

FINAL TRANSCRIPT

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HLF - HERBALIFE LTD Guidance Announcement

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PRESENTATION

Operator

Good morning and thank you for joining today's conference call to discuss the current business trends and updated 2007 guidance for Herbalife Limited. On the call today is Michael O. Johnson, the Company's CEO; Greg Probert, the Company's President and COO, and Rich Goudis, the CFO. I would now like to turn the call over to Rich Goudis, the Company's General Counsel, to read the Company's Safe Harbor language.

Rich Goudis - Herbalife Ltd. - CFO

Thank you. Brett has got a cold, so I am going to read the Safe Harbor language before we get on with the call. Before we begin, as a reminder, during this conference call, comments may be made that include some forward-looking statements. These statements involve risk and uncertainty as you know. Actual results may differ materially from those discussed or anticipated. We encourage you to refer to yesterday's press release and in our SEC filings for a complete discussion of risks associated with these forward-looking statements and our business.

In addition, during this call, certain financial information and measures may be discussed that differ from comparable measures contained in our financial statement prepared in accordance with the U.S. generally accepted accounting principles referred to as the SEC as non-GAAP financial measures. We believe that these non-GAAP financial measures assist management and investors in evaluating and comparing period-to-period results of operations in a more meaningful and consistent manner.

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Please refer to our investor relations section of our website at Herbalife.com to find our recent press releases, which contain a reconciliation of these measures. Now let me turn it over to our Chief Executive Officer, Michael.

Michael Johnson - Herbalife Ltd. - CEO

Thanks, Rich and what Rich really meant to say was Brett is in the other room taking his Best Defense to ward off his cold that is starting. I want to thank everyone for joining our investor update call this morning. There are four basic reasons why we wanted to have this call today.

First, we wanted to announce to our distributors that we achieved really a fantastic goal, a goal that we have all been very excited about and that is the goal of \$3 billion in retail sales. We wanted to do this now rather than waiting for our fourth-quarter earnings release in late February. This is such a really tremendous accomplishment. It reflects the hard work of our distributors, their commitment to our mission and the success of their daily methods of operation, which we call DMOs. It also reflects the strength of the business environment which we operate.

Our products address global megatrends in health; worldwide obesity of epidemic, as well as the increasing emphasis on the role of weight management, nutrition and energy in general health and fitness. Congratulations to all those distributors who are on this call; really a magnificent achievement.

Second, we wanted to update you on the growing pains we are experiencing in our largest market, Mexico and the steps we are taking to overcome issues that we have identified. As many of you know, Mexico has been an incredible catalyst for our growth, providing nearly half of our 20% growth rate in both 2005 and 2006.

In Mexico, there are three primary issues, somewhat interrelated, that have affected our sales growth rates. Infrastructure is one, distributor training, two and adherence to our distributor operating guidelines would be number three.

On our last investor call, we discussed the need to step up the pace of developing our infrastructure in Mexico and what we were doing to expand the reach of our products into more cities and towns throughout the market. We made progress in the fourth quarter on this issue by opening three new distribution centers, but we still have work to do in this area.

With regard to the issue of distributor training, because of the rapid growth in the number of new supervisors in Mexico over the past two years, we believe that some of these new distributors may have not received proper training and development, especially as it relates to the operation of our very successful Nutrition Club DMO.

We recognized this issue over the past several months when we conducted visits to a wide range of clubs. We believe this lack of training coupled with the lack of convenient access to product because of infrastructure issues led to some improper business practices that are inconsistent with Herbalife's policies and practices and the need for us to step up enforcement of our internal rules regarding distributor conduct. We have begun that process, which we believe will protect the business opportunity, retrain distributors and protect our brand image.

Over the past three months, we have seen the volume point growth rate decline from 41% in October to 29% in November and more dramatically to 11% in December. We believe the recent drop-off in the growth rate is related to the above issues and the distraction it has created among our distributors and our distributor leadership.

As a result of this most recent growth rate, we felt it was prudent to re-forecast and therefore to re-guide our top-line growth expectations for 2007 since we now believe that Mexico's volume could essentially be flat for that period.

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By making this information public to all investors now, it allows us to share this information with our distributor leadership in Mexico so we can begin a more aggressive corrective action plan. This is going to start next week with Greg's visit to Mexico. He is taking a team down there to work with our top distributors and analyze their business performance.

The third point for the call was to reiterate our commitment to expanding operating margins. As we have discussed previously, it is our goal to increase operating margins 50 basis points a year and we believe that as a result of our realignment for growth initiative we will be able to achieve that goal in 2007. This initiative will better align our incremental investments in people, product, promotions and events. It will give us an opportunity to expand our business. The new organizational structure that we implemented in July allows greater focus on our high potential markets such as Russia, Brazil, China and India.

And the final point is that we wanted to reaffirm our commitment to the global expansion and training of this wonderful distributor method of operation called Nutrition Clubs. We believe that there is a strong acceptance of this DMO by our European distributor leadership and expect to see increased penetration by this DMO in several key European markets during 2007.

We believe that we will successfully deal with the near-term growth issues in Mexico and that there are still significant growth opportunities by penetrating into metropolitan areas in Mexico. 75% of our Mexican business currently comes essentially from two cities; Mexico City and Guadalajara. We intend to reach out more broadly throughout Mexico and we are very, very bullish about Mexico.

And perhaps the most exciting discussion point (technical difficulty) has been successfully replicated for the U.S. Hispanic distributor segment, which represents over 50% of our U.S. business and this segment grew by 50% in the third quarter.

In closing, we are excited about the success we achieved in 2006 and I really want to underline that. We had a record year in both sales and earnings. Distributor confidence is at an all-time high and we see new momentum in our now second-largest market, the United States.

Let me turn it over to Rich to run through our new guidance and then we will open the call for questions and I just want to remind you that Greg, Rich and I are all here on this call.

Rich Goudis - Herbalife Ltd. - CFO

Thanks, Michael. In this section, please note that all references to EPS exclude the expenses associated with the realignment of the growth initiative that is indicated in the press release. For 2006, we wanted to reaffirm our fourth-quarter EPS guidance of \$0.52 to \$0.55 that we issued on November 6 based upon the initial estimate of net sales for the fourth quarter of between \$482.7 million and \$484.7 million.

