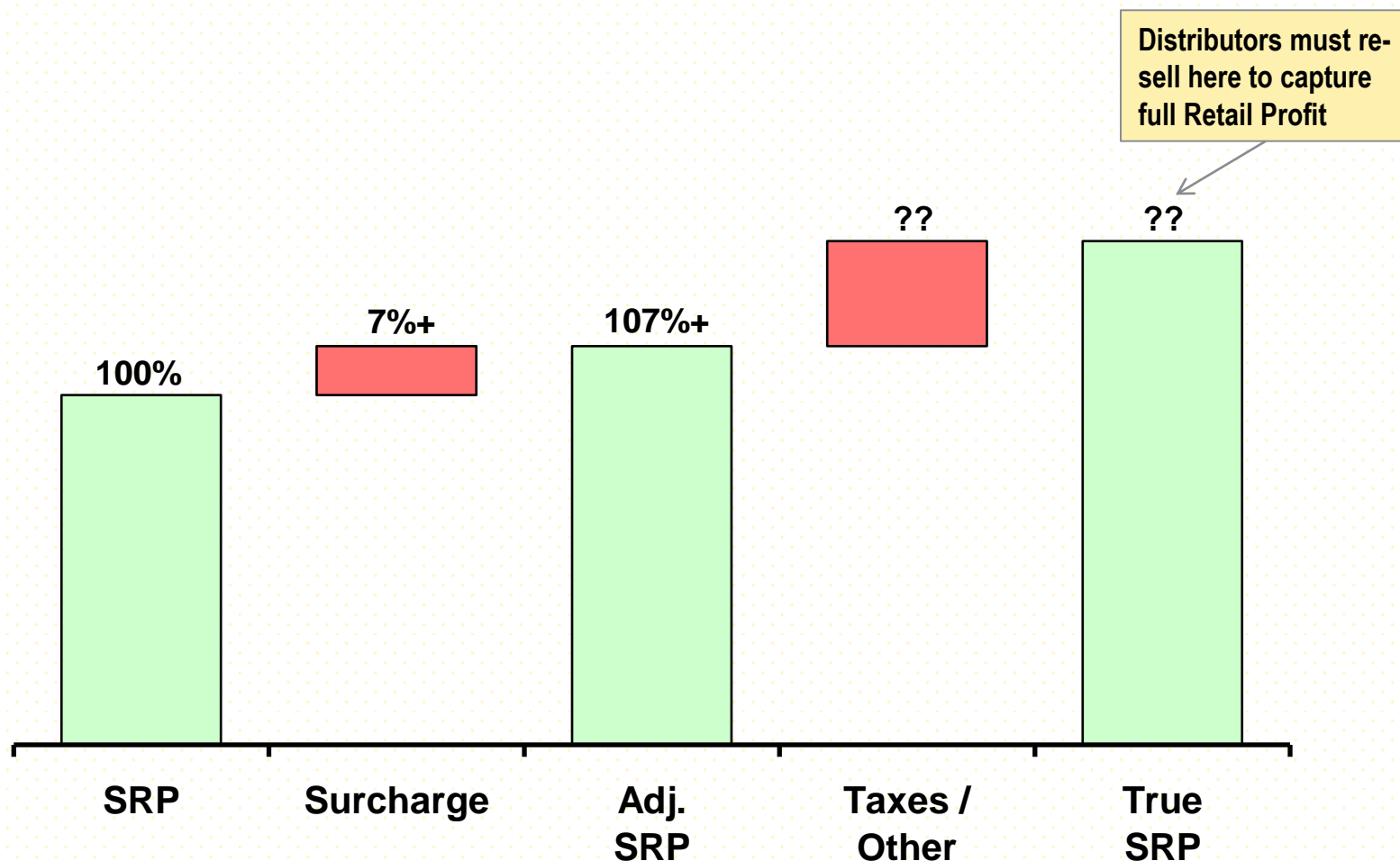
- ▶ Though VAT varies by country and product, it can be as high as 25% in some markets

 <b>HERBALIFE®</b>	<b>Key Points - Hungary</b>
<u>Orders &amp; Shipping</u>	
<ul style="list-style-type: none"><li>• All Orders can be placed directly at the Sales Center.</li><li>• Methods to place orders are: Walk-In, Mail-In, Fax-In, and E-mail</li><li>• Walk-In orders can be immediately collected upon full payment.</li><li>• Inbound / Outbound internal orders will be accepted.</li><li>• Details of shipping options available at ordering time.</li><li>• VAT rates:<ul style="list-style-type: none"><li>○ 25% on all products, literature and Promote!</li><li>○ 15% on Formula 2 – Multivitamin Complex; Fiber &amp; Herbs; Soy Nuts; Formula #1 in Vanilla and Strawberry.</li><li>○ 25% on Formula #1 in Chocolate</li></ul></li><li>• 7% Packaging &amp; handling on Full Retail.</li><li>• All prices are in local currency – Hungarian Forint</li><li>• Payment methods<ul style="list-style-type: none"><li>• Cash – Hungarian Forint</li><li>• Credit Cards – Visa, MasterCard</li><li>• Debit Cards – Visa Electron, Cirrus Maestro</li><li>• Bank Wires – Hungarian Forint</li></ul></li></ul>	

**25% VAT on Formula 1**

Source: Google.

# Herbalife Distributors Must Resell Product at a Significant Premium to SRP to Earn Full Retail Profit

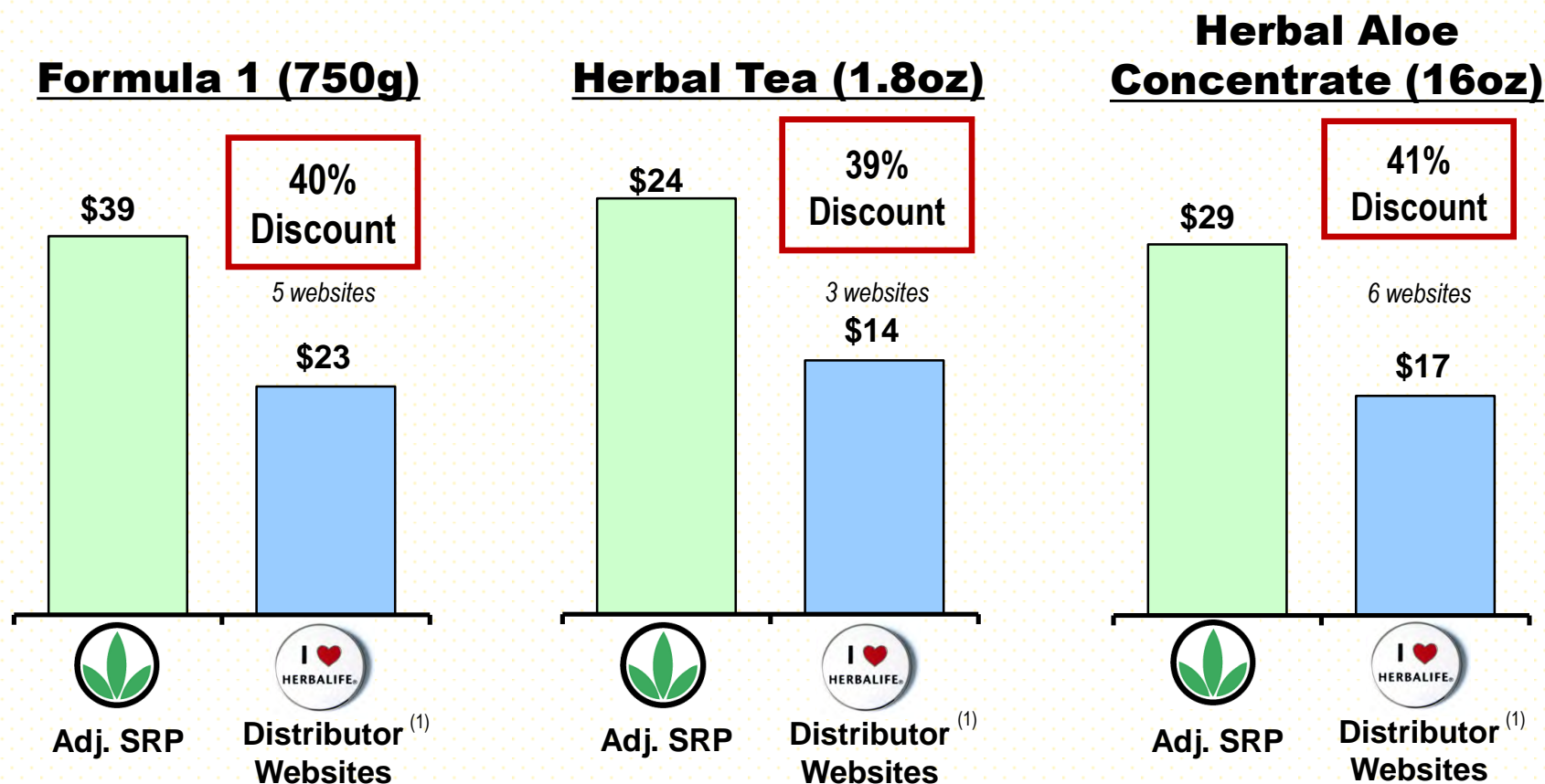


*We conservatively assume an Adjusted SRP of 107% for the purpose of our analysis*

**What is the actual retail price at which Herbalife products are sold?**

# Herbalife Products Sell for ~40% Discounts to Adjusted SRP on Independent Distributor Websites

As non-distributors, we were able to go online and purchase the products being distributed today for a ~40% discount to Adj. SRP



(1) Based on pricing during Nov-12 and Dec-12. Source: herbalforyes.com, lifemanavip.com, herbalwell.com, goherbalife.com/barbarawilson, freshestherbal.com, herbaloft.com, and herbalhappy.com. Only one site charged shipping and handling.

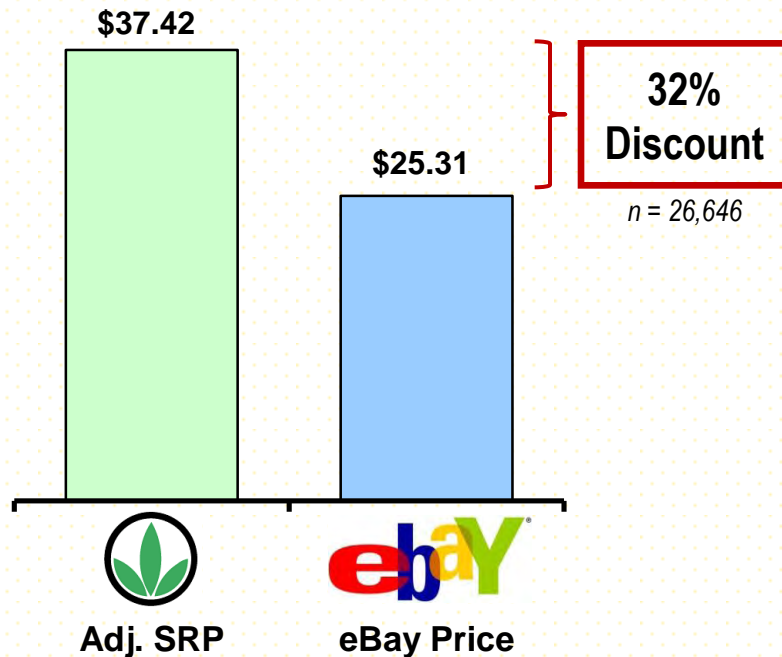


# Formula 1 Sells for a 34% Discount to Adjusted SRP on eBay

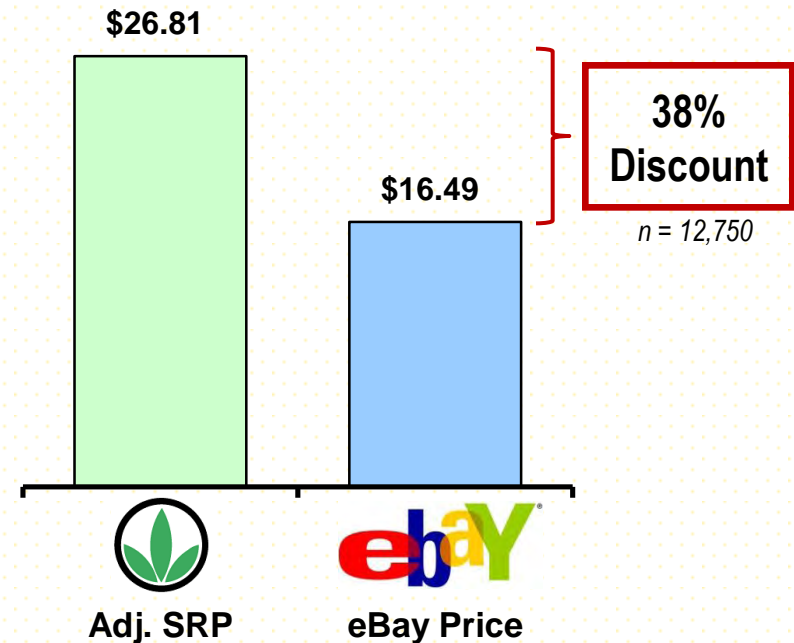


We hired a third-party research company to analyze every available Formula 1 transaction on eBay from 2007 through 2012. In total, we obtained price data for 39,396 canisters of 750g and 550g Formula 1

## Formula 1 (750g)



## Formula 1 (550g)



Note: Herbalife Adj. SRP represents the weighted average SRP for Formula 1 from 2007 through 2012 (e.g., as of 3-6-12, a 750g canister of Formula 1 had an Adj. SRP of \$38.68), which includes Herbalife's Surcharge but excludes shipping and taxes. eBay price data excludes shipping and taxes. We obtained data for 68,286 total Formula 1 transactions but only used the 39,396 transactions that included container size detail and were not bundled with other products. The 34% discount represents the weighted average of the discounts for the 750g and 550g canisters.

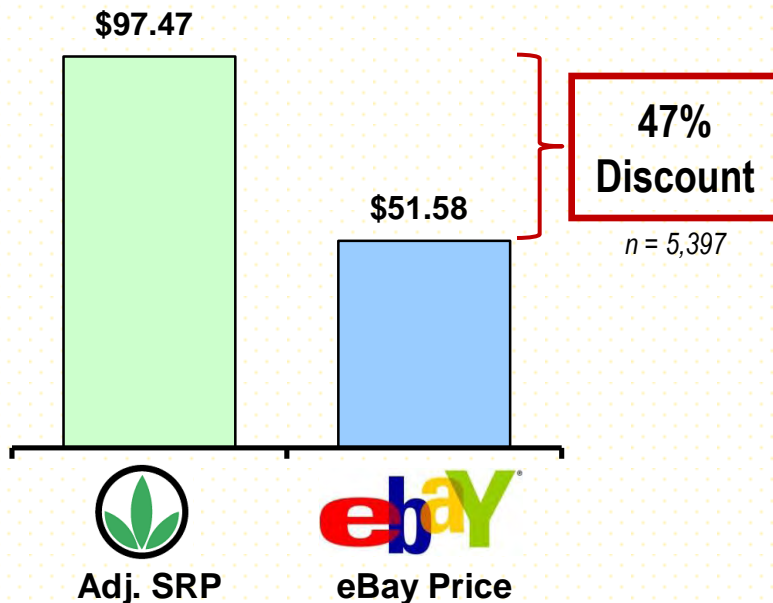
Source: ITG.

# Niteworks Sells for a 48% Discount to Adjusted SRP on eBay

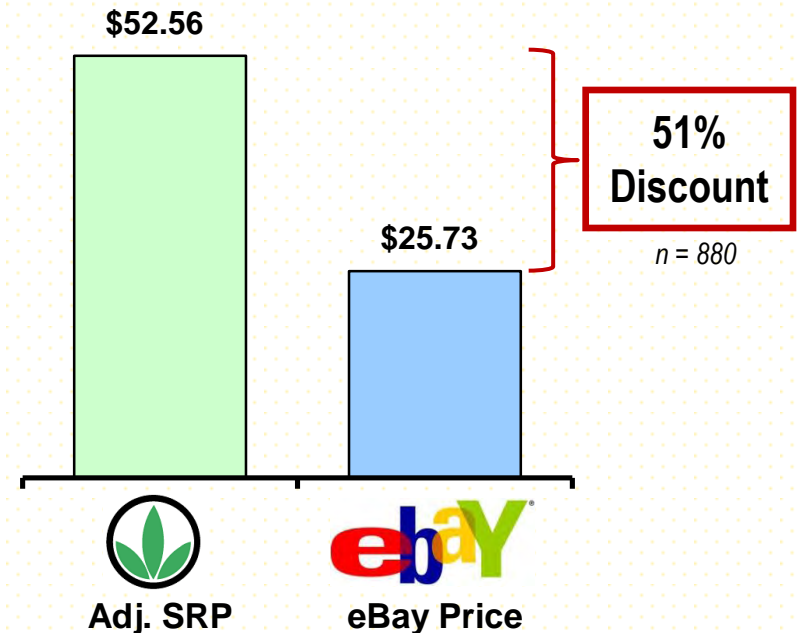


We hired a third-party research company to analyze every available Niteworks transaction on eBay from 2007 through 2012. In total, we obtained price data for 6,277 canisters of 10.6oz and 5.3oz Niteworks

## Niteworks (10.6oz)



## Niteworks (5.3oz)



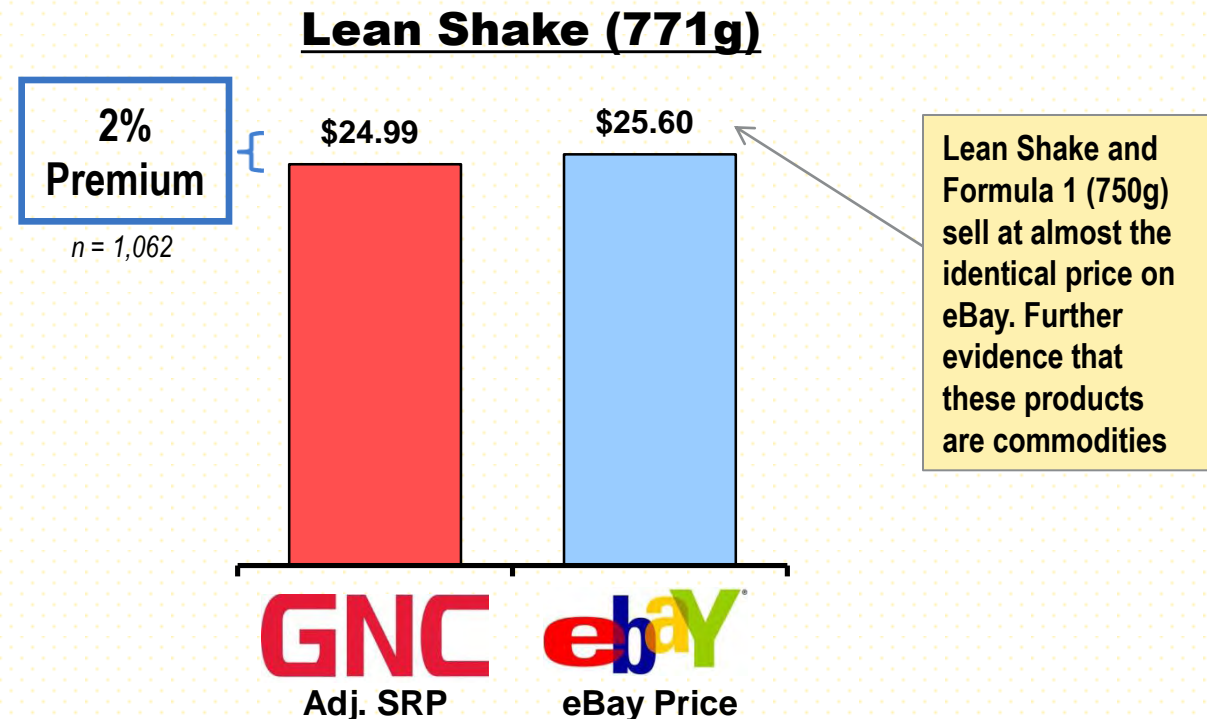
Note: Herbalife Adj. SRP represents the weighted average SRP for Niteworks from 2007 through 2012 (e.g., as of 3-6-12, a 10.6oz canister of Niteworks had an Adj. SRP of \$101), which includes Herbalife's Surcharge but excludes shipping and taxes. eBay price data excludes shipping and taxes. We obtained data for 8,505 total Niteworks transactions but only used the 6,277 transactions that included container size detail and were not bundled with other products. The 48% discount represents the weighted average of the discounts for the 10.6oz and 5.3oz canisters.

Source: ITG.

# GNC's Lean Shake Sells for a 2% Premium to Adjusted SRP on eBay



Recognizing the possibility that other comparable products might also sell at big discounts on eBay, we obtained price data for the sale of GNC's Lean Shake from 2007 through 2012 (1,062 canisters sold)



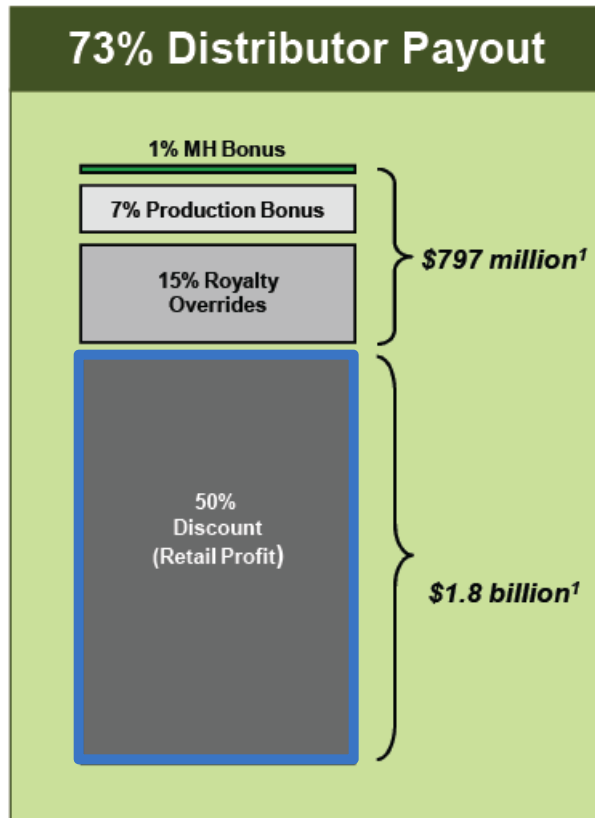
Note: GNC Adj. SRP represents the actual retail price for Lean Shake in 2012 (source: GNC.com, drugstore.com), which excludes shipping and taxes. GNC also offers an additional 20% discount for Gold Card members; to be conservative, we did not factor this into our retail price. eBay price data excludes shipping and taxes.

Source: ITG.

# Actual Retail Price Summary

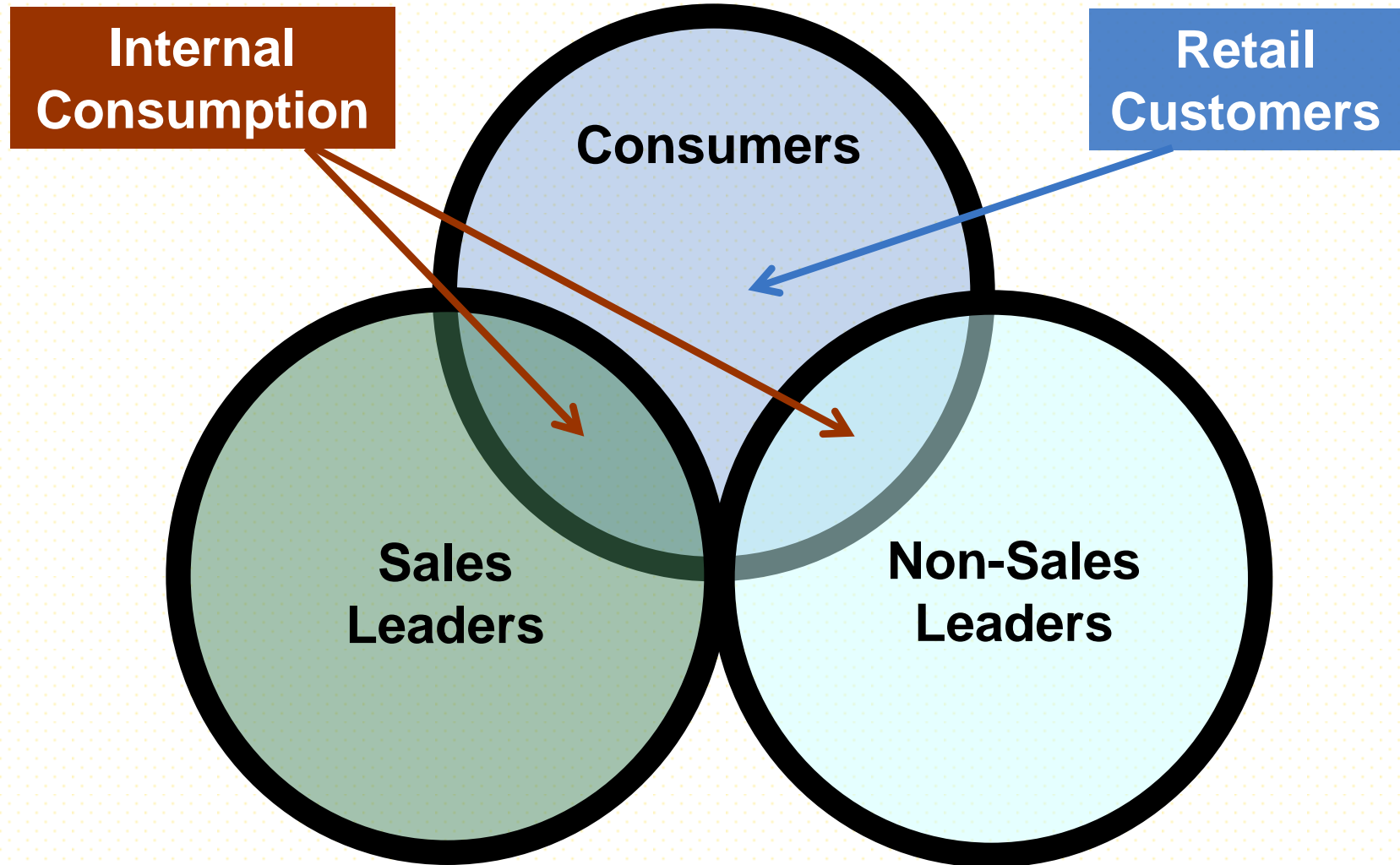
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- ▶ Because of the Surcharge and other fees, distributors must resell products at a substantial premium to SRP in order to capture Herbalife's promised 25% to 50% Retail Profit
- ▶ Suggested Retail Price is an artificial, inflated number with no relation to the price at which Herbalife's products are actually sold to Retail Customers
  - Independent distributor websites sell Herbalife products for a ~40% discount to Adjusted SRP
  - eBay data suggest Herbalife's most popular products sell for a 34% to 48% discount to Adjusted SRP
- ▶ For the purpose of our analysis, we conservatively assume Herbalife products are sold for a 35% discount to Adjusted SRP



**Adjustment #2:**  
**Internal Consumption  $\neq$**   
**Retail Profit**

# **Internal Consumption Refers to Product that is Purchased and Consumed by Distributors**



**How much product purchased by Herbalife distributors is actually resold to Retail Customers?**



# Herbalife Does Not Track How Much of its Product is Resold to Retail Customers

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## Herbalife's Published Response to David Einhorn's Questions:

### **Question #1 from David Einhorn:**

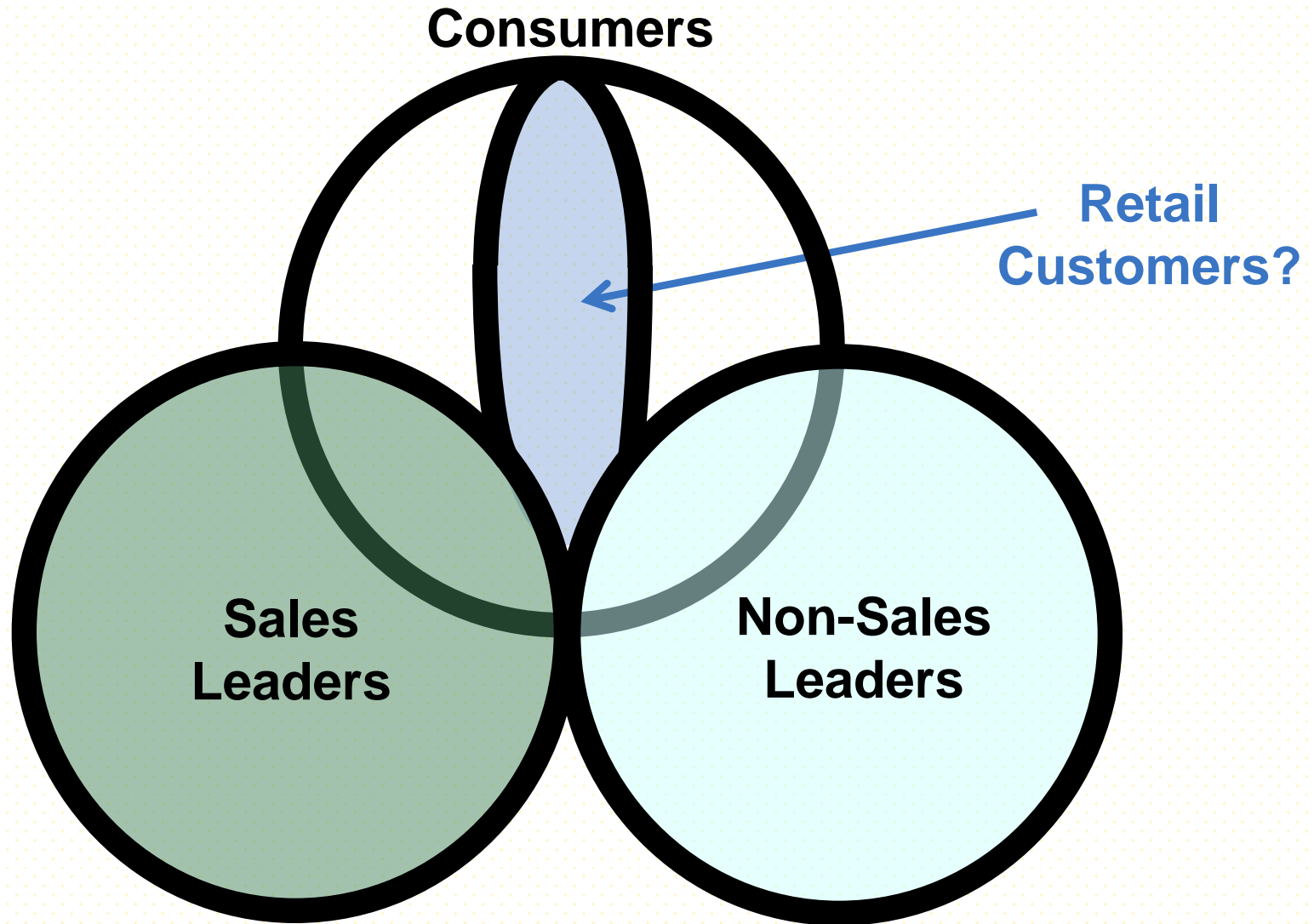
*"First, how much of the sales that you'd make in terms of final sales are sold outside the network and how much are consumed within the distributor base?"*

### **Answer:**

*We don't track this number and do not believe it is relevant to the business or investors.*

# If Herbalife Doesn't Track Sales Outside the Network, How Many Retail Customers Are There?

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# Herbalife Says that the FTC is not Concerned about Internal Consumption

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MAY 23, 2012 / 12:15PM, HLF - HERBALIFE LTD at Citi Global Consumer Conference

John DeSimone - Herbalife Ltd. - CFO

So, the attempt -- I'm going to go back to the beginning of this -- so the attempt of Herbalife 101 was to break the distributors into single and multilevel. Why? Because A, it is truly single, and B, nobody questions single-level, knowing that most people who are in single-level aren't in it to make a lot of money. They are either in it for part time or it is self-consumption. If you go back to the old Avon model, before they were multilevel, right, self-consumption, not even an issue. It isn't not even covered on the FTC's website. It is expected.

So what we are trying to educate the investment community and the media in general is those distributors have no earnings opportunity in the multilevel component. Okay? Yet when the press does their math, they get that 99%, and they use that 82% in the denominator, but they don't use the right numerator. They use -- I'm going to go to this page -- I think it is page five -- give me a second -- they use that far left -- that far right bar, which is the smaller piece of the earnings opportunity.

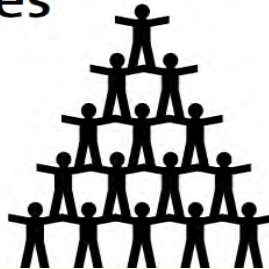
But at the end of the day, it really doesn't matter. It is all about consumption. And if people get in this business for self-consumption or to make a little bit of extra money, which is what most people get in the business for, we're fine with that, as long as the product is being consumed. I think it has been misrepresented as the product needs to be consumed outside the network, which it does not. A, the FTC said it does not. But, B, when you think of the 82% of the people at single-level, which is, again, that is all they are, it is not even a consideration as a challenge to the model.

# From the FTC's Website...

In 2009, the FTC published “The Bottom Line About MLM Plans and Pyramid Schemes” on its website. Though Herbalife believes the amount of Internal Consumption “is not relevant to the business or investors,” the FTC highlights it as a red flag for a pyramid scheme

## FTC FACTS for Consumers

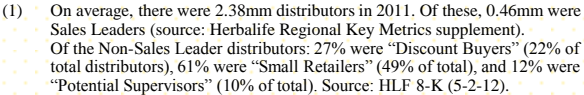
### The Bottom Line About Multilevel Marketing Plans and Pyramid Schemes



Not all multilevel marketing plans are legitimate. Some are pyramid schemes. It's best not to get involved in plans where the money you make is based primarily on the number of distributors you recruit and your sales to them, rather than on your sales to people outside the plan who intend to use the products.

#### Yes, it's a pyramid scheme!

- Do distributors sell more product to other distributors than they do to the public?
- Does the amount of money distributors make depend more on recruiting, (that is, getting new distributors to pay for the right to participate in the plan)?
- Does the money made depend mostly on selling to other distributors than on sales of the product to the public?



# Herbalife Says the Majority of its Distributors Sign Up to Become “Discount Buyers”

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## Herbalife’s Published Response to David Einhorn’s Questions (Cont’d):

### **Question #1 from David Einhorn:**

*“First, how much of the sales that you’d make in terms of final sales are sold outside the network and how much are consumed within the distributor base?”*

### **Answer:**

*We don’t track this number and do not believe it is relevant to the business or investors.*

*Herbalife believes the majority of its distributors are discount buyers, who become distributors in order to purchase their favorite Herbalife products at a minimum discount of 25 percent.*



**Why would anyone pay \$55 to get a 25% discount when Herbalife products are widely available online for discounts of more than 35%?**



# **Herbalife Would Like Others to Believe that its “Discount Buyer” Distributors are Like Costco Members**






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*“Often people ask well, what does a distributor look like? How do they behave? Last year, when distributors ordered from the Company, 51% of the time, their average order was \$100, and they received about a 25% discount. So most of the distributors tend to be discount buyers, similar to joining Costco or some club like that, where you pay \$49, and you get a 25% discount at Herbalife – just like you would buying a club card at Costco and enjoying the discount on the product.”*

**– Rich Goudis, CFO of Herbalife, Canaccord Adams  
Global Growth Conference (8-11-2009)**

# We Believe the Majority of Herbalife's So-Called "Discount Buyers" are, in Fact, Failed Distributors



			
<b>Signup Cost</b>	\$55	\$55-\$91	\$15
<b>Renewal Fee</b>	\$55	\$15	\$15
<b>Renewal Rate</b>	~90%	~10% <sup>(1)</sup>	~70% <sup>(2)</sup>
<b>Product Offering</b>	Everything	Supplements	Supplements
<b>Paperwork</b>	None	48,000 word Distributor Agreement	None
<b>Product Returns</b>	100% Money Back	82% <sup>(3)</sup> Money Back	100% Money Back
<b>Membership lost if product returned?</b>	No	Yes	No
<b>"Discount" Price</b>	NA	\$30 <sup>(4)</sup> 	\$20 <sup>(4)</sup> 

(1) Source: Herbalife 2005 Annual Report (the last time Herbalife published the churn rate for its Non-Sales Leader distributors):

"For the latest twelve month re-qualification period ending January 2005, approximately 60 percent of our supervisors did not re-qualify and more than 90% of our distributors that are not supervisors turned over."

(2) Source: Goldman Sachs.

(3) Herbalife NSL distributors who purchase from their upline in the "field" have no return policy. Herbalife NSL distributors who purchase directly from the company are entitled to return product to the Company, subject to a 10% restocking fee. The 82% assumes the surcharge is not reimbursed (e.g., a 25% discount buyer who pays \$75 plus a \$7 Surcharge for \$100 of SRP product is entitled to get back \$67.50 (\$82-\$7-10%\*\$75)). In mid-2012, Herbalife eliminated the restocking fee.

(4) A 25% distributor can buy a 750g canister of Formula 1 for \$29.64 including the Surcharge (Source: HLF Price List – Los Angeles (3-6-12)). Represents 20% Gold Card discount to 771g canister of Lean Shake (Source: GNC website (11-19-12)).

# Herbalife Admits that Internal Consumption is “Substantial”

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## Herbalife’s Published Response to David Einhorn’s Questions (Cont’d):

*“The percentage of product of any multi-level marketing company consumed by its distributors is substantial. This is not surprising since consumers who are enthusiastic about the products become distributors in order to purchase at a discount and possibly to share and sell the products to others. In addition, in order to minimize the risk of product being accumulated by distributors, the company has policies in place such as the 70% Rule, the Ten Customer Rule and the Buy Back policy.”*

***Though Herbalife admits Internal Consumption is substantial for any MLM, it notes that it has put in place rules to limit it***

# **The 70% Rule and Ten Customer Rule**

---

**The 70% Rule:** In any given month, a Distributor must sell to retail customers and/or sell at wholesale to downline Distributors, at least 70% of the total value of Herbalife products they hold for resale, in order to qualify for TAB Team and to earn and receive Royalty Overrides and Production Bonus for that month's business.

**Ten Retail Customers Rule:** A Distributor must make sales to at least ten (10) separate retail customers each month to qualify and receive Royalty Overrides and Production Bonus.

# **These Rules Do Not Limit Internal Consumption**

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- ▶ **Not all distributors have to comply with these rules. Only Sales Leaders, those entitled to Royalty Overrides, are required to sign certifications demonstrating compliance (~19% of total distributors) <sup>(1)</sup>**
  - ▶ **Sales Leaders do not receive their paychecks from Herbalife unless they sign a certification demonstrating compliance with these rules**
- ▶ **The 70% volume requirement can include sales to one's downline. By definition, this does nothing to limit Internal Consumption**

(1) Less than half of U.S. Sales Leaders earn royalties, which implies fewer than 10% of Herbalife distributors sign certifications demonstrating compliance with these rules.  
Source: Herbalife Statement of Average Gross Compensation of U.S. Supervisors (2011).

