

An Executive Summary of
Pershing Square Capital Management, L.P.’s Presentation of

“Who Wants to be a Millionaire?”

A Short Thesis on Herbalife, Ltd. (NYSE: HLF)¹

For the full Presentation and Related Materials,
please visit www.factsaboutheralife.com

Introduction to Herbalife

Herbalife says it is both a product company and a ‘business opportunity’ company. Its mission is “to *change people’s lives* by providing the best business opportunity in direct selling and the best nutrition and weight-management products in the world.” See Herbalife website.

Overview

Pershing Square believes Herbalife is a pyramid scheme because, among other reasons, distributors earn more than 10 times as much from recruitment as they do by selling the company’s overpriced products to bona fide retail customers. As a result, Herbalife distributors are incentivized to aggressively recruit new participants to buy in to a system that, like a chain letter, “must end up disappointing those at the bottom who can find no recruits,” as stated in the leading pyramid case of *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181 (1975), *aff’d mem. sub nom., Turner v. F.T.C.*, 580 F.2d 701 (D.C. Cir. 1978).

Our conclusion that Herbalife is a pyramid scheme is confirmed by the following facts and deceptions in the Herbalife network:

- Herbalife overstates the amount of income that is likely to be made by new participants and masks the low probability that this income will be achieved;

¹ This is an Executive Summary of the short thesis on Herbalife, Ltd. (NYSE: HLF) presented by Pershing Square Capital Management, L.P. on December 20, 2012. Please see www.factsaboutheralife.com for the full presentation and accompanying slides which provide a more complete version of Pershing Square’s opinions, evidence and reasoning. References herein to “slides” are to our Presentation slides. By accessing the Presentation, slides and website through this document, all users acknowledge and agree to the Disclaimer. As of the date hereof, Pershing Square maintains a substantial short position on HLF. **Please see the full Disclaimer appearing at the end of this Executive Summary and published in connection with the Presentation and the website.**

- Herbalife’s Statement of Average Gross Compensation of U.S. Supervisors and other recruiting materials are materially deceptive;
- Herbalife distributors experience an abnormally high failure rate;
- Taking all expenses into account, including the cost of ‘business method’ materials, the substantial majority of distributors lose money;
- Distributors are incentivized to recruit if they wish to achieve ‘financial freedom’ and the Herbalife ‘lifestyle’;
- Recruits must ‘apply’ to become Distributors and agree to a complex set of rules simply for the right to buy commodity products at a discount to the Company’s highly inflated Suggested Retail Prices that have little relationship to actual retail prices at which products can be resold;
- Herbalife has been sued numerous times for being a pyramid scheme and, in some cases, has been found to be a pyramid or to exhibit key characteristics of pyramids;
- There is evidence of saturation within key regions and affinity groups that are targeted by the Company;
- Herbalife’s top 1% of distributors earn the vast majority of rewards; and
- Herbalife distributor compensation scheme is substantially more pyramidal than typical multilevel marketing companies.

Herbalife is in the business of selling dreams, not weight-management products. This is evidenced by its limited R&D and advertising budgets and the inflated Suggested Retail Prices of its commodity-like products.

The only reason Herbalife can sell ~\$1.8bn of nutrition powder per year is because its distributors are buying it with the hope and dream of “achieving financial freedom.”

Unfortunately, for the vast majority of Herbalife participants, this dream never becomes a reality, and they leave Herbalife with increased debt, a sense of failure, and damaged relationships.

Worse yet, because Herbalife targets the most vulnerable populations, including low-income members of various ethnic and minority groups, those who fail at the Herbalife business opportunity are those who can least afford to.

Herbalife: The Product Company

Founded in 1980, Herbalife claims to be one of the largest consumer product companies in the world. It is of similar size to Church & Dwight, Energizer, and Clorox. Herbalife is not a typical consumer product company, however. Its gross margins at ~80% are more than twice the gross margins of a typical consumer product company. Unlike Church & Dwight, Energizer, and Clorox, Herbalife lacks a portfolio of household name brands.

