HERBALIFE LTD.
Form 10-Q
May 01, 2008

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2008

OR

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission file number: 1-32381

HERBALIFE LTD.
(Exact name of registrant as specified in its charter)

Cayman Islands	**98-0377871**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

P.O. Box 309GT
Ugland House, South Church Street
Grand Cayman, Cayman Islands
(Address of principal executive offices) (Zip code)
(310) 410-9600
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ Accelerated filer o Non-accelerated filer o Smaller reporting company o
(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ

Number of shares of registrant s common shares outstanding as of April 28, 2008 was 65,114,740.

HERBALIFE LTD.

PART I. FINANCIAL INFORMATION

Item 1.	Financial Statements	3
	Unaudited Consolidated Balance Sheets	3
	Unaudited Consolidated Statements of Income	4
	Unaudited Consolidated Statements of Cash Flows	5
	Notes to Unaudited Consolidated Financial Statements	6
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	18
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	33
Item 4.	Controls and Procedures	35
	Forward Looking Statements	35

PART II. OTHER INFORMATION

Item 1.	Legal Proceedings	36
Item 1.a.	Risk Factors	36
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	51
Item 3.	Defaults Upon Senior Securities	51
Item 4.	Submission of Matters to a Vote of Security Holders	51
Item 5.	Other Information	51
Item 6.	Exhibits	51
Signatures and Certifications		57

EXHIBIT 31.1
EXHIBIT 31.2
EXHIBIT 32.1

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. ***FINANCIAL STATEMENTS***

HERBALIFE LTD.

CONSOLIDATED BALANCE SHEETS

	March 31, 2008 (Unaudited)	December 31, 2007
	(In thousands, except share amounts)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 191,146	$ 187,407
Receivables, net of allowance for doubtful accounts of $7,963 (2008) and $7,863 (2007)	74,105	58,729
Inventories, net	126,512	128,648
Prepaid expenses and other current assets	89,727	72,193
Deferred income taxes	41,366	40,119
Total current assets	522,856	487,096
Property, at cost, net of accumulated depreciation and amortization of $77,821 (2008) and $66,000 (2007)	135,724	121,027
Deferred compensation plan assets	18,986	19,315
Deferred financing costs, net of accumulated amortization of $925 (2008) and $807 (2007)	2,352	2,395
Marketing related intangibles	310,060	310,060
Goodwill	111,481	111,477
Other assets	16,439	15,873
Total assets	$ 1,117,898	$ 1,067,243
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$ 33,131	$ 35,377
Royalty overrides	126,654	127,227
Accrued compensation	47,309	54,067
Accrued expenses	136,445	114,083
Current portion of long-term debt	3,856	4,661
Advance sales deposits	18,424	11,599
Income taxes payable	30,035	28,604

Total current liabilities	395,854	375,618
NON-CURRENT LIABILITIES:		
Long-term debt, net of current portion	329,855	360,491
Deferred compensation	19,978	20,233
Deferred income taxes	108,087	107,584
Other non-current liabilities	21,177	21,073
Total liabilities	874,951	884,999
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS EQUITY:		
Common shares, $0.002 par value, 500.0 million shares authorized, 65.0 million (2008) and 64.4 million (2007) shares issued and outstanding	130	129
Paid-in-capital in excess of par value	188,582	160,872
Accumulated other comprehensive loss	(3,909)	(3,947)
Retained earnings	58,144	25,190
Total shareholders equity	242,947	182,244
Total liabilities and shareholders equity	$ 1,117,898	$ 1,067,243

See the accompanying notes to consolidated financial statements

3

Table of Contents

HERBALIFE LTD.

CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended	
	March 31, 2008	**March 31, 2007**
	(Unaudited) (In thousands, except per share amounts)	
Product sales	$ 520,726	$ 437,993
Handling & freight income	83,711	70,106
Net sales	604,437	508,099
Cost of sales	117,666	107,283
Gross profit	486,771	400,816
Royalty overrides	212,720	180,260
Selling, general and administrative expenses	184,400	149,428
Operating income	89,651	71,128
Interest expense, net	3,791	2,204
Income before income taxes	85,860	68,924
Income taxes	23,493	27,744
NET INCOME	$ 62,367	$ 41,180
Earnings per share:		
Basic	$ 0.97	$ 0.57
Diluted	$ 0.93	$ 0.55
Weighted average shares outstanding:		
Basic	64,381	71,722
Diluted	67,200	74,943

See the accompanying notes to consolidated financial statements

HERBALIFE, LTD.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	March 31, 2008	March 31, 2007
	(Unaudited) (In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 62,367	$ 41,180
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,371	8,263
Stock-based compensation expense	5,133	3,482
Excess tax benefits from share-based payment arrangements	(10,709)	(1,321)
Amortization of discount and deferred financing costs	118	76
Deferred income taxes	(92)	3,951
Unrealized foreign exchange loss	1,926	2,474
Write-off of deferred financing costs and unamortized discounts		204
Other	556	887
Changes in operating assets and liabilities:		
Receivables	(13,843)	3,025
Inventories	7,734	15,174
Prepaid expenses and other current assets	(16,482)	(10,312)
Other assets	(77)	(103)
Accounts payable	(3,182)	(13,441)
Royalty overrides	(4,156)	(12,858)
Accrued expenses and accrued compensation	4,965	(14,254)
Advance sales deposits	6,242	(4,350)
Income taxes payable	12,184	23,860
Deferred compensation liability	(255)	163
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 62,800	$ 46,100
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property	(23,931)	(9,060)
Proceeds from sale of property		36
Deferred compensation plan assets	330	(395)
NET CASH USED IN INVESTING ACTIVITIES	$ (23,601)	$ (9,419)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments on long-term debt	(32,099)	(31,301)
Dividends paid	(12,869)	
Increase in deferred financing costs	(75)	

Share repurchases	(17,668)	
Proceeds from stock options exercised	12,553	976
Excess tax benefits from share-based payment arrangements	10,709	1,321
NET CASH USED IN FINANCING ACTIVITIES	$ (39,449)	$ (29,004)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	3,989	207
NET CHANGE IN CASH AND CASH EQUIVALENTS	3,739	7,884
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	187,407	154,323
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 191,146	$ 162,207
CASH PAID FOR:		
Interest	$ 4,976	$ 3,270
Income taxes	$ 11,411	$ 7,737
NON-CASH ACTIVITIES:		
Acquisitions of property through capital leases	$ 657	$ 47

See the accompanying notes to consolidated financial statements

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization

Herbalife Ltd. (and together with its subsidiaries, Herbalife or the Company) is a leading global network marketing company that sells weight management, nutritional supplements, energy & fitness products and personal care products through a network of over 1.8 million independent distributors, except in China, where the Company currently sells its products through retail stores and an employed sales force. The Company reports revenue in five geographic regions: North America, which consists of the U.S., Canada and Jamaica; Mexico and Central America, which consists of Mexico, Costa Rica, El Salvador, Panama and Dominican Republic; South America, which includes Brazil; EMEA, which includes Europe, the Middle East and Africa; and Asia Pacific, which includes Asia, New Zealand and Australia.

