Who wants to be a Millionaire?
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Welcome to Herbalife!

A great solution, at the right time

‘If you can dream it, you can do it!’
Walt Disney
Herbalife Ltd. ("HLF")

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.

Ticker: “HLF”

Stock price: $42.84 (1)

Daily Volume: ~$100mm

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 (2)

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1) As of 12-17-12.
2) Capital IQ consensus estimate (as of 12-17-12).
Herbalife’s Mission Statement

“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?

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

Herbalife’s mission is to change people’s lives by providing the best business opportunity in direct selling.
The Products

It’s all about the products!

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

Source: Herbalife Independent Distributor Presentation (2012)

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...

<table>
<thead>
<tr>
<th>Ticker</th>
<th>NYSE:CHD</th>
<th>NYSE:ENR</th>
<th>NYSE:CLX</th>
<th>NYSE:HLF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Company Value</strong>&lt;sup&gt;(1)&lt;/sup&gt;</td>
<td>$7.2bn</td>
<td>$6.7bn</td>
<td>$11.7bn</td>
<td>$8.1bn</td>
</tr>
<tr>
<td><strong>Revenue</strong>&lt;sup&gt;(2)&lt;/sup&gt;</td>
<td>$2.8bn</td>
<td>$4.6bn</td>
<td>$5.5bn</td>
<td>$3.9bn</td>
</tr>
<tr>
<td><strong>Countries</strong>&lt;sup&gt;(3)&lt;/sup&gt;</td>
<td>80+</td>
<td>160+</td>
<td>100+</td>
<td>80+</td>
</tr>
<tr>
<td><strong>Year Founded</strong></td>
<td>1846</td>
<td>1875</td>
<td>1913</td>
<td>1980</td>
</tr>
</tbody>
</table>

(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

<table>
<thead>
<tr>
<th>Key Brands</th>
<th>Gross Margin (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>43.9%</td>
</tr>
<tr>
<td></td>
<td>46.8%</td>
</tr>
<tr>
<td></td>
<td>42.4%</td>
</tr>
<tr>
<td></td>
<td>80.2%</td>
</tr>
</tbody>
</table>

Gross Margin (1) LTM as of 9/30/12. Source: public company filings.

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)  

- $2.4
- $2.3
- $2.3
- $1.9
- $1.8
- $1.7
- $1.5
- $1.4
- $1.4

$1.8bn based on Herbalife’s disclosure

(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

<table>
<thead>
<tr>
<th>Company</th>
<th>Herbalife</th>
<th>GNC</th>
<th>Unilever</th>
<th>Abbott Labs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Powder Offering?</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
<tr>
<td>Ready-To-Drink Offering?</td>
<td>✗</td>
<td>✔</td>
<td>✔</td>
<td>✔</td>
</tr>
</tbody>
</table>
Herbalife Sells ~10 to 20 Times More Nutrition Powder than its Competitors

<table>
<thead>
<tr>
<th>Powder</th>
<th>Ready-To-Drink</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0</td>
<td>$200</td>
</tr>
<tr>
<td>$400</td>
<td>$600</td>
</tr>
<tr>
<td>$800</td>
<td>$1,000</td>
</tr>
<tr>
<td>$1,200</td>
<td>$1,400</td>
</tr>
<tr>
<td>$1,600</td>
<td>$1,800</td>
</tr>
<tr>
<td>$2,000</td>
<td></td>
</tr>
</tbody>
</table>

(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 ~1/3rd 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

Retail Price Per 200 Calorie Serving (1)

<table>
<thead>
<tr>
<th>Product</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>GenSoy Soy Protein Shake</td>
<td>$0.88</td>
</tr>
<tr>
<td>Ensure Nutrition Powder</td>
<td>$1.03</td>
</tr>
<tr>
<td>Slim-Fast 3-2-1 Plan High Protein Shake</td>
<td>$1.04</td>
</tr>
<tr>
<td>Total Soy Lean Shake</td>
<td>$1.51</td>
</tr>
<tr>
<td>Herbalife Total Lean</td>
<td>$1.74</td>
</tr>
</tbody>
</table>

(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.

How does Herbalife price its other products?
Herbalife’s Multivitamin is more than 3x the Price of Comparable Products

Retail Price Per Multivitamin Tablet (1)

Average: $0.08

$0.30
$0.25
$0.20
$0.15
$0.10
$0.05
$0.00

$0.06
$0.08
$0.08
$0.11
$0.26

(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.

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

<table>
<thead>
<tr>
<th>Product</th>
<th>Retail Price Per Serving</th>
</tr>
</thead>
<tbody>
<tr>
<td>Herbalife's Niteworks</td>
<td>$3.37</td>
</tr>
<tr>
<td>L-Arginine Plus</td>
<td>$1.33</td>
</tr>
<tr>
<td>L-Arginine Advanced</td>
<td>$1.33</td>
</tr>
<tr>
<td>GNC L-Arginine 5000</td>
<td>$1.17</td>
</tr>
<tr>
<td>Cardio-Juvenate</td>
<td>$1.07</td>
</tr>
</tbody>
</table>

Average: $1.22

(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.

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

Is it because Herbalife has proprietary products for which there is limited competition?
## No, Herbalife’s Products are Commodities

<table>
<thead>
<tr>
<th>% of Volume (1)</th>
<th>Herbalife Product</th>
<th>Comparable Products</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Nutrition Powder</strong></td>
<td>32%</td>
<td>Formula 1</td>
</tr>
<tr>
<td><strong>Herbal Tea</strong></td>
<td>12%</td>
<td>Herbal Tea</td>
</tr>
<tr>
<td><strong>Protein Powder</strong></td>
<td>7%</td>
<td>Protein Powder</td>
</tr>
<tr>
<td><strong>L’Arginine Powder</strong></td>
<td>4%</td>
<td>Niteworks</td>
</tr>
</tbody>
</table>

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

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
Yet, Herbalife Spends “de minimis” Dollars on Advertising

Annual Advertising Spend (1)

$2.6bn

$2.5bn

“de minimis”

“The Company’s advertising costs are de minimis” (2)

– 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?

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

Source: Herbalife Website (2012)

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)

Video Clip:

http://www.pscmhlflibrary.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”

▶ 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...

Source: Herbalife Website (2012)

**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)
Herbalife Claims Niteworks was the First Nitric Oxide Product in the Marketplace

“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

Source: Herbalife Analyst Meeting (11-28-07).
But Herbalife Was Not the First Company to Develop and Market a Nitric Oxide Product

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® 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


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

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

- Herbalife: 1 design patent for an oral supplement (which appears to be an oral tablet with the Herbalife symbol on it). Source: Sullivan & Cromwell.

(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”...

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.”
"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

Source: Herbalife Q3’07 earnings call.
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
“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

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

From an HLF Letter to the SEC, December 2004

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?

- 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

“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.

Source: Herbalife public filings.
Herbalife is Not a Product Company

**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

**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 products**

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

– Michael Johnson, CEO
What is the Herbalife business opportunity?
An Opportunity To Be Your Own Boss

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

- Work Activity
- Income

Income with Herbalife

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

Making the world healthier.
“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?
Growing and Sustaining Royalties

<table>
<thead>
<tr>
<th>Level</th>
<th>Supervisors</th>
</tr>
</thead>
<tbody>
<tr>
<td>You</td>
<td>1</td>
</tr>
<tr>
<td>1st</td>
<td>5</td>
</tr>
<tr>
<td>2nd</td>
<td>25</td>
</tr>
<tr>
<td>3rd</td>
<td>125</td>
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</tbody>
</table>

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

Personal Sales = $2500

155 supervisors total
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, Jewel-Way*, 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).

