

MEDIFAST INC  
Form 10-Q  
November 08, 2007

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

**FORM 10-Q**

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

For the quarterly period ended September 30, 2007

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 0-23016

**MEDIFAST, INC.**  
(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction  
of organization)

**13-3714405**  
(I.R.S. employer  
identification no.)

**11445 Cronhill Drive  
Owings Mills, MD 21117  
Telephone Number (410) 581-8042**

Indicate by checkmark 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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by checkmark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Edgar Filing: MEDIFAST INC - Form 10-Q

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

<b>Class</b>	<b>Outstanding at November 7, 2007</b>
Common stock, \$.001 par value per share	13,709,098 shares

1

---

## Index

**Part I****Financial Information:**

Condensed Consolidated Balance Sheets - September 30, 2007 (unaudited) and December 31, 2006 (audited)	3
Condensed Consolidated Statements of Income - Three and Nine Months Ended September 30, 2007 and 2006 (unaudited)	4
Condensed Consolidated Statements of Cash Flows - Nine Months Ended September 30, 2007 and 2006 (unaudited)	5
Notes to Condensed Consolidated Financial Statements	7
Management Discussion and Analysis of Financial Condition and Results of Operations	14

**Part II**

Exhibits	22
EX 31.1	
EX 31.2	
EX 32.1	

**MEDIFAST, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

	(Unaudited) September 30, 2007	(Audited) (Restated) December 31, 2006
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 2,102,000	\$ 1,085,000
Accounts receivable-net of allowance for doubtful accounts of \$100,000	425,000	448,000
Inventory	8,471,000	8,255,000
Investment securities	1,477,000	1,540,000
Deferred compensation	830,000	673,000
Prepaid expenses and other current assets	3,208,000	2,599,000
Note receivable - current	174,000	174,000
Current portion of deferred tax asset	91,000	90,000
<b>Total current assets</b>	<b>16,778,000</b>	<b>14,864,000</b>
Property, plant and equipment - net	16,005,000	14,020,000
Trademarks and intangibles - net	5,749,000	5,874,000
Deferred tax asset, net of current portion	807,000	517,000
Note receivable, net of current assets	1,250,000	1,355,000
Other assets	84,000	47,000
<b>TOTAL ASSETS</b>	<b>\$ 40,673,000</b>	<b>\$ 36,677,000</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued expenses	\$ 2,805,000	\$ 2,913,000
Income taxes payable	101,000	535,000
Line of credit	-	1,256,000
Current maturities of long-term debt	1,460,000	548,000
<b>Total current liabilities</b>	<b>4,366,000</b>	<b>5,252,000</b>
<b>Other liabilities and deferred credits</b>		
Long-term debt, net of current portion	4,615,000	3,509,000
<b>Total liabilities</b>	<b>8,981,000</b>	<b>8,761,000</b>
<b>Stockholders' Equity:</b>		
Preferred stock, \$.001 par value (1,500,000 authorized, no shares issued and outstanding)	-	-
Common stock; par value \$.001 per share; 20,000,000 shares authorized; 13,709,098 and 13,631,898 shares issued and outstanding	14,000	14,000
Additional paid-in capital	26,930,000	26,629,000

Edgar Filing: MEDIFAST INC - Form 10-Q

Accumulated other comprehensive income	367,000	334,000
Retained earnings	9,216,000	5,981,000
	<b>36,527,000</b>	<b>32,958,000</b>
Less: cost of 270,534 and 249,184 shares of common stock in treasury	(1,971,000)	(1,686,000)
Less: Unearned compensation	(2,864,000)	(3,356,000)
<b>Total stockholders' equity</b>	<b>31,692,000</b>	<b>27,916,000</b>
<b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b>	<b>\$ 40,673,000</b>	<b>\$ 36,677,000</b>

See accompanying notes to condensed consolidated financial statements.

3

---

**MEDIFAST, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006 (Restated)	2007	2006 (Restated)
Revenue	\$ 21,846,000	\$ 19,642,000	\$ 63,975,000	\$ 58,779,000
Cost of sales	5,523,000	4,705,000	15,944,000	14,334,000
<b>Gross Profit</b>	<b>16,323,000</b>	<b>14,937,000</b>	<b>48,031,000</b>	<b>44,445,000</b>
Selling, general, and administration	14,766,000	13,166,000	43,116,000	37,362,000
<b>Income from operations</b>	<b>1,557,000</b>	<b>1,771,000</b>	<b>4,915,000</b>	<b>7,083,000</b>
Other income/(expense)				
Interest expense, net	(159,000)	(42,000)	(284,000)	(134,000)
Other income	2,000	24,000	90,000	184,000
	(157,000)	(18,000)	(194,000)	50,000
<b>Income before provision for income taxes</b>	<b>1,400,000</b>	<b>1,753,000</b>	<b>4,721,000</b>	<b>7,133,000</b>
Provision for income tax (expense)	(446,000)	(298,000)	(1,486,000)	(2,219,000)
<b>Net income</b>	<b>\$ 954,000</b>	<b>\$ 1,455,000</b>	<b>\$ 3,235,000</b>	<b>\$ 4,914,000</b>
Basic earnings per share	\$ 0.07	\$ 0.11	\$ 0.25	\$ 0.39
Diluted earnings per share	\$ 0.07	\$ 0.11	\$ 0.24	\$ 0.36
Weighted average shares outstanding -				
Basic	12,982,730	12,767,629	12,939,562	12,657,842
Diluted	13,683,809	13,603,208	13,640,641	13,493,421

See accompanying notes to condensed consolidated financial statements.

