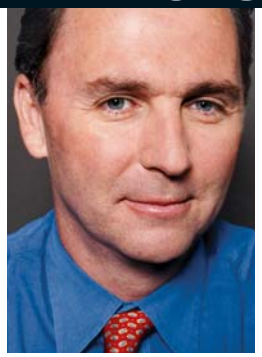


BY ROBERT BARKER

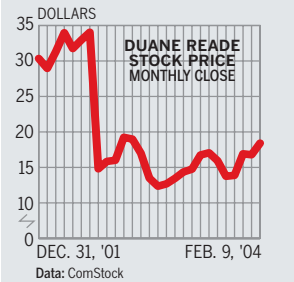
What's That Smell At Duane Reade?

The trouble with value stocks is that the value sometimes gets away. That may soon happen at Duane Reade, New York City's dominant drugstore chain. Along with the city, Duane Reade suffered through the fierce bear market in stocks and, worse, September 11: Its most lucrative store had been a World Trade Center fixture. Such extraordinary woes, plus the costs of an ambitious expansion, have been weighing on the stock (chart).

Then, two days before Christmas, a surprise arrived. Duane Reade announced it had agreed to be bought out by Oak Hill Capital Partners, a private-equity firm founded by Texas billionaire Robert Bass. That day, the stock rose 12%, to 17 a share, the price Oak Hill is offering public shareholders. "We are confident that this agreement delivers excellent value," said Duane Reade CEO Anthony Cuti. Yet some big investors beg to differ. One, Copper Arch Capital, a New York firm with 7.8% of Duane Reade, may start a proxy fight to kill the deal. A letter from Copper Arch Chairman Scott Sipprelle to Duane Reade's outside directors puts the company's minimum value at $27.75 a share—some $260 million more than the bid.

THIS WOULD BE OF MERE passing interest on the sidewalks of New York, and of nil interest beyond the metropolis, if not for the expectation among some investors that reforms are leveling Wall Street's playing field. In this case, several big investors are crying "tilt." As Roger King of King Investment Advisors, holder of nearly 1.3 million Duane Reade shares, told me: "Something about this just doesn't pass the smell test."

CONDITION: STABLE



Founded in 1960 as one store in lower Manhattan, the chain by 1997 counted 67 outlets. Then controlled by Donaldson, Lufkin & Jenrette, it went public in 1998 at 16.50 a share. The stock was a hit right off, opening on the NYSE at 22. With this and a 2001 sale of stock at 34.50, DLJ (by then a part of Credit Suisse First Boston) profited handsomely on its investment, having paid $8.33 a share.

The heroes were a pair of DLJ managing directors, Andrew Nathanson and David Jaffe. After Duane Reade went public, both also sat on its board, where Jaffe still serves as chairman of the compensation committee. Nathanson left the board after a couple of years. He is now managing partner of Oak Hill Capital. Yes, this is the same Oak Hill that is offering $17 a share to buy Duane Reade. Neither Nathanson nor Jaffe, now a managing director of private-equity firm Centre Partners Management, returned my phone calls.

A proxy statement with details of how the deal came together is due any day. One plain explanation is that Duane Reade still faces such risks that it drew no better bid than Oak Hill's. But longtime investors are dubious. They note that prospects for the chain's 241 stores are brightening in step with those of Wall Street and the metropolitan economy. Foot traffic is rising in lower Manhattan, with the recent reopening of a subway stop at Ground Zero a particular boost. They also complain that Cuti is set to keep his job and share in Duane Reade's revival as an investor, while they will be frozen out. "Duane Greed" is what one investor now calls the company.

A value-investing firm with over 10% of Duane Reade is Westport Asset Management. It has held its stake since 1998. Chief Investment Officer Andy Knuth sees Duane Reade very simply. "If a private equity group thinks it's worth $17 [a share] now, then they must think it's worth more later," he told me. And with Cuti keeping an equity stake, he adds: "I bet there will be an initial public offering of the company within three years." No reformer has yet changed this Wall Street rule: Value investing is good; value investing from the inside can't be beat.