Herbalife Is Well Aware of the Law

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 lest 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?

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

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

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 recruits Mark who recruits Maria who buys $75 of product from Herbalife:

Multiple levels of people above Maria receive commissions from Herbalife.

$100 Retail Sale Example

- Retail Cust. to Maria: $100?
- Maria to Mark: $75
- Mark to Pedro: $8
- Pedro to Sam: $7
- Sam to Pedro: $5
- Pedro to Pam: $5
- Pam to Bob: $5
- Bob to Lisa: $5
- Lisa to Sarah: $2
- Sarah to John: $2
- John to Leslie: $2
- Leslie to Doran: $1

"Upline" and "downline" commission structure.
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

- 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)

<table>
<thead>
<tr>
<th>SRP (1)</th>
<th>Amt.</th>
<th>Pct.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase price</td>
<td>$100</td>
<td>100%</td>
</tr>
<tr>
<td>Retail Profit</td>
<td>$25</td>
<td>25%</td>
</tr>
<tr>
<td>Recruiting Rewards</td>
<td>$48</td>
<td>48%</td>
</tr>
</tbody>
</table>

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

- If a Retail Customer pays $100 for the product, Maria earns $25 Retail Profit.
- From Maria’s $75 purchase, Herbalife distributes $48 “up the line.”
# Two Primary Types of Distributors

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

**(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.

<table>
<thead>
<tr>
<th>% of Total Distributors</th>
<th>Median Annual Compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.04%</td>
<td>$336,901</td>
</tr>
<tr>
<td>0.1%</td>
<td>$97,303</td>
</tr>
<tr>
<td>0.5%</td>
<td>$19,417</td>
</tr>
<tr>
<td>0.5%</td>
<td>$5,659</td>
</tr>
<tr>
<td>5.9%</td>
<td>$475</td>
</tr>
<tr>
<td>93.0%</td>
<td>$0</td>
</tr>
</tbody>
</table>

Despite the name, “Millionaire Team” distributors only earn $97k/yr.

(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

(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”).

Median Annual Compensation (1)

- $336,901
- $97,303
- $19,417
- $5,659 (2)
- $475
- $0
- $0

% of Total Distributors (1)

- 82.3%
- 10.7%
- 5.9%
- 0.5% (2)
- 0.5% (2)
- 0.1%
- .04%
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”

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.

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 14th Annual Retailing Conference (9-5-2007).
Senior Distributors Encourage Other Distributors to Recruit if they Want to Make “Lifestyle Money”

“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

Source: Herbalife independent distributor audiovisual presentation (11-28-11). Online Business Systems is an Herbalife affiliate overseen by Shawn Dahl (Chairman’s Club).
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”

- 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 salespeople 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

<table>
<thead>
<tr>
<th>Retail Profit</th>
<th>Recruiting Rewards</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Discount</td>
</tr>
<tr>
<td>Sales Leaders</td>
<td>50%</td>
</tr>
<tr>
<td></td>
<td>50%</td>
</tr>
<tr>
<td></td>
<td>50%</td>
</tr>
<tr>
<td></td>
<td>50%</td>
</tr>
<tr>
<td>Non-Sales Leaders</td>
<td>42%</td>
</tr>
<tr>
<td></td>
<td>35%</td>
</tr>
<tr>
<td></td>
<td>25%</td>
</tr>
</tbody>
</table>
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)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase price</td>
<td>(75)</td>
<td></td>
</tr>
<tr>
<td>Suggested Retail Price</td>
<td>$100</td>
<td>100%</td>
</tr>
<tr>
<td>Retail Profit</td>
<td>$25</td>
<td>25%</td>
</tr>
<tr>
<td>Wholesale Comm.</td>
<td>25</td>
<td>25%</td>
</tr>
<tr>
<td>Royalty Overrides</td>
<td>15</td>
<td>15%</td>
</tr>
<tr>
<td>Production Bonus</td>
<td>7</td>
<td>7%</td>
</tr>
<tr>
<td>Mark Hughes Bonus</td>
<td>1</td>
<td>1%</td>
</tr>
<tr>
<td>Recruiting Rewards</td>
<td>$48</td>
<td>48%</td>
</tr>
<tr>
<td>Total Payout</td>
<td>$73</td>
<td>73%</td>
</tr>
</tbody>
</table>
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 (in Theory)

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

“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.

Earnings opportunity available in wholesale retail discount (single-level) is more than 2x that from royalties and bonuses.

- Up to 50% Discount FY’11 = $2.4B
- Up to 23% Royalties And Bonuses FY’11 = $1.1b

No Distributor, sales leader or non-sales leader, can earn both royalties and retail sales profit on the same sale.

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

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

### Herbalife P&L

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

(1) Actual results referenced in Herbalife’s 2008 SEC filing, not including China.

(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.

Herbalife P&L
($ mms) 2008a 2011a

Retail Sales $3,811 $5,428
Distributor Allowances (1,779) (2,483)
Product Sales $2,032 $2,945
Shipping & handling revenues 327 510
Net Sales $2,359 $3,455
Cost of sales (458) (680)
Royalty overrides (797) (1,138)
SG&A (772) (1,075)
EBIT $332 $562

73% Distributor Payout

$797 million

$1.8 billion

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

<table>
<thead>
<tr>
<th></th>
<th>Year Ended December 31</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(In thousands)</td>
</tr>
<tr>
<td>Retail sales</td>
<td>$5,427,844</td>
</tr>
<tr>
<td>Distributor allowance</td>
<td>$(2,483,122)</td>
</tr>
<tr>
<td>Product sales</td>
<td>2,944,722</td>
</tr>
<tr>
<td>Shipping &amp; handling revenues</td>
<td>509,815</td>
</tr>
<tr>
<td>Net sales</td>
<td>$3,454,537</td>
</tr>
</tbody>
</table>

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**?

<table>
<thead>
<tr>
<th></th>
<th>As Reported (100% SRP)</th>
<th>As Adjusted (65% SRP)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>&quot;Retail Sales&quot;</strong></td>
<td>$5,428</td>
<td>$3,528</td>
</tr>
<tr>
<td><strong>Distributor Allowances</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(&quot;Retail Profit&quot;)</td>
<td>(2,483)</td>
<td>(583)</td>
</tr>
<tr>
<td>Product Sales</td>
<td>$2,945</td>
<td>$2,945</td>
</tr>
<tr>
<td>S&amp;H revenues</td>
<td>510</td>
<td>510</td>
</tr>
<tr>
<td>Net Sales</td>
<td>$3,455</td>
<td>$3,455</td>
</tr>
<tr>
<td>Cost of sales</td>
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<td>(680)</td>
</tr>
<tr>
<td><strong>Royalty overrides</strong></td>
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<tr>
<td>SG&amp;A</td>
<td>(1,075)</td>
<td>(1,075)</td>
</tr>
<tr>
<td>EBIT</td>
<td>$562</td>
<td>$562</td>
</tr>
</tbody>
</table>

(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...

