

MEDIFAST INC
Form 10-Q
May 10, 2011

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 March 31, 2011

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

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

| Class | Outstanding at March 9, 2011 |
|--|------------------------------|
| Common stock, \$.001 par value per share | 15,431,101 shares |

Medifast, Inc.
Index

| | |
|--|-----------|
| Part I - Financial Information: | |
| Item 1 – Financial Statements | |
| Condensed Consolidated Balance Sheets as of March 31, 2011 (unaudited) and December 31, 2010 (audited) | 4 |
| Condensed Consolidated Statements of Income (unaudited) for the Three Months Ended March 31, 2011 and 2010 | 5 |
| Condensed Consolidated Statements of Changes in Stockholders' Equity (unaudited) for the Three months Ended March 31, 2011 | 6 |
| Condensed Consolidated Statements of Cash Flows (unaudited) for the Three months Ended March 31, 2011 and 2010 | 7 |
| Notes to Unaudited Condensed Consolidated Financial Statements | 8 |
| Item 2 - Management's Discussion and Analysis of Financial Condition And Results of Operations | 15 |
| Item 3 – Quantitative and Qualitative Disclosures about Market Risk | 23 |
| Item 4 – Controls and Procedures | 23 |
| Part II - Other Information: | |
| Item 1 – Legal Proceedings | 24 |
| Item 1A – Risk Factors | 25 |
| Item 5 – Other Information | 25 |
| Item 6 - Exhibits | 27 |

Part 1 – Financial Statements

Item 1 – Financial Statements

3

MEDIFAST, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

| | (Unaudited) March 31, 2011 | (Audited) December 31, 2010 |
|---|-------------------------------|--------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 31,189,000 | \$ 17,165,000 |
| Accounts receivable-net of allowance for sales returns and doubtful accounts of \$336,000 and \$237,000 | 815,000 | 623,000 |
| Inventory | 15,867,000 | 19,534,000 |
| Investment securities | 19,257,000 | 17,271,000 |
| Income taxes, prepaid | 471,000 | 3,266,000 |
| Prepaid expenses and other current assets | 2,365,000 | 2,108,000 |
| Deferred tax assets | 734,000 | 703,000 |
| Total current assets | 70,698,000 | 60,670,000 |
| Property, plant and equipment – net | 32,355,000 | 30,589,000 |
| Trademarks and intangibles – net | 957,000 | 1,072,000 |
| Other assets | 1,506,000 | 1,728,000 |
| TOTAL ASSETS | \$ 105,516,000 | \$ 94,059,000 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | 18,598,000 | 15,020,000 |
| Current maturities of long-term debt | 933,000 | 944,000 |
| Total current liabilities | 19,531,000 | 15,964,000 |
| Other liabilities | | |
| Long-term debt, net of current portion | 4,627,000 | 4,855,000 |
| Deferred tax liabilities | 1,895,000 | 1,284,000 |
| Total liabilities | 26,053,000 | 22,103,000 |
| Stockholders' Equity: | | |
| 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; 15,431,101 issued and outstanding | 16,000 | 16,000 |
| Additional paid-in capital | 34,115,000 | 32,938,000 |
| Accumulated other comprehensive income | 212,000 | 240,000 |
| Retained earnings | 48,475,000 | 42,117,000 |
| Less: cost of 368,908 shares of common stock in treasury | (3,355,000) | (3,355,000) |
| Total stockholders' equity | 79,463,000 | 71,956,000 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 105,516,000 | \$ 94,059,000 |

See notes to unaudited condensed consolidated financial statements

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

| | Three Months Ended March 31, | |
|---------------------------------------|------------------------------|---------------|
| | 2011 | 2010 |
| Revenue | \$ 74,295,000 | \$ 60,585,000 |
| Cost of sales | 17,614,000 | 14,817,000 |
| Gross Profit | 56,681,000 | 45,768,000 |
| Selling, general, and administration | 46,630,000 | 37,567,000 |
| Income from operations | 10,051,000 | 8,201,000 |
| Other income/(expense) | | |
| Interest income/ (expense), net | 115,000 | 28,000 |
| Other | 115,000 | (15,000) |
| | 230,000 | 13,000 |
| Income before income taxes | 10,281,000 | 8,214,000 |
| Provision for income taxes | (3,923,000) | (3,313,000) |
| Net income | \$ 6,358,000 | \$ 4,901,000 |
| Basic earnings per share | \$ 0.44 | \$ 0.35 |
| Diluted earnings per share | \$ 0.44 | \$ 0.33 |
| Weighted average shares outstanding - | | |
| Basic | 14,320,959 | 13,908,144 |
| Diluted | 14,598,080 | 14,671,187 |

See notes to unaudited condensed consolidated financial statements.

MEDIFAST, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY AND
ACCUMULATED OTHER COMPREHENSIVE INCOME
Three Months Ended March 31, 2011
(Unaudited)

| | Number of Shares | Par Value \$0.001 Amount | Additional Paid-In Capital | Retained Earnings | Accumulated other comp income/(loss) | Treasury Stock | Total |
|---|---------------------|-----------------------------------|----------------------------------|----------------------|---|-------------------|---------------|
| Balance, December 31, 2010 | 15,431,101 | \$ 16,000 | \$ 32,938,000 | \$ 42,117,000 | \$ 240,000 | \$ (3,355,000) | \$ 71,956,000 |
| Share-based compensation to executives and directors | | | 682,000 | | | | 682,000 |
| Share-based compensation tax benefit | | | 495,000 | | | | 495,000 |
| Comprehensive income: | | | | | | | |
| Net income | | | | 6,358,000 | | | 6,358,000 |
| Net change in unrealized gain (loss) on investments, net | | | | | (28,000) | | (28,000) |
| Comprehensive income | | | | | | | 6,330,000 |
| Balance at March 31, 2011 | 15,431,101 | \$ 16,000 | \$ 34,115,000 | \$ 48,475,000 | \$ 212,000 | \$ (3,355,000) | \$ 79,463,000 |

See notes to unaudited condensed consolidated financial statements.