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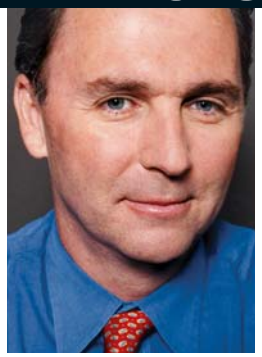
(TOP TO BOTTOM) PHOTOGRAPHS BY ETHAN HILL; FRANCES M. ROBERTS; CHART BY ALBERTO MENA/BW



BY ROBERT BARKER

Why Microsoft's Cash Makes It a Bargain

Is it safe to buy Microsoft yet? It's certainly an odd thing to ask about a stock that's up 34,186% since its 1986 debut. And if it says more about my aversion to risk than it does about Microsoft, so be it. Cash is as easy to lose on Wall Street as it is rare to find on a sidewalk: Buyers of the stock four years ago have 50¢ on the dollar now.

Still, with Microsoft near $25, its shares are getting hard to resist. In a minute, I'll explain my reasons why, but it's not because I have some special clue about Microsoft's fiscal third-quarter profit report, set for Apr. 22. Nor is it because the next version of Windows is sure to reignite the glory of 1996-2000, when net income quintupled. I'm simply betting that even amid such clear business risks as Linux, the stock offers a rich potential reward precisely because of where those wildly profitable years have put Microsoft today.

IN OTHER WORDS, it's all about the cash—specifically, the 53 billion greenbacks, give or take a few hundred million, in Microsoft's coffers, plus the billion or more that its operations mint each month. This financial muscle gives Microsoft unprecedented leeway to treat shareholders handsomely, even in an expected era of slower growth in sales and profits.

To see what I mean, let's walk through some numbers. In this fiscal year, ending June 30, Microsoft sees sales growing 11%, to nearly $36 billion. Operating income, it estimates, will climb 10%, to perhaps $10.5 billion, which should be good for earnings per share of up to $1.18. (Note: This excludes the 35¢ a share that Microsoft, famously conservative in its accounting, is deducting for the cost of options and other stock-based pay. Few companies do this yet, so to compare Microsoft, an adjustment is necessary.)

Now assume Microsoft's growth slows. A lot. Suppose in each of the next three fiscal years, net income grows not 40%, as it did last year, or 20% as it might this year, but 7%. How could investors stand for that? Because of Microsoft's hoard of cash. A comfort when it was besieged by rivals and regulators, the cash can now power the stock. As the fearsome monopolist makes nice, settling lawsuit after lawsuit, look for it also to convert the cash that's left over after legal settlements from a low-earning security blanket into higher returns for investors.

Its coffers could power the stock if growth slows

One obvious way is via dividends. Microsoft paid its first in March, 2003, and doubled it in November, to 16¢ a share, when it noted that it will review its dividend policy each year. It could easily triple the payout, giving the stock a middling yield of 1.9%, and at current operating rates still have up to $10 billion in annual cash flow even after spending on research, product development, and capital projects.

A more potent move would be reducing public shares. After rising steadily, the tide already has turned, with the number of fully diluted shares outstanding falling 2.5%, to 10.9 billion, in 2½ years. Suppose Microsoft devoted just half of its $53 billion in cash to repurchases. It could buy back a billion shares over, say, three years, lowering the total by over 9%. The effect: Even if net income rose just 7% a year, earnings per share could grow an average of 10.5% annually. With an average dividend yield of 1.7%, a buyer of Microsoft at $25 could reasonably expect a 12% annual return at low risk.

Will Microsoft precisely adopt my shareholder-rewards program? Doubtful. But the point is, Microsoft holds the easily realizable potential to please investors. Another way to view this value is by adjusting Microsoft's stock price for the strength of its balance sheet (table). If Microsoft were to pay off all of its liabilities—every last penny—it still would have $3.32 a share left over in cash. Subtract that from its recent $25 stock price, and the cost of Microsoft's underlying businesses is closer to $21.68 a share. That's 18 times fiscal 2004 earnings, when the Standard & Poor's 500-stock index sells for 21 times. Mighty Microsoft is selling at a discount. ■

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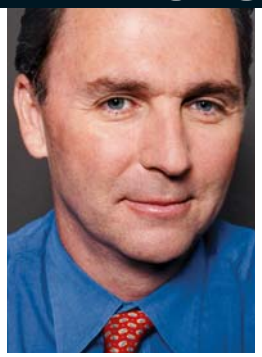
Discount Time

Recent price per share		**$25.00**
Cash and short-term investments, per share	**4.84**	
Total liabilities, per share	**–1.52**	
Net cash, per share	**3.32**	
Adjusted price of Microsoft's underlying business, per share		**21.68**
Estimated earnings per share, fiscal year ending on June 30		**1.18***
Adjusted price-earnings ratio (21.68÷1.18)		**18.4**
Standard & Poor's 500 p-e ratio, year ending on June 30		**21.0**