The net sales growth rate for the fourth quarter we expect to be in the range of 18% to 18.5% and that is at the lower end of the range of the 18% to 20% that we initially indicated, which was primarily a result of the slowdown in Mexico that Michael just described.

As a result of this recent slowdown in Mexico, we have reevaluated our top-line growth rate for 2007 and now believe a range of 6% to 10% is more reflective of our current business trends. We are fortunate to have a portfolio of 63 countries that roll up under the seven regional markets. Our expectation for '07 is that 50% of our volume will be derived from markets growing somewhere between 10% and 20% and conversely, 50% of our volume will be derived from markets that will be essentially flat to up slightly. We believe Mexico will essentially be flat, as Michael indicated, and the U.S. business will be up somewhere between 11% to 15%.

As a result of this high single-digit growth rate coupled with expansion in our operating margins and a lower effective tax rate, we are reaffirming our 2007 full-year EPS of \$2.40 to \$2.47. And for the first quarter of 2007 we believe the net sales growth rate

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will also be in that same range of 6% to 10% and the EPS will be in the range of \$0.50 to \$0.55. That concludes our review of the guidance and now we will open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(OPERATOR INSTRUCTIONS). Doug Lane, Avondale Partners.

Doug Lane - Avondale Partners - Analyst

A question I have -- I know it is preliminary and you didn't call these numbers out, but do you have any early read on the supervisor numbers for the total Company, as well as Mexico in the quarter?

Rich Goudis - Herbalife Ltd. - CFO

No, Doug. We will have that in another couple weeks.

Doug Lane - Avondale Partners - Analyst

Can you just characterize -- are we going to see a sharp fall-off? Is there concern in Mexico with the issues that you mentioned in you are losing some of your important leadership? I just want to get a feel for -- just what the timing is on getting Mexico back on track here? Is this something that you think can be done on relatively short order? Are you going to have to meaningfully rebuild leadership there?

Rich Goudis - Herbalife Ltd. - CFO

Let me start and I will pass it over to Greg. I think from the new supervisor -- I would expect our new supervisor growth rate trend to follow the fall-off that we are seeing in the volume points. So that is what we would expect and we will report that obviously in our fourth-quarter call in late February. As it relates to the business rebounding from where it is, I will pass it over to Greg.

Greg Probert - Herbalife Ltd. - President & COO

I think to address your specific question on loss of leadership, we really haven't lost any leadership down in Mexico. What we are seeing is that the lower end -- the distributors that were suspended were clubs -- all but one of them were below TAB Team -- so the supervisor or world team level and one of them was a TAB Team.

Actually, to tell you the truth, our Chairman's Club down in Mexico met with Michael and I at our extravaganza in July and again at our extravaganza in September down in Mexico and it is really leadership that brought the compliance issue to the forefront, as well as the infrastructure issue and they have been very supportive of the actions taken by the Company. I think some of the momentum that we have lost is because there is somewhat of an unlevel playing field down there because some of the distributors are not compliant with our rules.

We always address this point in every quarterly call, which is -- one of our goals is to keep a level playing field so all distributors are competing fairly with one another and the stepped-up compliance is really to do that.

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I think just to give you a couple of stats, we have done, over the past couple of months, about 500 audits of Nutrition Clubs in Mexico throughout about 16 different cities. Of that, we have about a 70% noncompliance rate. Now that was everything from an outdoor sign to some minor infractions, all the way up to selling individual tabs.

The good news is that once we notified the clubs that they were not compliant, we had a huge percentage of that, of the 350 that were not compliant, all but 49 became compliant within three days. So again a 90% rate. And that really points to us that this is not an issue of a lot of distributors willfully doing that practice. It is just because of the growth, there has been a lack of training and there's just a lack of knowledge that these distributors are breaking the rules.

So again, we think this is not only a compliance and auditing issue, but really a training issue and we are going to step up that training over the next few months in every one of the things that we are doing from STSs, HOMs, the world team schools will be training on ethics and proper ways of doing Nutrition Clubs. Leaders in their own individual meetings will do that and I think we are optimistic that the few clubs that are not following the rules, they will be asked to leave the business.

But again just to use that initial number -- less than 10% of the clubs did not become compliant. Even of the ones we suspended, about 25% of the suspensions -- within a week of being suspended, they became compliant. So again, we are seeing a real willingness amongst our distributors to operate ethically and I think this is we feel a short-term issue and it is hard to predict the ripple effect, but ultimately I think we are optimistic that we will get through this and it's just part of the growing pains of growing 100% growth down in Mexico for the past year and a half.

Doug Lane - *Avondale Partners - Analyst*

Just one last question on another topic. In China, did China end up doing the \$30 million or so that was expected in '06 and can you give us an update on the prospects for direct selling licensed there?

Rich Goudis - *Herbalife Ltd. - CFO*

Yes. We would expect when we report our fourth-quarter earnings that China will exceed that low end of the range and I will pass it over to Greg for a more update on China.

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

Where we are in the license process is we have received all local provincial approvals. Our license is sitting with [modcom] at the state level. As you may know, there are three different hurdles you go through there. We are through two of the three hurdles. So everything is progressing smoothly. No issues to date and we are not predicting a date we will get it because in China, it is a hard thing to do, but there is no issues and we are moving through the process very well.

Operator

Andy Speller, A.G. Edwards.

Andy Speller - *A.G. Edwards - Analyst*

I was hoping to get some more color around just -- I think you said there were 40-something suspensions of distributors, is that right?

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Greg Probert - Herbalife Ltd. - President & COO

That's correct. So 500 audits; 350 were not compliant and of that 350, only 49 did not become compliant within the three days that we give them and so we had 49 distributorships who were suspended. And of that 49, 10 of that 49 have subsequently to the suspension become compliant. So out of 500, 39 were not compliant.

Andy Speller - A.G. Edwards - Analyst

And I guess -- I am just trying to work through how that number can lead to the slowdown in which we saw over the last I guess eight weeks.

