

HERBALIFE LTD.
Form 10-Q
April 29, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from to .

Commission file number: 1-32381

HERBALIFE LTD.

(Exact name of registrant as specified in its charter)

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

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

P.O. Box 309GT

Ugland House, South Church Street

Grand Cayman, Cayman Islands

(Address of principal executive offices) (Zip code)

(213) 745-0500

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer ☒

Accelerated filer ☐

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

Smaller reporting company ☐

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

Number of shares of registrant's common shares outstanding as of April 24, 2013 was 102,955,950.

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EXPLANATORY NOTE

As previously disclosed, on April 8, 2013, KPMG LLP, or KPMG, notified Herbalife Ltd., or the Company, that KPMG was resigning, effective immediately, as the Company's independent accountant. KPMG stated it had concluded it was not independent because of alleged insider trading in the Company's securities by one of KPMG's former partners who, until April 5, 2013, was the KPMG engagement partner on the Company's audit. KPMG advised the Company it resigned as the Company's independent accountant solely due to the impairment of KPMG's independence resulting from its now former partner's alleged unlawful activities and not for any reason related to the Company's financial statements, its accounting practices, the integrity of the Company's management or for any other reason. While the Company has not engaged a new independent accounting firm, it has begun a search process to identify KPMG's successor.

As a result of the alleged insider trading activity by its now former partner and KPMG's resulting resignation on April 8, 2013, KPMG notified the Company its independence has been impaired and had no option but to withdraw its audit reports on the Company's financial statements for the fiscal years ended December 31, 2010, 2011 and 2012 and the effectiveness of internal control over financial reporting as of December 31, 2010, 2011 and 2012 and that such reports should no longer be relied upon as a result of KPMG's lack of independence created by the circumstances described above. The Company's Audit Committee and management continue to believe that the Company's financial statements covering the referenced periods fairly present, in all material respects, the financial condition and results of operations of the Company as of the end of and for the referenced periods and may continue to be relied upon and that the Company's internal control over financial reporting was effective during these periods.

Also, as a result of KPMG's resignation, the unaudited interim financial information presented in this Quarterly Report on Form 10-Q has not been reviewed by an outside independent accounting firm as required by the rules of the Securities and Exchange Commission, or the SEC. As a result, this Quarterly Report on Form 10-Q is considered deficient and the Company is no longer considered to be timely or current in its filings under the Securities Exchange Act of 1934, as amended, or the Exchange Act. While this filing does not comply with the requirements of Regulation S-X, and should not be interpreted to be a substitute for the review that would normally occur by the Company's independent registered public accounting firm, the Company's Audit Committee and management believe that the interim financial information presented herein fairly presents, in all material respects, the financial condition and results of operations of the Company as of the end of and for the referenced periods and may be relied upon. Except for the absence of this review of the unaudited interim financial information discussed above, this Quarterly Report on Form 10-Q fully complies with the requirements of the Exchange Act and the Company believes it is prudent to file this Report with the SEC in spite of the current circumstances to provide the financial and other information set forth herein to its shareholders and other interested parties. The Company plans to file an amendment to this Quarterly Report on Form 10-Q as soon as practicable following the engagement of a successor independent registered public accounting firm and the firm's review of the Company's interim financial statements included herein.

The CEO and CFO believe, to the best of their knowledge, that the financial statements accurately portray the financial condition of the Company. To that end, they have provided the certifications under Section 302 of SOX. The SOX Section 906 certification is omitted from this filing only because, as a result of KPMG's former partner's actions as described above, the financial statements accompanying this report have not been reviewed by an independent public accountant under SAS 100. The Company believes that this report otherwise meets all of the qualifications of the Exchange Act and the rules and regulations thereunder governing the preparation and filing of periodic reports as referenced in the certifications. Before the Company's officers can make a SOX Section 906 certification, the Company's independent public accounting firm must complete its review of the consolidated financial statements appearing elsewhere in this report under SAS 100, as required by SEC rules. Once the Company's new auditor completes its review of the Company's first quarter 2013 financial statements under SAS 100, the Company will file an amendment to this report with the SOX Section 906 certification.

See Notes 2, *Significant Accounting Policies*, and 14, *Subsequent Events*, to the Condensed Consolidated Financial Statements for information on the matters discussed above.