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

73% Distributor Payout

- 1% MH Bonus
- 7% Production Bonus
- 15% Royalty Overrides
- 50% Discount (Retail Profit)

$797 million

$1.8 billion


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

Adjustment #1: Suggested Retail Price ≠ 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

- 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%.
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

<table>
<thead>
<tr>
<th>Area</th>
<th>Scale</th>
<th>Area</th>
<th>Scale</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gran Asunción</td>
<td>Gs 0 a Gs 2,500,000</td>
<td>22,000</td>
<td>Gs 0 a Gs 2,500,000</td>
</tr>
<tr>
<td></td>
<td>Gs 2,501.000 a Gs 6,000,000</td>
<td>1,6%</td>
<td>Gs 2,501.000 a Gs 6,000,000</td>
</tr>
<tr>
<td></td>
<td>Gs 6,000.001 a Gs 10,000,000</td>
<td>1,2%</td>
<td>Gs 6,000.001 a Gs 10,000,000</td>
</tr>
<tr>
<td>Gran Asunción</td>
<td>Gs 10,000.001 o superior</td>
<td>1%</td>
<td>Gs 10,000.001 o superior</td>
</tr>
</tbody>
</table>

Source: Google.
Herbalife’s 7%+ “Surcharge” (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

Source: Google.
Herbalife’s 7%+ “Surcharge” (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-IBP. 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.
- A 7% 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% weight on Full Retail will apply.
- Walk-in, Phone orders. Face to face and E-mail orders can only be placed directly through the Johannesburg Sales Centre.
- E-mail orders may be sent to orders@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

Source: Google.
In Order to Realize their Full Markup, Distributors Must Pass the Surcharge through to Retail Customers

Distributors purchase product here

Distributors must re-sell here to capture the 25% Retail Profit
Sales Taxes Must Be Passed Through at Retail

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

<table>
<thead>
<tr>
<th>Formula 1 (750g)</th>
<th>Herbal Tea (1.8oz)</th>
<th>Herbal Aloe Concentrate (16oz)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$39 Adj. SRP</td>
<td>$24 Adj. SRP</td>
<td>$29 Adj. SRP</td>
</tr>
<tr>
<td><strong>40% Discount</strong></td>
<td><strong>39% Discount</strong></td>
<td><strong>41% Discount</strong></td>
</tr>
<tr>
<td>$23 Distributor Websites</td>
<td>$14 Distributor Websites</td>
<td>$17 Distributor Websites</td>
</tr>
</tbody>
</table>

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)**

- Adj. SRP: $37.42
- eBay Price: $25.31
- Discount: 32%
- n = 26,646

**Formula 1 (550g)**

- Adj. SRP: $26.81
- eBay Price: $16.49
- Discount: 38%
- n = 12,750

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)

\[ \text{Adj. SRP} = \$97.47 \]
\[ \text{eBay Price} = \$51.58 \]

47% Discount

\[ n = 5,397 \]

Niteworks (5.3oz)

\[ \text{Adj. SRP} = \$52.56 \]
\[ \text{eBay Price} = \$25.73 \]

51% Discount

\[ n = 880 \]

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).

Lean Shake (771g)

- Adj. SRP: $24.99
- eBay Price: $25.60

2% Premium

n = 1,062

Lean Shake and Formula 1 (750g) sell at almost the identical price on eBay. Further evidence that these products are commodities.

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

- 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 ≠ 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

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.

Source: Herbalife 8-K (5-2-12).
If Herbalife Doesn’t Track Sales Outside the Network, How Many Retail Customers Are There?
Herbalife Says that the FTC is not Concerned about Internal Consumption

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.
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.
Herbalife Refers to All Non-Sales Leaders as “Single-Level,” Though Most NSLs are Eligible to Receive Multilevel Wholesale Commissions

Herbalife refers to these distributors as “Single-Level” (59% of total distributors) (1)

(1) On average, there were 2.38mm distributors in 2011. Of these, 0.46mm were Sales Leaders (source: Herbalife Regional Key Metrics supplement). Of the Non-Sales Leader distributors: 27% were “Discount Buyers” (22% of total distributors), 61% were “Small Retailers” (49% of total), and 12% were “Potential Supervisors” (10% of total). Source: HLF 8-K (8-2-12).
Herbalife Says the Majority of its Distributors Sign Up to Become “Discount Buyers”

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%?
“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.”

<table>
<thead>
<tr>
<th></th>
<th>Signup Cost</th>
<th>Renewal Fee</th>
<th>Renewal Rate</th>
<th>Product Offering</th>
<th>Paperwork</th>
<th>Product Returns</th>
<th>Membership lost if product returned?</th>
<th>“Discount” Price</th>
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<tbody>
<tr>
<td></td>
<td>$55</td>
<td>$55</td>
<td>~90%</td>
<td>Everything</td>
<td>None</td>
<td>100% Money Back</td>
<td>No</td>
<td>NA</td>
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<tr>
<td></td>
<td>$55-$91</td>
<td>$15</td>
<td>~10%</td>
<td>Supplements</td>
<td>48,000 word Distributor Agreement</td>
<td>82% Money Back</td>
<td>Yes</td>
<td>$30 (4)</td>
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<tr>
<td></td>
<td>$15</td>
<td>$15</td>
<td>~70%</td>
<td>Supplements</td>
<td>None</td>
<td>100% Money Back</td>
<td>No</td>
<td>$20 (4)</td>
</tr>
</tbody>
</table>

(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 ($82-57-10%*$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”

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.

Source: Herbalife Sales & Marketing Plan.
These Rules Do Not Limit Internal Consumption

- 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) (1)

- 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.
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)


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)

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


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

- 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 ≠ 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”
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.

### What Actually Happens

- **SL pays HLF $50**
- **25% distributor pays SL $75 for SRP$100 of product and resells at retail for $100**
- **HLF pays upline SL $25 Wholesale Commission**
- **25% distributor pays HLF $75 (ex fees) for SRP$100 of product**

### Herbalife P&L

<table>
<thead>
<tr>
<th></th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Sales</td>
<td>$100</td>
</tr>
<tr>
<td>Distributor Allowances</td>
<td>(50)</td>
</tr>
<tr>
<td>Product Sales</td>
<td>$50</td>
</tr>
</tbody>
</table>
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

- SL pays HLF $50

### What Actually Happens

- HLF pays upline SL $25 Wholesale Commission

### Corrected Herbalife P&L

- Retail Sales $100
- Wholesale Commissions (25)
- Distributor Allowances (25)
- Product Sales $50

### Corrected Herbalife P&L

- Retail Sales $100
- Wholesale Commissions (25)
- Distributor Allowances (25)
- 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.

Herbalife P&L
($ mms) 2008a 2011a

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

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.

73% Distributor Payout

1% MH Bonus
7% Production Bonus
15% Royalty Overrides
50% Discount (Retail Profit)

$797 million

1.8 billion

1 Actual results referenced in Herbalife’s 2008 10K, not including China.
Wholesale Commissions ≠ Retail Profit (cont’d)

Herbalife accounts for and refers to this as “Retail Profit”
We believe that all of Herbalife’s payments to distributors are Recruiting Rewards, regardless of what they are called by Herbalife, and should be accounted for as commissions in HLF’s operating expenses.
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.”