**MEDIFAST, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	Nine Months Ended September 30,	
	2007	2006 (Restated)
<b>Cash flows from operating activities:</b>		
Net income	\$ 3,235,000	\$ 4,914,000
Adjustments to reconcile net income to net cash provided by operating activities from continuing operations:		
Depreciation and amortization	2,536,000	1,633,000
Realized (gain) loss on investment securities	43,000	(62,000)
Loss on sale of Consumer Choice Systems	-	323,000
Common stock issued for services	21,000	64,000
Stock options vested during period	77,000	18,000
Excess tax benefits from share-based payment arrangements	(30,000)	6,000
Vesting of unearned compensation	492,000	346,000
Net change in other comprehensive income (loss)	33,000	(74,000)
Deferred income taxes	(291,000)	(563,000)
<b>Changes in assets and liabilities:</b>		
Decrease in accounts receivable	23,000	56,000
(Increase) in inventory	(216,000)	(1,048,000)
(Increase) in prepaid expenses & other current assets	(609,000)	(2,886,000)
(Increase) in deferred compensation	(157,000)	346,000
( Increase) in prepaid taxes	-	(115,000)
(Increase) decrease in other assets	(37,000)	23,000
(Decrease) Increase in accounts payable and accrued expenses	(108,000)	398,000
(Decrease) in income taxes payable	(434,000)	(516,000)
Net cash provided by operating activities	4,578,000	2,863,000
<b>Cash Flow from Investing Activities:</b>		
Sales of investment securities	30,000	341,000
(Purchase) of property and equipment	(3,551,000)	(2,745,000)
(Purchase) of intangible assets	(844,000)	(607,000)
Net cash (used in) investing activities	(4,365,000)	(3,011,000)
<b>Cash Flow from Financing Activities:</b>		
Issuance of common stock, options and warrants	216,000	658,000
Increase (repayment) of long-term debt, net	(138,000)	(433,000)
Increase (Decrease) in line of credit, net	900,000	(21,000)
Decrease in note receivable	105,000	-
Excess tax benefits from share-based payment arrangements	30,000	(6,000)
(Purchase) of treasury stock	(309,000)	(420,000)

Edgar Filing: MEDIFAST INC - Form 10-Q

Net cash provided by (used in) financing activities	804,000	(222,000)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>1,017,000</b>	<b>(370,000)</b>
Cash and cash equivalents - beginning of the period	1,085,000	1,484,000
Cash and cash equivalents - end of period	\$ 2,102,000	\$ 1,114,000
Supplemental disclosure of cash flow information:		
Interest paid	\$ 313,000	\$ 271,000
Income taxes	\$ 1,435,000	\$ 3,403,000
Supplemental disclosure of non cash activity:		
Common stock issued to executives over 6-year vesting period		\$ 3,373,000
Common shares issued for options and warrants		\$ 454,000
Options vested during period	\$ 77,000	\$ 18,000
Common stock issued for services	\$ 21,000	\$ 64,000
Line of credit converted to long-term debt	\$ 2,156,000	

See accompanying notes to condensed consolidated financial statements.



**MEDIFAST, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (CONT.)**

**(Unaudited)**

Nine Months Ended September 30,  
 2007 2006  
(Restated)

Supplemental disclosure of non cash activity:

Sale of Consumer Choice Systems

Inventory	\$	-	\$	358,000
Accounts Receivable		-		131,000
Intangible assets, net		-		1,337,000
Note receivable		-		(1,503,000)
Loss on sale of Consumer Choice Systems		-		(323,000)
	\$	-	\$	-

See accompanying notes to condensed consolidated financial statements.

## Notes to Condensed Consolidated Financial Statements

### General

#### 1. Basis of Presentation

The condensed unaudited interim consolidated financial statements included herein have been prepared, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. The condensed consolidated financial statements and notes are presented as permitted on Form 10-Q and do not contain information included in the Company's annual statements and notes. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these condensed consolidated financial statements be read in conjunction with the December 31, 2006 audited consolidated financial statements and the accompanying notes thereto. While management believes the procedures followed in preparing these condensed consolidated financial statements are reasonable, the accuracy of the amounts are in some respects dependent upon the facts that will exist, and procedures that will be accomplished by the Company later in the year.

These condensed unaudited consolidated financial statements reflect all adjustments, including normal recurring adjustments, which, in the opinion of management, are necessary to present fairly the operations and cash flows for the period presented.

#### 2. Presentation of Financial Statements

The Company's condensed consolidated financial statements include the accounts of Medifast, Inc. and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

#### 3. Inventories

Inventories consist principally of finished packaged foods, packaging and raw materials held in either the Company's manufacturing facility or distribution warehouse. Inventories are valued with cost determined using the first-in, first-out (FIFO) method.

#### 4. Goodwill and Other Intangible Assets

In June 2001, the Financial Accounting Standards Board ("FASB") issued Statement No. 142 "Goodwill and Other Intangible Assets". This statement addresses financial accounting and reporting for acquired goodwill and other intangible assets and supersedes APB Opinion No. 17, "Intangible Assets". It addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. This Statement also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements. Upon the sale of Consumer Choice Systems, Inc. on January 17, 2006, the goodwill balance of \$894,000 was removed from the Company's books.

In addition, the Company has acquired other intangible assets, which include: customer lists, non-compete agreements, trademarks, patents, and copyrights. The non-compete agreements are being amortized over the legal life of the agreements ranging between 3 to 7 years. The customer lists are being amortized over a period ranging between 5 and 7 years based on management's best estimate of the expected benefits to be consumed or otherwise used up. The

costs of patents and copyrights are amortized over 5 and 7 years based on their estimated useful life, while trademarks representing brands with an infinite life, and are carried at cost and tested annually for impairment as outlined below. Goodwill and other intangible assets are tested annually for impairment in the fourth quarter, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. The Company assesses the recoverability of its goodwill and other intangible assets by comparing the projected undiscounted net cash flows associated with the related asset, over their remaining lives, in comparison to their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets.

7

---

	As of September 30, 2007		As of December 31, 2006 (Restated)	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Customer lists	\$ 6,369,000	\$ 2,761,000	\$ 5,587,000	\$ 1,969,000
Non-compete agreements	840,000	840,000	840,000	840,000
Trademarks, patents, and copyrights				
finite life	1,619,000	387,000	1,557,000	210,000
infinite life	909,000	-	909,000	-
Total	\$ 9,737,000	\$ 3,988,000	\$ 8,893,000	\$ 3,019,000

**Amortization expense for the nine months ended September 30, 2007 and 2006 was as follows:**

	(Restated)	
	2007	2006
Customer lists	\$ 791,000	580,000
Non-compete agreements	-	251,000
Trademarks and patents	178,000	102,000
Total Trademarks and Intangibles	\$ 969,000	\$ 933,000

Amortization expense is included in selling, general and administrative expenses.

5. Fixed Assets

Fixed assets are stated at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the related assets, which are generally three to seven years. Leasehold improvements and equipment under capital leases are amortized on a straight-line basis over the lesser of the estimated useful life of the asset or the related lease terms. Expenditures for repairs and maintenance are charged to expense as incurred, while major renewals and improvements are capitalized.