# Distributors Count as “Retail Customers”

- ▶ In some markets, and contrary to Herbalife’s definition of a “Customer,” distributors can use sales to downline distributors to meet the Ten Retail Customers Rule

In addition to all the existing Royalty Override requirements, you must also comply in a timely manner with the 10 RETAIL CUSTOMERS and 70% RULES in order to receive your Royalty Override/Production Bonus payments.

The 10 RETAIL CUSTOMERS RULE means that you must make not less than one sale at retail to each of 10 customers during a given month.

Other activities that can count towards this requirement are:

*A sale to a first line Distributor with up to 200 personally purchased Volume Points (and no downline Distributors) which may be counted as a sale to one (1) retail customer; and*

*\* A Nutrition Club member who consumed products during ten (10) visits to a Nutrition Club within one Volume month, which may be counted by the Nutrition Club operator as a sale to one (1) retail customer.*

The 70% RULE means that at least 70% of the total value of products you purchase each month must be sold or consumed, each month. Sales may be to retail customers, or wholesale to downline Distributors. Consumption may include Nutrition Club activities.

**EACH OF THESE REQUIREMENTS MUST BE MET OR ROYALTY OVERRIDE/PRODUCTION BONUS EARNINGS WILL NOT BE PAID**

# Herbalife's Lax Enforcement of Its Rules

---

- ▶ Between 2006 and 2009, Herbalife possibly disciplined about 10, but fewer than 25, distributors for violating the 70% Rule (fewer than 1 out of every 100,000 distributors)

## Deposition of Jacqueline Miller in Herbalife v. Ford (2009):

**Mr. Stephens: (Ford Counsel)**

*"Have more than 50 distributors since January of 2006 been disciplined for violating the 70-percent rule?"*

**Ms. Miller: (Herbalife Employee)**

*"I don't believe so."*

**Mr. Stephens:**

*"Have more than 25 distributors been disciplined for violating that rule?"*

**Ms. Miller:**

*"I don't believe so."*

**Mr. Stephens:**

*"Have more than 10 distributors been disciplined for violating the 70-percent rule?"*

**Ms. Miller:**

*"That's possible."*

## Herbalife's Lax Enforcement of Its Rules (*cont'd*)

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- ▶ Herbalife appears to audit compliance only when distributors seek to return product to the company

### Deposition of Jacqueline Miller in Herbalife v. Ford (2009):

**Mr. Stephens:** (*Ford Counsel*)

*"How did you know about the 1200 [audits performed for the ten customer rule]?"*

**Ms. Miller:** (*Herbalife Employee*)

*"I asked."*

**Mr. Stephens:**

*"Who did you ask?"*

**Ms. Miller:**

*"Julie Delaney... She works for Jenny [Heinrich]... She's director or senior director. She's been in the refunds and repurchase area, and I think she might have responsibility for the audits."*

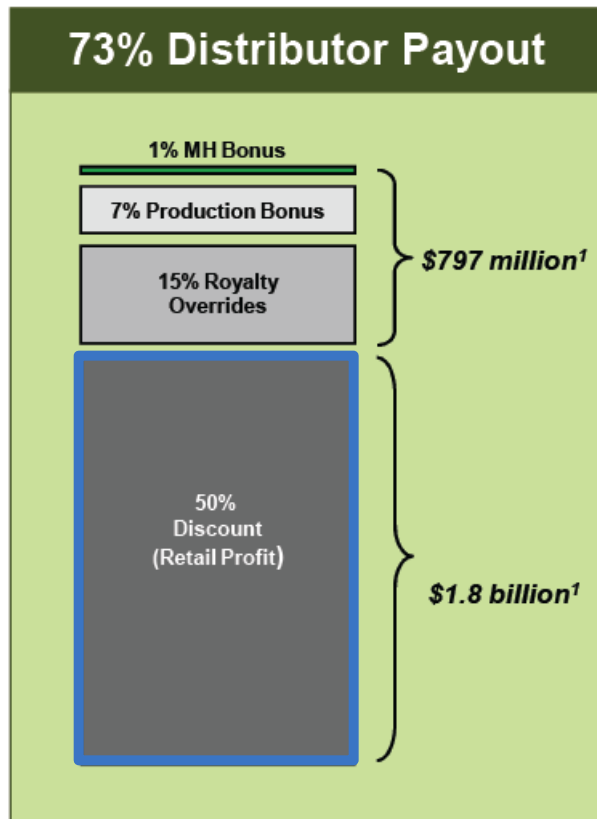
- ▶ Distributors seeking to return product to the Company who cannot demonstrate compliance with the rules will have their previous rewards payments netted against their product return. In many cases, this "clawback" is greater than the returned value of the products



# **Internal Consumption Summary**

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- ▶ **Herbalife does not track the amount of product that is sold outside the network, though it could if it wanted to**
  - ▶ **Contrary to Herbalife's belief that a large part of its "customer" base is comprised of distributors who sign up to receive a discount on product purchases, we believe the vast majority of "discount buyers" are nothing more than failed distributors**
  - ▶ **Herbalife has put rules in place to limit Internal Consumption, but these rules are ineffective and enforcement is lax**
- ▶ **A "substantial" amount of the product purchased from Herbalife is never sold at retail. For the purpose of our analysis, we conservatively assume that means 30%, though the true amount of Internal Consumption could be meaningfully higher**



**Adjustment #3:**  
**Wholesale Commissions  $\neq$**   
**Retail Profit**

**Herbalife's accounting attempts to conceal the total amount of commissions paid to distributors and increase the amount of so-called "Retail Profit"**

# Herbalife Accounting 101

- ▶ When a Non-Sales Leader distributor purchases product directly from Herbalife, Herbalife accounts for the transaction as if the product had been purchased from Herbalife by the upline Sales Leader

## How Herbalife Accounts For It



SL pays HLF \$50



25% distrib. pays SL \$75 for SRP\$100 of product and resells at retail for \$100



### Herbalife P&L

Retail Sales	\$100
Distributor Allowances	<u>(50)</u>
Product Sales	\$50

## What Actually Happens



HLF pays upline SL \$25 Wholesale Commission



25% distributor pays HLF \$75 (ex fees) for SRP\$100 of product



# Herbalife's Accounting is Misleading: *Wholesale Commissions ≠ Retail Profit*

- ▶ Wholesale Commissions “disappear” in the Distributor Allowances line item. This has the effect of reducing the perceived amount of commissions paid and increases the amount of so-called “Retail Profit”

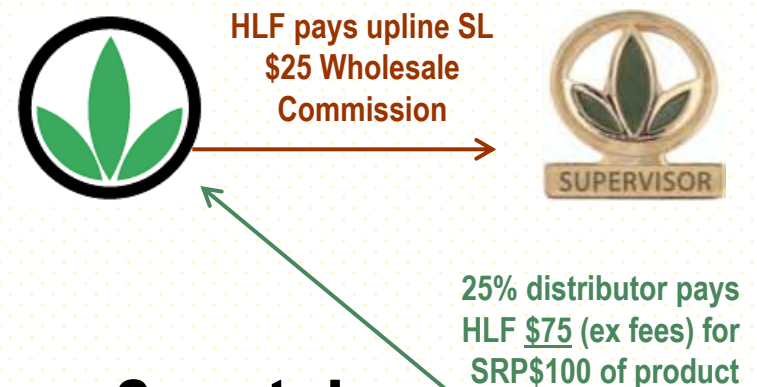
## How Herbalife Accounts For It



### Herbalife P&L

Retail Sales	\$100
Distributor Allowances	<u>(50)</u>
Product Sales	\$50

## What Actually Happens

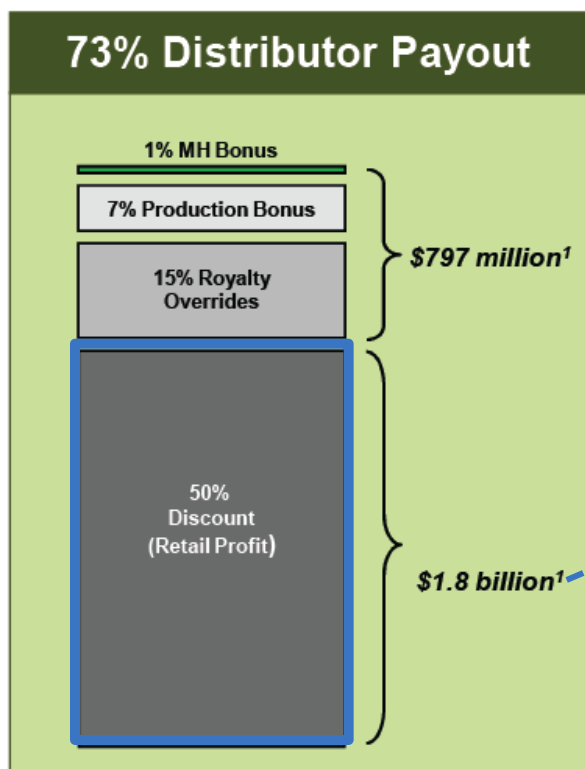


### Corrected Herbalife P&L

Retail Sales	\$100
<b>Wholesale Commissions</b>	<b>(25)</b>
Distributor Allowances	<u>(25)</u>
Product Sales	\$50

# Wholesale Commissions ≠ Retail Profit (*cont'd*)

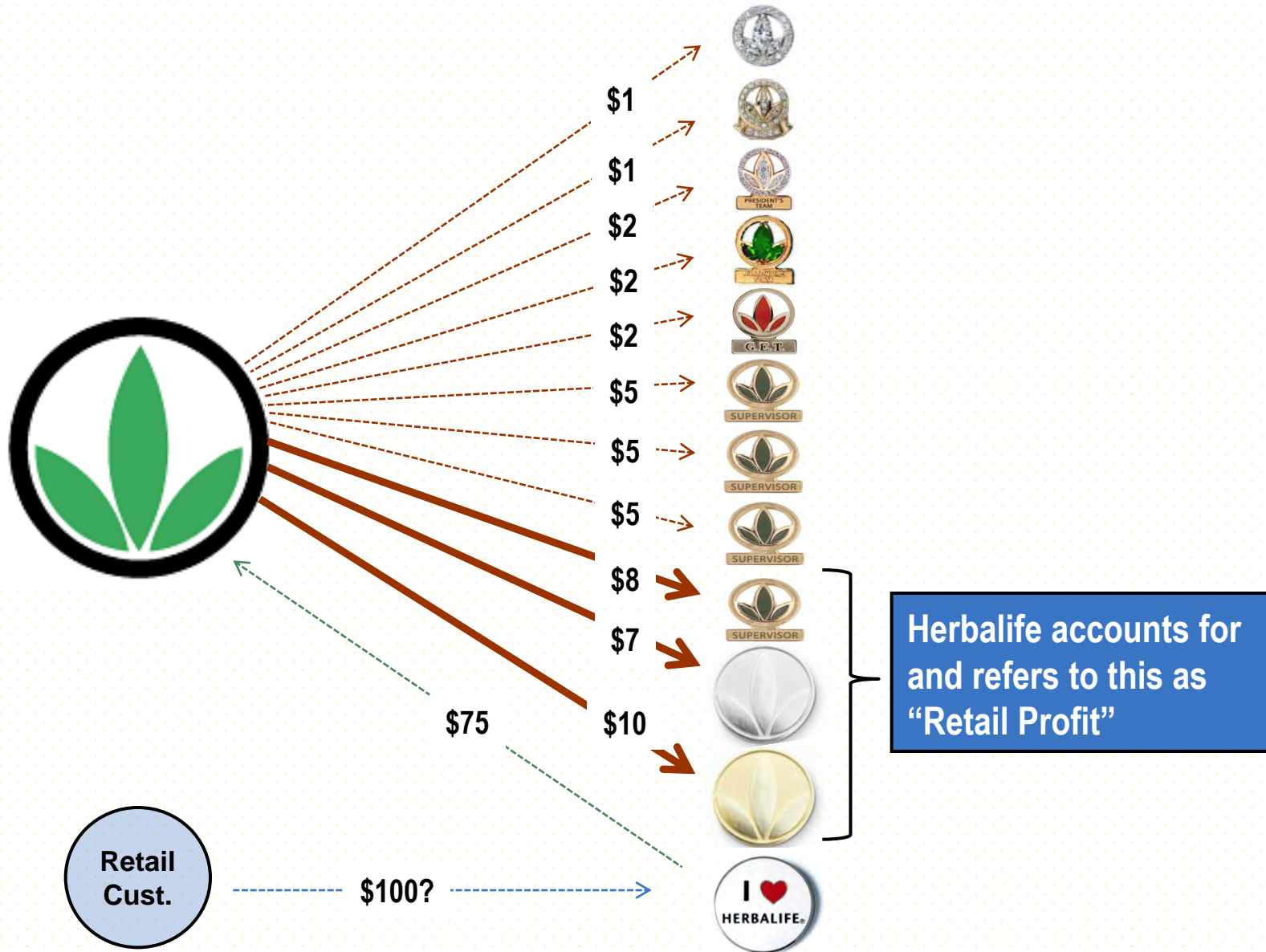
Recall that Herbalife refers to Distributor Allowances as “Retail Profit” in its investor presentations. Distributor Allowances include Wholesale Commissions, which are a form of Recruiting Rewards



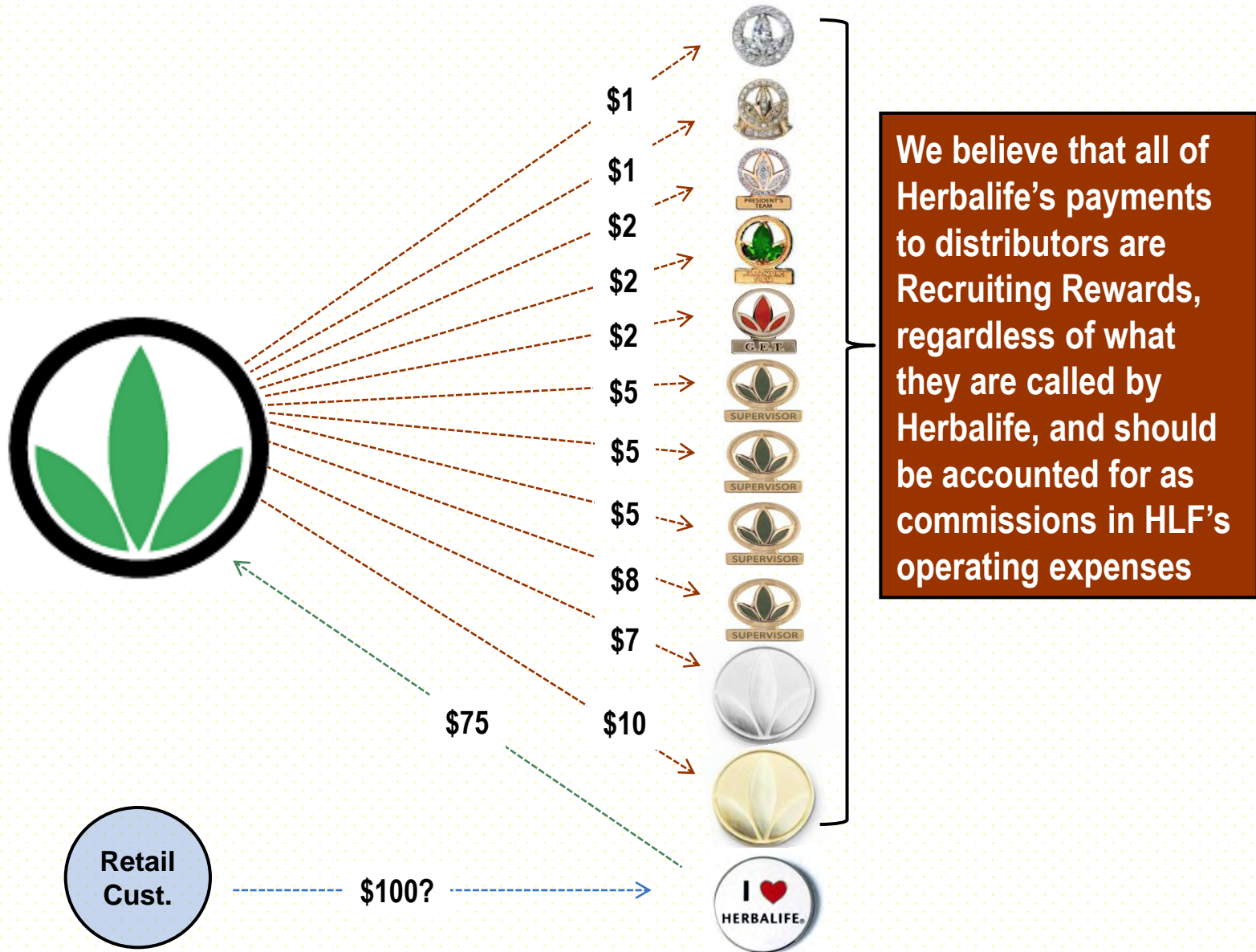
(1) Actual results referenced in Herbalife's 2008 10K, not including China.

Herbalife P&L		
(\$ mms)	2008a	2011a
Retail Sales	\$3,811	\$5,428
<b>Distributor Allowances</b>	<b>(1,779)</b>	<b>(2,483)</b>
Product Sales	\$2,032	\$2,945
Shipping & handling revenues	327	510
Net Sales	\$2,359	\$3,455
Cost of sales	(458)	(680)
<b>Royalty overrides</b>	<b>(797)</b>	<b>(1,138)</b>
SG&A	(772)	(1,075)
EBIT	\$332	562

# Wholesale Commissions ≠ Retail Profit (*cont'd*)



# Wholesale Commissions ≠ Retail Profit (*cont'd*)





## ***Wholesale Commissions ≠ Retail Profit (cont'd)***

---

### **Other MLMs account for Wholesale Commissions as operating expenses**

#### ***“Revenue Recognition***

*The Company receives payment by credit card, personal check, or guaranteed funds for orders from independent distributors and makes related commission payments in the following month. Net sales reflect product sales less the distributor discount of 20 percent to 40 percent of the suggested retail price. Sales revenue and commission expenses are recorded when the merchandise is shipped, as this is the point title and risk of loss pass. In accordance with EITF 01-09, the Company presents distributor royalty and commission expense as an operating expense, rather than a reduction to net sales, as these payments are not made to the purchasing distributor.”*

**– Reliv International, Inc. Annual Report (2007)**

# Wholesale Commissions are a Form of Recruiting Profit

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- ▶ **Retail Profit is profit on sales to Retail Customers, not other distributors. This interpretation is both intuitive and supported by the case law<sup>(1)</sup>**
- ▶ **Wholesale Commissions are substantively no different from royalty overrides. They are a form of Recruiting Rewards paid based upon the SRP of product purchased (not sold) by downline distributors<sup>(2)</sup>**
- ▶ **Other MLMs account for Wholesale Commissions as operating expenses**
- ▶ **We question how many of Herbalife's distributors are “discount buyers”**
  - **The vast majority of Herbalife's “discount buyers” are failed distributors**
  - **A Belgian court, which found Herbalife to be operating a pyramid scheme, dismissed the notion that distributors can be classified as customers<sup>(3)</sup>**

(1) *FTC v. JewelWay International*, No. 97-383, slip op. at 2 (D. Ariz. Dec. 1, 1997):

“Under this definition, sales to businesses or corporations connected to the company or to its participants, or to members of a participant's household, or otherwise not solely for the purpose of sale of the product to a person with no connection to the company's sales force, shall not be considered retail sales.”

(2) *Webster v. Omnitrition*, 79 F.3d 776, 782 (9th Cir. 1996):

“This compensation is facially ‘unrelated to the sale of the product to ultimate users’ because it is paid based on the suggested retail price of the amount ordered from Omnitrition, rather than based on actual sales to consumers.”

(3) *Test-Aankoop v. Herbalife International Belgium* [Comm. Ct. Brussels], Nov. 23, 2011, AR 2004/7787, No. JC-DC/27 [Jee] (Belg.), slip op. at 11:

“Herbalife confuses the terms ‘distributor’ and ‘consumers...’ From this [distributorship] agreement follows that all distributors in the network of Herbalife, without exception, are independent entrepreneurs and thus should be considered as such.”

# Quantifying Wholesale Commissions

Herbalife does not disclose the amount of Wholesale Commissions paid to distributors in its SEC filings. We have estimated them below:

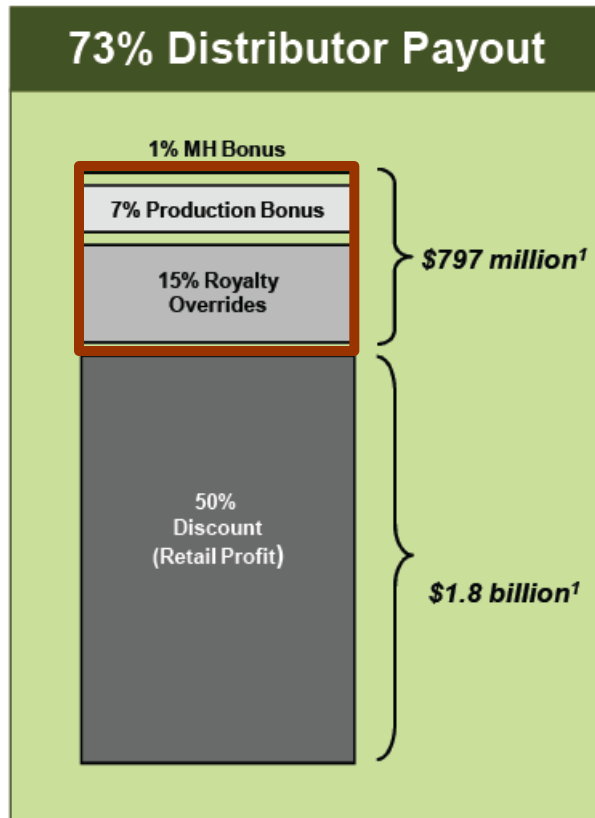
## Wholesale Commissions

(\$mms)	NSL "Direct" Retail Sales (1)	Wholesale Spread	Wholesale Comm.	% of NSLs (2)
Discount Buyers	\$497	25.0%	\$124	27.0%
Small Retailers	1,124	15.0%	169	61.0%
Potential Sales Leaders	<u>221</u>	8.0%	<u>18</u>	12.0%
<b>Subtotal</b>	<b>\$1,842</b>		<b>\$311</b>	

(1) Wholesale Commissions are only earned when NSL distributors purchase product "directly" from Herbalife. Assumes 35% of 2011 Retail Sales, excluding literature/promotional/other products, were NSL "direct" purchases.

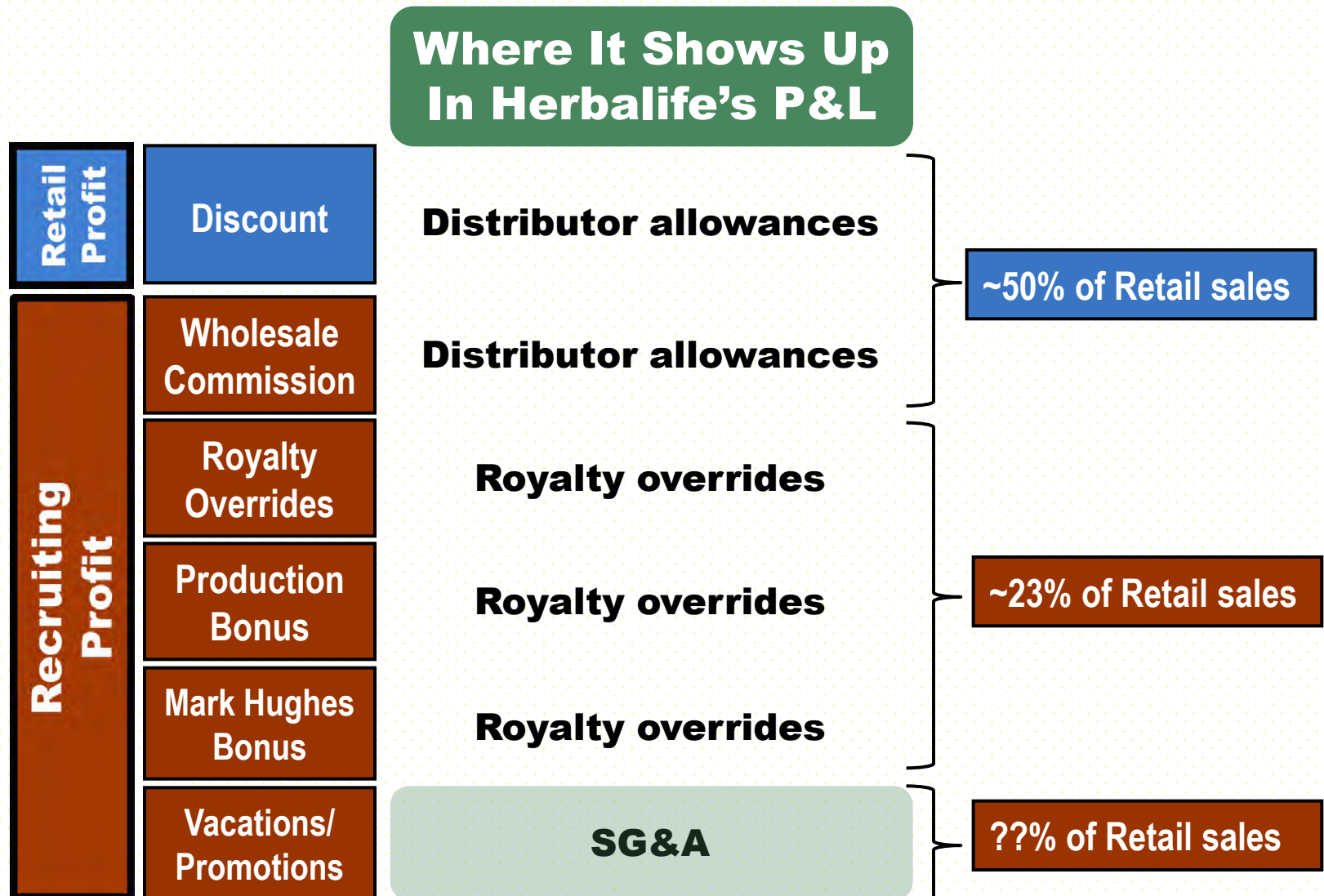
Source: HLF at Citi Global Consumer Conference (5-23-12). NSL "Direct" Retail Sales allocation is based on Herbalife's 2011 distributor composition. Source: HLF 8-K (5-2-12).

(2) For 2011, 27% of Herbalife Non-Sales Leader distributors were "Discount Buyers" (25% Discount), 61% were "Small Retailers" (35% Discount), and 12% were "Potential Supervisors" (42% Discount).



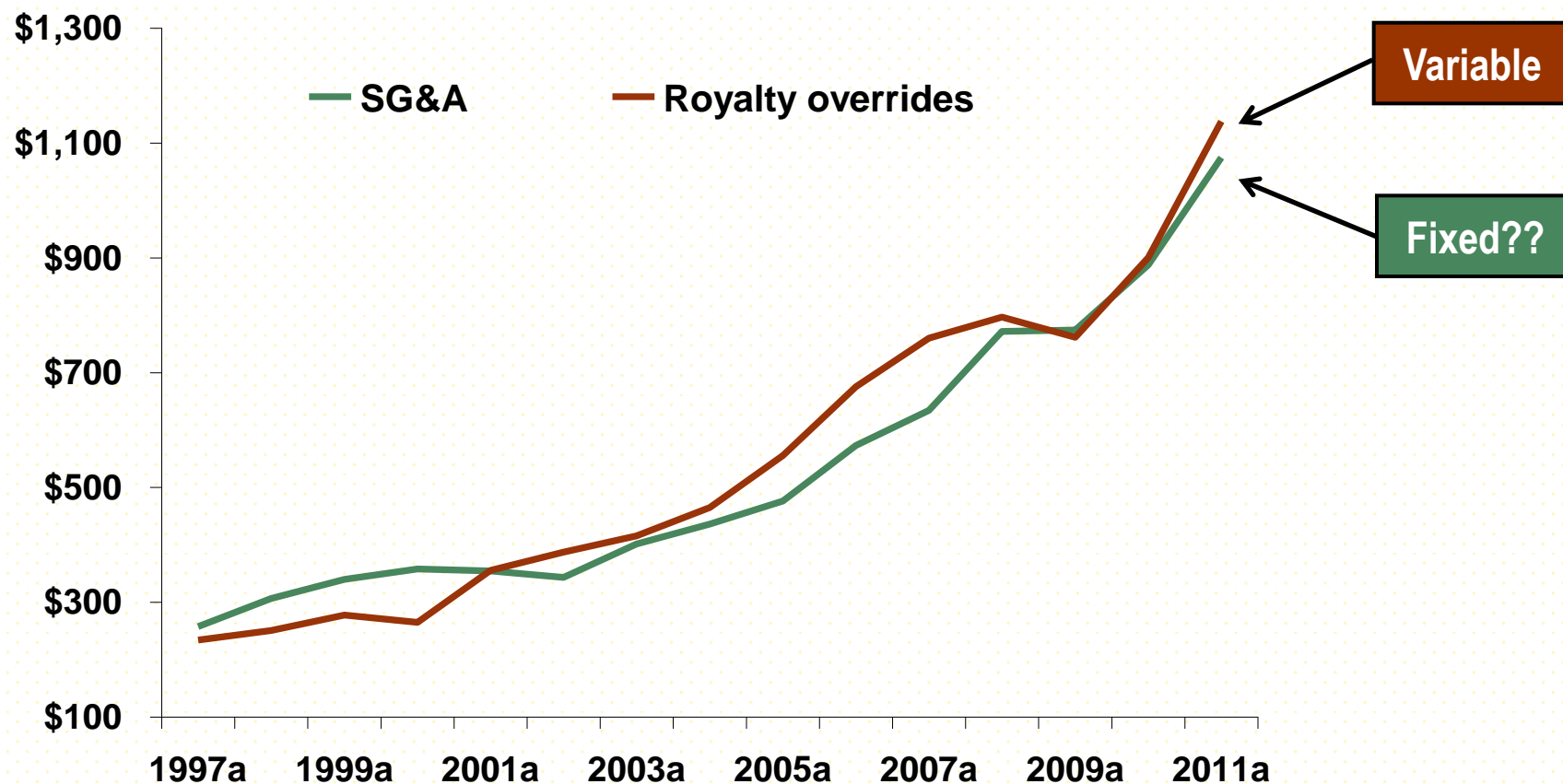
**Adjustment #4:**  
**Recruiting Rewards in SG&A**

# Herbalife Pays More Than 23% of Retail Sales to Distributors in Recruiting Rewards



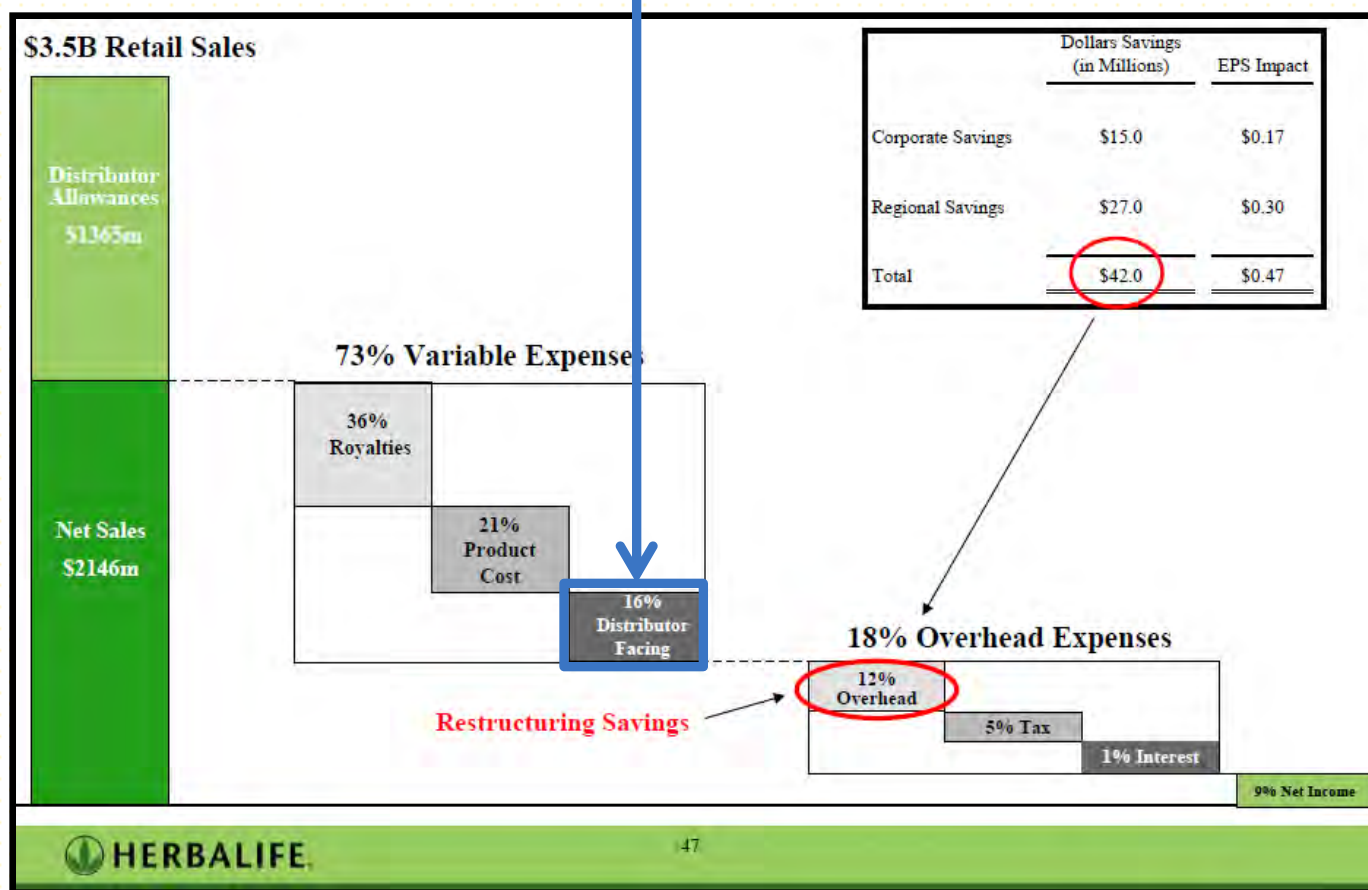
# SG&A's Lockstep Move with Royalty Overrides Provides a Clue as to Where Herbalife Conceals Other Reward Payments

**Herbalife SG&A and Royalty Overrides (\$mms) <sup>(1)</sup>**



# “Distributor Facing” Expenses

At its 2008 Investor Day presentation, Herbalife disclosed that approximately 54% of SG&A was “Distributor Facing” expenses<sup>(1)</sup>



(1) “Distributor Facing” expenses were 16% of net sales in 2007, or \$343mm, which represents 54% of reported SG&A (\$634mm). Source: Herbalife Investor Day presentation (12-16-08)

# **“Distributor Facing” Expenses are Incentives Similar to Royalty Overrides**

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## **From the Investor Day Transcript (12-16-08):**

*“Of our net sales, we believe that 73% of our business or our cost structure is highly variable. Our royalties that we pay distributors, about 36% of sales. Our product costs, 21%, and distributor facing spending, which is sort of sacrosanct. This is what Des mentioned earlier, and Michael. This is the last area that we want to touch as it relates to trying to leverage our margins.*

*In fact, if anything, what we try to do is over-invest in this area because we do believe that complementing our royalty expense with very prudent incentives and promotion can actually drive incremental ROI on the spending. So, when we look at our essentially fixed overhead, and fixed is relative depending on what time horizon, we look at 12% of our cost structure being essentially fixed.”*

**– Rich Goudis, CFO, Herbalife**



# A Substantial Portion of Distributor Facing Expenses are Effectively Recruiting Rewards

Though Herbalife's SG&A disclosure is limited, we estimate a meaningful portion of Distributor Facing expenses are dedicated to vacation packages, one-time cash bonuses, Herbalife pins and watches, and other similar promotions that can only be gained via recruiting



Why Active World Team?

**QUALIFY FOR AN UNFORGETTABLE EXPERIENCE**

HERBALIFE. **VACATIONS**

HERBALIFE.  
Independent Distributor

54

The graphic is a promotional slide for Herbalife's 'Active World Team' vacation package. It features a green header with the text 'Why Active World Team?'. Below this, the text 'QUALIFY FOR AN UNFORGETTABLE EXPERIENCE' is displayed in large, bold, orange and green letters. To the left of the main text are two filmstrip-style frames, each showing a beach scene with a blue umbrella and the text 'GREECE 2013' and 'HERBALIFE'. To the right is a large, stylized orange palm tree with a yellow sun behind it. Below the palm tree, the Herbalife logo (a green leaf) is followed by the word 'HERBALIFE.' and the word 'VACATIONS' in large, green, 3D-style letters. At the bottom left is the Herbalife logo and the text 'HERBALIFE. Independent Distributor'. At the bottom right is the number '54'.

# Quantifying Recruiting Rewards in SG&A

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Using the Company's 2008 statement that half of "Distributor Facing" expenses are vacation packages, one-time cash bonuses, Herbalife pins and watches, and other similar promotions that can only be gained via recruiting, \$291mm of Herbalife's SG&A in 2011 were Recruiting Rewards

## **Recruiting Rewards in SG&A**

<i>(\$mms)</i>	<u>2011a</u>
<b>SG&amp;A</b>	<b>\$1,075</b>
<b>% Distributor Facing expenses (1)</b>	<u><b>54%</b></u>
<b>Distributor Facing expenses</b>	<b>\$582</b>
<b>% of Distributor Facing expenses that are Recruiting Rewards (2)</b>	<u><b>50%</b></u>
<b>Recruiting Rewards in SG&amp;A</b>	<b>\$291</b>

(1) Assumes 54% of SG&A is Distributor Facing expenses (per Herbalife's Investor Day presentation on 12-16-08).

(2) Pershing Square assumption.

# Summary:

## Herbalife Distributors Earn Almost No Retail Profit

### HLF Representation

	2011a
Distributor Allowances (1)	\$2,492,300,000
Less: Internal Consumption	-
Less: Actual Retail Price adj.	-
Less: Wholesale Commissions	-
<b>Retail Profit</b>	<b>\$2,492,300,000</b>

Avg distributors (2) 2,380,000

#### Avg Retail Profit per Distributor:

Per Year	\$1,047
Per Month	\$87

### Reality

	2011a
Distributor Allowances (1)	\$2,492,300,000
Less: Internal Consumption (3)	(747,690,000)
Less: Actual Retail Price adj. (4)	(1,289,631,000)
Less: Wholesale Commissions (5)	(310,616,838)
<b>Retail Profit</b>	<b>\$144,362,162</b>

Avg distributors (2) 2,380,000

#### Avg Retail Profit per Distributor:

Per Year	\$61
Per Month	\$5

***Using reasonable assumptions, the typical Herbalife distributor only earns \$5 per month in Retail Profit (before taxes / expenses)***

(1) Distributor Allowances excluding literature, promotional and other. Source: Herbalife 10-K (2011).  
(2) Source: Herbalife public filings.  
(3) Assumes 30% of product is self-consumed.  
(4) Assumes Actual Retail Price is 35% off SRP; applied to 70% of Retail Sales.  
(5) Treats Wholesale Commissions as Recruiting Profit.