Wholesale Commissions are a Form of Recruiting Profit

- Retail Profit is profit on sales to Retail Customers, not other distributors. This interpretation is both intuitive and supported by the case law. (1)

- 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. (2)

- 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. (3)

---

(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 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 [Inc] (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:

<table>
<thead>
<tr>
<th>Wholesale Commissions</th>
<th>NSL &quot;Direct&quot; Retail Sales (1)</th>
<th>Wholesale Spread</th>
<th>Wholesale Comm.</th>
<th>% of NSLs (2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount Buyers</td>
<td>$497</td>
<td>25.0%</td>
<td>$124</td>
<td>27.0%</td>
</tr>
<tr>
<td>Small Retailers</td>
<td>1,124</td>
<td>15.0%</td>
<td>169</td>
<td>61.0%</td>
</tr>
<tr>
<td>Potential Sales Leaders</td>
<td>221</td>
<td>8.0%</td>
<td>18</td>
<td>12.0%</td>
</tr>
<tr>
<td><strong>Subtotal</strong></td>
<td><strong>$1,842</strong></td>
<td></td>
<td><strong>$311</strong></td>
<td></td>
</tr>
</tbody>
</table>

(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

Where It Shows Up In Herbalife’s P&L

- Discount
  - Distributor allowances
    - Royalty overrides
      - ~23% of Retail sales
    - Royalty overrides
      - ~50% of Retail sales
- Wholesale Commission
- Royalty Overrides
- Production Bonus
- Mark Hughes Bonus
- Vacations/ Promotions
- SG&A
  - ??% of Retail sales
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) (1)

Source: Herbalife public filings.
“Distributor Facing” Expenses

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

(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

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.
Quantifying Recruiting Rewards in SG&A

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.

<table>
<thead>
<tr>
<th>Recruiting Rewards in SG&amp;A $(mms)</th>
<th>2011a</th>
</tr>
</thead>
<tbody>
<tr>
<td>SG&amp;A</td>
<td>$1,075</td>
</tr>
<tr>
<td>% Distributor Facing expenses (1)</td>
<td>54%</td>
</tr>
<tr>
<td>Distributor Facing expenses</td>
<td>$582</td>
</tr>
<tr>
<td>% of Distributor Facing expenses</td>
<td></td>
</tr>
<tr>
<td>that are Recruiting Rewards (2)</td>
<td>50%</td>
</tr>
<tr>
<td>Recruiting Rewards in SG&amp;A</td>
<td>$291</td>
</tr>
</tbody>
</table>

(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

<table>
<thead>
<tr>
<th></th>
<th>2011a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distributor Allowances (1)</td>
<td>$2,492,300,000</td>
</tr>
<tr>
<td>Less: Internal Consumption</td>
<td>-</td>
</tr>
<tr>
<td>Less: Actual Retail Price adj.</td>
<td>-</td>
</tr>
<tr>
<td>Less: Wholesale Commissions</td>
<td>-</td>
</tr>
<tr>
<td><strong>Retail Profit</strong></td>
<td>$2,492,300,000</td>
</tr>
<tr>
<td>Avg distributors (2)</td>
<td>2,380,000</td>
</tr>
</tbody>
</table>

## Reality

<table>
<thead>
<tr>
<th></th>
<th>2011a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distributor Allowances (1)</td>
<td>$2,492,300,000</td>
</tr>
<tr>
<td>Less: Internal Consumption</td>
<td>(747,690,000)</td>
</tr>
<tr>
<td>Less: Actual Retail Price adj.</td>
<td>(1,289,631,000)</td>
</tr>
<tr>
<td>Less: Wholesale Commissions</td>
<td>(310,616,838)</td>
</tr>
<tr>
<td><strong>Retail Profit</strong></td>
<td>$144,362,162</td>
</tr>
<tr>
<td>Avg distributors (2)</td>
<td>2,380,000</td>
</tr>
</tbody>
</table>

## Retail Profit per Distributor:

<table>
<thead>
<tr>
<th></th>
<th>2011a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Per Year</td>
<td>$1,047</td>
</tr>
<tr>
<td>Per Month</td>
<td>$87</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2011a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Per Year</td>
<td>$61</td>
</tr>
<tr>
<td>Per Month</td>
<td>$5</td>
</tr>
</tbody>
</table>

---

*(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.*

---

**Using reasonable assumptions, the typical Herbalife distributor only earns $5 per month in Retail Profit (before taxes / expenses).**
### Summary:
**Recruiting Rewards are Greater than Retail Profit**

<table>
<thead>
<tr>
<th>HLF Representation</th>
<th>Reality</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Retail Sales (@ SRP) (1)</strong></td>
<td>Retail Sales (@ SRP) (1)</td>
</tr>
<tr>
<td>Amt.</td>
<td>$5,264</td>
</tr>
<tr>
<td>Pct.</td>
<td>100%</td>
</tr>
<tr>
<td>Distributor Allowances (1)</td>
<td>Distributor Allowances (1)</td>
</tr>
<tr>
<td>Amt.</td>
<td>$2,492</td>
</tr>
<tr>
<td>Pct.</td>
<td>47%</td>
</tr>
<tr>
<td>Less: Internal Consumption</td>
<td>Less: Internal Consumption (3)</td>
</tr>
<tr>
<td></td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>-</td>
</tr>
<tr>
<td>Less: Actual Retail Price adj.</td>
<td>Less: Actual Retail Price adj. (4)</td>
</tr>
<tr>
<td></td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>-</td>
</tr>
<tr>
<td>Less: Wholesale Commissions</td>
<td>Less: Wholesale Commissions (5)</td>
</tr>
<tr>
<td></td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>-</td>
</tr>
<tr>
<td><strong>Retail Profit</strong></td>
<td><strong>Retail Profit</strong></td>
</tr>
<tr>
<td>Amt.</td>
<td>$2,492</td>
</tr>
<tr>
<td>Pct.</td>
<td>47%</td>
</tr>
<tr>
<td>Royalty overrides (2)</td>
<td>Royalty overrides (2)</td>
</tr>
<tr>
<td>Amt.</td>
<td>$1,138</td>
</tr>
<tr>
<td>Pct.</td>
<td>22%</td>
</tr>
<tr>
<td>Plus: Wholesale Commissions</td>
<td>Plus: Wholesale Commissions (5)</td>
</tr>
<tr>
<td></td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>-</td>
</tr>
<tr>
<td>Plus: Rewards in SG&amp;A</td>
<td>Plus: Rewards in SG&amp;A (6)</td>
</tr>
<tr>
<td></td>
<td>-</td>
</tr>
<tr>
<td></td>
<td>-</td>
</tr>
<tr>
<td><strong>Recruiting Rewards</strong></td>
<td><strong>Recruiting Rewards</strong></td>
</tr>
<tr>
<td>Amt.</td>
<td>$1,138</td>
</tr>
<tr>
<td>Pct.</td>
<td>22%</td>
</tr>
<tr>
<td><strong>Payout Ratio</strong></td>
<td><strong>Payout Ratio</strong></td>
</tr>
<tr>
<td></td>
<td>69%</td>
</tr>
<tr>
<td>% of Payout that is Recruiting Rewards</td>
<td>% of Payout that is Recruiting Rewards</td>
</tr>
<tr>
<td></td>
<td>31%</td>
</tr>
</tbody>
</table>

(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

- Payout (per HLF): 69%
- Recruiting Rewards: 22%
- Retail Profit: 47%

- Payout (actual): 36%
  - Recruiting Rewards: 33%
  - Retail Profit: 3%

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

---

<table>
<thead>
<tr>
<th>Payout (per HLF)</th>
<th>Percent of Participants’ Income from Recruiting Rewards: 31%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recruiting Rewards:</td>
<td>22%</td>
</tr>
<tr>
<td>Retail Profit:</td>
<td>47%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Payout (actual)</th>
<th>Percent of Participants’ Income from Recruiting Rewards: 92%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recruiting Rewards:</td>
<td>33%</td>
</tr>
<tr>
<td>Retail Profit:</td>
<td>3%</td>
</tr>
</tbody>
</table>

---

Herbalife’s Compensation Plan Incentivizes Distributors to Recruit Aggressively

- 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

- 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?