Greg Probert - Herbalife Ltd. - President & COO

Right. Obviously, shutting down 49 clubs doesn't have a material impact on the business the size of Mexico in terms of the volume flowing through those clubs. The issue is more one of an unlevel playing field. As you guys know, this is a momentum business and when distributors -- It has been a distraction for distributors.

I think the distributors that were operating legitimate clubs felt it was unfair that other clubs were competing with them. As we told you, these clubs are in close proximity to one another. So if someone down the street is advertising or doing flyers or selling individual tabs, it is an unfair competitive advantage.

So I think it is a distraction element and what we feel is the compliance and the fact that we are suspending 49 distributorships and continue to do audits and we are going to continue to do those audits over the next six months, we are actually going to beef up and probably get up to 1000 audits a month over the next six months, we think we can abate this issue and really the legitimate distributors I think will then be reinvigorated and I think you will see a return to growth in the market.

Andy Speller - A.G. Edwards - Analyst

Greg, this is really more of a recruiting issue than a participation issue of the people who are participating there?

Greg Probert - Herbalife Ltd. - President & COO

I don't think it is a recruiting issue. I think it is a training issue. So many clubs were opened so fast that -- for instance, if you're recruited and your upline teaches you -- I use a sign or I sell individual tabs and you open up your store and within three weeks, you open up five stores underneath you, those bad practices get handed down and it is a case of ignorance of the rules and the right way of running the business.

So again, going out and through the audit process, I was very encouraged that of 500 audits, the bad news -- 350 were not compliant. The good news is of those 350, all but 49 became compliant within 72 hours of us doing the audit. So again, the audit is an educational tool as well as a compliance tool.

Andy Speller - A.G. Edwards - Analyst

I guess I am still kind of confused in terms of if it is people not showing up and selling more or is it just the trickle-down effect of not opening up the clubs at the same rate they were being opened up before?

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Rich Goudis - Herbalife Ltd. - CFO

I think it is really a combination. It is really the distraction factor that people are spending time now getting into compliance versus growing their businesses. This is a very emotional momentum business and I think when you have oversight from the company, that creates distraction amongst the distributor groups.

Andy Speller - A.G. Edwards - Analyst

Fair enough. Then in terms of where we think Mexico can get back to, kind of to Doug's question, have you guys identified a timeline in terms of when you think growth can occur and where is that growth on a longer-term basis?

Rich Goudis - Herbalife Ltd. - CFO

Our hope is that by announcing this today and as Michael said, Greg is going down next week with a team of folks, that we start working with our distributor leadership in a very open forum and that we move forward very quickly to resurrecting growth in the marketplace.

But given the precipitous drop from November to December without their participation and involvement, right now, we are taking a very cautious look and while seasonally we expect New Mexico would slow down in December, our expectations right now, we are calling for a flat year assuming that if we can get to somewhere between 40 million to 50 million volume points a month, that is essentially a flat year for Mexico.

So we need to have the distribution issues that we talked about in the November call, see new distribution centers open up. We opened up three in the fourth quarter. We need to see expanded and deeper training and we need to see better compliance and we think when the complements of those things are fixed, which are the growing pains we are talking about, again Michael said we are all very supportive of it, but the clubs are a fantastic business opportunity.

They really embody the three Rs in our business. That is very strong in high retention. Mexico has the highest retention of any country in our 63 market portfolio. So we are very bullish on the concept. Our distributor leadership -- it brought the issues forward to Michael and Greg and we believe that by getting at it early, hopefully we are talking about Mexico growing again by the end of the year.

Greg Probert - Herbalife Ltd. - President & COO

Well, we have very difficult comps in Q2 and Q3 with Mexico right now given where they are running in the business.

Andy Speller - A.G. Edwards - Analyst

Yes, but it is really more sequential than it is year-over-year I think from this point.

Greg Probert - Herbalife Ltd. - President & COO

Absolutely correct.

Andy Speller - A.G. Edwards - Analyst

And then lastly, Rich, I know that the tax situation in terms of how you are lowering your tax issue, if you could just kind of walk through that with me and again. I know it's complicated. If you want to cover it off-line, I guess we can do that.

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Rich Goudis - Herbalife Ltd. - CFO

Just very quickly, this is part of a two tax strategy that we put in place in '04 and '05. We had always expected that our effective tax rate would move down into the low 30s kind of best-in-class with what you see some of our peer companies have in our business given the global nature of our profitability where 80% of our profits are derived outside the U.S.

So I think our strategies are definitely on target. Because of the mix of where the profitability is coming from now that we have relooked at our 2007 year, we believe the effective rate will be a little bit lower than we initially guided. We would expect ongoing improvements in '07 and '08 as our tax strategies and the full impact of those are felt by the end of 2008.

Operator

Christopher Ferrara, Merrill Lynch.

Christopher Ferrara - Merrill Lynch - Analyst

Can you give a little bit more color I guess on specifically what rules were being broken? I know you mentioned advertising and I know people were maybe mixing in some products that weren't Herbalife products in there. Can you just talk about what the more meaningful rules were that were being broken?

Greg Probert - Herbalife Ltd. - President & COO

Because the two biggest noncompliance areas were advertising outside the store and selling individual tabs. So by far, those are the two biggest areas. And the other -- I think you named some of the other ones, which would be having employees run the store as opposed to a distributor running the store, franchising the concept -- the club concept, using flyers and different forms of advertising to attract people.

One of the things that we have done to address this again is we are issuing a new set of rules down there and again under the request of our leadership down there, we are actually publishing what we are calling a code of honor, which the entire TAB Team of Mexico will sign this. It will be attached to the rules and what it basically says is that they all agree to adhere to the rules and more importantly to train their downlines with those rules and so again, we are very encouraged by the fact that once these things are highlighted, the distributors in resounding numbers have been compliant almost immediately.

Christopher Ferrara - Merrill Lynch - Analyst

And then I guess if you think about it, you said I think, what, 300 and something were non-compliant. What is the average duration of time that these guys were doing stuff that is unfairly competitive? I am just trying to understand because it sounds like some of these guys were uncompliant; you shut them down quickly. Why would sales start to fall off now if some of these guys presumably started to become compliant back in October and November?