*Excluding charges for stock-based compensation
Data: Company reports, Standard & Poor's, *BusinessWeek*

PHOTOGRAPH BY ETHAN HILL



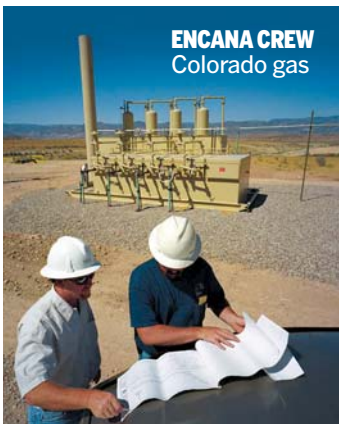
BY ROBERT BARKER

Keeping Hot Air Out of Energy Reserves

Humiliations in the Royal Dutch/Shell affair are many. Yet from the company's report on how it misstated oil and gas reserves, the most amazing lapse leaps out. Get this: The world's No. 2 energy producer relied on a lone former employee to audit its annual estimate of reserves—and he worked part-time.

It's enough to make you think Arthur Andersen had scruples. It's also enough to make you take the pledge against oil stocks. If you're still tempted, spend a few fruitful minutes with Shell's report (downloadable from shell.com/static/investor-en/downloads/gac_report.pdf). Soon you will be asking: How can I trust an oil company? Like banks, whose chief assets are loans that are impossible for everyday investors to evaluate, and insurers, whose policy risks are similarly hellish to grasp, energy producers' reserves are estimates built atop umpteen variables, a confounding mystery even sometimes to the companies themselves.

YET, AS USUAL, THERE are distinctions. You can see a big one in EnCana, Canada's top oil and gas producer. After its Apr. 15 bid to buy natural gas rival Tom Brown, EnCana's shares sold off 8%. Predictable, perhaps. But to me, the stock, lately near $42, offers an opportunity. Why? First, EnCana has a fine track record exploiting assets such as Tom Brown's, many of which lie next to some of its own in Colorado and Wyoming.



ENCANA CREW
Colorado gas

Second, EnCana comes up with its reserves estimates in a distinctive way. It hires outside consultants to do the job.

How unusual this is you can see from the table below. Some companies, particularly supermajors such as Shell, do the estimating themselves, with internal audits. Many others make their own estimates and then hire outsiders to audit. Some, such as Devon Energy, use a blended process. Consultants estimate a third of its reserves each year so they're all done by outsiders every three years.

Which way is best? It's a big industry debate. In a recent speech, Anadarko Petroleum CEO Jim Hackett defended internal estimates. "At the end of the day," he said, "investors are going to hold Anadarko accountable for our reserve estimates—not an outside consulting firm." EnCana CEO Gwyn Morgan told me he did not want to imply that other companies with internal estimates report "bad numbers." But then he added: "It's easier for investors to look at a completely independent process and have a higher degree of confidence." Are Anadarko's estimates, made by insiders and reviewed by a team of four insiders and one outsider, necessarily shakier? No. And as investors in Enron learned, venality can undermine any audit, even if a once-reputable firm such as Andersen does it.

Just the same, if you want to invest in energy, it's worth listening to someone who learned the hard way how difficult it can be to do the right thing while a paycheck hangs in the balance. Shell's former part-time auditor of oil and gas reserves, Anton Barendregt, told company investigators that in his first years as auditor, operating unit execs would object whenever he raised a red flag. Without his own engineering, financial, or legal allies, he quickly caved in. Soon he stopped raising red flags. "With hindsight, I should have been more forceful in this respect," he concluded. "It would have been a clear break with all my predecessors, and it would probably have cost me my job, but I should have."

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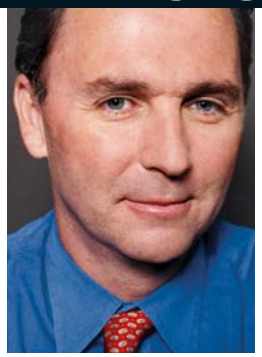
Outside Opinions?