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

| | Three Months Ended March 31, | |
|--|------------------------------|-------------------|
| | 2011 | 2010 |
| Cash flows from operating activities: | | |
| Net income | \$ 6,358,000 | \$ 4,901,000 |
| Adjustments to reconcile net income to net cash provided by operating activities from continuing operations: | | |
| Depreciation and amortization | \$ 1,648,000 | \$ 1,398,000 |
| Realized (gain) loss on investment securities, net | (115,000) | 14,000 |
| Share-based compensation | 682,000 | 610,000 |
| Deferred income taxes | 580,000 | 105,000 |
| Changes in assets and liabilities which provided (used) cash: | | |
| Accounts receivable | (192,000) | (425,000) |
| Inventory | 3,667,000 | (2,354,000) |
| Prepaid expenses & other current assets | (257,000) | 1,141,000 |
| Other assets | 4,000 | 136,000 |
| Accounts payable and accrued expenses | 3,578,000 | 5,656,000 |
| Income taxes | 2,795,000 | 2,947,000 |
| Net cash provided by operating activities | 18,748,000 | 14,129,000 |
| Cash Flow from Investing Activities: | | |
| Sale of investment securities | 3,638,000 | 954,000 |
| Purchase of investment securities | (5,537,000) | (2,371,000) |
| Purchase of property and equipment | (3,083,000) | (2,589,000) |
| Net cash used in investing activities | (4,982,000) | (4,006,000) |
| Cash Flow from Financing Activities: | | |
| Repayment of long-term debt | (239,000) | (199,000) |
| Decrease in note receivable | 2,000 | - |
| Excess tax benefits from share-based compensation | 495,000 | 286,000 |
| Net cash provided by financing activities | 258,000 | 87,000 |
| NET CHANGE IN CASH AND CASH EQUIVALENTS | 14,024,000 | 10,210,000 |
| Cash and cash equivalents - beginning of the period | 17,165,000 | 10,604,000 |
| Cash and cash equivalents - end of period | \$ 31,189,000 | \$ 20,814,000 |
| Supplemental disclosure of cash flow information: | | |
| Interest paid | \$ 25,000 | \$ 27,000 |
| Income taxes | \$ - | \$ - |

See notes to unaudited condensed consolidated financial statements

Medifast, Inc.
Notes to Unaudited 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.

The results for the three months ended March 31, 2011 are not necessarily indicative of the results to be expected for the year ending December 31, 2011 or any other portions thereof. Certain information in footnote disclosures normally included in annual financial statements has been condensed or omitted for the interim periods presented in accordance with the rules and regulations of the Securities and Exchange Commission (the "SEC") for interim consolidated financial statements.

These financial statements do not contain all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments consisting of normal, recurring adjustments considered necessary for a fair presentation of the financial position and results of operations have been included.

The consolidated balance sheet as of December 31, 2010 is derived from the audited financial statements included in the Company's Annual Report in Form 10-K filed with the Securities and Exchange Commission for the year ended December 31, 2010 (the 2010 form 10-K), which should be read in conjunction with these consolidated financial statements.

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.Recent Accounting Pronouncements

In January 2010, the FASB issued authoritative guidance revising certain disclosure requirements concerning fair value measurements. The guidance requires an entity to disclose separately significant transfers into and out of Levels 1 and 2 of the fair value hierarchy and to disclose the reasons for such transfers. It also requires the presentation of purchases, sales, issuances and settlements within Level 3, on a gross basis rather than a net basis. These new disclosure requirements were effective for the Company beginning with its first fiscal quarter of 2010, except for the additional disclosure of Level 3 activity, which is effective for fiscal years beginning after December 15, 2010. The Company did not have any such transfers into and out of Levels 1 and 2 during the twelve months ended December 31, 2010. The Company is currently evaluating the full impact of this guidance, but does not expect it to have a material impact on the disclosures in its consolidated financial statements in future filings.

4.Revenue Recognition

Revenue is recognized net of discounts, rebates, promotional adjustments, price adjustments, and estimated returns and upon transfer of title and risk to the customer which occurs at shipping (F.O.B. terms). Upon shipment, the Company has no further performance obligations and collection is reasonably assured as the majority of sales are paid for prior to shipping. Medifast Weight Control Centers program fees are recognized over the estimated service period.

5. Inventories

Inventories consist principally of packaged meal replacements held in the Company's warehouse. Inventory is stated at the lower of cost or market, utilizing the first-in, first-out method. The cost of finished goods includes the cost of raw materials, packaging supplies, direct and indirect labor and other indirect manufacturing costs. On a quarterly basis, management reviews inventory for unsalable or obsolete inventory.

Inventory consist of the following at March 31, 2011 and December 31, 2010

| | 2011 | 2010 |
|----------------|--------------|--------------|
| Raw Materials | \$4,933,000 | \$5,292,000 |
| Packaging | 2,527,000 | 2,791,000 |
| Finished Goods | 8,407,000 | 11,451,000 |
| | \$15,867,000 | \$19,534,000 |

6. Intangible Assets

The Company has acquired certain intangible assets, which include: customer lists, trademarks, patents, and copyrights. The customer lists are being amortized over a 3 year period based on management's best estimate of the expected. The costs of trademarks, patents and copyrights are amortized over 3 to 7 years based on their estimated useful life.