Herbalife's top-selling product, Formula 1, supposedly generated ~\$1.8bn in "retail sales" in 2011, according to the company, roughly comparable to Oreo, Charmin, Crest, Gerber, Palmolive, Listerine and Clorox. Surprisingly, however, few people have ever heard of Formula 1. The brand does not even have a proper logo. (See slide 12: <http://factsaboutherbalife.com/wp-content/uploads/2013/01/Who-wants-to-be-a-Millionaire.pdf#page=12>)

Formula 1 is a nutritional shake mix like Lean Shake, Slim-Fast or Ensure. Unlike these comparable products, Formula 1 is not sold in stores and lacks a "Ready-To-Drink" offering. Despite this competitive disadvantage, Formula 1 supposedly generated ~\$1.8bn in retail sales in 2011 while Ensure (Abbott Labs), Slim-Fast (Unilever) and Lean Shake (GNC) only sold ~\$300mm of nutrition powder, combined.

Formula 1 is expensive relative to comparable products. For a 200-calorie serving, Formula 1 costs nearly three times as much as Ensure or Slim-Fast, and nearly twice as much as Lean Shake. Herbalife's other products are similarly expensive. A multivitamin tablet from Herbalife supposedly retails for 26 cents, whereas Centrum (Pfizer) can be purchased for 6 cents per tablet.

Herbalife's advertising and R&D are immaterial. Herbalife's products are commodities that should have little to no pricing power. The company says it spends "de minimis" amounts to advertise its products, and its spending on R&D is "not material."

So how does Herbalife sell so much of its unadvertised, commodity products at such inflated prices?

Answer: Herbalife bundles its products with a 'business opportunity.'

Herbalife: The Business Opportunity

What we're doing at Herbalife, is we're building
the best business opportunity on the face of the earth.

- CEO Michael Johnson²

What is the Herbalife business opportunity? Said differently, what is Herbalife really selling?

Extravagant Promises. Herbalife Independent Distributor presentations market Herbalife as an opportunity to "be your own boss," to "work from home," to "achieve financial freedom," to create perpetual income and to improve one's lifestyle.

Promoting a Lifestyle. Herbalife recruits are shown videos or brochures of the lifestyles of the most successful Herbalife distributors – the top 0.1%. In these videos, Herbalife distributors live in mansions, drive Ferraris and live fabulous lifestyles. "Anyone can do it," Herbalife says, if

² 2010 First Quarter Earnings Call

they just work hard and dream big. <http://factsabouth Herbalife.com/category/herbalife-recruiting-affiliate-videos/financial-success-system-llc/doran-andrys-chairmans-club-member>³

Misleading Testimonials. Herbalife-published magazines are filled with testimonials of successful distributors. These testimonials follow a simple rags-to-riches formula. Before Herbalife: “I had my back against the wall. I needed to make some money!” After Herbalife: “In the first month we were able to save our home. Herbalife saved us from bankruptcy!” Another important theme: “If I can do it, anybody can. I only have a high-school education and no business background.” (See slide 209-212: <http://factsabouth Herbalife.com/wp-content/uploads/2013/01/Who-wants-to-be-a-Millionaire.pdf#page=209>)

In HLF’s *Herbalife Today* magazine from 1997 through 2004, there were 392 testimonials, boasting average earnings of ~\$178,000 per year.

Overstated Opportunity for Profits. These testimonials and other Herbalife distributor marketing materials create the perception for potential recruits that is inconsistent with their likelihood of success. They are led to believe that these results are not only possible but probable.

We believe the typical distributor earns less than \$100 per year *before expenses*. Only the top ~0.1% of Herbalife distributors earn enough to “achieve financial freedom.”

Blaming the Victims. According to the company’s website, Herbalife tells millions of people its opportunity will let you “earn what you’re worth.” That phrase allows Herbalife to blame the distributors when they fail, even though, unbeknownst to the recruits, they never had a reasonable likelihood of success in the first place. Apparently, Herbalife believes the vast majority of its millions of distributors are “worth” next to nothing.

What is a Pyramid Scheme?

In 2002, Dr. Peter J. Vander Nat, a Senior Economist at the FTC and expert witness for the agency in pyramid cases, defined a pyramid scheme as follows:

If an organization sells goods or services to the public and the participants in the organization obtain monetary benefits from (1) recruiting new members and (2) selling the organization’s goods and services to consumers, the organization is deemed a pyramid scheme if the participants obtain their monetary benefits primarily from recruitment rather than the sale of goods and services to consumers.⁴

³ Our website includes many more examples of these lifestyle and income testimonials. <http://factsabouth Herbalife.com/category/promoting-the-business-opportunity/>

⁴ Vander Nat, Peter J. and William W. Keep, “Marketing Fraud: An Approach for Differentiating Multilevel Marketing from Pyramid Schemes,” in *Journal of Public Policy and Marketing*, Vol. 21 (1), Spring 2002, at 139-51.