**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

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.

Source: Declaration of Bruce H. Roth, sworn 5-18-09, in Herbalife Int’l of America, Inc. v. Ford et al., Case No. CV 07-2529 (U.S.D.C., C.D. Cal.).
Why Herbalife Distributors “Pay-for-your-Paycheck”
Herbalife’s Compensation Plan Revisited

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.
Herbalife’s compensation plan is based on two types of volume:

**Personal Volume**

- 25%
- 35%
- 42%

**Organization Volume**

- 50%
- 50%

“Personal Volume” is not exclusively personal.

0-5% Royalty; 2-7% Production Bonus

0-5% Royalty; 2-7% Production Bonus

0-5% Royalty; 2-7% Production Bonus

No Royalty; 2-7% Production Bonus

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.

<table>
<thead>
<tr>
<th>Personal Volume Requirement (monthly)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Royalty Override Scale</td>
</tr>
<tr>
<td>Your Total Volume Points</td>
</tr>
<tr>
<td>0–499</td>
</tr>
<tr>
<td>500–999</td>
</tr>
<tr>
<td>1,000–1,499</td>
</tr>
<tr>
<td>1,500–1,999</td>
</tr>
<tr>
<td>2,000–2,499</td>
</tr>
<tr>
<td>2,500 plus</td>
</tr>
</tbody>
</table>

Source: Herbalife Sales & Marketing Plan.
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
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.

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.

---

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…
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.

<table>
<thead>
<tr>
<th>Production Bonus %</th>
<th>GET 2%</th>
<th>Millionaire 4%</th>
<th>President’s 6%</th>
<th>20K 6.5%</th>
<th>30K 6.75%</th>
<th>50K 7%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Volume Points Required</td>
<td>5,000</td>
<td>3,000</td>
<td>2,500</td>
<td>2,500</td>
<td>2,500</td>
<td>2,500</td>
</tr>
<tr>
<td>Royalty Points Required for Max 2% TAB Team PB</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Royalty Points Required for Max 4% TAB Team PB</td>
<td>4,000</td>
<td>4,000</td>
<td>4,000</td>
<td>4,000</td>
<td>4,000</td>
<td>4,000</td>
</tr>
<tr>
<td>Royalty Points Required for Max 6% TAB Team PB</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Royalty Points Required for Max 6.5% TAB Team PB</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Royalty Points Required for Max 7% TAB Team PB</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Herbalife Sales & Marketing Plan.
Powell purchases just enough Personal Volume to earn his Production Bonus ("pay-for-his-paycheck")
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 \(^{(1)}\)

---

\(^{(1)}\) 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?

<table>
<thead>
<tr>
<th>Volume Points</th>
</tr>
</thead>
<tbody>
<tr>
<td>World Team (no Prod Bonus)</td>
</tr>
<tr>
<td>GET Team (5,000 PV for PB)</td>
</tr>
<tr>
<td>Millionaire Team (3,000 PV for PB)</td>
</tr>
<tr>
<td>PT (2,500)</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>VP requirement</th>
<th>2,500</th>
</tr>
</thead>
<tbody>
<tr>
<td>RS / VP</td>
<td>1.0x</td>
</tr>
<tr>
<td>RS requirement</td>
<td>$2,500</td>
</tr>
<tr>
<td>Discount</td>
<td>(50.0%)</td>
</tr>
<tr>
<td>Surcharge (1)</td>
<td>6.0%</td>
</tr>
<tr>
<td><strong>Cost for VPs</strong></td>
<td><strong>$1,400</strong></td>
</tr>
</tbody>
</table>

**Cost of 5% Royalties**

<table>
<thead>
<tr>
<th>Month</th>
<th>Pers. Volume</th>
<th>Org. Volume</th>
<th>Royalty Overrides</th>
<th>Pay-for-Royalties?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A</td>
<td>B</td>
<td>A*B=C</td>
<td>D</td>
</tr>
<tr>
<td>Oct-97</td>
<td>2,504</td>
<td>61,874</td>
<td>5.0%</td>
<td>$3,094</td>
</tr>
<tr>
<td>Nov-97</td>
<td>5,390</td>
<td>98,610</td>
<td>5.0%</td>
<td>4,930</td>
</tr>
<tr>
<td>Dec-97</td>
<td>2,553</td>
<td>56,698</td>
<td>5.0%</td>
<td>2,835</td>
</tr>
<tr>
<td>Jan-98</td>
<td>5,627</td>
<td>89,946</td>
<td>5.0%</td>
<td>4,497</td>
</tr>
<tr>
<td>Feb-98</td>
<td>2,656</td>
<td>48,446</td>
<td>5.0%</td>
<td>2,422</td>
</tr>
<tr>
<td>Mar-98</td>
<td>5,017</td>
<td>70,883</td>
<td>5.0%</td>
<td>3,544</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Month</th>
<th>Pers. Volume</th>
<th>Org. Volume (2)</th>
<th>Production Bonus</th>
<th>Pay-for-Prod Bonus?</th>
</tr>
</thead>
<tbody>
<tr>
<td>VP requirement</td>
<td>2,500</td>
<td>61,874 (Oct-97)</td>
<td>2.0%</td>
<td>$1,237</td>
</tr>
<tr>
<td>RS / VP</td>
<td>1.0x</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>RS requirement</td>
<td>$2,500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Discount</td>
<td>(50.0%)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Surcharge (1)</td>
<td>6.0%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cost for VPs</strong></td>
<td><strong>$1,400</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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**

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

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?

- 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
If I Can Do It

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

—Mark Hughes

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

**Ponzi Scheme**
- New investors must be found to redeem old investors
  - (Ponzi paid agents 10% commissions to find new “investors”)
- 50% interest in 45 days
  - (Ponzi convinced investors he could sustainably earn these returns through an arbitrage involving international reply coupons for stamps)

**Chain Letter**
- Participants must send the letter to [5] friends “to whom [they] wish prosperity to come”
- $0.10 gets you $1,562.50
  - (See: Prosperity Club Send-a-Dime Chain Letter)

**Pyramid Scheme**
- “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”
- “Misrepresentations of the income to be made through recruitment” (1)

---

(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.”
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

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.