6. Note Receivable

Medifast realized a \$1,503,000 note receivable as a result of the sale of Consumer Choice Systems on January 17, 2006 to a former board member. The note has a 10-year term with imputed interest of 4% collateralized by 50,000 shares of Medifast stock and all the assets of Consumer Choice Systems. The amount of principal to be collected over each of the next 5 years is \$174,000 per year with the remaining amount collectible thereafter of \$495,000.

7. Income Per Common Share

Basic income per share is calculated by dividing net income by the weighted average number of outstanding common shares during the year. Basic income per share excludes any dilutive effects of options, warrants and other stock-based compensation.



8.

Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

9.

Deferred Compensation Plans

We maintain a non-qualified deferred compensation plan for Senior Executive management. Currently, Bradley MacDonald is the only participant in the plan. Under the deferred compensation plan that became effective in 2003, executive officers of the Company may defer a portion of their salary and bonus (performance-based compensation) annually. A participant may elect to receive distributions of the accrued deferred compensation in a lump sum or in installments upon retirement

Each participating officer may request that the deferred amounts be allocated among several available investment options established and offered by the Company. These investment options provide market rates of return and are not subsidized by the Company. The benefit payable under the plan at any time to a participant following termination of employment is equal to the applicable deferred amounts, plus or minus any earnings or losses attributable to the investment of such deferred amounts. The Company has established a trust for the benefit of participants in the deferred compensation plan. Pursuant to the terms of the trust, as soon as possible after any deferred amounts have been withheld from a plan participant, the Company will contribute such deferred amounts to the trust to be held for the benefit of the participant in accordance with the terms of the plan and the trust.

Retirement payouts under the plan upon an executive officer's retirement from the Company are payable either in a lump-sum payment or in annual installments over a period of up to ten years. Upon death, disability or termination of employment, all amounts shall be paid in a lump-sum payment as soon as administratively feasible.

10.

Share Based Payments

#### Stock-Based Compensation

Effective December 31, 2005, the Company adopted the provisions of Financial Accounting Standards Board Statement of Financial Accounting Standard ("SFAS") No. 123(R), "Share-Based Payments," which establishes the accounting for employee stock-based awards. Under the provisions of SFAS No.123(R), stock-based compensation is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the requisite employee service period (generally the vesting period of the grant). The Company adopted SFAS No. 123(R) using the modified prospective method and, as a result, periods prior to December 31, 2005 have not been restated. The Company recognized stock-based compensation for awards issued under the Company's stock option plans in other income/expenses included in the Condensed Consolidated Statement of Operations. Additionally, no modifications were made to outstanding stock options prior to the adoption of SFAS No. 123(R), and no cumulative adjustments were recorded in the Company's financial statements.

Prior to December 31, 2005, the Company accounted for stock-based compensation in accordance with provisions of Accounting Principles Board Opinion No. 25 ("APB No. 25"), "Accounting for Stock Issued to Employees," and related interpretations. Under APB No. 25, compensation cost was recognized based on the difference, if any, on the date of grant between the fair value of the Company's stock and the amount an employee must pay to acquire the stock. The Company grants stock options at an exercise price equal to 100% of the market price on the date of grant.

Accordingly, no compensation expense was recognized for the stock option grants in periods prior to the adoption of SFAS No. 123(R).

Unearned compensation represents shares issued to executives that will be vested over a 5-6 year period. These shares will be amortized over the vesting period in accordance with FASB 123(R). The expense related to the vesting of unearned compensation was \$570,000 and \$346,000 at September 30, 2007 and September 30, 2006, respectively.

9

---

The following summarizes the stock option activity for the Nine Months ended September 30, 2007:

September 30, 2007

	Shares	Weighted Average Exercise Price	Weighted Average Contractual Term (Years)
Outstanding, December 31, 2006	321,579	3.76	
Options granted			
Options reinstated			
Options exercised	(27,500)	0.89	
Options forfeited or expired			
Outstanding, September 30, 2007	294,079	4.16	2.47
Options exercisable, September 30, 2007	204,077	3.36	2.11
Options available for grant at end of year	928,421		

10.

Recent Accounting Pronouncements

In February 2006, the FASB issued SFAS No. 155, "Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140." SFAS No. 155 resolves issues addressed in SFAS No. 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets," and permits fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS No. 133, establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends SFAS No. 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. SFAS No. 155 is effective for all financial instruments acquired or issued after the beginning of the first fiscal year that begins after September 15, 2006. This standard did not have a material impact on the Company's consolidated financial position, results of operations, or cash flows.

In March 2006, the FASB issued SFAS No. 156, "Accounting for Servicing of Financial Assets, an amendment of FASB Statement No. 140." SFAS No. 156 requires an entity to recognize a servicing asset or liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract under a transfer of the servicer's financial assets that meets the requirements for sale accounting, a transfer of the servicer's financial assets to a qualified special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale or trading securities in accordance with SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities" and an acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates. Additionally, SFAS No. 156 requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, permits an entity to choose either the use of an amortization or fair value method for



subsequent measurements, permits at initial adoption a one-time reclassification of available-for-sale securities to trading securities by entities with recognized servicing rights and requires separate presentation of servicing assets and liabilities subsequently measured at fair value and additional disclosures for all separately recognized servicing assets and liabilities. SFAS No. 156 is effective for transactions entered into after the beginning of the first fiscal year that begins after September 15, 2006. This standard did not have a material impact on the Company's consolidated financial position, results of operations, or cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements, and ("FAS 157"). This Standard defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. The adoption of FAS 157 is not expected to have a material impact on the Company's consolidated financial position, results of operations or cash flows.

10

---

The FASB also issued in September 2006 Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* — an amendment of FASB Statement No. 87, 88, 106 and 132(R), (“FAS 158”). This Standard requires recognition of the funded status of a benefit plan in the statement of financial position. The Standard also requires recognition in other comprehensive income certain gains and losses that arise during the period but are deferred under pension accounting rules, as well as modifies the timing of reporting and adds certain disclosures. FAS 158 provides recognition and disclosure elements to be effective as of the end of the fiscal year after December 15, 2006 and measurement elements to be effective for fiscal years ending after December 15, 2008. The Company has not yet analyzed the impact FAS 158 will have on the Company's consolidated financial condition, results of operations, cash flows or disclosures.

