Herbalife Ltd

NYSE:HLF

Analyst: Pierre Gouesclou
Sector: Retail/Drug Store

Sell

Price Target: $27.32

Key Statistics as of 03/01/2016

Market Price:	$56.35
Industry:	Retail/Drug Store
Market Cap:	$5.07B
52-Week Range:	$30.27-61.95.
Leverage Beta:	0.8

Thesis Points:

- Herbalife is a complex Ponzi-Pyramid scheme.
- The firm has more debt than the total value.
- Had several inquiries regarding their products compositions.
- The company struggles to manage their costs
- The Company is overvalued.

Company Description:

Herbalife Ltd is a global network marketing company proposing a range of nutritional supplements and personal care products to lose weight. Incorporated in the Cayman Islands (George Town) Herbalife went public with its IPO in 2004 by issuing 14,500,000 share at $14 per share. The total value amount was estimated at $203,000,000 after the IPO. The company's sells were composed of 5 segments in 2014: Weight Management (64.1%), targeted Nutrition (22.3%), Sports & fitness (5.3%), Outer Nutrition (3.6%) and Literature & Promotional other products (4.7%). Nutritional additives represented over 95.3% of the company's revenues and is a risky bet given the amount of law suits triggered by such high risk health products. Herbalife Ltd operates in 95 countries and employs 7,800 people across the globe in addition to their 4.0 million independent "members". The company mostly owns distribution centers in order to dispatch their products to their "members" around the world and do not own any brick and stone shops. In 2014 Herbalife generated a negative cash flow of $-389.5 Million in repurchasing Capital stock from the markets.

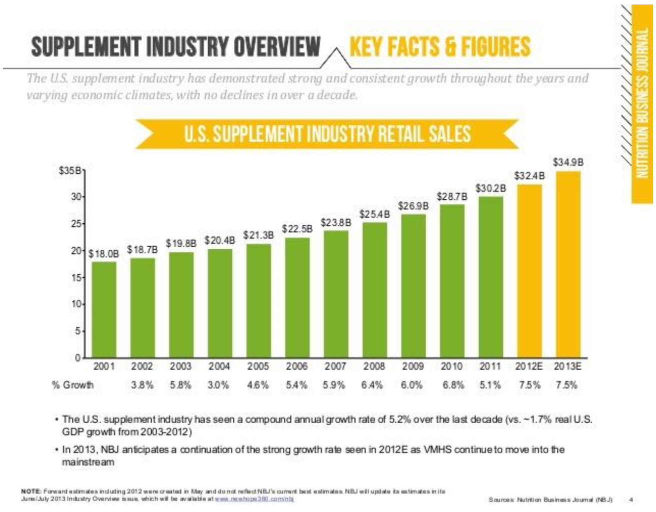
Thesis

Herbalife ltd is a leading company in his segment but has several financial weaknesses and flaws. On the 30th September 2015, the company had a Debt to Total Value of 1.05. In 2014, Herbalife launched a $1 Billion dollars repurchase program and was planning on taking $1.5 Billion dollars of debt in order to finance this project. Due to this repurchase of stock; the company generated a negative cash flow of $327.6 million dollars in 2014 when they purchased stocks worth $1,291.9 million dollars. In addition to these alarming signals the company announced a negative retained earnings of 665.4 million dollars despite a net income of $308.7 million. We have also observed a massive shortfall in their stock price from $83 (at most) to $38.5. During the period the company ceased purchasing their common stock by fear of financial difficulty. This phase of high instability within the financial structure of the firm creates a tempting breach to short a stock that is surely overvalued and on the decline.

Industry Outlook

The nutritional supplement market has known an impressive increase worldwide in the past years. The increasing amount of over-weighted individual has reached a record high in certain countries triggering a boost of sales of such products by individuals eager to watch over their health. The industry is expected to show a growth rate of 6% to 7% in the upcoming years in emerging and developed markets. Another aspect to take in consideration is the growing sales of these types of company in the emerging markets. As the middle class increases in countries such as China the population is starting to give more importance to their health and well-being rather than their primary needs. Furthermore as a new growing segment this industry is draining the attention of consumer good companies such as P&G. These big companies are trying to gain new market shares by purchasing smaller nutritional supplement companies through M&As.

The real threat for these companies is the creation or tightening of regulations related to the content of the products. These regulations are a real issue for the companies since they often lead to important lawsuits that can easily bring a company to bankruptcy. Pursuing business in a global scale enhances the difficulties brought by these regulations and can quickly become a legal burden for companies who are required to dose their products according to each country's legislation.