The Company's intangible assets and related amortization included the following:

| | As of March 31, 2011 | | As of December 31, 2010 | | Weighted-Avg. Amortization Period |
|-------------------------------------|--------------------------|-----------------------------|--------------------------|-----------------------------|---|
| | Gross Carrying Amount | Accumulated Amortization | Gross Carrying Amount | Accumulated Amortization | |
| Customer lists | \$235,000 | \$70,000 | \$235,000 | \$50,000 | 3 years |
| Trademarks, patents, and copyrights | 2,053,000 | 1,261,000 | 2,053,000 | 1,166,000 | 7 years |
| Total | \$2,288,000 | \$1,331,000 | \$2,288,000 | \$1,216,000 | |

Amortization expense for the three months ended March 31, 2011 and 2010 was as follows:

| | 2011 | 2010 |
|-------------------------------------|------------|-----------|
| Customer lists | \$ 20,000 | \$ 13,000 |
| Trademarks, patents, and copyrights | 95,000 | 60,000 |
| Total trademarks and intangibles | \$ 115,000 | \$ 73,000 |

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

7.Earnings per Share

Basic earnings per share (“EPS”) computations are calculated utilizing the weighted average number of common shares outstanding during the periods presented. Diluted EPS is calculated utilizing the weighted average number of common shares outstanding adjusted for the effect of dilutive common stock equivalents.

The following table sets forth the computation of basic and diluted EPS for the three months ended March 31:

| | Three Months Ended March 31, | |
|--|---------------------------------|--------------|
| | 2011 | 2010 |
| Numerator: | | |
| Net income | \$ 6,358,000 | \$ 4,901,000 |
| Denominator: | | |
| Weighted average shares of common stock outstanding | 14,320,959 | 13,908,144 |
| Effect of dilutive common stock equivalents | 277,121 | 763,043 |
| Weighted average diluted common shares outstanding | 14,598,080 | 14,671,187 |
| EPS | | |
| Basic | \$ 0.44 | \$ 0.35 |
| Diluted | \$ 0.44 | \$ 0.33 |

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.Fair Value Measurements

Certain financial assets and liabilities are accounted for at fair value, which is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following fair value hierarchy prioritizes the inputs used to measure fair value:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies.

Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management’s best estimate of fair value

from the perspective of a market participant.

The Company's financial instruments include cash and cash equivalents, trade receivables, investment in available-for-sale securities and debt. The carrying amounts of cash and cash equivalents and trade receivables approximate fair value due to their short maturities. The fair value of investment in available for-sale securities are based on quoted market rates. The carrying amount of debt approximates fair value due to the variable rate associated with the debt.

The following table represents the fair value hierarchy for those financial assets measured at fair value on a recurring basis as of March 31, 2011 and December 31, 2010:

| March 31, 2011 | Level I | Level II | Level III | Total |
|-----------------------|---------------|----------|-----------|---------------|
| Investment securities | \$ 19,257,000 | - | - | \$ 19,257,000 |
| Cash equivalents | 611,000 | - | - | 611,000 |
| Total Assets | \$ 19,868,000 | \$ - | \$ - | \$ 19,868,000 |

| December 31, 2010 | Level I | Level II | Level III | Total |
|-----------------------|---------------|----------|-----------|---------------|
| Investment securities | \$ 17,271,000 | - | - | \$ 17,271,000 |
| Cash equivalents | 2,017,000 | - | - | 2,017,000 |
| Total Assets | \$ 19,288,000 | \$ - | \$ - | \$ 19,288,000 |

10. Share-based Compensation

Restricted Stock

The Company has issued restricted stock to employees and directors generally with terms ranging from one to six years. The fair value is equal to the market price of the Company's common stock on the date of grant. Expense for restricted stock is amortized ratably over the vesting period. The following table summarizes the restricted stock activity:

| | Shares | Weighed-Average Grant Date Fair Value |
|-----------------------------|-----------|---|
| Unvested at January 1, 2011 | 786,421 | \$ 5.57 |
| Granted | - | - |
| Vested | (113,583) | 6.00 |
| Forfeited | (40,000) | 6.55 |
| Unvested at March 31, 2011 | 632,838 | 5.77 |

The total restricted stock awards vested and charged against income during the three months ended March 31, 2011 and 2010 was \$682,000 and \$610,000, respectively. The total income tax benefit recognized in the consolidated statement of income for these restricted stock awards was approximately \$266,000 and \$238,000 for the three months ended March 31, 2011 and 2010, respectively. The tax benefit recognized in additional paid-in capital upon vesting of restricted stock awards was approximately \$495,000 and \$286,000 for the three months ending March 31, 2011 and 2010, respectively. There was approximately \$3,652,000 of total unrecognized compensation cost related to restricted stock awards as of March 31, 2011. The cost is expected to be recognized over a weighted-average period of approximately 1.75 years.

11. 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 MWCC and Wholesale. The Medifast reporting segment consists of the following distribution channels: Medifast Direct and Take Shape for Life. The MWCC and Wholesale segment consists of Medifast Corporate and Franchise Weight Control Centers as well as Medifast Wholesale Physicians.

Total assets and operating expenses not identified with a specific segment are listed as “Other” and include items such as auditors’ fees, attorney’s fees, stock compensation expense and corporate governance related to NYSE, Sarbanes Oxley, and SEC regulations. Evaluation of the performance of operating segments is based on their respective income from operations before taxes. 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.

