

HERBALIFE NUTRITION LTD.  
Form 10-Q  
August 01, 2018

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 June 30, 2018

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 NUTRITION LTD.

(Exact name of registrant as specified in its charter)

Cayman Islands 98-0377871  
(State or other jurisdiction of (I.R.S. Employer

incorporation or organization) Identification No.)

P.O. Box 309GT

Ugland House, South Church Street

Grand Cayman, Cayman Islands

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(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, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

(Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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 July 25, 2018 was 157,171,861.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## HERBALIFE NUTRITION LTD. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	June 30,	December 31,
	2018	2017
	(in millions, except share and par value amounts)	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$839.4	\$ 1,278.8
Receivables, net of allowance for doubtful accounts	100.0	93.3
Inventories	315.1	341.2
Prepaid expenses and other current assets	181.8	147.0
Total current assets	1,436.3	1,860.3
Property, plant, and equipment, at cost, net of accumulated depreciation and amortization	355.9	377.5
Marketing-related intangibles and other intangible assets, net	310.1	310.1
Goodwill	93.5	96.9
Other assets	225.7	250.3
Total assets	\$2,421.5	\$ 2,895.1
<b>LIABILITIES AND SHAREHOLDERS' DEFICIT</b>		
Current liabilities:		
Accounts payable	\$83.9	\$ 67.8
Royalty overrides	255.7	277.7
Current portion of long-term debt	744.3	102.4
Other current liabilities	486.3	458.9
Total current liabilities	1,570.2	906.8
Long-term debt, net of current portion	1,456.4	2,165.7
Other non-current liabilities	174.3	157.3
Total liabilities	3,200.9	3,229.8
Commitments and contingencies		
Shareholders' deficit:		
Common shares, \$0.0005 par value; 2.0 billion shares authorized;		
147.1 million (2018) and 164.7 million (2017) shares outstanding	0.1	0.1
Paid-in capital in excess of par value	389.4	407.3
Accumulated other comprehensive loss	(193.6 )	(165.4 )
Accumulated deficit	(646.4 )	(248.1 )
Treasury stock, at cost, 10.0 million (2018) and 10.0 million (2017) shares	(328.9 )	(328.6 )

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Total shareholders' deficit	(779.4 )	(334.7 )
Total liabilities and shareholders' deficit	\$2,421.5	\$ 2,895.1

See the accompanying notes to unaudited condensed consolidated financial statements.

## HERBALIFE NUTRITION LTD. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Three Months		Six Months Ended	
	Ended June 30,	June 30,	June 30,	June 30,
	2018	2017	2018	2017
	(in millions, except per share amounts)			
Net sales	\$1,285.5	\$1,146.9	\$2,462.4	\$2,249.0
Cost of sales	235.4	218.8	475.3	423.4
Gross profit	1,050.1	928.1	1,987.1	1,825.6
Royalty overrides	349.8	318.9	687.1	634.0
Selling, general, and administrative expenses	510.2	443.2	970.3	881.8
Other operating income	(1.7 )	(38.9 )	(17.9 )	(38.9 )
Operating income	191.8	204.9	347.6	348.7
Interest expense, net	44.3	37.9	84.2	68.1
Other expense, net	4.7	—	29.1	—
Income before income taxes	142.8	167.0	234.3	280.6
Income taxes	48.4	29.4	57.8	57.8
Net income	\$94.4	\$137.6	\$176.5	\$222.8
Earnings per share:				
Basic	\$0.66	\$0.84	\$1.23	\$1.35
Diluted	\$0.62	\$0.81	\$1.15	\$1.30
Weighted-average shares outstanding:				
Basic	142.3	162.9	144.0	164.6
Diluted	151.9	170.6	153.0	172.1

See the accompanying notes to unaudited condensed consolidated financial statements.

## HERBALIFE NUTRITION LTD. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

	Three Months Ended June 30, June 30,		Six Months Ended June 30, June 30,	
	2018	2017	2018	2017
	(in millions)			
Net income	\$94.4	\$ 137.6	\$ 176.5	\$ 222.8
Other comprehensive (loss) income:				
Foreign currency translation adjustment, net of income taxes				
of \$(3.1) and \$2.7 for the three months ended June 30, 2018				
and 2017, respectively, and \$(2.0) and \$5.3 for the				
six months ended June 30, 2018 and 2017, respectively	(50.8)	6.7	(29.6)	29.7
Unrealized gain (loss) on derivatives, net of income taxes of				
\$— for both the three months ended June 30, 2018 and				
2017 and \$— for both the six months ended				
June 30, 2018 and 2017	4.5	(5.5)	1.4	(13.0)
Total other comprehensive (loss) income	(46.3)	1.2	(28.2)	16.7
Total comprehensive income	\$48.1	\$ 138.8	\$ 148.3	\$ 239.5

See the accompanying notes to unaudited condensed consolidated financial statements.

## HERBALIFE NUTRITION LTD. AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Six Months Ended June 30, 2018 (in millions)	June 30, 2017
Cash flows from operating activities:		
Net income	\$ 176.5	\$ 222.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	50.8	48.6
Share-based compensation expenses	20.2	22.7
Non-cash interest expense	34.4	29.5
Deferred income taxes	2.0	0.7
Inventory write-downs	13.2	11.2
Foreign exchange transaction loss	3.9	0.9
Other	29.9	(3.3 )
Changes in operating assets and liabilities:		
Receivables	(21.8 )	(17.8 )
Inventories	(2.0 )	5.2
Prepaid expenses and other current assets	(29.9 )	6.0
Accounts payable	23.8	10.3
Royalty overrides	(7.9 )	(23.3 )
Other current liabilities	46.5	(48.7 )
Other	5.3	12.3
Net cash provided by operating activities	344.9	277.1



Cash flows from investing activities:		
Purchases of property, plant, and equipment	(33.0 )	(45.9 )
Other	—	0.3
Net cash used in investing activities	(33.0 )	(45.6 )
Cash flows from financing activities:		
Borrowings from senior secured credit facility, net of discount	—	1,274.0
Principal payments on senior secured credit facility and other debt	(49.0 )	(441.3 )
Proceeds from convertible senior notes	550.0	—
Repurchase of convertible senior notes	(582.5 )	—
Debt issuance costs	(12.5 )	(22.6 )
Share repurchases	(685.6 )	(273.6 )
Proceeds from settlement of capped call transactions	55.9	—
Other	1.1	1.0
Net cash (used in) provided by financing activities	(722.6 )	537.5
Effect of exchange rate changes on cash, cash equivalents, and restricted cash	(29.7 )	13.4
Net change in cash, cash equivalents, and restricted cash	(440.4 )	782.4
Cash, cash equivalents, and restricted cash, beginning of period	1,295.5	857.0
Cash, cash equivalents, and restricted cash, end of period	\$ 855.1	\$ 1,639.4

See the accompanying notes to unaudited condensed consolidated financial statements.



## HERBALIFE NUTRITION LTD. AND SUBSIDIARIES

### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

#### 1. Organization

Herbalife Nutrition Ltd. (formerly Herbalife Ltd.), a Cayman Islands exempted company with limited liability, was incorporated on April 4, 2002. Herbalife Nutrition Ltd. (and together with its subsidiaries, the “Company” or “Herbalife”) is a global nutrition company that sells weight management; targeted nutrition; energy, sports, & fitness; and outer nutrition products to and through a network of independent members, or Members. In China, the Company sells its products to and through independent service providers, sales representatives, and sales officers to customers and preferred customers, as well as through Company-operated retail stores when necessary. The Company sells its products 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 consolidated 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 as of December 31, 2017 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 June 30, 2018 and for the three and six months ended June 30, 2018 and 2017 include Herbalife Nutrition Ltd. 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 June 30, 2018, and for the three and six months ended June 30, 2018 and 2017. 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, 2017, or the 2017 10-K. Operating results for the three and six months ended June 30, 2018, are not necessarily indicative of the results that may be expected for the year ending December 31, 2018.

On April 24, 2018, the Company’s shareholders approved a two-for-one stock split of the Company’s common shares. On May 14, 2018, shareholders of record received one additional share for each share held as of May 7, 2018. All share and per share amounts herein have been restated to reflect the stock split.

##### Recently Adopted Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2014-09, Revenue from Contracts with Customers (Topic 606). The new revenue recognition standard provides a

five-step analysis of contracts to determine when and how revenue is recognized. The core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB deferred the effective date of ASU No. 2014-09 for all entities by one year to annual reporting periods beginning after December 15, 2017. The FASB has issued several updates subsequently, including implementation guidance on principal versus agent considerations, on how an entity should account for licensing arrangements with customers, and to improve guidance on assessing collectability, presentation of sales taxes, noncash consideration, and contract modifications and completed contracts at transition. The amendments in this series of updates shall be applied either retrospectively to each period presented or as a cumulative-effect adjustment as of the date of adoption. The Company adopted Topic 606, Revenue from Contracts with Customers, with a date of initial application of January 1, 2018 using the modified retrospective method applied to all contracts existing as of January 1, 2018. Results for reporting periods beginning January 1, 2018 and thereafter are presented under Topic 606, while prior period amounts have not been adjusted and continue to be reported in accordance with Topic 605. The Company recorded a net reduction of \$2.3 million to beginning retained earnings as of January 1, 2018 due to the cumulative impact of adopting Topic 606 resulting from revenue recognition timing differences related to the transfer of control of products sold through certain of the Company's third-party importers which are not material. The cumulative impact to opening balance sheet accounts was not material. Additionally, certain third-party importer fees have changed classification from a reduction to revenue to selling, general, and administrative expense under Topic 606. For more information on the transitional impact of adopting Topic 606, see the section entitled "Revenue Recognition" below.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. The updated guidance enhances the reporting model for financial instruments by modifying how entities measure and recognize equity investments and present changes in the fair value of financial liabilities, and by simplifying the disclosure guidance for financial instruments. The adoption of this guidance during the first quarter of 2018 did not have a material impact on the Company's condensed consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-04, Liabilities — Extinguishments of Liabilities (Subtopic 405-20): Recognition of Breakage for Certain Prepaid Stored-Value Products. This ASU requires entities that sell prepaid stored-value products redeemable for goods, services or cash at third-party merchants to recognize breakage (i.e. the value that is ultimately not redeemed by the consumer) in a way that is consistent with how it will be recognized under the new revenue recognition standard. Under prior U.S. GAAP, there was diversity in practice in how entities accounted for breakage that resulted when a consumer did not redeem the entire product balance. This ASU clarifies that an entity's liability for prepaid stored-value products within its scope meets the definition of a financial liability. The adoption of this guidance during the first quarter of 2018 did not have a material impact on the Company's condensed consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments. This ASU provides clarification on eight specific cash flow issues regarding presentation and classification in the statement of cash flows with the objective of reducing the existing diversity in practice. The adoption of this guidance during the first quarter of 2018 did not have a material impact on the Company's condensed consolidated financial statements.

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory. This ASU requires that entities recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. The amendments in this update do not change U.S. GAAP for the pre-tax effects of an intra-entity asset transfer under Topic 810, Consolidation, or for an intra-entity transfer of inventory. The adoption of this guidance during the first quarter of 2018 did not have a material impact on the Company's condensed consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. This ASU requires that restricted cash and restricted cash equivalents be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period amounts shown on the statements of cash flows. The adoption of this guidance during the first quarter of 2018 resulted in a change in the presentation of restricted cash and restricted cash equivalents in the Company's condensed consolidated statements of cash flows for all periods presented. Other than this change, the adoption of this guidance did not have a material impact on the Company's condensed consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Compensation — Stock Compensation (Topic 718): Scope of Modification Accounting. This ASU provides additional guidance for when a company should apply modification accounting when there is a change in either the terms or conditions of a share-based payment award. Specifically, a company should not apply modification accounting if the fair value, vesting conditions, and classification of the award remains the same immediately before and after the modification. The adoption of this guidance during the first quarter of 2018 did not have a material impact on the Company's condensed consolidated financial statements.

#### New Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) and subsequently issued additional updates to Topic 842. The updated guidance requires lessees to recognize a lease liability and a right-of-use asset, measured at

the present value of the future minimum lease payments, at the lease commencement date. Recognition, measurement and presentation of expenses will depend on classification as a finance or operating lease. The amendments also require certain quantitative and qualitative disclosures. ASU 2016-02 is effective for all interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. As currently issued, the update requires entities to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach or allows entities to initially apply the new lease standard at the adoption date and recognize a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The Company is performing a comprehensive review to determine and implement changes required to support the adoption of this standard. As part of this review, the Company is implementing a new lease accounting system to support the lease reporting upon adoption. The Company is evaluating the potential impact of this adoption on its condensed consolidated financial statements. The adoption of this guidance is expected to increase both assets and liabilities.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instrument — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments. This ASU changes the impairment model for most financial assets, requiring the use of an expected loss model which requires entities to estimate the lifetime expected credit loss on financial assets measured at amortized cost. Such credit losses will be recorded as an allowance to offset the amortized cost of the financial asset, resulting in a net presentation of the amount expected to be collected on the financial asset. In addition, credit losses relating to available-for-sale debt securities will now be recorded through an allowance for credit losses rather than as a direct write-down to the security. The amendments in this update are effective for reporting periods beginning after December 15, 2019, with early adoption permitted for reporting periods beginning after December 15, 2018. The Company is evaluating the potential impact of this adoption on its condensed consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment. This ASU simplifies the test for goodwill impairment by removing Step 2 from the goodwill impairment test. Companies will now perform the goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount, recognizing an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value not to exceed the total amount of goodwill allocated to that reporting unit. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The amendments in this update are effective for goodwill impairment tests in fiscal years beginning after December 15, 2019, with early adoption permitted for goodwill impairment tests performed after January 1, 2017. The Company is evaluating the potential impact of this adoption on its condensed consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities. This ASU improves the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements and makes certain targeted improvements to simplify the application of existing hedge accounting guidance. The amendments in this update are effective for reporting periods beginning after December 15, 2018, with early adoption permitted. The Company is evaluating the potential impact of this adoption on its condensed consolidated financial statements.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement — Reporting Comprehensive Income (Topic 220). This ASU allows a reclassification from accumulated other comprehensive income to retained earnings for tax effects of items within accumulated other comprehensive income, or stranded tax effects, resulting from the Tax Cuts and Jobs Act and requires certain disclosures about those stranded tax effects. The amendments in this update are effective for reporting periods beginning after December 15, 2018, with early adoption permitted. The Company is evaluating the potential impact of this adoption on its condensed consolidated financial statements.

In June 2018, the FASB issued ASU No. 2018-07, Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting. This ASU expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. The amendments in this update are effective for reporting periods beginning after December 15, 2018, with early adoption permitted. The Company is evaluating the potential impact of this adoption on its condensed consolidated financial statements.