# Summary:

## Recruiting Rewards are Greater than Retail Profit

### HLF Representation

	2011a	
	Amt.	Pct.
Retail Sales (@ SRP) (1)	\$5,264	100%
Distributor Allowances (1)	\$2,492	47%
Less: Internal Consumption	-	-
Less: Actual Retail Price adj.	-	-
Less: Wholesale Commissions	-	-
<b>Retail Profit</b>	<b>\$2,492</b>	<b>47%</b>
Royalty overrides (2)	\$1,138	22%
Plus: Wholesale Commissions	-	-
Plus: Rewards in SG&A	-	-
<b>Recruiting Rewards</b>	<b>\$1,138</b>	<b>22%</b>
<b>Payout Ratio</b>		<b>69%</b>
<b>% of Payout that is Recruiting Rewards</b>		<b>31%</b>

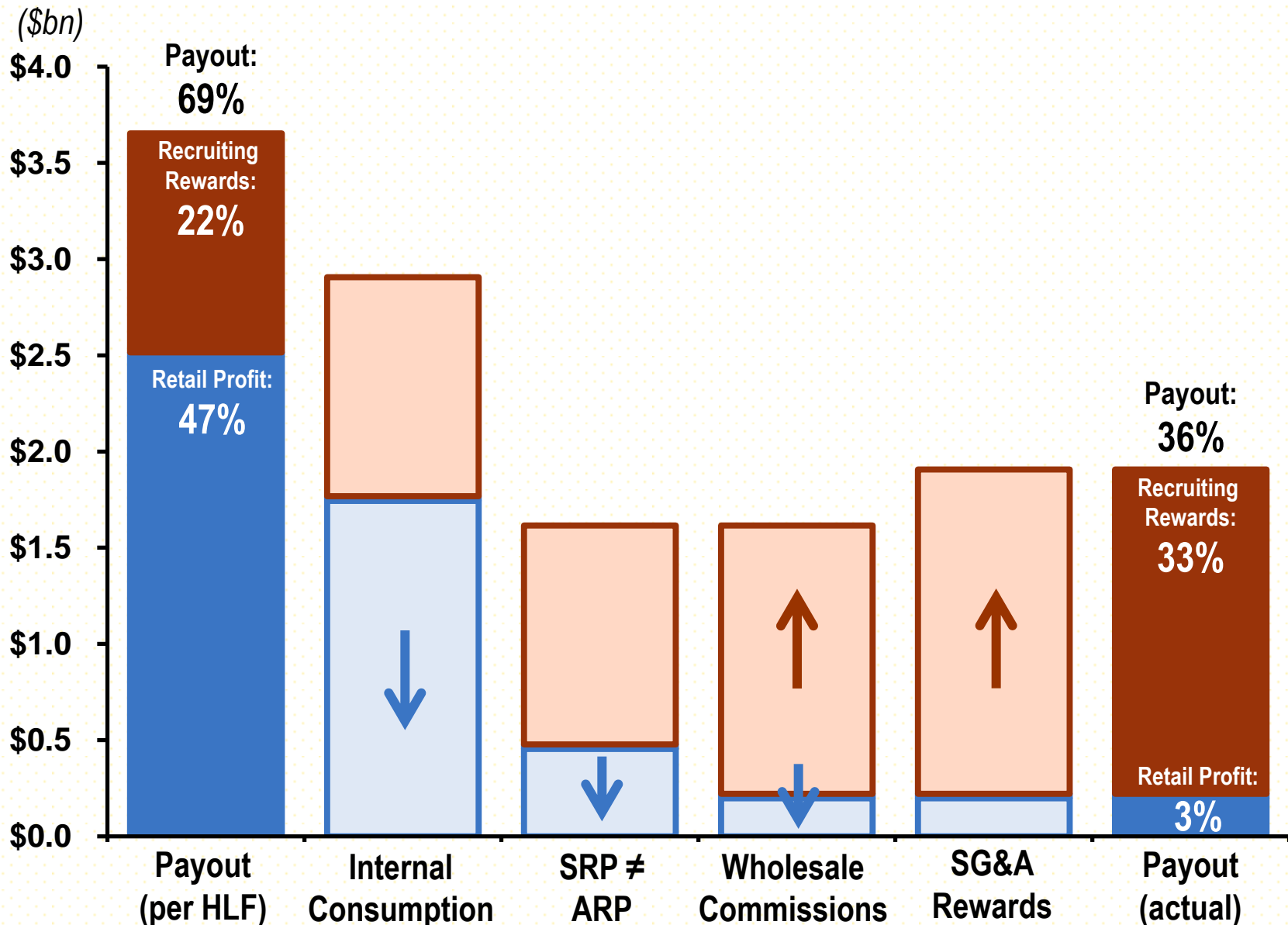
### Reality

	2011a	
	Amt.	Pct.
Retail Sales (@ SRP) (1)	\$5,264	100%
Distributor Allowances (1)	\$2,492	47%
Less: Internal Consumption (3)	(748)	(14%)
Less: Actual Retail Price adj. (4)	(1,290)	(25%)
Less: Wholesale Commissions (5)	(311)	(6%)
<b>Retail Profit</b>	<b>\$144</b>	<b>3%</b>
Royalty overrides (2)	\$1,138	22%
Plus: Wholesale Commissions (5)	311	6%
Plus: Rewards in SG&A (6)	291	6%
<b>Recruiting Rewards</b>	<b>\$1,739</b>	<b>33%</b>
<b>Payout Ratio</b>		<b>36%</b>
<b>% of Payout that is Recruiting Rewards</b>		<b>92%</b>

(1) 2011a Retail Sales and Distributor Allowances exclude literature, promotional and other. Distributor Allowances percentage is less than 50%, as Herbalife Sales Leaders purchase at less than 50% discounts in certain markets. Source: HLF 10-K.  
 (2) Defined as sales proceeds from sales to non-distributors at Actual Retail Price.  
 (3) Assumes 30% of product is self-consumed.  
 (4) Assumes Actual Retail Price is 35% off SRP; applied to 70% of Retail Sales (@ SRP).  
 (5) Treats Wholesale Commissions as Recruiting Rewards.  
 (6) Assumes \$291mm of SG&A are Recruiting Rewards.

# Summary:

## Recruiting Rewards are Greater than Retail Profit

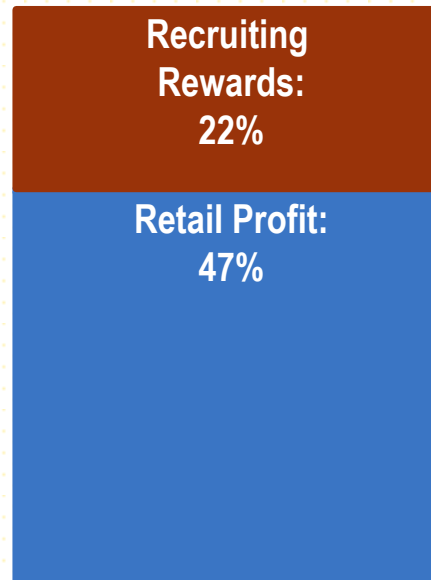


**“[T]he organization is deemed a pyramid scheme if the participants obtain their monetary benefits primarily from recruitment rather than the sale of goods and services to consumers”**

**- Dr. Peter J. Vander Nat, Senior Economist at the FTC <sup>(1)</sup>**

**Percent of Participants’  
Income from Recruiting Rewards:**

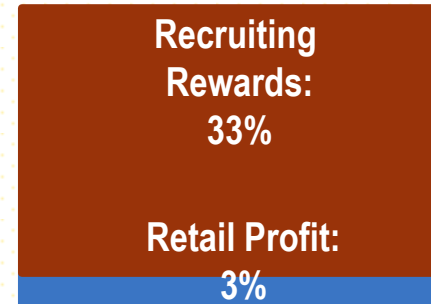
**31%**



**Payout  
(per HLF)**

**Percent of Participants’  
Income from Recruiting Rewards:**

**92%**



**Payout  
(actual)**

(1) Vander Nat, Peter J and Keep, William W.; (2002). Marketing Fraud: An approach for differentiating Multi-level Marketing from Pyramid schemes. *Journal of Public Policy and Marketing*. Vol 21-1, 139-151.



# **Herbalife's Compensation Plan Incentivizes Distributors to Recruit Aggressively**

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- ▶ **Distributors cannot get to the higher-income, upper levels of the Herbalife chain without recruiting**
  - **To get to Active World Team, GET Team, Millionaire Team, President's Team, or Chairman's Club, a distributor must accumulate Royalty Override Points, which requires having (recruiting) downline Sales Leaders**
- ▶ **Herbalife's most lucrative rewards (Royalty Overrides, Production Bonuses, and the Mark Hughes Bonus) are only available to distributors who have reached the rank of Sales Leader and have recruited Sales Leader's beneath them**
  - **As Sales Leaders recruit, and as they incentivize their recruits to recruit, they become eligible to receive additional recruiting rewards, and their commissions grow geometrically**
  - **Production Bonuses go “infinitely deep” into the distributor's downline**
- ▶ **Wholesale Commissions are only available to distributors who have recruited Non-Sales Leaders**



# **A Distributor's Ability to Earn Retail Profit via Herbalife's Business Opportunity is De Minimis**

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- ▶ **We estimate that the typical Herbalife distributor earns less than \$10 per month in Retail Profit**
  - **Even using Herbalife's reported "Retail Sales," the typical distributor only earns \$87 per month**
  - **Furthermore, these figures are gross, not net of distributor expenses, which we believe to be material**
- ▶ **The "wholesale" price paid by distributors for Herbalife products does not allow for meaningful Retail Profits. As a result, a distributor's only real chance to earn the money promised in Herbalife distributor presentations is by recruiting**
  - **No distributor can achieve "financial freedom," "generate perpetual income," or earn enough to buy a Ferrari by simply retailing**

**Herbalife's inflated Suggested Retail Prices for its products mask the fact that the Recruiting Rewards earned by distributors vastly exceed their Retail Profits**

# What Would You Rather Do?

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## Retail

*Sell an overpriced, unadvertised white powder to strangers, from whom you are required to obtain name, address, and purchase details*

**Or**

## Recruit

*Recruit friends and family to a business opportunity*



**What other factors might the FTC consider in determining whether a company is a pyramid scheme?**

# **An Alternative Way to Approach the Question**

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**In 2004, the FTC issued a Staff Advisory Opinion stating the following:**

The critical question for the FTC is whether the revenues that primarily support the commissions paid to all participants are generated from purchases of goods and services that are not simply incidental to the purchase of the right to participate in a money-making venture.

***Simply stated:  
Why do participants buy the product?***

# Why Do Senior Distributors Buy Product? To “Pay-for-your-Paycheck”

In 2009, Bruce Roth (former President’s Team member) provided the following declaration as part of a legal dispute against Herbalife that alleged that Herbalife was illegally perpetuating a pyramid scheme

6. By 2007, operating an Herbalife independent distributorship business had become unsustainable. Herbalife’s entire program is based on purchases made from Herbalife. Distributors have to purchase product from Herbalife each month in order to obtain their paychecks. Under this system, we would not be paid any money or commissions from the sales by people in our business organization in a given month unless we purchased products from Herbalife during that month. Herbalife products became almost impossible to retail because the “pay-for-your-paycheck” Herbalife product was being dumped by distributors on eBay for much less than we could sell it. Moreover, this product could not be returned to Herbalife or the distributor lost his or her paycheck and had to permanently resign from Herbalife. In addition, Herbalife’s product line is very limited and consists primarily of weight loss and nutritional products. This also makes it very difficult to retail because customers do not continue to buy the product or the customers find it cheaper to buy from eBay.

# Why Herbalife Distributors “Pay-for-your-Paycheck”

## *Herbalife’s Compensation Plan Revisited*

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- ▶ Herbalife’s compensation plan is based on two types of volume

### **Personal Volume**

*Derived from a distributor’s personal purchases and the purchases of his Non-Sales Leader downline*

### **Organization Volume**

*Derived from the Personal Volume of a distributor’s Sales Leader downline (“organization”)*

***Personal Volume is the monthly volume requirement that determines whether a distributor gets their paycheck; Organization Volume determines the size of the paycheck***



# Why Herbalife Distributors “Pay-for-your-Paycheck”

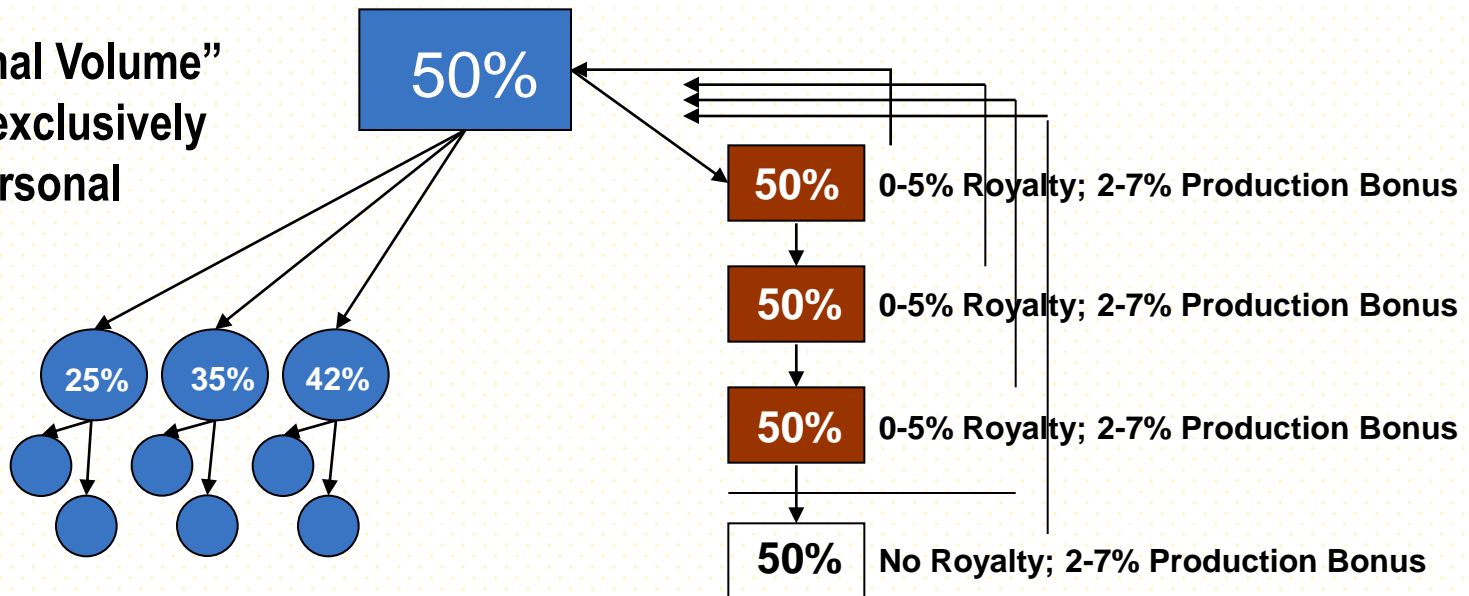
## *Herbalife’s Compensation Plan Revisited (Cont’d)*

- ▶ Herbalife’s compensation plan is based on two types of volume

**Personal  
Volume**

**Organization  
Volume**

“Personal Volume”  
is not exclusively  
personal



# Why Herbalife Distributors “Pay-for-your-Paycheck”

## *Herbalife’s Compensation Plan Revisited (Cont’d)*

- ▶ In order to receive Royalty Overrides, Sales Leaders must generate a set amount of Personal Volume *each month*. This can be achieved by “paying-for-your-paycheck” or by recruiting new NSL distributors

**Personal  
Volume  
Requirement  
(monthly)**

Personal Volume determines Royalty Override Earning % (“Royalty %”)	
Royalty Override Scale	
Your Total Volume Points	Royalty Override Earning %
0–499	0%
500–999	1%
1,000–1,499	2%
1,500–1,999	3%
2,000–2,499	4%
2,500 plus	5%

# **Why Herbalife Distributors “Pay-for-your-Paycheck”**

## ***Herbalife’s Compensation Plan Revisited (Cont’d)***

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- ▶ In addition, in order to receive Royalty Overrides, Sales Leaders must generate Organization Volume

**Royalty Override Points = (Royalty %) \* (Organization Volume)**

**One Royalty Override Point = ~ \$1.00 Royalty Override**

# **Why Herbalife Distributors “Pay-for-your-Paycheck”**

## ***The (not so) Curious Case of Anthony Powell***

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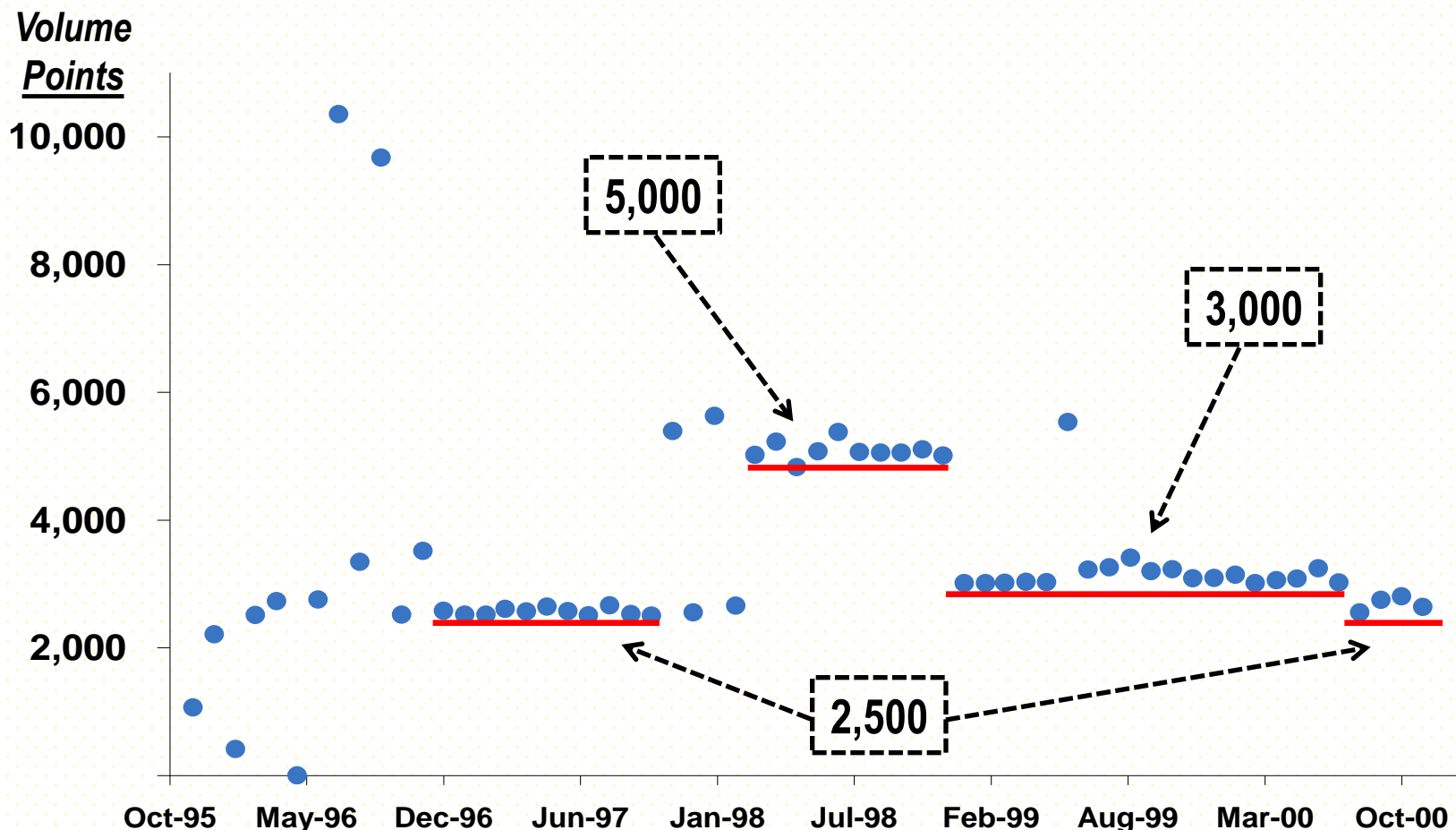
- ▶ In 2000, Jason McDowell (President’s Team member) filed a lawsuit against Herbalife alleging that the company had unjustifiably removed a Sales Leader, Anthony Powell, from his downline<sup>(1)</sup>
- ▶ In order to assess the damages incurred by McDowell for the loss of Powell’s Organization Volume, the monthly volume of Anthony Powell was made available as part of discovery
- ▶ Because Anthony Powell ascended the Herbalife chain from World Team to President’s Team, his Personal Volume purchasing behavior provides valuable insights into the incentives created by Herbalife’s compensation plan

(1) *McDowell v. Herbalife*, No. C00-2011Z (W.D. Wash.), complaint dated October 30, 2000.

# Why Herbalife Distributors “Pay-for-your-Paycheck”

## *The (not so) Curious Case of Anthony Powell (Cont’d)*

The chart below shows Anthony Powell’s monthly Personal Volume from 1996 to 2000. You might think it would be driven by the vagaries of retail demand...



# Why Herbalife Distributors “Pay-for-your-Paycheck”

## *The (not so) Curious Case of Anthony Powell (Cont’d)*

- ▶ In order to receive Production Bonuses, GET Team / Millionaire Team / President’s Team members (collectively, “TAB Team”) must generate a minimum amount of Personal Volume per month

### Personal Volume Requirement (monthly)

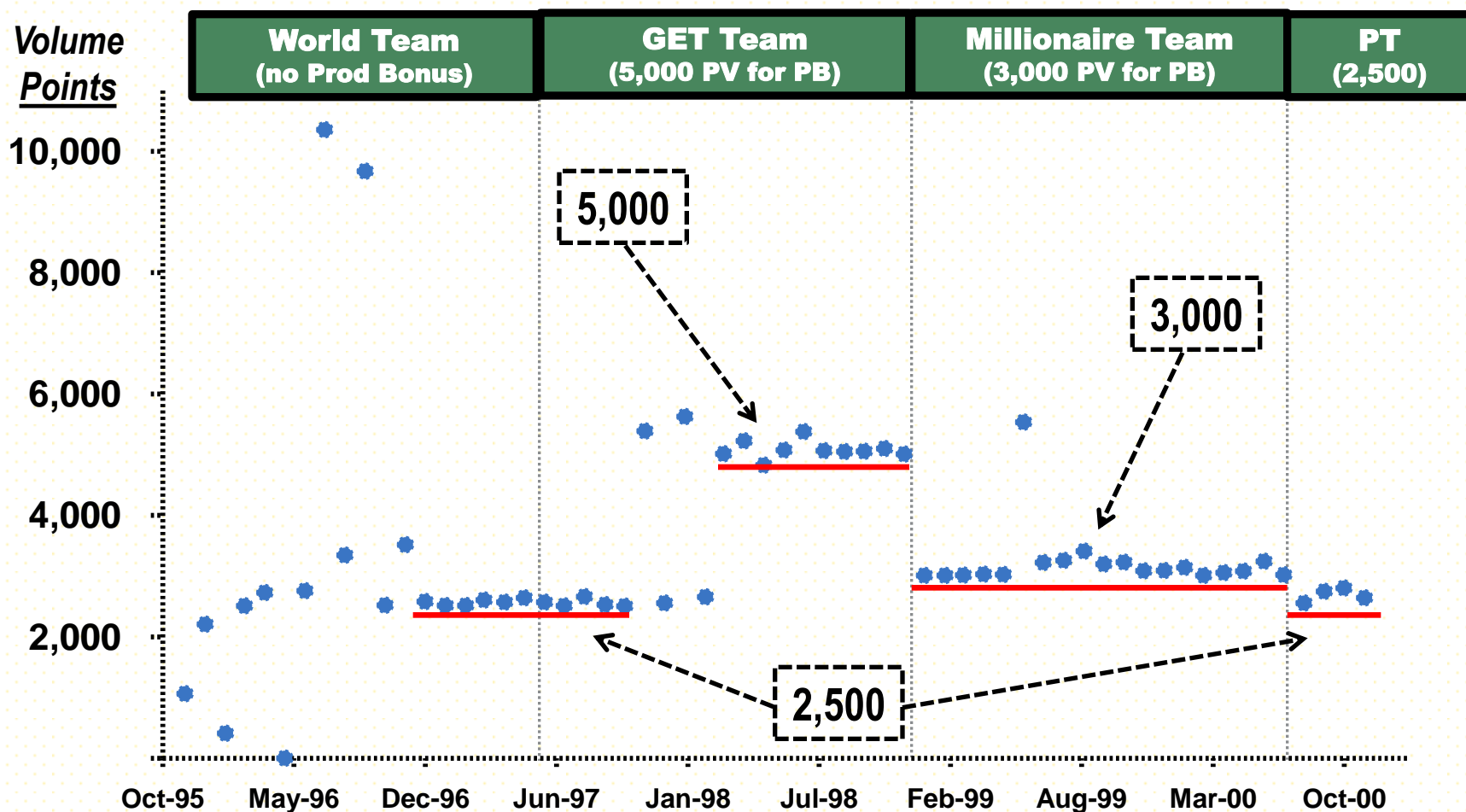
	Production Bonus %	Total Volume Points Required	Royalty Points Required for Max 2% TAB Team PB	Royalty Points Required for Max 4% TAB Team PB	Royalty Points Required for Max 6% TAB Team PB	Royalty Points Required for Max 6.5% TAB Team PB	Royalty Points Required for Max 6.75% TAB Team PB	Royalty Points Required for Max 7% TAB Team PB
GET	2%	5,000	1,000					
Millionaire	4%	3,000	1,000	4,000				
President’s	6%	2,500	1,000	4,000	10,000			
20K	6.5%	2,500	1,000	4,000	10,000	20,000		
30K	6.75%	2,500	1,000	4,000	10,000	20,000	30,000	
50K	7%	2,500	1,000	4,000	10,000	20,000	30,000	50,000



# Why Herbalife Distributors “Pay-for-your-Paycheck”

## *The (not so) Curious Case of Anthony Powell (Cont’d)*

Powell purchases just enough Personal Volume to earn his Production Bonus (“pay-for-his-paycheck”)



# **Why Herbalife Distributors “Pay-for-your-Paycheck”**

## ***The (not so) Curious Case of Anthony Powell (Cont’d)***

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- ▶ **Herbalife distributors supposedly meet their Personal Volume requirements by establishing a base of Retail Customers. If Powell had a sufficient base of Retail Customers as a GET Team member to support 5,000 VPs, why did it suddenly disappear when he reached Millionaire Team?**
- ▶ **Per Herbalife’s rules, “the purchase of products primarily as an attempt to qualify for advancement in the Marketing Plan is not permitted;” yet, Powell purchases just enough Personal Volume each month to advance up the chain<sup>(1)</sup>**

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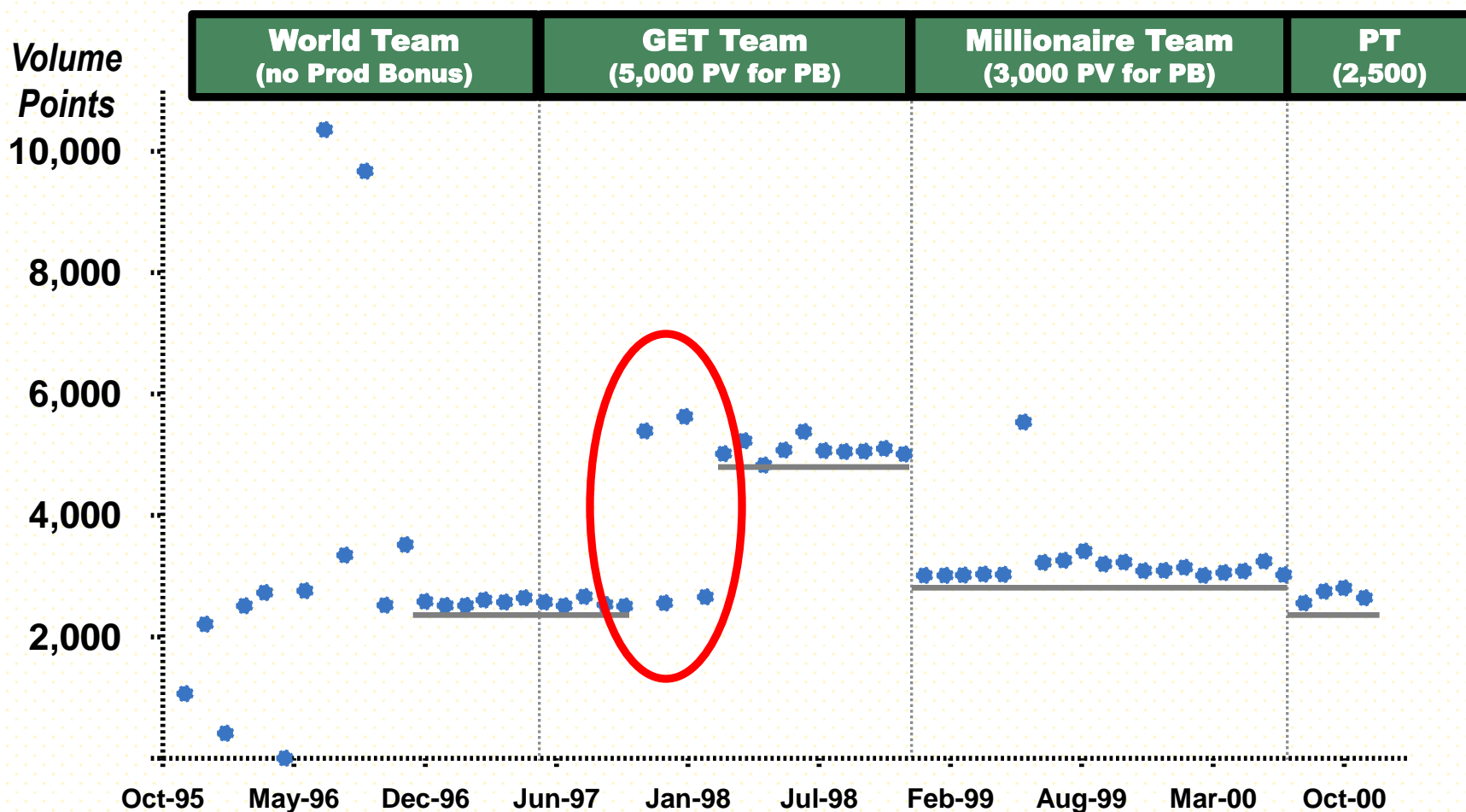
(1) See the Herbalife Sales & Marketing Plan (Rule 18-A Product Distribution).



# Why Herbalife Distributors “Pay-for-your-Paycheck”

## *The (not so) Curious Case of Anthony Powell (Cont’d)*

Why does Powell alternate between 2,500 and 5,000 Personal Volume when he first reaches GET Team?



# Why Herbalife Distributors “Pay-for-your-Paycheck”

## *The (not so) Curious Case of Anthony Powell (Cont’d)*

**At the GET Team level, it makes sense for Powell to pay for his royalties. This is why his Personal Volume is at least 2,500 Volume Points (“VPs”)**

Cost of 5% Royalties		Month	Pers. Volume	Org. Volume <sup>(2)</sup> A	Royalty Overrides			Pay-for- Royalties? C > D?
					% B	Value A*B=C	Cost D	
VP requirement	2,500							
RS / VP	1.0x	Oct-97	2,504	61,874	5.0%	\$3,094	\$1,400	Yes
RS requirement	\$2,500	Nov-97	5,390	98,610	5.0%	4,930	1,400	Yes
		Dec-97	2,553	56,698	5.0%	2,835	1,400	Yes
Discount	(50.0%)	Jan-98	5,627	89,946	5.0%	4,497	1,400	Yes
Surcharge (1)	6.0%	Feb-98	2,656	48,446	5.0%	2,422	1,400	Yes
<b>Cost for VPs</b>	<b>\$1,400</b>	Mar-98	5,017	70,883	5.0%	3,544	1,400	Yes

Source: Affidavit of William Partin (*McDowell v. Herbalife*, No. 00-2011 (W.D. Wash.)).

(1) Herbalife’s Surcharge was 6% in 1998.

(2) Technically, distributors earn Production Bonus off more than just Organization Volume because Org. Volume is only 3 levels and the Production Bonus goes “infinitely deep.” Powell’s third, fourth, and fifth levels were not disclosed as part of discovery. Assumes Level 3 volume is related to Level 2 volume as Level 2 volume is related to Level 1 volume.

# Why Herbalife Distributors “Pay-for-your-Paycheck”

## *The (not so) Curious Case of Anthony Powell (Cont’d)*

**Powell only “pays-for-his-Production Bonus” when his Organization Volume is large enough to justify the cost**

Incr. Cost for Prod Bonus		Pay-for-Prod Bonus?						
			Pers.	Org.	Production Bonus			
		Month	Volume	Volume <sup>(2)</sup>	%	Value	Cost	Bonus?
				A	B	A*B=C	D	D > C?
VP requirement	2,500							
RS / VP	1.0x	Oct-97	2,504	61,874	2.0%	\$1,237	\$1,400	No
RS requirement	\$2,500	Nov-97	5,390	98,610	2.0%	1,972	1,400	Yes
		Dec-97	2,553	56,698	2.0%	1,134	1,400	No
Discount	(50.0%)	Jan-98	5,627	89,946	2.0%	1,799	1,400	Yes
Surcharge (1)	6.0%	Feb-98	2,656	48,446	2.0%	969	1,400	No
Cost for VPs	\$1,400	Mar-98	5,017	70,883	2.0%	1,418	1,400	Yes

***If purchases were truly driven by retail demand, Powell’s Personal Volume and his Organization Volume should be independent of one another***

Source: Affidavit of William Partin (*McDowell v. Herbalife*, No. 00-2011 (W.D. Wash.)).

(1) Herbalife’s Surcharge was 6% in 1998.

(2) Technically, distributors earn Production Bonus off more than just Organization Volume because Org. Volume is only 3 levels and the Production Bonus goes “infinitely deep.” Powell’s third, fourth, and fifth levels were not disclosed as part of discovery. Assumes Level 3 volume is related to Level 2 volume as Level 2 volume is related to Level 1 volume.

# Why Do Mid-level Distributors Buy Product?

## Answer: Requalification

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### From Herbalife's Q4'06 Earnings Transcript:

**Greg Probert** - Herbalife Ltd. - President, COO

Right. Well, if you remember, January is our requalification month. So we have to take on that 52 million volume points is the requalification volume. So, a lot of our distributors requalified that month, so the orders are unusually high, January is always a big, big month for us, around the world due to that. So what we do is we take the 52 and try and cull out the requalification volume to really look at sort of the organic, and that gets us into the high 40s, and like we said, 45 to 47, we are tracking in February. Remember, February, again, is a shorter month. That leads us to believe that our guidance of 600 million volume points for the year is pretty good we are not coming off that guidance right now.

### What does requalification have to do with Retail Sales?

# Why Do Junior Distributors Buy Product?

## Answer: Advancement

Non-Sales Leaders are encouraged to work their way up the Herbalife chain to get to Supervisor<sup>(1)</sup>



Source: Herbalife independent distributor presentation (2012).

***“I want everyone to understand that the most important thing in this business is to get to Supervisor.” – Shawn Dahl (Chairman’s Club)***

(1) John Tartol, (Chairman’s Club member, director of Herbalife), Herbalife Broadcast Network.  
“Mentoring your downline to help them reach to Supervisor level – it’s such a large part of building a strong team and it can make or break your success at Herbalife.”

# **Why Do Distributors Buy Herbalife Product?**

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- ▶ **Senior distributors purchase product to “pay-for-their-paycheck”**
  - ▶ **Mid-level distributors purchase product to re-qualify and maintain their downline “lineage”**
  - ▶ **Junior distributors purchase product to participate and advance in the business opportunity**
- ▶ **Herbalife’s compensation plan incentivizes orders without regard to retail demand**

**How does Herbalife sell so much of its unadvertised, commodity products at an inflated price?**

**Herbalife bundles its products with a business opportunity**

Source: Herbalife Independent Distributor Presentation

## If I Can Do It

Everything is really easy. If I can do it, you can do it as well.

—Mark Hughes

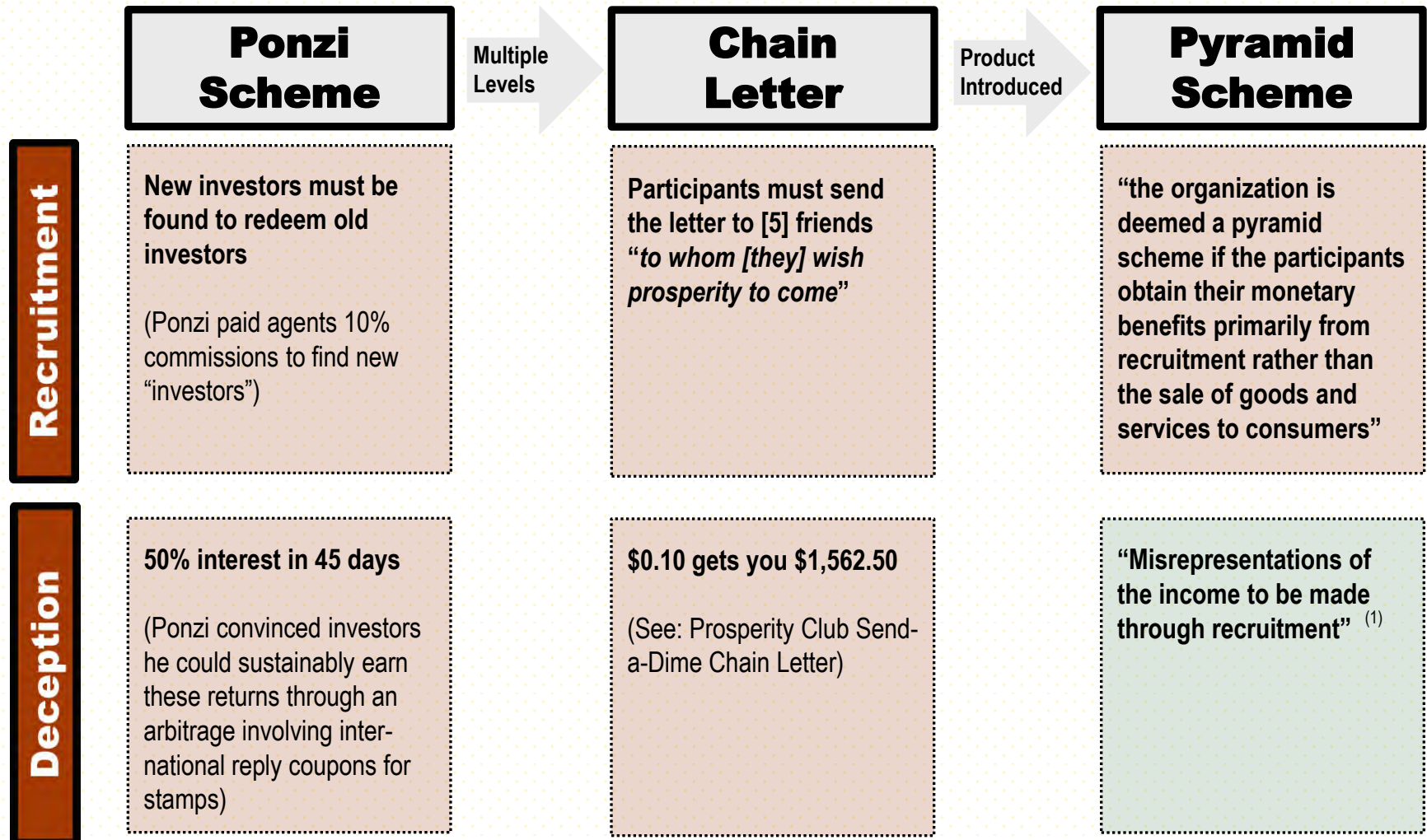


 HERBALIFE.