Business Model

Herbalife ltd's major strength relies on their "members". As the founding stone of the company, these members are expected to promote and sell products or services to new members of Herbalife. This is the most attractive aspect of the business as they are not considered as employees and are not paid as such by the company. As a consequence most of the company's expenses are directed towards the purchase of products from third party companies (25% of their products) or the distribution of their products across the globe. This direct sale strategy allows the firm to perceive comfortable resources without investing important amounts in the process. The success of their strategy is underlined by their impressive ROIC of 45% and WACC of 9% in 2015. On the other hand this strategy can also become a weakness for the company if members stop promoting Herbalife products. In that aspect the company is highly reliant on their customers in order to pursue business. In addition, a company that uses a client-distributor pyramid system will undeniably encounter a limit of growth once the potential customer pool has been dried out. The combination of both of these aspects underlines a high probability of an upcoming value creation.

People

Michael O. Johnson leads Herbalife ltd since his appointment in 2003 after the death of the company's founder Mark Hughes three years before. Michael O. Johnson previously worked for The Walt Disney Company since 1986 where he worked as the president of Buena Vista Home Entertainment. Recently Michael O. Johnson was sanctioned with a salary reduction of

36% caused by the reduction of revenue generated by the company. Michael is assisted by Brett R. Chapman, Strategic Advisor to Chairman and C.E.O. since 2003. Brett is an important asset for Herbalife regarding his strong law background gained during 13 years from his experience at The Walt Disney Company.

Product Differentiation

As opposed to their other competitors Herbalife focuses on a more direct approach of the customer. In order to obtain sales the company attracts their customers through free fitness events hosted by their trained coaches. Once the client is interested by the concept the coach offers the potential customer to join the community. The main product differentiation of the company relies on their pyramidal sales strategy. In Herbalife the customers are encouraged to promote the products in exchange of advantages and offers. As opposed to most of their competitors which sale their products directly to the retailers for commercialization, Herbalife focuses more on creating a vivid community. As a result, the risk of the company is increased as they rely on customer-distributors to sell their products.

Corporate Responsibility

Herbalife is very contradictory in their corporate responsibilities and doubts may rise on their goals. I believe that a company producing and selling complex nutritional supplements should have more ties and responsibilities towards their costumers and distributors. The business plan itself is in opposition with this aspect of the corporation. Herbalife is registered in the Cayman Island and has no strong ties with their members who are responsible of the majority of the company's sales. This corporate detachment will most likely backfire on Herbalife and have a negative blow on their sales and revenues one a decrease in new memberships will occur. Herbalife recently started to invest in social and green actions across the globe in order to enhance their brand image. The Herbalife Family Foundation (HFF) is focusing on improving the lives of children around the world by providing $2.6 million in funding in order to bring nutrition to 100,000 children in 50 countries. The foundation itself received several private awards but the procedures and content of this foundation remains globally unclear regarding its spectrum and range.

Financials

For the year ended 2014 the company announced an increase in their sales of $133.3 million dollars which represents an increase of 2.76% overall. Despite higher sales the company encountered a strong downfall in their net income of $218.8 million dollars, which represents a decrease of 41.48% of their net income. This decrease of revenue is due to a skyrocket of their Selling, general & administrative expenses which increased by 22.22% in 2014. Between 2012 and 2014 the percentage of net income from sales went from 11.4% to 6.2% and implies that the company is struggling in their cost management is unable to create as much value as it used to. In addition to this decrease of net income the cash flow for 2014 has been -$389.5 due to their massive repurchases of Common stock worth $1,291.9 million. This repurchase was barely covered by their issuance of debt issued through Interest baring Notes. This repurchasing strategy ended in 2015 when the company suddenly halted buying back their shares due to their disastrous cash flow. In 2015 the company's Debt to total value ratio was 1.14 against 0.77 in 2013. This ratio implies that the company holds more debt than the overall Enterprise Value of the structure. Although this increase is mostly due to their increase of debt; their retained earnings of -$665.4 is one of the biggest driver of this ratio. The company can be considered as a highly unstable debt hazard and can be at risk if their net income fails to cover the newly contracted debt of the company.