2. Basis of Presentation

The unaudited interim financial information of the Company has been prepared in accordance with Article 10 of the Securities and Exchange Commission s Regulation S-X. Accordingly, it does not include all of the information required by generally accepted accounting principles, or GAAP, in the U.S. for complete financial statements. The Company s unaudited consolidated financial statements as of March 31, 2008, and for the three months ended March 31, 2008 and 2007, include Herbalife and all of its direct and indirect subsidiaries. In the opinion of management, the accompanying financial information contains all adjustments, consisting of normal recurring adjustments, necessary to present fairly the Company s unaudited consolidated financial statements as of March 31, 2008, and for the three months ended March 31, 2008 and 2007. These unaudited consolidated financial statements should be read in conjunction with Company s Annual Report on Form 10-K for the year ended December 31, 2007. Operating results for the three months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

New Accounting Pronouncements

In March 2008, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards, or SFAS, No. 161, *Disclosures about Derivative Instruments and Hedging Activities An Amendment of FASB Statement No. 133*, or SFAS 161. SFAS 161 expands the disclosure requirements for derivative instruments and hedging activities. This Statement specifically requires entities to provide enhanced disclosures addressing the following: (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity s financial position, financial performance, and cash flows. SFAS 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 161 on the Company s consolidated financial statements.

In February 2008, the FASB issued FASB Staff Position FAS 157-2, or FSP FAS 157-2. FSP FAS 157-2 will delay the effective date of SFAS 157, *Fair Value Measurement,* or SFAS 157, for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). FSP FAS 157-2 partially defers the effective date of SFAS 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of FSP 157-2. The

Company is currently evaluating the potential impact, if any, of the application of FSP FAS 157-2 to its nonfinancial assets and nonfinancial liabilities on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations*, or SFAS 141R, which replaces FASB Statement No. 141. SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non controlling interest in the acquiree and the goodwill acquired. SFAS 141R also modifies the recognition for preacquisition contingencies, such as environmental or legal issues, restructuring plans and acquired research and development value in purchase accounting. SFAS 141R amends SFAS 109, *Accounting for Income Taxes*, to require the acquirer to recognize changes in the amount of its deferred tax benefits that are recognizable because of a

Table of Contents

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

business combination either in income from continuing operations in the period of the combination or directly in contributed capital, depending on the circumstances. SFAS 141R also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. SFAS 141R is effective as of the beginning of an entity s fiscal year that begins after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 141R on the Company s consolidated financial statements.

Adoption of New Accounting Standards

In September 2006, the FASB issued SFAS No. 157,which defines fair value, establishes a framework for measuring fair value in accordance with GAAP and expands disclosures about fair value measurements. The provisions of SFAS 157 are effective for fiscal years beginning after November 15, 2007. In February 2008, the FASB issued FASB Staff Position, FAS 157-1, or FSP FAS 157-1. FSP 157-1 amends SFAS 157 to exclude SFAS 13, *Accounting for Leases*, and its related interpretive accounting pronouncements that address leasing transactions. On January 1, 2008, the Company adopted the provisions of SFAS 157 related to its financial assets and liabilities, except as it applies to those nonfinancial assets and nonfinancial liabilities as noted in FSP FAS 157-2. The adoption did not have a material impact on the Company s consolidated financial statements.

SFAS No. 157, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). SFAS 157 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 inputs are unobservable inputs for the asset or liability.

The Company measures certain assets and liabilities at fair value as discussed throughout the notes to its consolidated financial statements. Assets or liabilities that have recurring measurements and are measured at fair value are shown below:

Fair Value Measurements at Reporting Date Using

	Quoted Prices in Active Markets for Identical	Significant Other Observable	Significant Unobservable

Description	March 31, 2008	Assets (Level 1)	Inputs (Level 2)	Inputs (Level 3)
		(In millions)		
Financial Liabilities:				
Forward exchange contracts	$ (5.4)	$	$ (5.4)	$
Interest rate swap	(2.5)		(2.5)	
Total financial liabilities	$ (7.9)	$	$ (7.9)	$

In January 2008, the Company adopted SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, or SFAS 159, which permits entities to choose to measure many financial instruments, and

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

certain other items, at fair value. SFAS 159 also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. The adoption of SFAS No. 159 did not have a material impact on the Company s consolidated financial statements.

In January 2008, the Company adopted FASB Staff Position No. FIN 39-1, *Amendment of FASB Interpretation No. 39*, or FSP FIN 39-1. FSP FIN 39-1 modifies FIN No. 39, *Offsetting of Amounts Related to Certain Contracts* and permits companies to offset cash collateral receivables or payables with net derivative positions under certain circumstances. The adoption of FSP FIN 39-1 did not have a material impact on the Company s consolidated financial statements.

Reclassifications

Certain reclassifications were made to the prior period financial statements to conform to current period presentation.

3. Long-Term Debt

Long-term debt consists of the following:

	As of March 31, 2008	As of December 31, 2007
	(In millions)	
Borrowings under senior credit facility	$ 326.7	$ 357.1
Capital leases	6.6	7.4
Other debt	0.4	0.7
Total	333.7	365.2
Less: current portion	3.8	4.7
Long-term portion	$ 329.9	$ 360.5

On July 21, 2006, the Company entered into a $300.0 million senior secured credit facility, comprised of a $200.0 million term loan and a $100.0 million revolving credit facility, with a syndicate of financial institutions as lenders and replaced the $225.0 million senior secured credit facility, originally entered into on December 21, 2004. The term loan bears interest at LIBOR plus a margin of 1.5%, or the base rate, which represents the prime rate offered by major U.S. banks, plus a margin of 0.50%, and matures on July 21, 2013. The revolving credit facility bears interest at LIBOR plus a margin of 1.25%, or the base rate, which represents the prime rate offered by major U.S. banks, plus a margin of 0.25%, and is available until July 21, 2012.

The Company incurred approximately $2.3 million of debt issuance costs in connection with entering into the new credit facility in July 2006, which are being amortized over the term of the new credit facility.