In September 2006, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin (“SAB”) No. 108, “Quantifying Misstatements.” SAB 108 provides interpretative guidance on how public companies quantify financial statement misstatements. There have been two common approaches used to quantify such errors. Under an income statement approach, the “roll-over” method, the error is quantified as the amount by which the current year income statement is misstated. Alternatively, under a balance sheet approach, the “iron curtain” method, the error is quantified as the cumulative amount by which the current year balance sheet is misstated. In SAB 108, the SEC established an approach that requires quantification of financial statement misstatements based on the effects of the misstatements on each of the company's financial statements and the related financial statement disclosures. This model is commonly referred to as a “dual approach” because it requires quantification of errors under both the roll-over and iron curtain methods. SAB 108 is effective for the first fiscal year ending after November 15, 2006. The adoption of SAB 108 did not have a material impact on the Company's consolidated financial position and results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48, “Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109” (“FIN 48”). FIN 48 prescribes a recognition threshold and measurement attribute for financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The adoption of FIN 48 did not have a material impact on the Company's consolidated financial position, results of operations, or cash flows.

In February, 2007 the FASB issued SFAS No. 159, “The Fair Value Option for Financial Assets and Liabilities,” including an amendment to SFAS No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” applicable to all entities with available-for-sale and trading securities. SFAS No. 159 permits entities to measure many financial instruments and certain other items at fair value. Eligible items include recognized financial assets and liabilities other than investments or interests which an entity is required to consolidate, financial assets or liabilities recognized under leases, deposit liabilities of financial institutions, or financial instruments that are classified by the issuer as a component of shareholders' equity. Also eligible are firm commitments that would otherwise not be recognized at inception and that involve only financial instruments, non-financial insurance contracts and warranties that the issuer can settle by paying a third party to provide those goods or services, and host financial instruments that result from separation of an embedded non-financial derivative instrument from a non-financial hybrid instrument. SFAS No. 159 is effective as of the beginning of an entity's fiscal year that begins after November 15, 2007. This pronouncement has no effect on the Company at this time.

## 11.

## Revenue Recognition

Revenue is recognized net of discounts, rebates, promotional adjustments, price adjustments, returns and other potential adjustments upon shipment and passing of risk to the customer and when estimates of are reasonably determinable, collection is reasonably assured and the Company has no further performance obligations.

12.

Restatements

The September 30, 2006 financial statements have been restated to increase amortization expense on customer lists by \$35,000. Net income for the quarter-ended September 30, 2006 decreased by \$35,000 from \$1,490,000 to \$1,455,000 and retained earnings decreased from \$5,764,000 to \$5,729,000. The restatement decreased basic earnings per share by \$.01 from \$.12 to \$.11. Diluted earnings per share remained unchanged at \$.11.

13. Reclassifications

Certain amounts for the quarter ended September 30, 2006 have been reclassified to conform to the presentation of the September 30, 2007 amounts. The reclassifications have no effect on net income for the quarters ended September 30, 2007 and 2006.

11

---

14.

Business Segments

Operating segments are components of an enterprise about which separate financial information is available that is regularly reviewed by the chief operating decision maker about how to allocate resources and in assessing performance. The Company has two reportable operating segments: Medifast and All Other. The Medifast reporting segment consists of the following distribution channels: Medifast Direct, Take Shape for Life, and Doctors and Clinics. The All Other reporting segments consist of Hi-Energy and Medifast Weight Control Centers, the Company's parent company operations, as well as the Consumer Choice Systems, Inc. division which was sold in January of 2006.

The accounting policies of the segments are the same as those of the Company. The presentation and allocation of assets, liabilities and results of operations may not reflect the actual economic costs of the segments as stand-alone businesses. If a different basis of allocation were utilized, the relative contributions of the segments might differ, but management believes that the relative trends in segments would likely not be impacted.

12

---

Edgar Filing: MEDIFAST INC - Form 10-Q

The following tables present segment information for the three and nine month periods ended September 30, 2007 and September 30, 2006:

	<b>Three Months Ended September 30, 2007</b>		
	<b>Medifast</b>	<b>All Other</b>	<b>Consolidated</b>
Revenues, net	20,792,000	1,054,000	21,846,000
Cost of Sales	5,374,000	149,000	5,523,000
Other Selling, General and Administrative Expenses	12,712,000	1,172,000	13,884,000
Depreciation and Amortization	579,000	301,000	880,000
Interest (net)	30,000	129,000	159,000
Provision for income taxes	446,000	-	446,000
Net income (loss)	1,651,000	(697,000)	954,000
Segment Assets	21,917,000	18,756,000	40,673,000

	<b>Three Months Ended September 30, 2006</b>		
	<b>Medifast</b>	<b>All Other</b>	<b>Consolidated</b> (restated)
Revenues, net	18,812,000	830,000	19,642,000
Cost of Sales	4,557,000	148,000	4,705,000
Other Selling, General and Administrative Expenses	10,907,000	1,476,000	12,383,000
Depreciation and Amortization	333,000	426,000	759,000
Interest (net)	39,000	3,000	42,000
Provision for income taxes	298,000	-	298,000
Net income (loss)	2,678,000	(1,223,000)	1,455,000
Segment Assets	18,869,000	16,259,000	35,128,000

	<b>Nine Months Ended September 30, 2007</b>		
	<b>Medifast</b>	<b>All Other</b>	<b>Consolidated</b>
Revenues, net	60,977,000	2,998,000	63,975,000
Cost of Sales	15,566,000	378,000	15,944,000
Other Selling, General and Administrative Expenses	37,350,000	3,141,000	40,491,000
Depreciation and Amortization	2,060,000	475,000	2,535,000
Interest (net)	112,000	172,000	284,000
Provision for income taxes	1,486,000	-	1,486,000
Net income (loss)	4,403,000	(1,168,000)	3,235,000
Segment Assets	21,917,000	18,756,000	40,673,000

	<b>Nine Months Ended September 30, 2006</b>		
	<b>Medifast</b>	<b>All Other</b>	<b>Consolidated</b> (restated)
Revenues, net	56,422,000	2,357,000	58,779,000
Cost of Sales	13,944,000	390,000	14,334,000
Other Selling, General and Administrative Expenses	31,178,000	4,210,000	35,388,000

Other Selling, General and Administrative Expenses			
Depreciation and Amortization	1,223,000	567,000	1,790,000
Interest (net)	123,000	11,000	134,000
Provision for income taxes	2,219,000	-	2,219,000
Net income (loss)	7,735,000	(2,821,000)	4,914,000
Segment Assets	18,869,000	16,259,000	35,128,000

**Management Discussion and Analysis of  
Financial Condition and Results of Operations**

*Except for the historical information contained herein, this Report on Form 10-Q contains certain forward-looking statements that involve substantial risks and uncertainties. When used in this Report, the words “anticipate,” “believe,” “estimate,” “expect” and similar expressions, as they relate to Medifast, Inc. or its management, are intended to identify such forward-looking statements. The Company’s actual results, performance or achievements could differ materially from the results expressed in, or implied by, these forward-looking statements. Accordingly, there is no assurance that the results in the forward-looking statements will be achieved.*

**Critical Accounting Policies and Estimates**

Our consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles. Our significant accounting policies are described in Note 2 of our audited consolidated financial statements as of December 31, 2006.