Greg Probert - Herbalife Ltd. - President & COO

Right. The audits were done. The first round of about 150 were done in late October, early November and another round was done in November and December. So again, it hasn't been that long since they were done. I think it is also just -- it has been building up over a couple of quarters. It got on our radar a quarter or so ago and we have been putting in fixes. But again it just takes a little bit of time. It's a momentum business and it has been very distractive and I think once we put the fixes in and we regain that momentum, we will return Mexico to growth.

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Michael Johnson - *Herbalife Ltd. - CEO*

This is Michael. I think it is a good question and I hear where you're going and you are trying to get say a very finite detail and so if this were Baskin-Robbins, how many less scoops of ice cream are being served a day and what impact we have on that.

This is a business that has got a lot of emotion and aspiration attached to it. So I opened up a Nutrition Club in Mexico City and I play by all the rules and right down the street from me, somebody (indiscernible) our table up or they do something -- they start selling a shake for less price. They may not have full ingredients to it. They are hanging an Herbalife sign. They may not even be an Herbalife distributor. They may not have Herbalife product, but they are trying to ride the brand on us.

What it does is it takes motivation away to open two more Nutrition Clubs and know that somebody is hawking right on top of me. We are going in and putting those people out of business and I don't want to put that -- I want to be very careful how I say it because a lot of times these are not distributors. These are people who are hurting distributor momentum and hurting our business down there.

Greg and I when we were down there in October visited a variety of Nutrition Clubs and what we saw was a scale of operational -- what should I say -- integrity that was a little wider than we wanted. So what we are concerned about and what we are going to focus on is making sure that a legitimate distributor has the opportunity to expand their business on a level playing field and in Mexico City and this is where we believe most of our issue is, is where this is occurring right now.

If I could take you on a visual tour of that, I would love to do it. We actually had some camera crews with us at the time just by happenstance; we had been doing something else. We went into see these and I will be very honest with you, we went into one -- what was called a Nutrition Club and the woman was selling a variety of products. She had a lousy presentation of (indiscernible). She complained about the Nutrition Club down the street. So we went down the street and it was a fabulous Nutrition Club, 10 people sitting there at 10 o'clock in the morning having a shake a tea, operating a very clean wonderful environment, well taken care of, very, very professionally done.

You see the difference in there and what we have to do is we have to support the legitimate businesses in order to protect ourselves. And some of our growth came out of these illegitimate businesses. So we are going to go back and I would say that these people are less than 10% of our business down there. We don't have an exact read on it, but as we get into the marketplace and get deeper into it and get our local management tuned in much more deeply to some of these issues because that is -- we have to make sure that local management is handling this, as well as the international management, but they need training too. So we are working with them.

They have been largely trained and steeped in distribution and now we are saying to them, guys, we have to get out in the marketplace, we have got to work with distributor leadership. We have got to work with distributor management because the distributors are where you get the real information about what is going on about our business. So we want to make sure that we're working very closely in the marketplace. So the training is with the distributors. It is with our management team. It is with ourselves to make sure that we are creating a level playing field for this wonderful business opportunity that is taking off in other parts of the world. We will learn from Mexico and we will apply this knowledge rapidly as the rest of the world expands.

Christopher Ferrara - *Merrill Lynch - Analyst*

I hear you. I am really not trying to count the ice cream scoops. I am just trying to --

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Michael Johnson - Herbalife Ltd. - CEO

I'm not suggesting you are. I just said I know that with your analytics, you want to dive in very deeply here and so do we. But there is a certain level that we can dive into.

Christopher Ferrara - Merrill Lynch - Analyst

I am just trying to more clearly understand the timing, right, because you're talking about the guy who sets up the card table right next door. If that started to happen in December, I can get that, but it seems like that was happening cumulatively until October or November and then it stopped. Now sales fell off. That seems like maybe -- did sales fall off because you started enforcing the rules more strictly. Is that what it is and does that imply there is a portion of your growth or a big portion of your growth coming from people who are doing things illegitimately?

Michael Johnson - Herbalife Ltd. - CEO

Let me just -- and I tried to answer that before, but I will try again. Greg speaks your language better than I do, so I am going to speak to highline on it. Distributor motivation is taken away and that is the expansion. The expansion of Herbalife in Mexico, the reason that we, in 2006, are almost three times larger than we were in 2004 and the reason is because people opened up a lot of new Nutrition Clubs.

There was a woman that I met down there that has 600 customers a month who had no customers a month eight months ago, nine months ago. She is expanding rapidly down there because she seized the opportunity. She is building it. When this card table comes in front of her and she has a competitor sitting right out there cutting the price in half, questionable product integrity, questionable Herbalife integrity there, that slows her momentum down.

It is not the guy with the card table who is buying product and stopping (indiscernible), it is the woman who doesn't expand our business. That is the bigger issue to me down there is the expansion of Nutrition Clubs. We talked about it in the opening comments. We are a Guadalajara/Mexico city predominant business. There's a lot of other cities in Mexico, but to get the momentum going, to get this going, the leadership has to have confidence that we are going to protect this golden goose and protect the opportunity to go forward. And that is what we are doing.

We are sending a signal into the market. So the slowdown in my mind and we don't have specific analytic metrics on it, the slowdown for us right now is looking at the market with our local management, with the leadership and saying that we have frankly lost a little momentum because the inspiration to go out and start a new Nutrition Club has been retarded by the fact that we have these rogue operators in front of us.

Greg Probert - Herbalife Ltd. - President & COO

The only thing I would add to that is that in addition to that, because of the suspension and the crackdown on some of the clubs that are not operating legitimately, people that, two months ago or three months ago, would have opened the same type of club now are not opening it. They are just not coming into the business.

So some of that growth that was driven by non-compliant activities that we have lost that growth and in conjunction with what Michael was talking about, which is the growth in our legitimate side of the business. So I think we started to see a slowdown a few months ago and I think it just, with the compliance taking effect, that just accelerated. But again, we need to get rid of the non-compliance so the other 90%-95% of the business can return to strong growth.

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Operator

Javier Escalante, Morgan Stanley.