#### Revenue Recognition

As a result of applying Topic 606, the impact to the Company's condensed consolidated balance sheet as of June 30, 2018 was as follows:

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	June 30, 2018		
		Impact due to	
	As reported (in millions)	ASC 606	Without adoption
<b>Assets:</b>			
Receivables, net of allowance for doubtful accounts	\$ 100.0	\$ 5.1	\$ 105.1
Inventories	315.1	(0.9 )	314.2
Total assets	2,421.5	4.2	2,425.7
<b>Liabilities:</b>			
Royalty overrides	255.7	2.4	258.1
Total liabilities	3,200.9	2.4	3,203.3
<b>Shareholders' deficit:</b>			
Accumulated deficit	(646.4 )	1.8	(644.6 )
Total shareholders' deficit	(779.4 )	1.8	(777.6 )
Total liabilities and shareholders' deficit	2,421.5	4.2	2,425.7

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As a result of applying Topic 606, the impact to the Company's condensed consolidated statement of income for the three months ended June 30, 2018 was as follows:

	Three Months Ended June 30, 2018		
	As reported (in millions)	Impact due to ASC 606	Without adoption
Net sales	\$1,285.5	\$ (5.1 )	\$1,280.4
Cost of sales	235.4	0.1	235.5
Gross profit	1,050.1	(5.2 )	1,044.9
Royalty overrides	349.8	0.2	350.0
Selling, general, and administrative expenses	510.2	(5.5 )	504.7
Other operating income	(1.7 )	—	(1.7 )
Operating income	191.8	0.1	191.9
Interest expense, net	44.3	—	44.3
Other expense, net	4.7	—	4.7
Income before income taxes	142.8	0.1	142.9
Income taxes	48.4	0.1	48.5
Net income	\$94.4	\$ —	\$94.4

As a result of applying Topic 606, the impact to the Company's condensed consolidated statement of income for the six months ended June 30, 2018 was as follows:

	Six Months Ended June 30, 2018		
	As reported (in millions)	Impact due to ASC 606	Without adoption
Net sales	\$2,462.4	\$(13.1)	\$2,449.3
Cost of sales	475.3	(0.4 )	474.9
Gross profit	1,987.1	(12.7)	1,974.4
Royalty overrides	687.1	(1.0 )	686.1
Selling, general, and administrative expenses	970.3	(11.1)	959.2
Other operating income	(17.9 )	—	(17.9 )
Operating income	347.6	(0.6 )	347.0
Interest expense, net	84.2	—	84.2
Other expense, net	29.1	—	29.1

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Income before income taxes	234.3	(0.6 )	233.7
Income taxes	57.8	—	57.8
Net income	\$176.5	\$(0.6 )	\$175.9

As a result of applying Topic 606, the impact to the Company's condensed consolidated statement of cash flows for the six months ended June 30, 2018 was not material.

In general, the Company's performance obligation is to transfer its products to its Members. The Company generally recognizes revenue when product is delivered to its Members. For China independent service providers, and for third-party importers utilized in certain other countries where sales historically have not been material, the Company recognizes revenue based on the Company's estimate of when the service provider or third-party importer sells the products because the Company is deemed to be the principal party of these product sales under Topic 606 due to the additional selling and operating requirements relating to pricing of products, conducting business with physical locations, and other selling and marketing activities required of the service providers and third-party importers; this timing difference relating to the Company recognizing revenues when these third-party entities sell the products compared to when the Company delivers the products to them did not have a material impact to the Company's consolidated net sales for the periods presented.

The Company's Members, excluding its China independent service providers, may receive distributor allowances, which are comprised of discounts, rebates and wholesale commission payments from the Company. Distributor allowances resulting from the Company's sales of its products to its Members are recorded against net sales because the distributor allowances represent discounts from the suggested retail price.

The Company compensates its sales leader Members with royalty overrides for services rendered, relating to the development, retention, and management of their sales organizations. Royalty overrides are payable based on achieved sales volume. Royalty overrides are classified as an operating expense reflecting the services provided to the Company. The Company compensates its China independent service providers and third-party importers utilized in certain other countries for providing marketing, selling, and customer support services. Under Topic 606, as the Company is the principal party of the product sales as described above, the service fees payable to China independent service providers and the compensation received by third-party importers for the services they provide are recorded within selling, general, and administrative expenses. For the periods presented under Topic 605, the service fees payable to its China independent service providers are similarly recognized within selling, general, and administrative expenses as they are under Topic 606. However, under Topic 605, the compensation received by third-party importers for the services they provide, which represents the discount provided to them, is recorded as a reduction to net sales, which differs from the treatment under Topic 606 as described above. This change in the accounting treatment under Topic 606 of the compensation for services provided by the Company's third-party importers did not impact the Company's consolidated net income and was not material to the Company's consolidated net sales for the periods presented.

The Company recognizes revenue when it delivers products to its United States Members; distributor allowances, inclusive of discounts and wholesale commissions, are recorded as a reduction to net sales; and royalty overrides are classified as an operating expense.

Shipping and handling services relating to product sales are recognized as fulfillment activities on the Company's performance obligation to transfer products and are therefore recorded within net sales as part of product sales and are not considered as separate revenues under Topic 606. Shipping and handling costs paid by the Company are included in cost of sales.

The Company presents sales taxes collected from customers on a net basis.

The Company generally receives the net sales price in cash or through credit card payments at the point of sale. Accounts receivable consist principally of credit card receivables arising from the sale of products to the Company's Members, and its collection risk is reduced due to geographic dispersion. Credit card receivables were \$82.3 million and \$68.1 million as of June 30, 2018 and December 31, 2017, respectively. Substantially all credit card receivables were current as of June 30, 2018 and December 31, 2017. The Company recorded \$0.4 million and \$0.2 million during the three months ended June 30, 2018 and 2017, respectively, and \$0.5 million and \$0.4 million during the six months ended June 30, 2018 and 2017, respectively, in bad-debt expense related to allowances for the Company's receivables. As of June 30, 2018 and December 31, 2017, the Company's allowance for doubtful accounts was \$1.3 million and \$1.2 million, respectively. As of June 30, 2018 and December 31, 2017, the majority of the Company's total outstanding accounts receivable were current.

The Company records advance sales deposits when payment is received but revenue has not yet been recognized. In the majority of the Company's markets, advance sales deposits are generally recorded to income when the product is delivered to its Members. Additionally, advance sales deposits also include deferred revenues due to the timing of revenue recognition for products sold through China independent service providers. The estimated deferral period for advance sales deposits is generally within one week. The Company recognized substantially all of the revenues that were included within advance sales deposits as of December 31, 2017 and any remaining such balance was not

material as of June 30, 2018. Advance sales deposits are included in Other current liabilities on the Company's condensed consolidated balance sheets. See Note 13, Detail of Certain Balance Sheet Accounts, for further information.

In general, if a Member returns product to the Company on a timely basis, they may obtain replacement product from the Company for such returned products. In addition, in general the Company maintains a buyback program pursuant to which it will repurchase products sold to a Member who has decided to leave the business. Allowances for product returns, primarily in connection with the Company's buyback program, are provided at the time the sale is recorded. This accrual is based upon historical return rates for each country and the relevant return pattern, which reflects anticipated returns to be received over a period of up to 12 months following the original sale. Allowances for product returns were \$4.8 million and \$3.9 million as of June 30, 2018 and December 31, 2017, respectively.

The Company's products are grouped in five principal categories: weight management; targeted nutrition; energy, sports & fitness; outer nutrition; and literature and promotional items. However, the effect of economic factors on the nature, amount, timing, and uncertainty of revenue recognition and cash flows are similar among all five product categories. The Company defines its operating segments through six geographic regions. The effect of economic factors on the nature, amount, timing, and uncertainty of revenue recognition and cash flows are similar among the regions with the Company's Primary Reporting Segment. See Note 6, Segment Information, for further information on the Company's reportable segments and the Company's presentation of disaggregated revenue by reportable segment.

#### Distributor Compensation – U.S.

In the U.S., distributor compensation, including Royalty overrides, is capped if the Company does not meet an annual requirement as described in the consent order discussed in more detail in Note 5, Contingencies. On a periodic basis, the Company evaluates if this requirement will be achieved by year end to determine if a cap on distributor compensation will be required, and then determines the appropriate amount of distributor compensation expense, which may vary in each reporting period. As of June 30, 2018, the Company believes that the cap to distributor compensation will not be applicable for the current year.

#### Other Operating Income

To encourage local investment and operations, governments in various China provinces conduct grant programs. The Company applied for and received several such grants in China. Government grants are recorded into income when a legal right to the grant exists, there is a reasonable assurance that the grant proceeds will be received, and the substantive conditions under which the grants were provided have been met. Generally, these substantive conditions are the Company maintaining operations and paying certain taxes in the relevant province and obtaining government approval by completing an annual application process. The Company believes the continuing obligation with respect to the funds is a general requirement that they are used only for its business in China. The Company recognized government grant income of approximately \$1.7 million and \$38.9 million during the three months ended June 30, 2018 and 2017, respectively, and \$17.9 million and \$38.9 million during the six months ended June 30, 2018 and 2017, respectively, in other operating income within its condensed consolidated statements of income, related to its regional headquarters and distribution centers within China. The Company intends to continue applying for government grants in China when programs are available; however, there is no assurance that the Company will receive grants in future periods.

#### Other Expense, Net

During the three months ended June 30, 2018, the Company recognized a loss of \$4.7 million on the revaluation of the non-transferable contractual contingent value right, or CVR, provided for each share tendered in the October 2017 modified Dutch auction tender offer (See Note 10, Shareholders' Deficit, for further information on the CVR). During the six months ended June 30, 2018, the Company recognized a loss of \$16.0 million on the revaluation of the CVR and a \$13.1 million loss on extinguishment of \$475.0 million aggregate principal amount of the Company's convertible senior notes due 2019 (See Note 4, Long-Term Debt) in other expense, net within its condensed consolidated statements of income. During the three and six months ended June 30, 2017, the Company did not recognize any other expense, net. These non-cash expenses are included as Other non-cash adjustments to net income in the Company's cash flows from operating activities within its condensed consolidated statements of cash flows.

## Restricted Cash

The following table provides a reconciliation of cash, cash equivalents, and restricted cash reported within the Company's condensed consolidated balance sheets that sum to the total of the same such amounts shown in the Company's condensed consolidated statements of cash flows:

	June 30, December 31,	
	2018	2017
	(in millions)	
Cash and cash equivalents	\$839.4	\$ 1,278.8
Restricted cash included in Prepaid expenses and		
other current assets	3.5	4.0
Restricted cash included in Other assets	12.2	12.7
Total cash, cash equivalents, and restricted cash shown		
in the statement of cash flows	\$855.1	\$ 1,295.5

The majority of the Company's consolidated restricted cash is held by certain of its foreign entities and consists of cash deposits that are required due to the business operating requirements in those jurisdictions.

## 3. Inventories

Inventories consist primarily of finished goods available for resale. Inventories are stated at lower of cost (primarily on the first-in, first-out basis) and net realizable value.

The following are the major classes of inventory:

	June 30, December 31,	
	2018	2017
	(in millions)	
Raw materials	\$50.2	\$ 44.2
Work in process	5.8	4.8
Finished goods	259.1	292.2
Total	\$315.1	\$ 341.2

## 4. Long-Term Debt

Long-term debt consists of the following:

	June 30,	December 31,
	2018	2017
	(in millions)	
Borrowings under senior secured credit facility, carrying value	\$ 1,145.3	\$ 1,190.2
2.000% convertible senior notes due 2019, carrying value of		
liability component	642.0	1,070.0
2.625% convertible senior notes due 2024, carrying value of		
liability component	405.8	—
Other	7.6	7.9
<b>Total</b>	<b>2,200.7</b>	<b>2,268.1</b>
Less: current portion	744.3	102.4
<b>Long-term portion</b>	<b>\$ 1,456.4</b>	<b>\$ 2,165.7</b>

### Senior Secured Credit Facility

On May 4, 2015, the Company amended its prior senior secured credit facility, or the Prior Credit Facility, to extend the maturity date of its revolving credit facility, or the Prior Revolving Credit Facility, by one year to March 9, 2017. Pursuant to this amendment and upon execution, the Company made prepayments of approximately \$20.3 million and \$50.9 million on its \$500.0 million term loan under the Prior Credit Facility, or the Prior Term Loan, and the Prior Revolving Credit Facility, respectively. Additionally, the Company's \$700.0 million borrowing capacity on its Prior Revolving Credit Facility was reduced by approximately \$235.9 million upon execution of this amendment, and was further reduced by approximately \$39.1 million on September 30, 2015, bringing the total available borrowing capacity to \$425.0 million. The Prior Term Loan matured on March 9, 2016 and was repaid in full. Prior to March 9, 2016, the interest rates on the Company's borrowings under the Prior Credit Facility remained effectively unchanged except that the minimum applicable margin was increased by 0.50% and LIBOR was subject to a minimum floor of 0.25%. After March 9, 2016, the applicable interest rates on the Company's borrowings under the Prior Credit Facility increased by 2.00% such that borrowings under the Prior Credit Facility began bearing interest at either LIBOR plus the applicable margin between 4.00% and 5.00% or the base rate plus the applicable margin between 3.00% and 4.00%, based on the Company's consolidated leverage ratio. The Company incurred approximately \$6.2 million of debt issuance costs in connection with the amendment. These debt issuance costs were recorded on the Company's condensed consolidated balance sheet and were amortized over the life of the Prior Revolving Credit Facility.

On February 15, 2017, the Company entered into a new \$1,450.0 million senior secured credit facility, or the Credit Facility, consisting of a \$1,300.0 million term loan B, or the Term Loan, and a \$150.0 million revolving credit facility, or the Revolving Credit Facility, with a syndicate of financial institutions as lenders, or Lenders. The Revolving Credit Facility matures on February 15, 2022 and the Term Loan matures on February 15, 2023. However, if the outstanding principal on the 2019 Convertible Notes, as defined below, exceeds \$250.0 million and the Company exceeds certain leverage ratios on February 14, 2019, the Revolving Credit Facility will mature on such date. In addition, if the outstanding principal on the 2019 Convertible Notes, as defined below, exceeds \$250.0 million and the Company exceeds certain leverage ratios on May 16, 2019, the Term Loan will mature on such date. The Credit Facility is secured by the equity interests of certain of Herbalife Nutrition Ltd.'s subsidiaries and substantially all of the assets of the domestic loan parties. The Credit Facility was amended, effective March 16, 2018, to make certain technical amendments in connection with the offering of the 2024 Convertible Notes, as defined below.

The Term Loan was issued to the Lenders at a 2% discount, or \$26.0 million. In connection with the Credit Facility, the Company also repaid the \$410.0 million outstanding balance on its Prior Revolving Credit Facility. The Company incurred approximately \$22.6 million of debt issuance costs in connection with the Credit Facility. The debt issuance costs and the discount are recorded on the Company's condensed consolidated balance sheet and are being amortized over the life of the Credit Facility using the effective-interest method.

Borrowings under the Term Loan bear interest at either the eurocurrency rate plus a margin of 5.50% or the base rate plus a margin of 4.50%. Prior to August 15, 2017, borrowings under the Revolving Credit Facility bore interest at the eurocurrency rate plus a margin of 4.75% or the base rate plus a margin of 3.75%. After August 15, 2017, borrowings under the Revolving Credit Facility, depending on the Company's consolidated leverage ratio, bear interest at either the eurocurrency rate plus a margin of either 4.50% or 4.75% or the base rate plus a margin of either 3.50% or 3.75%. The base rate represents the highest of the Federal Funds Rate plus 0.50%, one-month adjusted LIBOR plus 1.00%, and the prime rate set by Credit Suisse, and is subject to a floor of 1.75%. The eurocurrency rate is based on adjusted LIBOR and is subject to a floor of 0.75%. The Company is required to pay a commitment fee on the Revolving Facility of 0.50% per annum on the undrawn portion of the Revolving Credit Facility. Interest is due at least quarterly on amounts outstanding on the Credit Facility.



The Credit Facility requires the Company to comply with a leverage ratio. In addition, the Credit Facility contains customary events of default and covenants, including covenants that limit or restrict the Company's ability to incur liens, incur indebtedness, make investments, dispose of assets, make certain restricted payments, pay dividends, repurchase its common shares, merge or consolidate and enter into certain transactions with affiliates. The Company is also required to maintain a minimum balance of \$200.0 million of consolidated cash and cash equivalents. As of June 30, 2018 and December 31, 2017, the Company was in compliance with its debt covenants under the Credit Facility.

