PERSHING SQUARE CAPITAL MANAGEMENT, L.P.

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August 29th, 2013

Via E-mail and Overnight Courier

Mr. Dennis M. Nally
Chairman
PricewaterhouseCoopers International Ltd.
Mr. Robert E. Moritz
Chairman and Senior Partner
PricewaterhouseCoopers LLP
330 Madison Avenue, 24th Floor
New York, NY 10017

Re: Herbalife Ltd.

Dear Mssrs. Nally and Moritz:

I am writing to bring to your attention serious accounting and disclosure issues that I believe are deserving of Chairman and CEO-level attention at PricewaterhouseCoopers LLP ("PwC"). As has been widely reported in the press, Pershing Square delivered a public presentation on December 20, 2012 entitled "Who wants to be a Millionaire?" that explained with a high degree of particularity why we believe Herbalife Ltd. (the "Company") is a pyramid scheme.

We have attached a copy of our presentation as Exhibit H (and encourage you to visit www.factsaboutherbalife.com to view a video of the presentation and additional materials we have compiled) and request that you and your team carefully study the issues we have raised as part of PwC's review and audit of the Company's public filings. If we are correct that Herbalife is a pyramid scheme and PwC fails to accurately inform investors of this risk, PwC may incur substantial liabilities in the event of the Company's failure. For this reason, I believe this audit requires your personal attention.

We have previously raised a substantial number of questions about Herbalife's business practices and public statements in a questionnaire that we delivered to the Company and released publicly on February 7, 2013. To date, Herbalife has not answered any of these questions. We encourage you to review these questions as they should assist you and your team in your audit analysis and opinion. We have attached the questionnaire as Exhibit I.

In addition, we are writing to bring to your attention concerns that we and our accounting advisors have identified in the Company's financial statements that we believe are relevant and critical to PwC's reviews and audits of the Company's past, present, and future financial statements and accompanying disclosures.

Furthermore, we would also like you to explain how PwC intends to overcome and resolve the appearance of impaired independence with respect to its in-progress and impending audit and review work in light of non-audit services performed by PwC and/or members of the PwC global network for Herbalife. In light of the materiality of this audit to Herbalife, it is critical that investors can be confident of the independence and objectivity of PwC in light of the other work it has done and continues to perform for the Company.

We look forward to hearing from you and are available to respond to any questions that you may have.

Sincerely,

Pershing Square Capital Management, L.P.

William A. Ackman
Chief Executive Officer

Encl.

cc: Liora Sukhatme, Esq.
Christopher C. Mele
U.S. Securities and Exchange Commission
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I. Does Herbalife Improperly Account for Wholesale Commissions as an Offset to Revenue to Disguise the Fact That It Is a Pyramid Scheme?

Section summary:
The amount of money Distributors receive for recruiting is a critical factor in the determination of whether a multilevel marketing business is a pyramid scheme. The FTC's website states:

> "Not all multilevel marketing plans are legitimate. If the money you make is based on your sales to the public, it may be a legitimate multilevel marketing plan. **If the money you make is based on the number of people you recruit and your sales to them, it's not. It's a pyramid scheme.**" (emphasis added)
>
> ("Multilevel Marketing," http://business.ftc.gov/documents/inv08-bottom-line-about-multi-level-marketing-plans)

Unlike numerous other MLMs, Herbalife accounts for Wholesale Commissions[1] as an offset to revenue rather than as an operating expense. This accounting treatment has the effect of understating the amount of recruiting-based incentives Herbalife pays to its upline Distributors by approximately $300 million. By concealing this expense from investors and regulators, Herbalife's accounting masks the true nature of the Company's business operations and the fact that it is a pyramid scheme.

The difference between Wholesale Commissions and Wholesale Profit: According to Herbalife's Sales & Marketing Plan, "If you sell products directly to your Distributors you can earn up to 25% Wholesale Profit immediately. If your Distributors purchase their product *directly from Herbalife*, then Herbalife pays the difference in discount percentage to the Qualified Producer and/or Fully Qualified Supervisor on the order during the monthly Royalty Override process. These payments are called Commissions and are Wholesale Profit (see example)." (emphasis added)

WHOLESALE PROFIT			
Retail	Your Cost (at 50%)	Your Distributor's Cost (at 25%)	Your Profit
$100	$50	$75	$25

Wholesale Profit is earned by the upline Distributor when it purchases product from the Company (i.e. at a 50% discount) and then resells the product to a downline Distributor (i.e. at a 25% discount). In contrast, Wholesale Commissions are paid from Herbalife to the upline Distributor when the downline Distributor purchases product *directly from the Company*. In these transactions, the upline Distributor who receives the wholesale commission does not act as a reseller of the product.

Wholesale Commissions are a significant expense: Wholesale Commissions accrue when a non-Sales Leader (a Distributor who has not qualified for the level of Supervisor) purchases products directly from the Company. At an investor presentation, Herbalife's CFO disclosed that in 2011 "a little over 35% of our volume came from non-Sales Leader purchases."[2] This statement implies that approximately $1.8 billion of Herbalife's "retail sales" in 2011 were from orders placed by non-Sales Leader Distributors ordering product directly from the Company at less than a 50% discount. Based on Herbalife's disclosure detailing the breakdown of non-Sales Leader discount levels provided in its 5/2/12 8-K, we estimate that Herbalife paid approximately $300 million in *Wholesale Commissions* (as distinct from *Wholesale Profit*) in 2011.[3]

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[1] Wholesale commissions are commissions the Company pays to upline Distributors in respect of product the Company sells directly to their downline distributors.
[2] John DeSimone, CFO, Janney Consumer Conference, 5/22/12.
[3] See page 139 of "Who wants to be a Millionaire?" for more details regarding this calculation.

Wholesale Commissions are indistinguishable from Royalty Overrides: In its FY 12 10K, Herbalife describes Royalty Overrides as "compensation to Distributors for the development, retention and improved productivity of their sales organizations [that] are paid to several levels of Distributors on each sale." Moreover, Herbalife states that Royalty Overrides are "generally earned based on retail sales and provide potential earnings to Distributors of up to 23% of retail sales." In practice, Wholesale Commissions are indistinguishable from these Royalty Override commissions:

- Like Royalty Overrides, Wholesale Commissions are paid for the development, retention and improved productivity of Distributors' sales organizations. During the 2010 Sun City Extravaganza, Leon Waisbein (Chairman's Club member and former Herbalife Board Director) described Wholesale Commissions as profit "Supervisors earn from recruiting activities."[5]

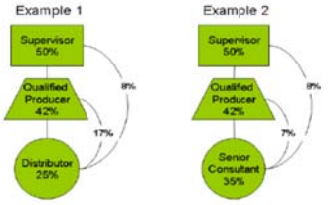
- Like Royalty Overrides, Wholesale Commissions are often paid to multiple levels of Distributors. For example, "split commissions" represent Wholesale Commissions that are paid to two separate levels of upline Distributors as demonstrated in the two charts below:[6]

Split Commision Example

Total Retail	Discount Level	Your Distributor's Cost	Spilt Commissions To the Quaified Producer (QP)	Spilt Commissions To the Supervisor
$100	25%	$75	$17	$8
$100	25%	$75	N/A (no QP)	$25
$100	35%	$65	$7	$8
$100	35%	$65	N/A (no QP)	$15

Q6: What are Split Commissions?

A6: Split Commission is the commission earned from a downline Distributor below a Qualified Producer who is purchasing at less than 42% discount. A commission of 7% or 17% is first paid to the first upline Qualified Producer and the remaining 8% is paid to the first upline Fully Qualified Supervisor.



- Like Royalty Overrides, Wholesale Commissions are earned and calculated as a set percentage of "retail sales."

- Wholesale Commissions are paid "during the monthly Royalty Override process" and are included in the same monthly commission check to Distributors along with other recruiting rewards, including Royalty Overrides and Production Bonuses.

Other MLMs Account for Wholesale Commission Equivalents as an Operating Expense:

<u>Nu Skin</u>

Nu Skin, which is audited by PwC, pays its Distributors a commission for "Company-Direct Consumer" purchases that it classifies as an operating expense. As the CFO of Nu Skin explained during an investor presentation, "Somebody can join our business in three different ways. You can join as a retail customer, directly with the consumer – or directly with the company, but you sign a specific form that says I'm a retail customer, I buy at a retail price. The profit between wholesale and retail, we send that to the Distributor who introduced you to the business."[7] The "profit between wholesale and retail" that Nu Skin sends to the referring Distributor who introduced the Company-Direct Consumer to the business is equivalent to Herbalife's Wholesale Commission.

Per the Nu Skin FY 12 10K, "Our selling expenses include commissions paid under our global sales compensation plan, which is focused on remunerating Distributors based primarily upon the selling efforts of the Distributors and/or the volume of products purchased by their sales organization." Calls with Nu Skin's IR department have confirmed that commissions for Company-Direct Consumer purchases are accounted for as an operating expense.

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[5] http://factsaboutherbalife.com/wp-content/uploads/2012/12/Waisbein-Extravaganza-Notes-2010.pdf

[6] Source for the Split Commission Example chart: Herbalife Sales & Marketing Plan. Source for the "What are Split Commissions" chart: Herbalife "Marketing Plan Enhancements Q&A" (2010).

[7] Rich Wood, CFO, ICR XChange Conference, 1/17/13.

Avon Products
According to the Sanford Bernstein research report "Is Avon a Pyramid Scheme?", Avon also accounts for all of its commission expenses in SG&A as opposed to as an offset to revenue:

> "First we believe that Avon accounts for 'recruiting incentives', including commissions and bonuses in its SG&A account, and the retail profit associated with Distributor discounts from product sales is netted out of sales to arrive at a net sales number that is presented on the P&L. **This presentation differs from Herbalife's statements, where the retail profit netted out of sales includes both product sales discounts and commissions on down-line sales**." (emphasis added)
>
> ("Is Avon a Pyramid Scheme?", Sanford Bernstein sell-side research, 1/30/13)

Reliv International
According to the 10K of Reliv International, the company treats Wholesale Commissions as an operating expense:

> "In accordance with EITF 01-09, the Company presents Distributor royalty and commission expense as an operating expense, rather than a reduction to net sales, as these payments are not made to the purchasing Distributor."
>
> (Reliv International FY 2008 10K)

As demonstrated above, we believe Nu Skin, Avon and Reliv account for Distributor commissions as operating expenses. Other than Herbalife, we are unaware of any publicly traded MLM that accounts for Distributor commissions as an offset to revenue.

EITF 01-9 Does Not Justify Herbalife's Wholesale Commissions Accounting Treatment:

Background on EITF 01-9: In 2001, the Emerging Issue Task Force (EITF) published Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)*, to address the accounting for consideration given by a vendor to a customer, reseller, or an entity that purchases the vendor's products from a reseller. ASC 605-50, *Revenue Recognition - Customer Payments and Incentives*, codified EITF Issue No. 01-9. The EITF reached a consensus that cash consideration given by a vendor to a customer is "presumed" to be a reduction of the sales price and should, therefore, be presented as a reduction to revenue in the vendor's income statement. The scope of EITF 01-9 is limited, however, to consideration paid to purchasers that are part of the "distribution chain." Further, consideration paid to purchasers within the distribution chain should be considered an operating expense if (1) the purchaser provides an identifiable benefit to the vendor and (2) the fair value of the identifiable benefit can be reasonably estimated.

We believe Herbalife incorrectly employs EITF 01-9 in an attempt to justify its treatment of Wholesale Commissions as an offset to revenue rather than as an operating expense.

Wholesale Commissions are outside the scope of EITF 01-9: FASB ASC 650-50-15-2, *Revenue Recognition-Customer Payments and Incentives-Scope and Scope Exceptions-Transactions,* states that the guidance applies to vendor (i.e. Herbalife) consideration to any purchasers of the vendor's product "at any point along the distribution chain."

> "Thus, the scope of Issue 01-9 includes vendor consideration to any purchasers of the vendor's products **at any point along the distribution chain**, regardless of whether the purchaser receiving the consideration is a direct customer or indirect customer of the vendor. **For example, a vendor may sell its products to a distributor who in turn resells the products to a retailer.** Consideration paid by the vendor to the retailer in that example is within the scope of this Subtopic. Examples of arrangements include, but are not limited to, sales incentive offers labeled as discounts, coupons, rebates, and free products or services as well as arrangements labeled as slotting fees, cooperative advertising, and buydowns. " (emphasis added)
>
> (ASC 650-50-15-2, *Revenue Recognition-Customer Payments and Incentives-Scope and Scope Exceptions-Transactions*)

When Herbalife pays Wholesale Commissions, the non-Sales Leader Distributor purchases and receives the product directly from Herbalife, and the upline Distributor does not buy, resell or transport the product; therefore, in these

transactions, **the upstream Distributors are not part of the "distribution chain."**[8] As such, consideration (i.e. Wholesale Commissions) paid to upstream Distributors in respect of these transactions are outside the scope of EITF 01-9 and should be recorded as a sales and marketing expense (i.e. an operating expense).

Wholesale Commissions should be recorded as an operating expense even if considered within the scope of EITF 01-9: Even within the scope of EITF 01-9, customer consideration should be recorded as an operating expense if (1) the consideration provides "an identifiable benefit" to the vendor and (2) "[t]he vendor can reasonably estimate the fair value of the benefit."

- **Identifiable benefit:** In light of Herbalife's self-described business model of network marketing, Wholesale Commissions (in addition to Royalty Overrides) to Distributors are compensation for performing sales and marketing tasks on behalf of Herbalife. Those payments are rewards for recruiting downline Distributors who order products directly from Herbalife. As a result, the Company receives an identifiable sales and marketing benefit from its upline Distributors in return for Wholesale Commissions, and therefore Wholesale Commissions should be recorded as an operating expense.

- **Estimate of fair value:** EITF 01-9 prescribes treatment as an expense if a transaction with a party other than the purchaser at an identifiable fair value would be possible. Herbalife could hire a direct sales staff to provide the sales and marketing benefits that Herbalife receives from upline Distributors in return for Wholesale Commissions. The fair value of that identifiable sales and marketing benefit could be reasonably estimated based on the (1) costs to hire a direct sales and marketing staff or (2) standard commission rates paid in analogous situations. In any event, one would presume that the fair value of the sales and marketing services performed by upline Herbalife Distributors would be reasonably equal to the amount of wholesale commissions paid by Herbalife as it has no incentive overpay for these services.

Wholesale Commissions fall outside the scope of EITF 01-9 because the upstream Distributor is not a part of the distribution chain in these transactions (he is not a reseller of the product); however, even if PwC were to determine that EITF 01-9 were applicable, then Wholesale Commissions should still be recognized as an operating expense because (1) Herbalife receives an identifiable sales and marketing benefit from its Distributors and (2) the fair value of the benefit can be reasonably estimated. As a result, whether or not EITF 01-9 applies, Wholesale Commissions should be recorded as an operating expense rather than a reduction to revenue.

Failure to recognize Wholesale Commissions as an expense overstates margin and understates expenses: In FY 11, Herbalife reported "retail sales" of $5,264 million, distributor allowances of $2,492 million, and net sales of $2,772 million (excluding literature, promotional and other items ("LPO")).[9] Had Wholesale Commissions been recorded as an operating expense rather than as a reduction to revenue, we estimate distributor allowances would have been only $2,181 million (12.5% lower) and net sales would have been $3,083 million (11.2% higher).

[8] None of the 15 illustrative examples provided in EITF 01-9 (or 18 illustrative examples provided in FASB ASC 650-50-55 *Implementation Guidance and Illustrations*) consider vendor consideration to individuals and/or entities outside of the "distribution chain." These examples provide further evidence that consideration given to individuals and/or entities outside of the "distribution chain" are not within the scope of this guidance.

[9] LPO items are excluded from these figures as Wholesale Commissions are not awarded for the purchase of these items.

Income Statement **as Reported** ($ in millions)	FY 2011	Income Statement **as Adjusted** ($ in millions)	FY 2011
"Retail sales" (ex LPO)	$5,264	"Retail sales" (ex LPO)	$5,264
Distributor allowances	($2,492)	Distributor allowances	($2,181)
Net sales (ex LPO)	$2,772	Net sales (ex LPO)	$3,083
Royalty Overrides	$1,138	Royalty Overrides	$1,138
Wholesale Commissions	$0	Wholesale Commissions	$311
Operating profit (ex SG&A)	$1,634	Operating profit (ex SG&A)	$1,634
Operating profit margin	58.9%	Operating profit margin	53.0%

Conclusion:
Given that the services performed by Herbalife Sales Leaders to earn Royalty Overrides and Wholesale Commissions are materially and conceptually similar, the recognition of those payments should be similar as well. Accounting for Wholesale Commissions as an operating expense rather than as a reduction to revenue would be consistent with the accounting treatment of at least three other publicly traded MLMs, including one that is audited by PwC. Further, Herbalife cannot use EITF Issue No. 01-9 to justify its accounting treatment because transactions where upstream Distributors receive commissions for product that is purchased directly by, and shipped directly to, downstream Distributors fall outside the scope of EITF 01-9 (and in any event Wholesale Commissions are paid in return for identifiable and quantifiable benefits and thus are to be treated as operating expenses even if they did fall within EITF 01-9). As a result of Herbalife's accounting treatment for Wholesale Commissions, Herbalife's operating expenses are significantly understated, its margins are overstated, and investors and regulators are misled as to the true amount of recruiting-related incentives paid by the Company to its Distributor base – a key factor in the determination of the legality of Herbalife's network marketing scheme.

II. Does Herbalife Employ an Aggressive Loan Scheme to Use Foreign Earnings to Fund US Operations and Share Repurchases?

Section summary:
In light of Herbalife's limited US-domiciled cash balances, unusual activity on its credit facility, and its establishment of a foreign cash pooling arrangement, it appears that Herbalife may be engaging in an aggressive treasury management policy to use untaxed offshore earnings to fund US operations and its share repurchase program, potentially exposing the Company to substantial US income tax and foreign withholding tax liability.