Javier Escalante - Morgan Stanley - Analyst

Sorry for keep asking questions about Mexico, but I just would like to understand a couple of things, right? In your flat forecast, are you guys assuming that you are going to be continuing shutting down nutritional clubs throughout 2007? That basically the non-compliance rate is 10%. So as you continue rolling out this audit, you inevitably are going to be losing 10% of the nutritional clubs. By doing that, this is kind of like somehow freeze out the growth of the market? Is that the assumption? Why is it down? Where is it flat? Why is it not up 10 or down 10? How do you come up with the flat number?

Rich Goudis - Herbalife Ltd. - CFO

We will have a much better read obviously when we give you an update at the end of the -- for our fourth-quarter earnings. As we said, Greg is going down next week to get into this with our distributors. But a couple of things we have said here, one is we are increasing our level of audits. We believe that by doing that throughout the course of the year and working on the training that this will -- the percentage that we talked about earlier will get smaller and smaller because the training and the quality of the training will get better and better.

We hope that when those actions come into place that we are talking about very good growth rate by the end of the year. But right now given our recent trends, and it is recent, so I want to underscore that, that when we look at Q2 and Q3 and the difficult comps of trying to hit 55 million volume points a month, right now, a lot of things need to get better to be able to withstand those negative comps that we expect in Q2 and Q3 before we start growing and comping better in the fourth quarter.

So right now, we're looking at a positive comp in Q1, maybe flat to down in Q2 into Q3 and then up again in Q4. So that is kind of our outlook and wholly by getting at this early, we come back in and revise these numbers and we revise them up.

Javier Escalante - Morgan Stanley - Analyst

Mathematically, Rich, what you are assuming is essentially say that I'm selling 10 million volume points per month, that you are not going to be able to grow that over the next 12 months and that is why you're going to have the dip in the second and third quarter, right? So you're basically assuming that there is not going to be volume loss. You are simply going to be flat on volume and because the seasonality of the business, you are going to be down in the second and third quarter. Is that right?

Rich Goudis - Herbalife Ltd. - CFO

On a volume basis, we believe that the worst is past, but if you look at where we are today at 44 million volume points in December, a lot of good things have to start happening, right? Some of it is seasonal, but a lot of good things have to start happening to get up to a 48 million to 50 million volume point run rate. That gets us flat.

Javier Escalante - Morgan Stanley - Analyst

And the issue I guess and this is basically what Michael was alluding to and I think that I agree. It seems like if 75% of the volume is coming from these two places, what you are basically discounting is whether these two places are saturated and you have the rest of Mexico to expand to. So what the barriers for that expansion? Why not accommodate whatever audits you need to do in Mexico City and Guadalajara and why not push strongly outside these two places so we don't need to be flat?

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Rich Goudis - Herbalife Ltd. - CFO

Well, first of all, we are opening up DCs. We said that on our last call. We said that was an issue that we raised midway through '06. We opened up three additional distribution centers in the fourth quarter. But again, we don't want to have that rampant and rapid growth at the risk of having this non-compliance permeate into the new market. So I think that we're going to have a more prudent and possibly slower growth approach to the club expansion if it takes more time and more training to get a more stable business.

Javier Escalante - Morgan Stanley - Analyst

Yes, but I think that one other thing that probably all of us were struggling with your commentary about what the distributors are doing that is so kind of like out of the rules, they don't seem serious to us I guess. I mean the fact that somebody put a sign that she or he is selling Herbalife and meeting people every day in the morning. So why is it so wrong? Why is it that that is such an unfair practice that paralyzes everybody from doing their job? I guess this is what probably some of us are trying to understand.

Greg Probert - Herbalife Ltd. - President & COO

I think it is really an issue back to a level playing field and Michael addressed this I think in the comments earlier is if I am operating under the rules and the club two blocks down is not, whether it is a big deal or it isn't and whether it is an unfair advantage, the perception of our distributors is that it is not fair. It is distractive and it kills momentum.

So again one of the things we always talk about -- one of our rules in the company side is to maintain a level playing field for all distributors. And if they believe that field has been tilted and we haven't done anything to correct that, it is incredibly distractive and it kills momentum. So what may seem like a small issue to you guys, whether it is advertising or whatever, to our distributors, it is incredibly distractive and it's a huge issue.

I can tell you how huge it is -- as I mentioned, this has brought by our chairman's club this issue to Michael and I. I think in the second or third quarter of last year, we met again with the S&P group. They were very emotional about it. So I think it has been building up and now we are addressing it. And it is an emotional issue, but as you know, this is an emotional business. It is an aspirational business and we have to maintain a level playing field.

Javier Escalante - Morgan Stanley - Analyst

And a question for you guys, Greg and probably Rich, right, you guys are keeping the EPS target unchanged with lower sales, right? So that sounds like something that sounds like risky from the outside. You guys are spending money I would imagine with the audits. My understanding talking to Mexican distributors yesterday is that you guys hire a company to do these audits. So that costs money. Should you guys -- are you guys cutting back in marketing and distributive spending at the wrong time? So give us some comfort that the fact that you guys are maintaining EPS unchanged with lower sales. This is not going to be eventually detrimental to the business.

Rich Goudis - Herbalife Ltd. - CFO

It's a great point initially. Let me hit the first one on our guidance and then I'll turn it over to Greg as it relates to his investment ideas and the amount of money he is going to invest in our high-growth markets this year, which we don't think are affected at all from this.

We went through a process over the last couple of days and as we looked at our top line and we took some expectations down as it relates primarily to Mexico and we challenged ourselves as it relates to our earnings level.

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Most companies, as you know and most investors know, when they announce information like this, they usually miss. They usually are not realistic internally. They have high hopes that they can do better and they don't take the number down enough. We believe we are in a position where we have taken a very strong scrub to the numbers.

We had a tremendous amount of leverage that came out of our alignment for growth initiative last year that if we didn't guide operating margin this year as we indicated, but we had a tremendous amount of operating leverage that essentially was upside for us to have potentially for discretionary investment that at this point we believe very, very comfortably that our EPS range given the 6% to 10% top line, we are very comfortable with that EPS range.