We previously included Medifast Weight Control Centers in “Other” segment, however, in 2010 due to the Weight Control Centers growth we separated this segment along with the Medifast Wholesale Physicians. In addition, we reclassified segment amounts for the prior periods.

The following tables present segment information for the three months ended March 31, 2011 and 2010:

| | Three Months Ended March 31, 2011 | | | |
|--|-----------------------------------|----------------------|-----------------|----------------|
| | Medifast | MWCC & Wholesales | Other | Consolidated |
| Revenues | \$ 66,097,000 | \$ 8,198,000 | \$ - | \$ 74,295,000 |
| Cost of Sales | 15,755,000 | 1,859,000 | - | 17,614,000 |
| Selling, General and Administrative Expense | 38,603,000 | 4,948,000 | 1,431,000 | 44,982,000 |
| Depreciation and Amortization | 1,318,000 | 248,000 | 82,000 | 1,648,000 |
| Interest(net) and other | 7,000 | - | (237,000) | (230,000) |
| Income before income taxes | \$ 10,414,000 | \$ 1,143,000 | \$ (1,276,000) | \$ 10,281,000 |
| Segment Assets | \$ 69,430,000 | \$ 9,831,000 | \$ 26,255,000 | \$ 105,516,000 |

| | Three Months Ended March 31, 2010 | | | |
|--|-----------------------------------|----------------------|-----------------|---------------|
| | Medifast | MWCC & Wholesales | Other | Consolidated |
| Revenues | \$ 53,840,000 | \$ 6,745,000 | \$ - | \$ 60,585,000 |
| Cost of Sales | 13,377,000 | 1,440,000 | - | 14,817,000 |
| Selling, General and Administrative Expense | 31,842,000 | 3,198,000 | 1,129,000 | 36,169,000 |
| Depreciation and Amortization | 1,094,000 | 226,000 | 78,000 | 1,398,000 |
| Interest(net) and other | 10,000 | - | (23,000) | (13,000) |
| Income before income taxes | \$ 7,517,000 | \$ 1,881,000 | \$ (1,184,000) | \$ 8,214,000 |

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| | | | | |
|----------------|---------------|--------------|---------------|---------------|
| Segment Assets | \$ 42,774,000 | \$ 7,226,000 | \$ 24,188,000 | \$ 74,188,000 |
|----------------|---------------|--------------|---------------|---------------|

12

12.Contingencies

The Company has assessed certain non-income tax contingencies in accordance with ASC 450, Accounting for Contingencies, that management believes could be challenged by tax authorities. During the ordinary course of business, there are many transactions for which the ultimate tax determination is uncertain. These potential exposures result from the varying application of statutes, rules, regulations and interpretations. Our assessment reflects assumptions and judgments about potential actions by taxing jurisdictions. We believe that these assumptions and judgments are reasonable; however, our assessment of tax exposures in the future due to new developments may alter our current position on loss contingencies. A successful assertion by one or more states regarding taxes could result in substantial tax liabilities and have a material impact on operating results or cash flows in the periods for which that determination is made.

The Company from time to time is involved in legal proceeding and with claims arising in the ordinary course of business. Although it is not possible to determine the outcome of these matters, it is management's opinion that settlement of such claims will not have a material adverse effect on the Company's financial condition or results in operations.

Medifast, Inc. filed a civil complaint on February 17, 2010 in the U.S. District Court (SD, Cal) against Barry Minkow, his Fraud Discovery Institute, Inc., its subsidiary iBusiness Reporting, its editor William Lobdell, Tracy Coenen, her Sequence, Inc., "Zee Yourself", and Robert L. Fitzpatrick for defamation, violations of California Corporation Code Sections 25400 et seq, and 17200 et seq alleging a scheme of market manipulation of Medifast, Inc. stock by damaging the business reputation of Medifast, Inc. (MED-NYSE) and its meal replacement weight loss products and organization for Defendants monetary gain. Bradley T. MacDonald, Executive Chairman, Medifast, Inc. who is also a large shareholder joined the lawsuit individually. The suit seeks at least \$270 Million in compensatory damages, punitive damages, and ancillary relief. Medifast, Inc. also continues to pursue its pending complaints filed in March, 2009 with the SEC, Maryland Securities Commissioner, and the U.S. Attorney against most of these same named Defendants.

The Chapter 7 Bankruptcy Trustee for Go Fig, Inc et al Debtors filed in early 2010 an adversary civil proceeding in the US Bankruptcy Court (ED, Missouri) against Jason Pharmaceuticals, Inc., a subsidiary of Medifast, Inc. (MED-NYSE) and other unrelated entities seeking to recover as to each alleged preferential payments. Jason sold product received by the Debtors and has previously filed a pending claim in the same bankruptcy. Medifast, Inc. disputes the Trustee's allegations and intends to vigorously defend through its local counsel. Medifast, Inc believes any likely result would not materially affect its operations. This action is currently in the discovery stage.

In 2010 and to date, Jason Pharmaceuticals received four (4) Notices of Charge of Discrimination alleging discrimination filed with the US EEOC by 3 current employees and 1 former employee. The Company intends to investigate and vigorously defend against these claims. Any potential adverse result based on what is presently known would not be material to Company operations.