The US Senate has reviewed potential corporate abuse of offshore profit shifting schemes: On 9/20/12, the Permanent Subcommittee on Investigations of the US Senate Homeland Security and Government Affairs Committee (hereafter "The Senate Subcommittee") reviewed how certain multinational corporations headquartered in the US transfer property and profits to offshore jurisdictions to avoid US taxes. The review focused on current weaknesses in the tax code's transfer pricing regulations, including Internal Revenue Code Section 956, *Investment of earnings in United States property*; and Financial Accounting Standards Board's (FASB) APB 23, related to deferred tax liabilities on permanently invested foreign earnings.

- **US corporate taxation:** The Senate Subcommittee highlighted that the US statutory corporate tax rate of 35.0% is among the highest in the world. Certain companies during the Senate Subcommittee investigation highlighted IRC §956 which allows taxes on foreign income to be deferred until repatriation. US companies have indicated a reluctance to repatriate offshore funds back to the US because of the high statutory corporate tax rate.

- **Section 956 – short-term loan loophole:** According to IRC § 956, loans from a foreign subsidiary of a US company to the US company are considered an investment and deemed a taxable dividend. IRC § 956 contains a number of exclusions and limitations. Short-term loans from a foreign subsidiary to its US parent are excluded from the rule if (1) repaid within 30 days and (2) all loans in aggregate are outstanding for less than 60 days during the year. Further, intercompany loans issued and repaid within the subsidiary's fiscal quarter are not subject to the 30-day and aggregate 60-day limitations. The Senate Subcommittee found these types of loans could provide a continual flow of offshore profits to US parent companies that would not be subject to US corporate taxes. The Internal Revenue Service has stated it will apply anti-abuse rules to assess offshore loans to ensure they do not circumvent the law.

- **Senate Subcommittee case study - Hewlett-Packard loan scheme results in "de facto repatriation:"** The Senate Subcommittee indicated that Hewlett-Packard Company initiated a loan program in 2003 to fund US operations with foreign cash. The Senate Subcommittee found the loan program appeared "to have been used as a way to **de facto repatriate** billions of dollars each year to the United States . . . without a formal dividend distribution that would be taxable." (emphasis added)

  In 2008, Hewlett-Packard replaced its previous loan program with a "staggered" or "alternating" loan program. Hewlett-Packard's US parent received loans from two offshore entities under its control, the Belgian Coordination Center (hereinafter BCC) and the Compaq Cayman Holding Corp. (hereinafter CCHC). BCC functions as an internal bank for Hewlett-Packard, receiving deposits from offshore entities and making loans to those entities. CCHC does not have any active operations, but has what Hewlett-Packard characterized as a "stagnant pool" of cash available primarily for lending to US operations. Over the years, a series of short-term, serial loans from these two entities have provided billions of dollars to fund Hewlett-Packard's general US operations, including payroll and share repurchases.

  After a careful review of HP's loan scheme, the Senate Subcommittee determined "it is clear from HP documents that it structured this program in an attempt to circumvent the spirit of Section 956."[10]

Herbalife may have established a treasury management strategy similar to Hewlett-Packard's: Given similarly low levels of US cash, the establishment of a pooling arrangement with foreign subsidiaries (some of which may be subsidiaries of Herbalife's US consolidated group), and a surge in quarterly borrowings and payments

[10] A copy of the Senate Subcommittee's findings and the associated exhibits can be made available upon request.

on its revolver, it appears that Herbalife may have engaged in a loan scheme similar to Hewlett-Packard's to circumvent IRC §956 and applicable withholding taxes in order to fund US operations and share repurchases with untaxed foreign earnings.

- **Similar to HP, Herbalife's low quarter-end US cash balances suggest a dependence on offshore cash to fund onshore operations:** The Senate Subcommittee highlighted that only 6.0% of Hewlett-Packard's cash as of FY 09 was in the US. Further, the Senate Subcommittee found that Hewlett-Packard's internal documents suggested it had inadequate "cash in the US to run its operations." Similarly, as of year-end 2012, Herbalife had only 3.7% of its cash in the US, which we do not believe is sufficient to fund Herbalife's US operations. We estimate that well over 3.7% of Herbalife's global operating costs are in the US given that (1) approximately 20% of its revenue comes from the US, (2) the Company is headquartered in California, and (3) the Company's primary manufacturing facilities are located in the US (for example, the Company has stated that 40% of its manufacturing capacity stems from its Lake Forest, CA manufacturing facility).

  In light of similar US cash levels, foreign earnings concentrations, and locations of primary operations (i.e. California), it appears that, similar to HP, Herbalife has used loans from its offshore entities to fund its US operations and share repurchases.

Cash and Foreign Earnings Analysis ($ in millions)	Hewlett-Packard (FY 2009)	Herbalife (FY 2012)	Herbalife (FY 2011)
Foreign cash	$12,500.0	$321.3	$246.0
US cash[11]	$800.0	$12.2	$12.8
Total cash	$13,300.0	$333.5	$258.8
US cash a % of total cash	6.0%	3.7%	4.9%
Foreign earnings before tax	$6,846.0	$478.6	$415.9
Foreign earnings before tax as % of total earnings before tax	72.7%	73.5%	74.3%

- **Herbalife's cash pooling arrangement mimics HP's BCC and CCHC entities:** In its FY 11 10K, Herbalife disclosed it had established "a cash pooling arrangement with a financial institution for cash management purposes. This cash pooling arrangement allows certain of our participating foreign locations to withdraw cash from this financial institution based upon our aggregate cash deposits held by certain of our participating [foreign] locations who participate in the cash pooling arrangement." Similarly, according to the Senate Subcommittee, HP relied on a "stagnant pool" of cash provided by BCC and CCHC to make a series of short-term loans from its offshore entities to fund HP's US operations.

  We note that the establishment of Herbalife's cash pooling arrangement coincides with (1) an unexplained surge in Herbalife's quarterly borrowings from its revolver, and (2) a significant reduction in Herbalife's foreign tax rate.[12] As a result, we believe Herbalife's cash pooling arrangement may have been established to facilitate a series of intra-quarter loans from foreign subsidiaries (potentially including subsidiaries of Herbalife's US consolidated group) to fund Herbalife's US operations and share repurchases, thereby reducing Herbalife's effective tax rate.

  The fact that Herbalife's cash pooling arrangement pools monies from various offshore entities heightens the risk that the relevant taxing authorities might view Herbalife's cash pooling program as "merely a conduit for repatriating funds from foreign sources":

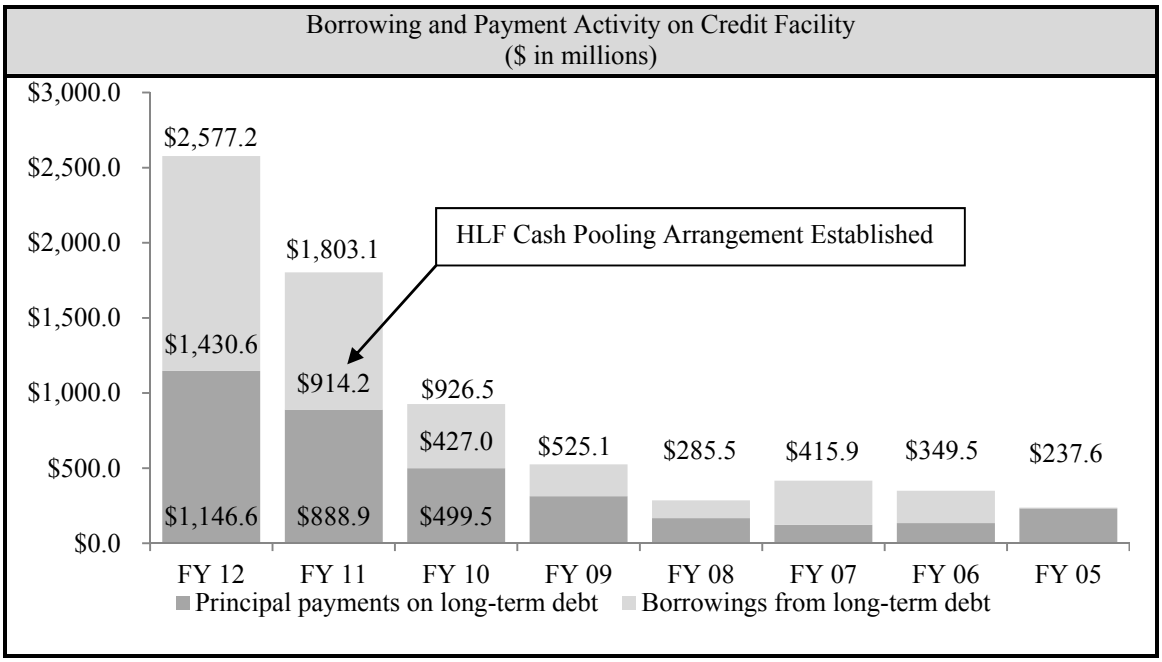
  > "Thus, it appears that both the courts and the IRS may seek to apply the substance over form [doctrine] to transactions that it views as abusive… Documents and/or workpapers that indicate an intention to circumvent or otherwise abuse the spirit of section 956 could prove particularly troublesome and thus should be avoided. **Furthermore, there should be**

[11] Herbalife's US cash is calculated as total cash (per the balance sheet) less foreign subsidiary cash (per the MD&A disclosure).
[12] Herbalife's foreign tax rate was 32.9%, 23.3%, 19.8% and 17.6% in Fiscal Years 2009 through 2012, respectively.

no loans between the two CFCs [BCC and CCHC] themselves, such that the IRS might argue that the CFC was merely a conduit for repatriating funds from other foreign sources. We should probably give this more thought as there has been some cash pooling." (emphasis added)

(*See* Correspondence between E&Y and HP, Senate Subcommittee on Offshore Profit Shifting and the US Tax Code, Exhibit #4a)

- **Borrowing and payment activity surges after establishment of cash pooling arrangement:** In FY 11, borrowings on Herbalife's Credit Facility increased 114.1% to $914.2 million and principal payments increased 78.0% to $888.9 million when compared with FY 10. In aggregate, borrowings and principal payments increased 94.6% to $1,803.1 million over the same period. Aggregate borrowings and principal payments increased again in FY 12 to $2,577.2 million, approximately equal to the cumulative borrowings and principal payments from FY 05 to FY 10.



We believe this surge in borrowings and repayments raises questions about the use of these borrowings given that (1) Herbalife's business is not particularly seasonal, but rather generates positive cash flow throughout the year, (2) Herbalife maintained significant cash balances throughout the course of 2011 and 2012 (why borrow and repay funds from the revolver and incur substantial interest expenses rather than use cash on hand?), and (3) Herbalife's disclosure that it has "historically met [its] working capital and capital expenditure requirements, including funding for expansion of operations, through net cash flows provided by operating activities." While the Company did modify its Credit Facility in 2012, which resulted in a $500 million Term Loan issuance that was used to repay outstanding amounts on the revolver, this does not fully explain the significant increase in Credit Facility borrowings and repayments in 2011 / 2012.

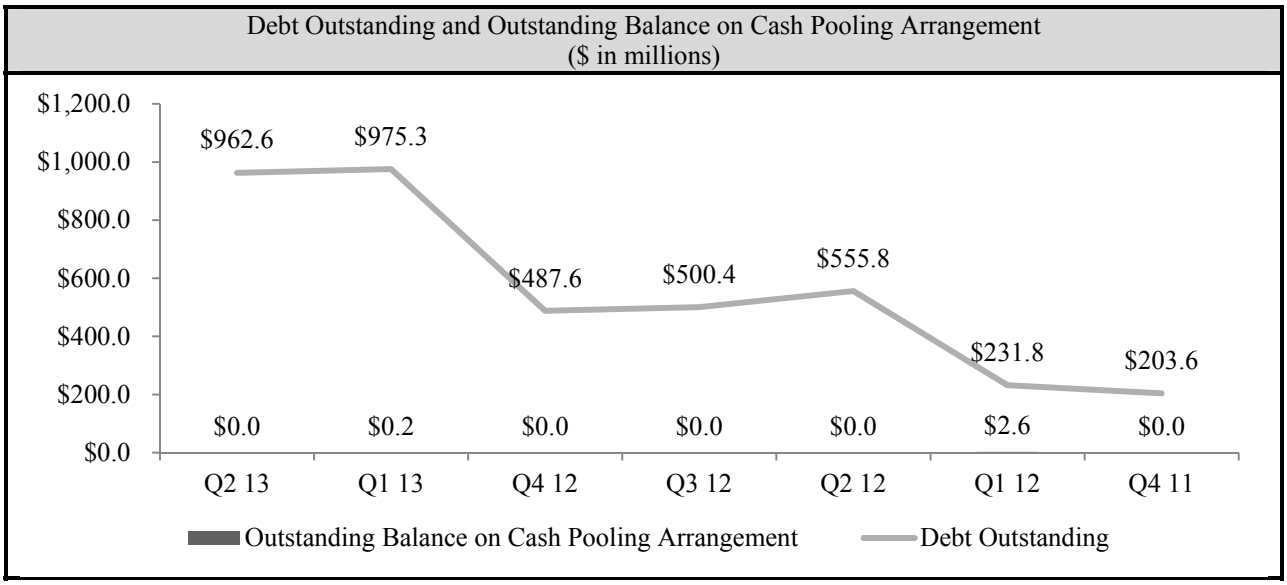
The surge in borrowings and payments is suggestive of elevated intra-quarter borrowings. For example, Herbalife may be borrowing monies from its revolver to repay amounts outstanding under its cash pooling arrangement at each quarter-end, and then reinitiating loans from the cash pooling arrangement at the inception of each quarter, in an attempt to (a) circumvent section 956 and classify the loans from its offshore entities as short-term loans rather than taxable dividends or (b) avoid potentially applicable withholding tax on purported loans from offshore entities that should have been treated as dividends. This approach would significantly increase the Company's periodic reliance on its revolver over the course of the year.

- **Both HP and Herbalife paid down their pooling liabilities at quarter-end:** At the Senate Subcommittee hearing, Hewlett-Packard's Tax Director said HP's short-term loans did not extend over quarter-ends in accordance with the technical requirements of IRC §956.

  "Hewlett-Packard technically met the temporary or short term lending requirements of Section 956, in that, the lenders **did not loan over their quarter ends**." (emphasis added)

  (HPQ Tax Director Lester Ezrati at the Senate Subcommittee on Offshore Profit Shifting and the US Tax Code, 9/20/12)

  Similarly, Herbalife has had no significant outstanding amounts on its cash pooling arrangement at any quarter-end since 2011, when the structure was created.[13]



  There are two potential explanations for the immaterial outstanding balance on Herbalife's cash pooling arrangement since its creation: (1) Herbalife created this treasury management structure in 2011 without any intent to use it, or (2) the Company is borrowing from the cash pooling arrangement intra-quarter and repaying the outstanding amounts at every quarter-end (potentially in an attempt to circumvent section 956 or withholding taxes of offshore jurisdictions). Given the unlikelihood of the first explanation, we believe Herbalife used its Credit Facility at the end of each quarter to repay amounts borrowed from the cash pooling arrangement.

IRS invalidates certain loan schemes that attempt to circumvent IRC §956: The Senate Subcommittee found that "[l]egal precedent show the IRS and courts have been willing to invalidate offshore loan programs that attempt to circumvent Section 956's restrictions by using serial short-term loans to bring a continual flow of untaxed offshore funds into the United States." (Senate Subcommittee on Offshore Profit Shifting and the US Tax Code, 9/20/12.) In 1999, the United States Court for the Ninth Circuit found that Jacobs Engineering Group Inc.'s twelve short-term loans from a foreign subsidiary functioned as a long-term loan lasting over two years.[14] The Ninth Circuit's territorial jurisdiction includes California, where Herbalife maintains its headquarters.

Senate Subcommittee criticizes Ernst & Young for supporting HP's loan scheme: The Senate Subcommittee highlighted that Ernst & Young, Hewlett-Packard's independent external auditor, reviewed the company's loan

[13] "We did not owe any amounts to this financial institution under the pooling arrangement as of December 31, 2012 and December 31, 2011." Herbalife FY 12 10-K. The table "Debt Outstanding and Outstanding Balance on Cash Pooling Arrangement" also shows that the outstanding amounts have been immaterial as of each quarter-end since the establishment of the cash pooling program in 2011.

[14] *Jacobs Engineering Group, Inc.* v. *United States*, 168 F.3d 499 (9th Cir. 1999)

program. While Ernst & Young concluded the loan program met the technical requirements of IRC §956, the Senate Subcommittee determined the loan program clearly attempted to circumvent the spirit of IRC §956.

> "HP's auditor, Ernst & Young (E&Y) was aware of the existence of the staggered loan program since it was initiated in 2008, reviewing it as part of their audit of HP's financial statements. Similar to the position taken by HP's tax director, E&Y took a technical view that the loans met the timing restrictions and the lending entities met the independence requirements of Section 956. **E&Y reached this conclusion, despite the fact over the course of years HP continually loaned billions of dollars regularly to HP's U.S. operations, which did not have adequate cash on shore. Moreover, it is clear from HP documents that it structured this program in an attempt to circumvent the spirit of Section 956**." (emphasis added)
>
> (Senate Subcommittee on Offshore Profit Shifting and the US Tax Code, 9/20/12)

The Senate Subcommittee's report explores just one type of potential violation and in just one jurisdiction (i.e. the US). Other jurisdictions (such as the jurisdictions in which the lending offshore entities are located) may also scrutinize such programs as to whether they inappropriately circumvent applicable rules on withholding. We encourage PwC to examine Herbalife's offshore loan program to determine whether it is in violation of the spirit or the letter of the law.