On August 23, 2006, the Company borrowed $200.0 million pursuant to the term loan under the new credit facility to fund the redemption of its 91/2% Notes due 2011 under the old credit facility. In September 2006, the Company prepaid $20.0 million of its new term loan borrowings. In March 2007, the Company made another prepayment of $29.5 million and expensed approximately $0.2 million of related unamortized deferred financing costs. As of March 31, 2008 and December 31, 2007, the amounts outstanding under the term loan were $148.0 million and $148.4 million, respectively.

In September 2007, the Company and its lenders amended the credit agreement governing the new credit facility, increasing the amount of its current revolving credit facility by an aggregate principal amount of $150.0 million to finance the increase in the share repurchase program (see Note 11 of the notes to unaudited

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

consolidated financial statements for further discussion on the share repurchase program). During 2007, the Company borrowed an aggregate amount of $293.7 million under the revolving credit facility to fund its share repurchase program and paid $85.0 million of the revolving credit facility. During the first quarter of 2008, the Company paid $30.0 million of the revolving credit facility. As of March 31, 2008 and December 31, 2007, the amounts outstanding under the revolving credit facility were $178.7 million and $208.7 million, respectively.

Through the course of conducting regular operations, certain vendors may require letters of credit to be issued in order to secure insurance policies or goods that are purchased. As of March 31, 2008 and December 31, 2007, the Company had no outstanding letters of credit.

4. Contingencies

The Company is from time to time engaged in routine litigation. The Company regularly reviews all pending litigation matters in which it is involved and establishes reserves deemed appropriate by management for these litigation matters when a probable loss estimate can be made.

Herbalife International and certain of its independent distributors have been named as defendants in a purported class action lawsuit filed February 17, 2005, in the Superior Court of California, County of San Francisco, and served on Herbalife International on March 14, 2005 *(Minton v. Herbalife International, et al).* The case was transferred to the Los Angeles County Superior Court. The plaintiff is challenging the marketing practices of certain Herbalife International independent distributors and Herbalife International under various state laws prohibiting endless chain schemes, insufficient disclosure in assisted marketing plans, unfair and deceptive business practices, and fraud and deceit. The plaintiff alleges that the Freedom Group system operated by certain independent distributors of Herbalife International products places too much emphasis on recruiting and encourages excessively large purchases of product and promotional materials by distributors. The plaintiff also alleges that Freedom Group pressured distributors to disseminate misleading promotional materials. The plaintiff seeks to hold Herbalife International vicariously liable for the actions of its independent distributors and is seeking damages and injunctive relief. On January 24, 2007, the Superior Court denied class certification of all claims, except for the claim under California law prohibiting endless chain schemes. That claim was granted California class certification, provided that class counsel is able to substitute in as a plaintiff a California resident with claims typical of the class. The Company believes that it has meritorious defenses to the suit.

Herbalife International and certain of its distributors were defendants in a class action lawsuit filed July 16, 2003, in the Circuit Court of Ohio County in the State of West Virginia *(Mey v. Herbalife International, Inc., et al).* The complaint alleged that certain telemarketing practices of certain Herbalife International distributors violated the Telephone Consumer Protection Act, or TCPA, and sought to hold Herbalife International vicariously liable for the practices of its independent distributors. More specifically, the plaintiffs complaint alleged that several of Herbalife International s distributors used pre-recorded telephone messages and faxes to contact prospective customers in violation of the TCPA s prohibition of such practices. Without in any way acknowledging liability or wrongdoing by the Company or its independent distributors, the Company and the other defendants have reached a binding settlement with the plaintiffs. Under the terms of the settlement, the defendants collectively paid $7 million into a fund to be distributed to qualifying class members. The relevant amount paid by the Company was previously fully reserved in the Company s financial statements. The settlement received the final approval of the Court in January 2008.

As a marketer of dietary and nutritional supplements and other products that are ingested by consumers or applied to their bodies, the Company has been and is currently subjected to various product liability claims. The effects of these claims to date have not been material to the Company, and the reasonably possible range of exposure on currently existing claims is not material to the Company. The Company believes that it has meritorious defenses to the allegations contained in the lawsuits. The Company currently maintains product liability insurance with an annual deductible of $10 million.

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Certain of the Company s subsidiaries have been subject to tax audits by governmental authorities in their respective countries. In certain of these tax audits, governmental authorities are proposing that significant amounts of additional taxes and related interest and penalties are due. The Company and its tax advisors believe that there are substantial defenses to their allegations that additional taxes are owed, and the Company is vigorously contesting the additional proposed taxes and related charges.

These matters may take several years to resolve, and the Company cannot be sure of their ultimate resolution. However, it is the opinion of management that adverse outcomes, if any, will not likely result in a material adverse effect on the Company s financial condition and operating results. This opinion is based on the belief that any losses suffered in excess of amounts reserved would not be material, and that the Company has meritorious defenses. Although the Company has reserved an amount that the Company believes represents the most likely outcome of the resolution of these disputes, if the Company is incorrect in the assessment the Company may have to record additional expenses.

5. Comprehensive Income

	Three Months Ended	
	March 31, 2008	March 31, 2007
	(In millions)	
Net income	$ 62.4	$ 41.2
Unrealized loss on derivative instruments, net of tax	(0.9)	(0.1)
Foreign currency translation adjustment	1.0	(0.3)
Comprehensive income	$ 62.5	$ 40.8

6. Segment Information

The Company is a network marketing company that sells a wide range of weight management products, nutritional supplements and personal care products within one industry segment as defined under SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. The Company s products are primarily manufactured by third party providers and then sold to independent distributors who sell Herbalife products to retail consumers or other distributors.

The Company sells products in 65 countries throughout the world and is organized and managed by geographic regions. The Company aggregates its operating segments into one reporting segment, as management believes that the Company s operating segments have similar operating characteristics and similar long term operating performance. In making this determination, management believes that the operating segments are similar in the nature of the products sold, the product acquisition process, the types of customers products are sold to, the methods used to distribute the products, and the nature of the regulatory environment.

Revenues reflect sales of products to distributors based on the distributors geographic location.