The Term Loan is payable in consecutive quarterly installments each in an aggregate principal amount of \$24.4 million which began on June 30, 2017. In addition, the Company may be required to make mandatory prepayments towards the Term Loan based on the Company's consolidated leverage ratio and annual excess cash flows as defined under the terms of the Credit Facility. The Company is also permitted to make voluntary prepayments. These prepayments, if any, will be applied against remaining quarterly installments owed under the Term Loan in order of maturity with the remaining principal due upon maturity.

As of June 30, 2018 and December 31, 2017, the weighted-average interest rate for borrowings under the Credit Facility was 7.34% and 6.79%, respectively.

During the three months ended March 31, 2018, the Company repaid a total amount of \$24.4 million on amounts outstanding under the Credit Facility. During the three months ended June 30, 2018, the Company repaid a total amount of \$24.4 million on amounts outstanding under the Credit Facility. During the three months ended March 31, 2017, the Company repaid a total amount of \$410.0 million to repay in full amounts outstanding under the Prior Revolving Credit Facility. During the three months ended June 30, 2017, the Company repaid a total amount of \$24.4 million on amounts outstanding under the Credit Facility. As of June 30, 2018 and December 31, 2017, the U.S. dollar amount outstanding under the Term Loan was \$1,178.1 million and \$1,226.9 million, respectively. There were no borrowings outstanding under the Revolving Credit Facility as of June 30, 2018 and December 31, 2017. There were no outstanding foreign currency borrowings as of June 30, 2018 and December 31, 2017 under the Credit Facility.

During the three months ended June 30, 2018 and 2017, the Company recognized \$24.5 million and \$23.4 million, respectively, of interest expense relating to the Term Loan, which included \$1.2 million and \$1.2 million, respectively, relating to non-cash interest expense relating to the debt discount and \$0.7 million and \$0.8 million, respectively, relating to amortization of debt issuance costs. During the six months ended June 30, 2018 and 2017, the Company recognized \$48.2 million and \$34.6 million, respectively, of interest expense relating to the Term Loan, which included \$2.3 million and \$1.8 million, respectively, relating to non-cash interest expense relating to the debt discount and \$1.5 million and \$1.2 million, respectively, relating to amortization of debt issuance costs.

The fair value of the outstanding borrowings on the Term Loan is determined by utilizing over-the-counter market quotes, which are considered Level 2 inputs as described in Note 12, Fair Value Measurements. As of June 30, 2018 and December 31, 2017, the carrying amount of the Term Loan was \$1,145.3 million and \$1,190.2 million, respectively, and the fair value was approximately \$1,189.2 million and \$1,226.1 million, respectively.

#### Convertible Senior Notes due 2019

During February 2014, the Company initially issued \$1 billion aggregate principal amount of convertible senior notes, or the 2019 Convertible Notes, in a private offering to qualified institutional buyers, pursuant to Rule 144A under the Securities Act of 1933, as amended. The Company granted an option to the initial purchasers to purchase up to an additional \$150 million aggregate principal amount of 2019 Convertible Notes which was subsequently exercised in full during February 2014, resulting in a total issuance of \$1.15 billion aggregate principal amount of 2019 Convertible Notes. The 2019 Convertible Notes are senior unsecured obligations which rank effectively subordinate to any of the Company's existing and future secured indebtedness, including amounts outstanding under the Credit Facility, to the extent of the value of the assets securing such indebtedness. The 2019 Convertible Notes pay interest at a rate of 2.00% per annum payable semiannually in arrears on February 15 and August 15 of each year, beginning on August 15, 2014. The 2019 Convertible Notes mature on August 15, 2019, unless earlier repurchased or converted. The Company may not redeem the 2019 Convertible Notes prior to their stated maturity date. Holders of the 2019 Convertible Notes may convert their notes at their option under the following circumstances: (i) during any calendar quarter commencing after the calendar quarter ending March 31, 2014, if the last reported sale price of the Company's common shares for at least 20 trading days (whether or not consecutive) in a period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price for the 2019 Convertible Notes on each applicable trading day; (ii) during the five business-day period immediately after any five consecutive trading day period, or the measurement period, in which the trading price per \$1,000 principal amount of 2019 Convertible Notes for each trading day of that measurement period was less than 98% of the product of the last reported sale price of the Company's common shares and the conversion rate for the 2019 Convertible Notes for each such day; or (iii) upon the occurrence of specified corporate

events. On and after May 15, 2019, holders may convert their 2019 Convertible Notes at any time, regardless of the foregoing circumstances. Upon conversion, the 2019 Convertible Notes will be settled in cash and, if applicable, the Company's common shares, based on the applicable conversion rate at such time. The 2019 Convertible Notes had an initial conversion rate of 23.1816 common shares per \$1,000 principal amount of the 2019 Convertible Notes, or an initial conversion price of approximately \$43.14 per common share, based on the retroactive adjustment due to the Company's two-for-one stock split described in Note 2, Significant Accounting Policies. The conversion rate is subject to adjustment upon the occurrence of certain events and was 23.2245 common shares per \$1,000 principal amount of the 2019 Convertible Notes, or a conversion price of approximately \$43.06 per common share, as of June 30, 2018.

The Company incurred approximately \$26.6 million of issuance costs during the first quarter of 2014 relating to the issuance of the 2019 Convertible Notes. Of the \$26.6 million issuance costs incurred, \$21.5 million and \$5.1 million were recorded as debt issuance costs and additional paid-in capital, respectively, in proportion to the allocation of the proceeds of the 2019 Convertible Notes. The \$21.5 million of debt issuance costs recorded on the Company's condensed consolidated balance sheet is being amortized over the contractual term of the 2019 Convertible Notes using the effective-interest method.

During February 2014, the \$1.15 billion aggregate principal amount of the 2019 Convertible Notes were initially allocated between long-term debt, or liability component, and additional paid-in capital, or equity component, within the Company's condensed consolidated balance sheet at \$930.9 million and \$219.1 million, respectively. The liability component was measured using the nonconvertible debt interest rate. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the face value of the 2019 Convertible Notes as a whole. Since the Company must still settle these 2019 Convertible Notes at face value at or prior to maturity, this liability component will be accreted up to its face value resulting in additional non-cash interest expense being recognized within the Company's condensed consolidated statements of income while the 2019 Convertible Notes remain outstanding. The effective-interest rate on the 2019 Convertible Notes is approximately 6.2% per annum. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

During March 2018, the Company issued \$550 million aggregate principal amount of new convertible senior notes due 2024, or 2024 Convertible Notes as described below, and subsequently used the proceeds, along with cash on hand, to repurchase \$475.0 million of its existing 2019 Convertible Notes from a limited number of holders in privately negotiated transactions for an aggregate purchase price of \$583.5 million, which included \$1.0 million of accrued interest. For accounting purposes, pursuant to ASC 470, Debt, these transactions were accounted for as an extinguishment of 2019 Convertible Notes and an issuance of new 2024 Convertible Notes. The Company allocated the purchase price between the fair value of the liability component and the equity component of the 2019 Convertible Notes at \$459.4 million and \$123.0 million, respectively. As a result, the Company recognized \$446.4 million as a reduction to long-term debt representing the carrying value of the liability component and \$123.0 million as a reduction to additional paid-in capital representing the equity component of the repurchased 2019 Convertible Notes. The \$13.1 million difference between the fair value and carrying value of the liability component of the repurchased 2019 Convertible Notes was recognized as a loss on extinguishment of debt as a result of the transaction and is recorded in other expense, net within the Company's condensed consolidated statement of income. The accounting impact of the new 2024 Convertible Notes is described in further detail below.

As of June 30, 2018, the remaining outstanding principal on the 2019 Convertible Notes was \$675.0 million, the unamortized debt discount and debt issuance costs were \$33.0 million, and the carrying amount of the liability component was \$642.0 million, which was recorded to current portion of long-term debt within the Company's condensed consolidated balance sheet, as holders may convert their 2019 Convertible Notes at any time on and after May 15, 2019 as described above within this Note. As of December 31, 2017, the outstanding principal on the 2019 Convertible Notes was \$1.15 billion, the unamortized debt discount and debt issuance costs were \$80.0 million, and the carrying amount of the liability component was \$1,070.0 million, which was recorded to long-term debt within the Company's condensed consolidated balance sheet. The fair value of the liability component relating to the 2019 Convertible Notes was approximately \$637.7 million and \$1,066.0 million as of June 30, 2018 and December 31, 2017, respectively.

During the three months ended June 30, 2018 and 2017, the Company recognized \$10.4 million and \$17.0 million, respectively, of interest expense relating to the 2019 Convertible Notes, which included \$6.4 million and \$10.2 million, respectively, relating to non-cash interest expense relating to the debt discount and \$0.6 million and \$1.0 million, respectively, relating to amortization of debt issuance costs. During the six months ended June 30, 2018 and 2017, the Company recognized \$27.4 million and \$33.7 million, respectively, of interest expense relating to the 2019 Convertible Notes, which included \$16.8 million and \$20.2 million, respectively, relating to non-cash interest expense relating to the debt discount and \$1.6 million and \$2.0 million, respectively, relating to amortization of debt issuance costs.

In conjunction with the issuance of the 2019 Convertible Notes, during February 2014, the Company paid approximately \$685.8 million to enter into prepaid forward share repurchase transactions, or the Forward

Transactions, with certain financial institutions, and paid approximately \$123.8 million to enter into capped call transactions with respect to its common shares, or the Capped Call Transactions, with certain financial institutions. Subsequently, in conjunction with the repurchase of a portion of the 2019 Convertible Notes, during March 2018, the Company entered into agreements with the option counterparties to the Capped Call Transactions to terminate a portion of such existing transactions. See Note 10, Shareholders' Deficit, for additional discussion on the Forward Transactions and Capped Call Transactions entered into in conjunction with the issuance of these 2019 Convertible Notes.

## Convertible Senior Notes due 2024

During March 2018, the Company issued \$550 million aggregate principal amount of convertible senior notes, or the 2024 Convertible Notes, in a private offering to qualified institutional buyers, pursuant to Rule 144A under the Securities Act of 1933, as amended. The 2024 Convertible Notes are senior unsecured obligations which rank effectively subordinate to any of the Company's existing and future secured indebtedness, including amounts outstanding under the Credit Facility, to the extent of the value of the assets securing such indebtedness. The 2024 Convertible Notes pay interest at a rate of 2.625% per annum payable semiannually in arrears on March 15 and September 15 of each year, beginning on September 15, 2018. The 2024 Convertible Notes mature on March 15, 2024, unless redeemed, repurchased or converted in accordance with their terms prior to such date. Holders of the 2024 Convertible Notes may convert their notes at their option under the following circumstances: (i) during any calendar quarter commencing after the calendar quarter ending June 30, 2018, if the last reported sale price of the Company's common shares for at least 20 trading days (whether or not consecutive) in a period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding calendar quarter exceeds 130% of the conversion price for the 2024 Convertible Notes on each applicable trading day; (ii) during the five business-day period immediately after any five consecutive trading day period, or the measurement period, in which the trading price per \$1,000 principal amount of 2024 Convertible Notes for each trading day of that measurement period was less than 98% of the product of the last reported sale price of the Company's common shares and the conversion rate for the 2024 Convertible Notes for each such day; (iii) if the Company calls the 2024 Convertible Notes for redemption; or (iv) upon the occurrence of specified corporate events. On and after December 15, 2023, holders may convert their 2024 Convertible Notes at any time, regardless of the foregoing circumstances. Upon conversion, the 2024 Convertible Notes will be settled, at the Company's election, in cash, the Company's common shares, or a combination thereof, based on the applicable conversion rate at such time. The 2024 Convertible Notes had an initial conversion rate of 16.0056 common shares per \$1,000 principal amount of the 2024 Convertible Notes, or an initial conversion price of approximately \$62.48 per common share, based on the retroactive adjustment due to the Company's two-for-one stock split described in Note 2, Significant Accounting Policies. The conversion rate is subject to adjustment upon the occurrence of certain events and was 16.0352 common shares per \$1,000 principal amount of the 2024 Convertible Notes, or a conversion price of approximately \$62.36 per common share, as of June 30, 2018.

The Company incurred approximately \$12.9 million of issuance costs during the first quarter of 2018 relating to the issuance of the 2024 Convertible Notes. Of the \$12.9 million issuance costs incurred, \$9.6 million and \$3.3 million were recorded as debt issuance costs and additional paid-in capital, respectively, in proportion to the allocation of the proceeds of the 2024 Convertible Notes. The \$9.6 million of debt issuance costs, which was recorded as an additional debt discount on the Company's consolidated balance sheet, is being amortized over the contractual term of the 2024 Convertible Notes using the effective interest method.

During March 2018, the \$550 million aggregate principal amount of the 2024 Convertible Notes were initially allocated between long-term debt, or liability component, and additional paid-in-capital, or equity component, within the Company's consolidated balance sheet at \$410.1 million and \$139.9 million, respectively. The liability component was measured using the nonconvertible debt interest rate. The carrying amount of the equity component representing the conversion option was determined by deducting the fair value of the liability component from the face value of the 2024 Convertible Notes as a whole. Since the Company must still settle these 2024 Convertible Notes at face value at or prior to maturity, this liability component will be accreted up to its face value resulting in additional non-cash interest expense being recognized within the Company's consolidated statements of income while the 2024 Convertible Notes remain outstanding. The effective interest rate on the 2024 Convertible Notes is approximately 8.4% per annum. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

As of June 30, 2018, the outstanding principal on the 2024 Convertible Notes was \$550.0 million, the unamortized debt discount and debt issuance costs were \$144.2 million, and the carrying amount of the liability component was \$405.8 million, which was recorded to long-term debt within the Company's condensed consolidated balance sheet. The fair value of the liability component relating to the 2024 Convertible Notes was approximately \$423.2 million as of June 30, 2018.

During the three months ended June 30, 2018, the Company recognized \$8.5 million of interest expense relating to the 2024 Convertible Notes, which included \$4.5 million relating to non-cash interest expense relating to the debt discount and \$0.3 million relating to amortization of debt issuance costs. During the six months ended June 30, 2018, the Company recognized \$9.3 million of interest expense relating to the 2024 Convertible Notes, which included \$5.0 million relating to non-cash interest expense relating to the debt discount and \$0.3 million relating to amortization of debt issuance costs.

## Valuation of 2019 Convertible Notes and 2024 Convertible Notes – Level 2 and Level 3 Inputs

In order to determine the initial value of the 2019 Convertible Notes and the 2024 Convertible Notes, the Company determined the fair value of the liability component of the 2019 Convertible Notes and the 2024 Convertible Notes using two valuation methods. The Company reviewed market data that was available for publicly traded, senior, unsecured nonconvertible corporate bonds issued by companies with similar credit ratings. Assumptions used in the estimate represent what market participants would use in pricing the liability component, including market yields and credit standing to develop the straight debt yield estimate. The Company also used a lattice model, which included inputs such as stock price, the Convertible Note trading price, volatility and dividend yield to estimate the straight debt yield. The Company combined the results of the two valuation methods to determine the fair value of the liability component of the 2019 Convertible Notes and the 2024 Convertible Notes. Most of these inputs are primarily considered Level 2 and Level 3 inputs. The Company used similar valuation approaches to determine the subsequent fair value of the liability component only for disclosure purposes.

## Total Debt

The Company's total interest expense was \$49.1 million and \$41.9 million for the three months ended June 30, 2018 and 2017, respectively, and \$93.7 million and \$74.4 million for the six months ended June 30, 2018 and 2017, respectively, which was recognized within its condensed consolidated statements of income.

As of June 30, 2018, annual scheduled principal payments of debt were as follows:

	Principal Payments (in millions)
2018	\$ 53.4
2019	775.0
2020	97.9
2021	97.5
2022	97.5
Thereafter	1,289.4
<b>Total</b>	<b>\$ 2,410.7</b>

Certain vendors and government agencies may require letters of credit or similar guaranteeing arrangements to be issued or executed. As of June 30, 2018, the Company had \$37.5 million of issued but undrawn letters of credit or similar arrangements, which included the Mexico Value Added Tax, or VAT, related surety bonds described in Note 5, Contingencies.