Conclusion:
The similarities between HP's loan scheme and Herbalife's cash pooling arrangement warrant a close review by PwC. To the extent it is determined that Herbalife has been using a series of intra-quarter offshore loans to fund US operations in an attempt to circumvent section 956 or withholding tax from the offshore jurisdictions, the Company may need to (1) restate earnings, and/or (2) record a significant unrealized tax liability for loans from offshore entities that should have been classified as taxable dividends. The amount will depend on a country-by-country analysis of applicable tax laws and treaties and could be highly material.

III. Has Herbalife Improperly Classified Unremitted Earnings as 'Permanently Reinvested'?

Section summary:
Given Herbalife's historically low levels of foreign working capital, limited international capital expenditures, and the Company's announced intention to aggressively buy back its shares, we believe it is unreasonable for Herbalife to assume that its $1.6 billion of unremitted foreign earnings are "permanently reinvested." If these unremitted foreign earnings are not permanently reinvested, then Herbalife's reported earnings may have been materially overstated in recent periods, its deferred tax liability may be materially understated, and the Company may owe a substantial amount of cash taxes and potential penalties.

Background on deferred tax liabilities related to undistributed foreign earnings: Withholding or other taxes that would be incurred in upstreaming foreign earnings from Herbalife subsidiaries are generally not payable until those foreign subsidiaries upstream those earnings. Similarly, US income tax on foreign earnings of subsidiaries underneath Herbalife's US consolidated group is generally not payable until the earnings have been repatriated to the US. Accordingly, companies typically record tax expense and a deferred tax liability (in lieu of taxes payable) to account for taxes that would be incurred when unremitted foreign earnings are upstreamed. FASB ASC 740-30-25-17 *Income Taxes-Other Considerations or Special Areas-Recognition-Exceptions to Comprehensive Recognition of Deferred Income Taxes* highlights the FASB's presumption that all undistributed foreign earnings will eventually be transferred to the parent company. **The repatriation presumption can be overcome if there is sufficient evidence that the subsidiary has "invested or will invest the undistributed earnings indefinitely."** In such cases, the codification indicates it is appropriate to *not* accrue for income taxes (i.e. not record a deferred tax liability).

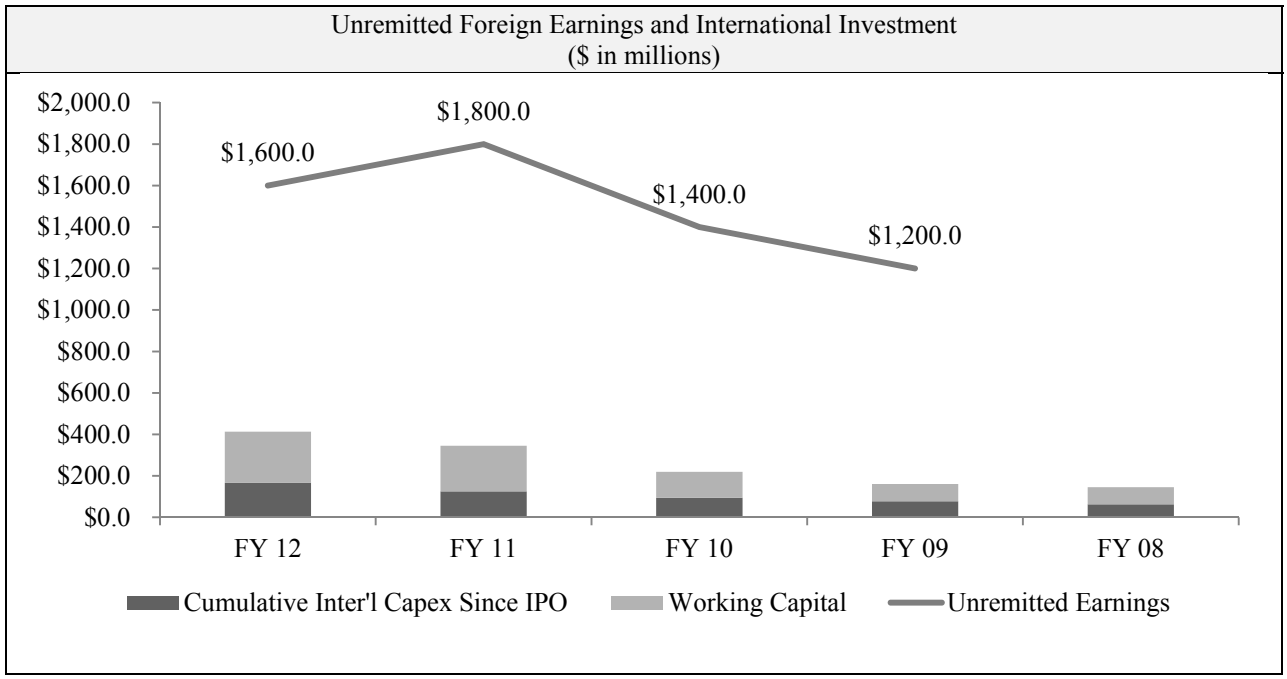
> "The presumption in paragraph 740-30-25-3 that all undistributed earnings will be transferred to the parent entity may be overcome, and no income taxes shall be accrued by the parent entity, for entities and periods identified in the following paragraph if sufficient evidence shows that the subsidiary has invested or will invest the undistributed earnings indefinitely or that the earnings will be remitted in a tax-free liquidation. A parent entity shall have evidence of specific plans for reinvestment of undistributed earnings of a subsidiary which demonstrate that remittance of the earnings will be postponed indefinitely. These criteria required to overcome the presumption are sometimes referred to as the indefinite reversal criteria."
>
> (FASB ASC 740-30-25-17 *Income Taxes-Other Considerations or Special Areas-Recognition-Exceptions to Comprehensive Recognition of Deferred Income Taxes*)

PwC suggests the following evidence is required to support assertion of indefinite reinvestment: In section 11.1.5.4 of PwC's Guide to Accounting for Income Taxes, PwC states a "mere history of not distributing foreign earnings does not serve as a replacement for specific reinvestment plans."[15] Further, PwC suggests its staff evaluate the parent's and subsidiaries' short- and long-term (1) forecasts and budgets, (2) financial requirements and projected working capital needs, (3) past history of dividend actions, and (4) reasons why any excess earnings are not needed by the parent or another subsidiary in the chain among other factors. The specific plans for reinvestment must be documented and maintained.

Insufficient evidence that foreign earnings will be invested indefinitely: In its FY 12 10K, Herbalife disclosed it had $1.6 billion of permanently reinvested unremitted earnings from its foreign operating subsidiaries.[16] Since the formation of its successor firm in 2002, Herbalife has only incurred total international capital expenditures of $166.2 million. Furthermore, Herbalife had $247.0 million of total working capital as of FY 12. **Given that Herbalife (1) has enough unremitted foreign earnings to maintain international capital expenditures for 40 years and fund a fourfold increase in working capital levels[17] and (2) has not completed a material foreign acquisition since its inception, it is not credible that Herbalife can provide "evidence of specific plans for reinvestment of**

[15] http://www.pwc.com/us/en/cfodirect/publications/accounting-guides/guide-to-accounting-for-income-taxes-2013-edition.jhtml
[16] We note that the amount of permanently reinvested unremitted earnings declined from $1.8bn in 2011 to $1.6bn in 2012 despite Herbalife posting significantly positive foreign earnings in 2012 and having its lowest foreign tax rate since going public. This decline is not explained in Herbalife's 2012 10K.
[17] Calculated assuming ~$16 million in annual foreign capex ($166 million over ~10 years) and $247 million in working capital as of YE 2012 (40yrs*$16mm + 4*$247mm = ~$1.6bn).

undistributed earnings."[18] Moreover, Herbalife spent $556.7 million in FY 12 to buy back shares and has announced that it plans to aggressively repurchase additional shares going forward; Herbalife may need to tap its foreign cash to fund a portion of those repurchases. As such, Herbalife would most likely be unable to overcome the presumption established in FASB ASC 740-30-25-3 that foreign earnings will be transferred to the parent company.



Decline in reinvested unremitted earnings suggests foreign earnings are not permanently reinvested: According to Herbalife's most recent 10K, in FY 12, Herbalife's permanently reinvested unremitted earnings declined by $200 million (11.1%) to $1.6 billion even though it had $394.6 million in after tax foreign earnings, and it paid $556.7 million to repurchase shares. This suggests that Herbalife may be funding part of its share repurchase program by drawing down on amounts it had characterized as permanently reinvested unremitted earnings. In light of the fact that Herbalife has publicly indicated that it intends to aggressively repurchase shares going forward, and the Company has not disclosed plans for capital expenditures or other investments that could consume the $1.6 billion of so-called "permanently reinvested" unremitted earnings according to the 2012 10K, we believe the amount of Herbalife's permanently reinvested earnings is materially less than $1.6 billion.

Conclusion:
In its FY 12 10K, Herbalife did not record a deferred tax liability related to the unremitted earnings and indicated that it would incur additional tax expense if it determined to repatriate the earnings.

> "For earnings not considered to be indefinitely reinvested, deferred taxes have been provided. For earnings considered to be indefinitely reinvested, deferred taxes have not been provided. **Should we make a determination to remit the cash and cash equivalents from our foreign subsidiaries to our US consolidated group for the purpose of repatriation of undistributed earnings, we would need to accrue and pay taxes. . . .** As of December 31, 2012, our parent, Herbalife Ltd., had $1.6 billion of permanently reinvested unremitted earnings relating to its operating subsidiaries. We do not have any plans to repatriate these unremitted earnings to our parent; therefore, we do not have any liquidity concerns relating to these unremitted earnings and related cash and cash equivalents." (emphasis added)
>
> (FY 12 10K)

[18] In our view, the ability to obtain debt with interest rates that are more favorable than withholding taxes from unremitted earnings does not constitute "evidence of specific plans for reinvestment." Further, it is impossible for Herbalife to determine that it can indefinitely access the debt market at favorable rates.

Given these facts, it is hard to understand how Herbalife could rebut the presumption in FASB ASC 740-30-25-17 that unremitted foreign earnings will be transferred to the parent entity. Thus, it appears to us that Herbalife should have recorded a tax expense and a deferred tax liability for a substantial portion of its $1.6 billion of undistributed foreign earnings.[19] Although the determination of the amount of tax expense and deferred tax liability would require an in-depth country-by-country analysis of tax laws, applicable tax treaties, and many other factors, in order to approximate the potential withholding taxes on unremitted earnings we estimate that Herbalife's weighted average withholding rate may be approximately 9.6% (see table below).[20,21]

Estimate of Weighted Average Dividend Withholding Rate ($ in millions)	2012 Revenue	2013 Dividend Withholding Rate
Mexico	$496.1	0.0%
South Korea	$421.4	20.0%
Brazil	$315.9	0.0%
China	$278.5	10.0%
Taiwan	$152.8	20.0%
India	$143.8	0.0%
Venezuela	$142.1	17.0%
Malaysia	$118.4	0.0%
Russia	$101.3	15.0%
Italy	$98.1	20.0%
Indonesia	$92.4	20.0%
Spain	$53.3	21.0%
Large foreign countries	$2,414.1	9.6%

If this estimate is correct, withholding taxes on unremitted earnings would be approximately $153 million.[22] We believe the potential impact of additional deferred tax expense relating to unremitted earnings could have important implications regarding the Company's ability to pay additional dividends and/or conduct incremental share repurchases, in light of certain Cayman Islands legal requirements for maintenance of certain levels of distributable reserves as discussed by the Company in its 10K.

[19] See Exhibit A of the Appendix for information about previous SEC inquiries into Herbalife's deferred tax liability (or lack thereof).
[20] 2013 dividend withholding rates based on Deloitte presentation available at http://www.deloitte.com/assets/Dcom-Global/Local%20Assets/Documents/Tax/Taxation%20and%20Investment%20Guides/matrices/dttl_WHT_rates_2013.pdf
[21] Assumes percentage of revenue by country is similar to earning percentage by country.
[22] Calculated by multiplying 9.6% by $1.6 billion.

IV. Has Herbalife Failed to Disclose Material Noncontrolling Interests?

Section summary:
In a credit agreement filed as an exhibit to the Company's Q2 2011 10Q, Herbalife disclosed that certain of its foreign subsidiaries are not wholly owned. Herbalife's consolidated balance sheet, however, reveals no minority interest liability. Thus, it appears that noncontrolling interests in foreign subsidiaries may not have been appropriately disclosed to investors in accordance with FASB ASC 810-10-45, *Consolidation-Overall-Other Presentation Matters* and Herbalife's net income and retained earnings may have therefore been overstated in recent periods.

Background on accounting requirements for non-controlling interests: FASB ASC 810, *Consolidation*, provides authoritative guidance on accounting for controlling financial interests in another entity and for non-controlling interests (formerly referred to, and commonly known, as minority interests) in such entities. ASC 810-10-45 *Consolidation-Overall-Other Presentation Matters* states that noncontrolling interests should be separately stated in the financial position within equity, and that the amount of noncontrolling interests should be "clearly identified and labeled" in the financial statements.

> "The ownership interests in the subsidiary that are held by owners other than the parent is a noncontrolling interest. The noncontrolling interest in a subsidiary is part of the equity of the consolidated group. **The noncontrolling interest shall be reported in the consolidated statement of financial position within equity (net assets), separately from the parent's equity (or net assets). That amount shall be <u>clearly identified and labeled</u>, for example, as noncontrolling interest in subsidiaries** (see paragraph 810-10-55-4I). An entity with noncontrolling interests in more than one subsidiary may present those interests in aggregate in the consolidated financial statements." (emphasis added)
>
> (FASB ASC 810-10-45-15:16 *Nature and Classification of the Noncontrolling Interest in the Consolidated Statement of Financial Position*)

Evidence suggests noncontrolling interests are not disclosed: In Exhibit 10.58 filed with Herbalife's Q2 11 10Q on 8/01/11, the Company disclosed certain equity interests in foreign subsidiaries not owned directly or indirectly by Herbalife. That exhibit suggested that noncontrolling interests owned 100.0% of PT Herbalife Indonesia, 14.4% of Herbalife International India Private Limited, 30.0% of Herbalife Products Malaysia SDN. BHD, and 5.0% of HIL Swiss International GmBH.[23]

Subsidiary With Equity Interests Not Owned Directly or Indirectly by Herbalife	Country	Shares Owned by Noncontrolling Interest	Shares Outstanding	% of Share Owned by Noncontrolling Interest
PT Herbalife Indonesia	Indonesia	550	550	100.0%
Herbalife International India Private Limited	India	--	--	14.4%
Herbalife Products Malaysia SDN. BHD	Malaysia	1,500,000	5,000,000	30.0%
HIL Swiss International GmBH	Switzerland	1,000	20,000	5.0%

Exhibit 21.1 of the FY 09 10K provides the most robust disclosure about Herbalife subsidiaries in recent periods.[24] Based upon Exhibit 21.1, Herbalife appears to operate only one subsidiary in each of the countries listed in the table above. As a result, it appears that the financial results for these countries relate solely to these subsidiaries.

Material noncontrolling interest suggests earnings may require restatement: In FY 12, Herbalife generated revenue of $92.4 million in Indonesia, $118.4 million in Malaysia, and $143.8 million in India. Assuming each region generated margins in-line with the Company-wide average, it appears noncontrolling earnings in Indonesia,

[23] Noncontrolling interests owned 60.0% of HIIP Investments Co., LLC, while HIIP Investments Co., LLC owned 24.0% of Herbalife International India Private Limited. Accordingly, we estimated noncontrolling interests owned 14.4% of Herbalife International India Private Limited.
[24] Exhibit 21.1 in the FY 09 10K included the location of incorporation for Herbalife's subsidiaries.

Malaysia, and India were $10.8 million, $4.2 million, and $2.4 million, respectively.[25] From FY 11 to FY 12, we estimate that total noncontrolling earnings increased 57.8% year-over-year to $17.4 million, and total noncontrolling earnings as a percentage of total earnings increased 100 basis points to 3.7%. **As a result, it appears that recent period earnings may have been materially overstated.** Noncontrolling interests have generated earnings of $34.4 million since FY 08.[26] As a result, retained earnings could be overstated by at least $34.4 million.

Noncontrolling Interest Earnings Analysis ($ in millions)	2012	2011	2010	2009	2008
Indonesia revenue	$92.4	$50.3	N/A	N/A	N/A
Indonesia earnings (estimate)	$10.8	$6.0	--	--	--
Indonesia noncontrolling earnings (estimate)	$10.8	$6.0	--	--	--
Malaysia revenue	$118.4	$84.2	$64.7	$51.0	$39.0
Malaysia earnings (estimate)	$13.9	$10.1	$7.1	$4.5	$3.7
Malaysia noncontrolling earnings (estimate)	$4.2	$3.0	$2.1	$1.4	$1.0
India revenue	$143.8	$117.0	$55.0	$25.8	$13.0
India earnings (estimate)	$16.9	$14.0	$6.0	$2.3	$1.2
India noncontrolling earnings (estimate)	$2.4	$2.0	$0.9	$0.3	$0.2
Total noncontrolling earnings	$17.4	$11.0	$3.0	$1.7	$1.3
Total noncontrolling earnings as % of earnings	3.7%	2.7%	1.0%	0.8%	0.6%
Cumulative noncontrolling earnings (since FY 08)	$34.4	$17.0	$5.9	$2.9	$1.3

There may be undisclosed noncontrolling interests in other countries: In exhibit 21.1 of the FY 12 10K, Herbalife disclosed 100 subsidiaries.[27] Given that part of Herbalife's strategy for entering new markets has historically been to form joint ventures (e.g. in China) or noncontrolling corporations (e.g. in India), **it is possible that certain of Herbalife's other subsidiaries may not be wholly owned.** Further confirmation with outside legal counsel of non-disclosed active and inactive subsidiaries may be appropriate. To the extent other minority interests exist, cumulative noncontrolling earnings may be significantly greater than we have estimated above.