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

In late 2007, the Company changed its geographic regions from seven to five regions as part of the Company s on-going Realignment for Growth plan. These changes were intended to create growth opportunities for distributors, support faster decision making across the organization by reducing the number of layers of management, improve the sharing of ideas and tools and accelerate growth in the Company s high potential markets. Historical information presented related to the Company s geographic regions has been reclassified to conform with its current geographic presentation. The Company s reporting segment s operating information and sales by product line are as follows:

	Three Months Ended	
	March 31, 2008	March 31, 2007
	(In millions)	
Net Sales:		
United States	$ 114.0	$ 99.7
Mexico	93.6	94.0
Others	396.8	314.4
Total Net Sales	$ 604.4	$ 508.1
Operating Margin(1):		
United States	$ 47.2	$ 36.1
Mexico	38.8	36.2
Others	188.1	148.2
Total Operating Margin	$ 274.1	$ 220.5
Selling, general and administrative expenses	$ 184.4	$ 149.4
Interest expense, net	3.8	2.2
Income before income taxes	85.9	68.9
Income taxes	23.5	27.7
Net Income	$ 62.4	$ 41.2

	As of	
	March 31, 2008	December 31, 2007
	(In millions)	
Total Assets:		
United States	$ 675.6	$ 668.6

Mexico	67.8	62.3
Others	374.5	336.3
Total Assets	$ 1,117.9	$ 1,067.2

Table of Contents

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

During the quarter ended June 30, 2007, the Company reorganized its product categories to add one more product line in order to better reflect its current product offerings. Historical information presented related to the Company product lines has been reclassified to conform to the current product line presentation.

	Three Months Ended (In millions)	
	March 31, 2008	March 31, 2007
Net sales by product line:		
Weight Management	$ 380.8	$ 320.7
Targeted Nutrition	125.6	103.0
Energy & Fitness	24.0	20.4
Outer Nutrition	40.2	36.4
Literature, promotional and other(2)	33.8	27.6
Total Net Sales	$ 604.4	$ 508.1
Net sales by geographic region:		
North America(3)	$ 118.6	$ 104.5
Mexico & Central America(4)	97.6	95.9
South America(5)	102.0	60.9
EMEA(6)	158.0	143.2
Asia Pacific(7)	128.2	103.6
Total Net Sales	$ 604.4	$ 508.1

(1) Operating margin consists of net sales less cost of sales and royalty overrides.

(2) Product buybacks and returns in all product categories are included in the literature, promotional and other category.

(3) Consists of the U.S., Canada and Jamaica.

(4) Consists of Mexico, Costa Rica, El Salvador, Panama and Dominican Republic.

(5) Includes Brazil.

(6) Includes Europe, Middle East and Africa.

(7) Includes Asia, New Zealand and Australia.

7. Stock Based Compensation

The Company has five stock-based compensation plans, the WH Holdings (Cayman Islands) Ltd. Stock Incentive Plan, or the Management Plan, the WH Holdings (Cayman Islands) Ltd. Independent Directors Stock Incentive Plan, or the Independent Directors Plan, the Herbalife Ltd. 2004 Stock Incentive Plan, or the 2004 Stock Incentive Plan, the Herbalife Ltd. 2005 Stock Incentive Plan, or the 2005 Stock Incentive Plan, and the Herbalife Ltd. Independent Directors Deferred Compensation and Stock Unit Plan, or the Independent Director Stock Unit Plan. The Management Plan provides for the grant of options to purchase common shares of Herbalife to members of the Company s management. The Independent Directors Plan provides for the grant of options to purchase common shares of Herbalife to the Company s independent directors. The 2004 Stock Incentive Plan replaced the Management Plan and the Independent Directors Plan and after the adoption thereof, no additional awards were made under either the Management Plan or the Independent Directors Plan. However, the shares remaining available for issuance under these plans were absorbed by and became available for issuance under the 2004 Stock

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Incentive Plan. The terms of the 2005 Stock Incentive Plan are substantially similar to the terms of the 2004 Stock Incentive Plan. The 2005 Stock Incentive Plan authorizes the issuance of 4,000,000 common shares pursuant to awards, plus any shares that remained available for issuance under the 2004 Stock Incentive Plan at the time of the adoption of the 2005 Stock Incentive Plan. The purpose of the Independent Directors Stock Unit Plan is to facilitate equity ownership in the Company by its independent directors through the award of stock units and to allow for deferral by the independent directors of compensation realized in connection with such stock units. The Company s stock compensation awards outstanding as of March 31, 2008 include stock options, stock appreciation rights, or SARS, and stock units.

The Company records compensation expense over the requisite service period which is equal to the vesting period. For awards granted prior to January 1, 2006, compensation expense is recognized on a graded-vesting basis over the vesting term. For awards granted on or after January 1, 2006, compensation expense is recognized on a straight-line basis over the vesting term. Stock-based compensation expense is included in selling, general and administrative expenses in the consolidated statements of income. For the three months ended March 31, 2008 and 2007, stock-based compensation expenses amounted to $5.1 million and $3.5 million, respectively, and the related income tax benefits recognized in earnings amounted to $1.9 million and $1.2 million, respectively.

As of March 31, 2008, the total unrecognized compensation cost related to non-vested stock awards was $71.5 million and the related weighted-average period over which it is expected to be recognized is approximately 2.0 years.

For the three months ended March 31, 2008 and 2007, excess tax benefits of $11.2 million and $1.3 million, respectively, were generated from option exercises.

The Company s stock-based compensation plans provide for grants of stock options, SARS, and stock units, which are collectively referred to herein as awards. Stock options typically vest quarterly over a five-year period beginning on the grant date, and certain stock option grants vest over a period of less than five years. Certain SARS vest quarterly over a five-year period beginning on the grant date. Other SARS vest annually over a three-year period. The contractual term of stock options and SARS is ten years. Stock unit awards under the 2005 Incentive Plan, or Incentive Plan Stock Units, vest annually over a three year period which is equal to the contractual term. Stock units awarded under the Independent Directors Stock Unit Plan, or Independent Director Stock Units, vest at a rate of 25% on each January 15, April 15, July 15 and October 15. In March 2008, the Company granted stock unit awards to its Chairman and Chief Executive Officer, which vest over a four-year period at a rate of 30% during each of the first three years and 10% during the fourth year. Unless otherwise determined at the time of grant, the value of each stock unit shall be equal to one common share of Herbalife.

In March 2008, the Company granted SARS with market conditions to its Chairman and Chief Executive Officer which will fully vest at the end of four years subject to his continued employment through that date and the achievement of certain conditions related to the market value of the Company s common stock. The market conditions include targets for stock price appreciation of both a 10% and a 15% compound annual growth rate.

With the exception of awards with market conditions, the fair value of each award is estimated on the date of grant using the Black-Scholes-Merton option-pricing model based on the assumptions in the following tables. The expected term of the award is based on the simple average of the average vesting period and the life of the award because of the

limited historical data. All groups of employees have been determined to have similar historical exercise patterns for valuation purposes. The expected volatility of stock awards is primarily based upon the historical volatility of the Company s common shares and, due to the limited period of public trading data for its common shares, it is also validated against the volatility rates of a peer group of companies. The risk free interest rate is based on the implied yield on a U.S. Treasury zero-coupon issue with a remaining term equal to the expected term of the award. The dividend yield reflects that the Company has not historically paid regular cash dividends from inception to the first quarter of 2007. Dividends paid by the predecessor company in 2002 and prior and special

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

dividends paid in 2004 in connection with the Company s initial public offering have been excluded from the calculation. Commencing in the second quarter of 2007, the board of directors approved a regular quarterly dividend program and the Company declared a $0.20 per share cash dividend for each of the consecutive four quarters. However, there is no guarantee that the board of directors will not terminate the quarterly dividend program.