How petroleum reserves are estimated and who reviews the estimates is decided company by company. Major integrated producers often do most of the work in-house. Independents often hire outside consultants:

COMPANY SYMBOL	WHO ESTIMATED THE RESERVES	WHO REVIEWED THE ESTIMATES	PERCENTAGE OF 2003 RESERVES REVIEWED BY OUTSIDERS
Anadarko Petroleum APC	Insiders	Team of four insiders, one consultant	**50%**
Apache APA	Insiders	Consultants	**76**
Burlington Resources BR	Insiders	Consultants	**80**
Devon Energy DVN	Insiders and consultants	Insiders and consultants	**63**
EnCana ECA	Consultants	Consultants	**100**

Data: Company reports, BusinessWeek

(TOP TO BOTTOM) PHOTOGRAPH BY ETHAN HILL; COURTESY ENCANA CORP.



BY ROBERT BARKER

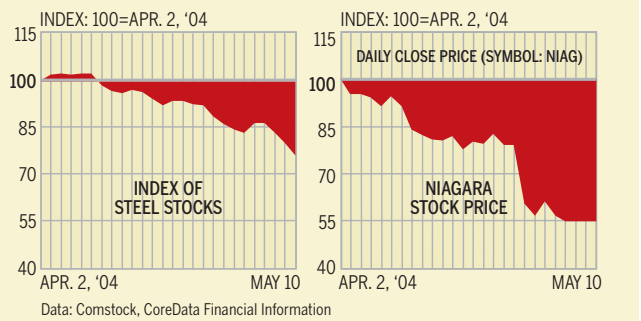
When Companies 'Go Dark,' Investors Can Lose

At 37 minutes past 6 p.m. on Apr. 27, Niagara Corp. filed its quarterly profit report. The steelmaker, which took in revenues of $295 million in 2003, is little-known yet in some ways extraordinary. For one, Niagara enjoys solid standing with Detroit, which uses its specialty bars for such critical systems as steering racks. For another, its headquarters can be found within one of Manhattan's most elegant towers, 667 Madison Ave. And, after years of tough industry conditions, the financial news from Niagara's home office that day was most special: First-quarter sales had risen 24%, while earnings per share doubled. CEO Michael Scharf pronounced the results "excellent."

INVESTORS, WHO HAVE TRADED Niagara shares since Scharf took it public in 1993, had to be delighted. They also had no time to celebrate. Nine minutes later, Niagara filed notice that it would deregister its stock with the Securities & Exchange Commission, stop filing public reports and proxy statements, and delist from NASDAQ. Trading over the counter, the stock plunged and lately rests about 30% lower, near $3.64 (chart).

This nightmare is growing. Two University of Alberta economists, Nadia Massoud and Andras Marosi, combed SEC filings and counted 135 deregistrations unrelated to mergers last year, up from 46 in 2001 and 75 in 2002. In a 36-stock sample, they also found that stocks lost an average of more than 12% within two trading days of deregistration news. "It's a mystery to me why the SEC is not focusing on this," said Nelson Obus, president of Wynnefield Capital, which owns 6% of Niagara. "It's a cancer in the confidence that has to exist between management and investors."

NIAGARA FALLS



Data: Comstock, CoreData Financial Information

Companies may deregister, or "go dark," if they have fewer than 300 shareholders of record (500 if assets fall below $10 million). With $186 million in assets, Niagara had 124 shareholders of record, but it likely has more actual holders because many accounts are in brokers' names. This criterion for deregistration is being challenged by a group of investors who last July petitioned the SEC to count ultimate shareholders, not just registered ones, in permitting companies to go dark. SEC staffers still are studying the issue.

Sarbanes-Oxley is raising the cost of being public

Why would Niagara deregister? Scharf's critics see him as an excellent operating executive with a stellar record of delivering big gains to investors in earlier metals companies. But some speculate that Scharf aims to depress its value, buy a majority, and perhaps take over the company for a song. He owns 37% of the stock, and a brother, Gilbert, owns another 7%. Others worry that Scharf, who in 2003 received a salary and bonus of $880,000, up from $680,000 in 2002 and $480,000 in 2001, will enrich himself now that Niagara need not disclose executive pay.