Conclusion:
In light of evidence suggesting that material noncontrolling interests may have been omitted from Herbalife's past disclosures, it appears that earnings and retained earnings may have been overstated in recent periods (i.e. income attributable to minority interests has not been segregated on the income statement). In addition, given that some investors consider minority interests to be a form of debt or a potential future liability, omission of minority interest disclosures (or classification of minority interest liabilities as other liabilities) may mislead investors about Herbalife's inherent leverage and the other risks associated with non-wholly owned subsidiaries.

[25] For example, in FY 12, Herbalife generated India revenue of $143.8 million and a Company-wide net income margin of 11.7%. Therefore, it is assumed that India generated earnings of $16.9 million. Given that noncontrolling interests own 14.4% of Herbalife International India Private Limited, it appears that noncontrolling earnings were $2.4 million.
[26] Herbalife did not consistently disclose revenue in India, Indonesia, and Malaysia prior to FY 08.
[27] See Exhibit B of the Appendix section for a list of subsidiaries disclosed in exhibit 21.1 of the FY 12 10K.

V. Are Herbalife's Venezuelan Assets Overstated? Should Herbalife Venezuela Be Consolidated?

Section summary:
In light of what may be an "other-than-temporary" lack of exchangeability of the Venezuelan Bolivar, it appears that Herbalife's Venezuelan operations should be deconsolidated in accordance with FASB ASC 830-20-30-2. If Herbalife concludes that the lack of exchangeability of the Venezuelan Bolivar were temporary, Venezuelan assets should be remeasured at the fair market value based on observable market transactions in which the Company has recently engaged.

Background on highly inflationary economies accounting: FASB ASC 830, *Foreign Currency Matters*, provides authoritative accounting guidance for subsidiaries operating in foreign currencies. The codification provides direction on determining the appropriate functional currency, reporting currency, and translation methodology for foreign subsidiaries.[28] Further, ASC 830-10-45, *Foreign Currency Matters-Overall-Other Presentation Matters*, provides a quantitative threshold (i.e. at least 100.0% inflation over a three-year period) to determine if a currency should be considered highly inflationary. As of 1/01/10, Venezuela was a highly inflationary economy.

Background on Venezuela operations and currency limitations: In 1994, Herbalife began operations in Venezuela. In 2003, the Venezuelan Government enacted more stringent currency restrictions that affected the Company's ability to exchange Venezuelan Bolivars for US Dollars at the official foreign exchange commission (the CADIVI). As an alternative exchange mechanism, the Company participated in certain Venezuelan government bond offerings and other less favorable parallel market exchanges. In January 2010, the Venezuelan Government announced an official exchange rate devaluation to 4.3 Bolivars per US dollar. In June 2010, the Venezuelan Government introduced SITME, a newly regulated system.[29]

Bolivar devaluation charge: In FY 12, the Company remeasured its Venezuela assets at the SITME rate of 5.3 VEF:USD. Effective 2/13/13, the Venezuela Government devalued the Bolivar 46.5% from 4.3 VEF:USD to 6.3 VEF:USD. In Q1 13, the Company recorded a Venezuela devaluation charge of $15.1 million ($10.5 million net of taxes) to remeasure Venezuelan assets that had been previously recorded at an exchange rate of 5.3VEF:USD.

Alternative exchange rates are significantly less favorable than Government sponsored exchange rates: In recent periods, the Company has used alternative legal exchange mechanisms such as Venezuelan bond offerings to exchange Bolivars for US dollars. For example, in Q1 13 the Company exchanged VEF5.6 million for $0.2 million through an alternative legal exchange mechanism. Accordingly, the effective Q1 13 exchange rate in the alternative legal exchange was 25.2 VEF:USD, approximately 75% less favorable than the official exchange rate of 6.3 VEF:USD. Since Q1 13, the effective exchange rate continued to deteriorate, declining significantly from the average Q4 12 rate of 13.3 VEF:USD to 28 to 1 according to recent press reports.

Bolivars Exchanged in Alternative Legal Exchanges Analysis (VEF and $ in millions)	Q2 2013	Q1 2013	Q4 2012	Q3 2012	Q2 2012	Q1 2012
Bolivars exchanged in alternative exchange	--	VEF5.6	VEF5.3	--	VEF25.9	VEF28.0
US dollars received	--	$0.2	$0.4	--	$2.8	$3.2
Bolivar exchange rate in alternative exchange	N/A	25.2x	13.3x	N/A	9.0x	8.8x
Bolivars remeasurement rate used in financial statements	6.3x	6.3x	5.3x	5.3x	5.3x	5.3x
Loss on foreign currency exchange in an alternative exchange	--	$0.7	$0.7	--	$2.0	$2.1

[28] Per ASC 830-10-20, *Foreign Currency Matters-Overall-Glossary*, the functional currency is the currency of the primary economic environment in which the entity operates, while the reporting currency is the currency in which the financial statements are prepared.
[29] See Exhibit C of the Appendix for further background on Venezuelan operations.

Key observations about Herbalife's Venezuelan operations:

1. **Alternative legal exchange rates suggest Venezuelan assets may be overstated:** In its Q2 13 10Q, the Company disclosed that if the current Bolivar to US dollar exchange rate were 75.0% less favorable (i.e. approximately in-line with the current alternative exchange rate), cash and cash equivalents would be $93.2 million lower. Herbalife's peers do not include similar disclosure in their public filings. It appears Herbalife may have been compelled to include such a disclosure given that it exchanges Bolivars for US dollars at rates significantly below the official exchange rate.

   > "To illustrate our sensitivity to potential future changes in the CADIVI rate or using unfavorable alternative legal exchange mechanisms to exchange Bolivars to U.S. dollars, if the exchange rate was approximately 75% less favorable than the current 6.3 CADIVI rate and this unfavorable exchange rate was used to convert our Bolivar denominated cash and cash equivalents as of June 30, 2013, our $124.6 million in Bolivar denominated cash and cash equivalents as of June 30, 2013 would be reduced by $93.2 million and result in a corresponding foreign exchange loss to our operating profit."
   >
   > (Q2 13 10Q, 7/29/13)

   The official Venezuelan exchange rate is arbitrary as government officials rather than free market dynamics determine the rate. In accordance with ASC 820-10-55, *Fair Value Measurements-Over-Implementation Guidance and Illustrations*, it appears the objective fair value of Herbalife's Venezuelan assets should be determined based on the price at which an orderly transaction to sell the asset would take place. Given persuasive evidence that "observable market transactions" are executed at exchange rates that are significantly less favorable than the official rate (Herbalife has exchanged Bolivars for dollars in 4 of the last 6 quarters at significant discounts to the CADIVI rate), certain of Herbalife's assets (particularly its cash and cash equivalents) may be overstated.

   We believe that if Herbalife continues to consolidate its Venezuean subsidiary, Herbalife's balance sheet should reflect Herbalife Venezuela's assets based on the exchange rate in which Herbalife could convert Bolivars to US dollars.

2. **Consolidation of Venezuelan operations may be inappropriate:** ASC 830-20-30-2, *Foreign Currency Matters-Foreign Currency Transactions-Initial Measurement-Exchange Rates*, articulates that if a lack of exchangeability is "other-than-temporary," consolidation or accounting for an operation with the equity method should be "carefully considered."

   > "If exchangeability between two currencies is temporarily lacking at the transaction date or balance sheet date, the first subsequent rate at which exchanges could be made shall be used for purposes of this Subtopic. **If the lack of exchangeability is other than temporary, the propriety of consolidating**, combining, or accounting for the foreign operation by the equity method in the financial statements of the reporting entity **shall be carefully considered.**" (emphasis added)
   >
   > (FASB ASC 830-20-30-2 *Foreign Currency Matters – Foreign Currency Transactions – Initial Measurement – Exchange Rates*)

In Herbalife's Q2 10Q filed on 8/02/10, the Company added a disclosure that the mere existence of the exchange restrictions does not in and of itself create a presumption that the lack of exchangeability is other-than-temporary. The Company then included this disclosure in eleven consecutive quarterly and annual filings.

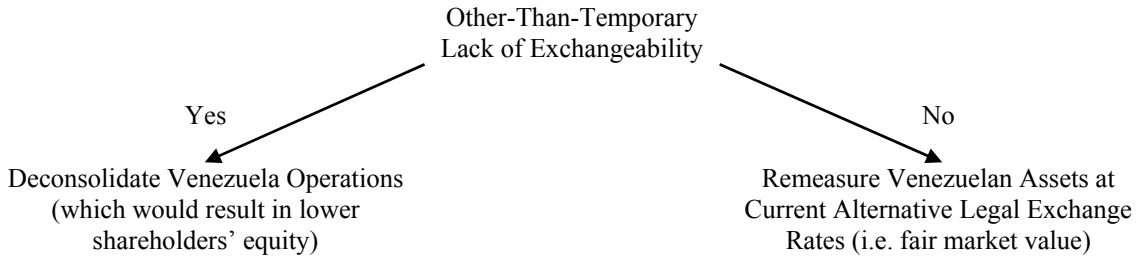
> "We currently plan to continue our operation in Venezuela and to import products into Venezuela. Herbalife Venezuela will continue to apply for legal exchange mechanisms to convert its Bolivars to U.S. dollars. Despite the currency exchange restrictions in Venezuela, we continue to control Herbalife Venezuela and its operations. **The mere existence of the exchange restrictions discussed above does not in and of itself create a presumption that this lack of exchangeability is other-than-temporary**, nor does it create a presumption that an entity should deconsolidate its Venezuelan operations. Therefore, we continue to consolidate Herbalife Venezuela in our consolidated financial statements for U.S. GAAP purposes." (emphasis added)
>
> (Q2 10 10Q, 8/02/10)

However, in its Q1 13 10Q, the Company removed the disclosure that currency restrictions did not create a presumption that lack of exchangeability is other-than-temporary.

> "We plan to continue our operation in Venezuela and to import products into Venezuela despite the foreign currency constraints that exist in the country. Herbalife Venezuela will continue to apply for legal exchange mechanisms to convert its Bolivars to U.S. dollars. Despite the currency exchange restrictions in Venezuela, we continue to control Herbalife Venezuela and its operations. Therefore, we continue to consolidate Herbalife Venezuela in our consolidated financial statements."
>
> (Q1 13 10Q, 4/29/13)

We believe that (1) three years of significant currency restrictions, (2) persistent use of alternative legal exchanges, and (3) removal of certain financial statement disclosures, taken together, suggest that the lack of exchangeability is "other-than-temporary."

Conclusion:
In light of what may be an "other-than-temporary" lack of exchangeability of the Venezuelan Bolivar, and in accordance with FASB ASC 830-20-30-2, it appears that Herbalife's Venezuelan operations should be deconsolidated. Even if Herbalife concluded the lack of exchangeability of the Venezuelan Bolivar were temporary, then Venezuelan assets should be remeasured at the fair market value based on observable market transactions. Remeasurement would result in lower reported cash assets, lower shareholders' equity (which could have implications for Herbalife's share repurchase program), and lower earnings (through impairment charges).



VI. Is Herbalife Improperly Crediting Unclaimed Foreign Royalty Overrides to Income?

Section summary:
According to Herbalife's 10K, Herbalife's practice is to cancel unclaimed foreign Royalty Override checks and reverse them into income after three years. PwC should investigate and consider whether this practice could be in violation of Nevada law regarding unclaimed property or foreign escheatment laws, and, more broadly, whether Herbalife properly escheats unclaimed Royalty Override checks in compliance with applicable law.

Royalty Overrides background: Herbalife reports (1) product sales, which represent "retail sales" less distributor allowances and product returns; (2) shipping and handling revenues; and (3) net sales, which represent product sales plus shipping and handling revenues. Royalty Overrides represent amounts paid by the Company to Distributors for the development, retention, and management of downstream Distributors and are the Company's most significant operating expense. Royalty Override expense includes Royalty Overrides (15% of "retail sales"), Production Bonuses (7% of "retail sales"), and Mark Hughes bonuses (1% of "retail sales"). Accordingly, Royalty Override expense totals approximately 23% of "retail sales." The Company reports a Royalty Overrides expense line item on its income statement and a Royalty Overrides current liability on its balance sheet. The Royalty Overrides current liability account represents Royalty Overrides expenses that have been accrued (i.e. recognized as expenses in the income statement) but not yet paid. Given that Royalty Override expense has remained constant at approximately 23% of "retail sales," it appears that Royalty Overrides expense (and the corresponding liability) is recorded when product is shipped.

Royalty Overrides Analysis ($ in millions)	2012	2011	2010
Retail sales	$6,404.3	$5,427.8	$4,306.3
Literature, Promotional and Other retail sales[30]	$189.0	$164.0	$136.4
China retail sales[31]	$334.9	$245.1	$208.4
Adjusted retail sales	$5,880.4	$5,018.7	$3,961.5
Royalty Overrides	$1,338.6	$1,137.6	$900.2
Royalty Overrides as % of adjusted retail sales	22.8%	22.7%	22.7%

Background on unclaimed foreign property: In its FY 12 10K, the Company disclosed that foreign Royalty Overrides checks that are uncashed (i.e. unclaimed) for three years are reversed into income.[32] The Nevada Unclaimed Property law provides that checks written by a Nevada corporation to a foreign payee that go unclaimed for three years shall be escheated to the state.[33]

Herbalife International, Inc. and Herbalife International of America, Inc. are incorporated in Nevada. To the extent that either of these entities wrote foreign Royalty Override checks, the amount of the check, if not cashed within three years, is likely required to be escheated to Nevada. There are reasons to believe that one or both of those companies may have written foreign Royalty Override checks. As an initial matter, Herbalife International of America, Inc., issues at least some of Herbalife's royalty checks to Distributors. A photograph of one such check, issued to Doran Andry, a domestic Distributor, is included in Exhibit E. Further, Herbalife publications indicate that, in numerous foreign countries, Herbalife pays Royalty Overrides in US dollars rather than in local currency, and, in some cases, those payments are made by "Herbalife USA." According to our research, this purported entity has not been incorporated in any US state and is not mentioned in Herbalife's filings with the Securities & Exchange Commission. Accordingly, it is unclear whether the term "Herbalife USA" is shorthand for Herbalife International, Inc. or Herbalife International of America, Inc.

[30] Excluded as Royalty Overrides are not paid on the purchase of these items.
[31] Excluded as Chinese commissions are recorded in SG&A.
[32] "Non-U.S. Royalty Overrides checks that have aged, for a variety of reasons, beyond a certainty of being paid, are taken back into income. Management has estimated this period of certainty to be three years worldwide." (FY 12 10K)
[33] See Exhibit D in the Appendix section for further information on Nevada unclaimed property law.

In the countries listed below, Herbalife publications state the following:

Colombia:
"Colombian earnings will be paid by Herbalife USA via check in US Dollars"
http://factsaboutherbalife.com/wp-content/uploads/2013/01/Columbia-Surcharge.pdf

Paraguay:
"Profits generated abroad for Distributors living in Paraguay will be sent in US dollar denominated checks from the United States."
http://factsaboutherbalife.com/wp-content/uploads/2013/01/Paraguay-Administrative-Fee.pdf

India:
"Non-Indian Supervisors will be paid their Indian earnings by Herbalife USA via cheque in US Dollars."
"Please note that any earnings outside of India for Indian resident Supervisors will be paid by Herbalife USA via cheque in US Dollars (with the exception of France and Belgium, which will be paid by the respective country in their local currency)."
http://factsaboutherbalife.com/wp-content/uploads/2013/01/India.pdf

Norway:
"Norwegian earnings to Non-Norwegian Supervisors will be paid by Herbalife USA via cheque in US Dollars."
"Please note that any earnings outside of Norway for Norwegian resident Supervisors will be paid by Herbalife USA via cheque in US Dollars (with the exception of France and Belgium, which will be paid by the respective country in their local currency)."
http://factsaboutherbalife.com/wp-content/uploads/2013/01/Norway-Surcharge.pdf

Jamaica:
"Jamaican earnings will be paid in US dollars, on a US dollar check."
http://factsaboutherbalife.com/wp-content/uploads/2013/01/Jamaica-Surcharge.pdf

Latvia:
"Latvian earnings will be paid in U.S. Dollars."
http://factsaboutherbalife.com/wp-content/uploads/2013/01/Latvia-Surcharge.pdf

Even if, or to the extent, Herbalife were paying foreign Royalty Override checks through foreign subsidiaries, unclaimed foreign Royalty Override checks may be subject to foreign escheatment laws. To take just one example, in New Zealand, where Herbalife has a large presence, Section 4 of the Unclaimed Money Act of 1971 may require unclaimed Royalty Override checks to be escheated to the State.

PwC should carefully consider and investigate whether Herbalife's practice of reversing unclaimed Royalty Override checks into income after three years rather than escheating the amounts covered by those checks to the appropriate state or foreign government violates Nevada or foreign escheatment law, and, more broadly, whether Herbalife properly escheats unclaimed Royalty Override checks in compliance with applicable law.

Royalty Override liability materially exceeds expected level: In Q2 13, Royalty Override expense of $379.6 million implied a monthly override expense of $126.5 million. As Distributors likely cash their Royalty Override checks within one month (probably within days or weeks), it appears rational that the Royalty Override liability would be equal to or less than one month of Royalty Override expense. Yet in Q2 13, the Royalty Override liability of $236.0 million exceeded the implied monthly Royalty Override expense by $109.5 million.

Estimate of Stale Dated/Aged Royalty Override Checks ($ in millions)	Q2 2013	Q2 2012	Q2 2011
Royalty Override expense	$379.6	$335.2	$289.2
Monthly Royalty Override expense (estimate)	$126.5	$111.7	$96.4
Royalty Override liability	$236.0	$206.1	$184.7
Royalty Override liability in excess of monthly royalty override	$109.5	$94.3	$88.2

Without access to Herbalife's internal accounting procedures, accounts, ledgers, and documentation, it is impossible to determine why the Royalty Override liability materially exceeds monthly royalty expense. However, the following reasons may explain why Herbalife's Royalty Override liability is substantially larger than 1/3rd of the quarterly expense:

- **Certain Distributors may not receive/cash their Royalty Override checks:** In light of Herbalife's promotion of its business opportunity to low-income individuals, certain Distributors may have less-than-stable lifestyles. For example, frequent moves (i.e. change of address/residence) by low-income Distributors may result in Royalty Override checks being "lost in the mail" or otherwise not delivered to the appropriate recipient. In addition, given that the "Distributor organization has a high turnover rate," former Herbalife Distributors that are entitled to Royalty Override compensation may have disassociated from Herbalife. Accordingly, unclaimed Royalty Override checks may explain why Herbalife's liability is in excess of the implied monthly Royalty Override amount.