## 5. Contingencies

The Company is from time to time engaged in routine litigation. The Company regularly reviews all pending litigation matters in which it is involved and establishes reserves deemed appropriate by management for these litigation matters when a probable loss estimate can be made.



The matters described in this Note may take several years to resolve. While the Company believes it has meritorious defenses, it cannot be sure of their ultimate resolution. Although the Company may reserve amounts for certain matters that the Company believes represent the most likely outcome of the resolution of these related disputes, if the Company is incorrect in its assessment, the Company may have to record additional expenses, when it becomes probable that an increased potential liability is warranted.

## Tax Matters

On May 7, 2010, the Company received an assessment from the Mexican Tax Administration Service in an amount equivalent to approximately \$57.6 million, translated at the June 30, 2018 spot rate, for various items, the majority of which was VAT allegedly owed on certain of the Company's products imported into Mexico during the years 2005 and 2006. This assessment is subject to interest and inflationary adjustments. On July 8, 2010, the Company initiated a formal administrative appeal process. On May 13, 2011, the Mexican Tax Administration Service issued a resolution on the Company's administrative appeal. The resolution nullified the assessment. Since the Mexican Tax Administration Service can further review the tax audit findings and re-issue some or all of the original assessment, the Company commenced litigation in the Tax Court of Mexico in August 2011 to dispute the assertions made by the Mexican Tax Administration Service in the case. The Company received notification on February 6, 2015 that the Tax Court of Mexico nullified substantially all of the assessment. On March 18, 2015, the Mexican Tax Administration Service filed an appeal against the verdict with the Circuit Court. On August 27, 2015, the Circuit Court remanded the case back to the Tax Court of Mexico to reconsider a portion of the procedural decision that was adverse to the Mexican Tax Administration Service. The Company received notification on March 18, 2016 that the Tax Court of Mexico nullified a portion of the assessment and upheld a portion of the original assessment. On August 25, 2016, the Company filed a further appeal of this decision to the Circuit Court. On April 6, 2017, the Circuit Court issued a verdict with the Company prevailing on some lesser issues and the Tax Administration Service prevailing on the core issue. On May 11, 2017, the Company filed a further appeal to the Supreme Court of Mexico. On June 14, 2017, the Supreme Court of Mexico agreed to hear the appeal. The Company believes that it has meritorious defenses if the assessment is reissued. The Company has not recognized a loss as the Company does not believe a loss is probable.

The Mexican Tax Administration Service commenced audits of the Company's Mexican subsidiaries for the period from January to September 2007 and on May 10, 2013, the Company received an assessment of approximately \$14.7 million, translated at the June 30, 2018 spot rate, related to that period. This assessment is subject to interest and inflationary adjustments. On July 11, 2013, the Company filed an administrative appeal disputing the assessment. On September 22, 2014, the Mexican Tax Administration Service denied the Company's administrative appeal. The Company commenced litigation in the Tax Court of Mexico in November 2014 to dispute the assertions made by the Mexican Tax Administration Service in the case. On January 16, 2018, the Tax Court of Mexico issued a verdict upholding the assessment issued by the Mexican Tax Administration Service. On April 16, 2018, the Company filed an appeal of this verdict, and litigation is ongoing. The Company has not recognized a loss as the Company does not believe a loss is probable. The Company issued a surety bond in the amount of \$17.4 million, translated at the June 30, 2018 spot rate, through an insurance company to guarantee payment of the tax assessment as required while the Company pursues an appeal of the assessment, and the surety bond remained effective as of June 30, 2018.

The Mexican Tax Administration Service has delayed processing VAT refunds for companies operating in Mexico and the Company believes that the process for its Mexico subsidiary to receive VAT refunds may be delayed. As of June 30, 2018, the Company had \$34.7 million of Mexico VAT related assets, of which \$26.1 million was within non-current other assets and \$8.6 million was within prepaid expenses and other current assets on its consolidated balance sheet. This amount relates to VAT payments made over various periods and the Company believes these amounts are recoverable by refund or they may be applied against certain future tax liabilities. The Company has not recognized any losses related to these VAT related assets as the Company does not believe a loss is probable.

On March 26, 2015, the Office of the President of Mexico issued a decree relating to the application of VAT to nutritional supplements. The Company continues to believe its application of the VAT law in Mexico is correct. As of June 30, 2018, the Company has not recognized any losses as the Company, based on its current analysis and guidance from its advisors, does not believe a loss is probable. The Company continues to evaluate and monitor its situation as it develops, including whether it will make any changes to its operations in Mexico.

With respect to these Mexican matters, the Company is currently unable to reasonably estimate a possible loss or range of loss that could result from an unfavorable outcome if an assessment was re-issued or any additional assessments were to be issued for these or other periods. The Company believes that it has meritorious defenses if an assessment is re-issued or would have meritorious defenses if any additional assessment is issued.

The Company received a tax assessment in September 2009 from the Federal Revenue Office of Brazil in an amount equivalent to approximately \$1.8 million, translated at the June 30, 2018 spot rate, related to withholding/contributions based on payments to the Company's Members during 2004. On December 28, 2010, the Company appealed this tax assessment to the Administrative Council of Tax Appeals (2nd level administrative appeal). The Company believes it has meritorious defenses and it has not recognized a loss as the Company does not believe a loss is probable. On March 6, 2014, the Company was notified of a similar audit of the 2011 year. In January 2016, the Company received a tax assessment for an amount equivalent to approximately \$4.6 million, translated at the June 30, 2018 spot rate, related to contributions based on payments to the Company's Members during 2011. The Company filed a first level administrative appeal against most of the assessment on February 23, 2016, which was subsequently denied. On March 13, 2017, the Company appealed this tax assessment to the Administrative Council of Tax Appeals (2nd level administrative appeal). The Company has not accrued a loss for the majority of the assessment because the Company does not believe a loss is probable. The Company is currently unable to reasonably estimate the amount of the loss that may result from an unfavorable outcome if additional assessments for other periods were to be issued.

The Company's Brazilian subsidiary pays ICMS-ST taxes on its product purchases, similar to VAT. As of June 30, 2018, the Company had \$8.4 million of Brazil ICMS-ST, of which \$2.2 million was within non-current other assets and \$6.2 million was within prepaid expenses and other current assets on its condensed consolidated balance sheet. The Company believes it will be able to utilize or recover these ICMS-ST credits in the future.

The Company is under examination in several Brazilian states related to ICMS and ICMS-ST taxation. Some of these examinations have resulted in assessments for underpaid tax that the Company has appealed. The State of Sao Paulo has audited the Company for the 2013 and 2014 tax years. During July 2016, for the State of Sao Paulo, the Company received an assessment in the aggregate amount of approximately \$41.6 million, translated at the June 30, 2018 spot rate, relating to various ICMS issues for its 2013 tax year. In August 2016, the Company filed a first level administrative appeal which was denied in February 2017. The Company filed a further appeal on March 9, 2017. On March 20, 2018, the Court held a hearing and a verdict is currently pending. During August 2017, for the state of Sao Paulo, the Company received an assessment in the aggregate amount of approximately \$15.4 million, translated at the June 30, 2018 spot rate, relating to various ICMS issues for its 2014 tax year. In September 2017, the Company filed a first level administrative appeal for the 2014 tax year. The Company has not recognized a loss as the Company does not believe a loss is probable. The Company has also received other ICMS tax assessments in Brazil. During the fourth quarter of 2015, the Company filed appeals with state judicial courts against three of the assessments. The Company had issued surety bonds in the aggregate amount of \$11.3 million, translated at the June 30, 2018 spot rate, to guarantee payment of some of the tax assessments as required while the Company pursues the appeals. In addition, the Company has received several ICMS tax assessments in the aggregate amount of \$6.6 million, translated at the June 30, 2018 spot rate, from several other Brazilian states where surety bonds have not been issued. Litigation in all these cases is currently ongoing. The Company has not recognized a loss as the Company does not believe a loss is probable.

The Company has received various tax assessments in multiple states in India for multiple years from the Indian VAT authorities in an amount equivalent to approximately \$9.2 million, translated at the June 30, 2018 spot rate. These assessments are for underpaid VAT. The Company is litigating these cases at the tax administrative level and the tax tribunal levels as it believes it has meritorious defenses. The Company has not recognized a loss as it does not believe a loss is probable.

The Korea Customs Service audited the importation activities of Herbalife Korea for the period January 2011 through May 2013. The total assessment for the audit period is \$31.8 million, translated at the June 30, 2018 spot rate. The Company has paid the assessment and has recognized these payments within other assets on its condensed consolidated balance sheet. The Company lodged a first level administrative appeal, which was denied on October 21,

2016. On January 31, 2017, the Company filed a further appeal to the National Tax Tribunal of Korea. The Company disagrees with the assertions made in the assessments, as well as the calculation methodology used in the assessments. The Company has not recognized a loss as the Company does not believe a loss is probable.

During the course of 2016, the Company received various questions from the Greek Social Security Agency and on December 29, 2016, the Greek Social Security Agency issued an assessment of approximately \$2.3 million, translated at the June 30, 2018 spot rate, with respect to Social Security Contributions on Member earnings for the 2006 year. For Social Security issues, the statute of limitations is open for 2007 and later years in Greece. The Company could receive similar assessments covering other years. The Company disputes the allegations that were raised in the assessment and filed an administrative appeal against the assessment with the Greek Social Security Agency. On November 14, 2017, the Administrative Review Committee of the Greek Social Security Agency notified the Company that it had remanded the case back to the Social Security Agency auditors with an instruction to reconsider the case since the majority of the assessment seemed to be unfounded. The administrative appeals committee published a mixed verdict in the case on June 5, 2018 whereby the Company won some issues and lost other issues. The Company intends to timely file an appeal to Civil Court. The Company has not recognized a loss as it does not believe a loss is probable.

The Italian tax authorities are currently auditing the Company covering the periods 2014 and 2015. The Company has responded to the various points relating to income tax and non-income tax matters initially raised by the tax authorities to date. The Italian tax authorities are discussing certain of its preliminary findings with the Company and the audit is ongoing. It is possible that the Company could receive a final assessment from the Italian tax authorities after these discussions and the audit are completed. The Company believes that it has adequately accrued for income tax matters that are known to date. In regards to non-income tax matters, the Company has not recognized a loss as it does not believe a loss is probable. The Company believes that it has meritorious defenses if a formal assessment is issued by the Italian tax authorities. The Company is currently unable to reasonably estimate the amount of loss that may result from an unfavorable outcome if a formal assessment is issued by the Italian tax authorities.

During March 2018, the Chinese Customs Service began an audit of the Company's Chinese importations covering the periods 2015 through 2017. The Company has responded to the initial questions from the Customs Service and the audit is ongoing. The Company is currently unable to reasonably estimate the amount of loss if an assessment is issued.

#### U.S. Federal Trade Commission Consent Order

On July 15, 2016, the Company and the Federal Trade Commission, or the FTC, entered into a proposed Stipulation to Entry of Order for Permanent Injunction and Monetary Judgment, or the Consent Order. The Consent Order was lodged with the U.S. District Court for the Central District of California on July 15, 2016 and became effective on July 25, 2016, or the Effective Date. The Consent Order resolved the FTC's multi-year investigation of the Company.

Pursuant to the Consent Order, under which the Company neither admitted nor denied the FTC's allegations (except as to the Court having jurisdiction over the matter), the Company made, through its wholly-owned subsidiary Herbalife International of America, Inc., a \$200 million payment to the FTC. Additionally, the Company agreed to implement certain new procedures and enhance certain existing procedures in the U.S., most of which the Company had 10 months from the Effective Date to implement. Among other requirements, the Consent Order requires the Company to categorize all existing and future Members in the U.S. as either "preferred members" – who are simply consumers who only wish to purchase products for their own household use, or "distributors" – who are Members who wish to resell some products or build a sales organization. The Company also agreed to compensate distributors on eligible U.S. sales within their downline organization, which include purchases by preferred members, purchases by a distributor for his or her personal consumption within allowable limits and sales of product by a distributor to his or her customers. The Consent Order also imposes restrictions on a distributor's ability to open Nutrition Clubs in the United States. The Consent Order subjects the Company to certain audits by an independent compliance auditor for a period of seven years; imposes requirements on the Company regarding compliance certification and record creation and maintenance; and prohibits the Company, its affiliates and its distributors from making misrepresentations and misleading claims regarding, among other things, income and lavish lifestyles. The FTC and the independent compliance auditor have the right to inspect Company records and request additional compliance reports for purposes of conducting audits pursuant to the Consent Order. In September 2016, the Company and the FTC mutually selected Affiliated Monitors, Inc. to serve as the independent compliance auditor. The Company continues to monitor the impact of the Consent Order and, while the Company currently does not expect the settlement to have a long-term and materially adverse impact on its business and its Member base, the Company's business and its Member base, particularly in the United States, may be negatively impacted as the Company and the Member base adjust to the changes. If the Company is unable to comply with the Consent Order then this could result in a material and adverse impact to the Company's results of operations and financial condition.

#### Other Matters

As a marketer of foods, dietary and nutritional supplements, and other products that are ingested by consumers or applied to their bodies, the Company has been and is currently subjected to various product liability claims. The effects of these claims to date have not been material to the Company. The Company currently maintains product liability insurance with an annual deductible of \$12.5 million.

As previously disclosed, the SEC and the Department of Justice have been conducting an investigation into the Company's anti-corruption compliance in China, which has mainly focused on entertainment and gift expenditures by the Company's local China external affairs department. The government has requested and is continuing to request documents and other information relating to these matters. The Company is conducting its own review and has taken remedial and improvement measures based upon this review, including replacement of a number of employees in China and enhancements of Company policies and procedures in China. The Company is continuing to cooperate with the government and cannot predict the eventual scope, duration, or outcome of the government investigation at this time.

A short seller has made allegations regarding the Company and its network marketing program. The Company believes these allegations are without merit and has vigorously defended itself against such claims, including proactively reaching out to governmental authorities about what the Company believes is manipulative activity with respect to its securities. Because of these allegations, the Company and others have received and may receive additional regulatory and governmental inquiries. For example, the Company has previously disclosed inquiries from the FTC, SEC and other governmental authorities. The SEC has also requested from the Company documents and other information relating to the Company's disclosures regarding its marketing plan in China and the Company cannot predict the eventual scope, duration, or outcome of this investigation at this time. In the future, governmental authorities may determine to seek information from the Company and other persons relating to these same or other allegations. If the Company believes any governmental or regulatory inquiry or investigation is or becomes material it will be disclosed individually. Consistent with its policies, the Company has cooperated and will continue to fully cooperate with any governmental or regulatory inquiries or investigations.

On September 18, 2017, the Company and certain of its subsidiaries and Members were named as defendants in a purported class action lawsuit, titled *Rodgers, et al. v Herbalife Ltd., et al.* and filed in the U.S. District Court for the Southern District of Florida, which alleges violations of Florida's Deceptive and Unfair Trade Practices statute and federal Racketeer Influenced and Corrupt Organizations statutes, unjust enrichment, and negligent misrepresentation. The plaintiffs seek damages in an unspecified amount. The Company believes the lawsuit is without merit and will vigorously defend itself against the claims in the lawsuit.

In September 2017, one of the Company's warehouses located in Mexico sustained flooding which damaged certain inventory stored within the warehouse. The Company maintains insurance coverage with third-party carriers on the affected property. As of June 30, 2018, the Company has recorded a loss relating to the damaged inventory and has recognized a combined equal and offsetting receivable and cash relating to the insurance recoveries. This event did not have a material negative impact on the Company's Mexico operations or its condensed consolidated financial statements.