On March 17, 2011, a class action complaint titled Oren Proter, et al v. Medifast, Inc., et al. (Civil Action 2011-CV-720[BEL]), alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5 promulgated under Section 10(b) of the Securities Exchange Act, was filed for an unspecified amount of damages in the United States District Court, District of Maryland. The complaint alleges that the defendants made false and/or misleading statements and failed to disclose material adverse facts regarding the Company's business, operations and prospects. On March 24, 2011, a class action complaint titled Fred Greenberg v Medifast, Inc. et al (Civil Action 2011-CV776{BEL}), alleging violations of Sections 10(b)5 and 20(a) of the Securities Exchange Act and Rule 10(b)5 promulgated under Section 10(b)5 of the Securities Exchange Act, was filed for an unspecified amount of damages in the United States District Court, District of Maryland. The complaint alleges that the defendants made false and/or

misleading statements and failed to disclose material adverse facts regarding the Company's business, operations and prospects. The Company believes that it has meritorious defenses to each complaint and intends to vigorously defend each proceeding. Accordingly, the Company believes that either proceeding is not likely to have a material adverse effect upon its business or operations.

On April 1, 2011 a shareholder derivative complaint titled Shane Rothenberger, derivatively on behalf of Medifast, Inc. v Bradley T. MacDonald et al. (Civil Action 2011-CV 863 [BEL]); and on April 11, 2011 a shareholder derivative complaint titled James A. Thompson, derivatively on behalf of Medifast, Inc. v Bradley T. MacDonald et al. (Civil Action 2011-CV934 [BEL]) were filed in the United States District Court, District of Maryland. The identically worded Complaints allege breach of fiduciary duties, unjust enrichment, abuse of control, gross mismanagement, and waste of corporate assets. Each requests an unspecified amount of damages, a Court Order directing reformation of corporate governance, restitution to Medifast, Inc. and payment of costs and disbursements. The Company is named as a nominal Defendant. The Company intends to investigate the allegations made in the Complaints.

13.Subsequent Events

The Board of Directors of Medifast, Inc. has authorized the repurchase of up to 500,000 shares of the Company's common stock and pursuant to that authority the Company purchased 200,000 shares of its common stock on April 7th and April 8, 2011 at an average price of \$17.22 per share, aggregating \$3,444,000. There are 165,000 shares remaining beyond the above noted purchase under the Board repurchase plan originally approved and authorized on June 3, 2004 and reaffirmed by recent unanimous Board consent on April 6, 2011. The stock repurchase program may be limited or terminated at any time without prior notice.

Stock repurchases under this program have been made by the Broker through open market and privately negotiated transactions at times and in such amounts as management deemed appropriate pursuant to Rule 10b-18 of the Exchange Act. The timing and actual number of shares repurchased will depend on a variety of factors including price, corporate authorization provisions , above noted regulatory requirements, and other market conditions.

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

Forward Looking Statements: Some of the information presented in this quarterly report constitutes forward-looking statements within the meaning of the private Securities Litigation Reform Act of 1995. Statements that are not historical facts, including statements about management's expectations for fiscal year 2011 and beyond, are forward-looking statements and involve various risks and uncertainties. Although the Company believes that its expectations are based on reasonable assumptions within the bounds of its knowledge, there can be no assurance that actual results will not differ materially from the Company's expectations. The Company cautions investors not to place undue reliance on forward-looking statements which speak only to management's experience on this data.

The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and related notes appearing elsewhere herein.

Background:

The Company is engaged in the production, distribution, and sale of weight management and disease management products and other consumable health and diet products. Medifast, Inc.'s product lines include meal replacements and vitamins. Our products and services are sold to weight loss program participants primarily via the Internet, telephone, and brick and mortar clinics. Customers of our health coaches in the Take Shape for Life person-to-person direct sales channel are directed to order our products through either the Internet or through the Company's in-house call center. Our meal food items accounted for 93% of our revenues for the three months ended March 31, 2011 and 95% of our revenues for the three months ended March 31, 2010. Program sales in our Medifast Weight Control Center channel accounted for 2% of revenues for the first three months of 2011 and 2% for the first three months of 2010. Shipping revenue and other accounted for 5% for the first three months of 2011 and 3% for the first three months of 2010. No other product or service has accounted for more than 1% of consolidated revenue in any of the last three years.

Revenue consists primarily of meal replacement food sales. For the first three months of 2011, revenue increased to \$74.3 million as compared to \$60.6 million for the first three months of 2010, an increase of \$13.7 million or 23%. The Take Shape for Life sales channel accounted for 63% of total revenue, direct response marketing 26%, and Medifast Weight Control Centers and Medifast Wholesale Physicians 11%.

We review and analyze a number of key operating and financial metrics to manage our business, including revenue to spend in the Medifast Direct channel, number of active health coaches and average revenue per health coach per month in the Take Shape for Life channel, and average same store sales improvement for the Medifast Weight Control Center channel.

In the first three months of 2011 we continued to see sales growth and improvement in: Take Shape for Life; Medifast Direct and Medifast Weight Control Centers and Medifast Wholesale Physicians. Take Shape for Life revenue increased 25% to \$46.8 million compared with \$37.6 million in the first three months of 2010. Growth in revenues for the segment was driven by increased customer product sales as a result of an increase in active health coaches. The number of active health coaches during the first three months of 2011 increased to 10,000 compared with 7,100 during the period a year ago, an increase of 41%. The number of active health coaches represents the number of health coaches receiving income from a product sale in the last month of the quarter. The average revenue per health coach per month decreased from \$1,775 in the first three months of 2010 to \$1,600 in the first three months of 2011. The decrease of 10% is primarily due to the challenges in delivering consistent and effective training to a much larger group of active health coaches. Currently, training to the field is done primarily through health coaches training their health coach teams utilizing print materials. To combat this challenge, the company is planning the release of the "official" training website, to be released at the Take Shape for Life annual conference to be held in July 2011. The new site will allow for the best practices of training to be delivered in a format that allows for more user

interaction and distance learning. The training website will be a function of the new e-commerce platform that was released in March of 2011. The new e-commerce platform provides health coaches and their clients with a simple approach to research the program, understand the individual health coaches personal success story and purchase product. The company is confident the release of the new e-commerce platform will simplify the ordering process for the client, leading to improvement in the revenue per health coach statistic. As the number of active health coaches increase, the Company receives additional sales proceeds from product referrals, approximately \$1,600 in product referrals per month for the average coach in the first three months of 2011.