Recruiting Rewards v. Retail Profits. To apply that standard, one examines the monetary rewards received by distributors. When a distributor gets paid for recruiting a new distributor, that is a recruiting reward. It is still a recruiting reward even if the commission is based upon the recruit's purchase of some products – because we don't know at that point if any of those products will ever be sold at retail. If the new distributor makes a profit selling HLF products to an actual consumer, that is retail profit.

This definition makes intuitive sense. If all participants follow the same set of incentives, and if those incentives primarily encourage recruiting, then the optimal decision for most, if not all, participants will be to recruit new participants into the scheme. If all participants focus their efforts on recruiting new participants, saturation – the inability to find new recruits – is inevitable.

Pyramid Schemes are Illegal. “Pyramid schemes are said to be inherently fraudulent because they must eventually collapse. Like chain letters, pyramid schemes may make money for those at the top of the chain or pyramid, but ‘must end up disappointing those at the bottom who can find no recruits.’” (see *Webster v. Omnitrition*, 79 F.3d 776, 782 (9th Cir. 1996), quoting *Koscot*). In a pyramid scheme, as in a chain letter, the money at the top is made from the losses of people at the bottom. “[T]he very reason for the *per se* illegality of the Endless Chain [pyramid] schemes is their inherent deceptiveness and the fact that the ‘futility’ of the plan is not ‘apparent to the consumer participant.’” *Id.* at 782. Regulators and prosecutors, however, need not wait until a pyramid actually collapses before stepping in to prevent losses to victims along the way.

Why We Believe Herbalife Meets the Legal Definition of a Pyramid

Herbalife has already been Found to be a Pyramid. In 2011, following seven years of proceedings examining Herbalife's marketing plan, a Belgian court found that Herbalife is a pyramid scheme. *Test-Aankoop v. Herbalife International Belgium* [Comm. Ct. Brussels], Nov. 23, 2011, AR 2004/7787, No. JC-DC/27.

Moreover, in a 2009 decision, in considering an endless-chain (pyramid) claim under California law, a federal judge opined:

Herbalife's entire business model appears to incentivize primarily the payment of compensation that is ‘facially unrelated to the sale of the product to the ultimate users because it is paid based on the suggested retail price of the amount ordered from [HLF], rather than based on actual sales to consumers.’⁵

⁵ *Herbalife v. Ford*, Memorandum & Order Regarding Cross-Motions for Summary Judgment, No. CV 07-02529, slip op. at 16 (C.D. Cal. Aug. 25, 2009). While the *Ford* case was disposed of on other grounds – namely, the parties challenging Herbalife as a pyramid failed to show that they were victims of the scheme, as opposed to participants who profited from it – the Court's finding was not disturbed or changed.

Recruiting Rewards Far Outweigh Any Retail Profit. Herbalife distributors “obtain their monetary benefits primarily from recruitment rather than the sale of goods and services to consumers,” meeting the definition of a pyramid scheme, quoted above.

We believe that while the vast majority of distributors earn little to no income, those who do are rewarded primarily for recruiting new distributors. Based on public data and the assumptions detailed in our presentation, we believe that recruiting-related rewards constitute over 90% of the earnings of Herbalife distributors.

Herbalife has no Genuine Data Demonstrating Retail Sales. Herbalife’s 10-K acknowledges among its risk factors that it must comply with consumer-protection and pyramid regulations.

Regulations applicable to network marketing organizations generally are directed at preventing fraudulent or deceptive schemes, often referred to as ‘pyramid’ or ‘chain sales’ schemes, by ensuring that product sales ultimately are made to consumers[.]

Yet, astonishingly, despite the ability to do so, Herbalife says: “We don’t track this number [of sales outside the distributor network] and do not believe it is relevant to the business or investors.” (See 8-K, dated May 1, 2012).

Herbalife’s Sales and Marketing Plan mandates that all distributors must keep detailed records of all sales.