Scharf told me none of these worries is valid. "I create shareholder value—that's what I try to do," he said. Instead, driving Niagara's decision were the rising costs of staying public under the Sarbanes-Oxley Act and other new rules. Scharf was vague, however, about his estimate of the cost of staying public, putting it at "hundreds of thousands of dollars on an annual basis." This seems small next to the $10 million in market value Niagara lost the week it quit NASDAQ. Scharf also said he did not know how many investors own the stock, even though public companies use such a count in mailing proxies. Finally, he would not elaborate on how much weight Niagara's board gave a NASDAQ rule that this year would have forced it to have a majority of independent directors. It has six directors, with just three independent. One, Andrew Heyer, did not return my calls, and Scharf declined to help me reach the other two. "I am the spokesman," he said.

What should you make of all this? First, small-cap stocks have had a great run, but the risk of sudden deregistration is growing. Second, with vast disclosures and SEC scrutiny, it's no snap for a company to issue stock and take the public's money. But once public, it shouldn't be a snap to go dark. ■

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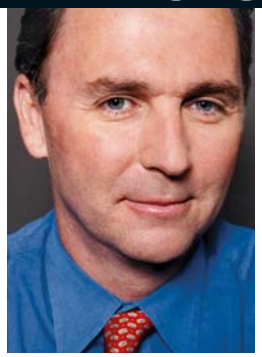
(TOP) PHOTOGRAPH BY ETHAN HILL; CHART BY RAY VELLA/BW



BY ROBERT BARKER

This IPO Flunks the Close Scrutiny Test

Whatever its ultimate merits, the federal No Child Left Behind Act education reform has already achieved what I had imagined to be impossible: It has expanded the universe of anxieties plaguing parents. The NCLB promotes "high-stakes" tests—the sort that if kids fail, they may get to spend a second year in third grade or to exit high school without a diploma.

To give their kids a boost, more parents are paying for tutors. That's a reason such test prep outfits as Princeton Review saw sales in its elementary- and secondary-school segment soar by 72%.

Now here comes Educate, the Baltimore parent of the nation's leading tutoring chain, Sylvan Learning Centers, with 1,039 outposts in North America. Led by Goldman Sachs, Educate aims soon to sell stock in an initial public offering estimated at $225 million. Given Sylvan's good reputation and the fast growth in supplemental educational services—more of them now sold to public schools and funded by the feds—you might be tempted to ask your broker for shares. My advice: Don't. I say that not because Educate isn't growing. First-half revenue rose 33%, to $169 million. But when you think about Educate, don't forget your ABCs.

A as in Audit Committee. In many IPOs, selling stockholders don't give up control. They aren't in this case, either, as Educate's chief owner, private equity firm Apollo Advisors, plans to keep 53%. An example of this control is Educate's decision to wait up to a year to comply with a rule that only independent directors serve on the board's audit committee. Instead the panel will be headed temporarily by an Apollo principal until the board finds the right outsider. Kevin Shaffer, Educate's chief financial officer, said this is a "critical position," so the board is conducting a thorough search. He hopes it will be done within six months.

B as in Balance Sheet. Of the 15 million shares set to go in the IPO at an estimated $15 each, 10 million are being dumped by current owners, principally Apollo. None of the proceeds will go to Educate, which figures to net just $67.5 million. All of that is going to repay some of the debt the company took on when Apollo acquired it. Educate owes this money to a syndicate of lenders, including three of the IPO's top underwriters, J.P. Morgan Chase, Merrill Lynch, and Bank of America. Assuming all goes as planned, Educate still will owe long-term debt of $106 million—all of it at variable interest rates. Some of that risk is hedged via interest-rate swaps. But as its registration statement notes, if rates go up, "our interest expense would increase, our ability to borrow additional funds may be reduced, and the risks related to our substantial indebtedness would intensify."

GOOD LESSON? The money raised will go to pay back some of Educate's debt

C as in Cost. The IPO is set to value Educate at some $790 million. That is, $639 million in equity value, plus the $152 million in net debt now on its books. Is that reasonable? We have a couple of points of comparison. The first is Princeton Review, which has no net debt. The market values its equity near $195 million, or 1.7 times revenue over the past four quarters. Educate is set to sell its stock at 2.8 times trailing revenue. Next we can look at what Apollo paid for Sylvan's operations, which form the bulk of what is now Educate. Apollo's purchase closed in June, 2003, at a price of $283 million. That was 1.3 times the prior year's revenues. Shaffer notes that Sylvan is now refocused on better opportunities, such as NCLB.