Conclusion

Herbalife Ltd's unstable financial situation provides an interesting short opportunity for investors. The company's financial statements clearly raise's red flags on their cost management and debt borrowing in the past years. In addition, Herbalife has been in the spot light for several years due to their business model and product quality. This undesired attention can prove to become a real handicap for a company who already acknowledged a downfall in their price from $61.95 to $56.35 in a period of 52 weeks (-9.03%). Furthermore I believe that the increase of 25% on their stock price following the earning call is a sign of overvaluation of the company's true value and will soon be corrected. In accordance with these data I rate HLF a short with a 12-month target price of $27.32, which implies a downfall of -67.72%.

SIENA college

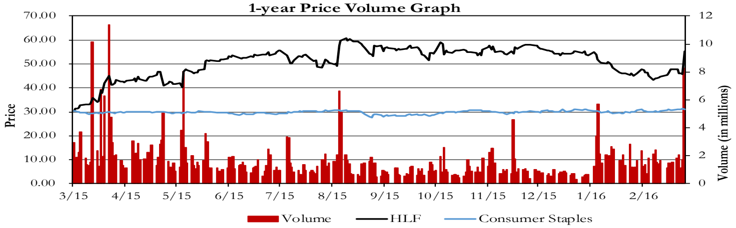
Siena Market Line
2nd week of March 2016

CENTER FOR GLOBAL FINANCIAL STUDIES

Herbalife Ltd. (HLF) — **BEARISH**

Analysis by Pierre Gouesclou	Current Price:	$56.35	Intrinsic Value	$25.44	Target 1 year Return: -50.86%
3/1/2016	Divident Yield:	0.7%	Target Price	$27.32	Probability of Price Increase: 0%

1-year Price Volume Graph



Description

Herbalife Ltd., a nutrition company, develops and sells weight management, healthy meals and snacks, sports and fitness, energy and targeted nutritional products, and personal care products.

General Information

Sector	Consumer Staples
Industry	Personal Products
Last Guidance	November 3, 2015
Next earnings date	NM
Estimated Country Risk Premium	5.61%
Effective Tax rate	22%
Effective Operating Tax rate	24%

Market Data

Market Capitalization	$5,073.88
Daily volume (mil)	1.87
Shares outstanding (mil)	92.67
Diluted shares outstanding (mil)	85.30
% shares held by institutions	16%
% shares held by investments Managers	48%
% shares held by hedge funds	19%
% shares held by insiders	6.98%
Short interest	23.63%
Days to cover short interest	14.09
52 week high	$61.95
52-week low	$30.27
Levered Beta	0.80
Volatility	53.92%

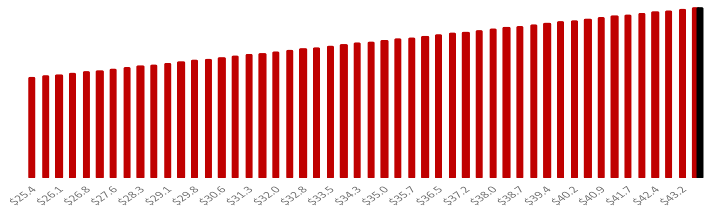
Past Earning Surprises

Quarter ending	Revenue	EBITDA
12/31/2014	-2.53%	-1.76%
3/31/2015	1.81%	-0.08%
6/30/2015	1.52%	-4.35%
9/30/2015	-3.67%	7.80%
12/31/2015	3.27%	6.43%
Mean	0.08%	1.61%
Standard error	1.3%	2.4%

Peers

Avon Products Inc.
Nu Skin Enterprises Inc.
Coty Inc.
The Estée Lauder Companies Inc.
Lifevantage Corporation
Elizabeth Arden, Inc.
USANA Health Sciences Inc.
Mannatech, Incorporated

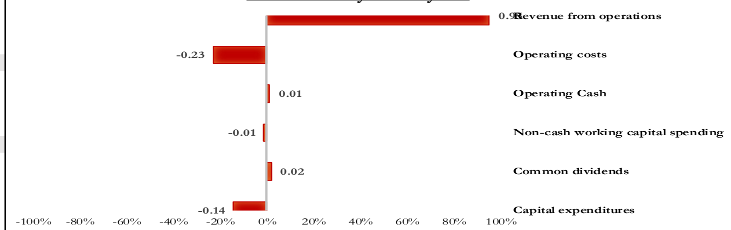
Target Price Distribution--Prob(Price Increase)= 0%