The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Management develops, and changes periodically, these estimates and assumptions based on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. Management considers the following accounting estimates to be the most critical in preparing our consolidated financial statements. These critical accounting estimates have been discussed with our audit committee.

**Revenue Recognition.** Revenue is recognized net of discounts, rebates, promotional adjustments, price adjustments, returns and other potential adjustments upon shipment and passing of risk to the customer and when estimates of are reasonably determinable, collection is reasonably assured and the Company has no further performance obligations.

**Impairment of Fixed Assets and Intangible Assets.** We continually assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Judgments regarding the existence of impairment indicators are based on legal factors, market conditions and our operating performance. Future events could cause us to conclude that impairment indicators exist and the carrying values of fixed and intangible assets may be impaired. Any resulting impairment loss would be limited to the value of net fixed and intangible assets.

**Income Taxes.** In the preparation of consolidated financial statements, the Company estimates income taxes based on diverse legislative and regulatory structures that exist in jurisdictions where the company conducts business. Deferred income tax assets and liabilities represent tax benefits or obligations that arise from temporary differences due to differing treatment of certain items for accounting and income tax purposes. The Company evaluates deferred tax assets each period to ensure that estimated future taxable income will be sufficient in character amount and timing to result in their recovery. A valuation allowance is established when management determines that it is more likely than not that a deferred tax asset will not be realized to reduce the assets to their realizable value. Considerable judgments are required in establishing deferred tax valuation allowances and in assessing probable exposures related to tax matters. The Company’s tax returns are subject to audit and local taxing authorities that could challenge the company’s tax positions. The Company believes it records and/or discloses such potential tax liabilities as appropriate and has reasonably estimated its income tax liabilities and recoverable tax assets.

**Allowance for doubtful accounts.** In determining the adequacy of the allowance for doubtful accounts, we consider a number of factors including the aging of the receivable portfolio, customer payment trends, and financial condition of the customer, industry conditions and overall credibility of the customer. Actual amounts could differ significantly

from our estimates.

14

---



## **General**

### **Nine Months Ended September 30, 2007 and September 30, 2006**

Revenue: Revenue increased to \$64 million for the first nine months of 2007 as compared to \$58.8 million for the first nine months of 2006, an increase of \$5.2 million or 9%. The direct marketing sales channel accounted for 58% of total revenue, Take Shape for Life 31%, doctors 5%, and clinics 6%. As compared to the first nine months of 2006, the direct response sales channel revenue increased by 2%. Direct response is fueled primarily by consumer advertising via print, TV, web, and radio, however, in the first quarter of 2006 it was also fueled largely by a substantial editorial placement in a major consumer publication at no cost to the Company. Take Shape for Life sales, which are fueled by person-to-person recruiting and support increased by 17% year-over-year. The Company's doctor's sales increased by 13% compared to the first nine months of 2006. The Company's clinic division which began operating under the Medifast Weight Control Center name in late 2006, increased sales by 34% as compared to the first nine months of 2006.

The Take Shape for Life division grew 17% year-over-year. This growth can largely be attributed to the tools and training that led to an increase in the ability of the division to both promote growth in recruiting of health coaches, as well as better supporting this growth as it occurs. This continued investment proved to be a large part of the current growth trends in Take Shape for Life sales, as well as the number of active health coaches. The number of active health coaches grew to 1,650 at the end of the third quarter 2007 compared to 1,200 at the same time period in 2006, an increase of 38%. This recent growth in health coaches was recently observed in July of 2007, with over 80% attendance growth at the 2007 National Convention compared to the attendance at the 2006 Convention. The company believes that the growth in health coach activity is a positive trend that should continue, and will lead to significant revenue growth in the near future

The Medifast Weight Control Centers, which represent approximately 6% of the Company's overall revenues, are currently operating in 9 locations in Dallas and Orlando. In the first nine months of 2007, the Company experienced revenue growth of 34% versus the same time period last year. The average monthly revenue per clinic also witnessed significant growth of 57%, averaging \$36,000 per clinic in 2007 as compared to \$23,000 in the first nine months of 2006. In the expanding Dallas, TX market, the average monthly revenue per clinic is approximately \$50,000. In the estimated \$40 billion weight loss and health living industry, the brick and mortar clinic model has always made up a significant portion of overall sales. Medifast has incorporated this model with the creation of the Medifast Weight Control Centers. The recent growth in this division has proven that the model is in high demand from a select portion of the weight loss consumers. The Company believes that with the recent industry launches of over-the-counter and anticipated launches of prescription appetite suppressant medications that this model will continue to grow. Therefore, throughout the 2<sup>nd</sup> and 3<sup>rd</sup> quarter, the Company invested in the infrastructure of its medical clinic model. The major aspects of the investment in this division included an expanded executive team, the creation of a point of sale system, a robust customer data tracking system, finalizing the franchise opportunity documentation, and the beginning stages of expansion into several new locations. The Company believes this business will be a major driver of revenues and profits for the Medifast business as it continues to expand. The Company plans to continue the expansion of the Medifast Weight Control Centers with both additional corporate locations as well as offering the model through a franchise opportunity. The Company plans to open an additional 6 corporately owned locations in a major market by the end of the first quarter of 2008.