Put it together, and what all this spells to me is a test of how to make money on Wall Street. But only the sellers will pass. ■

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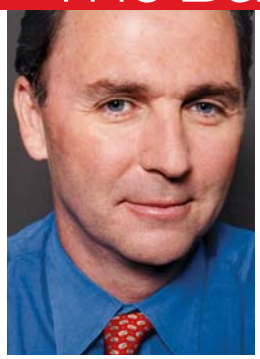
Studying Educate

Revenue	$283.9
Operating income	31.2
Net income	8.5
Net debt	152.3
Indicated market cap	638.6
Tentative symbol	EEEE

Data, in millions, for 12 months ended June 30; net income is from continuing operations
Data: Company reports

(FROM TOP) PHOTOGRAPHS BY ETHAN HILL; DON RYAN/AP/WIDE WORLD



BY ROBERT BARKER

Why a Big-Spending EBay Is a Bummer

See the latest eBay ads. Take a deep, cleansing breath. "People are good," the ads say. "They're joining a community where anything is possible if we all put our mind to it, and believe. EBay. The Power Of All Of Us." A nation, a world that we lately have found so harshly divided can be, on eBay, joyfully one.

If this were 1954, someone would call it a commie plot. Instead, Planet Earth's biggest flea market aims to be our common denominator. (Whether it's our lowest, I'll leave to you; to me, it's a mystery how the Age of Aquarius turned into the Age of Auctions.) As a business, anyway, eBay has made much progress. Next year, when it turns all of 10 years old, eBay expects $4.2 billion in revenue and nearly $1 billion in net income. The stock, a split-adjusted $1.50 at its 1998 initial public offering, recently topped $110. Powering that move—and differentiating eBay sharply from busts of the Internet bubble—was steady growth in cash flow. Even after capital spending and what little it spent on acquisitions, eBay generated megabucks to spare.

UNTIL NOW. EBAY'S most recent financials reveal a notable development in how the company is seeking future growth. You can see what I mean in the table below. Since 2000, each year has brought smart increases in eBay's cash from operations, minus capital spending and acquisitions. Last year, the surplus came to $292 million. But this year through Sept. 30, eBay had spent $10 million more in cash than it generated. In the comparable 2003 period, it had a surplus of $230 million.

What's going on? Acquisitions. In April, eBay spent $152 million to buy a German classified advertising site, mobile.de. In August, it paid $50 million for Baazee.com, an auction site in India. A month later, it raised its stake in a Korean trading site, Internet Auction, to 97% from 62% at a cost of $485 million.

Lifted by holiday shoppers, the current quarter will surely swell eBay's cash flow. But eBay also is shopping. In October, it bought most of Internet Auction's remaining shares for $37 million. On Nov. 11, it announced a $290 million deal for a Dutch classifieds site, Marktplaats.nl. Whether eBay ends 2004 having generated more cash than it used is questionable. Beyond doubt is that cash flow after capital projects and acquisitions this year will plunge below levels the past two years.

OUTREACH EBay has bought sites from Germany and the Netherlands to Korea and Taiwan

Don't get me wrong. EBay is itself in no financial danger. Its balance sheet shows nearly $2.1 billion in cash and short-term investments against less than $125 million in borrowings. So it plainly can afford this shopping excursion. Just the same, accelerated outlays raise a couple of warning flags for those investors who have vaulted the company's market value above $73 billion, past even American Express, never mind such humdrum retailers as Target ($46 billion) or Amazon.com ($16 billion).

First, the aim of anybody who owns a business is to get cash out of it. EBay easily could pay cash dividends to investors now but believes it can make the capital grow faster internally. "We expect to return excess cash to our shareholders at one point in the future," a spokesman told me via e-mail. "However, considering eBay's stage of growth, we don't believe that point is right now." Second, taking eBay's surplus cash and spending it on mostly foreign Internet sites could pay off as nicely as investing in its original domestic business has proved. But those potential rewards come at higher risks. In Taiwan, for example, eBay's auction site is locked in the kind of market-share war it never faced at home.