We talked about possibly taking it down and some investors actually said, hey, this stock is going to overreact today, why don't you take it down, give yourself some breathing room. We don't believe we need it. We believe you should expect the same kind of performance from this Company from this point forward.

You might think that this is an overreaction, but in this business given the independent nature of our distributors, the only way we can talk openly with them is to disclose this information publicly so we can get at it, get them inside the tent and start working the problem together. And better to do that on January 4 than wait until February 25 and release this information.

Javier Escalante - Morgan Stanley - Analyst

For instance in Mexico, Rich, you should be spending more now in order to do the audit, somehow establish controls to level the playing field and at the same time, you need to bring some re-excitement to the market. That will cost money, right? And you are still building up China. You will also start a business in Russia. So would these -- the math works basically. Do you guys have a spending cushion and probably this question for Greg? I mean do you feel that you have enough to reactivate Mexico and at the same time maintain the growth in the growth plan that you had in place prior to this issue?

Greg Probert - Herbalife Ltd. - President & COO

There are a couple of questions in there and let me address Mexico first. These audits don't cost a lot of money. Just to give you -- the 500 audits, we did that with nine staff members. We're probably going to add about another 20 staff on a temporary basis to get to 30 people, which is 15 teams of two people. That is about 1500 audits per month.

So in the next six months, we'll probably audit about 25% to 30% of our clubs and then we'll really understand the nature -- the early indication is that less than 10% of the clubs will ultimately not be compliant. So again, I gave you those numbers up 500 clubs, 49 suspensions. So slightly less than 10%. And then of that, a quarter of those suspended became compliant. So that gets it down to 70%. If that number holds up, fixing that is not going to be expensive; it is probably about \$100,000 of incremental SG&A spend in Mexico over that six-month period to get an understanding of that.

To reinvigorate the Mexican market, just getting rid of this issue, leveling the playing field will reinvigorate the market. I was down there in November. I did a three city tour with the leadership, saw all the TAB Teams in Mexico, Guadalajara, Monterey. We saw about 3000 TAB Team members and merely the fact that I announced we're going to enforce our rules got a standing ovation. This has been a pent-up issue and just relieving that pressure in and of itself will reinvigorate the market. I don't think there is a massive amount of incremental spending needed to reinvigorate Mexico. I think we just have to get rid of this one issue.

Javier Escalante - Morgan Stanley - Analyst

And what about the China, the Russias by --?

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Greg Probert - Herbalife Ltd. - President & COO

I think Rich already addressed this.

Javier Escalante - Morgan Stanley - Analyst

What about the spending to maintain the growth in the U.S. and all these other places?

Greg Probert - Herbalife Ltd. - President & COO

Well, I think Rich already addressed that, which is our organizing for growth initiative realigned our spending to those high-growth markets and to distributor facing activities and took it out of staff functions and back-office functions. So the reason we did that last year and took that one-time charge was to reallocate -- I think you are now going to see the results of that this year.

So we are not increasing our SG&A spend; we just, through our realignment last year, we realigned that spend to the high-growth markets like the U.S., like China, like India, like Russia and also to distributor facing activities in all our other markets. So we've already done that realignment and so for the same amount of spend, we are going to get a lot more bang for our buck.

Javier Escalante - Morgan Stanley - Analyst

Could you remind us how much is the realignment? How much savings did you guys were realizing with the realignment?

Rich Goudis - Herbalife Ltd. - CFO

Sure. What we said was we expected \$8 million to \$10 million of expenses to run through the P&L starting in the fourth quarter of '06 and through the first half of '07. And we expect the savings of that to be somewhere in the nature north of \$20 million.

Javier Escalante - Morgan Stanley - Analyst

North of \$20 million?

Rich Goudis - Herbalife Ltd. - CFO

Yes.

Operator

Rommel Dionisio, Wedbush Morgan.

Rommel Dionisio - Wedbush Morgan - Analyst

In your press release, you talk about sales growth in the U.S. in particular. Was there something that you saw in the fourth quarter or maybe it is just a continuation of trends in the third quarter that led you to go to that of 11% to 15% growth rate in '07? Are you still seeing strength in the Nutrition Clubs in the Hispanic market for example?

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Greg Probert - Herbalife Ltd. - President & COO

Yes, to give you the sense -- you know Michael gave you the stats for Mexico in his prepared comments. Let me give you similar stats for the U.S. business during the fourth quarter. In October, and remember that in the third quarter, the U.S. business grew 24%. In October, we saw volume in the U.S. up 26%. In November, up 27% and then December, up 22%. So we believe that the trends that we indicated with the Latino business growing very strongly in the third quarter, again strong adoption of the Nutrition Club DMO, we believe that it is only accelerating in the U.S. and we would hope that we carry that into 2007.

But what we have done is because of what we are seeing in Mexico, we don't want a repeat of that in the U.S. so we internally are just taking a little more cautious approach as it relates to our growth expectations for the U.S. business. I'm sure if you talk to our distributors, they probably have a lot higher expectations of the expansion in their growth rates. But better for us to be a little cautious and take the learnings that we're going to get out of Mexico and apply those to the U.S. and share those with our U.S. distributors.

Rommel Dionisio - Wedbush Morgan - Analyst

Fair enough. Are there any other markets that are seeing an acceleration? I take it a lot of this can be attributed to the introduction of Nutrition Clubs in the U.S. Any other markets that are seeing this kind of acceleration?

Rich Goudis - Herbalife Ltd. - CFO

A couple of other things to point out. A lot of people talked about Brazil and we talked about an inflection point in Brazil in July as it relates to the adoption of Nutrition Clubs. And we saw in each of the months during the fourth quarter in October, November and December that the year-on-year growth rates in Brazil continued to accelerate. For example, this is on a volume point basis now so it doesn't directly correlate to what we will report as net sales, but October was up 5%, November was up 10% and December was up 10% year-over-year.

So again, trend -- the positive trend in Brazil continues and then another large market for us, which is South America, the Spanish-speaking South America and Southeast Asia, we saw growth rates of 35% again on volume basis in October, 42% in November and 46% in December. So we have a lot of -- we have a lot of reasons to be very optimistic on some of these markets.