Overall, selling, general and administrative expenses increased by \$5.8 million as compared to the first nine months of 2006. The majority of the increase was due to investments in the Company's future advertising campaigns, along with the necessary infrastructure support tools to allow the future campaigns to improve in effectiveness. Advertising expense for the first nine months of 2007 was approximately \$15.1 million compared to approximately \$12.2 million for the same period last year, an increase of \$2.9 million. In the prior year, the Company benefited from a substantial editorial placement in a major consumer publication at no cost to the Company. During 2007, the Company has

invested in multiple celebrity endorsement contracts as well as increased public relations expense to focus on increasing brand awareness that will benefit our future advertising campaigns. Salaries and benefits increased by approximately \$1,300,000 for the nine months ended September 30, 2007 as the Company hired additional expertise in critical areas in order to assist in future growth and meet regulatory needs. This primarily includes IT, nutrition and product development, marketing, Medifast Weight Control Centers, and Take Shape for Life. Take Shape for Life commission expense, which is completely variable based upon revenue, increased by approximately \$1,200,000. Communication expense which includes outsourced call centers increased by \$270,000 due to two outsourced call centers handling calls relating to TV, print, and Take Shape for Life sales. The Company has spent a significant amount of time and materials in the first nine months of 2007 building the future call center infrastructure with related technology and personnel. This investment will allow the call center to increase the percentage of advertising calls to be handled in-house. It is believed that this initiative will amount to significant savings and improved closing rates in the future. In the third quarter of 2007 additional call volume was moved in-house resulting in an \$80,000 decrease in communication expense. The reduction of the outsourced call center expenses will occur in stages throughout the remainder of 2007 and into 2008. Other expenses increased by \$400,000, which included items such as depreciation, amortization, credit card processing fees, charitable contributions, and property taxes. Stock compensation expense increased by \$208,000 as compared to the first nine months of 2006 as stock awards vest over 5 and 6 year terms for executives. These increases were offset by an approximately \$175,000 decrease in office expense and the absence of a \$323,000 loss resulting from the sale of the Consumer Choice Systems division in the first quarter of 2006.

**Costs and Expenses:** Cost of revenue increased \$1.6 million to \$16 million in the first nine months of 2007 from \$14.3 million in 2006. As a percentage of sales, gross margin remained at approximately 75% for the first nine months of 2007 and 2006.

**Income taxes:** For the first nine months of 2007, we recorded \$1,486,000 in income tax expense, which represents an annual effective rate of 31.5%. For the first nine months of 2006, we recorded income tax expense of \$2,219,000 which reflected an estimated annual effective tax rate of 31.1%. The Company anticipates a tax rate of approximately 32-34% in 2007.

**Net income:** Net income was \$3.2 million in the first nine months of 2007 as compared to \$4.9 million in the first nine months of 2006, which reflected a decrease of \$1.7 million or 35%. The decrease was directly related to the initiatives of the Company to create its new advertising campaign and improve future capabilities to increase advertising effectiveness. Additionally, the Company did not have the benefit of the no cost editorial publication that occurred in the first quarter of 2006 that led to significant profits.

### **Three Months Ended September 30, 2007 and September 30, 2006**

**Revenue:** Revenue increased to \$21.8 million for the three months ended September 30, 2007 as compared to \$19.6 million for the same period in 2006, an increase of \$2.2 million or 11%. The direct marketing sales channel accounted for 58% of total revenue, Take Shape for Life 31%, doctors 5%, and clinics 6%. As compared to the three months ended September 30, 2006, the direct response sales channel revenue increased by 2%. Take Shape for Life sales, which are fueled by person-to-person recruiting and support increased by 30% year-over-year. Doctor's sales increased 10% as compared to prior year and the Company's clinic division, which began operating under the Medifast Weight Control Center name in late 2006, increased sales by 34% as compared to the quarter-ended September 30, 2006.

The Take Shape for Life division grew 30% year-over-year. This growth can largely be attributed to the 2007 National Convention that had over 80% attendance growth as compared to 2006. Health coaches were trained on tools and training materials that promoted growth in the recruitment of health coaches as well as enhanced customer support. As compared to prior year, health coach recruitment increased by 75% in the third quarter of 2007. The company believes that the growth in health coach activity is a positive trend that should continue, and will lead to significant revenue growth in the near future

Throughout the third quarter of 2007 the Company spent significant time and materials investing in the future growth capabilities of the Medifast business. This included building internal technical and personnel abilities, strategic alliances with industry leaders, and large investments in future advertising campaigns and awareness of the Medifast brand.

The Company believes that the expenses associated with investing in these necessary areas for future growth will be recognized in the near term and well into the future. Several of these expenses include two celebrity endorsement contracts for future advertising campaigns, investment in public relations efforts for building brand awareness, a state of the art in-house call center infrastructure to include a phone system and experienced call center personnel to make it effective, and investments in technical capabilities for several of the Medifast business models. The Company believes these expenses and improvements, which were largely associated with the future advertising campaign, will lead to a more effective advertising spend moving forward, and the ability to significantly increase the run rate of the advertising spend as the effectiveness is proven.

The Company believes that these expenses will prove to be the infrastructure building blocks of the future growth in the Medifast business. While building for the future, the Company spent significant time analyzing the current metrics of the business and the overall industry. The knowledge gained from this effort allow for significant tracking improvements in the Company's core metrics as it moves forward. These metrics include but are not limited to,

advertising response rates, customer closing rates via web and telephone, lifetime value of consumers, customer success statistics across our multiple channels and media costs. The Company made noteworthy advances in its ability to track these metrics, and is confident that with the investments it has placed in its future advertising campaigns and internal capabilities, that these metrics should continue to improve as it moves forward.

In the third quarter of 2007, the Company also continued to spend on the infrastructure necessary to meet the requirements of being a micro cap public company in today's regulatory environment. In 2006, the Company was required to become Sarbanes-Oxley compliant and in 2007, the Company has invested in both systems and personnel to maintain compliance and ensure the highest level of internal control over financial reporting.