So, yes, go ahead. Take a deep, cleansing breath. Join the eBay believers: People are good. Just remember that when people elect to pay 17 times next year's sales and 75 times next year's earnings, they're usually good and stupid. ■

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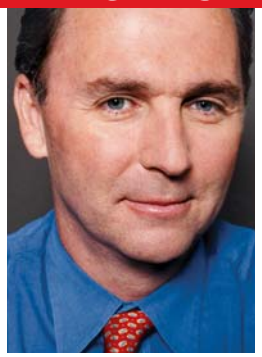
In the Mood to Shop

	2000	2001	2002	2003	2004*
Cash Flow from Operations	$100	$252	$480	$874	$904
Capital Spending	50	57	139	365	210
Acquisitions	0	112	59	216	704
Cash Flow after Capital Spending and Acquisitions	50	83	282	292	-10

In millions *Nine months ended Sept. 30 **Data:** Company reports

(TOP) PHOTOGRAPH BY ETHAN HILL



BY ROBERT BARKER

Suppress Your Appetite For Herbalife

Always a curious company, Herbalife just gets curiouser. The direct-sales marketer of dietary supplements grew like crazy from its founding in 1980 by high school dropout Mark Hughes. Today its Web site still features paeans to Hughes, plus a gallery of his photos. Yet it avoids mentioning the fact that he is long dead.

Strange, unless you sell such items as Relax Now, a jujube, ashwagandha, and passionflower combo that Herbalife says eases anxiety and stress. Especially strange since Hughes died at 44 in May, 2000, after a four-day alcoholic binge. The coroner found the booze didn't mix well with Doxepin, a prescription antidepressant Hughes had been taking. Nor did Hughes' death fit with the healthful image he nurtured as Herbalife's salesman-in-chief. When I asked why Herbalife's site features Hughes yet makes no mention of his passing, a spokeswoman told me the company is staying quiet while regulators review its plan for an initial public offering of stock. Its prospectus does note Hughes' death, but skips over how he died.

That alone is reason enough for investors to do their own skipping—right past this deal. But if you're among the morbidly curious, you might want to examine it more closely. Led by Merrill Lynch and Morgan Stanley, the IPO is estimated to come at $15.50 a share, raising some $225 million. In a flurry of transfers, most of that will go to Herbalife's owners, a pair of private-equity funds, Whitney & Co. and Golden Gate Capital. Some will repay part of what the company borrowed when Whitney and Golden Gate took it private in July, 2002. None will go to the benefit of investors, who stand to get 22% of Herbalife at the IPO.

How is Herbalife doing under its new owners? In some ways, better. Sales in 2002 were $1.1 billion. In the last four quarters, they reached nearly $1.3 billion. Net income, however, has only edged up, to $24 million in the past year from $23 million in 2002. Despite rebrandings and new formulations for some diet supplements—the company eliminated appetite-suppressant ephedra in 2002 and cut back on another, citrus aurantium, this year—Herbalife also depends more than ever on its mainstay, Formula 1 Nutritional Shake Mix. In 2004's first nine months, Formula 1 delivered 23% of sales, up from 21% in 2002.

Herbalife's Vital Signs

Revenue	$1,268
Operating Income	$123
Net Income	$24
Net Debt	$337
Indicated Equity Value	$1,022
Symbol*	HLF

Dollars in millions; income statement data for 12 months ended Sept. 30, 2004; net debt as of that date
*Tentative

Data: Company reports

VEXING EXIT Founder Hughes's death didn't fit the healthful image Herbalife cultivated

To push its products, Herbalife counts on an army of some one million independent distributors in 59 countries. These are the people that Hughes, with a rags-to-riches story of launching Herbalife from his car's trunk, proved so talented at firing up. But it's hardly steadily remunerative work, as the churn in Herbalife's ranks attests. At the last annual count, nearly 100% of distributors below the level of supervisor had turned over, as did 71% of the 191,000 supervisors.

So recruitment and inspiration remain vital to Herbalife. That's now the job of CEO Michael Johnson, who comes to it with a background different from Hughes's. After 17 years at Walt Disney, Johnson joined Herbalife in April, 2003, with a grant of nearly 3 million stock options. In his first year, his salary and bonus totaled $2.2 million. Is that a big nut for a $1.3 billion company? Yes. At Avon (2003 sales, $6.8 billion), CEO Andrea Jung last year received $2.5 million in salary and bonus, or 0.2% of operating income. Johnson's annual take came to more than 2% of Herbalife's 2003 operating income.

Herbalife is daring to go public at an equity value of more than $1 billion. That, plus its debt, would give the company a total buyout value near $1.3 billion, or one times 2004 sales. In 2002, Whitney and Golden Gate paid $652 million, or 0.6 times sales. I wonder what investors would pay if Herbalife's prospectus came with a copy of Hughes's autopsy report (Los Angeles County Coroner, Case No. 2000-03682).

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