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)

<table>
<thead>
<tr>
<th>Active Leaders</th>
<th>% of Total Leaders</th>
<th>% of Active Leaders</th>
<th>Average Earnings (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>President’s Team</td>
<td>0.2%</td>
<td>0.6%</td>
<td>$ 515,689</td>
</tr>
<tr>
<td>Millionaire Team</td>
<td>0.7%</td>
<td>1.7%</td>
<td>$ 100,195</td>
</tr>
<tr>
<td>GET</td>
<td>2.6%</td>
<td>6.5%</td>
<td>$ 22,766</td>
</tr>
<tr>
<td>World Team</td>
<td>2.9%</td>
<td>7.3%</td>
<td>$ 6,224</td>
</tr>
<tr>
<td>Supervisor</td>
<td>33.1%</td>
<td>83.9%</td>
<td>$ 901</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>39.4%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>$ 7,348</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>% of Total Distributors</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.04%</td>
</tr>
<tr>
<td>0.1%</td>
</tr>
<tr>
<td>0.5%</td>
</tr>
<tr>
<td>0.5%</td>
</tr>
<tr>
<td>5.9%</td>
</tr>
<tr>
<td><strong>7.0%</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Inactive Sales Leaders</th>
<th>60.6%</th>
<th>$ 0 (1)</th>
<th>10.7%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-Sales Leaders</td>
<td></td>
<td>$ 0</td>
<td>82.3%</td>
</tr>
<tr>
<td><strong>100.0%</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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


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.

<table>
<thead>
<tr>
<th>Earning Level</th>
<th>% of Total Leaders</th>
<th>% of Active Leaders</th>
<th>Average Earnings (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>President's Team</td>
<td>0.2%</td>
<td>0.6%</td>
<td>$ 315,089</td>
</tr>
<tr>
<td>Millionaire Team</td>
<td>0.7%</td>
<td>1.7%</td>
<td>$ 100,195</td>
</tr>
<tr>
<td>GET</td>
<td>2.6%</td>
<td>6.5%</td>
<td>$ 22,766</td>
</tr>
<tr>
<td>World Team</td>
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<td>7.3%</td>
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<tr>
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<td>83.9%</td>
<td>$ 901</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>39.4%</strong></td>
<td><strong>100.0%</strong></td>
<td><strong>$ 7,348</strong></td>
</tr>
</tbody>
</table>

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
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 (1).

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(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.

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

$2,713.85 GRAND TOTAL

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

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.

Herbalife cherry-picks the highest earning “Active” Supervisors for its distributor earnings disclosure.
Deception #4: “Over 25% of Distributors reach Supervisor”

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.
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

(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...
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?

North America Distributor Mix

<table>
<thead>
<tr>
<th></th>
<th>2009a</th>
<th>2010a</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Q1</td>
<td>Q2</td>
<td>Q3</td>
</tr>
<tr>
<td>New Sales Leaders</td>
<td>7,893</td>
<td>10,633</td>
<td>10,569</td>
</tr>
<tr>
<td>New distributors</td>
<td>50,738</td>
<td>59,712</td>
<td>58,586</td>
</tr>
</tbody>
</table>

Ratio of New Sales Leaders to New Distributors

In 2011, Herbalife stopped disclosing new Sales Leaders

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 TODAVÍA ESTÁ EN LA PRIMERA. Tiene usted miedo de dejar la primera base?
- Desafíese. ESTABLEZCA SUS METAS PROPIAS. Acuérdese 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”. “Olvídense 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

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.

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!”
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.

<table>
<thead>
<tr>
<th>Active Leaders</th>
<th>% of Total Leaders</th>
<th>% of Active Leaders</th>
<th>Average Earnings (EUR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>President’s Team</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0</td>
</tr>
<tr>
<td>Millionaire Team</td>
<td>0.0%</td>
<td>0.0%</td>
<td>0</td>
</tr>
<tr>
<td>GET</td>
<td>3.6%</td>
<td>8.4%</td>
<td>32,614</td>
</tr>
<tr>
<td>World Team</td>
<td>2.7%</td>
<td>6.3%</td>
<td>5,003</td>
</tr>
<tr>
<td>Supervisor</td>
<td>36.5%</td>
<td>85.3%</td>
<td>761</td>
</tr>
<tr>
<td>Total</td>
<td>42.8%</td>
<td>100.0%</td>
<td>EUR 3,711</td>
</tr>
</tbody>
</table>
There is almost no turnover at the top

Source: Herbalife Investor Day Presentation (Dec-2008).
From 2004 through 2009, we estimate that only one new President’s Team member was created for every 10,000 new distributors.

<table>
<thead>
<tr>
<th></th>
<th>2004a</th>
<th>2005a</th>
<th>2006a</th>
<th>2007a</th>
<th>2008a</th>
<th>2009a</th>
</tr>
</thead>
<tbody>
<tr>
<td>President's Team (1)</td>
<td>697</td>
<td>787</td>
<td>886</td>
<td>1,018</td>
<td>1,137</td>
<td>1,220</td>
</tr>
<tr>
<td>Non-PT SLs</td>
<td>274,182</td>
<td>298,341</td>
<td>333,114</td>
<td>401,925</td>
<td>450,418</td>
<td>455,638</td>
</tr>
<tr>
<td>Sales Leaders (2)</td>
<td>274,879</td>
<td>299,128</td>
<td>334,000</td>
<td>402,943</td>
<td>451,555</td>
<td>456,858</td>
</tr>
<tr>
<td>Non-Sales Leaders</td>
<td>796,000</td>
<td>825,000</td>
<td>899,000</td>
<td>1,163,793</td>
<td>1,153,291</td>
<td>1,296,236</td>
</tr>
<tr>
<td>Total Distributors (3)</td>
<td>1,070,879</td>
<td>1,124,128</td>
<td>1,233,000</td>
<td>1,566,736</td>
<td>1,604,846</td>
<td>1,753,094</td>
</tr>
</tbody>
</table>

**Churn**

<table>
<thead>
<tr>
<th></th>
<th>2004a</th>
<th>2005a</th>
<th>2006a</th>
<th>2007a</th>
<th>2008a</th>
<th>2009a</th>
</tr>
</thead>
<tbody>
<tr>
<td>President's Team (4)</td>
<td>(7)</td>
<td>(8)</td>
<td>(9)</td>
<td>(10)</td>
<td>(11)</td>
<td>(12)</td>
</tr>
<tr>
<td>Non-PT SLs</td>
<td>(105,244)</td>
<td>(120,611)</td>
<td>(121,669)</td>
<td>(146,072)</td>
<td>(177,702)</td>
<td>(188,297)</td>
</tr>
<tr>
<td>Sales Leaders</td>
<td>(105,251)</td>
<td>(120,619)</td>
<td>(121,678)</td>
<td>(146,082)</td>
<td>(177,713)</td>
<td>(188,309)</td>
</tr>
<tr>
<td>Non-Sales Leaders</td>
<td>(796,000)</td>
<td>(742,500)</td>
<td>(767,631)</td>
<td>(940,048)</td>
<td>(878,367)</td>
<td>(927,444)</td>
</tr>
<tr>
<td>Total Distributors</td>
<td>(901,251)</td>
<td>(863,119)</td>
<td>(889,309)</td>
<td>(1,086,130)</td>
<td>(1,056,080)</td>
<td>(1,115,753)</td>
</tr>
</tbody>
</table>