**Deception**



# Recruitment and Deception: The Two Hallmarks of Any Transfer Scheme



(1) In *Koscot*, 86 F.T.C. at 1136-37, the FTC found (¶54):  
"The deception inherent in the endless chain element of Koscot's marketing plan is but one of the numerous misrepresentations made by respondents. This basic deception necessarily involved, of course, gross misrepresentations of the income to be made through recruitment."

# Every Herbalife Distributor Sees the Company's Disclosure of Distributor Earnings

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FINAL TRANSCRIPT

Nov. 28. 2007 / 1:00PM, HLF - HERBALIFE LTD Analyst Meeting

**Michael Johnson** - *Herbalife Limited - Chairman and CEO*

We are transparent with our earnings potential among supervisors. The staff on this page which is the average gross compensation of U.S. supervisors is a public document, it is available on our website and is part of our introductory business pack that all new distributors receive. So, every new distributor in this Company knows exactly where they stand and what their opportunity is inside the Company.

# Herbalife's Disclosure of Distributor Earnings



## STATEMENT OF AVERAGE GROSS COMPENSATION OF U.S. SUPERVISORS – 2011

Herbalife offers its Distributors an opportunity to achieve a lifetime of better health through its scientifically advanced weight management and nutrition products. While many of our Distributors join the Herbalife family simply to enjoy our life-changing products, others want to share their results and take advantage of the many income benefits our business opportunity provides. With Herbalife, you can work part-time and earn a supplemental income, or focus solely on your Herbalife Distributorship and increase your financial potential. It's completely up to the individual how much he or she wants to achieve! A Distributor earns profits by buying Herbalife products at wholesale and reselling them at retail. If the Distributor wants to increase his or her involvement in the business and enjoy the possibility of higher levels of income, he or she may sponsor others into the business and develop an organization.

Over 25% of Distributors reach the rank of Supervisor and above ("Leader"), qualifying them for additional compensation which is paid by Herbalife based upon the sales production of those they have sponsored directly and indirectly. The annual gross compensation paid by Herbalife to all Leaders during 2011 averaged \$2,900. Over 39% of Supervisors are "Active" (defined as those who generated at least 2,500 points of volume in 2011 after becoming Supervisor). The annual gross compensation paid by Herbalife to Active Leaders during 2011 averaged approximately \$7,300.

### Active Leaders

Earning Level	% of Total Leaders	% of Active Leaders	Average Earnings (USD)
President's Team	0.2%	0.6%	\$ 515,689
Millionaire Team	0.7%	1.7%	\$ 100,195
GET	2.6%	6.5%	\$ 22,766
World Team	2.9%	7.3%	\$ 6,224
Supervisor	33.1%	83.9%	\$ 901
Total	39.4%	100.0%	\$ 7,348

The amounts above are in addition to and do not include profits earned on the resale of products to consumers or other Distributors.

The figures stated above are not a guarantee nor are they a projection of a typical Distributor's earnings or profits. Like any other independent business, the achievement or failure of a Distributor depends upon his or her skill set, commitment and desire to succeed. At Herbalife, the opportunity to earn more is always available to each and every Distributor.

Published: 03/02/12

**The table in Herbalife's disclosure of distributor earnings only includes "Active" Sales Leaders. Inactive Sales Leaders and Non-Sales Leaders are excluded**

# Deception #1:

## 93% of Distributors Excluded from the Table

**Herbalife excludes from the table the 93% of its U.S. distributor base earning \$0 in “Gross Compensation” (Inactive Sales Leaders and Non-Sales Leaders)**

Active Leaders				<b>% of Total Distributors</b>
Earning Level	% of Total Leaders	% of Active Leaders	Average Earnings (USD)	
President's Team	0.2%	0.6%	\$ 515,689	0.04%
Millionaire Team	0.7%	1.7%	\$ 100,195	0.1%
GET	2.6%	6.5%	\$ 22,766	0.5%
World Team	2.9%	7.3%	\$ 6,224	0.5%
Supervisor	33.1%	83.9%	\$ 901	5.9%
Total	39.4%	100.0%	\$ 7,348	7.0%
Inactive Sales Leaders 60.6%				
			\$ 0 <sup>(1)</sup>	10.7%
Non-Sales Leaders				
			\$ 0	82.3%
				100.0%

(1) Per the Company's disclosure, Inactive Sales Leaders must not be earning any Royalty Overrides  $[(39.4\%)*(\$7,348) = \$2,900$ ; which implies Inactive Supervisors "Gross Compensation" must be \$0].

## **93% of Distributors Excluded from the Table (Cont'd)**

**The FTC believes the exclusion of zero-earning distributors is relevant to a determination that an MLM is a pyramid scheme**

Source: *FTC v. Trek Alliance*, No. 02-9270 (C.D. Cal. June 24, 2003).

A. Failing to disclose, clearly and conspicuously, before any consumer becomes a Marketing Program participant, all information material to a consumer's decision to participate in the Marketing Program, including but not limited to the following:

- (1) The number and percentage of current Marketing Program participants who have not received any commissions, bonuses or overrides;

## Deception #2: “Gross” “Earnings”

Herbalife’s Statement of “Gross” Compensation refers to “Average Earnings,” but it is not adjusted for distributor expenses

### STATEMENT OF AVERAGE GROSS COMPENSATION OF U.S. SUPERVISORS – 2011

Active Leaders			
Earning Level	% of Total Leaders	% of Active Leaders	Average Earnings (USD)
President's Team	0.2%	0.6%	\$ 515,689
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Supervisor	33.1%	83.9%	\$ 901
Total	39.4%	100.0%	\$ 7,348

The amounts above are in addition to and do not include profits earned on the resale of products to consumers or other Distributors.

Published: 03/02/12

# “Gross” “Earnings” (Cont’d)

After David Einhorn questioned the company on a conference call, Herbalife revised its disclosure to explain that “Earnings” are before expenses. For at least 10 years, Herbalife had not disclosed this fact to its U.S. distributors<sup>(1)</sup>

## STATEMENT OF AVERAGE GROSS COMPENSATION OF U.S. SUPERVISORS – 2011

ACTIVE LEADERS				
Earning Level	% of Total Leaders	% of Active Leaders	Average Earnings Compensation (USD)	Median Compensation (USD)
President's Team	0.2 %	0.6 %	\$ 514,638	\$ 336,901
Millionaire Team	0.7 %	1.7 %	\$ 100,195	\$ 97,303
Get Team	2.6 %	6.5 %	\$ 22,766	\$ 19,417
World Team	2.9 %	7.3 %	\$ 6,224	\$ 5,659
Supervisor	33.1 %	83.9 %	\$ 901	\$ 475
Total	39.4 %	100 %	\$ 7,354	\$ 637

The amounts above do not include the income Distributors can earn from their retail or wholesale income, so the actual compensation can be somewhat higher, depending upon each Distributor's personal-selling efforts. Also, the figures above are gross, not net income.

Revised: 07/25/12

(1) Source: Herbalife Statement(s) of Average Gross Compensation of U.S. Supervisors 2002 through 2011.



# Failing to Disclose Expenses

This itemized list of Business Support Materials below comes from the blog of a former Herbalife Non-Sales Leader distributor showing nearly \$2,000 of expenses in only three months, excluding Herbalife product purchases. The Company seldom acknowledges these costs exist

DATE	COST	DESCRIPTION
03-Aug-09	\$449.00	charged by my upline Distributor for Distributorship sign up + remaining cost of decision pkg.
17-Aug-09	\$562.62	charged for leads purchased from Online Marketing Solutions
17-Aug-09	\$112.52	charged for website access from The Online Business
18-Aug-09	\$991.26	charged by Herbalife for an order put in by my upline Distributor and had sent to me
26-Aug-09	\$25.00	Merchant Account
27-Aug-09	\$75.00	Merchant Account
14-Sep-09	\$39.55	charged for new style Decision Package sent to lead
15-Sep-09	\$55.94	charged by The Online Business System for website access
21-Sep-09	\$35.00	Merchant Account
03-Oct-09	\$112.22	charged by Herbalife for website setup for one year
14-Oct-09	\$168.00	charged for Online Business System supplies that my upline Distributor order I pay for
15-Oct-09	\$52.74	charged by The Online Business System for website access
21-Oct-09	\$35.00	Merchant Account

**\$2,713.85 GRAND TOTAL**

<http://www.trishparr.com/what-online-business-systems-and-herbalife-don%E2%80%99t-tell-you/>

***In Jacobs v Herbalife, a class action lawsuit of 8,800 distributors against the company, average Sales Leader expenses were ~\$10,000 <sup>(1)</sup>***

(1) *Jacobs v. Herbalife International, Inc.*, Case No. CV-02-1431 (U.S.D.J., C.D. Cal.). Declaration of Michael Rosenbaum, sworn to August 23, 2005. Rosenbaum, managing director of claims administrator, sent 8,822 notices to potential class members and received back 2,701 claims. Submitted claims totaled \$27,345,366 and averaged \$10,124 per claimant. The highest totaled \$128,241.



## Deception #3: Cherry-Picking “Active” Leaders

Herbalife uses multiple definitions of the term “Active.” In its public filings, it broadly defines “Active” Sales Leaders. In its distributor earnings disclosure, it uses a more narrow definition

STATEMENT OF AVERAGE GROSS COMPENSATION  
OF U.S. SUPERVISORS – 2011

ACTIVE LEADERS	
Earning Level	% of Total Leaders
President's Team	0.2 %
Millionaire Team	0.7 %
Get Team	2.6 %
World Team	2.9 %
Supervisor	33.1 %
Total	39.4 %

Herbalife Regional Key Metrics - Reclassified for 6 Regions

	2011
North America	
Volume Points (in 000)	987,082
Net Sales (\$ in 000)	698,631
New Distributors	280,513
Avg Active Sales Leaders	56,741
Total Sales Leaders	108,211

% Active

52.4%

Source: Herbalife Regional Key Metrics supplement. Consistent with this disclosure, Herbalife reported 56,741 Average Active Sales Leaders in North America for the year ended 12/31/11 in its 2011 10-K.

***Herbalife cherry-picks the highest earning “Active” Supervisors for its distributor earnings disclosure***

## **Deception #4:**

### **“Over 25% of Distributors reach Supervisor”**

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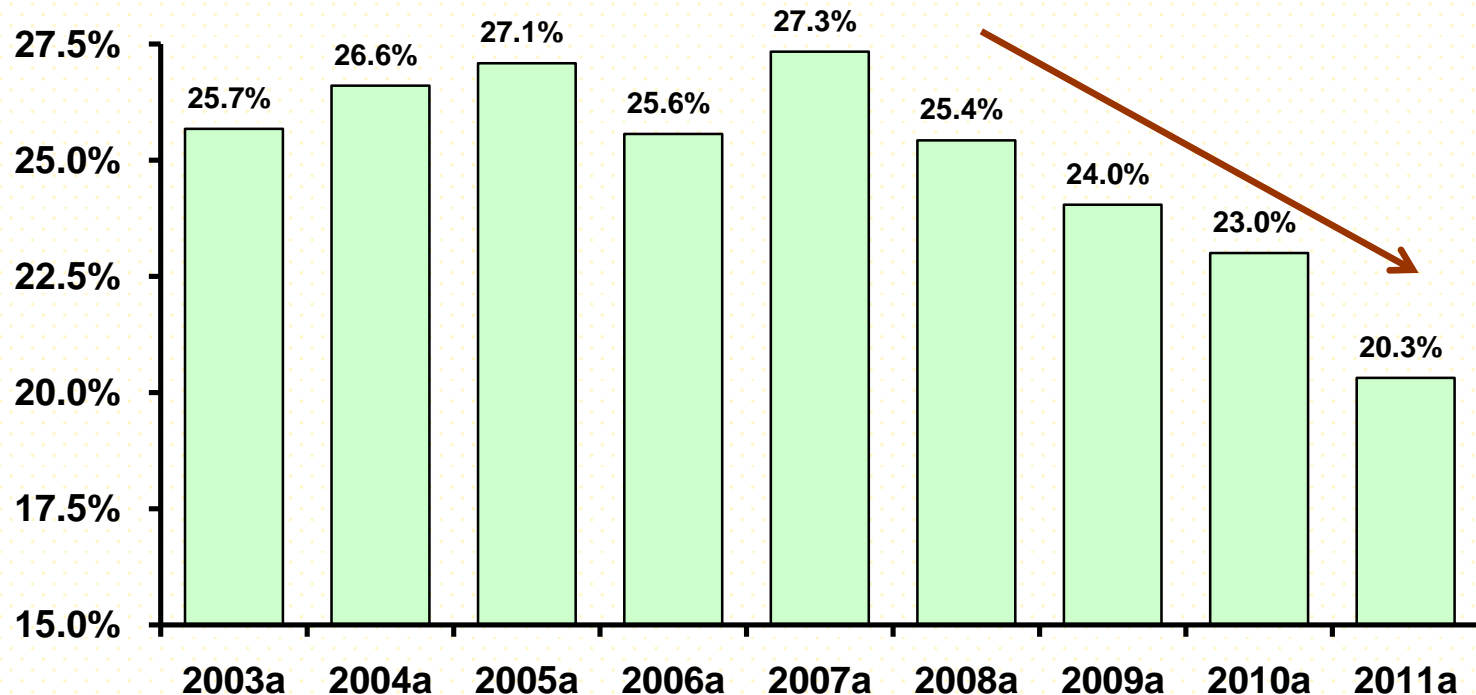
Herbalife states that “*over 25% of Distributors reach the rank of Supervisor and above,*” implying a new distributor has a one-in-four chance of being in one of the table’s earnings brackets (so long as they are “Active”)

Over 25% of Distributors reach the rank of Supervisor and above (“Leader”), qualifying them for additional compensation which is paid by Herbalife based upon the sales production of those they have sponsored directly and indirectly. The annual gross compensation paid by Herbalife to all Leaders during 2011 averaged \$2,900. Over 39% of Supervisors are “Active” (defined as those who generated at least 2,500 points of volume in 2011 after becoming Supervisor). The annual gross compensation paid by Herbalife to Active Leaders during 2011 averaged approximately \$7,300.

## **“Over 25% of Distributors reach Supervisor” (cont’d)**

Herbalife has made this statement in each of its U.S. distributor earnings disclosures since 2003, even though Sales Leaders as a % of total distributors has been lower than 25% since 2009

### **% of Total Distributors that are Sales Leaders <sup>(1)</sup>**



(1) Represents % of total distributors that are Sales Leaders for the entire company. Herbalife does not break out total distributors by region.  
Source: Herbalife public filings, Herbalife's Regional Key Metrics supplemental disclosure, and Herbalife Q1'09 Investor Presentation.

**But even this percentage is overstated...**

# “Over 25% of Distributors reach Supervisor” (Cont’d)

To determine what % of distributors make Sales Leader:

Don’t ask: what is the ratio of Sales Leaders to distributors?

Ask: what is the ratio of new Sales Leaders to new distributors?

In 2011, Herbalife stopped disclosing New Sales Leaders

## North America Distributor Mix

	2009a				2010a				
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Total
New Sales Leaders (1)	7,893	10,633	10,569	9,153	8,127	12,558	11,035	9,451	79,419
New distributors (2)	50,738	59,712	58,586	49,642	60,453	71,223	64,662	52,075	467,091
Ratio of New Sales Leaders to New Distributors									17.0%

*Only about one-out-of-six distributors makes Sales Leader rather than one-out-of-four*

(1) 2009 Source: Regional Key Metrics (2009); 2010 Source: Herbalife public filings.

(2) Source: Regional Key Metrics (2011).

# Deception #5: Getting to the Top is Much Harder than Advertised

Herbalife overstates a participant's likelihood of getting to the top of the pyramid

## Manual de Entrenamiento para

### Distribuidores Herbalife

MAYORISTA: SER O NO SER?

QUE SE NECESITA?

- ES IMPOSIBLE LLEGAR A LA SEGUNDA BASE SI SU PIE TODAVIA ESTÁ EN LA PRIMERA. Tiene usted miedo de dejar la primera base?
- Desafíese. ESTABLEZCA SUS METAS PROPIAS. Acuérdesse que los únicos que fracasan en la vida son aquellos que no lo intentaron. Usted no puede alcanzar una meta si no la establece primero
- SEA RESPONSABLE DE UD. MISMO. No culpe a los otros por su fracaso, no se queje. Usted es responsable por usted mismo y su negocio.

Use, Wear, Talk → President's Team in two years

- NO SE CONCENTRE EN "COMO HACER DINERO". "Olvídese de cuanto gana usted o las personas de su línea ascendente y concéntrese en cuanto ganan los DISTRIBUIDORES que dependen de Ud."

- USE, LLEVE Y HABLE -> EL EQUIPO DE LOS PRESIDENTES EN 2 AÑOS

(1)

# Getting to the Top is Much Harder than Advertised (Cont'd)

John Tartol, Chairman's Club member and an Herbalife director, stated in an Herbalife newsletter that Distributors today could make it to the President's Team in less than three years



The Luck  
of the Irish Now  
Includes Herbalife  
Herbalife welcomes its 49th country!

**In three years, Lori and John became members of the President's Team.**

"Distributors can make it even faster today than we did," says John. "There are so many more sales and marketing tools now and a support system everyone can plug into. We're not only working for ourselves, but for the Company as a whole. When a team succeeds, there's more for everyone!"

# **Getting to the Top is Much Harder than Advertised (Cont'd)**

**Herbalife entered Ireland in 2000. Ten years later not a single Irish distributor had even made it to Millionaire Team**

## Statement of Average Gross Compensation of Irish Supervisors

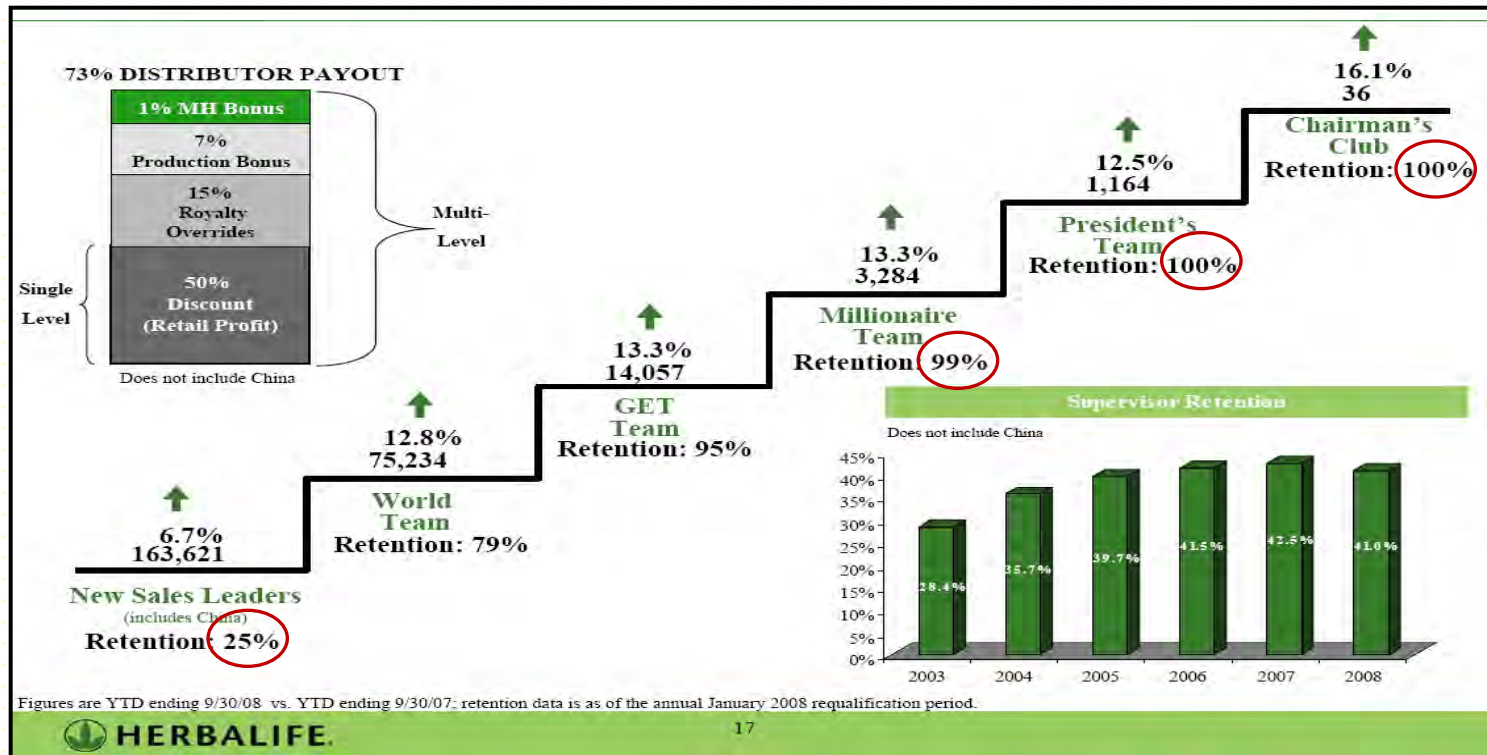
Over 21% of Distributors ranked as Supervisor and above ("Leader"), qualifying them for additional compensation which is paid by Herbalife based upon the sales production of those they have sponsored directly or indirectly. The annual gross compensation paid by Herbalife, in addition to profits earned on the resale of products to consumers or other Distributors, to all Leaders during 2010 averaged €1,500. Over 42% of Supervisors are "Active" (defined as those who generated at least 2,500 points of volume in 2010 after becoming Supervisor). The annual gross compensation paid by Herbalife to Active Leaders during 2010 averaged approximately €3,700.

Active Leaders			
Earning Level	% of Total Leaders	% of Active Leaders	Average Earnings (EUR)
President's Team	0.0%	0.0%	0
Millionaire Team	0.0%	0.0%	0
GET	3.6%	8.4%	32,614
World Team	2.7%	6.3%	5,003
Supervisor	36.5%	85.3%	761
Total	42.8%	100.0%	EUR 3,711



# Getting to the Top is Much Harder than Advertised (Cont'd)

There is almost no turnover at the top



# Getting to the Top is Much Harder than Advertised (Cont'd)

From 2004 through 2009, we estimate that only one new President's Team member was created for every 10,000 new distributors

	2004a	2005a	2006a	2007a	2008a	2009a
<b>Beginning of Period</b>						
President's Team (1)	697	787	886	1,018	1,137	1,220
Non-PT SLs	274,182	298,341	333,114	401,925	450,418	455,638
Sales Leaders (2)	274,879	299,128	334,000	402,943	451,555	456,858
Non-Sales Leaders	796,000	825,000	899,000	1,163,793	1,153,291	1,296,236
Total Distributors (3)	1,070,879	1,124,128	1,233,000	1,566,736	1,604,846	1,753,094
<b>Churn</b>						
President's Team (4)	(7)	(8)	(9)	(10)	(11)	(12)
Non-PT SLs	(105,244)	(120,611)	(121,669)	(146,072)	(177,702)	(188,297)
Sales Leaders	(105,251)	(120,619)	(121,678)	(146,082)	(177,713)	(188,309)
Non-Sales Leaders (5)	(796,000)	(742,500)	(767,631)	(940,048)	(878,367)	(927,444)
Total Distributors	(901,251)	(863,119)	(889,309)	(1,086,130)	(1,056,080)	(1,115,753)
<b>Additions</b>						
President's Team	97	107	141	129	94	93
Non-PT SLs	129,403	155,384	190,480	194,565	182,922	162,667
Sales Leaders (2)	129,500	155,491	190,621	194,694	183,016	162,760
Non-Sales Leaders	825,000	816,500	1,032,424	929,546	1,021,312	903,899
Total Distributors	954,500	971,991	1,223,045	1,124,240	1,204,328	1,066,659
<b>End of Period</b>						
President's Team (1)	787	886	1,018	1,137	1,220	1,301
Non-PT SLs	298,341	333,114	401,925	450,418	455,638	430,008
Sales Leaders (2)	299,128	334,000	402,943	451,555	456,858	431,309
Non-Sales Leaders	825,000	899,000	1,163,793	1,153,291	1,296,236	1,272,691
Total Distributors (3)	1,124,128	1,233,000	1,566,736	1,604,846	1,753,094	1,704,000

**From 2004 – 2009:**

**New President's  
Team Members:**

**661**

**÷**

**New Distributors:**

**6,544,763**

**=**

**~1 in 10,000**



(1) Source: Herbalife press releases. Uses Q3'09 for EOP 2009 as HLF stopped disclosing this metric in Q3'09.

(2) Source: Herbalife public filings. Excludes China.

(3) Source: Herbalife public filings and Investor Presentations. Excludes China.

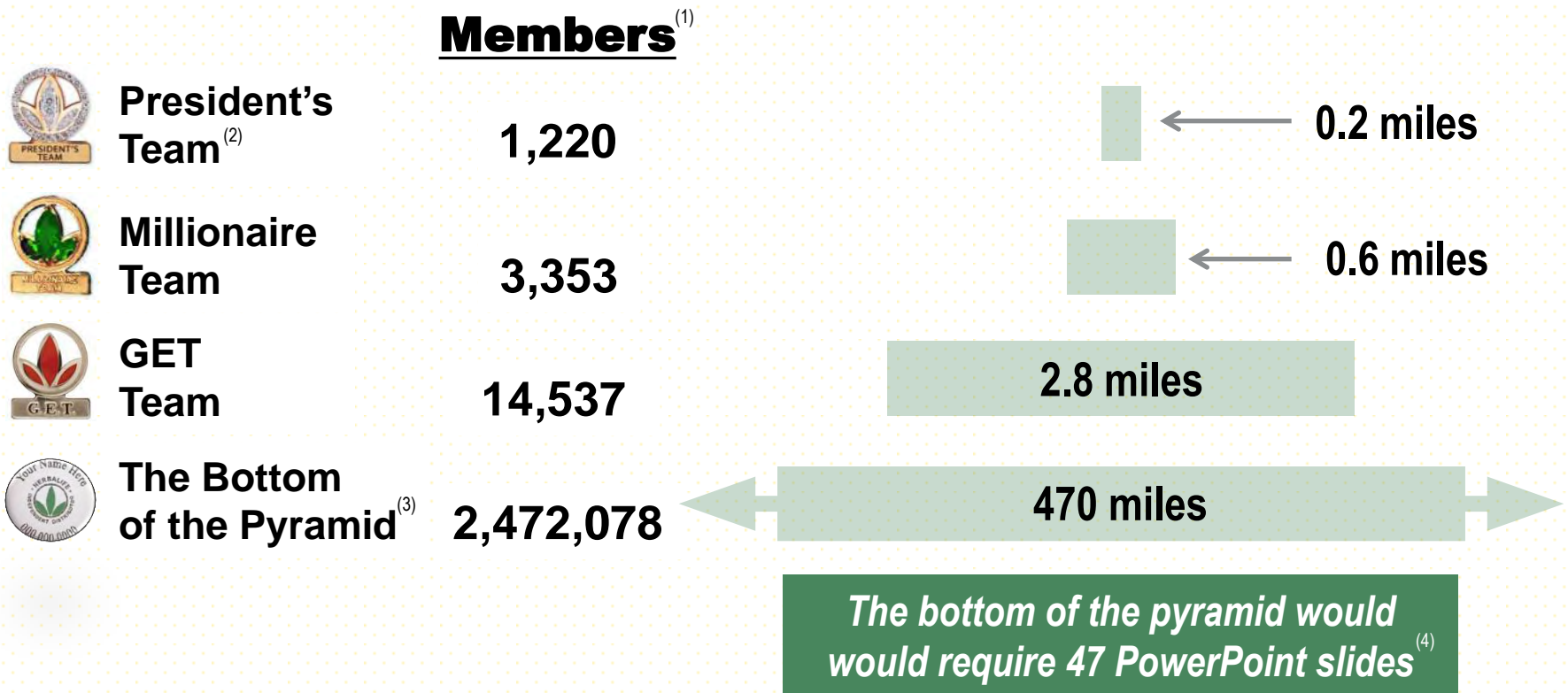
(4) Assumes PT retention is 99%. Source: Herbalife Investor Presentation (2008) (President's Team retention disclosed as 100%).

(5) 2004-2005 Source: HLF reported Non-SL churn in its 10-K (100% and 90%). 2009 Source: HLF reported new distributors in its Regional Key Metrics disclosure.

2006-2008: churn assumed to be linear average. Excludes China.

# Getting to the Top is Much Harder than Advertised (Cont'd)

If one member equals one foot, then the bottom of the pyramid would equal the distance from New York City to Cleveland (~470 miles)



(1) As of 9/30/08. Source: Herbalife Investor Presentation March 2009.

(2) President's Team includes Chairman's Club and President's Team members.

(3) The Bottom of the Pyramid includes Non-Sales Leaders, Supervisors and World Team members.

(4) Assuming PowerPoint slides are 10 inches wide.

# Getting to the Top is Much Harder than Advertised (Cont'd)

***The probability of a new distributor getting to these levels is statistically insignificant***



## STATEMENT OF AVERAGE GROSS COMPENSATION OF U.S. SUPERVISORS – 2011

Herbalife offers its Distributors an opportunity to achieve a lifetime of better health through its scientifically advanced weight management and nutrition products. While many of our Distributors join the Herbalife family simply to enjoy our life-changing products, others want to share their results and take advantage of the many income benefits our business opportunity provides. With Herbalife, you can work part-time and earn a supplemental income, or focus solely on your Herbalife Distributorship and increase your financial potential. It's completely up to the individual how much he or she wants to achieve! A Distributor earns profits by buying Herbalife products at wholesale and reselling them at retail. If the Distributor wants to increase his or her involvement in the business and enjoy the possibility of higher levels of income, he or she may sponsor others into the business and develop an organization.

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Active Leaders			
Earning Level	% of Total Leaders	% of Active Leaders	Average Earnings (USD)
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Published: 03/02/12


# Summary: Everything Is Not Really Easy

Source: Herbalife Independent Distributor Presentation (2011)

## If I Can Do It

Everything is really easy. If I can do it, you can do it as well.

—Mark Hughes



HERBALIFE.

- ▶ There is nothing easy about achieving the wealth and lifestyle new distributors are led to believe are possible
- ▶ Herbalife is effectively a closed system at the very top. The probability of making it to Millionaire Team, which would allow a new distributor to earn an amount commensurate with Herbalife's testimonial earnings claims (~\$178k), is approximately one in five-thousand<sup>(1)</sup>

(1) We analyzed 393 testimonials and earnings claims from editions of Herbalife Today magazines from 1997 – 2004. The average earnings per year from the claims implied an annual income of \$178,000 per year. To earn this amount per year, a new distributor would need to reach Millionaire Team (average income per year: ~\$100,000 in 2011). In 2008, there were ~3x more Millionaire Team members than President's Team members. Millionaire Team members also have a 99% retention rate, which implies roughly 3 times as many Millionaire Team members were created as President's Team members from 2004 through 2009, putting the odds at 1 out of every 3,400 new distributors achieved Millionaire Team. 1 in 5,000 is used because to earn \$178,000 per year, a distributor would either need to be a "senior Millionaire Team member" or a "junior President's Team member."

# **Indicia of Pyramid Schemes & Other Legal Issues**

## **Disclaimer – This is Not Legal Advice**

***This presentation reflects PSCM's own views of applicable legal standards and authorities.***

***PSCM is not a law firm and is not purporting to provide legal advice to anyone.***

***Readers should review the cited sources and other related materials and reach their own conclusions.***

***Readers should consult their own legal counsel on the subjects discussed here.***

# **Federal Trade Commission Act – Section 5**

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**Section 5 of the FTC Act provides: “unfair or deceptive acts or practices in or affecting commerce, are hereby declared unlawful.” 15 U.S.C. § 45**

- ✓ A general, flexible provision that is designed to protect consumers from unfair, misleading or abusive practices
- ✓ An objective standard: Are the acts or practices at issue likely to mislead consumers acting reasonably under the circumstances?
- ✓ No requirement to show that consumers were actually confused or misled or that they actually relied upon the challenged acts or practices
- ✓ Enforcement is by the Federal Trade Commission
- ✓ Remedies can include injunctive and monetary relief, restitution, and disgorgement. Aims for both remedies and prevention.



# State & Non-U.S. Laws

## States and non-U.S. jurisdictions regulate consumer protection and multi-level marketing

- ▶ States have their own consumer-protection statutes, some known as 'Little FTC Acts' that track federal standards, and some providing private rights to sue
- ▶ Many States have specific laws against pyramid schemes
- ▶ Non-U.S. jurisdictions have consumer protection regimes that regulate pyramid schemes. Some bar MLMs

## Overlapping roles for Feds, States and non-U.S. gov'ts and private actions

*Little FTC Acts: E.g., N.Y. Gen. Bus. Laws § 349; Tex. Bus. & Com. Code Ann. § 17.46(c); 815 Ill. Comp. Stat. Ann. 505/2. General consumer-protection statutes: E.g., California. Statutes with private rights of action: e.g., 815 Ill. Comp. Stat. Ann. 505/10a; Conn. Gen. Stat. Ann. § 41-100g; 73 PA Cons. Stat. Ann. § 201-9.2; Tex. Bus. & Com. Code Ann. § 17.50. For a compendium of state anti-pyramid laws, as of 1999, see U.S. v. Gold Unlimited, 177 F.3d 472, 483-84 (6<sup>th</sup> Cir. 1999). See F.T.C. v. Equinox International Corp. 1999 WL 1425373 (D. Nev. 1999), 1999-2 Trade Cases ¶ 72,704 (Index No. CV-S-99-0969). Canadian Competition Act, R.S.C. 1985, c. C-34 § 55.1 (penalties for 'scheme of pyramid selling'); U.K. Fair Trading Act of 1973, c. 41, Part XI § 118 (prohibiting 'trading scheme' based upon introduction of other persons who become participants with prospect of payment for introducing other persons); People's Republic of China Ban of Operational Activities of Pyramid Sales (April 1998). India Ministry of Corporate Affairs has proposed (Disguised) Money Circulation Scheme (Banning) rules, 2012 (to curb pyramids conceived as MLMs).*

# **What are “Unfair or Deceptive Practices”?**

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**In a key 1983 Policy Statement on Deception, the FTC explained that deceptive acts or practices involve three elements:**

- 1. A representation, omission or practice**
- 2. Likely to mislead reasonable consumers under the circumstances**
- 3. And that is material, meaning likely to affect a consumer’s choice or conduct with respect to the goods or services**

**The Policy Statement on Deception specifically mentions “failure to disclose information regarding pyramid sales” as a situation in which the FTC has found deception**

See FTC Policy Statement on Deception (Oct.14, 1983), appended to *Cliffdale Associates, Inc.*, 103 F.T.C. 110, 174 (1984); *F.T.C. v. Five-Star Auto Club, Inc.*, 97 F. Supp. 502, 526 (S.D.N.Y. 2000).

# **Herbalife Acknowledges its Regulatory Risks...**

## **From Herbalife's 10K – Risk Factors:**

***Our network marketing program could be found to be not in compliance with current or newly adopted laws or regulations in one or more markets, which could prevent us from conducting our business in these markets and harm our financial condition and operating results.***

...

We are subject to the risk that, in one or more markets, our network marketing program could be found not to be in compliance with applicable law or regulations. Regulations applicable to network marketing organizations generally are directed at preventing fraudulent or deceptive schemes, often referred to as “pyramid” or “chain sales” schemes, by ensuring that product sales ultimately are made to consumers and that advancement within an organization is based on sales of the organization’s products rather than investments in the organization or other non-retail sales-related criteria. The regulatory requirements concerning network marketing programs do not include “bright line” rules and are inherently fact-based and, thus, we are subject to the risk that these laws or regulations or the enforcement or interpretation of these laws and regulations by governmental agencies or courts can change. The failure of our network marketing program to comply with current or newly adopted regulations could negatively impact our business in a particular market or in general.

## **...And Tries to Mitigate Those Risks**

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*“We put together a political action committee inside our company. I am in Washington every quarter, if not more than that. I have a list of Senators and Congressman that I go in and see. . . .”*

- Michael O. Johnson, CEO  
Goldman Sachs 14th Annual Global Retailing Conference  
9/5/2007

# **Indicia of Pyramid Schemes**

# **Indicia of Pyramids: Summary**

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- ▶ **Exaggerated Earnings Claims**
- ▶ **Inflated Prices & Need to Sell to Other Members**
- ▶ **Emotional Sales Pitch – the ‘Dream’**
- ▶ **A History of Lawsuits**
- ▶ **Targeting the Financially Unsophisticated**
- ▶ **Complex Compensation Rules**

# Indicia of Pyramids: Exaggerated Earnings Claims

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Federal Trade Commission  
Protecting America's Consumers

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PREPARED STATEMENT OF  
**DEBRA A. VALENTINE**, GENERAL COUNSEL FOR  
THE U.S. FEDERAL TRADE COMMISSION  
on  
"PYRAMID SCHEMES"

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presented at the  
INTERNATIONAL MONETARY FUND'S  
SEMINAR ON CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS  
Washington, D.C.  
May 13, 1998

Here are some tips that consumers and business might find helpful.

1. Beware of any plan that makes exaggerated earnings claims, especially when there seems to be no real under-lying product sales or investment profits. The plan could be a Ponzi scheme where money from later recruits pays off earlier ones. Eventually this program will collapse, causing substantial injury to most participants.

# **Indicia of Pyramids: Exaggerated Earnings Claims**

Under FTC Act § 5, representations of profit potential are clearly material to consumers

*F.T.C. v. Five Star Auto*, 97 F. Supp. 2d at 529

The case law is clear that representations regarding the profit potential of a business opportunity are important to consumers, and therefore such are material misrepresentations in violation of Section 5. *See FTC v. Minuteman*, 53 F. Supp.2d at 258 (“misrepresentations -- which tend to bear directly on the economic viability of the transaction under consideration -- are both likely to deceive and material.”) (citing *FTC v. Security Rare Coin & Bullion Corp.*, 1989-2 Trade Cas. (CCH) ¶68,807 at 62,219 (D. Minn.)), *aff’d*, 931 F.2d 1312 (8<sup>th</sup> Cir. 1991); *FTC v. Kitco of Nevada, Inc.*, 612 F. Supp. 1282, 1292 (D. Minn. 1985). *See also FTC v. U.S. Oil and Gas Corp*, 1987 U.S. Dist. LEXIS 16137 (S.D. Fl. 1987).