The Medifast Direct Sales division sales increased 18% to \$19.3 million as compared with \$16.4 million in the first three months of 2010, an increase of \$2.9 million. The Company experienced a 2.8 to 1 return on advertising spend in the first three months of 2011 and 2010.

The Medifast Weight Control Centers and Medifast Wholesale Physicians experienced revenue growth of 23% versus the same time period last year. Revenue increased due to the opening of twelve new centers throughout 2010, opening one new centers in the first quarter of 2011, a 7% increase in the same store sales for Centers open for greater than one year, and the increased success of franchise centers. The Company is continuing to focus on improved advertising effectiveness, improved closing rates on leads generated through advertising and improved consumer lifetime value through value add service, and the hiring of more experienced clinic personnel.

If all of our sales divisions continue to grow, there will be increasing demands on our infrastructure. The increased demands could cause long hold times in the call center as well as delays on our website. In addition, there could be delays in order processing, packaging and shipping. We could run out of a majority of our inventory if product sales growth exceeded our production capacity. In order to mitigate these risks, a key focus for the Company in 2011 will be investing in infrastructure to ensure that the Company can support the revenue growth of each of our sales divisions. This initiative included a new Distribution Center that opened in July 2010 to better service our Midwest to West Coast customers and increase the maximum number of orders the Company can ship daily, improved logistics in manufacturing, purchasing and distribution to support our sales growth, an improved web platform for all our sales divisions that launched in March 2011, and expansion of an additional call center location to handle additional call volume. There is also risk that our Independent contractor field leaders and health coaches could leave the company for a better opportunity which could result in decreased revenue from Take Shape for Life channel. This risk is offset by a compensation program that fairly rewards the health coaches for the actions of supporting their clients to their weight loss and health goals, increased revenue per month earned as these same leader health coaches build their organization of health coaches because they have proven to be passionate about helping others and combating the growing obesity epidemic in America at present.

Overview of the Company

Distribution Channels

Take Shape for Life™ - Take Shape for Life is the personal coaching division of Medifast. Take Shape for Life is lead by its co-founder, a physician with a background in critical care. The coaching network consists of independent contractor health coaches, who are trained to provide coaching and support to clients on Medifast weight loss programs. Health coaches are conduits to give clients the encouragement and mentoring to assist them to successfully reach a healthy weight. Take Shape For Life programs provide a road map to empower the individual to take control of their health through better habits. Take Shape for Life offers the exclusive proprietary BeSlim® philosophy, which encourages long-term weight maintenance. Take Shape for Life also moves beyond the scope of weight loss to teach customers how to achieve optimal health through the balance of body, mind, and finances. Take Shape for Life uses the high quality, medically validated products of Medifast that have been proven safe and effective in clinical studies. Health coaches and their clients follow the Habits of Health book and companion workbook written by the Take Shape for Life co-founder to create a lifelong health optimization program. In addition to the encouragement and support of a health coach, clients of Take Shape for Life are offered a bio-network of support including website information, scheduled program support calls and access to registered dieticians via toll free telephone, email and web chats.

Program entrants are encouraged to consult with their primary care physician and a Take Shape for Life Health Coach to determine the Medifast program that is right for them. Health Coaches are required to become qualified based upon testing of their knowledge on Medifast products and programs. Health Coaches may also become certified by The Health Institute, a proprietary training program developed by Medifast professionals.

Take Shape for Life health coaches earn compensation on product sales by referring clients to their replicated Take Shape for Life website or to the Company's in-house call center to purchase product. The client purchases all Medifast

product directly from the Company which is shipped directly to the client. Our health coaches do not handle payment and are not required to hold inventory for resale to clients. In addition, our health coaches pay the same price for product as their clients. Our health coaches provide coaching and support to their clients throughout the weight loss and weight maintenance process. Most new health coaches are recruited by an existing health coach. The vast majority of our new health coaches started as weight loss clients of a health coach, had success on the Medifast product and program, and become a health coach to help others through the weight loss process and receive a commission on any product sales they refer to the Company. In addition, in the Take Shape for Life network approximately 20% of active health coaches are health care providers.

Take Shape for Life health coaches are independent contractors who are paid compensation on product sales referred to the Company. Health coaches can earn compensation in two ways:

- Commissions – The primary way a health coach is compensated is through earning commissions on product sold. Health coaches earn commissions by referring product sales through their own replicated website or through the Company’s in-house call center. The clients of health coaches are responsible for ordering and paying for product, and their order is shipped directly from the Company to the client’s home or designated address. Our health coaches do not handle payment and are not required to purchase or store product in order to receive a commission. In addition, health coaches do not receive a commission on their product orders for their personal use. Health coaches pay the same price for products as their clients. The Company pays retail commissions on a weekly basis.