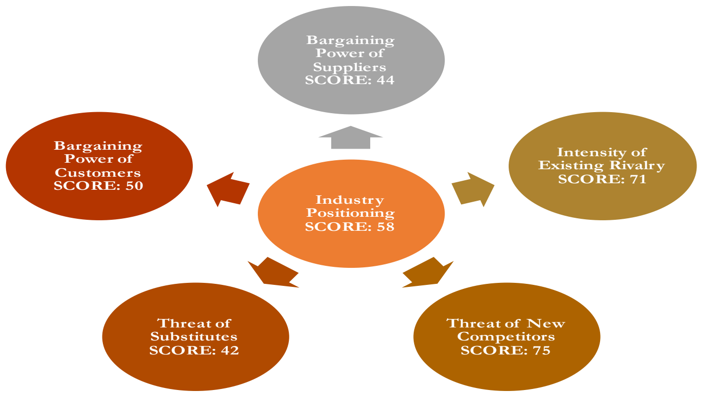
Management	Position	Total compensations growth	Total return to shareholders
Johnson, Michael	Chairman and Chief Executive	1.1% per annum over 5y	13.09% per annum over 5y
Walsh, Desmond	President	7.64% per annum over 5y	13.09% per annum over 5y
DeSimone, John	Chief Financial Officer	-4.02% per annum over 4y	8.2% per annum over 4y
Goudis, Richard	Chief Operating Officer	9.23% per annum over 5y	13.09% per annum over 5y
Hoffman, Alan	Executive Vice President of	N/M	0% per annum over 0y
Peterson, Susan	Founder	N/M	N/M

Profitability	HLF (LTM)	HLF (5 years historical average)	Industry (LTM)
ROIC	25.6%	50.49%	24.11%
NOPAT Margin	11%	12.47%	12.2%
Revenue/Invested Capital	2.34	4.05	1.98
ROE	38.2%	47.80%	25.36%
Adjusted net margin	9%	11.71%	11.7%
Revenue/Adjusted Book Value	4.31	4.08	2.16
Invested Funds	**HLF (LTM)**	**HLF (5 years historical average)**	**Industry (LTM)**
Total Cash/Total Capital	42.3%	36.3%	25%
Estimated Operating Cash/Total Capital	25.5%	21.1%	N/A
Non-cash working Capital/Total Capital	-5.6%	-4.9%	17%
Invested Capital/Total Capital	84.7%	86.0%	61%
Capital Structure	**HLF (LTM)**	**HLF (5 years historical average)**	**Industry (LTM)**
Total Debt/Common Equity (LTM)	0.40	0.28	0.06
Cost of Existing Debt	5.62%	5.97%	3.82%
Estimated Cost of new Borrowing	2.32%	1.41%	3.82%
CGFS Risk Rating	5.62%	AAA	BBB
Unlevered Beta (LTM)	5.89%	1.39	0.91
WACC	5.62%	10.06%	8.00%

Sensitivity Analysis



Porter's 5 forces (scores are out of 100)



Valuation

Period	Revenue growth	NOPAT margin	ROIC/WACC
Base Year	-9.9%	11.0%	4.05
12/31/2016	1.4%	12.5%	5.11
12/31/2017	4.6%	12.8%	4.90
12/31/2018	0.2%	11.9%	4.18
12/31/2019	1.1%	11.0%	3.71
12/31/2020	1.2%	10.2%	3.28
12/31/2021	1.5%	9.4%	2.89
12/31/2022	1.8%	8.5%	2.53
12/31/2023	2.1%	7.7%	2.20
12/31/2024	2.4%	6.9%	1.90
12/31/2025	2.7%	6.0%	1.61
Continuing Period	3.0%	5.2%	1.35

Period	Invested Capital	Net Claims	Price per share
Base Year	$919.93	$2,122.17	$38.31
1/0/1900	$960.64	$1,622.54	$43.83
1/0/1900	$1,075.11	$1,019.88	$49.67
1/0/1900	$1,623.28	$419.26	$55.44
1/0/1900	$1,912.93	-$151.52	$61.10
1/0/1900	$1,781.65	-$676.26	$66.67
1/0/1900	$1,984.46	-$1,537.96	$76.66
1/0/1900	$2,152.31	-$1,967.36	$82.10
1/0/1900	$2,278.47	-$2,352.64	$87.59
1/0/1900	$2,397.76	-$2,692.62	$93.18
1/0/1900	$2,525.23	-$2,985.46	$98.90
1/0/1900			