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

	March 31, 2013 (In thousands, except share and par value amounts)	December 31, 2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 722,474	\$ 333,534
Receivables, net of allowance for doubtful accounts of \$1,988 (2013) and \$2,273 (2012)	112,041	116,139
Inventories	334,412	339,411
Prepaid expenses and other current assets	126,465	125,425
Deferred income taxes	50,622	49,339
Total current assets	1,346,014	963,848
Property, at cost, net of accumulated depreciation and amortization of \$272,728 (2013) and \$255,862 (2012)	246,682	242,886
Deferred compensation plan assets	25,074	24,267
Deferred financing costs, net	6,809	7,462
Other assets	48,141	48,805
Marketing related intangibles and other intangible assets, net	311,090	311,186
Goodwill	105,490	105,490
Total assets	\$ 2,089,300	\$ 1,703,944
LIABILITIES AND SHAREHOLDERS EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 79,109	\$ 75,209
Royalty overrides	221,814	243,351
Accrued compensation	66,719	95,220
Accrued expenses	195,466	181,523
Current portion of long-term debt	62,807	56,302
Advance sales deposits	44,684	49,432
Income taxes payable	26,272	15,854
Total current liabilities	696,871	716,891
NON-CURRENT LIABILITIES:		
Long-term debt, net of current portion	912,517	431,305
Deferred compensation plan liability	32,529	29,454
Deferred income taxes	59,888	62,982
Other non-current liabilities	44,550	42,557
Total liabilities	1,746,355	1,283,189

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CONTINGENCIES

SHAREHOLDERS' EQUITY:

Common shares, \$0.001 par value; 1.0 billion shares authorized; 103.0 million (2013) and 106.9 million (2012) shares outstanding	103	107
Paid-in-capital in excess of par value	299,391	303,975
Accumulated other comprehensive loss	(41,711)	(31,695)
Retained earnings	85,162	148,368
Total shareholders' equity	342,945	420,755

Total liabilities and shareholders' equity	\$ 2,089,300	\$ 1,703,944
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See the accompanying notes to unaudited and unreviewed condensed consolidated financial statements.

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HERBALIFE LTD. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited and Unreviewed)

	Three Months Ended	
	March 31, 2013	March 31, 2012
	(In thousands, except per share amounts)	
Product sales	\$ 951,583	\$ 821,646
Shipping & handling revenues	172,064	142,529
Net sales	1,123,647	964,175
Cost of sales	225,977	196,144
Gross profit	897,670	768,031
Royalty overrides	364,029	317,533
Selling, general & administrative expenses	364,720	296,393
Operating income	168,921	154,105
Interest expense, net	5,373	1,373
Income before income taxes	163,548	152,732
Income taxes	44,692	44,570
NET INCOME	\$ 118,856	\$ 108,162
Earnings per share:		
Basic	\$ 1.14	\$ 0.93
Diluted	\$ 1.10	\$ 0.88
Weighted average shares outstanding:		
Basic	104,121	116,191
Diluted	108,068	122,373
Dividends declared per share	\$ 0.30	\$ 0.30

See the accompanying notes to unaudited and unreviewed condensed consolidated financial statements.

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HERBALIFE LTD. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited and Unreviewed)

	Three Months Ended	
	March 31,	March 31,
	2013	2012
	(In thousands)	
Net income	\$ 118,856	\$ 108,162
Other comprehensive income (loss):		
Foreign currency translation adjustment, net of income taxes of \$(305) and \$1,757 for the three months ended March 31, 2013 and 2012, respectively	(8,684)	11,219
Unrealized (loss) gain on derivatives, net of income taxes of \$(507) and \$(641) for the three months ended March 31, 2013 and 2012, respectively	(1,332)	(1,722)
Total other comprehensive income (loss)	(10,016)	9,497
Total comprehensive income	\$ 108,840	\$ 117,659

See the accompanying notes to unaudited and unreviewed condensed consolidated financial statements.

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

	Three Months Ended	
	March 31, 2013	March 31, 2012
	(In thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 118,856	\$ 108,162
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	20,964	18,590
Excess tax benefits from share-based payment arrangements	(447)	(20,675)
Share-based compensation expenses	7,866	7,227
Amortization of deferred financing costs	650	286
Deferred income taxes	(3,773)	(597)
Unrealized foreign exchange transaction (gain) loss	(10,971)	(3,868)
Foreign exchange loss from Venezuela currency devaluation	15,116	
Other	(890)	391
Changes in operating assets and liabilities:		
Receivables	3,216	(14,759)
Inventories	5,012	9,742
Prepaid expenses and other current assets	(8,200)	(4,029)
Other assets	(15)	(905)
Accounts payable	4,900	11,496
Royalty overrides	(21,472)	(2,302)
Accrued expenses and accrued compensation	(15,517)	(17,373)
Advance sales deposits	(3,857)	9,062
Income taxes	23,114	16,489
Deferred compensation plan liability	3,075	3,431
NET CASH PROVIDED BY OPERATING ACTIVITIES	137,627	120,368
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of property, plant and equipment	(24,856)	(24,691)
Proceeds from sale of property, plant and equipment	24	15
Deferred compensation plan assets		(2,552)
NET CASH USED IN INVESTING ACTIVITIES	(24,832)	(27,228)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(30,904)	(35,172)
Borrowings from long-term debt	513,223	114,560
Principal payments on long-term debt	(25,509)	