- Bonuses – health coaches are offered several bonus opportunities, including growth bonuses, generation bonuses, elite leadership bonuses, rolling consistency bonuses, client acquisition bonuses, and customer assist bonuses. The purposes of these bonuses are to reward health coaches for successfully referring product sales to the Take Shape for Life network and to incentivize health coaches to further develop health coaches within their network. The Company pays bonuses on a monthly basis.
 - o Growth bonuses are paid to health coaches that have at least five ordering clients per month and that have generated over \$1,000 in product sales per month. Monthly growth bonuses are incremental bonuses that enable health coaches to earn income on product orders placed by clients or health coaches within their network.
 - o Generation bonuses are paid to health coaches that have one or more health coaches in their business that have achieved the rank of executive director. An executive director is a health coach that either generates \$6,000 a month in frontline product sales to either clients or personally sponsored health coaches or personally sponsors five senior health coaches. A senior health coach is a health coach that generates at least \$1,000 a month in group product sales from a combination of at least five personally enrolled, ordering clients, and/or health coaches, health coach teams, or a combination of both.
 - o Elite leadership bonuses are paid to health coaches that have three or more health coaches in their business that have achieved the rank of executive director.
 - o Rolling consistency bonuses are paid to health coaches that display frontline product sales order consistency month after month. Health coaches that generate at least \$2,000 or more in frontline product sales for three consecutive months are paid a rolling consistency bonus.
 - o Client acquisition bonuses are paid out to new health coaches that within their first 30 calendar days in Take Shape for Life develop five clients and \$1,000 in frontline product sales.
 - o The assist bonuses are paid to health coaches that assist a new health coach in their business attain the client acquisition bonus.

Health coaches do not earn a commission or bonus when they recruit a new health coach into the Take Shape for Life network. Fees paid by new health coaches for start-up materials are at the Company's approximate cost and no commissions are paid thereon.

Take Shape for Life is a member of the Direct Selling Association (DSA), a national trade association representing over 200 direct selling companies doing business in the United States. To become a member of the DSA Take Shape for Life, like other active DSA member companies, underwent a comprehensive and rigorous one-year company review by DSA legal staff that included a detailed analysis of its company business plan materials. This review is designed to ensure that a company's business practices do not contravene DSA's Code of Ethics. Compliance with the requirements of the Code of Ethics is paramount to become and remain a member in good standing of DSA. Accordingly, we believe that membership in DSA by Take Shape for Life demonstrates its commitment to the highest standards of ethics and a pledge not to engage in any deceptive, unlawful, or unethical business practices. Among those Code of Ethics proscriptions are pyramid schemes or endless chain schemes as defined by federal, state, or local laws. Moreover, Take Shape for Life, like other DSA member companies in good standing, has pledged to provide consumers with accurate and truthful information regarding the price, grade, quality, and performance of the products Take Shape for Life markets.

Medifast Direct – In the direct to consumer channel ("Medifast Direct"), customers order Medifast product directly through the Company's website, www.choosemedifast.com, or our in-house call center. The product is shipped directly to the customer's home. This business is driven by an aggressive multi-media customer acquisition strategy that includes both national and regional print, radio, web advertising, direct mail and television as well as public relations and social media initiatives. The Medifast Direct division focuses on targeted marketing initiatives and provides customer support through its in-house call center and nutrition support team of registered dietitians to better serve its customers. In addition, Medifast continues uses leading web technology featuring customized meal planning

and web community components. MyMedifast is a robust online community which provides a library of support articles, support forums, meal planning tools and social media functions.

Medifast Weight Control Centers – The Medifast Weight Control Center is the brick and mortar clinic channel of Medifast with locations in Texas, Florida, Maryland and Virginia. In 2010, the Company opened twelve new Medifast Weight Control Centers and had a total of thirty-nine locations in operation at year-end. At March 31, 2011 forty Company owned Medifast Weight Control Centers were in operation. The centers offer a high-touch model including comprehensive Medifast programs for weight loss and maintenance, customized patient counseling, and Inbody TM composition analysis. Medifast Weight Control Centers conduct local advertising including radio, print, television and web initiatives. The centers also benefit from the nationally advertised brand which encourages walk-ins and referrals from other Medifast business channels.

In 2008, the Company began offering the clinic model as a franchise opportunity. The Company currently has franchisee centers located in Alabama, Arizona, California, Pennsylvania and Minnesota. At March 31, 2011 twenty-two franchise locations were in operation.

Medifast currently offers the Medifast Weight Control Center franchise opportunity in all States except Hawaii, N. Dakota, S. Dakota, and Wisconsin under an approved franchise disclosure document (FDD). The FDD requires a successful applicant to develop a minimum of three Medifast Centers within a defined geographic area in the time frame set forth in the area development agreement between Medifast and the franchisees.

Our franchise strategy depends upon on our franchisees' active involvement in and management of Medifast Weight Control Center operations. Candidates are reviewed for appropriate operational experience and financial stability, including specific net worth and liquidity requirements. Upon franchisee approval they shall promptly select a site for the Center and shall request Franchisor's approval of such selection based on guidelines, terms, and conditions.

A franchisees initial fee covers the cost of Company resources provided to train applicant and staff, and determine territory for development. If a successful applicant desires to open more than three centers in the designated territory, there is an additional fee for each location over the three to be developed. The Company provides initial investment estimates in the FDD and cautions applicants considering the franchise opportunity that their actual expenses may vary from the estimates given. Legal disclosures are given and the applicant cannot sign the Agreement until he/she has had 14 days to consider the FDD.