## 6. Segment Information

The Company is a nutrition company that sells a wide range of weight management, targeted nutrition, energy, sports & fitness, and outer nutrition products. The Company's products are manufactured by the Company in its Changsha, Hunan, China extraction facility; Suzhou, China facility; Nanjing, China facility; Lake Forest, California facility; and Winston-Salem, North Carolina facility, as well as by third-party providers, and then are sold to Members who consume and sell Herbalife products to retail consumers or other Members. Revenues reflect sales of products by the Company to its Members and are categorized based on geographic location.

As of June 30, 2018, the Company sold products in 94 countries throughout the world and was organized and managed by six geographic regions: North America, Mexico, South & Central America, EMEA, Asia Pacific, and China. The Company defines its operating segments as those geographical operations. The Company aggregates its operating segments, excluding China, into a reporting segment, or the Primary Reporting Segment, as management believes that the Company's operating segments have similar operating characteristics and similar long term operating performance. In making this determination, management believes that the operating segments are similar in the nature of the products sold, the product acquisition process, the types of customers to whom products are sold, the methods used to distribute the products, the nature of the regulatory environment, and their economic characteristics. China has been identified as a separate reporting segment as it does not meet the criteria for aggregation. The Company reviews its net sales and contribution margin by operating segment, and reviews its assets and capital expenditures on a consolidated basis and not by operating segment. Therefore, net sales and contribution margin are presented by



reportable segment and assets and capital expenditures by segment are not presented.

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The operating information for the two reportable segments is as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(in millions)			
<b>Net sales:</b>				
Primary Reporting Segment	\$998.7	\$904.2	\$1,963.4	\$1,790.8
China	286.8	242.7	499.0	458.2
Total net sales	\$1,285.5	\$1,146.9	\$2,462.4	\$2,249.0
<b>Contribution margin(1):</b>				
Primary Reporting Segment	\$440.7	\$393.2	\$855.0	\$779.8
China(2)	259.6	216.0	445.0	411.8
Total contribution margin	\$700.3	\$609.2	\$1,300.0	\$1,191.6
Selling, general, and administrative expenses(2)	510.2	443.2	970.3	881.8
Other operating income	(1.7 )	(38.9 )	(17.9 )	(38.9 )
Interest expense, net	44.3	37.9	84.2	68.1
Other expense, net	4.7	—	29.1	—
Income before income taxes	142.8	167.0	234.3	280.6
Income taxes	48.4	29.4	57.8	57.8
Net income	\$94.4	\$137.6	\$176.5	\$222.8

(1) Contribution margin consists of net sales less cost of sales and Royalty overrides. For the China segment, contribution margin does not include service fees to China independent service providers.

(2) Service fees to China independent service providers totaling \$151.7 million and \$104.5 million for the three months ended June 30, 2018 and 2017, respectively, and \$262.6 million and \$216.1 million for the six months ended June 30, 2018 and 2017, respectively, are included in selling, general, and administrative expenses.

The following table sets forth net sales by geographic area:

	Three Months Ended		Six Months Ended	
	June 30, 2018	June 30, 2017	June 30, 2018	June 30, 2017
	(in millions)			
<b>Net sales:</b>				
United States	\$256.4	\$213.1	\$481.9	\$437.8
China	286.8	242.7	499.0	458.2
Mexico	118.2	115.6	232.2	220.4
Others	624.1	575.5	1,249.3	1,132.6

Total net sales \$1,285.5 \$1,146.9 \$2,462.4 \$2,249.0

## 7. Share-Based Compensation

The Company has share-based compensation plans, which are more fully described in Note 9, Share-Based Compensation, to the Consolidated Financial Statements included in the 2017 10-K. During the six months ended June 30, 2018, the Company granted restricted stock units subject to service conditions and service and performance conditions.

Share-based compensation expense amounted to \$10.4 million and \$11.4 million for the three months ended June 30, 2018 and 2017, respectively, and \$20.2 million and \$22.7 million for the six months ended June 30, 2018 and 2017, respectively. As of June 30, 2018, the total unrecognized compensation cost related to all non-vested stock awards was \$73.9 million and the related weighted-average period over which it is expected to be recognized is approximately 1.4 years.

The following tables summarize the activity under all share-based compensation plans for the six months ended June 30, 2018:

	Number of Awards (in thousands)	Weighted-Average Exercise Price Per Award	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value(1) (in millions)
Outstanding as of December 31, 2017(2)(3)	19,193	\$ 23.36	6.2 years	\$ 212.0
Granted	—	\$ —		
Exercised(4)	(6,814 )	\$ 20.54		
Forfeited(5)	(236 )	\$ 28.52		
Outstanding as of June 30, 2018(2)(3)	12,143	\$ 24.84	5.9 years	\$ 350.7
Exercisable as of June 30, 2018(6)	8,737	\$ 22.94	5.0 years	\$ 268.9

- (1) The intrinsic value is the amount by which the current market value of the underlying stock exceeds the exercise price of the stock awards.
- (2) Includes less than 0.1 million and 0.2 million market condition SARs as of June 30, 2018 and December 31, 2017, respectively.
- (3) Includes 4.5 million and 6.2 million performance condition SARs as of June 30, 2018 and December 31, 2017, respectively, which represent the maximum amount that can vest.
- (4) Includes 0.2 million market condition and 1.7 million performance condition SARs.
- (5) Includes 0.1 million performance condition SARs.
- (6) Includes less than 0.1 million market condition and 3.2 million performance condition SARs.

There were no SARs granted during the three and six months ended June 30, 2018. The weighted-average grant date fair value of SARs granted during the three and six months ended June 30, 2017 was \$17.38 and \$14.17, respectively. The total intrinsic value of SARs exercised during the three months ended June 30, 2018 and 2017 was \$64.8 million and \$80.2 million, respectively. The total intrinsic value of SARs exercised during the six months ended June 30, 2018 and 2017 was \$187.0 million and \$97.0 million, respectively.

The following table summarizes the activities for stock units for the six months ended June 30, 2018:

	Number of Shares (in thousands)	Weighted-Average Grant Date Fair Value Per Share
Outstanding and nonvested as of December 31, 2017(1)	326	\$ 34.34
Granted(2)	1,366	\$ 43.57
Vested	(42 )	\$ 35.75
Forfeited	(25 )	\$ 43.15
Outstanding and nonvested as of June 30, 2018(1)	1,625	\$ 41.93

- (1) Includes 708,836 and 268,776 performance-based stock unit awards as of June 30, 2018 and December 31, 2017, respectively, which represents the maximum amount that can vest.
- (2) Includes 440,060 performance-based stock unit awards, which represents the maximum amount that can vest.

The total vesting date fair value of stock units which vested during the three months ended June 30, 2018 and 2017 was \$2.1 million and \$1.4 million, respectively. The total vesting date fair value of stock units which vested during the six months ended June 30, 2018 and 2017 was \$2.1 million and \$1.4 million, respectively.

## 8. Income Taxes

Income taxes were \$48.4 million and \$29.4 million for the three months ended June 30, 2018 and 2017, respectively, and \$57.8 million for both the six months ended June 30, 2018 and 2017. The effective income tax rate was 33.9% and 17.6% for the three months ended June 30, 2018 and 2017, respectively, and 24.7% and 20.6% for the six months ended June 30, 2018 and 2017, respectively. The increase in the effective tax rate for the three months ended June 30, 2018, as compared to the same period in 2017, was due to U.S. Tax Reform, which impacts the Company's ability to benefit from certain foreign tax credits, the impact of changes in the geographic mix of the Company's income, and a decrease in net benefits from discrete events. Included in the discrete events for the three months ended June 30, 2018 and 2017 was the impact of \$10.9 million and \$21.4 million, respectively, of excess tax benefits on share-based compensation arrangements. The increase in the effective tax rate for the six months ended June 30, 2018, as compared to the same period in 2017, was primarily due to U.S. Tax Reform, which impacts the Company's ability to benefit from certain foreign tax credits, and the impact of changes in the geographic mix of the Company's income, partially offset by an increase in net benefits from discrete events. Included in the discrete events for the six months ended June 30, 2018 and 2017 was the impact of \$30.2 million and \$25.7 million, respectively, of excess tax benefits on share-based compensation arrangements.

As of June 30, 2018, the total amount of unrecognized tax benefits, including related interest and penalties, was \$65.0 million. If the total amount of unrecognized tax benefits was recognized, \$46.8 million of unrecognized tax benefits, \$9.6 million of interest, and \$1.6 million of penalties would impact the effective tax rate.

The Company believes that it is reasonably possible that the amount of unrecognized tax benefits could decrease by up to approximately \$8.6 million within the next twelve months. Of this possible decrease, \$0.4 million would be due to the settlement of audits or resolution of administrative or judicial proceedings. The remaining possible decrease of \$8.2 million would be due to the expiration of statute of limitations in various jurisdictions. For a description on contingency matters relating to income taxes, see Note 5, Contingencies.

As described in Note 12, Income Taxes, to the Consolidated Financial Statements included in the 2017 10-K, on December 22, 2017, the U.S. enacted the Tax Cuts and Jobs Act, or the Act. The Act, which is also commonly referred to as "U.S. Tax Reform," significantly changes U.S. corporate income tax laws by, among other things, reducing the U.S. corporate income tax rate to 21% starting in 2018 and creating a modified territorial tax system with a one-time mandatory tax on previously deferred foreign earnings of U.S. subsidiaries. As a result of the Act, the Company recorded a provisional net expense during the fourth quarter of 2017 which was reflected in its prior year financial statements. There have not been any adjustments to these provisional amounts during the six months ended June 30, 2018. The Company continues to analyze other information and regulatory guidance, and accordingly the Company may record additional provisional amounts or adjustments to provisional amounts in future periods. Pursuant to the SEC's Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act, any adjustments to these provisional amounts will be reported as a component of tax expense in the reporting period in which any such adjustments are determined, which will be no later than the fourth quarter of 2018.

## 9. Derivative Instruments and Hedging Activities

### Foreign Currency Instruments

The Company designates certain foreign currency derivatives, primarily comprised of foreign currency forward contracts, as freestanding derivatives for which hedge accounting does not apply. The changes in the fair market value of these freestanding derivatives are included in selling, general, and administrative expenses in the Company's

condensed consolidated statements of income. The Company uses freestanding foreign currency derivatives to hedge foreign currency-denominated intercompany transactions and to partially mitigate the impact of foreign currency fluctuations. The fair value of the freestanding foreign currency derivatives is based on third-party quotes. The Company's foreign currency derivative contracts are generally executed on a monthly basis.

The Company designates as cash-flow hedges those foreign currency forward contracts it enters into to hedge forecasted inventory purchases and intercompany management fees that are subject to foreign currency exposures. Forward contracts are used to hedge forecasted inventory purchases over specific months. Changes in the fair value of these forward contracts, excluding forward points, designated as cash-flow hedges are recorded as a component of accumulated other comprehensive loss within shareholders' deficit, and are recognized in cost of sales in the condensed consolidated statement of income during the period which approximates the time the hedged inventory is sold. The Company also hedges forecasted intercompany management fees over specific months. These contracts allow the Company to sell Euros in exchange for U.S. dollars at specified contract rates. Changes in the fair value of these forward contracts designated as cash flow hedges are recorded as a component of accumulated other comprehensive loss within shareholders' deficit, and are recognized in selling, general, and administrative expenses in the condensed consolidated statement of income during the period when the hedged item and underlying transaction affect earnings.

As of June 30, 2018 and December 31, 2017, the aggregate notional amounts of all foreign currency contracts outstanding designated as cash flow hedges were approximately \$78.2 million and \$104.9 million, respectively. As of June 30, 2018, these outstanding contracts were expected to mature over the next fifteen months. The Company's derivative financial instruments are recorded on the condensed consolidated balance sheets at fair value based on third-party quotes. As of June 30, 2018, the Company recorded assets at fair value of \$1.5 million and liabilities at fair value of \$1.0 million relating to all outstanding foreign currency contracts designated as cash-flow hedges. As of December 31, 2017, the Company recorded assets at fair value of \$2.9 million and liabilities at fair value of \$4.0 million relating to all outstanding foreign currency contracts designated as cash-flow hedges. The Company assesses hedge effectiveness and measures hedge ineffectiveness at least quarterly. During the three and six months ended June 30, 2018 and 2017, the ineffective portion relating to these hedges was immaterial and the hedges remained effective as of June 30, 2018 and December 31, 2017.

As of June 30, 2018 and December 31, 2017, the majority of the Company's outstanding foreign currency forward contracts had maturity dates of less than twelve months with the majority of freestanding derivatives expiring within one month as of June 30, 2018 and December 31, 2017. As of June 30, 2018, the Company had aggregate notional amounts of approximately \$291.8 million of foreign currency contracts, inclusive of freestanding contracts and contracts designated as cash flow hedges.

The following tables summarize the derivative activity during the three and six months ended June 30, 2018 and 2017 relating to all the Company's derivatives.

#### Gains and Losses on Derivative Instruments

The following table summarizes gains (losses) relating to derivative instruments recorded in other comprehensive (loss) income during the three and six months ended June 30, 2018 and 2017:

	Amount of Gain (Loss) Recognized in Other Comprehensive (Loss) Income			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
	(in millions)			
<b>Derivatives designated as hedging instruments:</b>				
Foreign exchange currency contracts relating to inventory				
and intercompany management fee hedges	\$4.5	\$ (4.4 )	\$0.5	\$ (10.5 )

As of June 30, 2018, the estimated amount of existing net gains related to cash flow hedges recorded in accumulated other comprehensive loss that are expected to be reclassified into earnings over the next twelve months was \$2.7 million.

The following table summarizes gains (losses) relating to derivative instruments recorded to income during the three and six months ended June 30, 2018 and 2017:



	Amount of (Loss) Gain Recognized in Income				Location of (Loss) Gain Recognized in Income
	Three Months Ended June 30,		Six Months Ended June 30,		
	2018	2017	2018	2017	
	(in millions)				
<b>Derivatives designated as hedging</b>					
instruments:					
Foreign exchange currency contracts					
relating to inventory and					
intercompany management fee					
hedges(1)	\$ (0.2)	\$ 1.7	\$ (2.2)	\$ 1.2	Selling, general, and administrative expenses
<b>Derivatives not designated as</b>					
<b>hedging</b>					
instruments:					
Foreign exchange currency contracts	\$ 1.1	\$ (5.2 )	\$ (1.6)	\$ (6.5 )	Selling, general, and administrative expenses

(1) For foreign exchange contracts designated as hedging instruments, the amounts recognized in income primarily represent the amounts excluded from the assessment of hedge effectiveness. There were no material ineffective amounts reported for derivatives designated as hedging instruments.

The following table summarizes gains (losses) relating to derivative instruments reclassified from accumulated other comprehensive loss into income during the three and six months ended June 30, 2018 and 2017:

	Amount of Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss to Income				Location of Gain (Loss) Reclassified from Accumulated Other Comprehensive Loss to Income (Effective Portion)
	Three Months Ended June 30,		Six Months Ended June 30,		
	2018	2017	2018	2017	
Derivatives designated as hedging instruments:					
Foreign exchange currency contracts					
relating to inventory hedges	\$1.5	\$ 0.7	\$2.0	\$ 1.6	Cost of sales
Foreign exchange currency contracts					
relating to intercompany management					
fee hedges	\$(1.6)	\$ 0.4	\$(4.0)	\$ 0.9	Selling, general, and administrative expenses

The Company reports its derivatives at fair value as either assets or liabilities within its condensed consolidated balance sheets. See Note 12, Fair Value Measurements, for information on derivative fair values and their condensed consolidated balance sheets location as of June 30, 2018 and December 31, 2017.