There were no stock options granted during the three months ended March 31, 2008 and 2007. The following table summarizes the weighted average assumptions used in the calculation of fair market value for SARS and stock units granted during the three months ended March 31, 2008 and 2007:

	SARS Three Months Ended March 31,		Incentive Plan Stock Units Three Months Ended March 31,		Independent Directors Stock Units Three Months Ended March 31,	
	2008	2007	2008	2007	2008	2007
Expected volatility	39.48%		39.45%		39.73%	41.82%
Dividends yield	2.00%		zero		zero	zero
Expected term	5.8 years		2.7 years		3.0 years	3.0 years
Risk-free interest rate	2.56%		1.83%		2.49%	5.00%

The following tables summarize the activity under the stock-based compensation plans for the three months ended March 31, 2008:

Stock Options & SARS	Shares (In thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value (In millions)
Outstanding at December 31, 2007	8,159	$ 20.80		
Granted	1,486	45.88		
Exercised	(1,009)	12.68		
Forfeited	(25)	26.43		
Outstanding at March 31, 2008	8,611	$ 26.07	7.0 years	$ 185.4
Exercisable at March 31, 2008	3,593	$ 17.49	5.8 years	$ 107.8

Incentive Plan and Independent Directors Stock Units	**Shares (In thousands)**	**Weighted Average Grant Date Fair Value**	**Aggregate Fair Value (In millions)**
Outstanding and nonvested at December 31, 2007	273.9	$ 38.40	$ 10.5
Granted	398.5	44.76	17.8
Vested	(27.6)	32.67	(0.9)
Cancelled	(4.3)	39.13	(0.1)
Outstanding and nonvested at March 31, 2008	640.5	$ 42.60	$ 27.3

The weighted-average grant date per share fair value of stock awards granted during the three months ended March 31, 2008 and 2007 was $21.58 and $32.01, respectively. The total intrinsic value of stock awards exercised during the three months ended March 31, 2008 and 2007 was $32.9 million and $3.9 million, respectively.

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Employee Stock Purchase Plan

During 2007, the Company adopted a qualified employee stock purchase plan, or ESPP, which was implemented during the first quarter of 2008. In connection with the adoption of the ESPP, the Company has reserved for issuance a total of 1 million common shares. Under the terms of the ESPP, rights to purchase common shares may be granted to eligible qualified employees subject to certain restrictions. The ESPP enables the Company s eligible employees, through payroll withholdings, to purchase a limited number of common shares at 85% of the fair market value of a common share at the purchase date. Purchases are made on a quarterly basis.

8. Income Taxes

As of March 31, 2008, the total amount of unrecognized tax benefits, related interest and penalties was $41.1 million, $8.5 million and $3.3 million, respectively. During the three months ended March 31, 2008, the Company recorded tax, interest and penalties related to uncertain tax positions of $0.7 million, $0.3 million and $1.5 million, respectively. The unrecognized tax benefits relate primarily to uncertainties from international transfer pricing issues and the deductibility of certain operating expenses in various jurisdictions. If the total amount of unrecognized tax benefits was recognized, $34.7 million of unrecognized tax benefits, $8.5 million of interest and $3.3 million of penalties, would impact the effective tax rate and $6.4 million would result in an increase to goodwill.

During the three months ended March 31, 2008, the Company benefited from the terms of a tax holiday in the People s Republic of China. The tax holiday commenced on January 1, 2008 and will terminate on December 31, 2012. Under the terms of the holiday, the Company is subject to a zero tax rate in China during the 2008 and 2009 years and a concessionary tax rate in China for the remaining years included in the holiday period.

9. Derivative Instruments and Hedging Activities

Interest Rate Risk Management

The Company engages in an interest rate hedging strategy for which the hedged transactions are forecasted interest payments on the Company s variable rate term loan. The hedged risk is the variability of forecasted interest rate cash flows, where the hedging strategy involves the purchase of interest rate swaps. For the outstanding cash flow hedges on interest rate exposures at March 31, 2008 the maximum length of time over which the Company is hedging these exposures is less than two years.

Under its current credit facility, the Company is obligated to enter into interest rate hedges for up to 25% of the aggregate principal amount of the term loan for a minimum of three years. On August 23, 2006, the Company entered into a new interest rate swap agreement. The agreement provides for the Company to pay interest for a three-year period at a fixed rate of 5.26% on various notional amounts while receiving interest for the same period at the LIBOR rate on the same notional principal amounts. The swap has been designated as a cash flow hedge against the variability in LIBOR interest rate on the new term loan at LIBOR plus 1.50%, thereby fixing the Company s effective rate on the notional amounts at 6.76%. The Company formally assesses, both at inception and at least quarterly thereafter, whether the derivatives used in hedging transactions are effective in offsetting changes in cash flows of the hedged item. As of March 31, 2008 and December 31, 2007, the hedge relationship qualified as an effective hedge

under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Consequently, all changes in the fair value of the derivative are deferred and recorded in other comprehensive income until the related forecasted transaction is recognized in the consolidated statements of income. The fair value of the interest rate swap agreement is based on third-party bank quotes and the Company recorded the interest rate swap as a liability at fair value of $2.5 million and $1.4 million as of March 31, 2008 and December 31, 2007, respectively.

Table of Contents

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

Foreign Currency Instruments

The Company also designates certain derivatives, such as foreign currency forward contracts, as freestanding derivatives for which hedge accounting does not apply. The changes in the fair market value of the derivatives are included in selling, general and administrative expenses in the Company s consolidated statements of income. The Company uses foreign currency forward contracts to hedge foreign-currency-denominated intercompany transactions and to partially mitigate the impact of foreign currency fluctuations. The fair value of the forward contracts are based on third-party bank quotes. As of March 31, 2008, all of the Company s outstanding foreign exchange forward contracts have maturity dates of one year or less. See Part I, Item 3 *Quantitative and Qualitative Disclosures About Market Risk* in this Quarterly Report on Form 10-Q for foreign currency instruments outstanding as of March 31, 2008.