- **Herbalife may not pay all Distributors that have earned Royalty Override compensation:** There have been several Distributor lawsuits against the Company that accuse Herbalife of improperly withholding Royalty Override checks from its Distributors.[34] In addition, in public complaints filed with the FTC, Herbalife Distributors have alleged the Company "will impose hefty fines to its Distributors in an effort not to pay royalties and keep this earnings for their bottom line and even go as far as to suspend its Distributors and not pay to the upline the proper amount of royalties (AS THEY ARE THE ONES WHO CALCULATE THE PAYMENTS WITHOUT ANY OUTSIDE OVERSIGHT TO THE WHOLE PROCESS)."[35]

  Given lawsuits and complaints from Distributors that did not receive certain expected Royalty Overrides, the elevated Royalty Override liability may have resulted from non-payment of Royalty Overrides to Distributors.

  The SEC has stated that companies should "identify and address those key variables and other qualitative and quantitative factors which are peculiar to and necessary for an understanding and evaluation of the individual company" in the MD&A. Further, in its Release Nos. 33-8350 and 34-48960, *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*, **the SEC indicated companies are <u>required</u> to discuss key variables that would be material to investors in the MD&A.**

  > "Financial measures generally are the starting point in ascertaining these key variables and other factors. However, financial measures often tell only part of how a company manages its business. Therefore, when preparing MD&A, companies should consider whether disclosure of all key variables and other factors that management uses to manage the business **would be material to investors, and therefore required.**" (emphasis added)
>
> (Securities and Exchange Commission Release Nos. 33-8350 and 34-48960, *Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations*)

  To the extent Herbalife is booking a Royalty Override expense for monies it subsequently determines its Distributors are no longer entitled to, it should disclose these amounts as they are clearly relevant to investors.

Herbalife escheatment liability could be substantial: In light of Herbalife's elevated Royalty Overrides liability relative to the implied monthly expense, there is reason to believe the amount of foreign Royalty Overrides that go unclaimed could be substantial.

The Nevada Unclaimed Property law imposes a seven-year statute of limitations but provides that the period of

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[34] *See Herbalife* v. *Carley*, No. BC248710 (Cal. Sup. Ct. L.A. Cnty.), Cross-Complaint of Chris Carley, which alleges "Herbalife claimed that [defendant] was violating some Herbalife rules or regulations and determined to impose sanctions on Chris by withholding payment to her of monies due under the Herbalife Marketing Plan." *See also McDowell* v. *Herbalife*, No. C00-2011Z (W.D. Wash.), Declaration of James Nelson, which alleges Herbalife unfairly pulled distributors out of McDowell's downline thereby allowing it to withhold millions of dollars of royalties to McDowell.

[35] http://factsaboutherbalife.com/wp-content/uploads/2013/02/Federal_Trade_Commission_Feb_4_2013_1.pdf

limitations begins to run only when "the holder specifically identified the property in a report filed with the Administrator or gave express notice to the Administrator of a dispute regarding the property. In the absence of such a report or other express notice, the period of limitation is tolled," and the State Treasurer may perform back audits of unclaimed property without limitation.[36] The Nevada Unclaimed Property Act imposes certain fines and 18% annual interest on amounts that a company fails to pay.[37] Thus, if Herbalife failed to make required escheatment payments to Nevada, Nevada may be able to pursue payments that should have been made at any time from and after the time Herbalife was founded (plus interest thereon at 18% per annum).

Since Herbalife was founded in 1980, we conservatively estimate that the Company has paid approximately $9 billion in Royalty Overrides to foreign Distributors.

($ in millions)	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Royalty overrides (1)	$65	$64	$26	$21	$18	$17	$21	$28	$61	$107	$126	$139	$185	$234	$251
Foreign retail sales %	5.8%	7.9%	21.3%	25.5%	26.6%	31.9%	67.4%	78.0%	78.7%	64.4%	66.6%	63.9%	76.7%	80.0%	77.8%
Foreign royalties (est.)	$4	$5	$6	$5	$5	$6	$14	$22	$48	$69	$84	$89	$142	$187	$195
Memo: Retail Sales:															
Total	$423	$427	$178	$144	$120	$122	$138	$191	$405	$693	$884	$924	$1,200	$1,491	$1,645
US (2)	399	393	140	107	88	83	45	42	86	247	295	334	280	299	364
Foreign retail sales	$24	$34	$38	$37	$32	$39	$93	$149	$319	$446	$589	$590	$921	$1,192	$1,280
Foreign retail sales %	5.8%	7.9%	21.3%	25.5%	26.6%	31.9%	67.4%	78.0%	78.7%	64.4%	66.6%	63.9%	76.7%	80.0%	77.8%

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	1H13	TOTAL
Royalty overrides (1)	$397	$382	$355	$387	$415	$465	$556	$675	$760	$797	$762	$900	$1,138	$1,339	$744	
Foreign retail sales %	76.8%	74.3%	73.3%	75.9%	78.0%	81.2%	82.2%	82.4%	80.7%	79.9%	77.8%	78.0%	80.2%	79.8%	79.7%	
Foreign royalties (est.)	$305	$284	$260	$294	$324	$377	$457	$557	$614	$637	$592	$702	$912	$1,068	$593	$8,855
Memo: Retail Sales:																
Total	$1,794	$1,765	$1,656	$1,779	$1,894	$2,146	$2,576	$3,100	$3,511	$3,811	$3,690	$4,306	$5,428	$6,404	$3,642	
US (2)	416	453	442	429	417	404	458	545	677	764	819	948	1,077	1,296	740	
Foreign retail sales	$1,377	$1,312	$1,215	$1,350	$1,478	$1,742	$2,118	$2,555	$2,834	$3,047	$2,871	$3,359	$4,351	$5,109	$2,902	
Foreign retail sales %	76.8%	74.3%	73.3%	75.9%	78.0%	81.2%	82.2%	82.4%	80.7%	79.9%	77.8%	78.0%	80.2%	79.8%	79.7%	

(1) Prior to 1999, Herbalife underreported royalty overrides because it offset the expense with the revenue it received from its P&H surcharge.
(2) Uses North America retail sales as a proxy for US retail sales from 1987 to 1989.

We believe this $9 billion figure is conservative given that (1) it excludes years 1980 through 1983 due to the lack of availability of certain data, (2) our analysis uses North American retail sales as a proxy for US retail sales for 1987 through 1989 when US-specific data was not available, (3) Herbalife's Royalty Override expense was understated prior to 1999 because the Company's financials offset a portion of the Royalty Override expense with the revenue Herbalife received from its P&H surcharge, (4) Herbalife classifies commissions paid to Chinese Distributors in SG&A, and (5) Herbalife's Royalty Override expense fails to include Wholesale Commissions (we estimate consolidated Wholesale Commissions were approximately $300 million in FY 12 alone, excluding China).

[36] Nev. Rev. Stat. §§ 120A.680 and 120A.690.
[37] Nev. Rev. Stat. § 120A.730.

As an illustrative example of what the potential escheatment liability might be, the chart below assumes that (1) half of Herbalife's foreign Royalty Overrides are paid by check written by Herbalife International, Inc. or Herbalife International of America, Inc. (each a Nevada corporation) and thus subject to the Nevada escheatment statute and (2) 3% of Herbalife's collective foreign royalties have gone unclaimed. The chart further imposes an 18% annual interest penalty on amounts not escheated to Nevada. Based on these assumptions, Herbalife's unrecorded cumulative escheatment liability would be approximately $600 million.

($ in millions)	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Foreign royalties (est.)	$4	$5	$6	$5	$5	$6	$14	$22	$48	$69	$84	$89	$142	$187	$195
Subject to NV statute (illust.)	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%
% unclaimed (illust.)	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Annual esch. liability	$0	$0	$0	$0	$0	$0	$0	$0	$1	$1	$1	$1	$2	$3	$3
Penalty interest		18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%
Cum. liability + interest	$0	$0	$0	$0	$1	$1	$1	$2	$3	$4	$6	$8	$12	$17	$23

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	1H13
Foreign royalties (est.)	$305	$284	$260	$294	$324	$377	$457	$557	$614	$637	$592	$702	$912	$1,068	$593
Subject to NV statute (illust.)	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%	50.0%
% unclaimed (illust.)	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%	3.0%
Annual esch. liability	$5	$4	$4	$4	$5	$6	$7	$8	$9	$10	$9	$11	$14	$16	$9
Penalty interest	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%	18.0%
Cum. liability + interest	$32	$42	$53	$67	$84	$105	$131	$162	$201	$247	$300	$364	$444	$540	$597

This example is illustrative. We do not know what percentage (if any) of the amounts paid in foreign Royalty Overrides was paid by check written by Herbalife International, Inc., Herbalife International of America, Inc. or another Herbalife entity subject to escheatment law, nor do we know the percentage of the amounts paid in foreign Royalty Overrides that remain unclaimed after three years. We provide this example only to demonstrate as a hypothetical matter how substantial the liability might be and to ask that PwC carefully investigate Herbalife's potential escheatment liability.

Conclusion:

PwC should carefully consider and investigate whether Herbalife's practice of reversing unclaimed Royalty Override checks into income after three years and not escheating the amounts covered by those checks to the government violates Nevada or foreign escheatment law and GAAP accounting principles, and, more broadly, whether Herbalife properly escheats unclaimed Royalty Override checks in compliance with applicable law. In any event, Herbalife's MD&A should provide more disclosure into the frequency and materiality of the reversal into income and of instances when Herbalife expenses Royalty Override amounts but fails to send Distributors the cash.

VII. Herbalife's Non-GAAP Earnings Exclusions May Be Inconsistent with Regulatory Requirements

Section summary:
In light of Herbalife's long history of being required to respond to questions about its business model from investors, Distributors, analysts, the media, and public interest and governmental groups, and its 25-year history of court cases challenging the legality of its multilevel marketing program, Herbalife's expenses in defending its business model do not appear to be non-recurring, infrequent, nor unusual. As such, the SEC *Conditions for Use of Non-GAAP Financial Measures* suggests these expenses should not have been recorded as a non-GAAP adjustment in Herbalife's Q1 13 and Q2 13 press releases. Also, it appears that the Venezuelan devaluation charges in the Company's non-GAAP reported results should not have been added back to GAAP earnings because previous devaluations and increased political uncertainty suggest it is "reasonably likely" the Venezuelan Bolivar could be devalued again in the next two years.

Background on non-GAAP reporting: As directed by the Sarbanes-Oxley Act of 2002, the SEC adopted new rules and amendments to address public company disclosures or releases of certain financial information that is calculated and/or presented on a basis other than in accordance with generally accepted accounting principles (GAAP). On 1/22/03, the Securities and Exchange Commission (SEC) published release 33-8176 that detailed the final rule on *Conditions for Use of Non-GAAP Financial Measures*. Given that non-GAAP reporting is inherently inconsistent with GAAP as determined by the FASB, the SEC's publications provide the most relevant/authoritative guidance for non-GAAP disclosures. In its *Condition for Use of Non-GAAP Financial Measures*, the SEC prohibited adjusting non-GAAP performance metrics for non-recurring, infrequent, or unusual items when it is "reasonably likely" to recur within two years or had occurred within the prior two years. In another context, the SEC said that for something to be "reasonably likely," it "must be more than a mere possibility," but it need not be "more likely than not" (see SEC Release 33-8185).

> "In addition to these mandated disclosure requirements, amended Item 10 of Regulation S-K and Item 10 of Regulation S-B prohibit the following… adjusting a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual, when (1) the nature of the charge or gain is such that it is reasonably likely to recur within two years, or (2) there was a similar charge or gain within the prior two years." (emphasis added)
>
> (Conditions for Use of Non-GAAP Financial Measures, B-2 Requirements of amended Item 10 of Regulation S-K and Item 10 of Regulation S-B)

H1 13 non-GAAP adjustments: In Q1 13, non-GAAP earnings excluded a $10.5 million Venezuela devaluation charge and $8.0 million of expenses incurred responding to attacks on the Company's business model. In Q2 13, non-GAAP earnings excluded a $2.2 million Venezuela devaluation benefit and $7.1 million of expenses incurred responding to attacks on the Company's business model. In addition, the Company excluded a $9.7 million Venezuela devaluation charge from its Q1 10 results.

Herbalife's non-GAAP Adjustments ($ in millions)	Q2 2013	Q1 2013	Q1 2010
Net income (GAAP)	$143.2	$118.9	$51.9
Venezuela devaluation impact (net of tax)	($2.2)	$10.5	$9.7
Expenses incurred responding to attacks on business model (net of tax)	$7.1	$8.0	--
Net income (non-GAAP)	$150.7	$137.4	$61.6

Key observations about non-GAAP earnings:

1. **Herbalife's defense of its business model is neither non-recurring, infrequent, nor unusual:** In its FY 05 10K, Herbalife included a disclosure in its risk factors that it is subject to private parties challenging the legality

of its network marketing program. The Company has included this disclosure in each 10K filing since its initial public offering.

> "Our network marketing program is subject to a number of federal and state regulations administered by the Federal Trade Commission and various state agencies in the United States as well as regulations on direct selling in foreign markets administered by foreign agencies. We are subject to the risk that, in one or more markets, our network marketing program could be found not to be in compliance with applicable law or regulations. Regulations applicable to network marketing organizations generally are directed at preventing fraudulent or deceptive schemes, often referred to as "pyramid" or "chain sales" schemes. . . . **We are also subject to the risk of private party challenges to the legality of our network marketing program. The multi-level marketing programs of other companies have been successfully challenged in the past.**" (emphasis added)
>
> (FY 05 10K)

Herbalife has regularly disclosed certain court cases in its 10K filings that have challenged the legality of Herbalife's multilevel marketing program. In light of Herbalife's long history of being required to respond to questions about its business model from investors, Distributors, analysts, the media, and public interest and governmental groups and its 25-year history of court cases challenging the legality of its multilevel marketing program, Herbalife's expenses in defending its business model do not appear to be non-recurring, infrequent, or unusual. As such, "expenses incurred responding to attacks on business model" should not be excluded from GAAP earnings in accordance with the SEC Condition for *Use of Non-GAAP Financial Measures*.

Public Challenges to the Legality of HLF Multilevel Marketing System	Date
People v. Herbalife	1986
Miron v. Herbalife	1998
Her Majesty the Queen v. Global Online Systems Inc[38]	2004
Jacobs v. Herbalife	2003 – 2005
Minton v. Herbalife	2005
Fraud Discovery Institute	2007 – 2008
Herbalife v. Ford	2007 – 2010
Test-Aankoop v. Herbalife (Belgian court rules that HLF is a pyramid scheme)	2004 – 2011
Greenlight Capital Founder, Mr. David Einhorn	May 2012
Pershing Square	Dec. 2012 - present
Bostick v. Herbalife	2013

2. **Frequency of Venezuela devaluation charges may prohibit exclusion under non-GAAP reporting:** Given (1) two official currency devaluations from the Venezuelan government in the past three years, (2) a significant discrepancy between the Government sponsored exchange rate and the exchange rate as implied by Herbalife's observable market transactions, and (3) increased political uncertainty due to the death of long-time President Mr. Hugo Chavez in March 2013, it appears "reasonably likely" the Venezuelan Bolivar could be devalued in the next two years. As a result, the Venezuelan devaluation charge should not have been excluded from GAAP earnings in accordance with the SEC *Condition for Use of Non-GAAP Financial Measures*.

[38] Global Online Systems Inc. was involved in selling products marketed by Herbalife Ltd. and recruiting new distributors for Herbalife Ltd. in Canada.

Conclusion:
As Herbalife's auditor, PwC has a responsibility to inform the Company if its non-GAAP adjustments do not comply with regulatory guidelines. Given the recurring nature of Herbalife's expenses to defend public attacks on its business model, and the recurring nature of Herbalife's Venezuelan impairment charges, we do not believe it is appropriate for Herbalife to add these expenses back to net income in its presentation of non-GAAP earnings.

VIII. Inconsistencies between Herbalife's Public Filings and Its Supplemental Disclosures

Section summary:
Herbalife publishes various supplemental, presumably unaudited disclosures on its corporate website, including its "Herbalife Regional Key Metrics" supplement and its "Statement of Average Gross Compensation Paid by Herbalife to United States Distributors." Comparing and contrasting these disclosures with Herbalife's audited public filings suggests that these disclosures may not be internally consistent.

Potential overstatement of payments to US Distributors: Within the "Business Opportunity" section of its website, the Company provides a link to a document titled "Statement of Average Gross Compensation Paid by Herbalife to United States Distributors in 2012" (the FY 12 Statement of Average Gross Compensation hereinafter), which purports to list the average gross payments in FY 12 by Herbalife to various categories of Distributors in the United States. Based upon the information disclosed in the FY 12 Statement of Average Gross Compensation, total gross payments to US Sales Leaders with a downline were $369.8 million in FY 12.