# Exaggerated Earnings Claims

## Actual Herbalife Testimonials – The Formula:

### Before Herbalife:

"I had to seek hospital treatment for a stress-related illness because of my job."

"I felt like I was in a dark sea, without a light to guide me."

"With 500,000 in debt, we were devastated- and all we could do was pray for wisdom and guidance!"

"I had my back against the wall. I needed to make some money!"

### After Herbalife:

"In that first month we were able to save our home. Herbalife saved us from bankruptcy."

"Thanks to the income opportunity offered by Herbalife, we paid back all our creditors."

"Within a year of doing business together, we were debt-free and saving money."

"Herbalife is the key to waking people up and giving them the success I have received."

"If I can do it, anybody can. I only have a high-school education and no business background."

Source: Herbalife Today for 1997-2004 (as many editions as could be found through online research).

# **Exaggerated Earnings Claims**

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Data compiled from *Herbalife Today* magazines (published by HLF)

From 1997-2004, 392 testimonials and earnings claims:

Average Earnings/Year: ~\$178,000

Median Income/Year: ~\$120,000

These represent approximately the top 1/10<sup>th</sup> of 1% of Distributors  
**Fewer than 1 in 1000 achieve these results**

**Gross earnings** – limited mention of COGS and other business costs.

One person said: *"We sold everything—even our children's toys—just to pay for gasoline and the expenses of moving to California,"* after hearing people were having success with Herbalife.

Source: Herbalife Today for 1997-2004 (as many editions as could be found through online research); Herbalife filings and Statement of Average Gross Compensation of U.S. Supervisors.

# Exaggerated Earnings Claims

## Herbalife's More Recent Format – Similar Stories, Fewer Numbers

1 Million Lifetime Achievement:  
Health & Wealth  
(luxury cars, yachts, exotic travel, etc.) –  
“more money than he could have imagined”



**ENRIQUE CARRILLO**



Enrique was studying kinesiology at New Mexico State University, but wasn't living a lifestyle he was proud of. Enrique was introduced to the Herbalife® products, and eventually lost weight. He decided to become an Herbalife Independent Distributor, and grew his business by consistently working hard and staying positive. Now he is making more money than he could have imagined. He shares, "My Herbalife Independent Distributorship has transformed my life with health, wealth and happiness."<sup>††</sup>



**IRENE HAMASAKI**



Irene Hamasaki worked as a legal secretary for 13 years, and had struggled with weight problems since childhood. Introduced by a co-worker to Herbalife® products, Irene achieved great results and, encouraged by others wanting to know her secret, she became an Herbalife Independent Distributor. Now, she's healthy and has the freedom to travel to places she could never have imagined, and help others live healthier, happy lives.<sup>††</sup>

<sup>†</sup>Incomes applicable to the individuals (or examples) depicted and not average. For average financial performance data, see the Statement of Average Gross Compensation of U.S. Supervisors at Herbalife.com and MyHerbalife.com.

<sup>††</sup>An extensive questionnaire generated responses from more than 200 U.S. Herbalife Independent Distributors about their weight-loss programs and results. They reported weight loss ranging from 4 pounds to 167 pounds and a reduced body mass index (BMI) of 1.5 points to 24.1 points, suggesting that consumption of Herbalife® products is associated with weight loss and improvement in BMI in those ranges.

myherbalife.com | TODAY 29



# How Much Money Can You Expect to Make?

While HLF now uses 1 Million Lifetime stories, high-ranking distributors continue to use specific dollar testimonials.



## *The rewards of working from home are worth it*

Finding Online Business Systems was the best thing that happened to our family. We were previous business owners that kept us away from home 12-15 hours a day. When we heard about Online Business Systems and called our business coach to get more details, we realized that we had nothing to lose and everything to gain. We jumped in right away and made a commitment that we were going to make this work for the sake of our family.

Just like any other business, it takes serious commitment and self-discipline, but the rewards of working from home are so worth it. In our first month, we generated \$550 and by our fourth month, we had banked \$2,300. By our one year anniversary, we walked away from our other business and now we're working Online Business Systems around our family's schedule.

— Jill & Jamie Verdure, Alton, Iowa



## *Your shot at lasting wealth*

Seven years ago, I was selling real estate – some months I made great money, while other months were bone dry. Nicole was going to medical school. In America and I was living in Canada. We had a long commute to see each other and money was tight. When I found Online Business Systems, I knew I could make it work to bring us the extra income we needed. In my first month, I made \$600; in my second month, I made \$900. After just 13 months, I was up to \$6,000 a month so I quit my full-time job. My income has continued to climb every year and it's a bit hard to believe myself, but this year, I will make more than a quarter of a million dollars! That's the power of residual income.

— Shawn and Nicole Dahl, Vancouver, B.C.



## *Pay your bills... easily*

I was an engineer and my wife was an at-home mom. As our family grew, we found it increasingly difficult to pay all the bills from just one salary. So my wife took a part-time job driving a school bus. After seeing the kids off to school every morning, I'd leave for work and wouldn't get home until after they were asleep. Over time, the bills began to pile up and we found ourselves facing personal bankruptcy. We signed up with Online Business Systems, and with help from our personal coach, we saw immediate results – making \$300 in our first month. After only 15 months, we earned more than \$10,000 a month. We've had to work hard to get where we are, but that's OK with us. We're now spending the "quality time" with our children that we always dreamed of and paying the bills no longer is a challenge.

— Phil and Shari Koogh, Loretto, Ontario



## *I never will answer to a boss again*

Five years ago, I was a piano teacher in my late 20s working a crazy schedule and barely making ends meet. I'll be honest, here... when I first found Online Business Systems I was a little skeptical, because I had tried other things before that didn't work out. But once I talked with my business coach and learned how she was making six figures working at home part time around her young family, I decided to get started right away.

By my 2nd month in business, I earned over \$800 and after one year, I was earning more money running my business part time than I had made teaching piano full time. I'm now earning over \$6,300 every month. My time is my own – my day starts at 10:00 a.m. – no more rush hour traffic, and I never will answer to a boss again!

— Adam Page, Vancouver, B.C.



## *We did it... you can too*

For 20 years, we worked together in the printing and graphic industries. Industry changes and downsizing began to significantly impact us, so we started looking for a way to build a retirement income in a business that would allow us to continue working together. We found this online business and, despite our skepticism, we decided to give it a try. In our first month, we earned \$1,200 and our second month, \$2,400. After only 10 months, we now earn more than \$5,000 per month! Now we're able to travel and not spend money for our retirement. Our positive attitude and willingness to work hard is paying off and we're finally able to earn what we feel we are worth!

— Mike and Posie Dolan, Port Orchard, Washington



## *You can get out of the 'Rat Race'*

I spent 20 years working hard in a dead-end 45+ hours-a-week management job in corporate America. My husband and I had maxed out our credit cards and we were living from one payday to the next. With four teenagers, we worried about how we were going to pay for clothes, cars and college. So when I heard about Online Business Systems, I decided to get started right away. I earned an extra \$600 in my first month working just a few hours a week around my family's schedule. By the third month, I was banking more than \$2,600. After only 18 months, I was consistently earning more than \$7,000 a month. I'm now earning a six-figure income, paying cash for college tuition for 4 kids, and I'm traveling all over the world with my family. I'm so glad I found a way out of the rat race!

— Karen and Curt Winter, Milwaukee, Wisconsin



## *After one year, I fired my bosses*

Six years ago, I was working two part-time jobs. My life was crazy. I got up, took my children to their respective schools and headed to my first job. At 2:00 p.m., I raced to my second job in real estate, and later that afternoon, I ran to pick up my kids. I always felt behind, frustrated and exhausted. I wanted to be home with my kids, and when I found Online Business Systems, I knew that I'd found the best opportunity to make my dream come true.

Working closely with my business coach, I earned over \$1,000 in my first month in business. Within three months, I made \$2,600, and within one year, I replaced the income from my two part-time jobs. I fired my bosses and I came home. Today, I earn a six-figure income. I'm privileged to home school my children and I'm actively involved in their lives. What a change, to be LIVING, rather than existing.

— Cindy Leno-Brown-Theriot, New York, N.Y.

**\$2,300/mo  
by month 4**

**\$6,000/mo  
by month 13**

**\$10,000/mo  
by month 16**

**\$5,500/mo  
by month ?**

**\$5,000/mo  
by month 10**

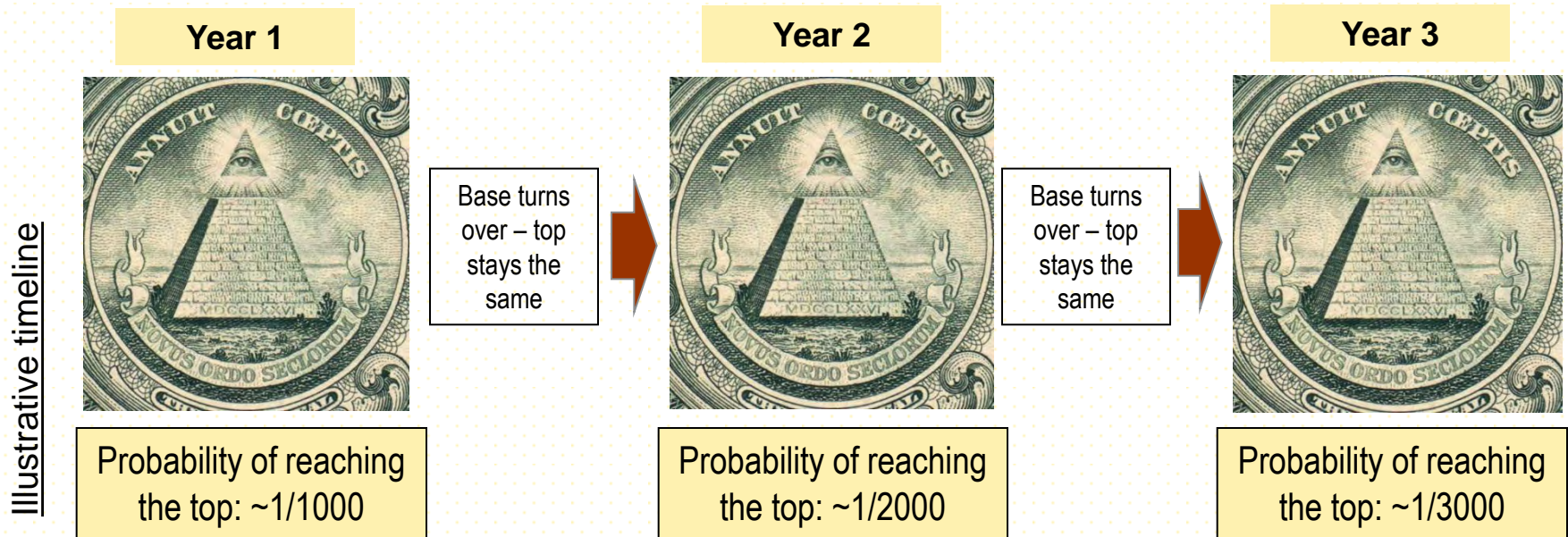
**\$7,000/mo  
by month 18**

**Six-figures/yr  
by month ?**

Source: Online Business Systems Decision Package (2007). Online Business Systems is a dedicated Herbalife marketing company headed by Shawn Dahl, Herbalife Chairman's Club member.

# Anybody Can Do It? An Illustration

The probability of success declines over time as more and more entrants arrive, but most can't reach the upper levels because the market is saturated



Statistically, it is highly unlikely that any new Distributor will cross the gap from bottom to top. The precise statistics require knowing the relative turnover rates in the top and bottom segments. HLF provides minimal data on these rates

Disclaimer: This is only an illustration of a time series of new entrants v. a static upper group – These are not HLF numbers.

# **The Importance of “Anybody Can Do it”**

Webster v. Omnitrition, 79 F.3d 776, 782 (9th Cir. 1996):

***“[T]he very reason for the per se illegality of the Endless Chain schemes is their inherent deceptiveness and the fact that the ‘futility’ of the plan is not ‘apparent to the consumer participant.’”***

**Anybody Can't Do it**



# MLM's Responsibility for Their Representatives' Conduct

## MLM Sponsors can be held responsible for misrepresentations by independent contractors

From *FTC v. Five-Star Auto Club*, 97 F. Supp. 2d 502, 527 (S.D.N.Y. 2000):

**Sponsors can be held responsible for misrepresentations by independent contractors.  
Principals can be personally liable**

See also *F.T.C. v. Equinox Int'l, Inc.*, No. CV-S-990969HBR, 1999 WL 1425373, at \*9 (D. Nev. Sept. 14, 1999)

3. Defendants suggest that they should not be held responsible for misrepresentations about the Five Star program made by others, and specifically for misrepresentations made by the Five Star Marketing Directors Kevin Cole and Thomas Bewley. Defendants' position is based on their assertions that both Mr. Cole and Mr. Bewley were independent contractors rather than employees of Five Star, and therefore not under Defendants' control, and that at least Mr. Cole sent out some material not authorized by Defendants.
4. However, for purposes of liability under the FTC Act, it does not matter whether Mr. Cole and Mr. Bewley would be considered at law as employees of the company or independent contractors. *See Goodman v. FTC*, 244 F.2d 584, 591-92 (9<sup>th</sup> Cir. 1957). The law is clear that under the FTC Act, a principal is liable for misrepresentations made by his/her agents (i.e., those with the actual or apparent authority to make such representations) regardless of the unsuccessful efforts of the principal to prevent such misrepresentations. *See Standard Distributors v. FTC*, 211 F.2d 7, 13 (2d Cir. 1954); *Goodman v. FTC*, 244 F.2d at 591-593. *See also Southwest Sunsites, Inc. v. FTC*, 785 F.2d 1431, 1438-39 (9<sup>th</sup> Cir.), *cert. denied* 479 U.S. 828 (1986). Indeed, it would be inappropriate for Defendants to hold out Mr. Cole and Mr. Bewley as Five Star representatives and to "reap the fruits from their acts and doings without incurring such liabilities as attach thereto." *Goodman*, 244 F.2d at 592 (quoting *International Art Co. v. FTC*, 109 F.2d 393, 396 (7<sup>th</sup> Cir.), *cert denied* 310 U.S. 632 (1940)).

# **State Laws on Earning Claims by MLMs**

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**Five States – Georgia, Louisiana, Maryland, Massachusetts, and Wyoming – specifically regulate or bar earnings claims with respect to multi-level marketing programs.**

For example, Massachusetts and Wyoming statutes provide:

“Multi-level distribution companies shall not represent, directly or indirectly, that participants in a multi-level marketing program will earn or receive any stated gross or net amount, or represent in any manner, the past earnings of participants . . .

“Multi-level distribution companies shall not represent, directly or indirectly, that additional distributors or sales personnel are easy to secure or retain, or that all or substantially all participants will succeed.”

Ga. Code § 10-1-414(2); La. Rev. Stat. § 51:1823(1); Md. Code, Bus. Reg. § 14-303; Mass. Gen. L. ch. 93 § 69(e); Wyo. Stat. § 40-3-107.



# Disclaimers of Typicality re Earnings Claims

## “Your Results May Vary”

In *Herbalife Today* ('97-'04), the company used what are called “disclaimers of typicality” . . . but not on every page

***“The financial testimonials in this publication reflect the results of individual Distributors. Your results may vary.”***

FTC Policy Statement on Deception (1983): “Pro forma statements or disclaimers may not cure otherwise deceptive messages or practices.”



President's Team

*Rox Anna & John Chauvenne*

Rox Anna Chauvenne has her brother, Brad Harris, to thank for her introduction to Herbalife. He had watched Rox Anna and her husband, John, struggle to make ends meet and knew that Herbalife could offer them a way out. And it did.

***“We were living paycheck to paycheck, and there were no ‘extras’ in our budget.”***

“I had worked for TWA for years, but when we had children I decided to stay home with them,” explains Rox Anna. “We went from two paychecks to one and that’s when we really had to watch what we were spending.”

“It was also at this time that I was trying to lose the last 20 pounds after having had two children,” she continues. “So when Brad told us about Herbalife’s weight-loss products, we decided to try them. I lost 20 pounds and my husband dropped 32 pounds. People started asking us for the products and we referred them to Brad and his wife, Pam. When Brad told me how much money I could earn selling the products myself, I signed up as a Distributor.”

***“I was earning \$1,500 a month part time.”***

After Rox Anna’s children started school, she focused her attention on her Herbalife business full time. She also began attending Success Training Seminars (STS) and encouraged her downline to do the same.

“I make a big deal out of going to an STS because that’s where my group is going to see the ‘big picture’ and get trained fast. It maximizes my time, so I can be at home with my family as well as have a knowledgeable downline.”

***“We are earning on average \$20,000 a month.”***

“So many things have changed since Brad told us about Herbalife,” Rox Anna says. “Now we can take vacations whenever we want and stay in the most luxurious hotels. And we recently purchased a brand-new Ford Expedition. Before Herbalife, I had never owned a new car. We are also saving for our daughters’ college education, so they can go to whatever schools they choose. Herbalife is a dream come true for us!”

\*The financial testimonials in this publication reflect the results of individual Distributors. Your results may vary.



*The Chauvenne’s children, Courtney and Kinsey, enjoying a family vacation.*

9 NEWLY QUALIFIED USA JANUARY 2000

# Disclaimers of Typicality re Earnings Claims

## Herbalife's More Recent Approach:

Disclaimer-of-typicality, directing the reader to find online the "Average Gross U.S. Supervisor Compensation." Each term in this phrase is an important qualifier

***"Incomes applicable to the individuals (or examples) depicted [are] not average. For average financial performance data, see the Statement of Average Gross Compensation of U.S. Supervisors at Herbalife.com and MyHerbalife.com."***



**ENRIQUE CARRILLO**



Enrique was studying kinesiology at New Mexico State University, but wasn't living a lifestyle he was proud of. Enrique was introduced to the Herbalife® products, and eventually lost weight. He decided to become an Herbalife Independent Distributor, and grew his business by consistently working hard and staying positive. Now he is making more money than he could have imagined. He shares, "My Herbalife Independent Distributorship has transformed my life with health, wealth and happiness."<sup>†</sup>



**IRENE HAMASAKI**



Irene Hamasaki worked as a legal secretary for 13 years, and had struggled with weight problems since childhood. Introduced by a co-worker to Herbalife® products, Irene achieved great results and, encouraged by others wanting to know her secret, she became an Herbalife Independent Distributor. Now, she's healthy and has the freedom to travel to places she could never have imagined, and help others live healthier, happy lives.<sup>†</sup>

<sup>†</sup>Incomes applicable to the individuals (or examples) depicted and not average. For average financial performance data, see the Statement of Average Gross Compensation of U.S. Supervisors at Herbalife.com and MyHerbalife.com.

<sup>†</sup>An extensive questionnaire generated responses from more than 200 U.S. Herbalife Independent Distributors about their weight-loss programs and results. They reported weight loss ranging from 4 pounds to 167 pounds and a reduced body mass index (BMI) of 1.5 points to 24.1 points, suggesting that consumption of Herbalife® products is associated with weight loss and improvement in BMI in those ranges.

myherbalife.com | TODAY 29

# FTC Guides on Testimonials

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The FTC is concerned that businesses make “clear and conspicuous disclosure of the generally expected performance whenever the testimonial is not generally representative of what consumers can expect.” 72 Fed. Reg. 2214, 2217 (Jan. 18, 2007).

The FTC’s 2009 Guides Concerning the Use of Endorsements and Testimonials in Advertising note the Commission’s concern with the ***ineffectiveness*** of “disclaimers of typicality.”

## Section 255.2. Consumer Endorsements:

(b) An advertisement containing an endorsement relating the experience of one or more consumers on a central or key attribute of the product or service also will likely be interpreted as representing that the endorser’s experience is representative of what consumers will generally achieve with the advertised product or service in actual, albeit variable, conditions of use. Therefore, an advertiser should possess and rely upon adequate substantiation for this representation. If the advertiser does not have substantiation that the endorser’s experience is representative of what consumers will generally achieve, the advertisement should clearly and conspicuously disclose the generally expected performance in the depicted circumstances, and the advertiser must possess and rely on adequate substantiation for that representation.<sup>105</sup>

**Guides Concerning the Use of Endorsements and Testimonials in Advertising** (published in Fed. Reg. Vol. 74, No. 198, amending Rules appearing at 16 CFR Part 255, effective Dec. 1, 2009)

# Testimonials, Earnings Claims & Disclaimers

Based upon its own research, the FTC considers pro forma disclaimers (“Results are not typical”) unlikely to be effective to negate testimonials – unless the advertiser presents empirical tests showing non-deception

## Section 255.2. Consumer Endorsements - footnote:

<sup>105</sup>The Commission tested the communication of advertisements containing testimonials that clearly and prominently disclosed either “Results not typical” or the stronger “These testimonials are based on the experiences of a few people and you are not likely to have similar results.” Neither disclosure adequately reduced the communication that the experiences depicted are generally representative. Based upon this research, the Commission believes that similar disclaimers regarding the limited applicability of an endorser’s experience to what consumers may generally expect to achieve are unlikely to be effective.

Nonetheless, the Commission cannot rule out the possibility that a strong disclaimer of typicality could be effective in the context of a particular advertisement. Although the Commission would have the burden of proof in a law enforcement action, the Commission notes that an advertiser possessing reliable empirical testing demonstrating that the net impression of its advertisement with such a disclaimer is non-deceptive will avoid the risk of the initiation of such an action in the first instance.

“The Effect of Consumer Testimonials and Disclosures on Ad Communication for a Dietary Supplement,” Report by Manoj Hastak, Ph.D. and Michael B. Hazis, Ph.D, submitted to the FTC Sept. 30, 2003, available at <http://www.ftc.gov/reports/endorsements/study1/report.pdf>; “Effects of Consumer Testimonials in Weight Loss, Dietary Supplement and Business Opportunity Advertisements,” Report by Manoj Hastak, Ph.D. and Michael B. Hazis, Ph.D, submitted to the FTC Sept. 22, 2004, available at <http://www.ftc.gov/reports/endorsements/study2/report.pdf>

Summary on FTC website:  
<http://business.ftc.gov/documents/bus71-ftcs-revised-endorsement-guideswhat-people-are-asking>



# Testimonials, Earnings Claims & Disclaimers

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Herbalife acknowledges that, under the 2009 FTC Guides, its and its distributors' use of income opportunity testimonials may be “significantly impacted and therefore might negatively impact our sales.”

## From Herbalife's 2009-2011 10Ks (emphasis added):

The FTC has approved revisions to its Guides Concerning the Use of Endorsements and Testimonials in Advertising, or Guides, which became effective on December 1, 2009. Although the Guides are not binding, they explain how the FTC interprets Section 5 of the FTC Act's prohibition on unfair or deceptive acts or practices. Consequently, the FTC could bring a Section 5 enforcement action based on practices that are inconsistent with the Guides. Under the revised Guides, advertisements that feature a consumer and convey his or her atypical experience with a product or service are required to clearly disclose the results that consumers can generally expect. In contrast to the 1980 version of the Guides, which allowed advertisers to describe atypical results in a testimonial as long as they included a disclaimer such as “results not typical”, the revised Guides no longer contain such a safe harbor. The revised Guides also add new examples to illustrate the long-standing principle that “material connections” between advertisers and endorsers (such as payments or free products), connections that consumers might not expect, must be disclosed. Herbalife has adapted its practices and rules regarding the practices of its independent distributors to comply with the revised Guides. However, **it is possible that our use, and that of our independent distributors, of testimonials in the advertising and promotion of our products, including but not limited to our weight management products and of our income opportunity[,]** will be significantly impacted and therefore might negatively impact our sales.

# Indicia of Pyramids: Inflated Prices

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Federal Trade Commission  
Protecting America's Consumers

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PREPARED STATEMENT OF  
**DEBRA A. VALENTINE**, GENERAL COUNSEL FOR  
THE U.S. FEDERAL TRADE COMMISSION

on  
"PYRAMID SCHEMES"

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presented at the  
INTERNATIONAL MONETARY FUND'S  
SEMINAR ON CURRENT LEGAL ISSUES AFFECTING CENTRAL BANKS  
Washington, D.C.  
May 13, 1998

3. If a plan purports to sell a product or service, check to see whether its price is inflated, whether new members must buy costly inventory, or whether members make most “sales” to other members rather than the general public. If any of these conditions exist, the purported “sale” of the product or service may just mask a pyramid scheme that promotes an endless chain of recruiting and inventory loading.

# **Indicia of Pyramids: Inflated Prices**

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**Compare Herbalife products with other nutrition products:**

- ❌ Suggested Retail Price is substantially above market value
- ❌ *De minimus* advertising of products
- ❌ Limited, if any, proprietary or innovative science

**To be successful, Distributors need to recruit and sell to other Distributors**

# **Indicia of Pyramids: Emotional Sales Pitch – the ‘Dream’**

High-pressure, emotional sales techniques, emphasizing lifestyle, achieving one’s dreams and rapid success are often used.

In *Koscot*, 86 F.T.C. at 1136-37, the FTC found (¶ 68):

## **Opportunity Meetings and GO-Tours**

68. Distributorship sales were generally accomplished by high-pressure sales methods applied at golden opportunity meetings and on golden opportunity tours (GO-Tours). The opportunity meetings were carefully contrived and scripted to create a highly-charged emotional atmosphere in which prospects were persuaded that Koscot offered a fantastic opportunity to “achieve financial success beyond [their] greatest expectations” (CX 11, p. 1). Koscot was presented as an opportunity for “ordinary men and women” to earn from \$5,000 to \$20,000 a month (CX 15, p. 13; CX 11, p. 5; CPF 70, 76, 82). Scripts were generally followed, but even the exaggerated figures that they contained would sometimes be further exaggerated by overly enthusiastic distributors (CPF 71-72).

“more money than he could have imagined” –  
“anybody can do it”

**Koscot: Offering “virtually unlimited potential to earn large sums of money in a relatively short time . . . [in] the charged atmosphere of an old-fashioned revival meeting, except that the god was Mammon.”**



## **Emotional Sales Pitch – the ‘Dream’**

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**“Part of our business is entertainment. We entertain our distributors with opportunity, with dreams, stories, it's all a part of what this company is.”**

**--CEO Michael O. Johnson  
Goldman Sachs 14th Annual Global Retailing Conference  
9/5/2007**

## **Emotional Sales Pitch – the ‘Dream’**

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**“Michael sets the tone for not only the Company, but, more importantly, for independent distributors, that there is room at the top, that this is an aspirational business, and he paints that picture with kind of dreamy type of goals.”**

**--CFO Rich Goudis  
Herbalife Ltd. Investor Day at NYSE  
12/16/2008**

# Indicia of Pyramids: A History of Lawsuits

The FTC recommends considering whether the MLM has a history of lawsuits that allege deceptive practices?

## FTC FACTS for Consumers

The Bottom Line About  
Multilevel Marketing Plans  
and Pyramid Schemes



- Has anyone sued the company for deceptive business practices? Checking with your local Better Business Bureau, Chamber of Commerce and state Attorney General for complaints about any company you're considering investing in is a prudent thing to do. But remember that a lack of complaints doesn't guarantee a company's legitimacy.

Source: FTC publication "Bottom Line about Multilevel Marketing Plans" (Oct. 2009).

# A History of Lawsuits

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Herbalife has been in approximately 270 lawsuits around the world. Many involve run-of-the-mill commercial disputes, but a significant number go to the heart of Herbalife's business and practices

- **Test-Aankoop v. Herbalife Int'l Belgium**. After seven years of proceedings, in 2011, a Belgian judge in the Commercial Court in Brussels (capital of the EU) determined Herbalife was operating a pyramid scheme. The case is on appeal.
- **Herbalife v. Ford**. In federal court in California, Herbalife sued former distributors for joining another MLM, alleging a violation of Herbalife's non-competition rule (no. 8A in the Sales and Marketing Plan). The distributors invoked California's Endless Chain Scheme statute. In a key pre-trial ruling, the Court found Herbalife's compensation system to be facially unrelated to sales of products to end users. Before trial, the case was disposed of on other grounds.
- **Minton v. Herbalife**. In 2009, in a California state court proceeding, Herbalife was sued by a group of former distributors that claimed Herbalife's Sales and Marketing Plan constituted an endless chain scheme.
- **Jacobs v. Herbalife**. In 2004, Herbalife settled a lawsuit brought on behalf of a class of 8,700 former and current Herbalife distributors, accusing the company of running a pyramid, securities-law violations and other deceptive practices, including its "Newest Way to Wealth" promotion. HLF discontinued this promotion and defendants entered into a settlement totaling \$6 million.

# A History of Lawsuits (*cont'd*)

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## Additional Significant Herbalife Cases

- **Her Majesty the Queen v. Global Online Systems, Inc.** In 2004, a Canadian Competition Bureau investigation revealed that Global Online Systems Inc., a recruiting front led by senior Herbalife distributors, was operating a pyramid selling scheme. Following indictment and conviction, the Federal Court entered a Prohibition Order against Global Online Systems, Inc. and its principals Deborah Stoltz and Marilyn Thom.
- **Mey v. Herbalife**. In 2003, consumers filed a class action in West Virginia, alleging that Herbalife and its distributors were violating the Telephone Consumer Protection Act of 1991 by the use of “Herbatel” phone service and the Herbal Dialer Lead Generation System to auto-dial tens of thousands of consumers. Herbalife discontinued the practice, and defendants settled for \$7 million. A similar case was filed 10/2012.
- **Ralo v. Zehavi**. In 2003, an Israeli judge, deciding a dispute between distributors, noted that Herbalife’s “method of marketing reminds [me] of the ‘pyramid’ marketing method.” The Court cited FTC warnings about what to watch for in assessing potential pyramids.
- **People of the State of California v. Herbalife International, Inc.** In 1986, Herbalife consented to the entry of a Final Judgment and Permanent Injunction, under which the company promised to desist from certain product claims and to pay \$850,000 to settle allegations by the Attorney General of the State of California that it operated as an “endless chain” and made deceptive medicinal claims. The Final Judgment included provisions regulating the compensation structure of Herbalife’s marketing program and the medicinal claims made by Herbalife.

# A History of Lawsuits: the *Ford* case

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In 2009, the California federal court stated that Herbalife appears to pay compensation facially unrelated to sale of products to ultimate users – an essential element of finding of an MLM to be a pyramid.

In *Herbalife v. Ford*, a group of senior Herbalife distributors, including a former President's Team member (top 0.1%) – network insiders who knew how the system works – accused HLF of operating an illegal pyramid scheme. In 2009, after extensive factual discovery, the Federal Court in California, Herbalife's headquarters, applied the Ninth Circuit's *Omnitrition* decision to Herbalife and stated:

***“Herbalife’s entire business model appears to incentivize primarily the payment of compensation that is ‘facially unrelated to the sale of the product to the ultimate users because it is paid based on the suggested retail price of the amount ordered from [HLF], rather than based on actual sales to consumers.’”***  
***- District Judge Gary A. Feess***

Memorandum & Order Regarding Cross-Motions for Summary Judgment, No. CV 07-02529, slip op. at 16 (C.D. Cal. Aug. 25, 2009) (quoting *Webster v. Omnitrition*, 79 F.3d 776, 782 (9th Cir. 1996)). The Ninth Circuit in *Omnitrition* said that **compensation unrelated to ultimate-user sales is the “sine qua non” of a pyramid scheme**. 79 F.3d at 781 (emphasis added). The marketing system in *Omnitrition* (found prima facie to be a pyramid) is nearly identical to Herbalife's plan. While the *Ford* case was disposed of on other grounds – namely, the parties challenging Herbalife as a pyramid failed to show that they were victims of the scheme, as opposed to participants who profited from it – the Court's finding was not disturbed or changed.

# **Indicia: Targeting People Vulnerable to the ‘Dream’**

Pyramids target people with little or no business experience, those most vulnerable to high-pressure offers of an ‘opportunity,’ but who may not see the risks and costs – and people of similar profiles

In *Koscot*, 86 F.T.C. at 1145, the FTC found (§ 100) (emphasis added):

100. Many persons who purchased Koscot distributorships were unqualified to operate a cosmetics selling business by reason of their age, lack of education and training, or lack of business, administrative, or sales experience. Koscot's recruitment methods tended to result in the enrollment of persons without any special qualifications, including frequently the credulous, who in turn tended to recruit others with similar profiles. By reason of their limited education and modest backgrounds, such persons tended to have a limited degree of sophistication in financial and business matters. (CPF 100, 103, 106-09, 111, 304-06, 310-11) They were particularly vulnerable to the misrepresentations and the high-pressure enrollment techniques used at opportunity meetings and on GO-Tours (*supra*, p. 26 [p.1137, herein]).



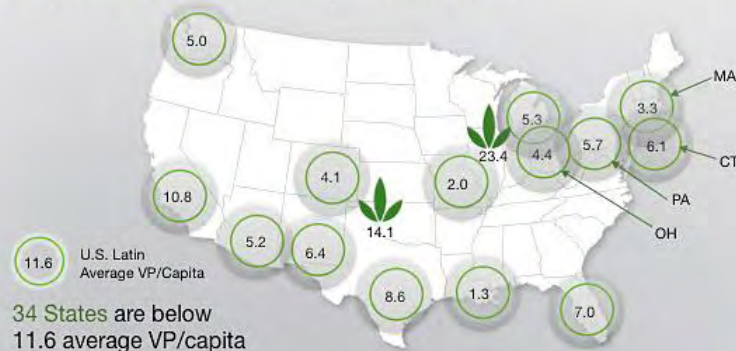
# Indicia of Pyramids: Herbalife Targets People of Similar Profile

Herbalife targets Latinos, African-Americans, ethnic minorities, the young, and stay-at-home moms – focusing on those in financial need

## From Herbalife's 2010 Analyst Day Presentation

### U.S. Latin Market—Opportunity Remains

#### Hispanic Population Density and VP/Capita



### Further Opportunities for Growth – Market Segmentation

Continue to focus on metro areas and states that are **under-penetrated** via city-by-city analysis

Expand into **Gen H** market (under 30 age group)

Target additional **ethnic markets** (Korean, Vietnamese, Chinese, Russian, Polish)

Support African-American initiative with Distributor trainings and events

Peter J. Vander Nat & William W. Keep, *Marketing Fraud: An Approach for Differentiating Multilevel Marketing from Pyramid Schemes*, 21 J. PUB. POL'Y & MARKETING 139, 141 (Spring 2002) ("The lucrative earnings emphasized in promotional messages depend on reaching a high position in the pyramid, but new participants lack requisite information on the realistic odds of obtaining such a position.").



## **Herbalife Targets People of Similar Profile (cont'd)**

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*“The Latino business is now about 61% of the U.S. business, 46% up. One of the big things, markets that we are going to penetrate next year is the college market.”*

**--COO Greg Probert  
Analyst Meeting  
11/28/2007**

## **Herbalife Targets People of Similar Profile (cont'd)**

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*“This [soccer] sponsorship supports retailing with sampling and activation opportunities for our distributors and it will help in recruiting a key target segment of the U.S. population, the stay-at-home-mom.”*

**--CEO Michael Johnson  
Earnings Conference Call  
2/27/2008**

## **Herbalife Targets People of Similar Profile (cont'd)**

*“For the Company though, we do see, right. So we do see the segments that can provide Herbalife a broader base. So, for example, the African-American initiative that we're doing, it started about three years ago.”*

**--Amy Greene, VP-IR  
Barclays Capital Retail and Restaurants Conference  
4/24/2012**

## **Herbalife Targets People of Similar Profile**

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*“I'm getting ready to hire somebody that's Korean for the US, because that's a huge opportunity for us. But, again, it has to be -- have been a distributor, starts it right, because we can't. We can hire all the Koreans and -- but if -- there's not a distributor out there that's really taking the business. But, definitely, I mean when we think about Korea, I mean, Korea is one of the top countries for Herbalife and Los Angeles has a huge Korean population, San Francisco, New York, so, we're targeting that.”*

**-- Ibi Fleming, SVP and Managing Director, North America**  
**Barclays Capital Retail and Restaurants Conference**  
**4/24/2012**

## **Targeting People Vulnerable to the 'Dream'**

*“They now are charging people on a daily basis. So if you think about where the money is in the pyramid, and there's more people at the bottom of the pyramid, especially in some of these developing markets, a lot of poor, lower middle class people. They're creating the opportunity for them to have that access to the Herbalife experience. That's what's driving very strong growth in these markets.”*

**--CFO Rich Goudis**

**Herbalife Bank of America Consumer Conference**

**9/12/2009**

## **Targeting People Vulnerable to the ‘Dream’**

*“. . . If you had to pay \$60 at the beginning of each month for that month's supply of coffee, far fewer people could participate. But when you pay \$2 a day, it is such a low price point, people can afford it. People living hand to mouth or whatever it may be, so far more people can afford that.”*

**--CFO John DeSimone  
Jefferies Consumer Conference  
6/22/2010**

# **Indicia of Pyramids: Complex Compensation Rules**

Often, an MLM's compensation system is complex, with many layers of periodic purchase and sales requirements, subject to numerous qualifications and cross-referenced standards.

In *F.T.C. v. BurnLounge*, No. 2:07-cv-03654, slip op. at 9 (C.D. Cal. July 1, 2011) (footnotes omitted), the Court found it difficult to provide an accurate delineation of the compensation plan . . .

*given the degree of complexity in its composition and the failure of its creators to value intelligibility, consistency, and useful definitions. Indeed, it would appear that BurnLounge was attempting to create a labyrinth of obfuscation rather than a readily understood compensation system.*

# Complex Compensation Rules

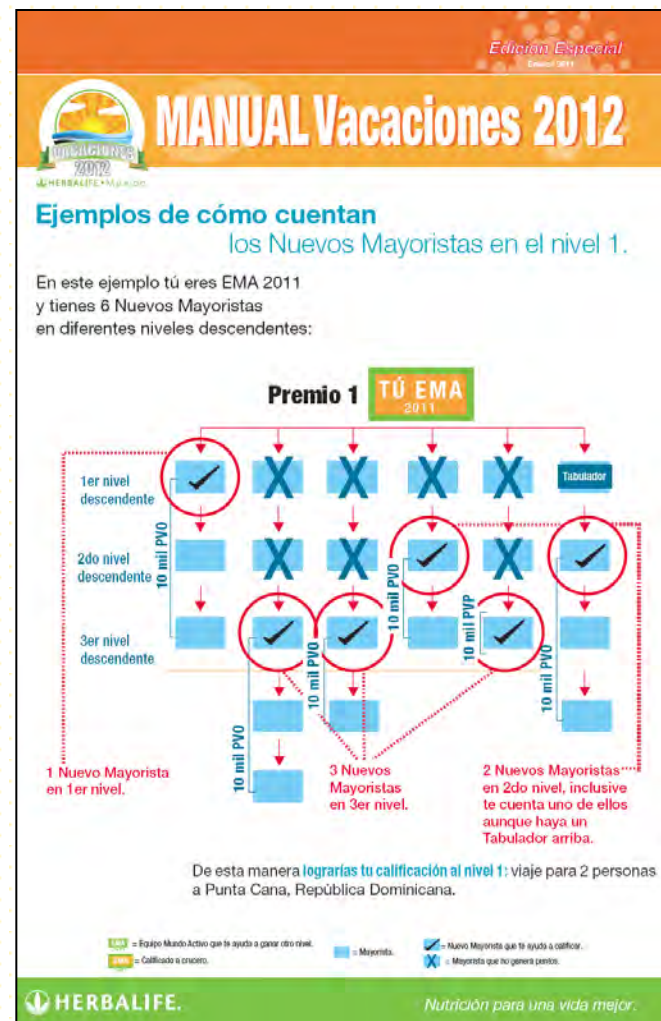
## Herbalife Sales and Marketing Plan

- ✗ 125 pages of text and forms
- ✗ ~48,000 words
- ✗ Numerous Levels of Distributors
- ✗ Scores of Rules and Subparts
- ✗ Very little marketing advice

## From Sales & Marketing Plan:

### How do I retail the products?

Retailing the Herbalife products will be one of the most important keys to your success! As Herbalife's Founder and first Distributor Mark Hughes always stressed, use the products, wear the button and talk to people. You will develop your own selling style, which might include talking to your circle of influence, Distributing flyers, conducting surveys and/ or participating in seasonal promotions. Your Sponsor has the field experience to provide you with the proper training.



