

HERBALIFE LTD.
Form 10-Q
April 28, 2014
[Table of Contents](#)

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

Form 10-Q

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2014

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____ .

Commission file number: 1-32381

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

Cayman Islands
(State or other jurisdiction of
incorporation or organization)

98-0377871
(I.R.S. Employer
Identification No.)

P.O. Box 309GT

Ugland House, South Church Street

Grand Cayman, Cayman Islands

(Address of principal executive offices) (Zip code)

(213) 745-0500

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

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

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☐

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

Number of shares of registrant's common shares outstanding as of April 23, 2014 was 98,107,055.

Table of Contents

HERBALIFE LTD.

PART I. FINANCIAL INFORMATION

<u>Item 1. Financial Statements</u>	
<u>Unaudited Condensed Consolidated Balance Sheets</u>	3
<u>Unaudited Condensed Consolidated Statements of Income</u>	4
<u>Unaudited Condensed Consolidated Statements of Comprehensive Income</u>	5
<u>Unaudited Condensed Consolidated Statements of Cash Flows</u>	6
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	7
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	39
<u>Item 4. Controls and Procedures</u>	41
<u>Forward Looking Statements</u>	41

PART II. OTHER INFORMATION

<u>Item 1. Legal Proceedings</u>	42
<u>Item 1A. Risk Factors</u>	42
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	57
<u>Item 3. Defaults Upon Senior Securities</u>	58
<u>Item 4. Mine Safety Disclosures</u>	58
<u>Item 5. Other Information</u>	58
<u>Item 6. Exhibits</u>	58
<u>Signatures and Certifications</u>	62

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****HERBALIFE LTD. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)**

	March 31, 2014	December 31, 2013
	(In thousands, except share and par value amounts)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 1,261,921	\$ 972,974
Receivables, net of allowance for doubtful accounts of \$1,991 (2014) and \$2,211 (2013)	118,610	100,326
Inventories	324,992	351,201
Prepaid expenses and other current assets	162,842	148,774
Deferred income taxes	67,739	69,845
Total current assets	1,936,104	1,643,120
Property, at cost, net of accumulated depreciation and amortization of \$345,950 (2014) and \$327,864 (2013)	346,363	318,860
Deferred compensation plan assets	26,969	26,821
Deferred financing costs, net	27,367	4,896
Other assets	103,567	63,713
Marketing related intangibles and other intangible assets, net	310,729	310,801
Goodwill	105,490	105,490
Total assets	\$ 2,856,589	\$ 2,473,701
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 87,174	\$ 82,665
Royalty overrides	259,758	266,952
Accrued compensation	74,940	111,905
Accrued expenses	276,532	267,501
Current portion of long-term debt	87,509	81,250
Advance sales deposits	83,592	68,079
Income taxes payable	32,400	43,826
Total current liabilities	901,905	922,178

NON-CURRENT LIABILITIES:

Long-term debt, net of current portion	1,760,778	850,019
Deferred compensation plan liability	40,523	37,226
Deferred income taxes	63,182	66,026
Other non-current liabilities	48,095	46,806
Total liabilities	2,814,483	1,922,255

CONTINGENCIES

SHAREHOLDERS' EQUITY:

Common shares, \$0.001 par value; 1.0 billion shares authorized; 101.3 million (2014) and 101.1 million (2013) shares outstanding	101	101
Paid-in-capital in excess of par value	423,515	323,860
Accumulated other comprehensive loss	(22,485)	(19,794)
(Accumulated deficit) retained earnings	(359,025)	247,279
Total shareholders' equity	42,106	551,446
Total liabilities and shareholders' equity	\$ 2,856,589	\$ 2,473,701

See the accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

HERBALIFE LTD. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months Ended	
	March 31, 2014	March 31, 2013
	(In thousands, except per share amounts)	
Product sales	\$ 1,156,134	\$ 951,583
Shipping & handling revenues	106,515	172,064
Net sales	1,262,649	1,123,647
Cost of sales	251,165	225,977
Gross profit	1,011,484	897,670
Royalty overrides	381,819	364,029
Selling, general & administrative expenses	502,062	364,720
Operating income	127,603	168,921
Interest expense, net	14,961	5,373
Other expense, net	3,161	
Income before income taxes	109,481	163,548
Income taxes	34,853	44,675
NET INCOME	\$ 74,628	\$ 118,873
Earnings per share:		
Basic	\$ 0.78	\$ 1.14
Diluted	\$ 0.74	\$ 1.10
Weighted average shares outstanding:		
Basic	95,397	104,121
Diluted	100,780	108,068
Dividends declared per share	\$ 0.30	\$ 0.30