I think the reason for this call was one, to celebrate the success that Michael talked about and second and most importantly is to get this information about Mexico and regarding Mexico in the hands of our Mexican distributors so they, along with our local management, can start working this issue early in the year.

Operator

Michael Lasser, Lehman Brothers.

Michael Lasser - Lehman Brothers - Analyst

Given what has taken place in Mexico, what gives you confidence that some of those practices aren't taking place in other markets? Do you think you'll need to suspend distributors in other countries?

Rich Goudis - Herbalife Ltd. - CFO

Right now, we don't know is the real answer. The audits that Greg discussed that we started in late 2006 in Mexico, we will start doing something similar in markets where the clubs are starting to appear. Again, more just to give feedback to our distributors

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on how they might have to tweak their training method, but right now, there is no early indication that there are any of these problems outside of what we have already discussed in Mexico.

Michael Lasser - *Lehman Brothers - Analyst*

And it sounds like you feel that the practices that are not compliant with the Company's rules are just taking place in the Nutrition Clubs, not distributors who use other DMOs?

Rich Goudis - *Herbalife Ltd. - CFO*

Well, I think the primary DMO in Mexico are clubs. Clubs are what is the accelerant for growth. So that is really where the focus has been. It is a lot more difficult to audit somebody who is doing a business from their home on the phone, on the street corner, right? So the clubs are the ones that are easier to audit. They are visible to us and to consumers. So that is really the focus of our audits.

Obviously, we have a very expansive ethical business practice group as it relates to watching and monitoring distributor behavior and their order patterns, etc., etc. from a compliance standpoint. So that goes on in all of our markets and that is well in place.

Michael Johnson - *Herbalife Ltd. - CEO*

This is Michael. I just want to add to that a little bit. This is not just about compliance. We also have a distribution issue in Mexico that we are addressing. We talked about that. We seem to be very focused on compliance on this call, which is fine, but we have a distribution issue there that we think is somewhat equally weighted to this and we have a training issue in those markets.

So when Greg heads down there next week, one of the reasons we wanted to get this call out of the way is really kind of twofold. One, we can open up the kimono and have a full discussion with leadership about the performance in their organization that we couldn't have before this good old -- because of all the Reg FD issues that we live under. Welcome to the CEO life. Then two is that we will today follow this call up with a call with our chairman's club.

One of the reasons we wanted to get this out of the way, our chairman's club, who are the real go-getters, the real leaders, the people who take the stage who lead the parade in this Company who are the heavily inspiring motivating people, we have highly aspirational folks, we will be on the phone with them in two hours to go through this in more depth with more discussion to say here is what we have got to do.

They will give us a ton of input and say here is what you need to do and here is the support we need and together -- and this will also be because these are global leaders, a very straightforward message to them that as this gets going in Europe, as this gets going in India, as it gets going in other marketplaces in the world, we want to make sure we are doing this right so we don't hit this bump in the road that we have hit here.

Michael Lasser - *Lehman Brothers - Analyst*

Mexico has been used as a model to describe what can be achieved in other markets. It has been said as the aspirational message for other distributors. So could the negative momentum in this market proliferate to others and how might you be able to prevent against that?

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Michael Johnson - Herbalife Ltd. - CEO

Here is the message. Two years ago, Mexico did 200 million. This year, 600 million in volume points. That means that my check has tripled in two years.

Rich Goudis - Herbalife Ltd. - CFO

We will take that problem.

Michael Johnson - Herbalife Ltd. - CEO

Yes, I will take that problem all day long.

Greg Probert - Herbalife Ltd. - President & COO

(indiscernible) It's a great question because it was a concern of mine and Michael's and we have spoken to several of our chairman's club and some of our leadership and they see it the same way we do, which is that's to be expected. When you grow that fast, there is always going to be a bump in the road and some growing pains. We are not surprised by it. We will get through it.

Again, one of the reasons we are having the chairman's club -- this call this afternoon is they will help reinvigorate the market and they will help ensure that in Europe and the U.S. and all the other countries that are rolling out (indiscernible) clubs that we don't throw out the baby with the bathwater. This is a great DMO. It is a great concept. It is built on retailing, home business. It is a great microeconomic strategy for people around the world. And we want to make sure that that is put in the proper context with our distributor leadership.

So part of the call this afternoon, part of my going down to Mexico is to make sure that the small bump in the road is perceived as that and not as something wrong with the DMO. Michael and I and everyone are very enthusiastic. We still think this is a fantastic way of doing business and very encouraged by the fact that our distributor leadership was brought into this and they are very encouraged by it and you can see the evidence of that in countries like the U.S. now.

Michael Lasser - Lehman Brothers - Analyst

Two more questions. One way to characterize Mexico is that it's just matured. You probably wouldn't have had some of the distributors complaining if they had an easier time selling their products and competition wasn't so significant and the market was saturated. So using the example of some of the other more mature direct selling markets that haven't fared well in recent -- in the last couple of years like Japan, like Germany, what could be the best -- what could be the worst-case scenario for the next 12 to 24 months for Mexico? And then I have one follow-up after that.

Greg Probert - Herbalife Ltd. - President & COO

Again, I will go back to what I think Michael said is Mexico City is a little less than 20% of the population of Mexico. It is roughly 50% of our business. So obviously we're very heavily concentrated in Mexico City. Guadalajara 10% of the population, 25% of our business.

So part of this infrastructure build is to really go and penetrate some of the other large cities, Monterey, Villahermosa, Hermocillo, Tijuana, the Baja Peninsula. We are not heavily penetrating any of those markets and to tell you the truth, in 24 of the states in Mexico, we have almost no penetration. So again, we are not even close in my opinion to being penetrated in that market. We

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only address about 30% of the population of the country with our existing distribution centers and the nature of Nutrition Clubs is if you can't service that daily business with some type of infrastructure, it is very hard for us to grow.

So I think the issue is stabilize the business in Mexico City and make sure this issue doesn't permeate into some of our other existing cities and build the infrastructure to attack the rest of the market.