From 2012 Herbalife Publication in Mexico



# **Indicia of Pyramids: Conclusion**

- ✗ Exaggerated Earnings Claims**
- ✗ Inflated Prices & Need to Sell to Other Members**
- ✗ Emotional Sales Pitch – the ‘Dream’**
- ✗ A History of Lawsuits**
- ✗ Targeting the Financially Unsophisticated**
- ✗ Complex Compensation Rules**

# **Protecting the Consumer**

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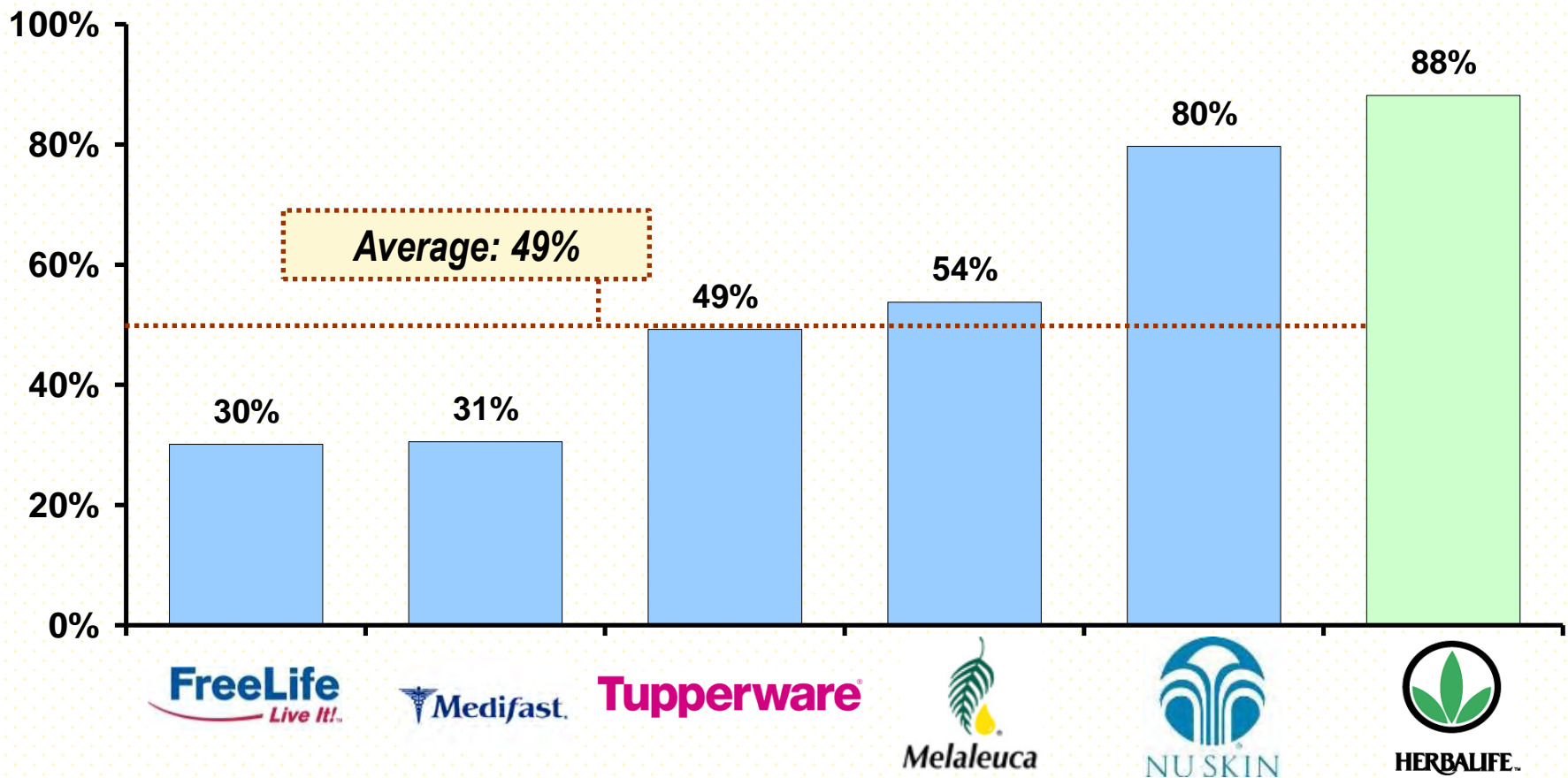
**“In evaluating a tendency or capacity to deceive, it is appropriate to look not at the most sophisticated, but the least sophisticated consumer.” *F.T.C. v. Five Star Auto*, 97 F. Supp. 2d at 532.**

# **Red Flags**

**HLF: Not Your Typical MLM**

# The Top 1% of Herbalife Distributors Earn a Greater Share of Total Commissions than Those at Other MLMs

Top 1% of Distributors' Commissions  
As % of Total Commissions <sup>(1)</sup>



(1) Source: Company filings. Based on most recently disclosed distributor compensation summary forms. Average excludes Herbalife. Herbalife data excludes Wholesale Commissions as they are excluded from the company's Statement of Gross Compensation. Herbalife data applies to U.S. distributors.

# Herbalife v. Avon:

## Herbalife's Compensation Plan Incentivizes Recruiting

In addition to paying out a higher percentage of Retail Sales than Avon, Herbalife's commission structure varies from Avon's in two critical ways: (i) Herbalife's royalties are "flat," whereas Avon's are "descending;" and (ii) Herbalife has a Production Bonus ("infinity bonus"), Avon only pays Recruiting Rewards three levels deep <sup>(1)</sup>

Downline Level	Maximum Distributor Commissions <sup>(2)</sup>		
	Avon (% Net Sales) (As Reported)	Avon (% Retail Sales) (As Adjusted) <sup>(3)</sup>	Herbalife (% Retail Sales) (As Reported)
1	15.0% <sup>(4)</sup>	10.0%	5.0%
2	5.0%	3.3%	5.0%
3	2.0%	1.3%	5.0%
Levels 1 to 3	22.0%	14.7%	15.0%
4 to ∞			8.0% ←
Total Payout	22.0%	14.7%	23.0%

Descending

Flat

Production Bonus (7%) / Mark Hughes Bonus (1%)

Source: Company filings, Avon Sales Leader Bonus Chart, Herbalife Marketing Plan. Assumes 1 Herbalife Personal Volume point = \$1 of Herbalife Retail Sales.

(1) Avon FY 2011 10-K: "This program [Sales Leadership] generally limits the number of levels on which commissions can be earned to three and continues to focus on individual product sales by Sales Leadership Representatives."

(2) While all Herbalife Supervisors may receive the levels 1-3 Herbalife maximum commissions, only the most senior Avon distributors (Senior Executive Unit Leaders) may receive the levels 1-3 Avon maximum commissions.

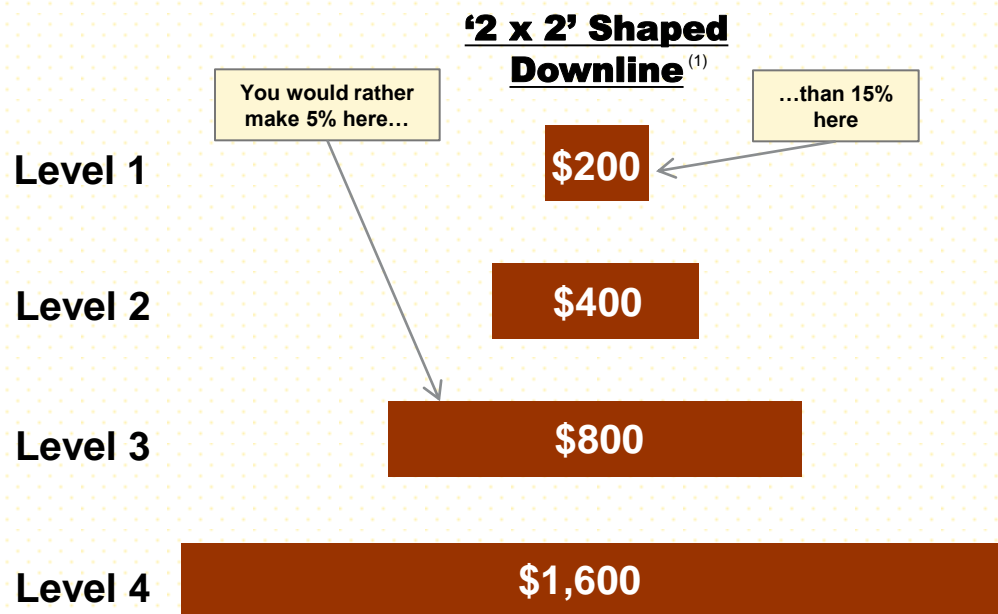
(3) Avon distributes Recruiting Rewards based on net sales. To make the comparison apples to apples, we assume a 33% discount from Retail Sales to Net Sales.

(4) Avon Sales Leader Bonus Chart as of August 2012: "Senior Executive Unit Leaders who are performing at title earn an additional 2% on the Total Unit Leadership Sales of each 1st Generation Executive Unit Leader's Unit."

# Herbalife v. Avon: Which System Would You Prefer?

Not all percentages are created equal. The illustrative example below demonstrates why the top 1% of Herbalife's distributors generate 88% of Recruiting Rewards, and why Herbalife's compensation plan incentivizes distributors to recruit dramatically more so than other MLMs (there is a greater reward *if* you can get to the top)

## Illustrative Compensation Schematic:



$$(7\%)(\$200) + (5\%)(\$200) = \$24$$

$$(7\%)(\$400) + (5\%)(\$400) = \$48$$

$$(7\%)(\$800) + (5\%)(\$800) = \$96$$

$$(7\%)(\$1,600) + (0\%)(\$1,600) = \$112$$

**Total Payout:**  
**\$280**



$$(10\%)(\$200) = \$20$$

$$(3.3\%)(\$400) = \$13$$

$$(5\%)(\$800) = \$11$$

$$(0\%)(\$1,600) = \$0$$

**Total Payout:**  
**\$44**

Source: Company filings, Avon Sales Leader Bonus Chart, Herbalife Marketing Plan. Assumes maximum possible commission at each level. Herbalife commission schedule excludes Mark Hughes bonus.

(1) Assumes downline distributors generate \$100 Retail Sales worth of monthly volume ("Personal Volume"). For illustrative purposes, assumes the Herbalife Production Bonus is not "blocked."

**“Pop-and-Drop”**



*“We go through phases in new marketplaces where recruiting is the initial phase of our business and then retailing comes in to function at the base of it. We try to train distributors and we’re taking a much more aggressive stance...*

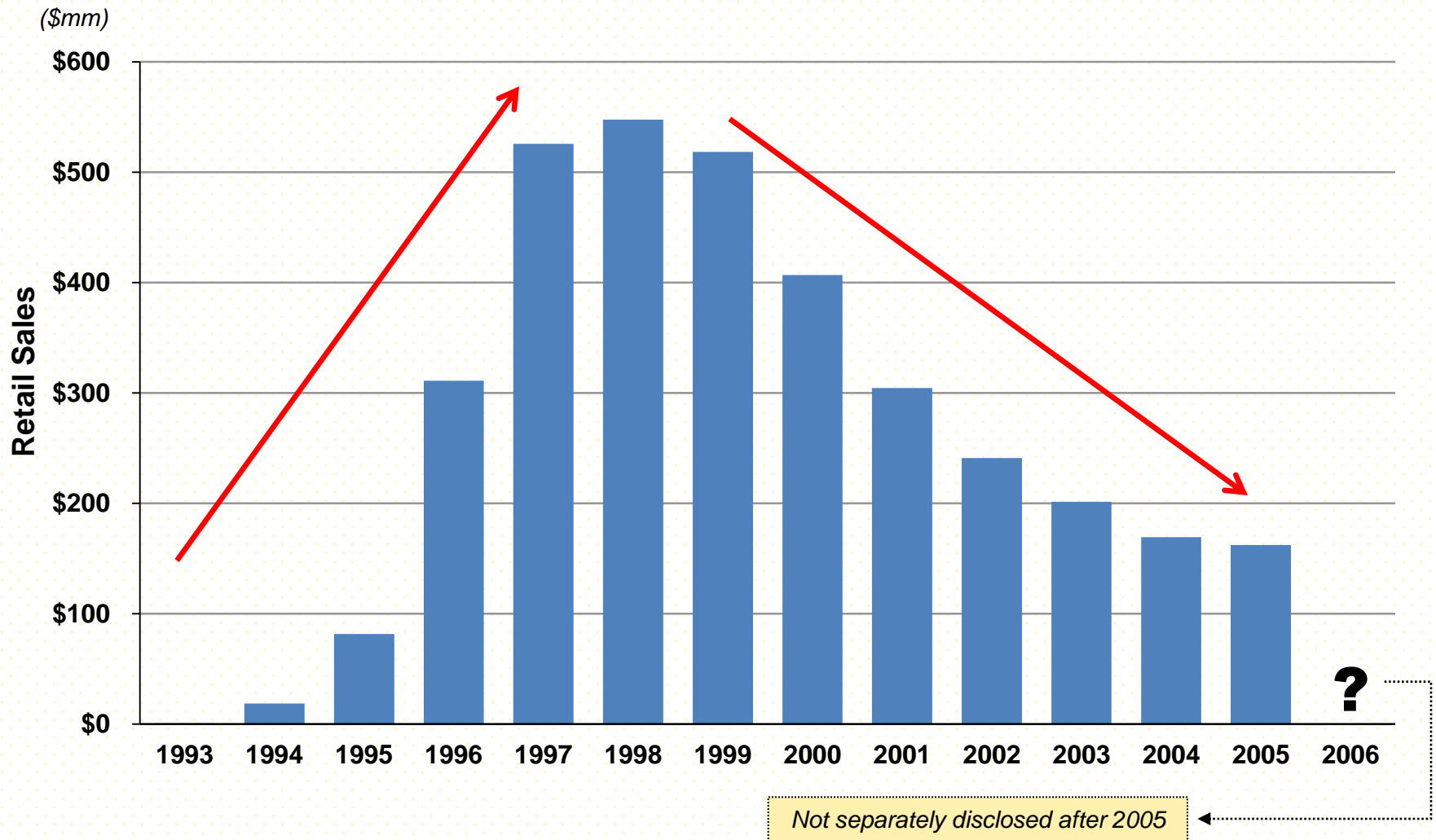
*China is 1.3 billion people, you can recruit for a long time there before we had what was called the classic ‘pop-and-drop’ in that marketplace. So we’re trying to build in right away a retailing base into that marketplace. I would say initially there is going to be a lot of recruiting, a lot of business opportunity development.”*

*– Michael Johnson, Herbalife CEO, 8/6/08*

*“So India is not -- it's teetering on the top ten market for us. We went into India ten years ago. And we went in and it was a big -- it's called pop and drop. You go in. A lot of distributors come in. They recruit and you get a lot of volume. Those distributors leave the country and you get a big drop.”*

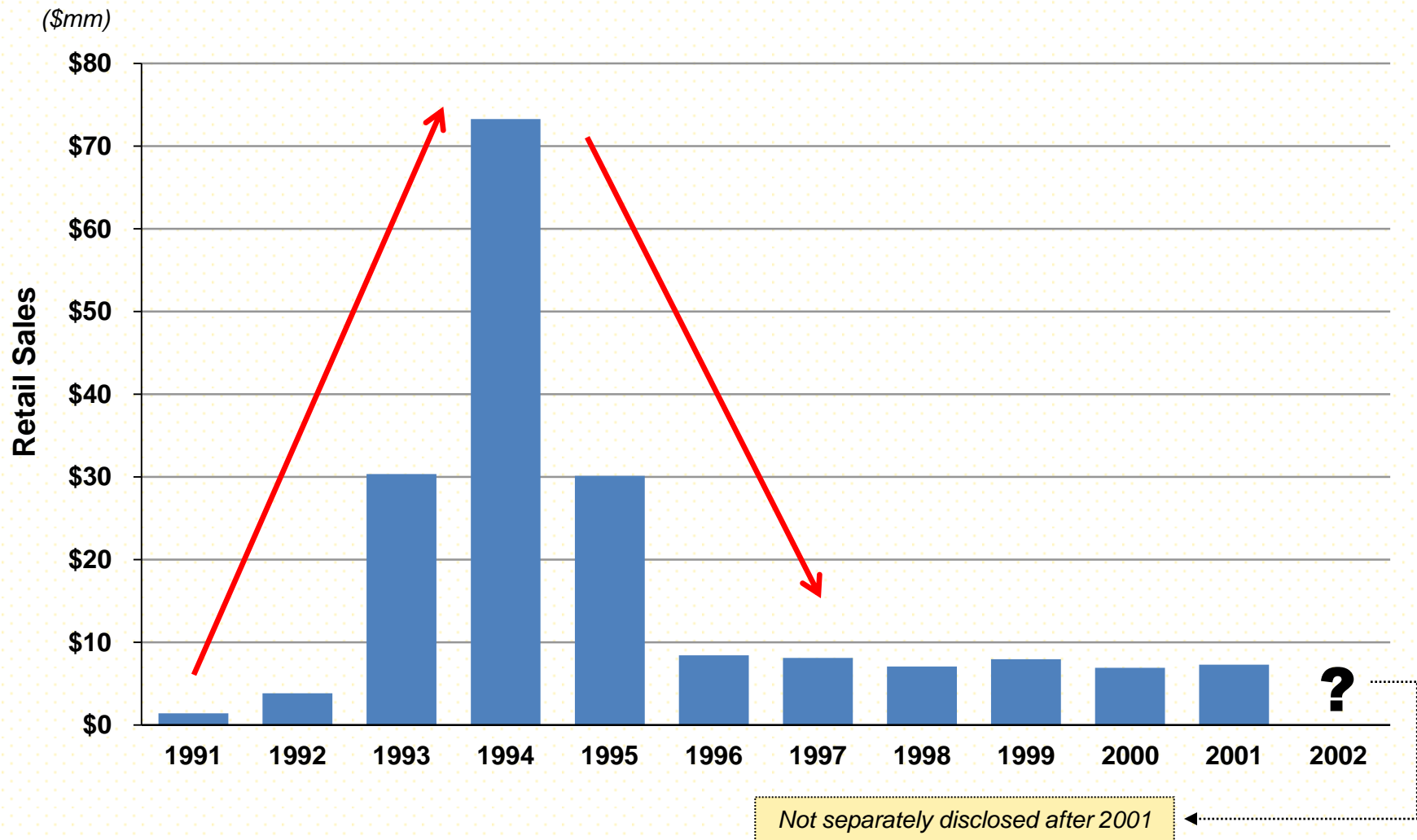
– John DeSimone, Herbalife CFO, 3/10/10

# Japan: 1993–2005



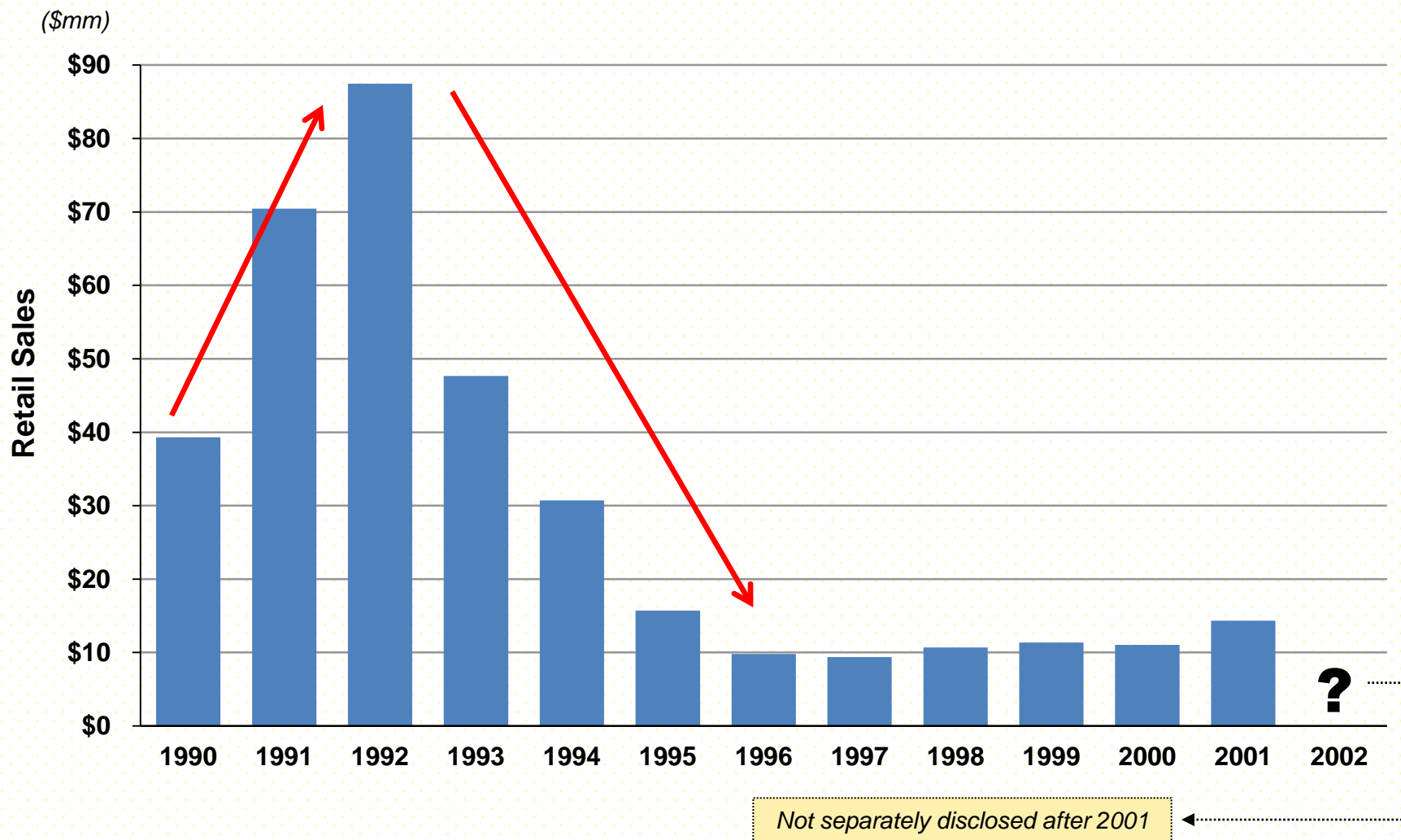
Source: Herbalife filings.

# Israel: 1991–2001



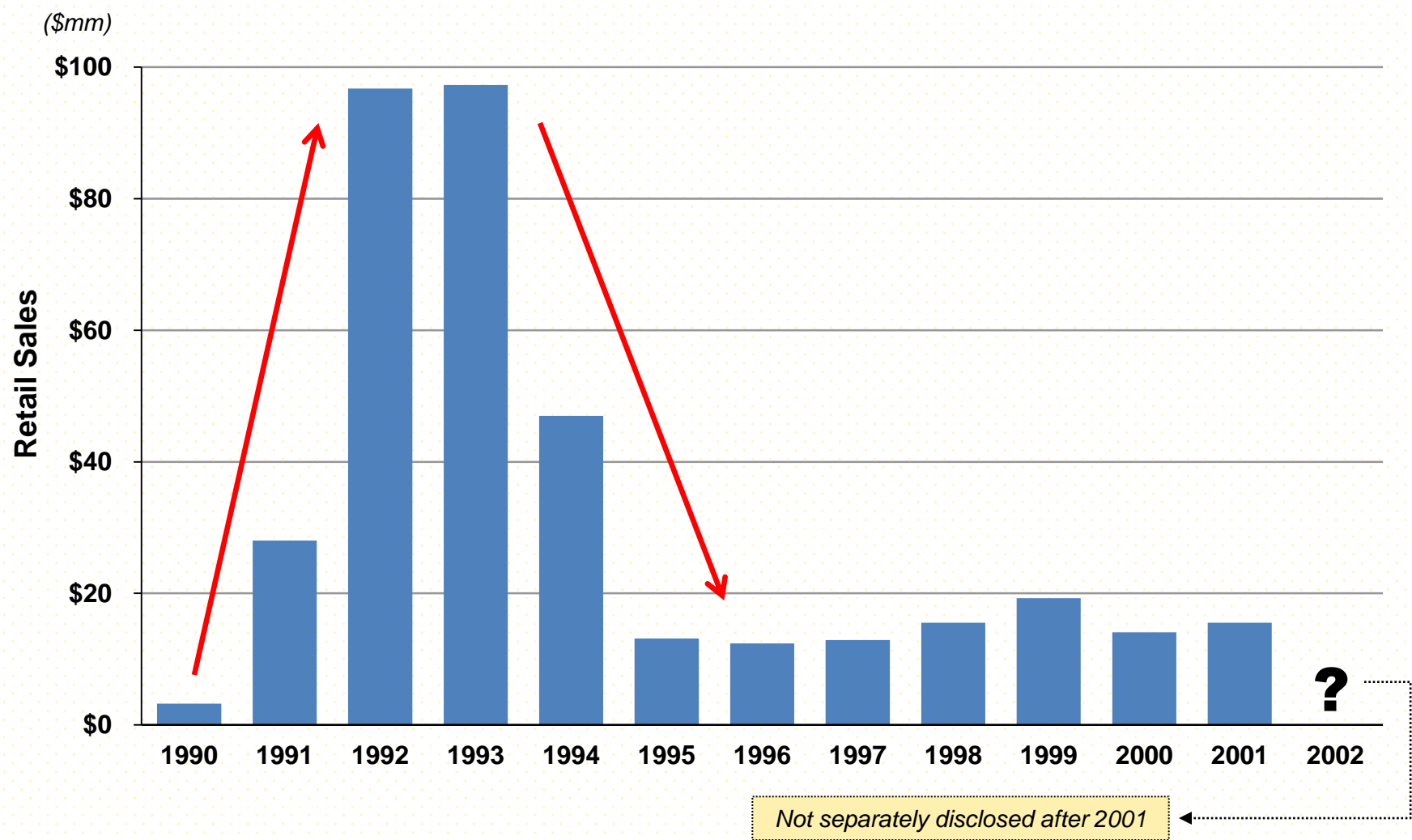
Source: Herbalife filings.

# Spain: 1990–2001



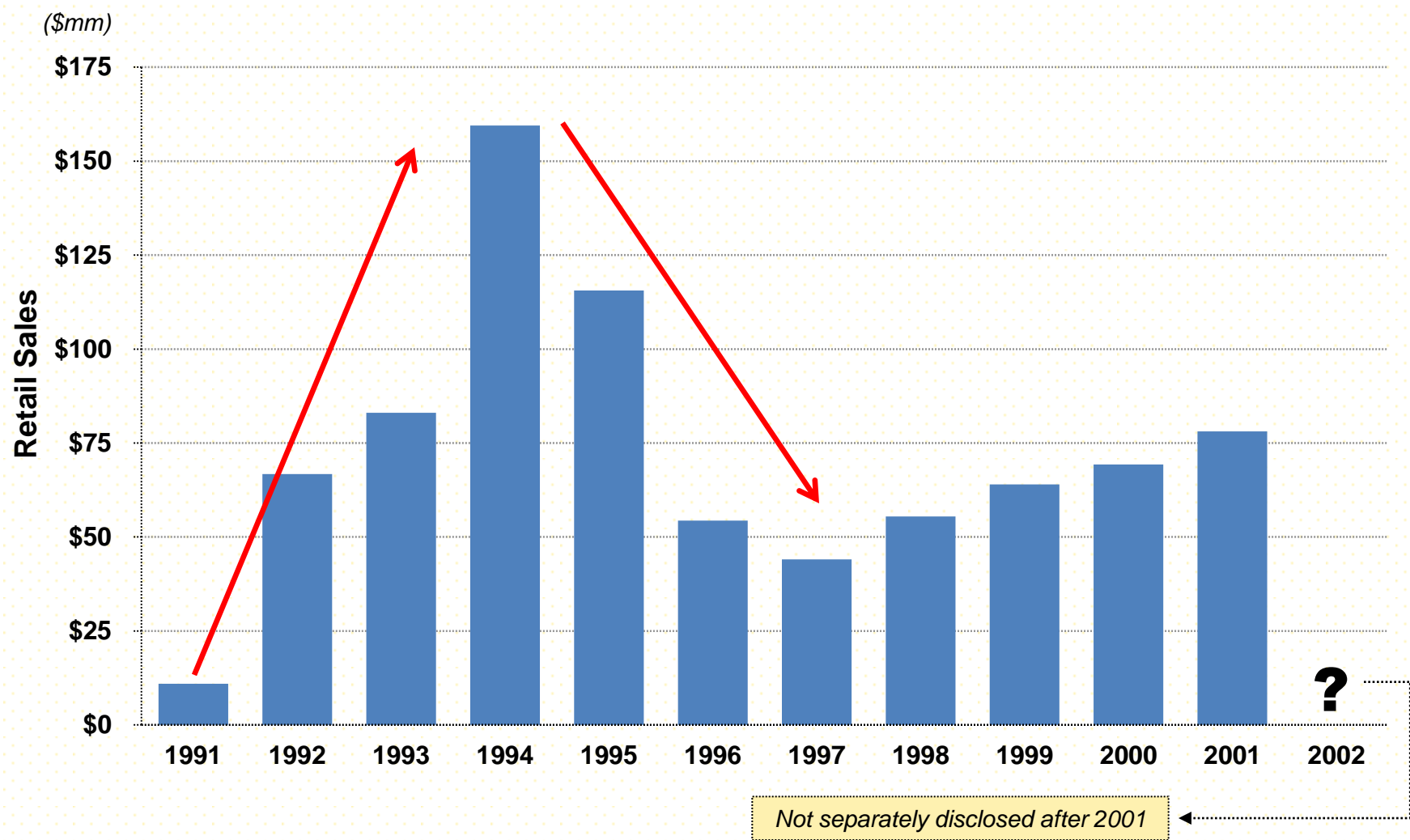
Source: Herbalife filings.

# France: 1990–2001



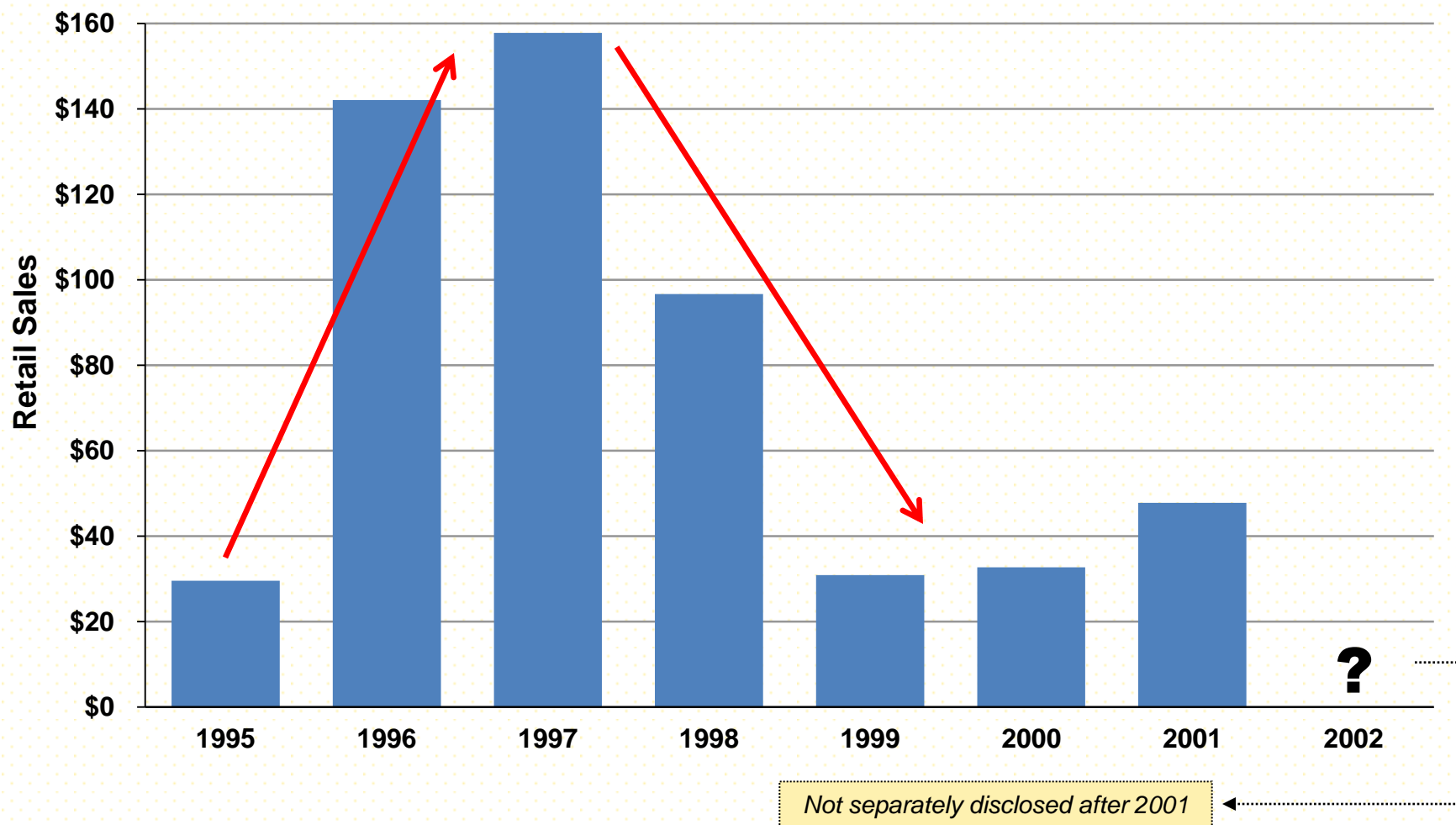
Source: Herbalife filings.

# Germany: 1991–2001



Source: Herbalife filings.

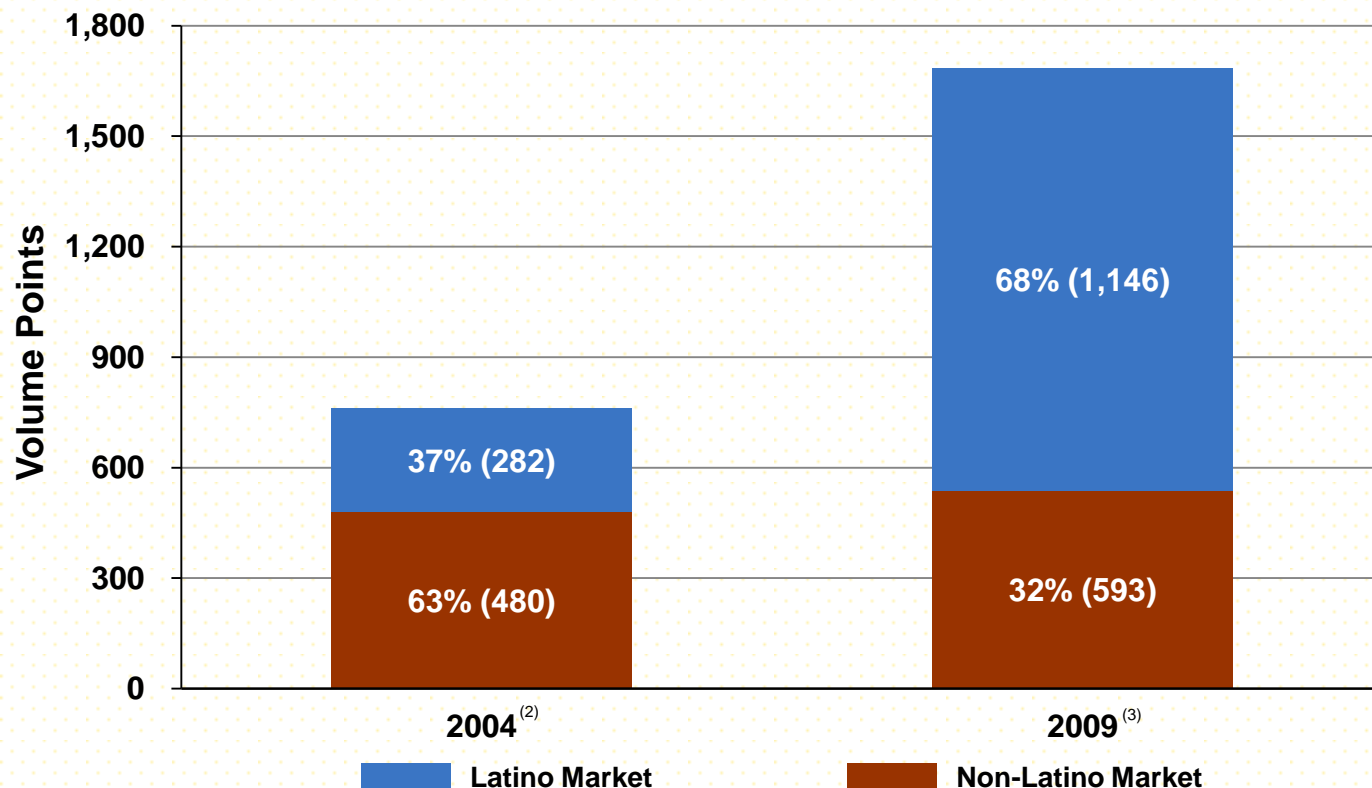
# Russia: 1995–2001





# Even Within the N. American Market, It's a Story of “Pop” Latino Nutrition Clubs vs. “Drop” ‘Core’ N. American Base

**Latino Volume Points as % of Americas <sup>(1)</sup>**



*From 2004–2009, Latino market Volume Points as a % of total Americas Volume Points more than doubled, while the ‘Core’ U.S. market appeared to stagnate*

(1) Source: Herbalife Investors Day Presentation dated December 2009 and Herbalife filings.