Section 17 Customer Retail Receipts and the Customer Refund Policy

Rule 17-A Providing Retail Receipts to Customer

A Distributor must provide an official completed Herbalife Retail Order Form to all retail customers when the sale is completed. This must list the products sold, the sales price, and the name, address and telephone number of the Distributor and the customer. Distributors are required to maintain their copy of all Retail Order Forms on file for a period of two (2) years. Herbalife maintains the right to request copies of these and to verify the transactions and the terms and conditions of the sale, and the service provided by the Distributor.

But Herbalife does not collect this readily available data that it requires its distributors to record.

Herbalife’s Major Push is for New Recruits to Seek ‘Lifestyle Money’ from Recruiting. Senior Herbalife distributors encourage new recruits to recruit others (as opposed to focusing on retail sales) if they want to make ‘Lifestyle Money.’

If you want some money today, perfect, put together a retail plan. But if you want lifestyle money, if you want to build that financial independence, you want to lock in that security for life, you need to recruit. And the other thing you need to do, be prepared to roll that cash flow for

straight 9 to 12 months. Because you know what, in that short space of time, by making that commitment, you are going to create a foundation for life. Absolutely. Not just for yourself, but a legacy, a legacy for your family, for your children, and their children's children.⁶

With just a few years of work, an Herbalife distributor supposedly obtains ever-increasing income for life. (See slide 55: <http://factsaboutheralife.com/wp-content/uploads/2013/01/Who-wants-to-be-a-Millionaire.pdf#page=55>)

Just as senior distributors encourage junior distributors to recruit, Herbalife's highly complicated compensation plan incentivizes distributors to recruit aggressively. Distributors cannot get to the upper levels of the Herbalife ranks without recruiting. Only the upper levels of Herbalife's ranks earn more than \$6,000 per year of gross earnings *before expenses*.

True Retail Profits are De Minimis. We believe a distributor's ability to profit from true retail sales of Herbalife products is *de minimis*. The "suggested retail price" of Herbalife products is an artificial, inflated number with no relation to the price at which Herbalife's products are actually sold to bona fide retail customers. Herbalife products are widely available online, from independent distributor websites and on eBay, at approximately 35-40% discounts to their "Suggested Retail Price." Taking into account the actual price at which Herbalife products are resold to the public, we estimate that the average Herbalife distributor earns less than \$10 per month selling product to true retail customers.

Rewards for Recruiting Constitute Nearly All of HLF Distributor Profits. A distributor's only real chance to earn the 'lifestyle' money promised in Herbalife marketing materials is from recruiting. Using the assumptions detailed in our presentation, we estimate that Herbalife participants obtain approximately 10 times more from recruiting rewards, or "rewards unrelated to the sale of products to ultimate users," than they do from selling the product to retail customers. After adjusting HLF's reported data to fully account for realistic retail-related profits and all recruiting-related rewards, we believe ~92% of participants' income is from recruiting. (See slide 150: <http://factsaboutheralife.com/wp-content/uploads/2013/01/Who-wants-to-be-a-Millionaire.pdf#page=150>). This is why we believe Herbalife is far past the line of being a legitimate multi-level marketing company ("MLM") and is a pyramid scheme.

Herbalife Displays Indicators of Being a Pyramid Scheme

Definitionally, an MLM is a pyramid scheme if its compensation plan incentivizes participants to focus on recruiting at the expense of retailing. Over the years, however, the FTC has described numerous indicators of pyramid schemes, supported by the case law, in publicly released statements, commentary, and consumer alerts. Below, we will focus on nine such indicators and show why, in each case, they support our conclusion that Herbalife is a pyramid scheme.

⁶ Source: Herbalife independent distributor audiovisual presentation (11-28-11). Online Business Systems is an Herbalife affiliate overseen by Shawn Dahl (Chairman's Club).

Indicator #1: Deception regarding Likely Success

Pyramid schemes are said to be inherently deceptive.⁷ Herbalife deceives new participants in numerous ways.

Exaggerated Representations of What Level a New Recruit can Achieve. Herbalife marketing materials tell new recruits that “everything is really easy” and claim that “anybody can do it.” However, there is nothing easy about achieving the wealth and lifestyle new distributors are led to believe are possible. Because of low turnover amongst Herbalife’s senior-most ranks, it is effectively a closed system at the top. We estimate that the probability of making \$178,000 per year, the average income suggested by Herbalife’s published testimonials, is about 1-in-5000.