Sales Leaders With a Downline			
Average Payments from Herbalife	Number of Distributors	Average Gross Payments	Total Gross Payments ($ in millions)
> $250,000	194	$724,030	$140.5
$100,001-$250,000	452	$148,808	$67.3
$50,001-$100,000	539	$68,912	$37.1
$25,001-$50,000	1,136	$35,581	$40.4
$10,001-$25,000	1,940	$15,538	$30.1
$5,001-$10,000	2,552	$7,008	$17.9
$1,001-$5,000	11,307	$2,216	$25.1
$1-$1,000	39,151	$292	$11.4
$0	25,193	$0	$0.0
Total	82,464	$4,485	$369.8

According to the FY12 Statement of Average Gross Compensation, the figures above "do not include any retail / wholesale profit that a Distributor makes from selling Herbalife's products to others." This suggests that the figures above include only Royalty Overrides, Production Bonuses and the Mark Hughes bonus. In 2012, $369.8mm (the total gross payments to US Sales Leaders with a downline according to the FY 12 Statement of Average Gross Compensation) represented 45.3% of US net sales, which seems high in light of disclosure in Herbalife's 2012 10K that "Royalty Overrides are generally earned based on retail sales and provide potential earnings to Distributors of up to 23% of retail sales or approximately 33% of our net sales." (emphasis added)

Moreover, in the "Segment Information" section of its 10Q and 10K filings, the Company discloses revenue and contribution margin, which represents revenue less cost of sales and Royalty Overrides. Accordingly, the amount of Royalty Overrides attributable to each geographic segment can be estimated by utilizing the Company's consolidated gross margin as a proxy for segment gross margin. Pursuant to this approach, in FY 12, implied Royalty Overrides in the Company's United States segment were $294.4 million, or $75.4 million (20.4%) lower than the $369.8 million of total gross payments to US Sales Leaders with a downline implied by the amounts disclosed in the Company's FY 12 Statement of Average Gross Compensation.[39]

[39] The Company does not disclose gross profit on a segment basis in its public filings. In FY 12, the Company reported consolidated gross margin of 80.0% and a contribution margin of 44.0% in its United States segment. Accordingly, in our estimate of royalty override payments in the United States segment, we assumed a gross margin of 80.0%.

Royalty Override Payments Analysis (United States segment, $ in millions)	2012
Revenue (A)	$816.9
Gross profit estimate (assumes US gross margin = consolidated gross margin = 80%) (B)	$653.9
Contribution margin (C)	$359.5
Implied Royalty Override payments (B-C)	$294.4
Total gross payments as disclosed in FY12 Statement of Average Gross Compensation	$369.8
Discrepancy	*($75.4)*

There are three potential explanations for the $75.4mm discrepancy highlighted by the table above. First, perhaps the gross margin in the US is significantly higher than in other regions. However, unless Herbalife's gross margin in the US is 89% (significantly higher than the 80% consolidated gross margin), then the numbers will fail to reconcile. Second, perhaps Wholesale Commissions are included in the FY 12 Statement of Average Gross Compensation in payments from Herbalife to Sales Leaders with a downline. If this is the case, then Herbalife's disclosure in the FY 12 Statement of Average Gross Compensation that "the figures below do not include any retail/ wholesale profit that a Distributor makes from selling Herbalife's products to others" is misleading, as the Company defines Wholesale Commissions as a form of Wholesale Profit in its Sales & Marketing Plan. To the extent Wholesale Commissions account for the discrepancy, this is further confirmation that, in practice, Wholesale Commissions and Royalty Overrides are effectively the same (i.e. "gross compensation paid by Herbalife to Distributors") and should therefore be accounted for similarly, as discussed in Section I. A third potential explanation is that Herbalife may have overstated payments to US Sales Leaders with a downline in its FY 12 Statement of Average Gross Compensation.

Irreconcilable Distributor disclosure: In its 10Q and 10K filings, the Company discloses the total number of Distributors in its distribution network and the number of supervisors who fail to requalify for supervisor status during the Q1 requalification process. In addition, in the Company's unaudited Regional Key Metrics supplement, Herbalife discloses the number of new Distributors added in a particular quarter. Utilizing these disclosures, one can calculate an implied churn rate for the Company's non-Sales Leader Distributors.

Distributor Roll-Forward Analysis (ex China) (Demoted Sales Leaders Removed from Distributor Base in Q1 13)	Q2 13	Q1 13	Q1 12
Distributors - beginning of period	3,400,000	3,000,000	2,529,000
New Distributors	517,701	471,962	409,285
Demoted Sales Leaders[40]	0	(182,800)	(151,300)
Resigned Sales Leaders[41]	(1,950)	(1,950)	(1,200)
Non-Sales Leader churn (implied)	(715,751)	112,788	(156,785)
Distributors - end of period[42]	3,200,000	3,400,000	2,629,000

Non-Sales Leader Quarterly Churn (Demoted Sales Leaders Removed from Distributor Base in Q1 13)	Q2 13	Q1 13	Q1 12
Distributors - beginning of period	3,400,000	3,000,000	2,529,000
Sales Leaders - beginning of period	(455,829)	(583,058)	(501,299)
Non-Sales Leaders - beginning of period	2,944,171	2,416,942	2,027,701
Non-Sales Leader churn (implied)	(715,751)	112,788	(156,785)
Non-Sales Leader quarterly churn % (implied)	24.3%	(4.7%)	7.7%

As demonstrated in the table above, the Company's implied non-Sales Leader churn rate in Q1 13 was negative – an impossibility. We assume part of the explanation for this discrepancy is due to a change in the Company's policies, which caused all demoted supervisors in Q1 13 to be transferred from supervisor status to non-Sales Leader status for a period of 90 days.[43] Based on the figures above, we believe this was a change in the Company's policy as compared to FY 12 that was not disclosed in the public filings, but should have been, in order that the disclosure not be misleading.

The above explanation, however, does not fully clarify the trend in the implied churn rate of the Company's non-Sales Leaders. As demonstrated by the table below, even adjusting for the Company's demotion of supervisors to non-Sales Leaders in Q1 13, there is still a significant, unexplained inconsistency in the Company's reported Distributor metrics from quarter to quarter. For example, Herbalife's non-Sales Leader quarterly churn rate appears to have increased from 2.9% in Q1 13 to 18.1% in Q2 13 (and the 18.1% churn rate in Q2 13 excludes the 182,800 supervisors who were demoted to non-Sales Leader status in Q1 13 and removed from the Distributor base in Q2 13). We believe this may be evidence that the Company has changed other policies, perhaps in an attempt to

[40] Prior to 2013, we believe Herbalife's practice had been to remove demoted sales leaders from the distributor base altogether.
[41] Herbalife only reports sales leaders who resign in January and February. We assume constant monthly resignations at January/February levels (i.e. if a total of 800 sales leaders resigned in Jan/Feb, we assume a total of 1,200 resigned in Jan/Feb/Mar).
[42] The figure for distributors at the end of Q1 12 assumes total China distributors as of 3/31/12 was 171,000 (in-line with 12/31/11).
[43] On the Q2 13 earnings call, CFO DeSimone stated "one other thing that's unique in the quarter. So, in the first quarter when our sales leaders were – the ones that were not retained, they were demoted to senior consultant [non-sales leader] for 90 days and actually dropped out of the system in the second quarter."

overstate its Distributor base in its public filings, which could have the effect of misleading investors to believe that the implied retention rate of non-Sales Leader Distributors was higher than reality in previous periods. Therefore, we would encourage PwC to evaluate whether Herbalife truly had 3.4 million unique Distributors (excluding China) as of March 31, 2013, and to examine carefully Herbalife's methodology for tracking Distributors and presenting Distributor retention metrics.

Distributor Roll-Forward Analysis (ex China) (as adjusted) (Demoted Sales Leaders Removed from Distributor Base in Q2 13)	Q2 13	Q1 13	Q1 12
Distributors - beginning of period	3,400,000	3,000,000	2,529,000
New Distributors	517,701	471,962	409,285
Demoted Sales Leaders	(182,800)	0	(151,300)
Resigned Sales Leaders	(1,950)	(1,950)	(1,200)
Non-Sales Leader churn (implied)	(532,951)	(70,012)	(156,785)
Distributors - end of period	3,200,000	3,400,000	2,629,000

Non-Sales Leader Quarterly Churn (as adjusted) (Demoted Sales Leaders Removed from Distributor Base in Q2 13)	Q2 13	Q1 13	Q1 12
Distributors - beginning of period	3,400,000	3,000,000	2,529,000
Sales Leaders - beginning of period	(455,829)	(583,058)	(501,299)
Non-Sales Leaders - beginning of period	2,944,171	2,416,942	2,027,701
Non-Sales Leader churn (implied)	(532,951)	(70,012)	(156,785)
Non-Sales Leader quarterly churn % (implied)	18.1%	2.9%	7.7%

Potential "cherry picking" of Distributors for inclusion in compensation statistics: In its FY 11 Statement of Average Gross Compensation of US Supervisors (the FY 11 Statement of Average Gross Compensation hereinafter), the Company provided the average and median compensation of active Distributors in the US that had achieved the level of Sales Leader or above in its distribution network.[44] According to this disclosure, **39.4%** of Herbalife's US Sales Leaders were deemed "active." In this disclosure, the Company defined active Sales Leaders as those that generated at least 2,500 volume points in FY 11 after becoming a supervisor, representing a narrower definition than provided in its FY 11 10K.

[44] A copy of the FY 11 Statement of Average Gross Compensation is available at: http://factsaboutherbalife.com/wp-content/uploads/2012/12/2012_StatementAverageCompensation2011EN.pdf

Active Sales Leaders				
Earning Level	% of Total Sales Leaders	% of Active Sales Leaders	Average Earnings Compensation	Median Compensation
President's Team	0.2%	0.6%	$514,638	$336,901
Millionaire Team	0.7%	1.7%	$100,195	$97,303
Get Team	2.6%	6.5%	$22,766	$19,417
World Team	2.9%	7.3%	$6,224	$5,659
Supervisor	33.1%	83.9%	$901	$475
Total	39.4%	100.0%	$7,354	$637

In contrast, in the Regional Key Metrics supplement published on the Company's website, the Company disclosed that the number of average active Sales Leaders in the North America geographic segment was 56,741 in FY 11, representing **52.4%** of total Sales Leaders in that region. This disclosure is consistent with the reported number of average actives Sales Leaders in the Company's FY 11 10K.

Why did the Company report in its FY 11 Statement of Average Gross Compensation that active Sales Leaders represented 39.4% of total Sales Leaders in the US while it reported in its Regional Key Metrics supplement and its FY 11 10K that active Sales Leaders represented 52.4% of total Sales Leaders in the North America?

Key Metrics Analysis (Source: Regional Key Metrics document)	2011
Average active Sales Leaders (Regional Key Metrics document)	56,741
Total Sales Leaders (Regional Key Metrics document)	108,211
Average active Sales Leaders as % total Sales Leaders (Regional Key Metrics document)	52.4%
Active Sales Leaders as % total Sales Leaders (Statement of Average Gross Compensation)	39.4%
Difference (in bps)	*1,300*

Two potential explanations of the differential are (1) the inclusion of other regions in the North America segment Distributor statistics and/or (2) the impact of averaging on the average active Sales Leader metric presented in the Company's Regional Key Metrics supplement. The impact of the inclusion of other regions in the North America segment Distributor statistics should have been minimal given that 96.9% of North America segment revenue was generated in the US. Further, it is unlikely that the impact of averaging would generate such a large discrepancy between the two figures. In this light, the primary driver of the differential would seem to be the narrower definition of active leader utilized in the Company's FY 11 Statement of Average Gross Compensation. **Accordingly, it appears that the Company may have "cherry picked" the highest earning Sales Leaders for inclusion in the compensation figures presented in its FY 11 Statement of Average Gross Compensation.**

Conclusion:
This section provides three examples where Herbalife's metrics as reported in its audited public filings appear inconsistent with disclosures Herbalife publishes in its supplemental statements available on its corporate website: (1) an apparent discrepancy in the amount of Royalty Overrides paid to US Distributors, (2) an apparent discrepancy in the total number of Distributors and the implied non-Sales Leader churn rate, and (3) an apparent discrepancy in the definition of "active" Sales Leaders. As the Company's auditor, PwC should require Herbalife to correct any previous false and misleading disclosures in its published reports, and should put in place controls to ensure that all of Herbalife's publicly disclosed metrics are accurate and consistent.

IX. Certain Irreconcilable Differences and Potential Financial Statement Misstatements

Section summary:
We have identified what appear to be multiple financial statement misstatements in Herbalife's public filings from 2010 through 2013 that invite further investigation. While these errors may not on their own appear material, they are suggestive of weak internal controls over Herbalife's financial reporting.

Comparative review of certain share-based compensation disclosures identifies potential misstatements: A comparative review of certain Herbalife share-based compensation disclosures from 2010 through 2012 identified several instances of what appear to be misstatements and/or undisclosed restatements.

- **Intrinsic value of stock options exercised may have been misstated:** In its Q1 10 10Q, Herbalife reported Q1 10 intrinsic value of stock option awards exercised of $6.0 million. In its Q1 11 10Q, Herbalife reported Q1 10 intrinsic value of stock option awards exercised of $1.2 million, $4.8 million less than had been reported in the prior year 10Q. It seems likely that Herbalife failed to update its prior year balance when it prepared its Q1 11 10Q (i.e. the Q1 09 balance, also $1.2 million, reported in the Q1 10 10Q was carried forward in to the Q1 11 10Q). **As a result, Q1 11 10Q likely misstated the value of Q1 10 intrinsic value of stock option awards exercised.**

Intrinsic Value of Stock Options and Stock Appreciation Rights Analysis ($ in millions)	Q1 2011	Q1 2010	Q1 2009
Total intrinsic value of stock awards exercised (as originally reported)	$16.9	$6.0	$1.2
Total intrinsic value of stock awards exercised (as reported the next year)	$16.9	$1.2	$1.2
Potential restatement and/or misstatement	$0.0	$4.8	$0.0

- **Weighted average grant date fair values may have been misstated and/or restated in multiple periods:** In Herbalife's share-based compensation disclosures from Q1 09 through Q1 13, there were four instances where the weighted-average grant date for the fair value of equity awards granted changed from prior disclosures.[45,46] Given that the first discrepancy occurred in Q2 11, Herbalife's change in disclosure in Q3 11 from the weighted-average grant date fair value "of stock awards" to "of SARs" cannot explain the discrepancies. In addition, Herbalife's Q2 11 stock split does not explain the discrepancies given (1) adjustments for the stock split and the fact that (2) a discrepancy remained after the stock split annualized in Q2 12.

  "The weighted-average grant date fair value **of stock awards** granted…" (Q2 11 10Q) (emphasis added)

  "The weighted-average grant date fair value **of SARs** granted…" (Q3 11 10Q) (emphasis added)

[45] Given limited quarterly disclosure in the Q4 period, it is not possible to perform a comparative analysis in the Q4 period for Herbalife's weighted-average grant date fair value of equity awards granted.
[46] In FY 11, Herbalife ceased awarding named executive officers (NEOs) restricted stock units (RSU) and solely awarded SARs. It is likely Herbalife ceased awarding RSU to all employees, a decision likely made in May 2011 (Q2 11) at a Board meeting to determine annual equity awards for NEO. Accordingly, the change in Q3 11 disclosure from "of stock awards" to "of SARs" resulted in a change in the type of awards granted.

Weighted-average Grant Date Fair Value of Equity Awards Analysis	Q2 2011	Q1 2011	Q4 2010	Q3 2010	Q2 2010
Weighted-average grant date FV of EA (as originally reported)	$21.01	$41.74	--	$31.38	$21.43
As originally reported - adjusted for stock split	$21.01	$20.87	--	$15.69	$10.72
Weighted-average grant date FV of EA (as reported next year)	$21.42	$15.23	--	$11.02	$10.99
Potential misstatement and/or undisclosed restatement	($0.41)	$5.64	--	$4.67	($0.27)
Shares granted (in thousands)	1,172.0	40.0	2.0	34.0	1,396.0
Potential misstatement and/or undisclosed restatement ($ in millions)	($0.5)	$0.2	--	$0.2	($0.4)

The persistent discrepancies may suggest (1) weak US payroll controls, (2) weak internal controls over financial reporting (ICOFR), and/or (3) undisclosed restatements of equity award fair values (i.e. changes to grant date exercise price or pricing model assumptions).

Potential overstatement of Sales Leader retention rate: The Company's compensation system requires Sales Leaders to re-qualify prior to February each year. Every February, the Company demotes Sales Leaders that do not satisfy the re-qualification requirements during the preceding twelve-month period. Distributors that meet the Sales Leader requirements at any time during the year (including demoted Sales Leaders) are promoted to Sales Leaders at that time. In its 10K and 10Q filings, the Company discloses (1) the total number of Sales Leaders that needed to re-qualify during the relevant re-qualification period, (2) the total number of demoted Sales Leaders that did not re-qualify, and (3) the total number of Sales Leaders that successfully re-qualified in the relevant requalification period. The Company calculates the Sales Leader retention rate by dividing the total number of Sales Leaders that successfully re-qualified by the total number of Sales Leaders that were required to re-qualify.

Sales Leader Analysis (ex China, in thousands)	Requalification Period Ended 1/31/13	Requalification Period Ended 1/31/12	Requalification Period Ended 1/31/11
Sales Leaders needed to re-qualify	379.6	314.9	283.2
Demoted Sales Leaders	(182.8)	(151.3)	(144.8)
Total Sales Leaders re-qualified	196.8	163.6	138.4
Retention rate	51.8%	52.0%	48.9%

A separate disclosure provides a reconciliation of total Sales Leaders at the beginning of the relevant calendar year to the number of Sales Leaders at the end of February (subsequent to the closing of the re-qualification period). Within this disclosure, the Company includes a reconciling item for "other Sales Leaders" that resigned or left the Company for other reasons. These Sales Leaders are **not** included in the Company's retention rate calculation.