10. Restructuring Reserve

In July 2006, the Company initiated its realignment of its employee base as part of the first phase of its Realignment for Growth plan and during the fourth quarter of 2007, the Company initiated the second phase of its Realignment for Growth plan. The Company recorded $0.4 million and $1.5 million of professional fees, severance and related costs for the three months ended March 31, 2008 and 2007, respectively, related to the Realignment for Growth plan. All such amounts were included in selling, general and administrative expenses.

The Company expects to complete its Realignment for Growth plan in 2008 and estimates that the corresponding severance and related cost that will be incurred for the full 2008 fiscal year will be approximately $3.0 million to $5.0 million.

The following table summarizes the components of this reserve as of March 31, 2008 (in millions):

	Severance	Retention Benefits	Others	Total
Balance as of December 31, 2007	$ 2.9	$	$ 0.6	$ 3.5
Charges	0.4			0.4
Cash payments	1.6		0.2	1.8
Balance as of March 31, 2008	$ 1.7	$	$ 0.4	$ 2.1

11. Shareholders Equity

Dividends

During the second quarter of 2007, the Company s board of directors adopted a regular quarterly cash dividend program. On January 31, 2008, the Company s Board of Directors approved a quarterly cash dividend of $0.20 per

common share in an aggregate amount of $12.9 million, for the fourth quarter of 2007 that was paid to shareholders of record on March 14, 2008.

Share Repurchases

On April 18, 2007, the Company s board of directors authorized the repurchase of up to $300 million of the Company s common shares during the next two years, at such times and prices as determined by Company management, as market conditions warrant. On August 23, 2007, the Company s board of directors approved an increase of $150 million to its previously authorized share repurchase program raising the total value of Company common shares authorized to be repurchased to $450 million. During the quarter ended March 31, 2008, the Company repurchased approximately 0.4 million of its common shares through open market purchases at an aggregate cost of $17.7 million or an average cost of $39.28 per share.

Table of Contents

HERBALIFE LTD.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(Unaudited)

12. Earnings Per Share

Basic earnings per share represents net income for the period common shares were outstanding, divided by the weighted average number of common shares outstanding for the period. Diluted earnings per share represents net income divided by the weighted average number of shares outstanding, inclusive of the effect of dilutive securities such as outstanding stock options and warrants.

The following are the share amounts used to compute the basic and diluted earnings per share for each period (in thousands):

	For the Three Months Ended March 31,	
	2008	2007
Weighted average shares used in basic computations	64,381	71,722
Dilutive effect of exercise of options outstanding	2,497	2,972
Dilutive effect of warrants	322	249
Weighted average shares used in diluted computations	67,200	74,943

Options to purchase 1.5 million and 0.3 million common shares were outstanding during the three months ended March 31, 2008 and 2007, respectively, but were not included in the computation of diluted earnings per share because the option exercise prices were greater than the average market price of a common share and therefore such options would be anti-dilutive.

Table of Contents

Item 2. *MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

Overview

Herbalife is a global network marketing company that sells weight management, nutritional supplements, energy & fitness products and personal care products. We pursue our mission of changing people s lives by providing a financially rewarding business opportunity to distributors and quality products to distributors and their customers who seek a healthy lifestyle. We are one of the largest network marketing companies in the world with net sales of approximately $2.1 billion for the year ended December 31, 2007. As of March 31, 2008, we sell our products in 65 countries through a network of over 1.8 million independent distributors except in China, where we sell our products through retail stores and an employed sales force. We believe the quality of our products and the effectiveness of our distribution network, coupled with geographic expansion, have been the primary reasons for our success throughout our 28-year operating history. Unless otherwise noted, the terms we, our, us, Company and Herbalife refer to Herbalife Ltd. and its subsidiaries.

During the quarter ended June 30, 2007, we reorganized our product categories to better reflect how our distributors sell products and programs. Our products are grouped in four principal categories: weight management, targeted nutrition, energy & fitness and Outer Nutrition. Our products are often sold in programs that are comprised of a series of related products designed to simplify weight management and nutrition for consumers and maximize our distributors cross-selling opportunities.

Industry-wide factors that affect us and our competitors include the increasing prevalence of obesity and the aging of the worldwide population, which are driving demand for nutrition and wellness-related products and the recruitment and retention of distributors.

The opportunities and challenges upon which we are most focused are: retailing of our products, recruitment and retention of distributors, improving distributor productivity, entering new markets, further penetrating existing markets including China, globalizing successful distributor methods of operation such as Nutrition Clubs, introducing new products, developing niche market segments and further investing in our infrastructure.

In late 2007, we changed our geographic regions from seven to five regions as part of our on-going Realignment for Growth plan. This updated regional structure allows us to better support the distributor leadership and enhance synergies within the regions. Under the new geographic regions, we report revenue from:

- North America, which consists of the U.S., Canada and Jamaica;
- Mexico and Central America, which consists of Mexico, Costa Rica, El Salvador, Panama and Dominican Republic;
- South America, including Brazil;
- EMEA, which includes Europe, the Middle East and Africa; and
- Asia Pacific, which includes Asia, New Zealand and Australia.

Historical information presented in this Quarterly Report on Form 10-Q relating to our geographic regions has been reclassified to conform with our current geographic presentation.

Table of Contents

Volume Points by Geographic Region

A key non-financial measure we focus on is Volume Points on a Royalty Basis, or Volume Points, which is essentially our weighted unit measure of product sales volume. It is a useful measure for us, as it excludes the impact of foreign currency fluctuations and ignores the differences generated by varying retail pricing across geographic markets. In general, an increase in Volume Points in a particular geographic region or country indicates an increase in local currency net sales.

	For the Three Months Ended March 31,		
	2008	2007	% Change
	(Volume points in millions)		
North America	178.1	162.2	9.8%
Mexico & Central America	154.7	154.8	(0.1)%
South America	112.2	83.1	35.0%
EMEA	137.1	140.4	(2.4)%
Asia Pacific	127.0	110.2	15.2%
Worldwide	709.1	650.7	9.0%

Number of New Sales Leaders by Geographic Region during the Reporting Period

Another key non-financial measure on which we focus is the number of distributors qualified as new sales leaders under our compensation system. Excluding China, distributors qualify for supervisor status based on their Volume Points. The growth in the number of new sales leaders is a general indicator of the level of distributor recruitment, which generally drives net sales in a particular country or geographic region.

	For the Three Months Ended March 31,		
	2008	2007	% Change
North America	9,010	9,008	0.0%
Mexico & Central America	7,644	7,181	6.4%
South America	12,491	8,877	40.7%
EMEA	6,533	7,642	(14.5)%
Asia Pacific (excluding China)	8,777	9,354	(6.2)%
Total New Supervisors	44,455	42,062	5.7%
New China Sales Employees	4,350	2,164	101.0%
Worldwide Total New Sales Leaders	48,805	44,226	10.4%

Number of Supervisors and Retention Rates by Geographic Region as of Requalification Period

Our compensation system requires each supervisor to re-qualify for such status each year, prior to February, in order to maintain their 50% discount on product and be eligible to receive royalty payments. In February of each year, we demote from the rank of supervisor those distributors who did not satisfy the supervisor re-qualification requirements during the preceding twelve months. The re-qualification requirement does not apply to new supervisors (i.e. those who became supervisors subsequent to the January re-qualification of the prior year).