Exaggerated Representations of How Quickly One Can Succeed. As an example, in 2000, Herbalife entered Ireland. In an Herbalife magazine published that same year, John Tartol, a senior Herbalife distributor and a current member of Herbalife’s board of directors, was quoted as saying “distributors can make it [to President’s Team] even faster today than we did [that is, faster than three years].” (President’s Team is one of the highest levels in the Herbalife chain, with a median annual compensation of ~\$337,000). Ten years later, not a single Irish distributor had even reached the rank of Millionaire Team (median income: ~\$97,000).

Luring Recruits through Affiliates; Delayed Identification of Herbalife. Another way in which Herbalife is deceptive is how it recruits new participants. Distributors use the “curiosity approach” and lure new recruits to Opportunity Meetings or work-at-home websites before they reveal Herbalife’s true identity. Often, those considering the Herbalife business opportunity will be approached by seemingly different companies altogether (e.g., “Online Business Systems LLC” or “Financial Success Systems LLC”). For examples of how these affiliated companies recruit, visit our website: <http://factsaboutheralife.com/category/herbalife-recruiting-affiliate-videos/online-business-system>. We believe these omissions and the delayed identification of Herbalife are deceptive.

Indicator #2: Exaggerated Earnings Claims

In May 1998, Debra Valentine, former General Counsel of the FTC, issued a prepared statement to the IMF on “Pyramid Schemes.” Valentine warned consumers to “beware of exaggerated earnings claims.”

“More Money Than You Can Imagine.” Recall that Herbalife testimonials lead new participants to believe that earning ~\$178,000 per year – or ‘more money than you can imagine’ – is reasonably achievable. We believe the average Herbalife distributor earns less than \$100 per year (before expenses). Herbalife recruiting materials that market an opportunity to “achieve financial freedom” are a gross exaggeration of typical outcomes.

⁷ *Webster v. Omnitrition*, 79 F.3d 776 (9th Cir. 1996); *Federal Trade Commission v. BurnLounge, Inc.*, No. CV 07-3654 (U.S.D.C., C.D. Cal); *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181 (1975), *aff’d mem. Sub nom.*, *Turner v. F.T.C.*, 580 F.2d 701 (D.C. Cir. 1978).

Misleading Statistics and Failure to Disclose Net Income After Expenses. Any reasonable promotion of a business opportunity should make clear the net income a typical new participant can expect to achieve – after paying all of the business’ expenses. Moreover, we estimate that Herbalife’s Statement of Average Gross Compensation of U.S. Supervisors excludes ~93% of all distributors who try to earn commissions from Herbalife, and fail.

See HLF’s misleading disclosure...

<http://opportunity.herbalife.com/Content/en-US/pdf/business-opportunity/StatementAverageCompensation2011EN.pdf>

...and our analysis showing ~93% of distributors are excluded from HLF’s disclosure:

<http://factsaboutherbalife.com/wp-content/uploads/2013/01/Who-wants-to-be-a-Millionaire.pdf#page=180>

Herbalife’s Statement of Gross Compensation uses its own selective term ‘Active Leaders’ (excluding those who earn no commissions) and includes President’s Team and Millionaire Team (with median annual earnings of \$336,901 and \$97,303, respectively), which new recruits have almost no statistical chance of ever reaching. The Statement describes “Gross Compensation” without providing any estimate of expenses, including the cost of product purchases and other ‘business method’ materials, leads, overhead, etc. Only beginning in July 2012 did the Statement even note that its figures are gross, not net – that is, receipts without considering expenses – but still without any estimate of what expenses and after-expense income might be.

Indicator #3: High Failure Rate

High turnover of participants is another characteristic of a pyramid scheme. We estimate that approximately 90% of Herbalife Sales Leaders (that is, distributors who have “invested” thousands of dollars to participate in the Herbalife business opportunity) have turned over – and an even higher percentage and millions more victims if you include all of the failed disappointed distributors who never even reach the level of Sales Leader. In 2005, Herbalife stopped disclosing distributor turnover.