Sales Leader Analysis (ex China, in thousands)	CY 2013	CY 2012	CY 2011
January 1 total Sales Leaders	583.1	501.3	434.2
January & February new Sales Leaders	37.1	34.8	28.9
Demoted Sales Leaders (did not re-qualify)	(182.8)	(151.3)	(144.8)
Other Sales Leaders (resigned, etc)	(1.3)	(0.8)	(0.8)
End of February total Sales Leaders	436.1	384.0	317.5

In CY 13, 1,300 Sales Leaders were classified as "other Sales Leaders" that resigned or left the Company for other reasons **only in January and February** (and were not considered in the Company's retention rate calculation). We multiplied the number of "other Sales Leaders" that resigned or left in these two months by six to estimate

annualized "other" departures. We used this estimate to adjust the total number of Sales Leaders needed to re-qualify for the relevant re-qualification period. For example, assuming an equivalent number of resignations (and other departures) over a twelve-month period, the Sales Leader retention rate for the requalification period ending 1/31/13 would have been 50.8%, 100 basis points below the reported retention rate of 51.8%.

Pro Forma Sales Leader Analysis (ex China, in thousands)	Requalification Period Ended 1/31/13	Requalification Period Ended 1/31/12	Requalification Period Ended 1/31/11
Pro forma Sales Leaders needed to re-qualify	387.4	319.7	288.0
Demoted Sales Leaders (as originally reported)	(182.8)	(151.3)	(144.8)
Other Sales Leader departures (est.)	(7.8)	(4.8)	(4.8)
Total Sales Leaders re-qualified	196.8	163.6	138.4
Pro forma retention rate	50.8%	51.2%	48.1%
Reported retention rate	51.8%	52.0%	48.9%
Amount pro forma rate above (below) reported rate	*(100 bps)*	*(80 bps)*	*(80 bps)*

We do not understand why the Company excludes Sales Leader resignations from its reported Sales Leader retention rate. We also believe it is misleading to report Sales Leader resignations for only two months of the year (i.e. only January and February). Accordingly, the Company's public filings may overstate its retention rate of Sales Leaders within its distribution network and understate the true number of Sales Leader departures.

Potential misrecognition of taxes prepaid by Distributors as revenue: In the *Revenue Recognition* section of Herbalife's FY 12 10K, the Company states that it "currently presents sales taxes collected from customers on a net basis." This would suggest that Herbalife does not record revenue for cash received from Distributors who prepay sales taxes when they order product directly from the Company and that Herbalife does not record prepaid sales taxes as expenses when they are remitted from Herbalife to various states and foreign governments. Presumably this treatment would apply to both sales taxes and value added taxes.

However, based upon the Company's disclosure in its 10K, it is clear that Herbalife records an undisclosed amount of value added tax and sales tax in its SG&A expense. Indeed, Herbalife reported that SG&A increased in 2012 partially due to "$10.9 million in higher non-income tax expenses such as value added tax and sales tax."

If Herbalife is recording value added tax and sales tax in its SG&A expense, it seems reasonable to assume that the Company may also be including value added tax and sales tax payments from Distributors in revenue. If this is true, Herbalife's income statement would effectively be grossed up (i.e. revenue and expense would be added to the income statement in equal amounts) resulting in (1) revenue growth, (2) SG&A growth, and (3) margin deterioration. This could explain why, in recent quarters, the Company has posted double-digit revenue growth but only modest operating income growth.

Therefore, PwC should investigate whether Herbalife is recording value added tax and/or sales tax in net sales and whether this is consistent with the Company's stated revenue recognition policy to present "sales taxes collected from customers on a net basis." Whatever the case may be, Herbalife should disclose any value added tax and sales tax recorded in revenue.

Conclusion:
We believe the issues presented above (in this section and in previous sections) suggest that the Company may have material weaknesses in its internal controls over financial reporting. We note that a "material weakness" is a deficiency, or a combination of deficiencies, in internal controls such that there is a "reasonable possibility" that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. There is a "reasonable possibility" of an event when the likelihood of the event is either "reasonably possible" or "probable" as those terms are used in Financial Accounting Standards Board Statement No. 5, *Accounting for Contingencies*. PCAOB Auditing Standard No. 5 requires an independent auditor, prior to issuing its

report on a company's internal controls over financial reporting, to communicate in writing to the audit committee and management all material weaknesses. In addition, an independent auditor must communicate all significant deficiencies to the audit committee and must communicate to management all deficiencies (and inform the audit committee when that communication has been made) in internal controls identified during an audit.

In addition to the issues highlighted previously in this letter, when assessing the Company's internal controls, we would urge PwC to focus on the Company's global operations including, without limitation, its ability to track and verify value added tax reporting, sales tax reporting, customs duties and similar assessments.

X. Miscellaneous Topics

Revenue may have been overstated prior to FY 12 due to "synthetic FOB shipping" terms: In FY 12, Herbalife changed its revenue recognition criteria from "when products are shipped" to "upon delivery." In general, inventory in transit to customers at consumer product companies' period-ends generally ranges from five days (for companies with many points of distribution) to two weeks (for companies with fewer points of distribution). Given the change in revenue recognition criteria to "upon delivery," FY 12 revenue may have contained 1.3% - 3.8% fewer deliveries than prior years.

> "The Company generally **recognizes revenue upon delivery** and when both the title and risk and rewards pass to the independent Distributor or importer, or as products are sold in retail stores in China or through the Company's independent service providers in China." (emphasis added)
>
> (Revenue Recognition Disclosure FY 12 10K)
>
> "**Revenue is recognized when products are shipped** and title and risk of loss passes to the independent Distributor or importer." (emphasis added)
>
> (Revenue Recognition Disclosure FY 11 10K)

It seems likely that Herbalife has historically replaced or credited lost and/or damaged shipments to its Distributors. Notwithstanding a material revision to shipping terms for each Distributor agreement, the change in revenue recognition criteria in FY 12 to "upon delivery and when both title **and risk and rewards** pass to the independent Distributor" may suggest that Herbalife historically replaced damaged shipments to Distributors.

If Herbalife typically replaced damaged shipments to its Distributors, "synthetic FOB shipping terms" suggest that revenue should have been recognized upon delivery rather than at shipping point in fiscal years prior to FY 12. Accordingly, FY 10 and FY 11 revenue may have been overstated as revenue recognition on year-end shipments was not deferred until delivery.[49]

Elevated level of inventory – more disclosure needed: In Q2 13, inventory increased 26.4% year-over-year in absolute terms to $331.5 million and increased 5.8% relative to product revenue to 0.314. In addition, days' sales of inventory (DSI) increased 7.0% year-over-year to 122.6 days, representing the thirteenth consecutive year-over-year increase. In previous periods, the Company attributed the inventory build to an increase in self-manufacturing and a building of buffer inventory to support certain sourcing strategies.[50] The Company did not discuss the increase in inventory levels on its Q2 13 Conference Call, in its Earnings Release, or in its 10Q filing.

Inventory Analysis ($ in millions)	Q2 2013	Q1 2013	Q4 2012	Q3 2012	Q2 2012
Product sales	$1,055.0	$951.6	$902.7	$869.5	$883.1
Inventory	$331.5	$334.4	$339.4	$313.6	$262.4
Inventory-to-product sales	0.314	0.351	0.376	0.361	0.297
Y-o-Y change	*5.8%*	*15.3%*	*14.5%*	*23.7%*	*1.8%*
DSI	122.6	134.2	142.3	131.4	114.6
Y-o-Y change	*7.0%*	*16.1%*	*12.5%*	*13.4%*	*6.7%*

Key observations about the increase in inventory:

1. **Potentially excess inventory levels:** In Q2 13, finished goods increased 160 basis points year-over-year as a

[49] See Exhibit F of the Appendix for additional background on SEC revenue recognition requirements and PwC publications of "synthetic FOB shipping."
[50] See Exhibit G in the Appendix for further background on increased self-manufacturing.

percentage of total inventory to $306.5 million. Further, raw materials declined 140 basis points as a percentage of total inventory. In light of increased self-manufacturing, raw material levels should have increased as a percentage of total inventory. The increase in finished goods suggests demand may have been overestimated and that inventory impairment risk is elevated.

Inventory Compensation Analysis ($ in millions)	Q2 2013	Q1 2013	Q4 2012	Q3 2012	Q2 2012
Finished goods	$306.5	$311.8	$317.9	$291.1	$238.3
As % total inventory	92.5%	93.2%	93.7%	92.8%	90.8%
Y-o-Y change in bps	*160*	*290*	*340*	*420*	*100*

2. **Software upgrades heighten risk of logistics issues:** In its FY 11 10K, the Company represented that it was upgrading the software and hardware in its largest distribution centers to support future business growth and a shift towards daily consumption DMO's, which lead to more frequent and smaller orders. In its FY 12 10K, the Company represented that it implemented Oracle's process manufacturing model in its botanical extract facility in Changsha, Hunan, China. Given changes to the distribution system concurrent with an increase in inventory, potential operational or logistical challenges may have contributed to the inventory build. In this light, inventory obsolescence risk may be elevated.

3. **Explanation for inventory build is necessary:** The Company should be able to manufacture inventory at a price lower than external finished product purchases from third parties (i.e. suppliers would require some profit/mark up on the sales and the Company would be unlikely to insource if it was at a higher cost). In this light, significant increases in inventory during recent periods do not appear rational and have not been adequately explained by the Company. The Company's MD&A should include a full discussion and explanation of these inventory trends.

No disclosure of prepaid expense composition in Herbalife's SEC filings – additional disclosure needed: In Q1 13, Herbalife's prepaid expenses and other current assets (OCA) declined 0.6% year-over-year in absolute terms and declined 27.1% relative to total assets. While the Company does not provide a detailed breakdown of prepaid expenses and OCA in its 10K filing, it does disclose the fair value of foreign currency derivative contracts included in the account. Based upon disclosure provided in the 10K filing, the derivative amounts included within prepaid expenses accounted for an immaterial portion (less than 1.0%) of total prepaid expenses and OCA. Hence, there is no disclosure in Herbalife's SEC filings of the composition of a majority of the prepaid expense account.

Prepaid Expenses and OCA Analysis ($ in millions)[51]	Q1 2013	Q4 2012	Q3 2012	Q2 2012	Q1 2012
Prepaid expenses and OCA	$126.5	$125.4	$124.1	$131.9	$127.2
Total assets	$2,089.3	$1,703.9	$1,618.1	$1,530.8	$1,532.4
Prepaid expenses-to-total assets	0.061	0.074	0.077	0.086	0.083
Year-over-year change	*(27.1%)*	*(9.1%)*	*13.6%*	*15.1%*	*2.1%*

Key observations about prepaid expenses and other current assets:

1. **Composition of prepaid expenses should be disclosed:** In addition to Avon's disclosure of prepaid expense composition (beginning in 2008), we note that Nu Skin Enterprises, Inc. (NUS) also discloses the composition of prepaid expense in its 10K filings. Given that a material portion of Herbalife's total assets reside within the prepaid expenses and OCA account (7.1% as of Q2 13), we believe the individual components and year-over-year changes should be disclosed, at a minimum, on an annual basis.

[51] Due to the Company's recent restatement of its prepaid expense account, Q2 13 has been excluded from the table so that the amounts that appear are apples to apples.

2. **We believe capitalization of any sales incentives may be aggressive:** As discussed below, we believe the prudent accounting treatment for sales incentives is to account for the costs as a current period expense. If its prepaid expense balance includes any type of capitalized sales incentives, Herbalife's margins would have benefited from delayed expense recognition.

Background on Avon's prepaid expenses - lack of disclosure obfuscated significant increase in capitalized investment for sales initiatives: Certain multilevel marketing companies such as Avon Products, Inc. (AVP) have established a precedent of capitalizing material, amortizable costs within prepaid expenses on their balance sheets. From 2006 to 2009, prepaid expenses and other assets at Avon increased 92.9% from $534.8 million to $1.0 billion. As a percentage of total assets (revenue), prepaid expenses increased nearly 500 (400) basis points over the same period.

Avon did not disclose the composition of prepaid expenses until it was subject to significant investor scrutiny as to why the balance of prepaid expenses expanded so rapidly. Market participants speculated that Avon's high single-digit constant currency revenue growth (at the time) was being driven by increased investment into its sales distribution network by providing representatives with what were effectively bonuses (prepaid gas cards, free product) that were capitalized to the balance sheet.

When Avon began disclosing the composition of prepaid expenses in its FY 08 10K, it became clear the primary drivers of growth in the account were related to amortizable expenses that included capitalized sales commissions for Distributors.[52] As the prepaid expenses gradually declined with higher levels of amortization in the income statement, Avon's operating margins deteriorated from 9.8% in FY 09 to 2.9% by the end of FY 12.

<u>Issues requiring further diligence:</u>

1. **Herbalife NatSource (Hunan) Natural Products Co., Ltd.:** Herbalife's 2010 10K disclosed the Company announced a joint venture in Changsha China to build a Botanical Extraction Facility. Although the 10K provided limited details on this joint venture, a new Herbalife subsidiary, Herbalife NatSource (Hunan) Natural Products Co., Ltd., was added to the Company's list of subsidiaries as filed in Exhibit 21.1 to Herbalife's 2010 Form 10K. We believe this subsidiary may represent a joint venture between Herbalife's Botanical Extraction Facility and the Chinese company, Natsource Chemicals.

   We have reason to believe that, as part of the joint venture agreement, NatSource Chemicals and its principal scientists received an ownership interest in Herbalife's Botanical Extraction Facility in return for certain assets of NatSource Chemicals. We would encourage PwC to investigate whether the fair value of the assets of NatSource Chemicals represented a fair and valid exchange for the consideration received in return (i.e. the ownership interest in the Botanical Extraction Facility). We would further encourage PwC to investigate the Company's purchase accounting treatment for the assets it received from NatSource Chemicals.

   We have reason to believe that the grant of an equity interest in Herbalife's Botanical Extraction Facility may have been designed to obscure compensation to an individual that assisted Herbalife in obtaining approvals for the facility from Chinese government officials.

2. **Herbalife's Luxembourg Subsidiaries:** We have reason to believe that much of the Company's intellectual property is held by the Company's Luxembourg subsidiaries. Given that the Company has spent an immaterial amount of research & development expenditures (as defined by GAAP), we have reason to doubt that these intellectual property rights carry much, if any, value. Therefore, we would encourage PwC to investigate the extent to which certain of Herbalife's subsidiaries pay royalties to Herbalife's Luxembourg subsidiaries via intercompany transactions in return for the right to license intellectual property, and the extent to which this

[52] In its FY 09 10K, Avon's disclosure of prepaid expense composition included (1) significant growth in capitalized sales incentives that were disclosed in the 10K as "receivables other than trade" (up 12.7% year-over-year from most likely a significantly elevated base period), (2) new disclosure of a large balance in deferred charges (from a zero balance to $36.9 million year-over-year), and (3) other amortizable expenses such as prepaid brochure costs, paper, other literature, and "other" assets.

impacts the Company's effective tax rate.

We have reason to believe that certain of Herbalife's owned and third-party manufacturing facilities are encouraged to get their product "to the port" immediately after it is produced. This procedure allows Herbalife to transfer so-called "flash title" to its Herbalife Luxembourg subsidiaries. We would encourage PwC to investigate how this practice impacts the Company's effective tax rate, and whether it complies with appropriate regulatory and accounting guidelines.

3. **Herbalife's Transfer Pricing Procedures:** We have reason to believe that Herbalife keeps "two sets of books" with respect to the amount it charges certain of its international subsidiaries for product that is exchanged in intercompany transactions. We would encourage PwC to investigate the extent to which this allows the Company to reduce the importation taxes paid by certain of its international subsidiaries. Specifically, how does the Company determine the price of product sold to Herbalife subsidiaries in countries with high transfer pricing or importation tax regimes?

4. **Employees Who Hold Equity Interests Not Owned Directly or Indirectly by Herbalife Ltd.:** On August 29, 2013, Bloomberg reported that the Justice Department had joined the Securities and Exchange Commission "in examining whether JPMorgan hired people so that their family members in government and elsewhere would steer business to the firm, possibly violating bribery laws."[53] Given the government's heightened scrutiny of firms hiring employees primarily for the benefit of their familial or personal relationships with foreign officials, we would encourage PwC to examine the individual holders of certain "Equity Interests not owned directly or indirectly by [Herbalife] Holdings" as disclosed in Herbalife's Credit Agreement as Exhibit 10.58 to the Company's Q2 11 Form 10Q. For example, we believe that at least two of the individuals listed in this disclosure as shareholders in HIIP Investment Co., LLC are currently employees of the Company.[54] PwC should also consider the extent to which the scientists employed at Herbalife's Chinese botanical extraction facility are employees with "real jobs."

5. **Abnormal Growth in Established Markets:** On its Q2 13 earnings call, management noted that the Company "experienced 92% growth in volume" in the United Kingdom. While this high degree of growth sounds spectacular, one might ask the question, however, what legitimate consumer packaged goods company has ever shown year-on-year growth of 92% in a market they entered 30 years ago? By comparison, Pepsico posted 3% organic revenue growth in the UK in Q2 13, aided, in part, by the successful launch of a new product.[55] We would encourage PwC to investigate the extent to which inventory loading or other factors played a role in the implausible growth rate reported by Herbalife's UK region in the second quarter.

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[53] "JPMorgan Bribery Probe Said to Expand as Spreadsheet Found," Bloomberg (8/29/13).

[54] Imtiaz Ebrahim, holder of 30% of HIIP Investment Co., is currently listed as "Director Finance & Operations at Herbalife" according to his LinkedIn profile (http://www.linkedin.com/pub/imtiaz-ebrahim/24/39b/822). Julie Holait, holder of 30% of HIIP Investment Co., is currently listed as "Director, Distributor Services Optimisation & Business Support, EMEA at Herbalife Europe Limited" according to her LinkedIn profile (http://uk.linkedin.com/pub/julie-holait/13/94/592).

[55] Source: Q2 13 PEP earnings call. "We saw good performance in some of our larger markets. France grew organic revenue 9%, and the UK and Germany each posted 3% organic revenue growth. Innovation played a large part of our success with the launch of a naturally-sweetened Pepsi Next in France, and Trop 50 in the UK."