#### 10. Shareholders' Deficit

Changes in shareholders' deficit for the six months ended June 30, 2018 were as follows:

Total  
shareholders'  
deficit

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	(in millions)
Balance as of December 31, 2017	\$ (334.7 )
Net income	176.5
Additional paid-in capital from share-based compensation	20.2
Repurchases of common shares	(681.4 )
Foreign currency translation adjustment	(29.6 )
Increase in additional paid-in capital due to issuance of	
2024 Convertible Notes	136.7
Decrease in additional paid-in capital due to repurchase of	
2019 Convertible Notes	(123.0 )
Increase in additional paid-in capital due to partial unwind	
of Capped Call Transactions	55.9
Balance as of June 30, 2018	\$ (779.4 )

### Dividends

The declaration of future dividends is subject to the discretion of the Company's board of directors and will depend upon various factors, including its earnings, financial condition, Herbalife Nutrition Ltd.'s available distributable reserves under Cayman Islands law, restrictions imposed by the Credit Facility and the terms of any other indebtedness that may be outstanding, cash requirements, future prospects and other factors deemed relevant by its board of directors.

## Share Repurchases

On February 21, 2017, the Company's board of directors authorized a new three-year \$1.5 billion share repurchase program that will expire on February 21, 2020, which replaced the Company's prior share repurchase authorization that was set to expire on June 30, 2017 and had approximately \$233 million of remaining authorized capacity as of December 31, 2016. This share repurchase program allows the Company, which includes an indirect wholly-owned subsidiary of Herbalife Nutrition Ltd., to repurchase the Company's common shares at such times and prices as determined by management, as market conditions warrant, and to the extent Herbalife Nutrition Ltd.'s distributable reserves are available under Cayman Islands law. The Credit Facility permits the Company to repurchase its common shares as long as no default or event of default exists and other conditions, such as specified consolidated leverage ratios, are met.

In conjunction with the issuance of the 2019 Convertible Notes during February 2014, the Company paid approximately \$685.8 million to enter into Forward Transactions with certain financial institutions, or the Forward Counterparties, pursuant to which the Company purchased approximately 19.9 million common shares, at an average cost of \$34.51 per share, for settlement on or around the August 15, 2019 maturity date for the 2019 Convertible Notes, subject to the ability of each Forward Counterparty to elect to settle all or a portion of its Forward Transactions early. The Forward Transactions were generally expected to facilitate privately negotiated derivative transactions between the Forward Counterparties and holders of the 2019 Convertible Notes, including swaps, relating to the common shares by which holders of the 2019 Convertible Notes establish short positions relating to the common shares and otherwise hedge their investments in the 2019 Convertible Notes concurrently with, or shortly after, the pricing of the 2019 Convertible Notes. The approximate 19.9 million common shares effectively repurchased through the Forward Transactions are treated as retired shares for basic and diluted EPS purposes. During the three months ended June 30, 2018, the Forward Counterparties delivered approximately 8.4 million shares to the Company, which were subsequently retired by the Company, and as a result, the Company expensed \$3.1 million of unamortized non-cash issuance costs relating to these shares, which is included in the non-cash interest expense amounts disclosed below. As of June 30, 2018, approximately 11.5 million shares still remained legally outstanding.

As a result of the Forward Transactions, the Company's total shareholders' equity within its condensed consolidated balance sheet was reduced by approximately \$685.8 million during the first quarter of 2014, with amounts of \$653.9 million and \$31.9 million being allocated between accumulated deficit and additional paid-in capital, respectively, within total shareholders' equity. Also, upon executing the Forward Transactions, the Company recorded, at fair value, \$35.8 million in non-cash issuance costs to other assets and a corresponding amount to additional paid-in capital within its condensed consolidated balance sheet. These non-cash issuance costs will be amortized to interest expense over the contractual term of the Forward Transactions. The Company recognized \$4.7 million and \$1.6 million for the three months ended June 30, 2018 and 2017, respectively, and \$6.3 million and \$3.2 million for the six months ended June 30, 2018 and 2017, respectively, of non-cash interest expense within its condensed consolidated statements of income relating to amortization of these non-cash issuance costs.

During the three months ended March 31, 2018, an indirect wholly-owned subsidiary of the Company purchased 8,400 of Herbalife Nutrition Ltd.'s common shares through open market purchases at an aggregate cost of approximately \$0.3 million, or an average cost of \$33.90 per share. The Company's indirect wholly-owned subsidiary did not purchase any of Herbalife Nutrition Ltd.'s common shares in the open market during the three months ended June 30, 2018. During the three months ended March 31, 2017, an indirect wholly-owned subsidiary of the Company purchased approximately 2.2 million of Herbalife Nutrition Ltd.'s common shares through open market purchases at an aggregate cost of approximately \$60.7 million, or an average cost of \$28.05 per share. During the three months ended June 30, 2017, an indirect wholly-owned subsidiary of the Company purchased approximately 5.3 million of Herbalife Nutrition Ltd.'s common shares through open market purchases at an aggregate cost of approximately \$179.8 million, or an average cost of \$33.53 per share. These share repurchases increased the Company's total shareholders' deficit and

are reflected at cost within the Company's accompanying condensed consolidated balance sheets. Although these shares are owned by an indirect wholly-owned subsidiary of the Company and remain legally outstanding, they are reflected as treasury shares under U.S. GAAP and therefore reduce the number of common shares outstanding within the Company's condensed consolidated financial statements and the weighted-average number of common shares outstanding used in calculating earnings per share. The common shares of Herbalife Nutrition Ltd. held by the indirect wholly-owned subsidiary, however, remain outstanding on the books and records of the Company's transfer agent and therefore still carry voting and other share rights related to ownership of the Company's common shares, which may be exercised. So long as it is consistent with applicable laws, such shares will be voted by such subsidiary in the same manner, and to the maximum extent possible in the same proportion, as all other votes cast with respect to any matter properly submitted to a vote of Herbalife Nutrition Ltd.'s shareholders. As of both June 30, 2018 and December 31, 2017, the Company held approximately 10.0 million of treasury shares for U.S. GAAP purposes. In May 2018, the Company completed its modified Dutch auction tender offer and then subsequently paid cash to repurchase and retire a total of approximately 11.4 million of its common shares at an aggregate cost of approximately \$600.0 million, or \$52.50 per share. As of June 30, 2018, the remaining authorized capacity under the Company's \$1.5 billion share repurchase program was \$113.3 million.

In connection with the Company's October 2017 modified Dutch auction tender offer, the Company incurred \$1.6 million in transaction costs and also provided a non-transferable contractual contingent value right, or CVR, for each share tendered, allowing participants in the tender offer to receive a contingent cash payment in the event Herbalife is acquired in a going-private transaction (as defined in the CVR Agreement) within two years of the commencement of the tender offer. The initial fair value of the CVR was \$7.3 million, which was recorded as a liability in the fourth quarter with a corresponding decrease to shareholders' equity. In determining the initial fair value of the CVR, the Company used a lattice model, which included inputs such as the underlying stock price, strike price, time to expiration, and dividend yield. Subsequent changes in the fair value of the CVR liability, using a similar valuation approach as the initial fair value determination, are recognized within the Company's condensed consolidated balance sheets with corresponding gains or losses being recognized in non-operating expense (income) within the Company's condensed consolidated statements of income during each reporting period until the CVR expires in August 2019 or is terminated due to a going-private transaction, which is also incorporated in the valuation of the CVR; this going-private probability input is considered to be a Level 3 input in the fair value hierarchy. Any subsequent increase or decrease in this input or other inputs described above in subsequent valuations could significantly impact the fair value of the CVR. The Company recognized a \$4.7 million and \$16.0 million loss in other expense, net within its condensed consolidated statement of income during the three and six months ended June 30, 2018, respectively, due to the change in the fair value of the CVR, which was primarily driven by the increase in the market price of the Company's common shares. As of June 30, 2018 and December 31, 2017, the fair value of the CVR was \$22.9 million and \$6.9 million, respectively.

During the three and six months ended June 30, 2018 and 2017, the Company also withheld shares on its vested restricted stock units and exercised SARs relating to its share-based compensation plans, which are treated as share repurchases in the Company's condensed consolidated financial statements as discussed further below.

The Company reflects the aggregate purchase price of its common shares repurchased as an increase to shareholders' deficit. The Company allocated the purchase price of the repurchased shares to accumulated deficit, common shares, and additional paid-in capital, with the exception of treasury shares, which are recorded separately on the Company's condensed consolidated balance sheets.

The number of shares issued upon vesting or exercise for certain restricted stock units and SARs granted pursuant to the Company's share-based compensation plans is net of the statutory withholding requirements that the Company pays on behalf of its employees. Although shares withheld are not issued, they are treated as common share repurchases in the Company's condensed consolidated financial statements, as they reduce the number of shares that would have been issued upon vesting. These shares do not count against the authorized capacity under the Company's share repurchase program described above.

For the six months ended June 30, 2018 and 2017, the Company's share repurchases, inclusive of transaction costs, were \$600.7 million and \$240.5 million, respectively, under the Company's share repurchase programs, and \$80.7 million and \$45.7 million, respectively, due to shares withheld for tax purposes related to the Company's share-based compensation plans. For the six months ended June 30, 2018 and 2017, the Company's total share repurchases, including shares withheld for tax purposes, were \$681.4 million and \$286.2 million, respectively, and have been recorded as an increase to shareholders' deficit within the Company's condensed consolidated balance sheets. The Company recorded \$685.6 million of total share repurchases within financing activities on its condensed consolidated statement of cash flows for the six months ended June 30, 2018, which includes \$4.2 million of share repurchases that were reflected as an increase to shareholders' deficit within the Company's condensed consolidated balance sheet as of December 31, 2017 but were subsequently paid during the six months ended June 30, 2018. The Company recorded \$273.6 million of total share repurchases within financing activities on its condensed consolidated statement of cash flows for the six months ended June 30, 2017, which excludes \$12.6 million of share repurchases for which payment was made subsequent to the period end and was therefore reflected as a liability within the

Company's condensed consolidated balance sheet as of June 30, 2017.

#### Capped Call Transactions

In February 2014, in connection with the issuance of the 2019 Convertible Notes, the Company paid approximately \$123.8 million to enter into Capped Call Transactions with certain financial institutions. The Capped Call Transactions are expected generally to reduce the potential dilution upon conversion of the 2019 Convertible Notes in the event that the market price of the common shares is greater than the strike price of the Capped Call Transactions, initially set at \$43.14 per common share based on the retroactive adjustment due to the Company's two-for-one stock split described in Note 2, Significant Accounting Policies, with such reduction of potential dilution subject to a cap based on the cap price initially set at \$60.39 per common share based on the retroactive adjustment due to the Company's two-for-one stock split described in Note 2, Significant Accounting Policies. The strike price and cap price are subject to certain adjustments under the terms of the Capped Call Transactions. Therefore, as a result of executing the Capped Call Transactions, the Company in effect will only be exposed to potential net dilution once the market price of its common shares exceeds the adjusted cap price. As of June 30, 2018, the weighted-average adjusted cap price was approximately \$54.44 per common share. As a result of the Capped Call Transactions, the Company's additional paid-in capital within shareholders' equity on its condensed consolidated balance sheet was reduced by \$123.8 million during the first quarter of 2014.

During March 2018, in connection with the Company's repurchase of a portion of the 2019 Convertible Notes, the Company entered into partial settlement agreements with the option counterparties to the Capped Call Transactions to terminate a portion of such existing transactions, in each case, in a notional amount corresponding to the aggregate principal amount of 2019 Convertible Notes that were repurchased. As a result of terminating a portion of the Capped Call Transactions, which were in a favorable position, the Company received \$55.9 million in cash and recognized an offsetting increase to additional paid-in capital as of June 30, 2018.

#### Accumulated Other Comprehensive Loss

The following table summarizes changes in accumulated other comprehensive loss by component during the three months ended June 30, 2018 and 2017:

	Changes in Accumulated Other Comprehensive Loss by Component					
	Three Months Ended June 30, 2018			June 30, 2017		
	Foreign Currency Translation Adjustments	Unrealized Gain (Loss) Derivatives	Total	Foreign Currency Translation Adjustments	Unrealized Gain (Loss) Derivatives	Total
	(in millions)					
Beginning balance	\$ (149.4)	\$ 2.1	\$ (147.3)	\$ (192.5)	\$ 2.9	\$ (189.6)
Other comprehensive (loss) income						
before reclassifications, net of tax	(50.8 )	4.4	(46.4 )	6.7	(4.4 )	2.3
Amounts reclassified from accumulated other comprehensive loss						
to income, net of tax(1)	—	0.1	0.1	—	(1.1 )	(1.1 )
Total other comprehensive (loss) income, net of reclassifications	(50.8 )	4.5	(46.3 )	6.7	(5.5 )	1.2
Ending balance	\$ (200.2)	\$ 6.6	\$ (193.6)	\$ (185.8)	\$ (2.6)	\$ (188.4)

(1) See Note 9, Derivative Instruments and Hedging Activities, for information regarding the location in the condensed consolidated statements of income of gains (losses) reclassified from accumulated other comprehensive loss into income during the three months ended June 30, 2018 and 2017.

Other comprehensive income (loss) before reclassifications was net of tax benefit of \$3.1 million for foreign currency translation adjustments for the three months ended June 30, 2018.

Other comprehensive income (loss) before reclassifications was net of tax expense of \$2.7 million for foreign currency translation adjustments for the three months ended June 30, 2017.





The following table summarizes changes in accumulated other comprehensive loss by component during the six months ended June 30, 2018 and 2017:

	Changes in Accumulated Other Comprehensive Loss by Component					
	Six Months Ended June 30, 2018			June 30, 2017		
	Foreign Currency Translation Adjustments	Unrealized Gain (Loss) Derivatives	Total	Foreign Currency Translation Adjustments	Unrealized Gain (Loss) Derivatives	Total
	(in millions)					
Beginning balance	\$ (170.6)	\$ 5.2	\$ (165.4)	\$ (215.5)	\$ 10.4	\$ (205.1)
Other comprehensive (loss) income						
before reclassifications, net of tax	(29.6 )	0.5	(29.1 )	29.7	(10.5 )	19.2
Amounts reclassified from accumulated other comprehensive loss						
to income, net of tax(1)	—	0.9	0.9	—	(2.5 )	(2.5 )
Total other comprehensive (loss) income, net of reclassifications	(29.6 )	1.4	(28.2 )	29.7	(13.0 )	16.7
Ending balance	\$ (200.2)	\$ 6.6	\$ (193.6)	\$ (185.8)	\$ (2.6 )	\$ (188.4)

(1) See Note 9, Derivative Instruments and Hedging Activities, for information regarding the location in the condensed consolidated statements of income of gains (losses) reclassified from accumulated other comprehensive loss into income during the six months ended June 30, 2018 and 2017.

Other comprehensive income (loss) before reclassifications was net of tax benefit of \$2.0 million for foreign currency translation adjustments for the six months ended June 30, 2018.

Other comprehensive income (loss) before reclassifications was net of tax expense of \$5.3 million for foreign currency translation adjustments for the six months ended June 30, 2017.

## 11. Earnings Per Share

Basic earnings per share represents net income divided by the weighted-average number of common shares outstanding for the period. Diluted earnings per share represents net income divided by the weighted-average number of common shares outstanding, inclusive of the effect of dilutive securities, such as outstanding SARs, stock units, and convertible notes.