Indicator #4: Inflated Prices

In a 1998 statement to the IMF, former FTC General Counsel Debra Valentine noted that inflated prices are indicative of a pyramid scheme.

Inflated SRP. Based on our analysis, we believe Herbalife’s “Suggested Retail Price” (SRP) at which distributors are told to resell products is two-to-three times the cost of similar and better-known, commodity-like products. Herbalife products routinely sell online for more than 35% discounts to SRP.

Other Fees and Charges. Herbalife charges its distributors numerous additional fees (typically calculated as a percentage of the inflated SRP) that we believe are not readily apparent to recruits. These come in the form of “packaging and handling” fees, freight charges, shipping charges, cross-border charges, and taxes that must be paid upfront. For Herbalife distributors to

earn their full retail markup, all of these charges must be passed through to the ultimate customer. These fees serve to further inflate the price at which distributors must resell product to earn a profit.

Indicator #5: A History of Lawsuits

In a consumer alert published on the FTC's website in 2009, "The Bottom Line About Multilevel Marketing Plans and Pyramid Schemes," the FTC recommended that consumers should consider whether or not an MLM has been sued for deceptive business practices, because a history of lawsuits is an indication of a pyramid scheme.

Herbalife's corporate history is replete with lawsuits alleging that it is a pyramid scheme:

- ***HLF Found to be a Pyramid by Belgian Court.*** In 2011, after seven years of proceedings, a Belgian judge determined Herbalife was operating a pyramid scheme (see *Test-Aankoop v. Herbalife Int'l Belgium*).
- ***Adverse Court Statement on Key Pyramid Issue in Case with Distributors.*** In *Herbalife v. Ford*, a group of senior Herbalife distributors, including multiple former President's Team members (top 0.1%) – network insiders who knew how the system works – accused Herbalife of illegally operating a pyramid scheme. In 2009, after extensive factual discovery, the Federal Court in California applied the Ninth Circuit's *Omnitrition* decision to Herbalife and stated: "Herbalife's entire business model appears to incentivize primarily the payment of compensation that is 'facially unrelated to the sale of product to the ultimate users' because it is paid based on the suggested retail price of the amount ordered [from Herbalife], rather than based on actual sales to consumers."⁸
- ***Criminal Conviction of Senior Distributors for Operating a Pyramid.*** In 2004, a Canadian Competition Bureau investigation revealed that Global Online Systems, Inc., a recruiting operation led by senior Herbalife distributors, was operating a pyramid selling scheme (see *Her Majesty the Queen v. Global Online Systems, Inc.*).
- ***Class-Action Distributor Claims of HLF as an Endless Chain (Pyramid).*** In 2006, Herbalife was sued by a group of former distributors that claimed Herbalife's Sales and Marketing Plan constituted an endless chain scheme (see *Minton v. Herbalife*).
- ***HLF Settles Claims Asserted by a Class of Distributors Accusing HLF of Deception and Running a Pyramid.*** In 2005, Herbalife settled a lawsuit brought on behalf of a class of 8,700 former and current Herbalife distributors who accused the company of running a pyramid scheme, securities-law violations and other deceptive practices (see *Jacobs v. Herbalife*). The value of the settlement totaled \$6 million. Claims were received from over 2,700 distributors,

⁸ *Herbalife v. Ford*, Memorandum & Order Regarding Cross-Motions for Summary Judgment, No. CV 07-02529, slip op. at 16 (C.D. Cal. Aug. 25, 2009). While the *Ford* case was disposed of on other grounds – namely, the parties challenging Herbalife as a pyramid failed to show that they were victims of the scheme, as opposed to participants who profited from it – the Court's finding was not disturbed or changed.

documenting losses of ~\$10,000 each on average; the highest single-distributor claim was ~\$128,000.

Indicator #6: Targeting Financially Vulnerable Members of Ethnic Groups

Herbalife aims its pitch at the poorest, most vulnerable members of various targeted ethnic groups, following what HLF euphemistically calls “Market Segmentation,” targeting Latinos, African-Americans, Koreans, Polish, Vietnamese, Chinese, Russians, under-30s, and stay-at-home moms. See slides 232-238: <http://factsabouth Herbalife.com/wp-content/uploads/2013/01/Who-wants-to-be-a-Millionaire.pdf#page=232>.