(2) Source: Herbalife filings. Represents “Americas” as defined in Herbalife’s FY2004 10-K.

(3) Source: Herbalife filings. Represents “North America”, “Mexico” and “South/ Central America” as defined in Herbalife’s FY2009 10-K.

*“We are thirty-two year old company. I think that's incredibly important for a multi-level marketing sales company. Longevity is an indication of credibility.*

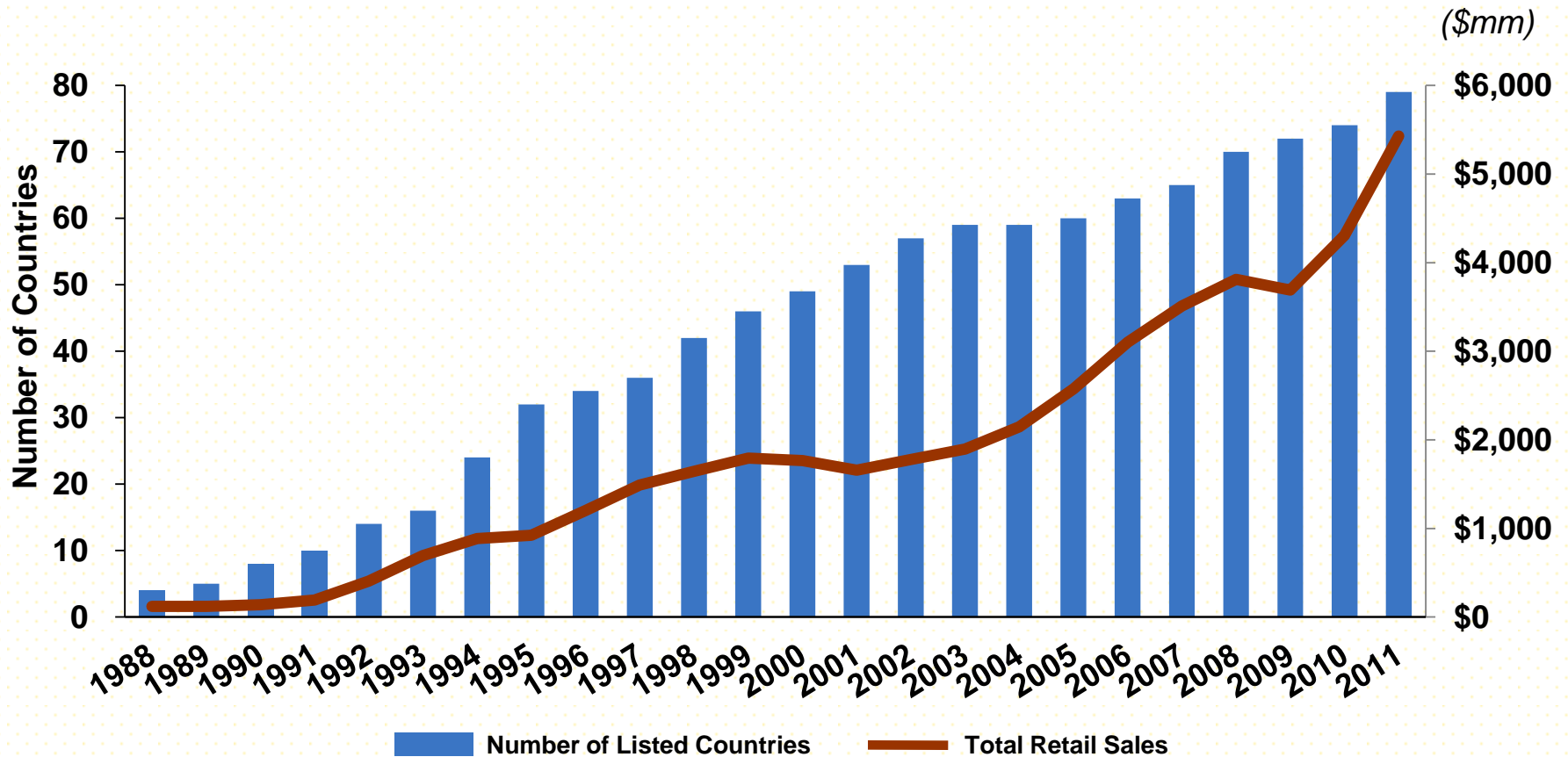
*There are companies that get in the industry that have rapid growth and decline. It's called a pop and drop. They have a rapid growth and then decline quickly also. So, that longevity is an important point for investors from a confidence standpoint into the business model.”*

*– John DeSimone, Herbalife CFO, 9/6/12*

**How has Herbalife stayed in business for over 30 years?**

# As Herbalife Enters New Regions, 'Drops' In Mature Markets are Masked By the 'Pops' of New Markets...

**Number of Listed Countries vs. Total Retail Sales**

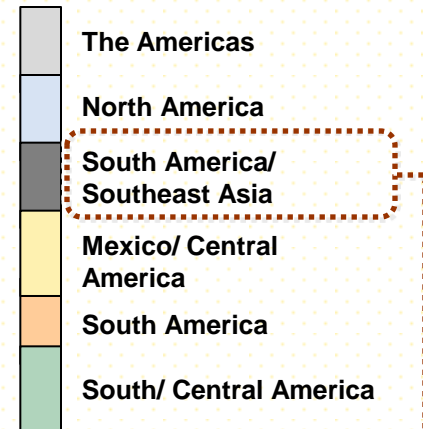


# HLF Re-classified the Countries that Comprise the America's Region Four Times in the Last Five Years

## Geographic Presence in The Americas <sup>(1)</sup>

Country	Year						
	Entered	2005A	2006A	2007A	2008A	2009A	
United States	1980						
Canada	1982						
Jamaica	1999						
Dominican Republic	1994						
Venezuela	1994						
Argentina	1994						
Brazil	1995						
Chile	1997						
Panama	2000						
Colombia	2001						
Bolivia	2004						
Mexico	1989						
Costa Rica	2006	NA					
Peru	2006	NA					
El Salvador	2007	NA	NA				
Ecuador	2008	NA	NA	NA			
Honduras	2008	NA	NA	NA			
Nicaragua	2008	NA	NA	NA			
Guatemala	2008	NA	NA	NA			
Paraguay	2009	NA	NA	NA	NA		
Aruba	2010	NA	NA	NA	NA	NA	

### Classification



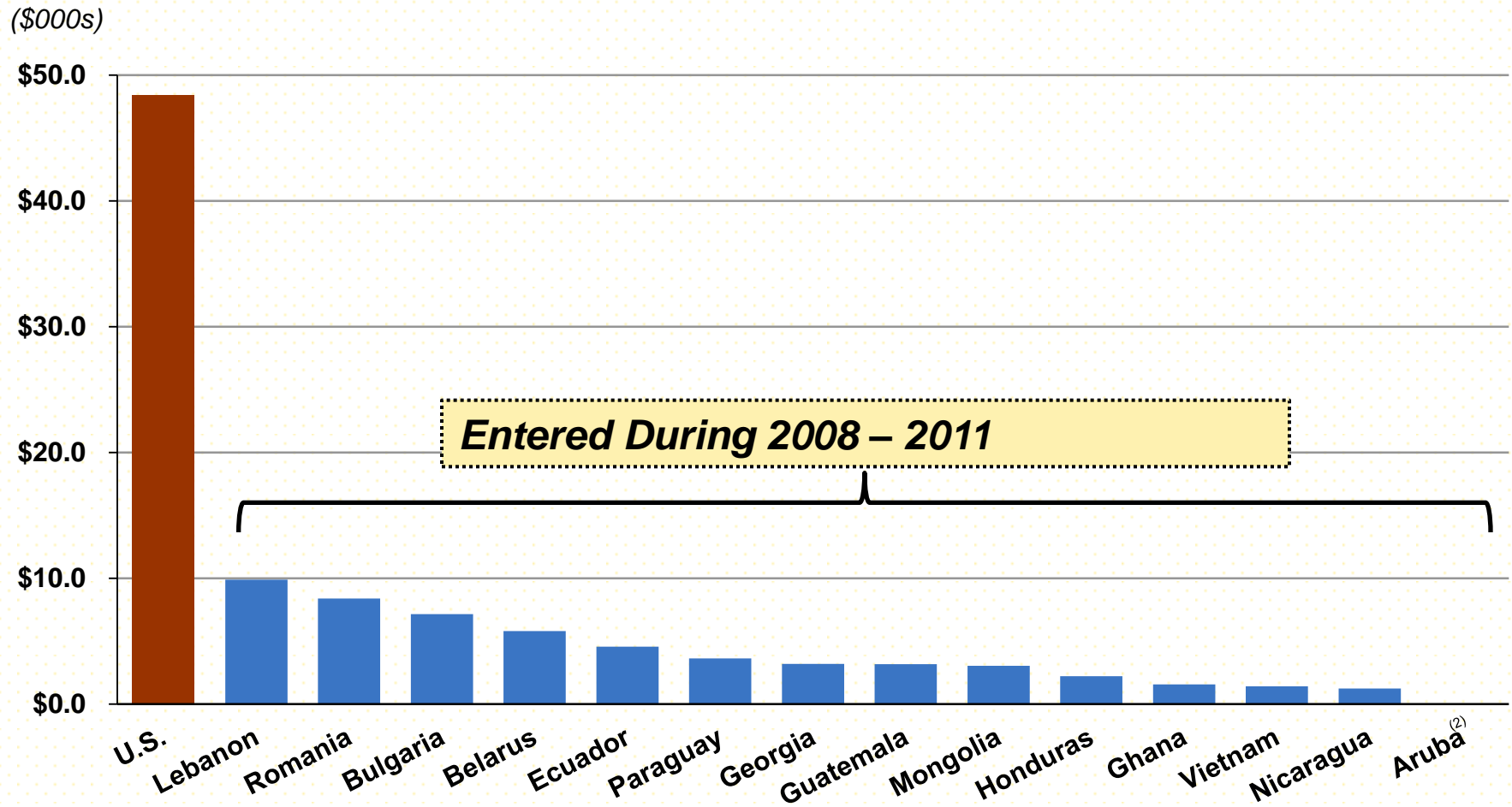
In 2006, South America was grouped with Southeast Asia

(1) Source: Herbalife filings. Southeast Asia portion of South America/ Southeast Asia includes: Australia, New Zealand, Philippines, Thailand, Indonesia, India, Singapore and Malaysia.

**Herbalife may be running out of growth opportunities to continue its expansion**

# During 2008–2011, Herbalife Entered Fourteen Countries With an Average GDP Per Capital of \$4,260 <sup>(1)</sup>

## GDP Per Capita



(1) Source: The World Bank. Based on 2011 estimates.

(2) GDP Per Capita for Aruba not available.

Source: Herbalife Independent Distributor Nutrition Club Presentation

HERBALIFE INDEPENDENT DISTRIBUTION  
**nutrition**  
club

"Where Friends of Good Nutrition Meet Every Day"

Nutrition Club Party



18

 HERBALIFE.

*Making the world healthier.*

## Nutrition Clubs



# What is a Nutrition Club?

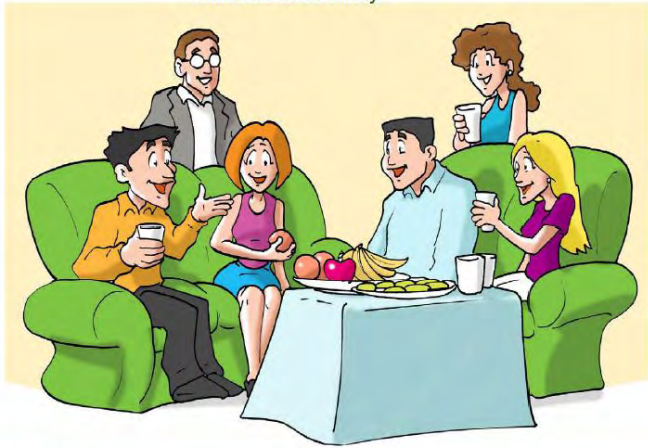
*“Nutrition Clubs, conducted at residential or [brick and mortar] non-residential locations are social gatherings, bringing together persons who become members wishing to focus on good nutrition and regular exercise in order to achieve optimum health.”*

– Herbalife, Sales & Marketing Plan and Business Rules Manual

Source: Herbalife Independent Distributor Nutrition Club Presentation

HERBALIFE INDEPENDENT DISTRIBUTOR  
**nutrition club** “Where Friends of Good Nutrition Meet Every Day”

Nutrition Club Party



19

**HERBALIFE.** *Making the world healthier.*

The illustration depicts a group of six people (three men and three women) gathered around a green sofa and a small table covered with a white cloth. They are engaged in conversation and holding white cups. On the table, there is a plate of fruit, including apples and bananas, and a small bowl of snacks. The background is a simple yellow wall.

# What is a Nutrition Club?

## HLF's Proof that Consumption & Retail Sales Exist

*"So metrics that are indicative of consumption, our visibility is always a question in direct selling...And some of the stats on this page were introduced in the last 6 months as just evidence of the type of visibility that we have.*

*So the first row looks at the core 3 products of the foundation of Nutrition Clubs...In 2002, those 3 products represented 35% of our volume. And last year and through this year, third quarter, it represents more than half our volume. Why? Because that shows - because the expansion of daily consumption is driving our growth. In daily consumption, those 3 products are the products that are sold in Clubs...And therefore, that growth is indicative of consumption growth. That growth in those 3 core products."*

– John DeSimone, CFO, Investor Presentation, November 14, 2012

Source: Herbalife Investor Presentation, November 2012

### Metrics Indicative of Consumption

Key metrics illustrate significant shift to daily consumption \*

	2002	2007	2011	3Q 2012 YTD
Top 3 products % of total volume (Formula 1, Tea & Aloe)	35%	48%	52%	52%
Retention of Sales Leaders	27%	41%	52%	n/a
Sales Leader activity rate	37%	40%	53%	55%
5K Sales Leader qualification %	n/a	n/a	18%	24%
New Sales Leader qualification volume, % of total volume	27%	26%	16%	14%***
Buyback % of retail sales **	2.4%	1.0%	0.4%	0.3%

\* Excludes China because of its different marketing plan

\*\* HLF offers to repurchase product from resigning Distributors for up to 12 months in most countries

\*\*\* YTD August, 2012



# Herbalife Portrays Nutrition Clubs as Vibrant, Retail Channels...

Source: Herbalife's Today Magazine



"Nutrition Clubs in commercial locations are a great way to build a stable customer base and downline."  
— LARRY MESSINA, AMERICANATO TOWN

Source: Herbalife 2012 Investor Day Presentation



# ...Selling Desirable Products to Consumers

All nutrition clubs serve the same three products: aloe water, tea, and Formula 1 as a “meal replacement”

Source: Herbalife Nutrition Club Presentation by Independent Distributor

**nutrition club** “Where Friends of Good Nutrition Meet Every Day”

HERBALIFE Products in the Nutrition Club



- ✦ Shakes made of Formula 1
- ✦ Tea, Herbal Concentrate
- ✦ Herbal Aloe Drinks

14

HERBALIFE. Making the world healthier.

Source: Herbalife 2012 Investor Day Presentation

Formula 1 Positioned as a Meal

Replacement spending vs. discretionary



vs.



INVESTOR DAY 2012

## **Herbalife Encourages Investors to See the Clubs...**

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*“We've made clubs visible to investors. We have taken investors to clubs. Amy is consistently putting club tours together. I think it's important for somebody interested in this model to go see a club. And you'll understand that within clubs, it is all consumption based.”*

**– John DeSimone, CFO, November 14, 2012**

## **...So We Visited Various Nutrition Clubs**

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**We sent a Pershing Square team member to Queens, NY and Omaha, NE to research nutrition clubs**

**What follows are photos of nutrition clubs we visited...**



## Our Research Revealed a Different Experience

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# Our Research Revealed a Different Experience

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# Our Research Revealed a Different Experience

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## Our Research Revealed a Different Experience

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# Our Research Revealed a Different Experience

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# Our Research Revealed a Different Experience

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# Our Research Revealed a Different Experience

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# **Our Research Revealed a Different Experience**

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# **Our Research Revealed a Different Experience**

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**You might notice several things about the Nutrition Clubs we observed:**

- ❌ No exterior signage**
- ❌ No mention of Herbalife or its logo on the Club exterior**
- ❌ Windows are covered so you cannot see inside**
- ❌ No advertising or promotion**
- ❌ No depiction of product**
- ❌ No indication when the Club is open or closed**
- ❌ Product is poorly prepared and presented**



# Herbalife Imposes Many Constraints on its Club Operators' Ability to Retail Product

**If residential, no exterior signage of any kind** →

## 4-F Nutrition Club Signage

Residential Locations: Clubs operating from residential locations may not use exterior signage of any kind. For signage Rules that apply to Clubs operating from non-residential locations, refer to Section 5 of these Nutrition Club Rules.

**If non-residential, may have a sign IF...**

▶ ...it does not imply a store, restaurant, or retail location and doesn't invite product purchase →

▶ ...it does not imply any relationship to Herbalife

▶ ...it does not promote shakes or products →

▶ ...it does not state if the Club is open / closed →

## 5-B Signage Restrictions for Clubs Operating in Non-Residential Locations

A Nutrition Club may have a sign identifying itself, but that signage must meet the following standards:

- The design and content of the proposed sign must meet Herbalife's published standards to ensure that the location is not perceived as a store, restaurant, franchise or similar operation, or other retail location, and does not invite passersby to purchase product.
- Signs may not directly or indirectly identify, imply or signal that the occupant is an Herbalife Independent Distributor (or otherwise indicate an Herbalife business).
- Signs may not state or suggest that Herbalife products are available for retail purchase on the premises.
- Signs may not use the terms "Nutrition Club," "Herbalife®," "L.A. Live," "Mark Hughes," "Liftoff®," "Shapeworks®," "Skin Activator®," "NouriFusion®" or any other Herbalife intellectual property, product names or brands, or the word "shake" or any other words that imply or signal that Herbalife products are available at that location.
- The following terms, and any similar terms, are not acceptable: "café," "restaurant," "bar," "mart," "store," or "shop."
- Signs that depict "Open/Closed" may not be visible from the exterior.

# Herbalife Imposes Many Constraints on its Club Operators' Ability to Retail Product (cont'd.)

- ▶ No product or other promotional displays visible from the exterior

## 3-G Product Packaging and Display

Club operators may display product-related literature, promotional items, Herbalife products, unopened and in their original packaging, but such displays may not be visible from the exterior.

- ▶ No advertising nor attracting any traffic

## 4-D Advertising

Nutrition Clubs are social gatherings publicized exclusively through word of mouth and attended only by persons who are personally invited by the Club operator, another independent Distributor or a customer, either through oral conversation or through conversation accompanied by the provision of a written invitation. Nutrition Clubs are not intended to nor may they attract "walk-in" traffic. Accordingly, Club operators may not use any advertising materials, including, but not limited to materials on the interiors of their Clubs in a manner that is visible from the exterior.

- ▶ Must cover windows to ensure interior of Club is not visible

## 5-C Window Coverings

Nutrition Clubs operating in non-residential locations must ensure the interior of the Club is not visible to persons from the exterior, by use of window coverings.

- ▶ Must not state, imply, or suggest any retail products available for purchase

- Window coverings must be unbranded, and they may not state, imply or suggest (even without words) that retail products are available for purchase inside.
- "Before & After" photographs are not permitted in or as window coverings.
- The word "shake" or pictures of shakes, or any other products, even if unbranded, are not permitted in or as window coverings.

# Herbalife Imposes Many Constraints on its Club Operators' Ability to Retail Product (cont'd.)

- ▶ Club Operators may charge membership fee only to cover operating costs; prohibited from earning Retail Profit

## 2-A Fees

A daily, weekly or monthly membership fee may be charged to cover operational costs such as rent, utilities, etc.; these membership fees must not represent the price or cost of products, which may be offered to members and their guests for consumption.

- ▶ Not a retail store, nor a restaurant

## 3-B Product Consumption

Nutrition Clubs are social gatherings, bringing people together with a focus on good nutrition. They are not retail stores or outlets, nor are they restaurants or carry-out establishments.

- ▶ No prices or charges for product servings

Subject to this restriction, Club operators may offer complimentary products such as shakes, teas, Formula 1 pies and Herbal Aloe Concentrate. Club operators may post a list of available flavors of shakes and teas, as well as any optional ingredients such as protein or fiber, but consistent with the proper operation of a Nutrition Club they may not post, list or charge individual prices for these products or ingredients.

- ▶ Always use disposable cups

## 1-N Good Hygiene

### Food Sourcing, Handling and Preparation

- Always use disposable cups to serve complimentary beverages.

- ▶ “Members”, not others, only allowed to leave premises with limited carry-outs if in “small, unbranded” containers

## 3-C Carry-outs

Although it is preferable that all product offerings be consumed on the Club premises, registered Club members may carry-out one shake per day.

Carry-outs must be in unbranded containers of not more than 12 oz. (or 354 ml) in capacity. Carry-outs may only be for the personal consumption of that Club member, or another registered Club member. Carry-out is limited to shakes and does not include teas, Formula 1 pies or Herbal Aloe Concentrate.

## As the CFO Explains...

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***“So the clubs first and foremost can't be retail establishments. They can't be Herbalife signed stores. Okay?...The consumer cannot know it is a club until they have come inside.***

***They can't know it has anything to do with Herbalife. So the windows are blocked, or – you can have no reference where somebody walking by will know it is Herbalife.”***

**- John DeSimone, CFO, Nov. 16, 2011**

### **Query:**

**If the goal is consumption, why does Herbalife make it virtually impossible to generate sales?**



# The Company's Depiction of Nutrition Clubs Does Not Adhere to its Own Nutrition Club Rules

Source: Herbalife Today Magazine



"Nutrition Clubs in commercial locations are a great way to build a stable customer base and downline."  
— Lorie Maesta, Millionaire Team

**Rule 5-C:**  
Must ensure the interior of the Club is not visible, by use of window coverings

Source: Herbalife 2012 Investor Day Presentation



**Rule 1-N:**  
Always use disposable cups to serve complimentary beverages



# Herbalife Claims its Competition is Fast Food

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- ▶ Despite the operating constraints placed on its Nutrition Clubs, Herbalife says their competition is McDonald's

*“You're not going to like my answer on competition because strategically we view the competition as fast food...It is the steal a meal a day from fast food. It is not to go after other supplement companies. It's to go after McDonald's, to go after KFC.”*

*- John DeSimone, CFO, Sept. 7, 2011*

- ▶ Note, however, that Herbalife makes no mention of fast food competitors in its SEC filings

*“Our competitors include both direct selling companies such as NuSkin Enterprises, Nature's Sunshine, Alticor/Amway, Melaleuca, Avon Products, Oriflame, Tupperware and Mary Kay, as well as retail establishments such as Weight Watchers, Jenny Craig, General Nutrition Centers, Wal-Mart and retail pharmacies.”*

*- Herbalife, 2011 10-K*

# **Imagine You Operated a McDonald's, But Were Subject to the Following Constraints:**

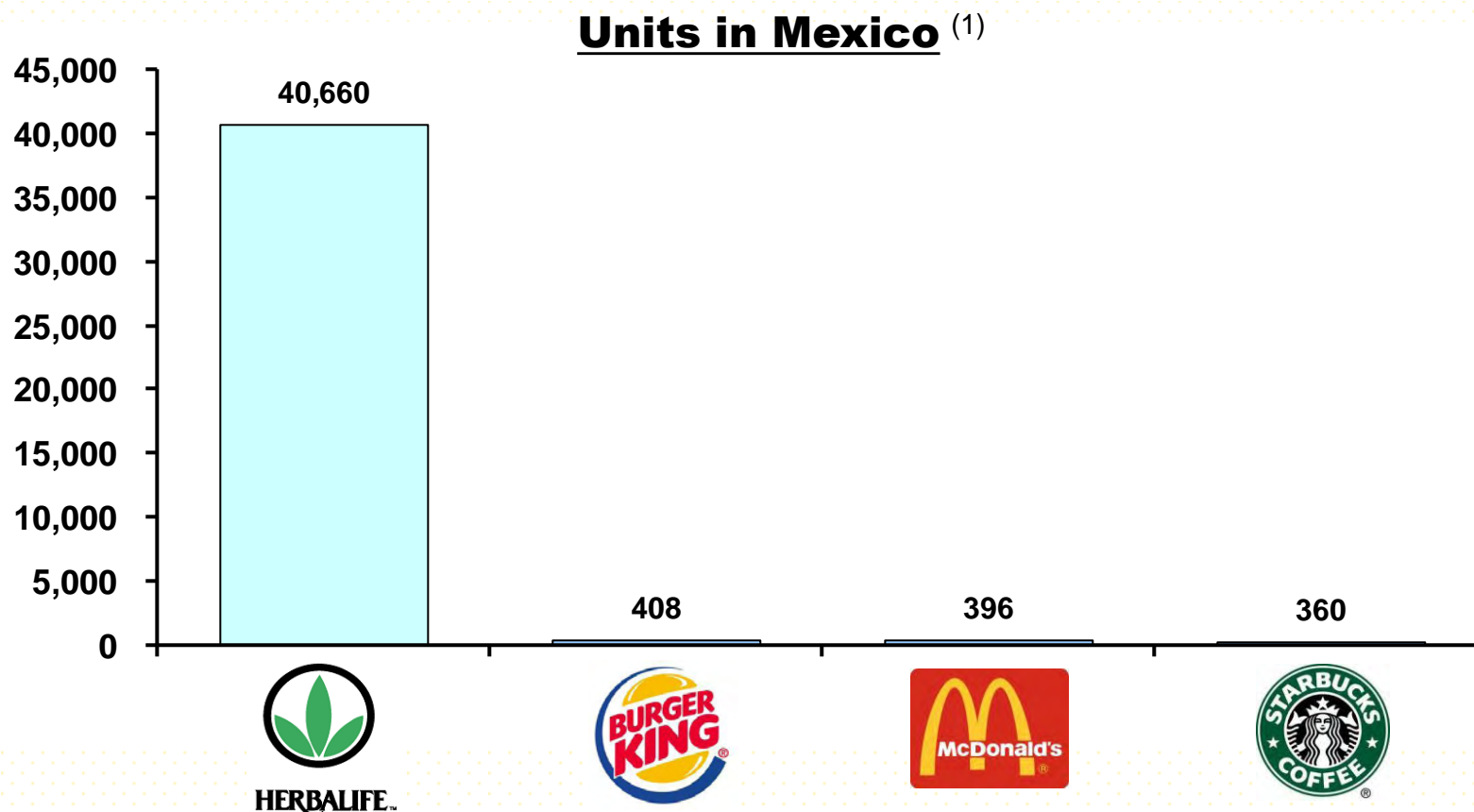
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- ✗ No signage, including external displays of the Company's name or logo**
- ✗ No advertising or promotion**
- ✗ Must cover windows**
- ✗ Must serve exact same three liquid products to every customer for breakfast, lunch, and dinner**
- ✗ No "Open / Closed" sign**
- ✗ Not allowed to attract customers or walk-ins**
- ✗ No sales of product servings, only complimentary offerings**
- ✗ Only can charge fees to cover operating costs; product costs explicitly cannot be recovered**
- ✗ Customers not allowed to carry out food unless in a small, unmarked container**

## ***So How Does HLF Compare to the Competition?***

### **Herbalife Appears to Have an Impressive Number of Clubs**

The number of Nutrition Clubs in Mexico has expanded from 50 to 40,550 in the last decade and Herbalife has 100x the units of the “competition”

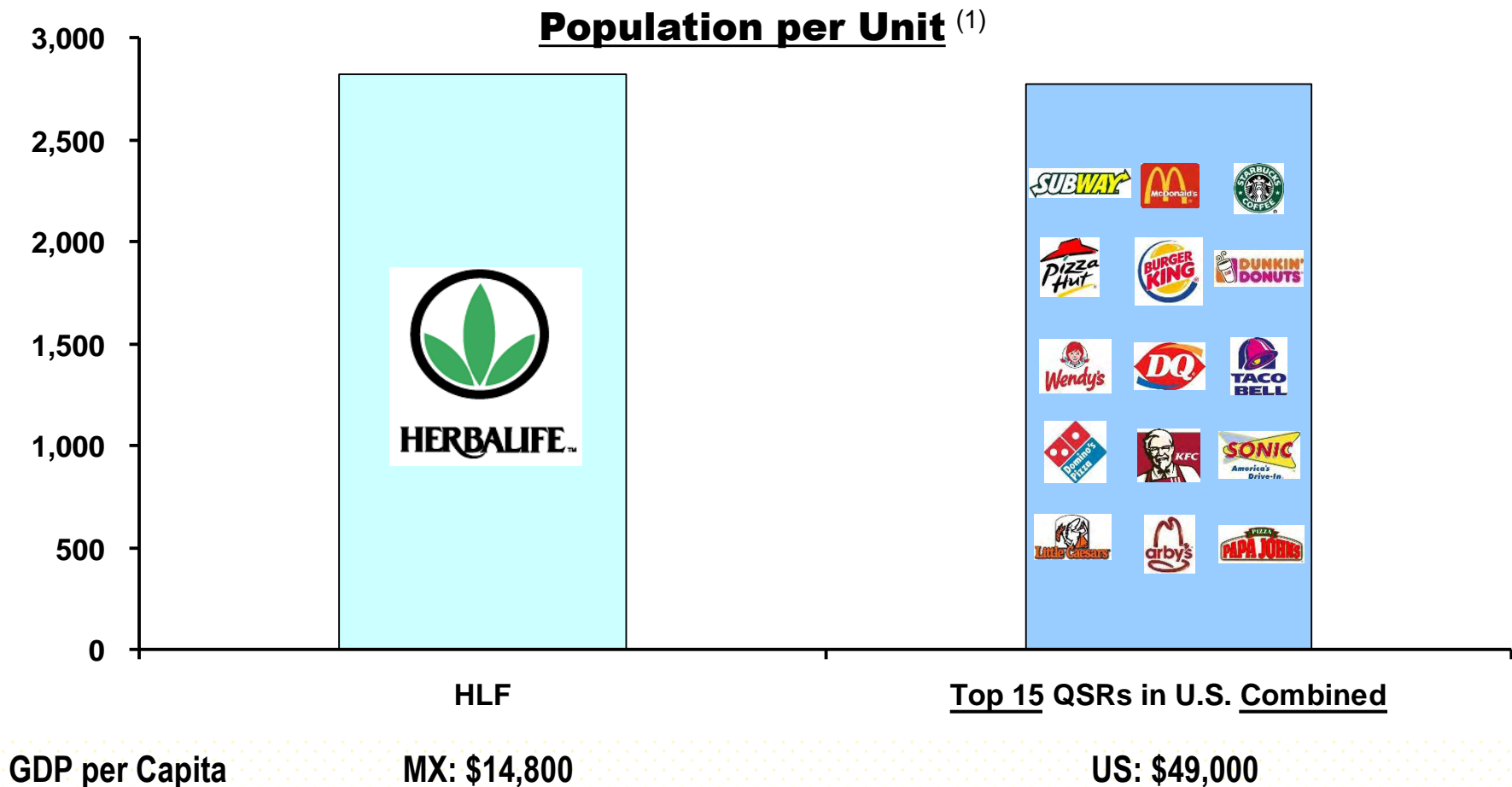


(1) Source: public company filings and news releases. Represents Herbalife nutrition clubs. For QSR restaurants, represents total number of owned and franchised units.

# So How Does HLF Compare to the Competition?

## One Might Even Conclude HLF has Saturated the Market

Herbalife has one Nutrition Club for every 2,800 people in Mexico, equivalent to the density of the top 15 QSRs in the U.S. combined

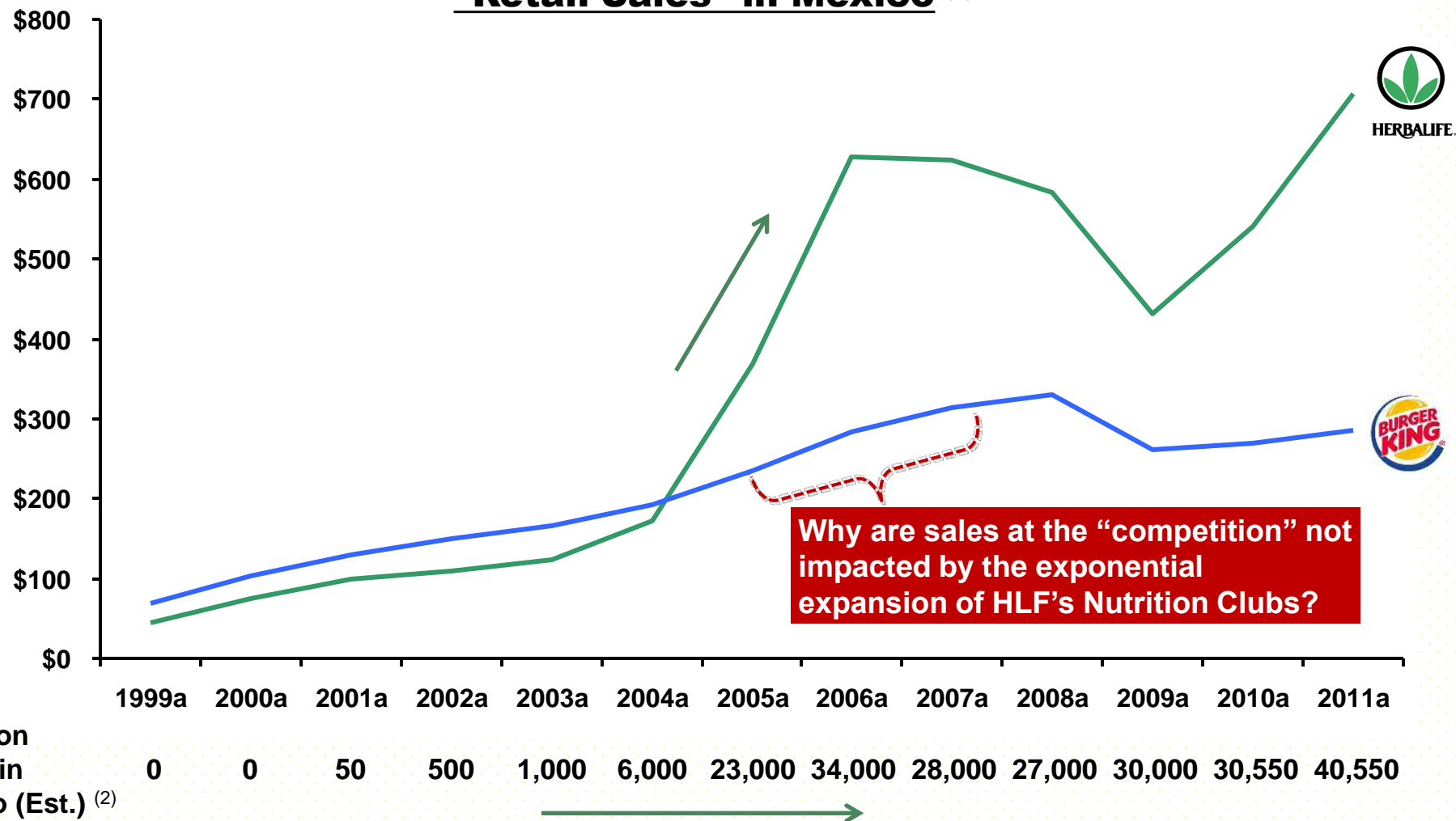


Source: public company filings, QSR Magazine, CIA World Factbook.

(1) Represents Herbalife nutrition clubs per capita in Mexico. For QSR restaurants, represents total number of owned and franchised units per capita in U.S.

# Despite What Seems to be Impressive Growth, Herbalife Doesn't Appear to be "Stealing Meals" from Fast Food

**"Retail Sales" in Mexico** <sup>(1)</sup>



(1) Source: Herbalife filings, Burger King. Represents Herbalife "retail" sales.  
 (2) Pershing Square estimates, per Herbalife filings, presentations, and transcripts.

# **The Nutrition Clubs Have Grown Remarkably Rapidly**

*“We have always talked about how long it took for the nutrition clubs to ramp up. It’s exponential. So you’re probably talking 18 -24 months out into the future till you see maybe the explicit exponential growth.”*

**- Michael Johnson, CFO, May 2, 2007**

**Query:**

**What retail business grows exponentially?**

***So if Herbalife Nutrition Clubs are not  
“stealing a meal a day from fast food” what  
are they really doing?***



# What is the Real Purpose of the Nutrition Clubs?

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## Guidelines to Run and Operate a "NC Centre" – Western Australia

### Guidelines:

The WA Nutrition Club Owners Committee (Kim Broemer, Mariani Broemer, Bruce Hutchinson, Kaye Hutchinson, Bill Bell) have established the following points as a guide to operating a successful club. It is important to recognize that each club will have its own unique environment and style; however, the fundamentals should remain the same. Keep in mind that your club should be a member based model, the more attractive and interesting the activities you provide the more likely will be your clubs success. These Guidelines should be read in conjunction with the Herbalife Australia Nutrition Club Manual.