Supervisor Statistics (Excluding China)	**2008**	**2007**
	(In thousands)	
January 1 total supervisors	451.6	400.6
January & February new supervisors	28.6	26.7
Demoted supervisors (did not requalify)	(167.7)	(135.9)
Other supervisors (resigned, etc)	(2.8)	(1.4)
End of February total supervisors	309.7	290.0

The distributor statistics below further highlight the calculation for retention.

Supervisor Retention (Excluding China)	2008	2007
	(In thousands)	
Supervisors needed to requalify	284.0	236.2
Demoted supervisors (did not requalify)	(167.7)	(135.9)
Total requalified	116.3	100.3
Retention rate	41.0%	42.5%

The table below reflects the number of sales leaders as of February (subsequent to the annual re-qualification date) and supervisor retention rate by year and by region.

	Number of Sales Leaders		Supervisor Retention Rate	
	2008	2007	2008	2007
North America	64,383	54,314	43.5%	43.1%
Mexico & Central America	62,418	62,683	44.4%	55.2%
South America	66,075	51,302	34.4%	32.9%
EMEA	59,446	64,862	46.6%	46.2%
Asia Pacific (excluding China)	57,355	56,871	34.3%	35.0%
Total Supervisors	309,677	290,032	41.0%	42.5%
China Sales Employees	25,294	8,759		
Worldwide Total Sales Leaders	334,971	298,791		

The number of supervisors by geographic region as of the quarterly reporting dates will normally be higher than the number of supervisors by geographic region as of the requalification period because supervisors who do not re-qualify during the relevant twelve-month period will be dropped from the rank of supervisor the following February. Since supervisors purchase most of our products for resale to other distributors and consumers, comparisons of supervisor totals on a year-to-year, same period basis are good indicators of our recruitment and retention efforts in different geographic regions.

The value of the average monthly purchase of Herbalife products by our sales leaders has remained relatively constant over time. Consequently, increases in our sales are driven primarily by our retention of supervisors and by our recruitment and retention of distributors, rather than through increases in the productivity of our overall supervisor base.

We provide distributors with products, support materials, training, special events and a competitive compensation program. If a distributor wants to pursue the Herbalife business opportunity, the distributor is responsible for growing

his or her business and personally pays for the sales activities related to attracting new customers and recruiting distributors by hosting events such as Herbalife Opportunity Meetings or Success Training Seminars; by advertising Herbalife s products; by purchasing and using promotional materials such as t-shirts, buttons and caps; by utilizing and paying for direct mail and print material such as brochures, flyers, catalogs, business cards, posters and banners and telephone book listings; by purchasing inventory for sale or use as samples; and by training, mentoring and following up (in person or via the phone or internet) with customers and recruits on how to use Herbalife products and/or pursue the Herbalife business opportunity.

Presentation

Retail sales represent the gross sales amounts on our invoices to distributors before distributor allowances, as defined below, and Net sales, which reflect distribution allowances and handling and freight income, represent what we collect and recognize as net sales in our financial statements. We discuss retail sales because of its fundamental role in our compensation systems, internal controls and operations, including its role as the basis upon which distributor discounts, royalties and bonuses are awarded. In addition, it is used as the basis for certain

information included in daily and monthly reports reviewed by our management. However, such a measure is not in accordance with Generally Accepted Accounting Principles in the U.S., or GAAP. You should not consider retail sales in isolation from, nor as a substitute for, net sales and other consolidated income or cash flow statement data prepared in accordance with GAAP, or as a measure of profitability or liquidity. A reconciliation of net sales to retail sales is presented below under Results of Operations. 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 approximate 50% of retail sales prices. Distributor allowances as a percentage of retail sales may vary by country depending upon regulatory restrictions that limit or otherwise restrict distributor allowances.

Our gross profit consists of net sales less cost of sales, which represents the prices we pay to our raw material suppliers and manufacturers of our products as well as costs related to product shipments, duties and tariffs, freight expenses relating to shipment of products to distributors and importers and similar expenses.

Royalty overrides are our most significant expense and consist of:

- royalty overrides and production bonuses which total approximately 15% and 7%, respectively, of the retail sales of weight management, targeted nutrition, energy & fitness, Outer Nutrition and promotional products;

- the Mark Hughes bonus payable to some of our most senior distributors in the aggregate amount of up to 1% of retail sales of weight management, targeted nutrition, energy & fitness and Outer Nutrition; and

- other discretionary incentive cash bonuses to qualifying distributors.

Royalty overrides are generally earned based on retail sales and approximate in the aggregate about 22% of retail sales or approximately 36% of our net sales. Royalty overrides together with distributor allowances represent the potential earnings to distributors of up to approximately 73% of retail sales. The compensation to distributors is generally for the development, retention and improved productivity of their distributor sales organizations and is paid to several levels of distributors on each sale. Due to restrictions on direct selling in China, our full-time employed sales representatives in China are compensated with wages, bonuses and benefits instead of the distributors earnings, distributor allowances and royalty overrides. Because of local country regulatory constraints, we may be required to modify our typical distributor incentive plans as described above. Consequently, the total distributor discount percentage may vary over time. We also offer reduced distributor allowances and pay reduced royalty overrides with respect to certain products worldwide.

Our operating margins consist of net sales less cost of sales and royalty overrides.

Selling, general and administrative expenses represent our operating expenses, components of which include labor and benefits, sales events, professional fees, travel and entertainment, distributor marketing, occupancy costs, communication costs, bank fees, depreciation and amortization, foreign exchange gains and losses and other miscellaneous operating expenses.