**Additions**

<table>
<thead>
<tr>
<th></th>
<th>2004a</th>
<th>2005a</th>
<th>2006a</th>
<th>2007a</th>
<th>2008a</th>
<th>2009a</th>
</tr>
</thead>
<tbody>
<tr>
<td>President's Team</td>
<td>97</td>
<td>107</td>
<td>141</td>
<td>129</td>
<td>94</td>
<td>93</td>
</tr>
<tr>
<td>Non-PT SLs</td>
<td>129,403</td>
<td>155,384</td>
<td>190,480</td>
<td>194,563</td>
<td>182,922</td>
<td>162,667</td>
</tr>
<tr>
<td>Sales Leaders (2)</td>
<td>129,500</td>
<td>155,491</td>
<td>190,621</td>
<td>194,694</td>
<td>183,016</td>
<td>162,760</td>
</tr>
<tr>
<td>Non-Sales Leaders</td>
<td>825,000</td>
<td>816,500</td>
<td>1,032,424</td>
<td>929,546</td>
<td>1,021,312</td>
<td>903,899</td>
</tr>
<tr>
<td>Total Distributors</td>
<td>954,500</td>
<td>971,991</td>
<td>1,223,045</td>
<td>1,124,240</td>
<td>1,204,328</td>
<td>1,066,659</td>
</tr>
</tbody>
</table>

**End of Period**

<table>
<thead>
<tr>
<th></th>
<th>2004a</th>
<th>2005a</th>
<th>2006a</th>
<th>2007a</th>
<th>2008a</th>
<th>2009a</th>
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<td>1,220</td>
<td>1,301</td>
</tr>
<tr>
<td>Non-PT SLs</td>
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<td>1,604,846</td>
<td>1,753,094</td>
<td>1,704,000</td>
</tr>
</tbody>
</table>

(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.
### 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)

<table>
<thead>
<tr>
<th>Members</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>President’s Team</td>
<td><img src="image" alt="1,220 Members" /></td>
</tr>
<tr>
<td>Millionaire Team</td>
<td><img src="image" alt="3,353 Members" /></td>
</tr>
<tr>
<td>GET Team</td>
<td><img src="image" alt="14,537 Members" /></td>
</tr>
<tr>
<td>The Bottom of the Pyramid</td>
<td><img src="image" alt="2,472,078 Members" /></td>
</tr>
</tbody>
</table>

### Members

- **President’s Team**: 1,220
- **Millionaire Team**: 3,353
- **GET Team**: 14,537
- **The Bottom of the Pyramid**: 2,472,078

---

(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.

---

The bottom of the pyramid would require 47 PowerPoint slides.
The probability of a new distributor getting to these levels is statistically insignificant

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.

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

<table>
<thead>
<tr>
<th>Active Leaders</th>
<th>% of Total Leaders</th>
<th>% of Active Leaders</th>
<th>Average Earnings (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>President’s Team</td>
<td>0.2%</td>
<td>0.6%</td>
<td>$515,889</td>
</tr>
<tr>
<td>Millionaire Team</td>
<td>0.7%</td>
<td>1.7%</td>
<td>$100,105</td>
</tr>
<tr>
<td>GET</td>
<td>2.6%</td>
<td>6.5%</td>
<td>$22,766</td>
</tr>
<tr>
<td>World Team</td>
<td>2.9%</td>
<td>7.3%</td>
<td>$6,224</td>
</tr>
<tr>
<td>Supervisor</td>
<td>33.1%</td>
<td>83.9%</td>
<td>$901</td>
</tr>
<tr>
<td>Total</td>
<td>39.4%</td>
<td>100.0%</td>
<td>$7,348</td>
</tr>
</tbody>
</table>

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
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.

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(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.
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

What are “Unfair or Deceptive Practices”?

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.

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.
“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

- 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

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

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 (8th 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

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 1/10th 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 grow 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.”

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.

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.

<table>
<thead>
<tr>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>The rewards of working from home are worth it</td>
</tr>
</tbody>
</table>

| Your shot at lasting wealth |

- $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 ?

- $2,300/mo by month 4
- $6,000/mo by month 13
- $10,000/mo by month 16
- $5,500/mo by month 10
- $7,000/mo by month 18
- Six-figures/yr by month ?
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.

**Probability of reaching the top:** ~1/1000

Anybody Can Do It? An Illustration

- **Year 1:** Base turns over – top stays the same
  - Probability of reaching the top: ~1/1000

- **Year 2:** Base turns over – top stays the same
  - Probability of reaching the top: ~1/2000

- **Year 3:** Base turns over – top stays the same
  - Probability of reaching the top: ~1/3000

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.


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

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 (9th 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 (9th 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 (7th Cir.), cert denied 310 U.S. 632 (1940)).
State Laws on Earning Claims by MLMs

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.”

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.”

“Your Results May Vary”
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.”

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**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.”

---

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Now, she’s healthy and has the freedom to travel to places she could never have imagined, and help others live healthier, happier lives.

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*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.

*We obtained questionnaires generated responses from more than 230 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.*
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.105

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:

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.

Summary on FTC website:
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.
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

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):

> 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.”
“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
“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.

A History of Lawsuits

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.
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.


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

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.”).
“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
“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
“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
“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
"... 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
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
“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 (1)

Average: 49%

(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.
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.

<table>
<thead>
<tr>
<th>Downline Level</th>
<th>Avon (% Net Sales)</th>
<th>Avon (% Retail Sales)</th>
<th>Herbalife (% Retail Sales)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(As Reported)</td>
<td>(As Adjusted)</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>15.0%</td>
<td>10.0%</td>
<td>5.0%</td>
</tr>
<tr>
<td>2</td>
<td>5.0%</td>
<td>3.3%</td>
<td>5.0%</td>
</tr>
<tr>
<td>3</td>
<td>2.0%</td>
<td>1.3%</td>
<td>5.0%</td>
</tr>
<tr>
<td>Levels 1 to 3</td>
<td>22.0%</td>
<td>14.7%</td>
<td>15.0%</td>
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<tr>
<td>4 to ∞</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Payout</td>
<td>22.0%</td>
<td>14.7%</td>
<td>23.0%</td>
</tr>
</tbody>
</table>

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:

Level 1: $200
Level 2: $400
Level 3: $800
Level 4: $1,600

Total Payout: $280

Total Payout: $44

(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

Retail Sales

Source: Herbalife filings.

Not separately disclosed after 2005

Retail Sales

Source: Herbalife filings.

Not separately disclosed after 2001
Spain: 1990–2001

Source: Herbalife filings.
France: 1990–2001

Source: Herbalife filings.

Not separately disclosed after 2001

Retail Sales

($mm)


Source: Herbalife filings.

Not separately disclosed after 2001
Russia: 1995–2001

Retail Sales

Source: Herbalife filings.

Not separately disclosed after 2001
Even Within the N. American Market, It’s a Story of “Pop” Latino Nutrition Clubs vs. “Drop” ‘Core’ N. American Base

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

Source: Herbalife filings.
HLF re-classified the countries that comprise the America's region four times in the last five years.

### Geographic Presence in The Americas

<table>
<thead>
<tr>
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<td>Ecuador</td>
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<td>Honduras</td>
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<tr>
<td>Guatemala</td>
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<tr>
<td>Aruba</td>
<td>2010</td>
<td>NA</td>
<td>NA</td>
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</tbody>
</table>

### Classification

- **The Americas**
  - North America
  - South America/Southeast Asia
  - Mexico/Central America
  - South America
  - South/Central America

In 2006, South America was grouped with Southeast Asia.