Michael Lasser - *Lehman Brothers - Analyst*

Okay. Sorry. I just have a couple of questions because this is a good forum to do it. Have you re-thought -- because of the change in the guidance, have you re-thought your uses of cash? Might you consider a share repurchase program if the levels get attractive enough?

Michael Johnson - *Herbalife Ltd. - CEO*

Well, we certainly have got those ideas in our head too and we are working with the Board right now to formulate what the best use of cash is for our Company.

Michael Lasser - *Lehman Brothers - Analyst*

Two last questions. Last quarter, you talked about increasing inventory by \$12 million in Mexico. Do you anticipate having to take a write-off due to the slowing growth?

Rich Goudis - *Herbalife Ltd. - CFO*

Probably not from here forward. We have taken some reductions as it relates to some inventory in Mexico during the quarter, but that is just kind of normal.

Michael Lasser - *Lehman Brothers - Analyst*

And last question, Greg provided great commentary on the progression of China approval earlier in the call. Could you provide some color around the timing of -- you said you have got two of the three approvals? Perhaps when did those occur? When did all the provincial and local approvals come in just so we can get some sense of how fast this is moving along?

Rich Goudis - *Herbalife Ltd. - CFO*

Michael, I think Greg said more than we probably were prepared to say and we will leave it at that.

Michael Johnson - *Herbalife Ltd. - CEO*

We will take one more question.

Operator

Scott Van Winkle, Canaccord Adams.

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Scott Van Winkle - *Canaccord Adams - Analyst*

Thanks for taking my question. There has been a lot of questions about whether the market was saturated in Mexico. Do you think that the indications that -- maybe the last crop of distributors to come into those markets in those two major cities in Mexico might have been a little lower quality distributor that you are having these issues with? And is that an indication of saturation of kind of the distributor opportunity? I hope that was clear.

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

I think I understand the question, Scott. No, it is not necessarily a new crop of distributors. I think what we are doing is doing a deep dive into organizations and trying to isolate which organizations are having these particular issues.

And again, like I said before, if you were trained to do it the wrong way, then you are going to keep moving that down through generation after generation. So again, what we want to do is isolate where this is occurring and go into those organizations and meet with leadership and make sure that they are training and retraining and reeducating their distributors.

So again, I don't think it is a recent phenomenon. I think it is just something that has been building up over time. It has become known to us recently and I think as we address it with the leadership and again to reiterate, this was an issue with our leadership. They are willing to work with us very closely. I've been down there a couple of times over the past few months, going down again next week. I think it is just an ongoing process and we will get through it.

Scott Van Winkle - *Canaccord Adams - Analyst*

And when you do audits of Nutrition Clubs, is there any way you can measure inventory at the club level with a slowing growth rate and kind of ties on to the last question?

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

They don't keep much inventory to tell you the truth. It is, like we said, it is almost a daily or a bi-weekly replenishment type of business by its nature. They don't have a lot of working capital to maintain inventory. What we do hope eventually is that through the (indiscernible) bring everyone to compliance and do trainings, but we will maybe make some better points on the clubs and do some research on a number of members and that type of thing. So hopefully we'll get some better analytics through these audits also.

Scott Van Winkle - *Canaccord Adams - Analyst*

And obviously, short term, you can get in there and do training in that market. Does this (technical difficulty) back and maybe change or deploy a new strategy around training on a worldwide basis or have some requirements for distributors, TAB Team and above or something, to have a certain level of training each year?

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

Right. I think the key learnings are to get ahead of this growth curve particularly in the U. S. now. Des, our head of sales, Des Walsh, our head of sales and Jack [Dewillich], who is our head of this initiative are meeting with leadership. I met with them last November, the U.S. Hispanic leadership.

We went through what was happening in Mexico and they were very support of hey, let's prevent this in the U.S. as opposed to dealing with it after the fact. So I think distributor leadership is very focused on this. Again, that is why we are having calls

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with Chairman's club. This will be something that we will address on stage at major events. I will address it in my comments this March at our leadership retreat, honors program. This is a Mexico isolated issue. The key learnings are let's get in front of this around the rest of the world and I think leadership is behind that very strongly.

Michael Johnson - *Herbalife Ltd. - CEO*

I want to thank everyone, this is Michael, for your questions today. We are going to wrap up. It is 9 o'clock out here and we have got to get on with Mexico today. We will always be open and direct with our shareholders and our owners in this Company. It is a philosophy that I will never back off of and we came forward with this news, as we said, really for four reasons early this morning.

We thought it was important that you know the news as we know it. I must tell you I am somewhat surprised by the reaction in the market. Maybe I need more seasoning. This is what I am going to call a bump in the road. Greg and I have looked at each other deep in the eye and through the night and talked to our Mexico team and our leadership. We believe that this is a short-term issue, certainly not a long-term issue. The penetration rates in Mexico are still very low. We are in two cities there where we run a majority of our business and I am confident that the leadership, the Chairman's Club, the President's Team and all of our Millionaire TAB Team and GET Team members are going to live up to their opportunity and share that opportunity with others in Mexico and I am really confident about the world at large for Herbalife.

I would put one cautionary note at there. I think China is an '08 story for us. I think '07 is still an investment year and a build year for us in China. We have no definite date for our license there. We are a different company there than many of our competitors because our competitors were in what they call the change mode and had to get a license in order to legally operate. We were operating just fine there last year and we are operating fine there this year.

I continue to be excited about our long-term prospects based upon the megatrends in health and obesity and the strength of our marketing plan and the diverse stage of our business, the hard work and the strong momentum throughout this really fantastic distributor organization we have.

And I would like to just take a moment because I know a lot of them are on this call to congratulate the distributors once again for \$3 billion and I would like to invite all of you on this call to join us and where we will have this March 5000 distributor leaders from all over the world come together to celebrate the extraordinary accomplishment of \$3 billion and we will hand out in excess of \$30 million on stage right here in Southern California and it will be a very exciting moment for this Company, our distributors and hopefully for you, our investors and analysts, who follow this Company. So come on and join us. Come on and see us in March.

We will be on the phone again with you in February recording our quarterly earnings and ready for your questions and hope to talk to you throughout the quarter. So just want to say thank you all very much for your support of Herbalife.

Operator

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

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