In the third quarter of 2007 selling, general, and administrative expenses increased by \$1.6 million as compared to Q3 of 2006. As compared to prior year, advertising expense increasing by approximately \$400,000. Advertising expense for Q3 of 2007 was approximately \$5.1 million compared to \$4.7 million for the same period last year. The primary reason for the increase in advertising expense was due to increased spending on future campaigns that include celebrity endorsement contracts and the public relations and promotions associated with them, that the Company feels would increase sales and exposure of the Medifast brand. The Company has invested in multiple celebrity endorsement contracts that increased advertising expense in the current year. In the third quarter of 2007, in order to prepare for the first quarter of 2008 the Company invested in testing a celebrity endorsed campaign, while only minimal weight loss had been experienced by both celebrities. This test was done to prove the believed increased effectiveness of a celebrity endorsed campaign. Due to the proven success of the celebrity endorsed campaign in the third quarter, and with the celebrities now having experienced substantially more weight loss, the Company invested in the creation of an advertising campaign to be launched in the first quarter of 2008. Salaries and benefits increased by approximately \$500,000 as compared to the third quarter of 2006 as the Company hired additional expertise and incurred additional recruiting fees in critical areas in order to assist in future growth. This primarily includes IT, nutrition and product development, marketing, Medifast Weight Control Centers, and Take Shape for Life. The salaries are attributed to the investing of internal abilities to improve capabilities of the Company moving forward. These internal teams were associated with the building of several areas to include the additional capabilities of the Company's website and call center. One of these major initiatives was the mid June launch of the Company's auto-ship program that has proven successful as approximately 35% of all new customers choose the auto-ship option. The Company believes that this, along with the many other innovative updates completed, will significantly improve its customer retention strategies, while positively impacting the lifetime value of consumers and providing clearer future revenue expectations from reoccurring customers. Take Shape for Life commission expense, which is directly related to sales, increased by approximately \$700,000. Communication expense which includes outsourced call centers decreased by \$80,000 as the Company continues to bring more call volume into its in-house call center. Other expenses increased by \$200,000, which included items such as depreciation, amortization, credit card processing fees, charitable contributions, and property taxes. These increases were offset by an approximately \$75,000 decrease in office expense.

The Company has continued to invest in building the platform for the future growth of the business. The building of a seasoned Executive Team with extensive experience and capabilities, along with providing the internal resources required to utilize these capabilities was a core focus of the business throughout the third quarter. The Company believes that each investment has provided positive improvements, however the true effect of these investments will be in the near future as the company continues its long term growth plan.

Costs and Expenses: Cost of revenue increased \$800,000 to \$5.5 million in Q3 of 2007 from \$4.7 million in 2006. As a percentage of sales, gross margin remained at approximately 75% for the third quarter of 2007 and 2006.

Income taxes: In the third quarter of 2007, we recorded \$446,000 in income tax expense, which represents an annual effective rate of 31.9%. In the third quarter of 2006, we recorded income tax expense of \$298,000 which reflected an estimated annual effective tax rate of 17%. The Company anticipates a tax rate of approximately 32-34% in 2007.

Net income: Net income was \$954,000 in the third quarter of 2007 as compared to \$1,455,000 in the third quarter of 2006, which reflected a decrease of \$501,000 or 34%. The decrease was directly related to the initiatives of the Company to create its new advertising campaign and improve future capabilities to increase advertising effectiveness through technology and personnel.

## SEGMENT RESULTS OF OPERATIONS

### Net Sales by Segment for the Three Months Ended September 30,

Segments	2007		2006	
	Sales	% of Total	Sales	% of Total
Medifast	20,792,000	95%	18,812,000	96%
All Other	1,054,000	5%	830,000	4%
Eliminations	-	0%	-	0%
Total Sales	21,846,000	100%	19,642,000	100%

### Net Sales by Segment for the Nine Months Ended September 30,

Segments	2007		2006	
	Sales	% of Total	Sales	% of Total
Medifast	60,977,000	95%	56,422,000	96%
All Other	2,998,000	5%	2,357,000	4%
Eliminations	-	0%	-	0%
Total Sales	63,975,000	100%	58,779,000	100%

**Three Months Ended September 30, 2007 and September 30, 2006**

Medifast Segment: The Medifast reporting segment consists of the sales of Medifast Direct, Take Shape for Life, and Doctors and Clinics. As this represents the majority of our business this is referenced to the “Consolidated Results of Operations” management discussion for the three months ended September 30, 2007 and 2006 above.

All Other Segment: The All Other reporting segment consists of the sales of Medifast Weight Control Centers. Sales increased by \$224,000 year-over year as a result of an increase in Medifast Weight Control Centers sales to \$1,054,000. The increase in the Medifast Weight Control Center’s sales was due to the opening of more clinics in Texas, the closing of less profitable centers, spending efficiencies in advertising, improved closing rates on sales, as well as the hiring of more experienced clinic operators to manage the clinics. In addition, new programs were developed that extended the lifetime value of each customer.

**Nine Months Ended September 30, 2007 and September 30, 2006**

Medifast Segment: The Medifast reporting segment consists of the sales of Medifast Direct, Take Shape for Life, and Doctors and Clinics. As this represents the majority of our business this is referenced to the “Condensed Consolidated Results of Operations” management discussion for the nine months ended September 30, 2007 and 2006 above.

All Other Segment: The All Other reporting segment consists of the sales of Medifast Weight Control Centers. Sales increased by \$641,000 year-over year as a result of an increase in Medifast Weight Control Centers sales to \$2,998,000. The increase in the Medifast Weight Control Center’s sales was due to the opening of more clinics in Texas, the closing of less profitable centers, spending efficiencies in advertising, improved closing rates on sales, as well as the hiring of more experienced clinic operators to manage the clinics. In addition, new programs were developed that extended the lifetime value of each customer. The “umbrella” effect of Medifast direct advertising has also had an impact on sales by increasing brand recognition as well as walk-in customers.

**Net Profit by Segment for the Three Months Ended September 30,**

Segments	2007		2006	
	Profit	% of Total	Profit	% of Total
Medifast	1,651,000	173%	2,678,000	184%
All Other	(697,000)	-73%	(1,223,000)	-84%
Eliminations	-	0%	-	0%
Total Sales	954,000	100%	1,455,000	100%

**Net Profit by Segment for the Nine Months Ended September 30,**

Segments	2007		2006	
	Profit	% of Total	Profit	% of Total
Medifast	4,403,000	136%	7,735,000	157%
All Other	(1,168,000)	-36%	(2,821,000)	-57%
Eliminations	-	0%	-	0%
Total Sales	3,235,000	100%	4,914,000	100%

**Three Months Ended September 30, 2007 and September 30, 2006**

Medifast Segment: The Medifast reporting segment consists of the profits of Medifast Direct, Take Shape for Life, and Doctors and Clinics. As this represents the majority of our business this is referenced to the “Condensed Consolidated Results of Operations” management discussion for the three months ended September 30, 2007 and 2006 above. See footnote 14, “Business Segments” for a detailed breakout of expenses

18

---

All Other Segment: The All Other reporting segment consists of the losses of Medifast Weight Control Centers, and corporate expenses related to the parent company operations. Year-over-year, the loss in the All Other segment improved by \$526,000. The decreased expenses were due to a restructuring of the Hi-Energy and Medifast Weight Control Centers management team, improved advertising spend, and reduction in salary expense. The Hi-Energy and Medifast Weight Control Centers showed an improvement year-over-year of \$231,000. Corporate expenses increased in the third quarter of 2007 as compared to the prior year, which includes auditor's fees, refinancing fees, attorney's fees, board of director expenses, investor relations, corporate consulting, education and training, and corporate outings. See footnote 14, "Business Segments" for a detailed breakout of expenses.