See the accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

HERBALIFE LTD. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended	
	March 31,	March 31,
	2014	2013
	(In thousands)	
Net income	\$ 74,628	\$ 118,873
Other comprehensive income (loss):		
Foreign currency translation adjustment, net of income taxes of \$(73) and \$(305) for the three months ended March 31, 2014 and 2013, respectively	(2,183)	(8,684)
Unrealized loss on derivatives, net of income taxes of \$(104) and \$(507) for the three months ended March 31, 2014 and 2013, respectively	(413)	(1,332)
Unrealized loss on available-for-sale investments, net of income taxes of \$(51) for the three months ended March 31, 2014	(95)	
Total other comprehensive income (loss)	(2,691)	(10,016)
Total comprehensive income	\$ 71,937	\$ 108,857

See the accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents**HERBALIFE LTD. AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	Three Months Ended	
	March 31, 2014	March 31, 2013
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 74,628	\$ 118,873
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	21,283	20,964
Excess tax benefits from share-based payment arrangements	(3,154)	(447)
Share-based compensation expenses	10,995	7,866
Non-cash interest expense and amortization of deferred financing and issuance costs	7,154	650
Deferred income taxes	(2,313)	(3,773)
Inventory write-downs	11,037	6,554
Unrealized foreign exchange transaction loss (gain)	3,390	(10,971)
Foreign exchange loss relating to Venezuela	86,108	15,116
Other	4,462	(890)
Changes in operating assets and liabilities:		
Receivables	(17,953)	3,216
Inventories	14,198	(1,542)
Prepaid expenses and other current assets	(23,850)	(8,200)
Other assets	(5,180)	(15)
Accounts payable	6,224	4,900
Royalty overrides	(3,703)	(21,472)
Accrued expenses and accrued compensation	(12,487)	(15,517)
Advance sales deposits	17,416	(3,857)
Income taxes	(903)	23,097
Deferred compensation plan liability	3,297	3,075
NET CASH PROVIDED BY OPERATING ACTIVITIES	190,649	137,627
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(58,517)	(24,856)
Proceeds from sale of property, plant and equipment	2	24
Investments in Venezuelan bonds	(3,224)	
NET CASH USED IN INVESTING ACTIVITIES	(61,739)	(24,832)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(30,399)	(30,904)
Dividends received	3,444	

Edgar Filing: HERBALIFE LTD. - Form 10-Q

Payments for Capped Call Transactions	(123,825)	
Borrowings from Long-Term Debt	1,150,000	513,223
Principal payments on long-term debt	(18,750)	(25,509)
Debt issuance costs	(28,837)	
Share repurchases	(694,503)	(164,485)
Excess tax benefits from share-based payment arrangements	3,154	447
Proceeds from exercise of stock options and sale of stock under employee stock purchase plan	60	425
NET CASH PROVIDED BY FINANCING ACTIVITIES	260,344	293,197
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(100,307)	(17,052)
NET CHANGE IN CASH AND CASH EQUIVALENTS	288,947	388,940
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	972,974	333,534
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 1,261,921	\$ 722,474
CASH PAID DURING THE PERIOD		
Interest paid	\$ 7,533	\$ 5,486
Income taxes paid	\$ 39,403	\$ 31,853
NON CASH ACTIVITIES		
Accrued capital expenditures	\$ 20,452	\$ 10,070

See the accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

HERBALIFE LTD. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization

Herbalife Ltd., a Cayman Islands exempt limited liability company, or Herbalife, was incorporated on April 4, 2002. Herbalife Ltd. (and together with its subsidiaries, the Company) is a global nutrition company that sells weight management products, nutritional supplements, energy, sports & fitness products and personal care products. As of March 31, 2014, the Company sold its products to and through a network of 3.9 million independent members, or Members, which included 0.2 million in China. In China, the Company sells its products through retail stores, sales representatives, sales officers and independent service providers. The Company reports revenue in six geographic regions: North America; Mexico; South and Central America; EMEA, which consists of Europe, the Middle East and Africa; Asia Pacific (excluding China); and China.