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(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 \(^{(1)}\)

GDP Per Capita

(\$000s)

\(\text{U.S.} \quad \text{Lebanon} \quad \text{Romania} \quad \text{Bulgaria} \quad \text{Belarus} \quad \text{Ecuador} \quad \text{Paraguay} \quad \text{Georgia} \quad \text{Guatemala} \quad \text{Mongolia} \quad \text{Honduras} \quad \text{Ghana} \quad \text{Vietnam} \quad \text{Nicaragua} \quad \text{Aruba}\)

\(^{(1)}\) Source: The World Bank. Based on 2011 estimates.
\(^{(2)}\) GDP Per Capita for Aruba not available.
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
“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
Herbalife Portrays Nutrition Clubs as Vibrant, Retail Channels...

Source: Herbalife’s Today Magazine

Join the Club!

“Nutrition Clubs in commercial locations are a great way to build a stable customer base and downline.” - Lori Menz, Jacksonville, FL

Source: Herbalife 2012 Investor Day Presentation

Two women holding cups of Herbalife products and smiling.
...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

Source: Herbalife 2012 Investor Day Presentation

Formula 1 Positioned as a Meal

Replacement spending vs. discretionary

VS.
“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

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
Our Research Revealed a Different Experience
Our Research Revealed a Different Experience
Our Research Revealed a Different Experience
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Our Research Revealed a Different Experience
Our Research Revealed a Different Experience
Our Research Revealed a Different Experience

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

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
Herbalife Imposes Many Constraints on its Club Operators’ Ability to Retail Product (cont’d.)

- No product or other promotional displays visible from the exterior
- No advertising nor attracting any traffic
- Must cover windows to ensure interior of Club is not visible
- Must not state, imply, or suggest any retail products available for purchase

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

- Not a retail store, nor a restaurant

- No prices or charges for product servings

- Always use disposable cups

- “Members”, not others, only allowed to leave premises with limited carry-outs if in “small, unbranded” containers

“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

Rule 5-C: Must ensure the interior of the Club is not visible, by use of window coverings

Rule 1-N: Always use disposable cups to serve complimentary beverages

Source: Herbalife Today Magazine
Source: Herbalife 2012 Investor Day Presentation
Herbalife Claims its Competition is Fast Food

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:

- 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”

Units in Mexico (1)

- Herbalife: 40,660
- Burger King: 408
- McDonald’s: 396
- Starbucks: 360

(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

<table>
<thead>
<tr>
<th>Population per Unit (1)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>HLF</strong></td>
</tr>
<tr>
<td><strong>Top 15 QSRs in U.S. Combined</strong></td>
</tr>
</tbody>
</table>

| GDP per Capita | MX: $14,800 | US: $49,000 |

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 (1)

Why are sales at the “competition” not impacted by the exponential expansion of HLF’s Nutrition Clubs?

Nutrition Clubs in Mexico (Est.) (2)

(1) Source: Herbalife filings, Burger King. Represents Herbalife “retail” sales.
(2) Pershing Square estimates, per Herbalife filings, presentations, and transcripts.
“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?

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

What is the Real Purpose of the Nutrition Clubs?

May 2, 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 retrench 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…

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”.

Avon
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 (1).

<table>
<thead>
<tr>
<th>Source: Herbalife Response Letter to SEC (2011)</th>
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<tbody>
<tr>
<td>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.</td>
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<tr>
<td>Company Response:</td>
</tr>
<tr>
<td>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 handling costs for 2010, 2009 and 2008 were $58 million, $49 million and $48 million, respectively.</td>
</tr>
</tbody>
</table>

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 (1).

(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

(1) Source: Herbalife filings and SEC response letter dated April 21, 2011.
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
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

Disclosed Number of Properties

<table>
<thead>
<tr>
<th>Company</th>
<th>Number of Properties</th>
</tr>
</thead>
<tbody>
<tr>
<td>Herbalife</td>
<td>5</td>
</tr>
<tr>
<td>Energizer</td>
<td>32</td>
</tr>
<tr>
<td>Church and Dwight</td>
<td>34</td>
</tr>
<tr>
<td>Ralcorp</td>
<td>40</td>
</tr>
<tr>
<td>Clorox</td>
<td>44</td>
</tr>
</tbody>
</table>

(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?

- **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\(^{(1)}\)

- **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”

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\(^{(1)}\) 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)\(^{(1)}\)

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\(^{(2)}\)

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\(^{(1)}\) Returns were 0.4% of Retail Sales in 2011. Source: Herbalife Investor Presentation (May 2012).

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

- 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

- 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

- 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.
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

- 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.\(^{(1)}\)

- Limited distributor sophistication and the financial incentive to falsify certifications make it likely that many distributors lack the proper records to return product.

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Distributor Frustration

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...

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

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 (9th 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.

*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.

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?

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

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 (9th Cir. 1996).
How Much Financial Harm Has Herbalife Caused?

Number of People Harmed

$\times$

Net Losses per Person

Total Net Losses

319
How Many Sales Leaders Have Failed?

- 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 opportunity¹

  - The Company provides detailed Sales Leader statistics between 2004 and 2012;

  - Using this data, we estimate that in the 2006-2012 period ~1.1mm Sale Leaders failed² and left the business, a ~90% failure rate³

---

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).

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.

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

$2,713.85

- $991.26 Product purchases

$1,723 Total non-product expenses

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

Senior distributors have profitable side businesses by selling leads at high prices to low-level distributors eager to grow their downlines.

Source: Online Business Systems (Herbalife affiliate) distributor presentation.
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.

- 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.

Source: Jacobs v Herbalife International, Inc., Case No. CV-02-1431 (U.S.D.J., C.D. Cal.)
We estimate that the average failed Sales Leader has $2,000 of expenses, net of minimal retail and/or recruiting profit.

### Summary Cost Analysis

<table>
<thead>
<tr>
<th>Item</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>Waisbein Presentation</td>
<td>$1,275+</td>
</tr>
<tr>
<td>Itemized Business Support Materials</td>
<td>$1,700 – Non-Sales Leader</td>
</tr>
<tr>
<td>Cost to Open a Nutrition Club</td>
<td>$5,000 - $6,000</td>
</tr>
<tr>
<td>“Newest Way to Wealth”</td>
<td>$10,000 = Average</td>
</tr>
</tbody>
</table>

### 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.

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(1) Herbalife Statement of Gross Compensation 2011. Our analysis includes active and inactive Sales Leaders.
Have Much Have Failed Sales Leaders Lost?

1.9mm = People Harmed

$2k = Net Losses per Person

$3.8bn = Total Net Losses Since 1980

This estimate does not include harm done to the ~10mm¹ former Non-Sales Leader distributors. As such, we think the true financial damage Herbalife has inflicted is materially higher than $3.8bn

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(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

Video Clip:

http://www.pscmhlflibrary.com/herbalife-cnbc-clips/
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 year¹
The chart shows how pyramid schemes can become impossible to sustain:

- Levels 1-3: 1.6, 2.36
- Levels 4-5: 3.216, 4.1296
- Levels 6-7: 5.12, 6.1776
- Levels 8-9: 6.46, 8.192
- Levels 10-11: 9.679, 12.9906
- Levels 12-13: 15.169, 21.2544

- More than the U.S. Population: 362,797,056
- More than the World Population: 2,176,782,336

**Conclusion**
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