### Purpose of an NC:

1. Promote two Supervisors per month
2. Duplicate the Nutrition Club

### Partners/Associates:

# What is the Real Purpose of the Nutrition Clubs?

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FINAL TRANSCRIPT

May. 02. 2007 / 11:00AM, HLF - Q1 2007 HERBALIFE LTD Earnings Conference Call

**Greg Probert** - Herbalife Ltd. - President, COO

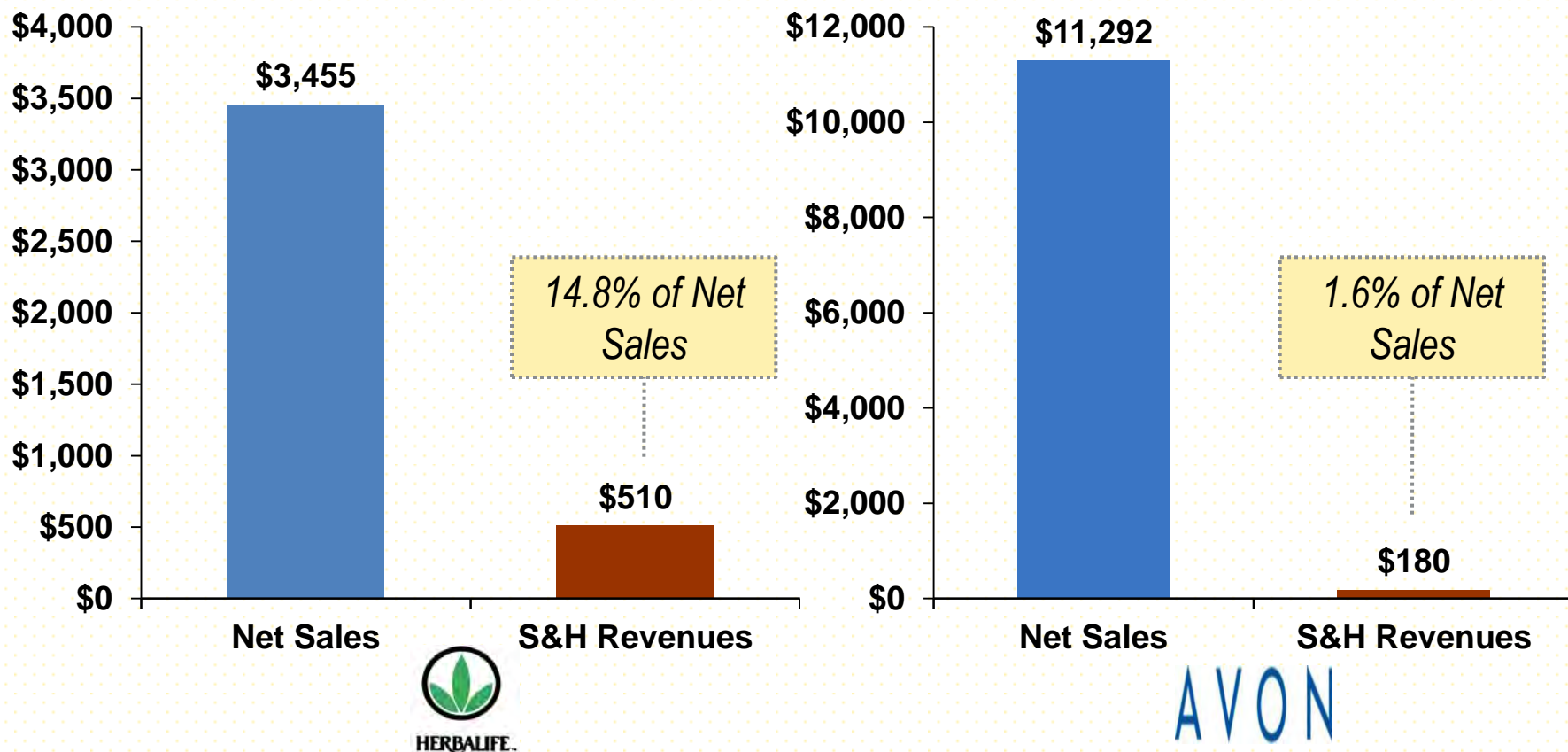
They're not so much dropping out of the business other than I think what we talked about in response to Javier's question about there's maybe 4, 5% of the business that are leaving. What we're seeing is really the slowdown is more attributable to not opening up new stores. And that is on purpose. Our distributors want to retrain and retrain and then go back through a period of accelerated growth.

So I think what you will see is retention will probably actually go up as we go through this phase. And then, we want to get back to active recruiting which is another word for opening new Nutrition Clubs.

## **Shipping & Handling**

# Herbalife's Shipping & Handling Revenues Are Surprisingly High...

**2011 S&H Revenues as % of Net Sales** <sup>(1)</sup>



***Herbalife charges a 7% Shipping & Handling surcharge above ordinary Shipping & Handling costs***

(1) Source: Company filings. Avon Shipping and Handling Revenues are included in 'Other Revenue', which "primarily includes shipping and handling and order processing fees billed to Representatives".

## **...However, Herbalife's Shipping & Handling Costs Are Surprisingly Low**

- ▶ Herbalife does not detail Shipping & Handling costs on its Income Statement
- ▶ In a response letter to an April 11, 2011 SEC inquiry, however, Herbalife disclosed its Shipping & Handling costs for the fiscal years 2008–2010 <sup>(1)</sup>

### **Source: Herbalife Response Letter to SEC (2011)**

Please tell us where you record shipping and handling costs and provide us with the amounts for each period presented. If these amounts are not included in costs of sales and are material, please confirm in future Exchange Act filings you will revise to disclose (i) your policy for recording shipping and handling costs and (ii) the amounts for each period presented.

#### **Company Response:**

We note the Staff's comment, and in response thereto, respectfully advise the Staff that in Note 2, Basis of Presentation, under the heading of "Revenue Recognition," in the notes to consolidated financial statements on page 104 of the 2010 10-K, we disclose that shipping and handling costs paid by the Company are included in cost of sales. The shipping and handlings costs for 2010, 2009 and 2008 were \$58 million, \$49 million and \$48 million, respectively.

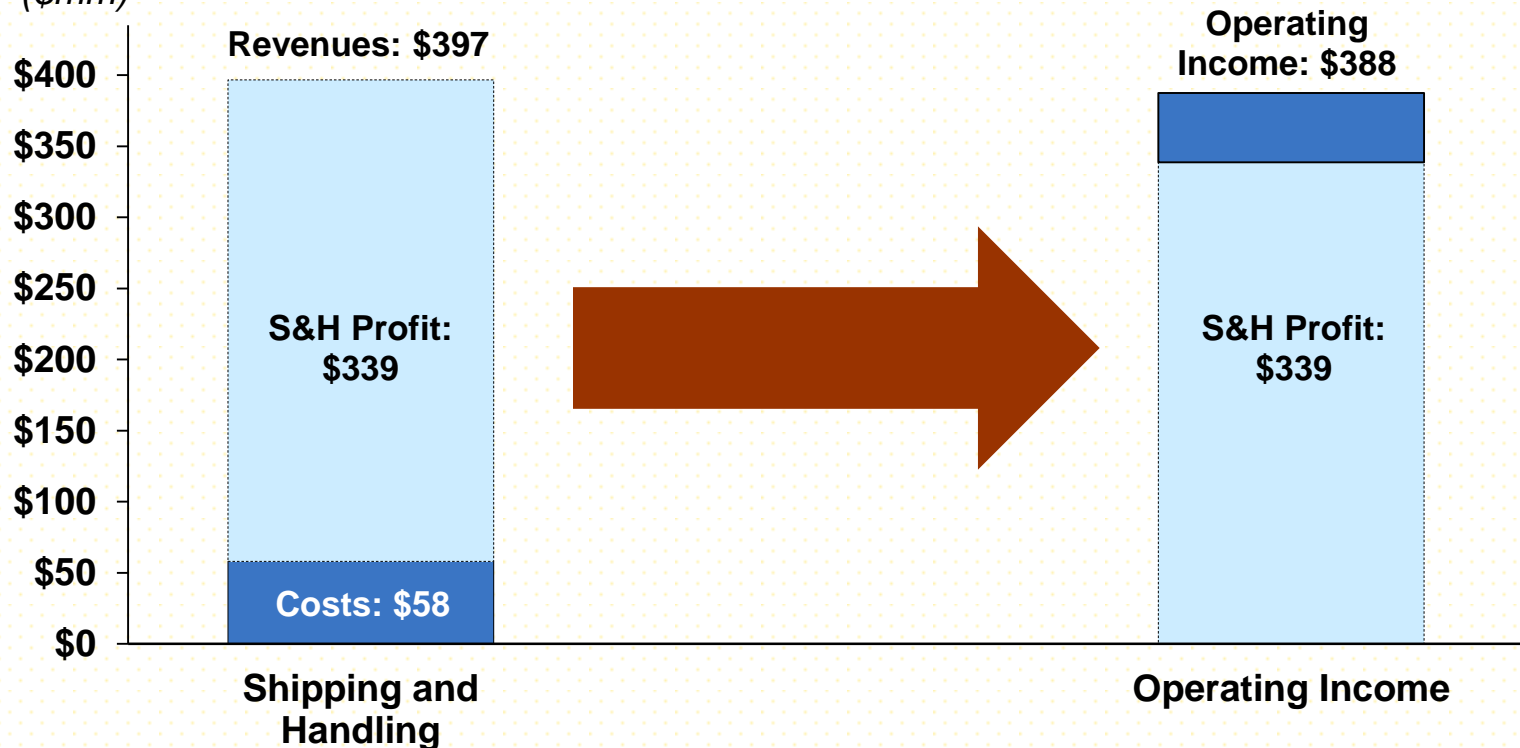
***Based on Herbalife's SEC correspondence, its Shipping & Handling costs as a percentage of Net Sales is 2.1%, or 1.3% of Retail sales <sup>(1)</sup>.***

(1) Source: Herbalife filings and SEC response letter dated April 21, 2011.

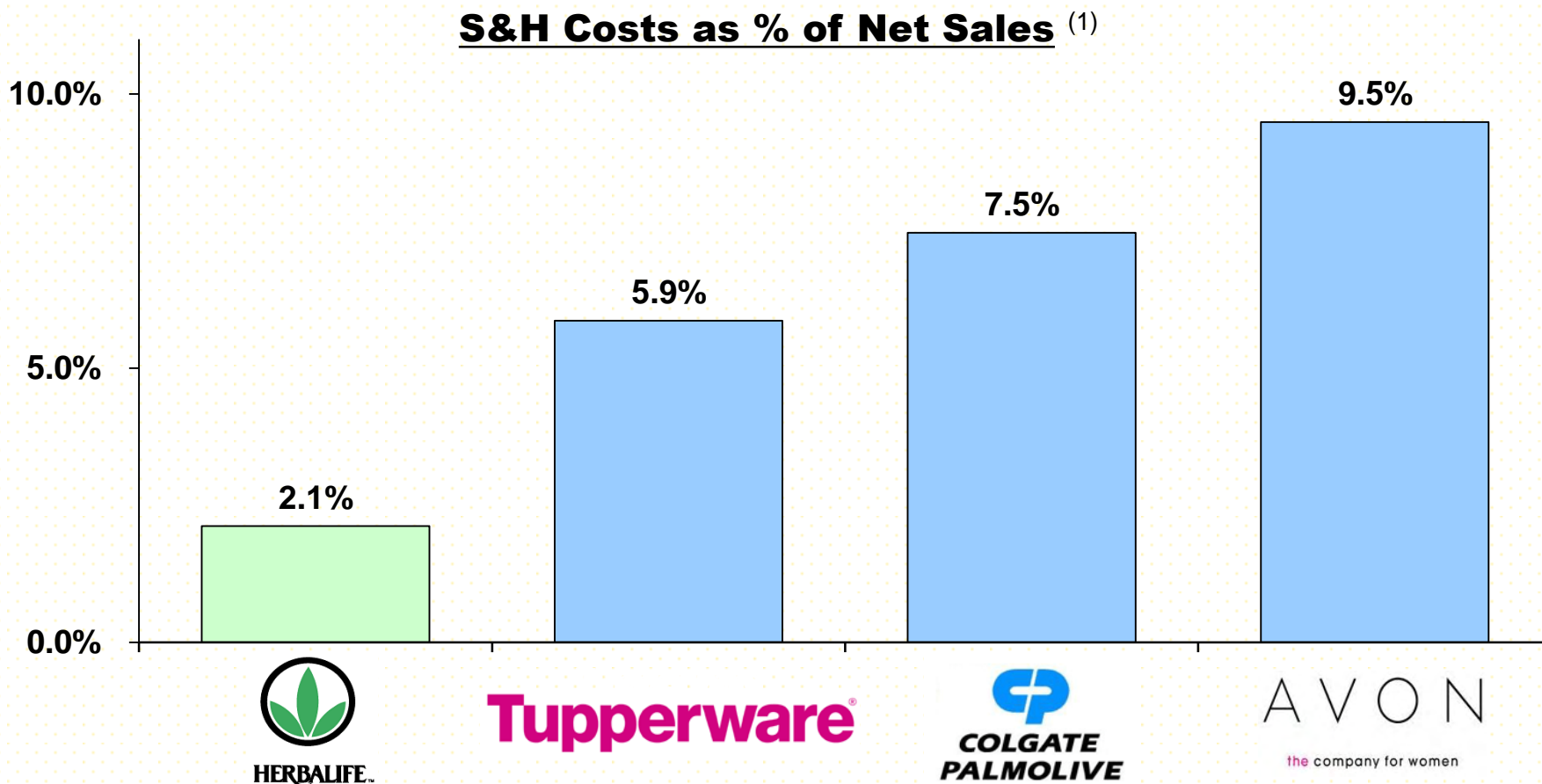
# **As Such, Herbalife's Shipping & Handling Profit Accounts For \$339mm of Its Total Operating Income**

**2010a**

(\$mm)



# S&H Costs Typically Account for 6–9% of Net Sales of Consumer Product Companies



*In addition, Herbalife's products are typically sold at a 50% discount to SRP, whereas many of its competitors sell their products at a 30–40% discount*

(1) Source: Company filings. Based on 2011 estimates; Herbalife reflects 2010 data, as disclosed in SEC correspondence dated April 21, 2011.



# However, Herbalife's Products are Relatively Heavy and Expensive to Ship

Generally  
Heavier

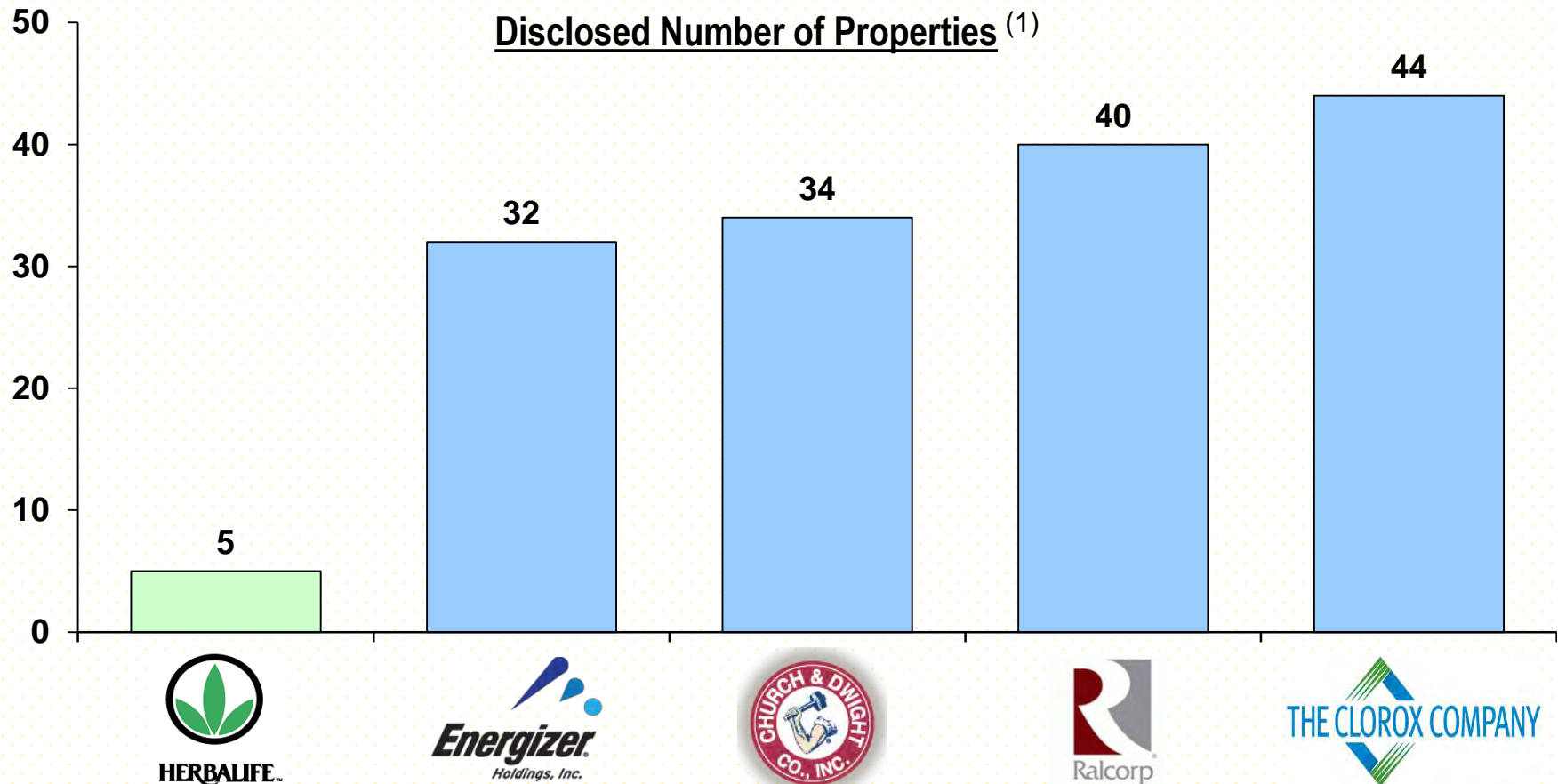


Generally  
Lighter



# Herbalife Also Has a More Limited Logistics Footprint Than That of Similarly-Sized Consumer Product Companies

Herbalife has only three company operated distribution centers of 150k sq. ft or less each



(1) Source: Company filings. For Energizer, Church & Dwight, Ralcorp and Clorox, represents only disclosed production/ manufacturing, distribution and warehouse facilities, which are a subset of total.

# Why Are Herbalife's Shipping & Handling Costs So Low?

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- ⊗ HLF has heavier products at a given price point: Peers have significantly higher S&H costs despite selling products that are cheaper to ship
- ⊗ HLF has a limited company-operated manufacturing footprint
- ⊗ HLF has fragmented distribution: approximately 3 million independent distributors located in 84 countries <sup>(1)</sup>
- ⊗ HLF uses expensive outsourced shipping: outsourced shipping through FedEx, a relatively expensive distribution form
- ⊗ HLF products have 'fast-moving' consumption patterns: frequent shipments given customer base and move toward “everyday consumption”

(1) Source: Herbalife FY 2012 Q3 10-Q..

## **Product Buyback**

# **Herbalife's Primary Evidence that Retail Activity Exists is the Fact that Product Returns are Low (0.4% of Retail Sales)<sup>(1)</sup>**

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I don't think there's any way that anyone can ensure retail sales, except to look at the evidence of how many people do we have who came back to Herbalife with a garage full of product and said, you know, "I've been duped into this, and here's my product. I can't sell this product. I'm not able to sell this product"? The evidence is to the contrary. The evidence is considerably to the contrary.

- Charles Patterson, Herbalife Attorney<sup>(2)</sup>

(1) Returns were 0.4% of Retail Sales in 2011. Source: Herbalife Investor Presentation (May 2012).

(2) *Herbalife International of America v. Ford*, No. 2:07-cv-02529, Hearing Transcript at 16-17 (C.D. Cal. June 2, 2009).

**Herbalife's 'buyback' policy is effective at limiting product returns. Therefore, we believe the 0.4% return percentage is not a useful indicator of Retail Sales**

# Herbalife's 0.4% Return Percentage Does Not Necessarily Indicate Retail Activity

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- ▶ **A meaningful amount of product is purchased by Non-Sales Leaders from Sales Leaders in the “field,” not directly from the company, and is not eligible to be returned to Herbalife<sup>(1)</sup>**
- ▶ **Herbalife's buyback policy permits the company to deduct recruiting rewards earned on returned product retroactively (“clawback”)**
  - This clawback gives Sales Leaders an incentive to discourage their downline from returning product to Herbalife
  - In many cases, Sales Leaders are better off repurchasing product from their downline rather than allowing them to return it to Herbalife
- ▶ **Herbalife's buyback policy is not a 100% cash back guarantee**
  - A non-refundable Surcharge and a 10% restocking fee mean that Sales Leaders only get 79% of their money back on returned product<sup>(2)</sup>
- ▶ **To return product to the company, distributors are required to resign, forfeiting their hard-earned downline forever**

(1) Products are only eligible for return to the company “if the products were purchased from Herbalife.” (Source: Herbalife Sales & Marketing Plan); “Purchases directly from the company – of that 82%, a lot of people never purchase from the company. So they sign up to be a distributor from their sponsor, but they still buy product from the sponsor... Again, a million of our distributors don't order directly from the company.” (Source: John DeSimone, CFO, Herbalife at the Citi Global Consumer Conference (5-23-12)).

(2) E.g., a Sales Leader who pays \$50 plus a \$7 Surcharge for \$100 of SRP product is entitled to get back \$45 (\$57-\$7-10%\*\$50). In mid-2012, after David Einhorn questioned the company, Herbalife eliminated the restocking fee.

# **Herbalife's 0.4% Return Percentage Does Not Necessarily Indicate Retail Activity (Cont'd)**

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- ▶ **Distributors are encouraged to sell to friends and family**
  - Herbalife encourages new distributors to sell product to friends and family who may be reluctant to return product even if they are not using it
- ▶ **Distributors are encouraged to “Use, Wear, Talk”**
  - Herbalife pushes new distributors to create their own personal testimonial by using their newly purchased Herbalife products. Only unopened product can be returned
- ▶ **Trend toward smaller order sizes reduces likelihood of returns**
  - Distributors who buy in smaller quantities are less likely to go through the enormous effort required to return product. They are also more likely to sample and use a higher percentage of the product they purchase, thereby making it ineligible for return
- ▶ **Returns are reported as a percent of Retail Sales not Product Sales**
  - Herbalife's return percentage would be twice as high if the company reported returns as a percent of GAAP Product Sales

# Herbalife Documentation Requirements Prevent Distributors from Returning Product

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- ▶ To return product, distributors are required to produce lengthy sales documentation, in part to verify the 70% Rule and Ten Customer Rule certifications

*Equinox, which was found to be a pyramid scheme, had a similar policy:*

As written and applied, the 70% Rule becomes a sword for Equinox to deny refunds, instead of a shield to protect distributors from inventory loading.<sup>(1)</sup>

- Limited distributor sophistication and the financial incentive to falsify certifications make it likely that many distributors lack the proper records to return product

(1) *FTC v. Equinox International Corp.*, No. 990969HBR, 1999 WL 1425373, at \* 8 (D. Nev. Sept. 14, 1999).



# Distributor Frustration

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**Distributors find Herbalife's Inventory Repurchase conditions so restrictive that they don't even bother to return product:**

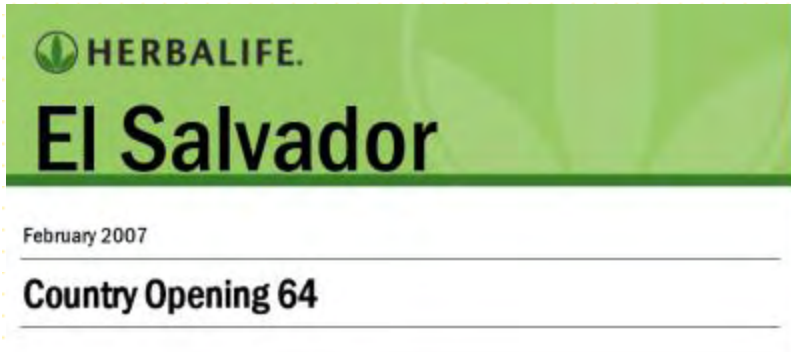
## Deposition of Bruce Roth (Former Distributor):

At the time that we left Herbalife, we had leftover product that we had been forced to purchase to get our paycheck from Herbalife. For approximately the last seven (7) months we were in Herbalife (i.e mid-June 2006 to January 2007), we had to purchase approximately \$7,500 in Herbalife product to be eligible to receive our monthly paycheck from Herbalife. When we left Herbalife, we had to throw out about \$5,000 of useless Herbalife product. We did not ask Herbalife to repurchase this product because Herbalife's buyback policy imposed too many restrictions.

*Herbalife International of America, Inc., v. Robert E. Ford and Julia A. Ford, Et, Al.,*

# And In Some Countries, Herbalife Does Not Even Have a Return Policy...

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HERBALIFE.

## El Salvador

February 2007

Country Opening 64

### Rules

Legal age: 18, No Minors.

No 30-day money back guarantee.

No Repurchase policy.

Weight Control claims are not permitted.

No Advertising of any kind will be allowed, including flyers, newspaper advertisements, signs, etc. (Product or Business Opportunity).

No public gatherings or meetings are permitted such as HOM's or STS's. Private Distributor meetings are allowed.

Applications with El Salvador address can be accepted as of February 12, 2007.

We will start selling IBP's as of February 12, 2007.

EOM rules apply – All orders MUST be received on or before the designated "EOM" day in order to count for that month's Volume.

## Existence Of a Buyback Policy Is Not a Safe Harbor

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Amway's buyback policy was an important consideration in the court's decision that Amway was not a pyramid scheme; however, courts have later clarified that the policy must be effective and enforced to be a relevant defense

Omnitrition misreads *Amway* as holding that any “multi level marketing” program employing policies like Amway's is not a pyramid scheme as a matter of law. That was not the FTC's holding. The FTC held that Amway was not a pyramid scheme as a matter of fact because its policies were *enforced* and were *effective* in encouraging retail sales. This ruling does not help Omnitrition at the summary judgment stage.

*Webster v. Omnitrition*, 79 F.3d 776, 784 (9<sup>th</sup> Cir. 1999).

# Compared to Amway, HLF's Buyback Policy Does Not Adequately Protect Distributors From Losses

## (1) Herbalife's restocking fee is 10%; Amway's was 5%

*Courts have established that a 10% restocking fee is large enough to burden distributors with a material non-refundable expense*

*FTC v. Equinox International, Corp.*, No. 990969HBR, 2008 WL 1425373, at \* 8 (D. Nev. Sept. 14, 1999).

\*8 Equinox does have a refund policy. Equinox, however, only refunds 90% of the price of the product which is less than Amway refunded in the case considered by the Ninth Circuit. *See Omnitrition*, 79 F.3d at 783. Distributors that enter as Managers and purchase \$5000 in product are effectively paying \$500 for the right to participate in the Equinox opportunity.

## (2) HLF's buyback policy has a 12-Month Expiration; Amway had none

*A court ruled that time limits on product returns significantly increase distributors' financial risk*

*Webster v. Omnitrition*, 79 F.3d 776, 784 (9th Cir. 1999).

The latter fact is very significant. The buy-back rule is only effective if it can reduce or eliminate the possibility of inventory loading by insuring that program participants do not find themselves saddled with thousands of dollars worth of unsaleable products. Omnitrition's rule potentially would not achieve this goal for any person who participated in the program for more than three months.

## **How Much Harm Has Herbalife Caused**

# Let's Revisit: Why are Pyramid Schemes Illegal?

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A.

Pyramid schemes are said to be inherently fraudulent because they must eventually collapse. *See, e.g., S.E.C. v. International Loan Network, Inc.*, 968 F.2d 1304, 1309 (D.C.Cir.1992). Like chain letters, pyramid schemes may make money for those at the top of the chain or pyramid, but “must end up disappointing those at the bottom who can find no recruits.” *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181 (1975), *aff’d mem. sub nom., Turner v. F.T.C.*, 580 F.2d 701 (D.C.Cir.1978).

Source: Webster v. Omnitrition, 79 F.3d 776, 781 (9<sup>th</sup> Cir. 1996).

**In a pyramid scheme, the money at the top is made from the losses of people at the bottom of the pyramid**

# **How Much Financial Harm Has Herbalife Caused?**

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**Number of People Harmed**

**X**

**Net Losses per Person**

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**Total Net Losses**



# How Many Sales Leaders Have Failed?

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- ▶ **Sales Leaders join Herbalife to participate in the business opportunity, not to consume the product**
  
- ▶ **Since 1980, we estimate that ~1.9mm Sales Leaders (ex-China) have failed in the business opportunity<sup>1</sup>**
  - ❑ The Company provides detailed Sales Leader statistics between 2004 and 2012;
  
  - ❑ Using this data, we estimate that in the 2006-2012 period ~1.1mm Sales Leaders failed<sup>2</sup> and left the business, a ~90% failure rate<sup>3</sup>

(1) Uses the Company's data to determine how many Sales Leaders "failed" between 2006 and 2012 (using churn as a proxy for failure). Using 1980-2012 Retail Sales as a proxy, we extrapolated our 2006-2012 churned Sales Leaders to approximate the number of Sales Leaders who have failed since 1980.

(2) Total Sales Leaders Demoted and Resigned in Jan. and Feb. between 2006 and 2012 was 1.07mm per HLF 10Ks filed during the period. In addition, by comparing full year Sales Leader additions with the beginning and ending Sales Leader totals, we estimate that an additional 42k distributors left between March and December in the 2006 – 2012 period (2012 was estimated using prior year trends).

(3) Failure rate = (Total Failed Sales Leaders Feb. 2006 – Feb. 2012)/(New Sales Leaders Mar. 2004 – Feb. 2011).

# How Much Money do Failed Distributors Lose?

**Distributors incur substantial non-refundable, non-product expenses in their attempt to succeed**

Leon Waisbein – Future President's Team Retreat Presentation: Malta 2010

## From Supervisor to GET Team



**Step 1:** Making Supervisor business profitable and attractive for duplication

### Supervisor Economics Example

- Personal product use: € 200-300
- Business Tools, Communication: € 200-300
- Events: € 100-200
- Office/Club: € 200-300 and more
- LDW, Extravaganza: € 200-300

**Expenses Total: € 1,000 and more...**

# Distributors Face a Long List of Expenses

The itemized list of Business Support Materials below comes from the blog of a former (non- Sales Leader) Herbalife distributor showing nearly \$2,000 of expenses in only three months, excluding Herbalife product purchases. The company seldom acknowledges these costs exist

DATE	COST	DESCRIPTION
03-Aug-09	\$449.00	charged by my upline Distributor for Distributorship sign up + remaining cost of decision pkg.
17-Aug-09	\$562.62	charged for leads purchased from Online Marketing Solutions
17-Aug-09	\$112.52	charged for website access from The Online Business
18-Aug-09	\$991.26	charged by Herbalife for an order put in by my upline Distributor and had sent to me
26-Aug-09	\$25.00	Merchant Account
27-Aug-09	\$75.00	Merchant Account
14-Sep-09	\$39.55	charged for new style Decision Package sent to lead
15-Sep-09	\$55.94	charged by The Online Business System for website access
21-Sep-09	\$35.00	Merchant Account
03-Oct-09	\$112.22	charged by Herbalife for website setup for one year
14-Oct-09	\$168.00	charged for Online Business System supplies that my upline Distributor order I pay for
15-Oct-09	\$52.74	charged by The Online Business System for website access
21-Oct-09	\$35.00	Merchant Account

Closer Look at  
Sales Leads

\$2,713.85

- \$991.26      Product purchases

**\$1,723    Total non-product expenses**

# Sales Leads

Senior distributors have profitable side businesses by selling leads at high prices to low-level distributors eager to grow their downlines

GREAT SHAPE today MARCH 29TH, 2012

GST LEADS ACT NOW! SPECIAL OFFER!

GREAT SHAPE today  
**RETAIL LEADS!**  
**PROMO**

DON'T MISS OUT...  
GET YOURS NOW!

4 GST SHAKE LEADS &  
12 GST CALL ME LEADS

ONLY  
**\$349**  
REG. \$399

# Nutrition Clubs Are Expensive to Operate

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**Nutrition Clubs, an increasingly important channel for Herbalife, are expensive to open**

***John DeSimone, Herbalife CFO:***

*“So it depends on the marketplace, but the clubs can vary from \$5,000 to \$6,000 to open to something greater than that”*

*11/16/11, Morgan Stanley Global Consumer Conference*

# **“Newest Way to Wealth”**

## **– Jacobs v Herbalife International Inc.**

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- ▶ **In 2002, distributor plaintiffs filed a class action against Herbalife challenging the marketing practices of Herbalife and several high-ranking distributors**
- ▶ **Distributors were pitched the costly “Newest Way to Wealth” program as a way to build their Herbalife business**
- ▶ **Claims filed in connection with settling the case totaled \$27mm and averaged \$10k per claimant; the highest claim was \$128k**
- ▶ **Herbalife settled the case for \$6mm**

# How Much Money do Failed Distributors Lose?

We estimate that the average failed Sales Leader has \$2,000 of expenses, net of minimal retail and/or recruiting profit

## Summary Cost Analysis

<b>Waisbein Presentation</b>	<b>\$1,275+</b>
<b>Itemized Business Support Materials</b>	<b>\$1,700 – Non-Sales Leader</b>
<b>Cost to Open a Nutrition Club</b>	<b>\$5,000 - \$6,000</b>
<b>“Newest Way to Wealth”</b>	<b>\$10,000 = Average</b>

## Revenue Assumption

The typical failed Sales Leader makes nearly no retail profit after product expenses, surcharges, and price discounts. According to HLF’s own income disclosure, the median recruiting revenue for Sales Leaders is zero<sup>1</sup>



# Have Much Have Failed Sales Leaders Lost?

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**1.9mm** = People Harmed

**X**

**\$2k** = Net Losses per Person

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**\$3.8bn** Total Net Losses Since 1980

This estimate does not include harm done to the ~10mm<sup>1</sup> former Non-Sales Leader distributors. As such, we think the true financial damage Herbalife has inflicted is materially higher than \$3.8bn

(1) Assumes: 1.9mm failed Sales Leaders 1980-2012 at an 89% Sales Leader failure rate implies 2.2mm Total Sales Leaders. 17% of Distributors become Sales Leaders (previous slide), implies 12.7mm total Distributors 1980-2012. Implies ~10mm Non-Sales Leader Distributors 1980-2012.

**To quantify the harm numerically is inherently conservative. No analysis can properly demonstrate the loss of time, damaged relationships, and emotional harm that is perpetrated by Herbalife on those who have been deceived**



## **Management Credibility**

# Michael Johnson in His Own Words

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Video Clip:

<http://www.pscmhflibrary.com/herbalife-cnbc-clips/>

# **Michael Johnson on CNBC, 12/19/12**

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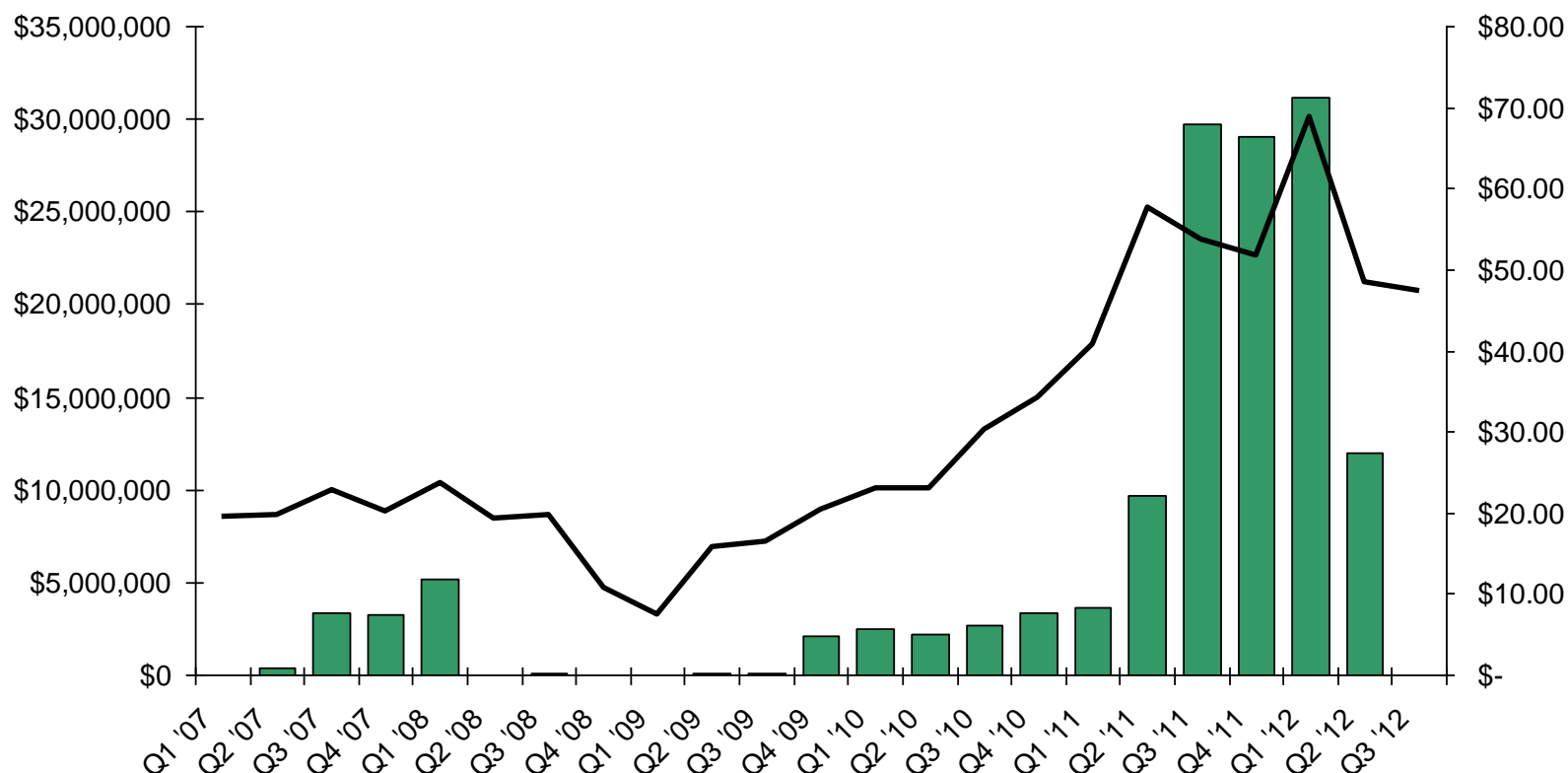
Video Clip:

<http://www.pscmhflibrary.com/herbalife-ceo-on-cnbc-121912/>

# Actions Speak Louder Than Words

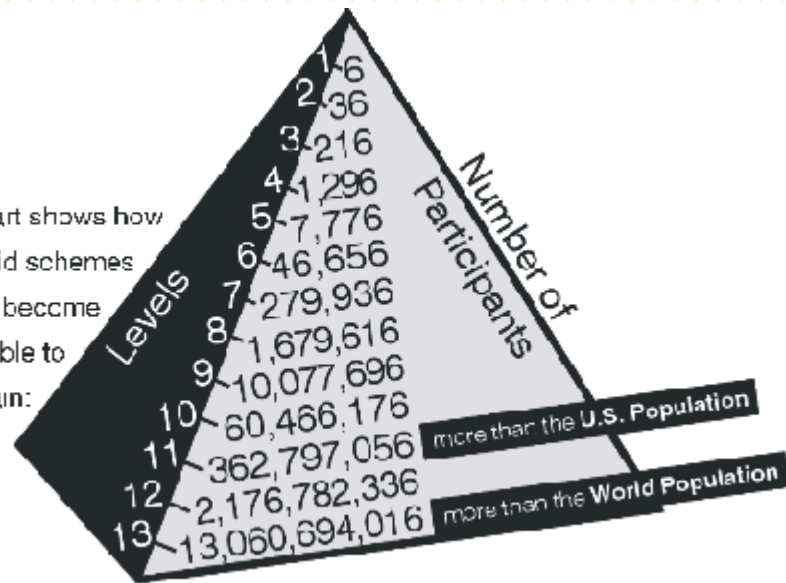
Since 2007, Michael Johnson has sold ~\$140mm of HLF stock. These sales were discretionary. His shortest dated options were not set to expire until 2013

Michael Johnson Stock Sales and HLF Share Price (Quarterly)



**Johnson was paid \$89.4mm in 2011, making him the highest earning Russell 3000 CEO that year<sup>1</sup>**

The chart shows how  
pyramid schemes  
can become  
impossible to  
sustain:



## Conclusion



# Conclusion

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- ▶ **Herbalife is a Pyramid Scheme**
- ▶ **It has caused and continues to cause enormous harm to the most vulnerable communities in the U.S. and around the world**
- ▶ **Our goal with this presentation is to shine a spotlight on Herbalife**

***“Sunshine is the best disinfectant”***

**Justice Louis Brandeis**