2. Significant Accounting Policies

Basis of Presentation

The unaudited condensed interim financial information of the Company has been prepared in accordance with Article 10 of the Securities and Exchange Commission's, or the SEC, Regulation S-X. Accordingly, as permitted by Article 10 of the SEC's Regulation S-X, it does not include all of the information required by generally accepted accounting principles in the U.S., or U.S. GAAP, for complete financial statements. The condensed consolidated balance sheet at December 31, 2013 was derived from the audited financial statements at that date and does not include all the disclosures required by U.S. GAAP, as permitted by Article 10 of the SEC's Regulation S-X. The Company's unaudited condensed consolidated financial statements as of March 31, 2014, and for the three months ended March 31, 2014 and 2013, include Herbalife and all of its direct and indirect subsidiaries. In the opinion of management, the accompanying financial information contains all adjustments, consisting of normal recurring adjustments, necessary to present fairly the Company's unaudited condensed consolidated financial statements as of March 31, 2014, and for the three months ended March 31, 2014 and 2013. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2013, or the 2013 10-K. Operating results for the three months ended March 31, 2014, are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

Reclassifications

Certain reclassifications were made to the prior period statement of cash flows, within cash flows from operating activities, to conform to current period presentation. These reclassifications did not impact the prior period total net cash provided by (used in) operating activities, investing activities and financing activities, nor did it impact the Company's accompanying condensed consolidated balance sheets and related condensed consolidated statements of income and comprehensive income.

Venezuela

Currency restrictions enacted by the Venezuelan government have become more restrictive and have impacted the ability of the Company's subsidiary in Venezuela, Herbalife Venezuela, to timely obtain U.S. dollars in exchange for

Venezuelan Bolivars, or Bolivars, at the official foreign exchange rate. The application and approval process continues to be delayed and the Company's ability to timely obtain U.S. dollars using the official exchange rate mechanisms described below remains uncertain. In recent instances, the Company has been unsuccessful in obtaining U.S. dollars at these official rates and it remains uncertain whether the Company's future anticipated applications will be approved. The current operating environment in Venezuela also continues to be challenging for the Company's Venezuela business, with high inflation in the country, government restrictions on foreign exchange and pricing controls, and the possibility of the government announcing further devaluations to its currency. These foreign exchange controls in Venezuela limit Herbalife Venezuela's ability to repatriate earnings and settle the Company's intercompany obligations at any official rate which is causing its Bolivar denominated cash and cash equivalents to accumulate in Venezuela.

In February 2013, the Venezuela government announced that it devalued its Bolivar currency and eliminated the SITME regulated system. The SITME 5.3 Bolivars per U.S. dollar rate was eliminated and the CADIVI rate was devalued from 4.3 Bolivars to 6.3 Bolivars per U.S. dollar. This CADIVI rate was approximately 16% less favorable than the previously published 5.3 SITME rate. The Company recognized approximately \$15.1 million of net foreign exchange losses within its condensed consolidated statement of income for the three months ended March 31, 2013, as a result of remeasuring the Company's Bolivar denominated monetary assets and liabilities at the CADIVI rate of 6.3 Bolivars per U.S. dollar.

Table of Contents

In March 2013, the Venezuelan government also announced they will introduce an additional complimentary exchange mechanism known as SICAD. During the first quarter of 2014, the Venezuelan government announced the establishment of CENCOEX which replaced the previous foreign exchange commission, CADIVI. Also, during the first quarter of 2014, additional activities, such as processing of dividend payments, which were previously administered by CADIVI, are now required to be processed at the SICAD auction rate, or SICAD I rate. During the fourth quarter of 2013, the Company received an approval through the SICAD mechanism for a bid of approximately 6.8 million Bolivars, or approximately \$1.1 million U.S. dollars remeasured using the CADIVI rate, for a distribution of approximately \$0.6 million in U.S. dollars, which resulted in a foreign exchange loss of approximately \$0.5 million during the fourth quarter of 2013, or an effective exchange rate of 11.3 Bolivars per U.S. dollar.