Indicator #7: Complex Compensation Rules

Herbalife imposes an extremely complex set of compensation rules on its distributors. The Sales & Marketing Plan is comprised of ~125 pages of rules and forms, totaling ~48,000 words. These rules impose substantial restrictions and obligations on distributors that most new distributors, especially those inexperienced in business, would find extremely difficult to understand.

Indicator #8: Evidence of Saturation

In a key case, *In re Koscot Interplanetary, Inc.*, the FTC pointed to saturation as a key indicator of a pyramid scheme. As new participants recruit multiple new participants into the scheme, the saturation of local markets or affinity groups can happen quickly.⁹

Pop-and-Drop. The larger the incentive to recruit, the faster the geometric progression of the saturation. Inevitably, as new recruits cannot be found to replace exiting participants, sales decline. This phenomenon, dubbed by Herbalife executives as “pop-and-drop,” has occurred many times throughout Herbalife’s corporate history. In our presentation, we charted pop-and-drop sales in Japan (1993-2005), Israel (1991-2001), Spain, (1990-2001), France (1990-2001), Germany (1991-2001), and Russia (1995-2001). After 2001, Herbalife stopped disclosing data for specific countries. (See slides 248-263: <http://factsabouth Herbalife.com/wp-content/uploads/2013/01/Who-wants-to-be-a-Millionaire.pdf#page=248>)

Herbalife has been able to grow for 32 years by entering new markets. This process masks “drops” in mature markets with the “pops” of new markets.

Exploiting Sub-Markets. Herbalife apologists are quick to point to Herbalife’s ability to endure in seemingly mature markets as evidence that the company must not be a pyramid scheme. For example, Herbalife has been in the U.S. for over 32 years and, after a decline, is again experiencing growth.

⁹ E.g., 86 F.T.C. 1114, 1132-33 (“The demand for prospective participants thus increased in geometric progression while the number of potential investors available in a given community or geographical area remained relatively constant. . . . The exhaustion of prospects results from over-saturation . . . [T]he imposition of an inappropriate statewide quota did not negate the endless chain representation, nor did it prevent the chain from soon reaching the saturation point in a number of local areas. This was largely because, with rare exceptions, distributors naturally tended to recruit in their own circumscribed local areas, and the chain soon ended in such an area before a statewide quota was breached.”)

Even within the North American market, however, Herbalife's growth appears to be a story of "popping" Latino Nutrition Clubs versus a "dropping" 'core' U.S. customer base. In mature markets, Herbalife simply moves from one affinity group to the next until each sub-market has reached its saturation point.¹⁰

Indicator #9: Top 1% of HLF Distributors Earn 88% of "Gross Compensation"

A key indicator of any transfer scheme is evidence that those at the top receive the lion's share of the financial rewards. Distributions to those at the top are funded by the losses of those at the bottom of the pyramid.

The top 1% of Herbalife's U.S. distributors receive ~88% of the "gross compensation." Think of this metric as similar to a Gini coefficient, a statistical measure of income inequality. In a pyramid scheme, the higher the income of those at the top, the larger and more widespread the losses for those at the bottom. In many other multi-level marketing companies, the Gini coefficient is much lower. For example, the top 1% of Tupperware distributors earn less than 50% of the rewards.

The lop-sided allocation of wealth in the Herbalife system is the result of Herbalife's carefully engineered compensation plan. The plan rewards those at the top substantially more than other well-known multi-level marketing companies. For example, Avon distributors generally earn a commission on only three levels of recruits, at a declining percentage of commissions for each lower level, whereas, in Herbalife, senior distributors receive commissions from the product purchases of junior distributors "infinitely deep" in the distribution pyramid.

Injury to Consumers from Herbalife's Pyramid Scheme

We believe Herbalife has caused, and continues to cause, unsuspecting consumers substantial monetary and non-monetary harm. This monetary harm, we conservatively estimate, equals many billions of dollars. In a class action settled by Herbalife in 2005 (*Jacobs v. Herbalife International, Inc.*, Case No. CV-02-1431 (U.S.D.J., C.D. Cal.)), over 2,700 distributors filed claims to participate in the settlement. Submitted claims totaled \$27,345,366 and averaged \$10,124 per claimant. The highest single-distributor claim showed losses of \$128,241. The plaintiffs' losses included both product purchases and the cost of so-called 'business method' materials.