Most of our sales to distributors outside the United States are made in the respective local currencies. In preparing our financial statements, we translate revenues into U.S. dollars using average exchange rates. Additionally, the majority of our purchases from our suppliers generally are made in U.S. dollars. Consequently, a strengthening of the U.S. dollar versus a foreign currency can have a negative impact on our reported sales and operating margins and can generate transaction losses on intercompany transactions. Throughout the last five years, foreign currency exchange rates have fluctuated significantly. From time to time, we enter into foreign exchange forward contracts to mitigate our foreign currency exchange risk as discussed in further detail in Part I, Item 3 *Quantitative and Qualitative Disclosures about Market Risk.*

Summary Financial Results

Net sales for the three months ended March 31, 2008 increased 19.0% to $604.4 million from $508.1 million for the same period in 2007. The increase was primarily due to growth in several of the Company s top countries including, the U.S., Venezuela, China, and Italy with increases of 14.3%, 299.6%, 111.5% and 29.7%, respectively, as compared to the same period in 2007. The increase in these countries reflects a robust supervisor base, the continued success of our distributors with various operating methods like the Nutrition Club DMO, Internet/Sampling DMO and Wellness Coach DMO, and distributor momentum from our recent sales extravaganzas. Overall, the

Table of Contents

appreciation of foreign currencies had a $36.3 million favorable impact on net sales for the three months ended March 31, 2008, representing 37.7% of the total net sales increase of $96.3 million.

Net income for the three months ended March 31, 2008 increased 51.5% to $62.4 million, or $0.93 per diluted share, compared to $41.2 million, or $0.55 per diluted share, for the same period in 2007. The increase was driven by revenue growth in many of our markets, expansion in operating profit margins, and a lower effective tax rate, partially offset by higher labor costs, sales events costs, advertising and promotion expenses and depreciation expense.

Net income for the three months ended March 31, 2007 included a $1.0 million unfavorable after tax impact in connection with the Realignment for Growth plan and a $3.6 million charge for an increase in tax reserve.

Results of Operations

Our results of operations for the periods described below are not necessarily indicative of results of operations for future periods, which depend upon numerous factors, including our ability to recruit new distributors and retain existing distributors, open new markets, further penetrate existing markets, introduce new products and programs that will help our distributors increase their retail efforts and develop niche market segments.

The following table sets forth selected results of our operations expressed as a percentage of net sales for the periods indicated.

	Three Months Ended	
	March 31, 2008	March 31, 2007
Operations:		
Net sales	100.0%	100.0%
Cost of sales	19.5	21.1
Gross profit	80.5	78.9
Royalty overrides	35.2	35.5
Selling, general and administrative expenses	30.5	29.4
Operating income	14.8	14.0
Interest expense, net	0.6	0.4
Income before income taxes	14.2	13.6
Income taxes	3.9	5.5
Net income	10.3%	8.1%

Table of Contents

Three months ended March 31, 2008 compared to three months ended March 31, 2007

Net Sales

The following chart reconciles retail sales to net sales:

Sales by Geographic Region

	Three Months Ended March 31,										
	2008					2007					
	Retail Sales	Distributor Allowance	Product Sales	Handling & Freight Income	Net Sales	Retail Sales	Distributor Allowance	Product Sales	Handling & Freight Income	Net Sales	Chang in Net Sales
	(Dollars in millions)										
rth America	$ 189.5	$ (90.2)	$ 99.3	$ 19.3	$ 118.6	$ 168.4	$ (80.2)	$ 88.2	$ 16.3	$ 104.5	13.5
xico & ntral erica	163.6	(80.0)	83.6	14.0	97.6	161.3	(78.4)	82.9	13.0	95.9	1.8
uth America	184.8	(95.2)	89.6	12.4	102.0	102.7	(49.4)	53.3	7.6	60.9	67.5
EA	257.0	(124.2)	132.8	25.2	158.0	234.1	(112.7)	121.4	21.8	143.2	10.3
a Pacific	198.9	(83.5)	115.4	12.8	128.2	164.7	(72.6)	92.1	11.5	103.6	23.7
rldwide	$ 993.8	$ (473.1)	$ 520.7	$ 83.7	$ 604.4	$ 831.2	$ (393.3)	$ 437.9	$ 70.2	$ 508.1	19.0

Changes in net sales are directly associated with the recruiting and retention of our distributor force, retailing of our products, the quality and completeness of the product offerings that the distributor force has to sell and the number of countries in which we operate. Management s role, both in-country and at the corporate level is to provide distributors with a competitive and broad product line, encourage strong teamwork and leadership among the Chairman s Club and President s Team distributors and offer leading edge business tools to make doing business with Herbalife simple. Management uses the distributor marketing program coupled with educational and motivational tools and promotions to incentivize distributors to increase recruiting, retention and retailing, which in turn affect net sales. Such tools include Company sponsored sales events such as Extravaganzas and World Team Schools where large groups of distributors gather, thus allowing them to network with other distributors, learn recruiting, retention and retailing techniques from our leading distributors and become more familiar with how to market and sell our products and business opportunities. Accordingly, management believes that these development and motivation programs increase the productivity of the supervisor network. The expenses for such programs are included in selling, general and administrative expenses. Sales are driven by several factors, including the number and productivity of distributors and supervisors who continually build, educate and motivate their respective distribution and sales organizations. We also use event and non-event product promotions to motivate distributors to increase recruiting, retention and retailing activities. These promotions have prizes ranging from qualifying for events to product prizes and vacations. The costs of these promotions are included in selling, general and administrative expenses.

The factors described above have helped distributors increase their business, which in turn has driven growth in our business. The discussion below of net sales by geographic region further details some of the above factors and describes unique growth factors specific to certain major countries. We believe that the correct business foundation,

coupled with ongoing training and promotional initiatives, is required to increase recruiting and retention of distributors and retailing our products. The correct business foundation includes strong country management that works closely with the distributor leadership, unified distributor leadership, a broad product line that appeals to local consumer needs, a favorable regulatory environment, a scalable and stable technology platform and an attractive distributor marketing plan. Initiatives, such as Success Training Seminars, World Team Schools, Promotional Events and regional Extravaganzas, are integral components of developing a highly motivated and educated distributor sales organization that will work toward increasing the recruitment and retention of distributors.

Our strategy will continue to include creating and maintaining growth within existing markets, while expanding into new markets. We expect to increase our spending in selling, general and administrative expenses to maintain or stimulate sales growth, while making strategic investments in new initiatives and in new markets. In addition, new ideas and DMOs are being generated in our regional markets and globalized where applicable, either by distributors, country management or corporate management. Examples of DMOs include the Nutrition Clubs in Mexico, the Total Plan in Brazil, the Wellness Coach in France and the Internet/Sampling in the U.S. Management s

Table of Contents

strategy is to review the applicability of expanding successful country initiatives throughout a region, and where appropriate, financially support the globalization of these initiatives.

North America

The North America region reported net sales of $118.6 million for the three months ended March 31, 2008. Net sales increased $14.1 million, or 13.5%, for the three months ended March 31, 2008, as compared to the same period in 2007. In local currency, net sales increased by 12.9% for the three months ended March 31, 2008, as compared to the same period in 2007. The fluctuation of foreign currency rates had a positive impact of $0.6 million on n