During March 2014, the government introduced an additional exchange mechanism known as SICAD II. During March 2014, the Company submitted a SICAD II bid to exchange its 5.3 million Bolivars for \$0.1 million U.S. dollars which was approved and resulted in the Company recognizing a \$0.7 million U.S. dollar foreign exchange loss at an effective exchange rate of approximately 56.2 Bolivars per U.S. dollar. The Company is currently evaluating the viability of this SICAD II mechanism and its public availability and accessibility to the Company in future periods. The SICAD II mechanism is still in its early stages and there is limited information being published around this mechanism so it is currently difficult to determine how the SICAD II mechanism functions and if there are any volume constraints around this mechanism.

Based on the events above and the Company's latest facts and circumstances, the Company remeasured its financial statements at the SICAD I rate of 10.7 Bolivars per U.S. dollar at March 31, 2014. As a result of using the less favorable SICAD I rate for remeasurement, during the three months ended March 31, 2014 the Company's cash and cash equivalents were reduced by approximately \$96.0 million, and the Company recognized \$86.1 million of foreign exchange losses in selling, general & administrative expenses within its condensed consolidated statement of income.

As of March 31, 2014, if the Company had used the SICAD II rate of approximately 50 Bolivars per U.S. dollar to remeasure its net monetary assets and liabilities denominated in Bolivars, the Company would have incurred an additional approximate foreign exchange loss of \$99.3 million during the three months ended March 31, 2014, and its Herbalife Venezuela cash and cash equivalents would have been further reduced by approximately \$108.0 million at March 31, 2014.

Due to the evolving foreign exchange control environment in Venezuela, it is possible that the Company's ability to access certain foreign exchange mechanisms, including the SICAD I and SICAD II exchange mechanisms, could change in future quarters which may have an impact on what rate the Company uses in the future to remeasure Herbalife Venezuela's net monetary Bolivar denominated assets and liabilities. The Company is closely monitoring the SICAD I and SICAD II exchange mechanisms as they continue to evolve.

As of March 31, 2014, the Company's net monetary assets and liabilities denominated in Bolivars were approximately \$129.0 million, and included approximately \$137.5 million in Bolivar denominated cash and cash equivalents. These Bolivar denominated assets and liabilities were remeasured at the SICAD I rate. These remeasured amounts, including cash and cash equivalents, being reported on the Company's condensed consolidated balance sheet using the published official SICAD I rate may not accurately represent the amount of U.S. dollars that the Company could ultimately realize. Herbalife Venezuela's net sales represented approximately 4% of the Company's consolidated net sales for the three months ended March 31, 2014 and 2013, and its total assets represented approximately 6% and 10% of the Company's consolidated total assets as of March 31, 2014 and December 31, 2013, respectively. As of March 31, 2014 and December 31, 2013, the majority of Herbalife Venezuela's total assets consisted of Bolivar denominated cash and cash equivalents.

Investments in Bolivar-Denominated Bonds

During the first quarter of 2014, the Company invested in additional Bolivar denominated bonds with a purchase price of 20.3 million Bolivars, or approximately \$3.2 million. The Company classifies these bonds as long-term available-for-sale investments which are carried at fair value, inclusive of unrealized gains and losses, and net of discount accretion and premium amortization. The fair value of these bonds are determined using Level 2 inputs which include prices of similar assets traded in active markets in Venezuela and observable yield curves. Net unrealized gains and losses on these bonds are included in other comprehensive income (loss) and are net of applicable income taxes. During the three months ended March 31, 2014, the Company did not sell any of its bonds.

The Company's investments in Bolivar denominated bonds as of March 31, 2014 are summarized as follows:

	Amortized Costs	Gross Unrealized Gain	Gross Unrealized Loss	Net Unrealized Gain (In thousands)	Other-Than- Temporary Impairment	Market Value
Investments in Venezuelan bonds	\$ 7,253	\$	\$	\$	\$ 3,161	\$ 4,092