The following are the common share amounts used to compute the basic and diluted earnings per share for each period:

	Three Months Ended June 30, June 30,		Six Months Ended June 30, June 30,	
	2018	2017	2018	2017
	(in millions)			
Weighted-average shares used in basic computations	142.3	162.9	144.0	164.6
Dilutive effect of exercise of equity grants outstanding	6.8	7.7	7.1	7.5
Dilutive effect of 2019 Convertible Notes	2.8	—	1.9	—
Weighted-average shares used in diluted computations	151.9	170.6	153.0	172.1

There were an aggregate of 1.7 million and 6.6 million of equity grants, consisting of SARs and stock units, that were outstanding during the three months ended June 30, 2018 and 2017, respectively, and an aggregate of 2.1 million and 7.2 million of equity grants, consisting of SARs and stock units, that were outstanding during the six months ended June 30, 2018 and 2017, respectively, but were not included in the computation of diluted earnings per share because their effect would be anti-dilutive or the performance condition for the award had not been satisfied.

Since the Company will settle the principal amount of its 2019 Convertible Notes in cash and settle the conversion feature for the amount above the conversion price in common shares, or the conversion spread, the Company uses the treasury stock method for calculating any potential dilutive effect of the conversion spread on diluted earnings per share, if applicable. The conversion spread will have a dilutive impact on diluted earnings per share when the average market price of the Company's common shares for a given period exceeds the conversion price of the 2019 Convertible Notes. The dilutive impact for the three and six months ended June 30, 2018 is disclosed in the table above. For the three and six months ended June 30, 2017, the 2019 Convertible Notes have been excluded from the computation of diluted earnings per share, as the effect would be anti-dilutive since the conversion price of the 2019 Convertible Notes exceeded the average market price of the Company's common shares for the three and six months ended June 30, 2017. The initial conversion rate and conversion price for the 2019 Convertible Notes are described further in Note 4, Long-Term Debt.

For the 2024 Convertible Notes, the Company has the intent and ability to settle the principal amount in cash and intends to settle the conversion feature for the amount above the conversion price, or the conversion spread, in common shares. The Company uses the treasury stock method for calculating any potential dilutive effect of the conversion spread on diluted earnings per share, if applicable. The conversion spread will have a dilutive impact on diluted earnings per share when the average market price of the Company's common shares for a given period exceeds the conversion price of the 2024 Convertible Notes. For the three and six months ended June 30, 2018, the 2024 Convertible Notes have been excluded from the computation of diluted earnings per share, as the effect would be anti-dilutive since the conversion price of the 2024 Convertible Notes exceeded the average market price of the Company's common shares for the three and six months ended June 30, 2018. The initial conversion rate and conversion price for the 2024 Convertible Notes are described further in Note 4, Long-Term Debt.

The Capped Call Transactions are excluded from the calculation of diluted earnings per share because their impact is always anti-dilutive. Additionally, the Forward Transactions are treated as retired shares for basic and diluted EPS purposes. See Note 10, Shareholders' Deficit, for additional discussion regarding the Capped Call Transactions and Forward Transactions.

See Note 10, Shareholders' Deficit, for a discussion of how common shares repurchased by the Company's indirect wholly-owned subsidiary are treated under U.S. GAAP.

## 12. Fair Value Measurements

The Company applies the provisions of FASB ASC Topic 820, Fair Value Measurements and Disclosures, or ASC 820, for its financial and non-financial assets and liabilities. ASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. ASC 820 establishes a fair value hierarchy, which prioritizes the inputs used in measuring fair value into three broad levels as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date.

Level 2 inputs include quoted prices for similar assets or liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 inputs are unobservable inputs for the asset or liability.

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The Company measures certain assets and liabilities at fair value as discussed throughout the notes to its condensed consolidated financial statements. Foreign exchange currency contracts are valued using standard calculations and models primarily based on inputs such as observable forward rates, spot rates and foreign currency exchange rates at the reporting period ended date. The Company's derivative assets and liabilities are measured at fair value and consisted of Level 2 inputs and their amounts are shown below at their gross values as of June 30, 2018 and December 31, 2017:

Balance Sheet Location	Significant Other Observable Inputs (Level 2) Fair Value as of		Significant Other Observable Inputs (Level 2) Fair Value as of	
	June 30, 2018	June 30, 2017	December 31, 2018	December 31, 2017
	(in millions)			
<b>ASSETS:</b>				
Derivatives designated as hedging				
instruments:				
Foreign exchange currency contracts relating				
to inventory and intercompany				
management fee hedges	Prepaid expenses and other current assets	\$ 1.5	\$ 2.9	
Derivatives not designated as hedging				
instruments:				
Foreign exchange currency contracts	Prepaid expenses and other current assets	4.2	2.9	
		\$ 5.7	\$ 5.8	
<b>LIABILITIES:</b>				
Derivatives designated as hedging				
instruments:				
Foreign exchange currency contracts relating				
to inventory and intercompany				
management fee hedges	Other current liabilities	\$ 1.0	\$ 4.0	
Derivatives not designated as hedging				
instruments:				
Foreign exchange currency contracts	Other current liabilities	2.0	2.6	
		\$ 3.0	\$ 6.6	

The Company's CVR liability is measured at fair value and consisted of Level 3 inputs. See Note 10, Shareholders' Deficit, for a further description of the CVR liability. The following is a reconciliation of the CVR liability reported in Other non-current liabilities within the Company's condensed consolidated balance sheet as of June 30, 2018:

	Contingent Value Right (in millions)
Fair value as of December 31, 2017	\$ 6.9
Net unrealized loss(1)	16.0
Fair value as of June 30, 2018	\$ 22.9

(1) Unrealized gains and losses related to the revaluation of the CVR are recorded in Other expense, net within the Company's condensed consolidated statements of income.

The Company considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents. Cash and cash equivalents are comprised of money market funds and foreign and domestic bank accounts. These cash and cash equivalents are valued based on Level 1 inputs which consist of quoted prices in active markets. To reduce its credit risk, the Company monitors the credit standing of the financial institutions that hold the Company's cash and cash equivalents.

The Company's deferred compensation plan assets consist of Company owned life insurance policies. As these policies are recorded at their cash surrender value, they are not required to be included in the fair value table above. See Note 6, Employee Compensation Plans, to the Consolidated Financial Statements included in the 2017 10-K for a further description of the Company's deferred compensation plan assets.

The following tables summarize the offsetting of the fair values of the Company's derivative assets and derivative liabilities for presentation in the Company's condensed consolidated balance sheets as of June 30, 2018 and December 31, 2017:

	Offsetting of Derivative Assets		
	Gross Amounts of Assets Recognized in Balance Sheet	Offset in the Balance Sheet	Net Amounts of Assets Presented in the Balance Sheet
	(in millions)		
<b>June 30, 2018</b>			
Foreign exchange currency contracts	\$5.7	\$ (2.5 )	\$ 3.2
<b>Total</b>	<b>\$5.7</b>	<b>\$ (2.5 )</b>	<b>\$ 3.2</b>
<b>December 31, 2017</b>			
Foreign exchange currency contracts	\$5.8	\$ (4.3 )	\$ 1.5
<b>Total</b>	<b>\$5.8</b>	<b>\$ (4.3 )</b>	<b>\$ 1.5</b>

	Offsetting of Derivative Liabilities		
	Gross Amounts of Liabilities Recognized in Balance Sheet	Offset in the Balance Sheet	Net Amounts of Liabilities Presented in the Balance Sheet
	(in millions)		
<b>June 30, 2018</b>			
Foreign exchange currency contracts	\$3.0	\$ (2.5 )	\$ 0.5
<b>Total</b>	<b>\$3.0</b>	<b>\$ (2.5 )</b>	<b>\$ 0.5</b>
<b>December 31, 2017</b>			
Foreign exchange currency contracts	\$6.6	\$ (4.3 )	\$ 2.3
<b>Total</b>	<b>\$6.6</b>	<b>\$ (4.3 )</b>	<b>\$ 2.3</b>

The Company offsets all of its derivative assets and derivative liabilities in its condensed consolidated balance sheet to the extent it maintains master netting arrangements with related financial institutions. As of June 30, 2018 and December 31, 2017, all of the Company's derivatives were subject to master netting arrangements and no collateralization was required for the Company's derivative assets and derivative liabilities.



## 13. Detail of Certain Balance Sheet Accounts

## Other Assets

The Other assets on the Company's accompanying condensed consolidated balance sheets includes deferred compensation plan assets of \$33.8 million and \$33.6 million and deferred tax assets of \$74.4 million and \$77.5 million as of June 30, 2018 and December 31, 2017, respectively.

## Other Current Liabilities

Other current liabilities consist of the following:

	June 30, December 31,	
	2018	2017
	(in millions)	
Accrued compensation	\$103.3	\$ 117.3
Accrued service fees to China independent service providers	66.3	58.7
Accrued advertising, events, and promotion expenses	45.7	46.3
Advance sales deposits	90.9	65.2
Income taxes payable	29.2	25.7
Other accrued liabilities	150.9	145.7
Total	\$486.3	\$ 458.9

Other Non-Current Liabilities

The Other non-current liabilities on the Company's accompanying condensed consolidated balance sheets includes deferred compensation plan liabilities of \$55.3 million and \$58.1 million and deferred income tax liabilities of \$7.3 million and \$7.8 million as of June 30, 2018 and December 31, 2017, respectively. See Note 6, Employee Compensation Plans, to the Consolidated Financial Statements included in the 2017 10-K for a further description of the Company's deferred compensation plan assets and liabilities.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included in Part I, Item 1 — Financial Information, of this Quarterly Report on Form 10-Q and our consolidated financial statements appearing in our Annual Report on Form 10-K for the year ended December 31, 2017, or the 2017 10-K. Unless the context otherwise requires, all references herein to the “Company,” “we,” “us” or “our,” or similar terms, refer to Herbalife Nutrition Ltd., a Cayman Islands exempt limited liability company, and its consolidated subsidiaries.

### Overview

We are a global nutrition company that sells weight management, targeted nutrition, energy, sports & fitness, and outer nutrition products to and through independent members, or Members. In China, we sell our products to and through independent service providers, sales representatives, and sales officers to customers and preferred customers, as well as through Company-operated retail stores when necessary. We refer to Members that distribute our products and achieve certain qualification requirements as “sales leaders.”

In certain geographic markets, we have introduced segmentation of our Member base into two categories: “preferred members” – who are simply consumers who wish to purchase product for their own household use, and “distributors” – who are Members who also wish to resell products or build a sales organization. Any existing Members in these markets who do not convert to preferred member will be categorized as distributors and may convert at a later date; future new Members will join as either a preferred member or a distributor. Future increases in the number of preferred members, as conversions take place or as we introduce segmentation into other markets, does not in and of itself represent an increase in the total number of Members, nor is it necessarily indicative of our future expected financial performance.

As of December 31, 2017, we had approximately 4.0 million Members, including 0.6 million preferred members and 0.5 million distributors in the markets where we have provided these two categories and 0.3 million sales representatives, sales officers and independent service providers in China.

We pursue our purpose to make the world healthier and happier by providing high quality, science-based products to Members and their customers who seek a healthy lifestyle and we also offer a business opportunity to those Members who seek additional income. We believe the global obesity epidemic has made our products more relevant and the effectiveness of our distribution network has been the primary reason for our recent success.

Our products are grouped in four principal categories: weight management; targeted nutrition; energy, sports & fitness; and outer nutrition, along with literature and promotional items. Our products are often sold through a series of related products and literature designed to simplify weight management and nutrition for consumers and maximize our Members' cross-selling opportunities.

Industry-wide factors that affect us and our competitors include the global obesity epidemic, the aging of the worldwide population and rising public health care costs, which are driving demand for weight management, nutrition and wellness-related products along with the global increase in under employment and unemployment which can affect the recruitment and retention of Members seeking additional income opportunities.

While we continue to monitor the current global financial environment, we remain focused on the opportunities and challenges in retailing of our products, sponsoring and retaining Members, improving Member productivity, further penetrating existing markets, globalizing successful Distributor Methods of Operation, or DMOs, such as Nutrition Clubs and Weight Loss Challenges, introducing new products and globalizing existing products, developing niche market segments and further investing in our infrastructure.



We sell our products 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.

On July 15, 2016, we reached a settlement with the FTC and entered into the Consent Order, which resolved the FTC's multi-year investigation of the Company. We are monitoring the impact of the Consent Order and our Board of Directors has established the Implementation Oversight Committee in connection with the Consent Order. The committee has met and will meet regularly with management to oversee our compliance with the terms of the Consent Order. While we currently do not expect the settlement to have a long-term and materially adverse impact on our business and our Member base, our business and our Member base, particularly in the U.S., may be negatively impacted as we and they continue to adjust to the changes. The terms of the Consent Order do not change our going to market through direct selling by independent distributors, and compensating those distributors based upon the product they and their sales organization sell. See Item 1A — Risk Factors of this Quarterly Report on Form 10-Q for a discussion of risks related to the settlement with the FTC.

#### Volume Points by Geographic Region

A key non-financial measure we focus on is Volume Points on a Royalty Basis, or Volume Points, which is essentially our weighted-average measure of product sales volume. Volume Points, which are unaffected by exchange rates or price changes, are used by management as a proxy for sales trends because in general, excluding the impact of price changes, an increase in Volume Points in a particular geographic region or country indicates an increase in our local currency net sales while a decrease in Volume Points in a particular geographic region or country indicates a decrease in our local currency net sales. The criteria we use to determine how and when we recognize Volume Points are not identical to our revenue recognition policies under U.S. GAAP. Unlike net sales, which are generally recognized when the product is delivered and when control passes to the Member, as discussed in greater detail in Note 2, Significant Accounting Policies, to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q, we recognize Volume Points when a Member pays for the order, which is generally prior to the product being delivered. Further, the periods in which Volume Points are tracked can vary slightly from the fiscal periods for which we report our results under U.S. GAAP. Therefore, there can be timing differences between the product orders for which net sales are recognized and for which Volume Points are recognized within a given period. However, historically these timing differences generally have been immaterial in the context of using changes in Volume Points as a proxy to explain volume-driven changes in net sales. We are evaluating our current approach to assigning and maintaining Volume Point values for certain products or markets. Any changes to this approach may have an impact on the use of Volume Points as a proxy for sales trends in future periods.

Currently, the specific number of Volume Points assigned to a product, and generally consistent across all markets, is based on a Volume Point to suggested retail price ratio for similar products. If a product is available in different quantities, the various sizes will have different Volume Point values. In general, once assigned, a Volume Point value is consistent in each region and country and does not change from year to year. For strategic reasons, certain Volume Point values were adjusted during 2018 for the Mexico and certain South & Central America markets. The reason Volume Points are used in the manner described above is that we use Volume Points for Member qualification and recognition purposes and therefore we generally keep Volume Points for a similar or like product consistent on a global basis. However, because Volume Points are a function of value rather than product type or size, they are not a reliable measure for product mix. As an example, an increase in Volume Points in a specific country or region could mean a significant increase in sales of less expensive products or a marginal increase in sales of more expensive

products.

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	Three Months Ended			Six Months Ended		
	June 30, 2018	June 30, 2017	% Change	June 30, 2018	June 30, 2017	% Change
	(Volume Points in millions)					
North America	336.4	284.1	18.4 %	639.6	586.7	9.0 %
Mexico(1)	237.1	228.9	3.6 %	458.9	454.4	1.0 %
South & Central America(2)	136.3	137.5	(0.9) %	284.8	290.7	(2.0) %
EMEA	319.5	283.6	12.7 %	614.2	557.8	10.1 %
Asia Pacific	302.8	275.9	9.7 %	589.4	536.7	9.8 %
China	196.1	153.9	27.4 %	337.2	335.9	0.4 %
Worldwide(3)	1,528.2	1,363.9	12.0 %	2,924.1	2,762.2	5.9 %

(1) Excluding Volume Point adjustments made during 2018 for certain products, the percent change for the three and six months ended June 30, 2018 would have been an increase of 1.7% and a decrease of 0.8%, respectively.