### **Nine Months Ended September 30, 2007 and September 30, 2006**

Medifast Segment: The Medifast reporting segment consists of the profits of Medifast Direct, Take Shape for Life, and Doctors and Clinics. As this represents the majority of our business this is referenced to the "Condensed Consolidated Results of Operations" management discussion for the nine months ended September 30, 2007 and 2006 above. See footnote 14, "Business Segments" for a detailed breakout of expenses

All Other Segment: The All Other reporting segment consists of the losses of Medifast Weight Control Centers, and corporate expenses related to the parent company operations. Year-over-year, the loss in the All Other segment decreased by \$1,653,000. These segments include the selling, general, and administrative expenses of the corporate operation, which includes auditor fees, refinancing fees, attorney's fees, board of director expenses, investor relations, corporate consulting, education and training, and corporate outings, and the Hi-Energy and Medifast Weight Control Centers. The Medifast Weight Control Centers showed an improvement year-over-year of \$440,000 associated with expanding the clinic model, and increased sales within that model. See footnote 14, "Business Segments" for a detailed breakout of expenses

### **Seasonality**

The Company's weight management products and programs have historically been subject to seasonality. Traditionally the holiday season in November/December of each year is considered poor for diet control products and services. January and February generally show increases in sales, as these months are considered the commencement of the "diet season." In 2007, seasonality has not been a significant factor. This is largely due to the increase in the consumer's awareness of the overall health and nutritional benefits accompanied with the use of the Company's product line. As consumers continue to increase their association of nutritional weight loss programs with overall health, seasonality will continue to decrease.

### **Inflation**

To date, inflation has not had a material effect on the Company's business.

## **Item 5. Other Information**

### **Litigation:**

Leonard Z. Sotomeyer on December 30, 2003 filed an action in the Supreme Court of the State of New York, County of New York, against his former business partner, David Scheffler, and T-1 Holdings, LLC, and included Medifast, Inc., formerly Heathrite, Inc., as a Defendant, Case 604076-03, seeking monetary damages for failure of his former business partner to compensate him under several consulting agreements with Medifast, Inc. made with H-T Capital, Inc. and derivatively on behalf of T-1 Holdings, LLC. The Court dismissed on Defendants' motions Sotomeyer's complaint in its entirety by Order of September 30, 2004. Following an appeal, the Appellate Division, First Department, reinstated the first and second causes of action while affirming the dismissal of Plaintiff's remaining



derivative claims by its decision April 13, 2006. During the third quarter of 2007, the Court ruled favorably to Medifast preliminarily dismissing all counts against Medifast, except one. Medifast believes it continues to have a meritorious defense to the sole remaining count and that any decision rendered would not materially impact the ongoing operations of Medifast, Inc.

Earnings Per Share: The Company follows the provisions of Statement of Financial Accounting Standards No. 128, "Earnings Per Share." The calculation of basic and diluted earnings per share ("EPS") is reflected on the accompanying Consolidated Statement of Operations.

Code of Ethics: In September 2002, the Company implemented a Code of Ethics by which directors, officers and employees commit and undertake to personal and corporate growth, dedicate themselves to excellence, integrity and responsiveness to the marketplace, and work together to enhance the value of the Company for the shareholders, vendors, and customers.

Trading Policy: In March 2003, the Company implemented a Trading Policy whereby if a director, officer or employee has material non-public information relating to the Company, neither that person nor any related person may buy or sell securities of the Company or engage in any other action to take advantage of, or pass on to others, that information. Additionally, on October 16, 2006 the Board of Directors approved an updated trading policy in which insiders may purchase or sell MED securities if such purchase or sale is made 7 days after or 14 days before an earnings announcement to include the 10-K or 10-Q in order to insure that investors have available the same information necessary to make investment decisions as insiders.

Controls and Procedures:

The Corporation maintains disclosure controls and procedures designed to ensure that information required to be disclosed in reports filed under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the specified time periods.

Medifast's management, with the participation of its chief executive officer and its chief financial officer, evaluated the effectiveness of Medifast's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) or 15d-15(e)) as of September 30, 2007. Based on that evaluation, Medifast's chief executive officer and chief financial officer concluded that, as of that date, Medifast's disclosure controls and procedures required by paragraph (b) of Exchange Act Rules 13a-15 or 15d-15, were effective at the reasonable assurance level.

As discussed in Medifast's Annual Report on Form 10-K/A for the year ended December 31, 2006, management's assessment identified the following material weakness and significant deficiency:

(A) As previously disclosed in our Form 10-K/A for the year ended December 31, 2006 the Company identified a material weakness related to its internal control over the accounting for its customer lists under Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets." The material weakness resulted in the restatement of the Company's consolidated financial statements as of December 31, 2006 and 2005, and the interim financial information for each of the quarters in 2006, commencing with the quarter ended March 31, 2006.

In the third quarter of 2007, management implemented enhanced internal controls over its accounting for all intangible assets under Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets." All key management involved in the financial reporting process was trained on the accounting for intangible assets under FASB 142. In addition, any new intangible assets are reviewed by three financial management personnel before being recorded on the financial statements to ensure proper accounting and disclosure. As a result of the additional controls, management has assessed the operating effectiveness of these enhanced internal controls and believes the material weakness has been remediated.

Other than indicated above, there were no changes in the Corporation's internal control over financial reporting that occurred during the quarter ended September 30, 2007, that have materially affected, or are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

**Medifast, Inc.**

BY: /S/ MICHAEL S. MCDEVITT  
Michael S. McDevitt  
Chief Executive Officer and Chief  
Financial Officer  
(principal executive officer and  
principal financial officer)

November 8, 2007

Index to Exhibits

Exhibit Number Description of Exhibit

31.1 Certification of Chief Executive Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

31.2 Certification of Chief Financial Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

32.1 Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

22

---