The *Jacobs* case represented only 2,700 statements of losses – out of millions of people, including, we estimate, ~10 million non-sales leaders, who have attempted the Herbalife 'opportunity.' We estimate conservatively that total losses are many billions of dollars.

¹⁰ Nutrition Clubs, supposedly a source of material growth in daily consumption of HLF products, are claimed to be 'social clubs,' but are defined mostly by what they may not do: no signage, no advertising, no promotions, etc. – and no retail sales. Yet Nutrition Clubs, according to HLF, compete with McDonald's and account for a meaningful portion of Herbalife's retail sales. We believe these establishments are formed for the purpose of recruitment, not retail sales. (See slides 296-298: <http://factsabouth Herbalife.com/wp-content/uploads/2013/01/Who-wants-to-be-a-Millionaire.pdf#page=296>)

No monetary analysis can properly encompass the loss of time, the diversion of productive effort, the damaged relationships, and the emotional harm that can result from buying into a pyramid scheme. On our website, www.factsaboutheralife.com, there are numerous statements of former distributors who have lost their homes, families, and meaningful relationships because they elected to pursue what is an effectively impossible financial goal. A web search quickly reveals many more such examples of Herbalife-induced hardship.

Recruiting family members, friends, work and church acquaintances and others in their communities into a rigged game, one that is highly likely to exact financial and emotional harm on those loved and trusted by them, has an impact that cannot be repaired or recompensed with dollars alone. These victims part with money they can't afford to lose in reliance on Herbalife's false promises, pursuing their misplaced hopes for 'financial freedom' and the Herbalife 'lifestyle.'

Disclaimer

Pershing Square Capital Management, L.P. (“Pershing Square”) is an investment adviser to funds that are in the business of buying and selling securities and other financial instruments.

Pershing Square currently has a short position in Herbalife Ltd. (“Herbalife”) common stock. We do not own any options on Herbalife common stock.

Pershing Square will profit if the trading price of Herbalife common stock declines and will lose money if the trading price of common stock of Herbalife increases.

Pershing Square may change its views about or its investment positions in Herbalife at any time, for any reason or no reason. Pershing Square may buy, sell, cover or otherwise change the form or substance of its Herbalife investment. Pershing Square disclaims any obligation to notify the market of any such changes.

The information and opinions expressed in this presentation (the “Presentation”) are based on publicly available information about Herbalife. Pershing Square recognizes that there may be non-public information in the possession of Herbalife or others that could lead Herbalife or others to disagree with Pershing Square’s analyses, conclusions and opinions.

The Presentation includes forward-looking statements, estimates, projections and opinions prepared with respect to, among other things, certain legal and regulatory issues Herbalife faces and the potential impact of those issues on its future business, financial condition and results of operations, as well as, more generally, Herbalife’s anticipated operating performance, access to capital markets, market conditions, assets and liabilities. Such statements, estimates, projections and opinions may prove to be substantially inaccurate and are inherently subject to significant risks and uncertainties beyond Pershing Square’s control.

Although Pershing Square believes the Presentation is substantially accurate in all material respects and does not omit to state material facts necessary to make the statements therein not misleading, Pershing Square makes no representation or warranty, express or implied, as to the accuracy or completeness of the Presentation or any other written or oral communication it makes with respect to Herbalife, and Pershing Square expressly disclaims any liability relating to the Presentation or such communications (or any inaccuracies or omissions therein). Thus, shareholders and others should conduct their own independent investigation and analysis of the Presentation and of Herbalife and other companies mentioned.

The Presentation is not investment advice or a recommendation or solicitation to buy or sell any securities. Except where otherwise indicated, the Presentation speaks as of the date hereof, and Pershing Square undertakes no obligation to correct, update or revise the Presentation or to otherwise provide any additional materials. Pershing Square also undertakes no commitment to take or refrain from taking any action with respect to Herbalife or any other company.

All users and listeners agree and consent to exclusive jurisdiction and venue of any dispute or proceeding relating to or arising from Pershing Square’s Herbalife Presentation, website, this Executive Summary or any related subject matter in the Courts of the State of New York in New York County or in the Federal courts located in the Southern District of New York. As used herein, except to the extent the context otherwise requires, Pershing Square includes its affiliates and its and their respective partners, directors, officers and employees.