XI. Modified Audit Strategy May Be Required Given Potential Conflicts of Interest

Section summary:
In light of certain conflicts of interest between PwC and Herbalife, investor scrutiny of the audit engagement may be elevated. Further, given that PwC has performed certain procedures that may impair its independence as defined in the Sarbanes-Oxley Act, market participants may expect increased disclosures about audit procedures performed and the use of secondary auditors to alleviate independence issues.

Background on auditor independence rules, Sarbanes-Oxley Act of 2002 tightens independence standards:
On 1/22/03, the SEC adopted rules to fulfill the mandate of Title II of the Sarbanes-Oxley Act of 2002 to strengthen auditor independence. Accordingly, the new rules listed the following non-audit services that, if provided by an accounting firm, impair the firm's independence:

- Performance of certain non-audit services including bookkeeping or other services related to the accounting records or financial statements of the audit client.
- Any services related to the design and implementation of financial information systems, valuation services and fairness opinions, actuarial services, internal audit services, management functions, human resources, and legal services would impair auditor independence.

Even prior to the passage of the Sarbanes Oxley Act, auditors were strictly prohibited from providing certain bookkeeping to their audit clients, according to SEC and AICPA Ethics Rules.

> "Even prior to our proposals, auditors were restricted by AICPA Ethics Rules and the Codification from providing certain bookkeeping services. As explained in the Codification and reiterated in the Proposing Release, providing bookkeeping services for an audit client impairs the auditor's independence because the auditor will be placed in the position of auditing the firm's work when auditing the client's financial statements."
>
> (SEC Revisions of the Commission's Auditor Independence Requirements, 2/05/01)

In its 8-K filed on 5/21/13, Herbalife disclosed certain non-audit services that PwC or another firm in the PwC global network had performed for Herbalife in the previous three fiscal years. The non-audit services included bookkeeping, payroll, administrative, financial reporting, and legal work, among other services. Further, PwC staff members worked in Herbalife's US payroll department and PwC staff performed financial reporting services (i.e. prepared financial statements) for Herbalife in Israel.

Country Where Non-audit Services Were Performed	Type of Non-audit Service Performed	2013	2012	2011	2010
United States	Seconded two PwC staff members who served in the US payroll department	--	--	--	Yes
Colombia	Payroll and administrative services	Yes	Yes	--	--
Ghana	Payroll and administrative services	Yes	Yes	Yes	--
India	Secondment services and/or tax services pursuant to a contingent fee arrangement	Yes	Yes	Yes	Yes
Israel	Financial reporting, secondment and bookkeeping service	--	Yes	Yes	--
Bulgaria, and Russia	Routine corporate and administrative legal advisory and financial statement filing services	Yes	Yes	Yes	Yes
Macedonia	Routine corporate and administrative legal advisory and financial statement filing services	Yes	Yes	Yes	--
Romania and Slovakia	Routine corporate and administrative legal advisory and financial statement filing services	Yes	Yes	--	--

While Herbalife's Audit Committee and PwC determined the non-audit services would not impair PwC's ability to serve as Herbalife independent auditor, services rendered appear to violate SEC requirements, AICPA Ethics Rules, and provisions under the Sarbanes Oxley Act of 2002.

Herbalife indicates PwC independence issues were eliminated: In her article "Herbalife Gets A New Auditor: The SEC Passes on PwC's Conflicts," Ms. Francine McKenna quoted Herbalife CFO Mr. John G. DeSimone stating that "Herbalife sought the SEC's guidance over hiring PwC, and secured a determination from the commission that it wouldn't object to the move." [56,57]

The SEC's decision to not object to Herbalife's engagement of PwC may have been predicated on certain Herbalife representations that have not been disclosed to outsiders. Thus, even if the SEC may have determined that PwC could be "independent in fact," PwC's relationship with Herbalife may still "lead outsiders to doubt their independence."

Conclusion:
We suggest that PwC provide additional details about the audit procedures performed and the use of secondary auditors to enable members of the investment community and general public to assess whether PwC has alleviated all potential conflicts of interest in its review and audit of Herbalife.

[56] The quote represents a reference from a news story published exclusively on The Wall Street Journal's Dow Jones Newswire. We were unable to obtain a copy of the original article.
[57] http://www.forbes.com/sites/francinemckenna/2013/05/22/herbalife-gets-a-new-auditor-the-sec-passes-on-pwcs-conflicts/

XII. Exhibits

List of Exhibits

Exhibit A – SEC inquiry into deferred tax liability

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Exhibit I – Pershing Square Questions for Herbalife Management

Exhibit A

SEC inquiry into deferred tax liability: In its 04/21/11 Correspondence Letter, Herbalife responded to the SEC's inquiry about Herbalife's representation in its FY 11 10K that "it is not practicable to determine the amount of unrecognized deferred tax liability related to the over $1.4 billion in undistributed earnings." Herbalife responded that there was uncertainty regarding the amount of deferred tax liabilities for a substantial portion of its undistributed earnings. **While there may be uncertainty regarding the amount of deferred tax liability, it appears the primary criteria to not record a deferred tax liability is that the undistributed earnings will be indefinitely reinvested.**

> "We note the Staff's comment and in response thereto, respectfully advise the Staff that it is not practicable to determine the amount of unrecognized deferred tax liability related to the $1.4 billion in undistributed earnings as **there is uncertainty regarding the amount of deferred tax liabilities for a substantial portion of these undistributed earnings**. The amount of the unrecognized deferred tax liability depends on judgment required to analyze the withholding tax due, the applicable tax law and related tax treaties, and factual circumstances in effect at the time of any such distribution, such as a determination of the tax residencies of the public shareholders of the registrant. Therefore, we believe it is not practicable at this time to reliably determine the amount of the unrecognized deferred tax liability related to the Company's undistributed earnings." (emphasis added)
>
> (Vice President of Finance and Principal Accounting Officer Mr. Bosco Chiu, SEC Correspondence Letter, 4/21/12)

Exhibit B

In exhibit 21.1 of its FY 12 10K, the Company disclosed the following subsidiaries:

Subsidiary #	Subsidiary Name
1	HBL Luxembourg Holdings S.à R.L.
2	HBL, Ltd.
3	HBL Products S.A. (Switzerland)
4	Herbalife (China) Health Products Ltd.
5	Herbalife (NZ) Limited
6	Herbalife (UK) Limited
7	Herbalife Africa S.à R.L
8	Herbalife Asia Pacific Services Limited
9	Herbalife Australasia Pty, Ltd.
10	Herbalife Bela, LLC
11	Herbalife Bolivia, Ltda.
12	Herbalife Bulgaria EOOD
13	Herbalife (Cambodia) Co., Ltd.
14	Herbalife Central America LLC
15	Herbalife China, LLC
16	Herbalife d.o.o. (Croatia)
17	Herbalife Denmark ApS
18	Herbalife Distribution Ltd.

Subsidiary #	Subsidiary Name
19	Herbalife Dominicana, S.A.
20	Herbalife Europe Limited
21	Herbalife Foreign Sales Corporation
22	Herbalife Hungary Trading, Limited also known as (Herbalife Magyarorszag Kereskedelmi Kft.)
23	Herbalife Internacional de México, S.A. de C.V
24	Herbalife International (Thailand), Ltd.
25	Herbalife International (Netherlands) B.V.
26	Herbalife International (Thailand), Ltd.
27	Herbalife International Argentina, S.A.
28	Herbalife International Belgium, S.A.
29	Herbalife International Communications, LLC
30	Herbalife International Costa Rica, Sociedad de Responsabilidad Limitada
31	Herbalife International del Colombia
32	Herbalife International Del Ecuador, S.A.
33	Herbalife International Deutschland GmbH
34	Herbalife International Distribution, Inc.
35	Herbalife International Do Brasil Ltda.
36	Herbalife International España, S.A.
37	Herbalife International Finland OY
38	Herbalife International France, S.A.
39	Herbalife International Greece S.A.
40	Herbalife International India Private Limited
41	Herbalife International Luxembourg S.à R.L.
42	Herbalife International of America, Inc.
43	Herbalife International of Europe, Inc.
44	Herbalife International of Hong Kong Limited
45	Herbalife International of Israel (1990) Ltd.
46	Herbalife International Philippines, Inc.
47	Herbalife International Products N.V.
48	Herbalife International Russia 1995 Ltd.
49	Herbalife International Singapore, Pte. Ltd.
50	Herbalife International South Africa, Ltd.
51	Herbalife International Urunleri Tic. Ltd. Sti.
52	Herbalife International, Inc.

Subsidiary #	Subsidiary Name
53	Herbalife International, S.A.
54	Herbalife Italia S.p.A.
55	Herbalife Kazakhstan LLP
56	Herbalife Korea Co., Ltd.
57	Herbalife Ltd.
58	Herbalife Luxembourg Distribution S.à R.L.
59	Herbalife Macau Limited
60	Herbalife Manufacturing LLC
61	Herbalife Mexicana, S.A. de C.V.
62	Herbalife Mongolia LLC
63	Herbalife NatSource (Hunan) Natural Products Co., Ltd.
64	Herbalife Natural Products LP
65	Herbalife Norway Products AS
66	Herbalife of Canada, Ltd.
67	Herbalife of Ghana Limited
68	Herbalife of Japan K.K.
69	Herbalife Paraguay S.R.L.
70	Herbalife Peru S.R.L.
71	Herbalife Polska Sp.z o.o
72	Herbalife Products Malaysia SDN. BHD.
73	Herbalife Products De México, S.A. de C.V.
74	Herbalife RO S.R.L.
75	Herbalife Sweden Aktiebolag
76	Herbalife Taiwan, Inc.
77	Herbalife Ukraine, LLC
78	Herbalife Uruguay S.R.L.
79	Herbalife Vietnam SMLLC
80	Herbalife Worldwide Events, LLC
81	Herbalife Zambia Limited
82	HIL Swiss International GmbH
83	HLF (Gibraltar) Limited
84	HLF Colombia Ltd.
85	HLF Luxembourg Distribution S.à R.L.
86	HLF Luxembourg Holdings S.à R.L.

Subsidiary #	Subsidiary Name
87	HV Holdings Ltd.
88	iChange Network, Inc.
89	I.C.S. Herbalife MA, S.R.L.
90	Importadora y Distribuidora Herbalife International de Chile, Limitada
91	Limited Liability Company Herbalife International RS
92	NatSource Pharmaceutical and Chemicals (Changsha) Co., Ltd.
93	Promotions One, Inc.
94	PT Herbalife Indonesia
95	Servicios Integrales HIM, S.A. de C.V.
96	Vida Herbal Suplementos Alimenticios, C.A.
97	WH Capital Corporation
98	WH Intermediate Holdings Ltd.
99	WH Luxembourg Holdings S.à R.L.
100	WH Luxembourg Intermediate Holdings S.à R.L.

Exhibit C

Background on Venezuela operations and currency limitations: In 1994, the Company began operations in Venezuela, one of its first South American markets. In 2003, the Venezuelan Government enacted more stringent currency restrictions that affected the Company's ability to exchange Venezuelan Bolivars for US Dollars at the official foreign exchange commission (the CADIVI).[58] As an alternative exchange mechanism, the Company participated in certain Venezuelan Government bond offerings and other less favorable legal parallel market exchanges. In January 2010, the Venezuelan Government announced an official exchange rate devaluation to 4.3 Bolivars per US dollar for non-essential items and 2.6 Bolivars per US dollar for essential items. In May 2010, the legal parallel market mechanism was discontinued. In June 2010, the Venezuelan Government introduced SITME, a newly regulated system. SITME established an exchange rate of 5.3 Bolivars per US dollar, but limited the amounts exchanged to $50,000 per day and $350,000 per month. In January 2011, the Venezuelan Government set the Bolivar:US dollar exchange rate at 4.3 for all essential and non-essential items. In February 2013, the Venezuela Government devalued the official exchange rate to 6.3 Bolivar per US dollar.

Venezuela Operations and Currency Limitations Time Line	Date
Herbalife operations initiated in Venezuela	1994
Currency restriction become more stringent – CADIVI established	2003
Venezuelan Gov't devalued the official rate to 4.3 VEF:USD for non-essential and 2.6 for essential items	January 2010
Venezuela becomes a highly inflationary economy according to US GAAP requirements	January 2010
Legal parallel market mechanism discontinued	May 2010
Central Bank of Venezuela establishes SITME, allows limited exchange at 5.3 VEF:USD	June 2010
Venezuelan Gov't eliminates essential item exchange rate, official rate is 4.3 VEF:USD	January 2011
Venezuelan Gov't eliminates SITME, official rate devalued to 6.3 VEF:USD	February 2013

Net Monetary Assets Denominated in Bolivars Analysis (VEF and $ in millions)	Q2 13	Q1 13	Q4 12	Q3 12	Q2 12
Cash denominated in Bolivars	$124.6	$102.3	$99.2	$71.6	$52.6
Monetary assets (liabilities) denominated in Bolivars (ex cash)	($11.9)	($12.8)	($16.3)	($2.6)	($2.2)
Net monetary assets denominated in Bolivars	$112.7	$89.5	$82.9	$69.0	$50.4
Bolivars remeasurement rate used in financial statements	6.3x	6.3x	5.3x	5.3x	5.3x
Official foreign exchange rate used	CADIVI	CADIVI	SITME	SITME	SITME
Net monetary assets in Venezuela (estimate)	VEF710.0	VEF563.9	VEF439.4	VEF365.7	VEF267.1

[58] Formed on 02/05/03, the Comisión de Administración de Divisas (CADIVI) is the Venezuelan Government body that enables legal currency exchange in Venezuela.

Exhibit D

Nevada unclaimed property laws: Nevada's Unclaimed Property Law defines "holder" as "a person obligated to hold for the account of, or deliver or pay to, the owner property that is subject to this chapter," Nev. Rev. Stat. § 120A.080, and defines "owner" as "a person who has a legal or equitable interest in property subject to this chapter," Nev. Rev. Stat. 120A.100. Property subject to the law is defined to include "a check," Nev. Rev. Stat. § 120A.113, and such property is deemed abandoned "3 years after . . . the obligation to pay or distribute the property arises," Nev. Rev. Stat. § 120A.500, provided that (1) the last known address of the apparent owner is in a foreign country, and (2) the holder is domiciled in Nevada, Nev. Rev. Stat. § 120A.530. Herbalife International, Inc. and Herbalife International of America, Inc. are both incorporated in Nevada.

Exhibit E


US Country of Processing

PLEASE DETACH BEFORE DEPOSITING AND RETAIN FOR YOUR RECORDS

THE FACE OF THIS DOCUMENT HAS A BLUE & RED BACKGROUND PRINTED ON WHITE PAPER, WITH BLACK DATA

HERBALIFE.
INTERNATIONAL OF AMERICA, INC
950 W. 190TH STREET
TORRANCE, CA 90502

WARNING
DO NOT CASH UNLESS YOU CAN VERIFY:

0000001

HSBC BANK USA, N.A.
ONE HSBC CENTER
BUFFALO, NEW YORK 14203

DATE 03/18/2008

PAY *One million thirty four thousand six hundred eighty four and 32/100 Dollars*

PAY ONLY $ 1034684 32

TO THE ORDER OF
H B INTERNATIONAL GROUP INC.
C/O DORAN ANDRY
620 NEWPORT CENTER DR 400
NEWPORT BEACH, CA 92660-8004
USA

2007 Mark Hughes Bonus

⑈0000001⑈ ⑆123456789⑆ 000000000⑈

Exhibit F

Background on SEC revenue recognition requirements: The SEC's Staff Accounting Bulletin (SAB) No. 104 (issued on 12/17/03) determined that revenue is generally realized or realizable and earned when all of the following criteria are met (1) persuasive evidence of an arrangement exists, (2) delivery has occurred or services have been rendered, (3) the seller's price to the buyer is fixed or determinable, and (4) collectability is reasonably assured. The SEC clarified that if title and risk are transferred when a product is shipped (i.e. Freight, or Free, On Board (FOB) shipping point), the delivery requirement of SAB No. 104 would be considered met.

> "Typically this occurs when a product is delivered to the customer's delivery site (if the terms of the sale are 'FOB destination') or when a product is shipped to the customer (if the terms are 'FOB shipping point')."
> (SEC Staff Accounting Bulletin No. 104, 12/17/03)

Background on synthetic FOB shipping terms: In its "A look at Current Financial Reporting Issues" published on 11/30/11, PwC discussed consumer product companies that often replace or issue credits for lost or damage shipments even when legal title had transferred at shipment. PwC concluded that revenue would likely be deferred until delivery as risks and rewards of ownership had not been substantively transferred to the customer. PwC and other public accounting firms refer to these shipping arrangements as "synthetic FOB shipping."

> "Consumer products entities will often replace or credit lost or damaged shipments even when sales contracts contain 'free on board' (FOB) shipping point terms, and it is clear that title legally transfers at the time of shipment. Many consumer products entities have a customary business practice of compensating the customer for lost or damaged shipments such that the customer is in the same position as if the shipping terms were FOB destination. Revenue for shipments would likely be deferred until the product has been received by the customer under today's guidance because the risks and rewards of ownership have not been substantively transferred to the customer at the point of shipment. The timing of revenue recognition might change under a control based model."
>
> (PwC Dataline A look at Current Financial Reporting Issues, 11/30/11)

Exhibit G

Background on manufacturing: In Q2 11, the Company completed modifications to its manufacturing facility in Lake Forest, CA pursuant to a planned increase in self-manufacturing. In its FY 10 10K, the Company represented that, subsequent to the modifications, it intended to increase self-manufacturing to cover approximately 40.0% of its global demand. In its FY 11 10K, the Company represented that, in FY 11, self-manufacturing through its Lake Forest, CA, and Suzhou, China manufacturing facilities represented approximately 20.0% of its global demand. In its FY 12 10K, the Company disclosed the purchase of a manufacturing facility in Winston-Salem, NC would further increase self-manufacturing.

Exhibit H

[see enclosure: "Who wants to be a Millionaire?" (12/20/13)]

Exhibit I

[see enclosure: "Questions for Herbalife" (2/7/13)]