(2) Excluding Volume Point adjustments made during 2018 for certain products in certain markets, the percent change for the three and six months ended June 30, 2018 would have been a decrease of 2.9% and 3.5%, respectively.

(3) Excluding the Volume Point adjustments made during 2018 for certain products in Mexico and certain South & Central America markets noted above, the percent change for the three and six months ended June 30, 2018 would have been an increase of 11.6% and 5.4%, respectively.

Volume Points increased 12.0% for the three months ended June 30, 2018 after having decreased 8.1% for the same period in 2017, and increased 5.9% for the six months ended June 30, 2018 after having decreased 3.5% for the same period in 2017. Excluding the impact of the adjustments made in the 2018 periods, Volume Points increased 11.6% and 5.4% for the three and six months ended June 30, 2018, respectively. We believe North America's increase for the quarter and year-to-date period, after decreases for 2017, reflects the successful adaptation to date of our Members to the Consent Order implementation actions, including new tools and methods for documenting sales. We believe Mexico's increase for the quarter, after a decrease for the prior year period, reflects the contribution of programs designed to increase the activity and productivity of sales leaders and promotions to encourage sponsorship and Member activity. The South & Central America region saw a continuing, though lesser, decline in Volume Points for 2018 as we believe markets in the region continue to transition to sustainable, customer-oriented business practices. The EMEA region saw increased Volume Point growth, a result, we believe, of customer-oriented efforts including Member training, brand awareness, and product line expansion. The Volume Point performance for the APAC region has been mixed by country, with positive net results for the quarter, after a decline for the prior year period, led by the India market. The significant Volume Point increase in China for the three months ended June 30, 2018 is primarily due to reduced sales for the prior year quarter as a result of Member response to a price increase announced in March 2017 that was effective April 1, 2017. This price increase announcement, our first for the market in six years, drove significant sales orders late in March 2017, including orders that were pulled forward from the second quarter of 2017, as Members made purchases ahead of the price change. Results are discussed further below in the applicable sections of Sales by Geographic Region.

#### Presentation

“Retail value” represents the suggested retail price of products we sell to our Members and is the gross sales amount reflected on our invoices. Retail value is a Non-GAAP measure which may not be comparable to similarly-titled measures used by other companies. This is not the price paid to us by our Members. Our Members purchase product from us at a discount from the suggested retail price. We refer to these discounts as “distributor allowance”, and we refer to retail value less distributor allowances as “product sales.”

Total distributor allowances were 39.5% and 40.1% of retail value for the three months ended June 30, 2018 and 2017, respectively, and 39.9% and 40.3% of retail value for the six months ended June 30, 2018 and 2017, respectively. Distributor allowances and Marketing Plan payouts generally utilize 90% to 95% of suggested retail price, depending on the product and market, to which we apply discounts of up to 50% for distributor allowances and payout rates of up to 15% for royalty overrides, up to 7% for production bonuses, and approximately 1% for the Mark Hughes bonus. Distributor allowances as a percentage of retail value may vary by country depending upon regulatory restrictions that limit or otherwise restrict distributor allowances. We also offer reduced distributor allowances with respect to certain products worldwide. Each Member's level of discount is determined by qualification based on volume of purchases. In cases where a Member has qualified for less than the maximum discount, the remaining discount, which we also refer to as a wholesale commission, is received by their sponsoring Members. Therefore, product sales are recognized net of product returns and distributor allowances.

“Net sales” equal product sales plus shipping and handling, and generally represents what we collect.



We do not have visibility into all of the sales from our Members to their customers, but such a figure would differ from our reported “retail value” by factors including (a) the amount of product purchased by our Members for their own personal consumption and (b) prices charged by our Members to their customers other than our suggested retail prices. We discuss retail value because of its fundamental role in our systems, internal controls and operations, and its correlation to Member discounts and Royalty overrides. In addition, retail value is a component of the financial reports we use to analyze our financial results because, among other things, it can provide additional detail and visibility into our net sales results on a Company-wide and a geographic region and product category basis. Therefore, this non-GAAP measure may be useful to investors because it provides investors with the same information used by management. As this measure is not in accordance with U.S. generally accepted accounting principles, or U.S. GAAP, retail value should not be considered in isolation from, nor as a substitute for, net sales and other consolidated income or cash flow statement data prepared in accordance with U.S. GAAP, or as a measure of profitability or liquidity. A reconciliation of retail value to net sales is presented below under Results of Operations.

Our international operations have provided and will continue to provide a significant portion of our total net sales. As a result, total net sales will continue to be affected by fluctuations in the U.S. dollar against foreign currencies. In order to provide a framework for assessing how our underlying businesses performed excluding the effect of foreign currency fluctuations, in addition to comparing the percent change in net sales from one period to another in U.S. dollars, we also compare the percent change in net sales from one period to another period using “net sales in local currency”. Net sales in local currency is not a U.S. GAAP financial measure. Net sales in local currency removes from net sales in U.S. dollars the impact of changes in exchange rates between the U.S. dollar and the local currencies of our foreign subsidiaries, by translating the current period net sales into U.S. dollars using the same foreign currency exchange rates that were used to translate the net sales for the previous comparable period. We believe presenting net sales in local currency is useful to investors because it allows a meaningful comparison of net sales of our foreign operations from period to period. However, net sales in local currency measures should not be considered in isolation or as an alternative to net sales in U.S. dollar measures that reflect current period exchange rates, or to other financial measures calculated and presented in accordance with U.S. GAAP.

Additionally, the impact of foreign currency fluctuations in Venezuela and the price increases we implement as a result of the highly inflationary economy in that market can each, when considered in isolation, have a disproportionately large impact to our consolidated results despite the offsetting nature of these drivers and that net sales in Venezuela, which represent less than 1% of our consolidated net sales, are not material to our consolidated results. Therefore, in certain instances, we believe it is helpful to provide additional information with respect to these factors as reported and excluding the impact of Venezuela to illustrate the disproportionate nature of Venezuela’s individual pricing and foreign exchange impact to our consolidated results. However, excluding the impact of Venezuela from these measures is not in accordance with U.S. GAAP and should not be considered in isolation or as an alternative to the presentation and discussion thereof calculated in accordance with U.S. GAAP.

Our “gross profit” consists of net sales less “cost of sales,” which represents our manufacturing costs, the price we pay to our raw material suppliers and manufacturers of our products as well as shipping and handling costs including duties, tariffs, and similar expenses.

While certain Members may profit from their activities by reselling our products for amounts greater than the prices they pay us, Members that develop, retain, and manage other Members may earn additional compensation for those activities, which we refer to as “Royalty overrides.” Royalty overrides are our most significant operating expense and consist of:

- royalty overrides and production bonuses;
- the Mark Hughes bonus payable to some of our most senior Members; and
- other discretionary incentive cash bonuses to qualifying Members.

Royalty overrides are compensation to Members for the development, retention and improved productivity of their sales organizations and are paid to several levels of Members on each sale. Royalty overrides are compensation for services rendered to us and, as such, are recorded as an operating expense.

In China, our independent service providers are compensated for marketing, sales support, and other services instead of the distributor allowances and royalty overrides utilized in our global marketing plan. Service fees to China independent service providers are included in selling, general, and administrative expenses.

Because of local country regulatory constraints, we may be required to modify our Member incentive plans as described above. We also pay reduced royalty overrides with respect to certain products worldwide. Consequently, the total Royalty override percentage may vary over time.

Our “contribution margins” consist of net sales less cost of sales and Royalty overrides.

“Selling, general, and administrative expenses” represent our operating expenses, which include labor and benefits, service fees to China service providers, sales events, professional fees, travel and entertainment, Member promotions, occupancy costs, communication costs, bank fees, depreciation and amortization, foreign exchange gains and losses, and other miscellaneous operating expenses.

Our “other operating income” consists of government grant income related to China.

Our “other expense, net” consists of non-operating income and expenses such as gains or losses on extinguishment of debt and gains or losses due to subsequent changes in the fair value of the non-transferable contractual contingent value right, or CVR, provided for each share tendered in the October 2017 modified Dutch auction tender offer. See Note 10, Shareholders’ Deficit, to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for further information on the CVR.

Most of our sales to Members outside the United States are made in the respective local currencies. In preparing our financial statements, we translate revenues into U.S. dollars using average exchange rates. Additionally, the majority of our purchases from our suppliers generally are made in U.S. dollars. Consequently, a strengthening of the U.S. dollar versus a foreign currency can have a negative impact on our reported sales and contribution margins and can generate foreign currency losses on intercompany transactions. Foreign currency exchange rates can fluctuate significantly. From time to time, we enter into foreign currency derivatives to partially mitigate our foreign currency exchange risk as discussed in further detail in Part I, Item 3 — Quantitative and Qualitative Disclosures about Market Risk.

## Summary Financial Results

Net sales for the three and six months ended June 30, 2018 were \$1,285.5 million and \$2,462.4 million, respectively. Net sales increased \$138.6 million, or 12.1% (\$137.7 million, or 12.0% excluding Venezuela), and \$213.4 million, or 9.5% (\$208.4 million, or 9.3% excluding Venezuela) for the three and six months ended June 30, 2018, respectively, as compared to the same periods in 2017. In local currency, net sales increased 28.1% and 18.0% (10.6% and 6.1% excluding Venezuela) for the three and six months ended June 30, 2018, respectively, as compared to the same periods in 2017. The increase in net sales of 12.1% for the three months ended June 30, 2018 was primarily driven by a 19.9% favorable impact of price increases (2.3% favorable impact excluding Venezuela) and an increase in sales volume, as indicated by a 12.0% increase in Volume Points; partially offset by a 16.0% unfavorable impact of fluctuations in foreign currency rates (1.5% favorable impact excluding Venezuela), a 2.6% unfavorable impact of timing differences between recognition of net sales and sales volume mainly driven by China, and a 0.9% unfavorable impact of country sales mix. The increase in net sales of 9.5% for the six months ended June 30, 2018 was primarily driven by a 14.6% favorable impact of price increases (2.6% favorable impact excluding Venezuela) and an increase in sales volume as indicated by a 5.9% increase in Volume Points; partially offset by an 8.5% unfavorable impact of fluctuations in foreign currency rates (3.2% favorable impact excluding Venezuela), and a 0.6% unfavorable impact of country sales mix.

Net income for the three and six months ended June 30, 2018 was \$94.4 million, or \$0.62 per diluted share, and \$176.5 million, or \$1.15 per diluted share, respectively. Net income decreased \$43.2 million, or 31.4%, and \$46.3 million, or 20.8%, for the three and six months ended June 30, 2018, respectively, as compared to the same periods in 2017. The decrease in net income for the three months ended June 30, 2018 was mainly due to \$67.0 million higher selling, general, and administrative expenses; \$37.2 million lower government grant income from China; and \$19.0 million higher income taxes; partially offset by \$91.1 million higher contribution margin from higher net sales. The decrease in net income for the six months ended June 30, 2018 was mainly due to \$88.5 million

higher selling, general, and administrative expenses; \$21.0 million lower government grant income from China; a \$16.0 million loss on the revaluation of the CVR (See Note 10, Shareholders' Deficit, to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q); a \$13.1 million loss on extinguishment of \$475.0 million of our 2019 Convertible Notes (See Note 4, Long-Term Debt, to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q); and \$16.1 million higher interest expense; partially offset by \$108.4 million higher contribution margin from higher net sales.

Net income for the three months ended June 30, 2018 included a \$1.7 million pre-tax favorable impact (\$1.4 million post-tax) of government grant income in China; a \$15.6 million pre-tax unfavorable impact (\$17.0 million post-tax) of non-cash interest expense related to the 2019 Convertible Notes, 2024 Convertible Notes, and the Forward Transactions (See Note 4, Long-Term Debt, to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q); a \$2.0 million pre-tax unfavorable impact (\$2.6 million post-tax) from expenses related to regulatory inquiries; a \$0.2 million post-tax unfavorable impact of foreign exchange losses related to Venezuela; a \$1.6 million post-tax unfavorable impact of loss on extinguishment of \$475.0 million of our 2019 Convertible Notes; and a \$4.7 million pre-tax unfavorable impact (\$5.2 million post-tax) of loss on the revaluation of the CVR.

Net income for the six months ended June 30, 2018 included a \$17.9 million pre-tax favorable impact (\$11.8 million post-tax) of government grant income in China; a \$28.1 million pre-tax unfavorable impact (\$29.2 million post-tax) of non-cash interest expense related to the 2019 Convertible Notes, 2024 Convertible Notes, and the Forward Transactions (See Note 4, Long-Term Debt, to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q); a \$4.3 million pre-tax unfavorable impact (\$4.7 million post-tax) from expenses related to regulatory inquiries; a \$4.7 million pre-tax unfavorable impact (\$3.3 million post-tax) of foreign exchange losses related to Venezuela; a \$13.1 million pre-tax unfavorable impact (\$11.0 million post-tax) of loss on extinguishment of \$475.0 million of our 2019 Convertible Notes; and a \$16.0 million pre-tax unfavorable impact (\$13.2 million post-tax) of loss on the revaluation of the CVR.

The income tax impact of the expenses discussed above is based on forecasted items affecting our 2018 full year effective tax rate. Adjustments to forecasted items unrelated to these expenses, as well as impacts related to interim reporting, will have an effect on the income tax impact of these items in subsequent periods.

Net income for the three months ended June 30, 2017 included a \$38.9 million pre-tax favorable impact (\$27.7 million post-tax) of government grant income in China; an \$11.8 million pre-tax unfavorable impact (\$12.6 million post-tax) of non-cash interest expense related to the 2019 Convertible Notes and the Forward Transactions (See Note 4, Long-Term Debt, to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q); a \$2.9 million pre-tax unfavorable impact (\$1.9 million post-tax) from expenses related to regulatory inquiries; a \$1.6 million pre-tax unfavorable impact (\$1.2 million post-tax) related to legal, advisory services and other expenses for our response to allegations and other negative information put forward in the marketplace by a hedge fund manager which started in late 2012; and a \$5.2 million pre-tax unfavorable impact (\$3.5 million post-tax) from expenses related to the implementation of the Consent Order.

Net income for the six months ended June 30, 2017 included a \$38.9 million pre-tax favorable impact (\$27.7 million post-tax) of government grant income in China; a \$23.5 million pre-tax unfavorable impact (\$25.3 million post-tax) of non-cash interest expense related to the 2019 Convertible Notes and the Forward Transactions (See Note 4, Long-Term Debt, to the Condensed Consolidated Financial Statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q); a \$6.7 million pre-tax unfavorable impact (\$4.4 million post-tax) from expenses related to regulatory inquiries; a \$3.1 million pre-tax unfavorable impact (\$2.3 million post-tax) related to legal, advisory services and other expenses for our response to allegations and other negative information put forward in the marketplace by a hedge fund manager which started in late 2012; and a \$13.7 million pre-tax unfavorable impact (\$9.2 million post-tax) from expenses related to the implementation of the Consent Order.

## Results of Operations

Our results of operations for the periods below are not necessarily indicative of results of operations for future periods, which depend upon numerous factors, including our ability to sponsor Members and retain sales leaders, further penetrate existing markets, introduce new products and programs that will help our Members increase their retail

efforts and develop niche market segments.

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The following table sets forth selected results of our operations expressed as a percentage of net sales for the periods indicated:

	Three Months Ended June 30, June 30,		Six Months Ended June 30, June 30,	
	2018	2017	2018	2017
Operations:				
Net sales	100.0%	100.0 %	100.0%	100.0 %
Cost of sales	18.3	19.1	19.3	18.8
Gross profit	81.7	80.9	80.7	81.2
Royalty overrides(1)	27.2	27.8	27.9	28.2
Selling, general, and administrative expenses(1)	39.7	38.6	39.4	39.2
Other operating income	(0.1 )	(3.4 )	(0.7 )	(1.7 )
Operating income				