Prior to the opening of each Medifast® Center established under the area development agreement, the company will do the following:

- i. designate the Center's Protected Territory,
- ii. if the Company has not already approved a site that the franchisee has selected before signing the Franchise Agreement, designate the area within which the franchisee will locate the Center and approve the site the franchisee has selected for the location of the Center.
- iii. if the Company has not already approved a site before signing the Franchise Agreement, review and approve the franchisee lease or purchase agreement for the site for the approved location.
- iv. provide the franchisee with standard plans and specifications for the build-out of the Center along with a list of equipment and improvements which the franchisee is required to purchase and install.
- v. provide an initial training program.
- vi. provide the franchisee on-site assistance and guidance for approximately three (3) to five (5) days during or close to the opening of the Center.
- vii. provide the franchisee with online access to a password-protected, electronic version of the Medifast Weight Control Centers® Operations Manual.

No products or equipment are provided at a discounted purchase price. In addition, the Company does not offer direct or indirect financing. We do not guarantee franchisee's notes, leases or obligations.

The Company does not currently have a purchase option included in the franchise agreement. The Company does have the right of first refusal to acquire a center if the franchisee wishes to sell or defaults in his/her/ or its obligations

MEDIFAST WHOLESALE PHYSICIANS

Medifast physicians have implemented the Medifast program within their practice or clinic since 1980. These physicians carry an inventory of Medifast products and resell them to patients. They also provide appropriate medical monitoring, testing, and support for patients on the program. Management estimates that more than 20,000 physicians nationwide have recommended Medifast as a treatment for their overweight patients since 1980, and over an estimated 1 million patients have used its' products at the recommendation of Medifast Physicians to lose and maintain their weight. Many Medifast physicians prefer not to carry inventory and resell products in their offices and take advantage of the Medifast Direct or the Take Shape for Life program to support their patient base.

The Company offers an additional in-house support program to assist customers that are consulting their primary care physician. Customers have access to registered dieticians that provide program support and advice via a toll free telephone help line, by e-mail and online chats.

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 the consolidated financial statements filed on Form 10-K.

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, and estimated returns and upon transfer of title and risk to the customer which occurs at shipping (F.O.B. terms.) Upon shipment, the Company has no further performance obligations and collection is reasonably assured as the majority of sales are paid for prior to shipping. Medifast Weight Control Centers program fees are recognized over the estimated service period.

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: The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more-likely-than-not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

We evaluated our material tax positions and determined that we did not have any material uncertain tax positions requiring recognition of a liability. Our policy is to recognize interest and penalties accrued on uncertain tax positions as part of income tax expense. For the three months ended March 31, 2011 and 2010, no estimated interest or penalties were recognized for the uncertainty of certain tax positions. We file income tax returns in the United States and various states jurisdictions. With few exceptions, we are no longer subject to U.S. federal, state and local income tax examinations by tax authorities for the years before 2007.

Reserves for Returns: We review the reserves for customer returns at each reporting period and adjust them to reflect data available at that time. To estimate reserves for returns, we consider actual return rates in preceding periods. To the extent the estimate of returns changes, we will adjust the reserve, which will impact the amount of product sales revenue recognized in the period of the adjustment. Our estimates for returns have not differed materially from our actual returns. The provision for estimated returns as of March 31, 2011 and December 31, 2010 were \$0.3 million and \$0.2 million, respectively.

Advertising Costs: Advertising costs, other than direct-response advertising, such as preparation, layout, design and production of advertising are expensed when the advertisement is first used, except for the costs of executory contracts, which are amortized as performance under the contract is received.

Inventory: Inventories consist principally of packaged meal replacements held in the Company's warehouse. Inventory is stated at the lower of cost or market, utilizing the first-in, first-out method. The cost of finished goods includes the cost of raw materials, packaging supplies, direct and indirect labor and other indirect manufacturing costs. On a quarterly basis, management reviews inventory for unsalable or obsolete inventory.

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Overview of the Three Months Ended March 31, 2011 Compared to Three Months Ended March 31, 2010

| | Three Months Ended March 31, 2011, | | | |
|--------------------------------------|------------------------------------|---------------|---------------|----------|
| | 2011 | 2010 | \$ Change | % Change |
| Revenue | \$ 74,295,000 | \$ 60,585,000 | \$ 13,710,000 | 23 % |
| Cost of sales | 17,614,000 | 14,817,000 | 2,797,000 | 19 % |
| Gross Profit | 56,681,000 | 45,768,000 | 10,913,000 | 24 % |
| Selling, general, and administration | 46,630,000 | 37,567,000 | 9,063,000 | 24 % |
| Income from operations | 10,051,000 | 8,201,000 | 1,850,000 | 23 % |
| Other income/(expense) | | | | |
| Interest income (expense), net | 115,000 | 28,000 | 87,000 | 311 % |
| Other | 115,000 | (15,000) | 130,000 | -867 % |
| | 230,000 | 13,000 | 217,000 | 1669 % |
| Income before income taxes | 10,281,000 | 8,214,000 | 2,067,000 | 25 % |
| Provision for income tax | (3,923,000) | (3,313,000) | (610,000) | 18 % |
| Net income | \$ 6,358,000 | \$ 4,901,000 | \$ 1,457,000 | 30 % |
| % of revenue | | | | |
| Gross Profit | 76.3 % | 75.5 % | | |
| Selling, general, and administration | 62.8 % | 62.0 % | | |
| Income from Operations | 13.5 % | 13.5 % | | |

Three Months Ended March 31, 2011 and March 31, 2010

Revenue: Revenue increased to \$74.3 million in the first quarter of 2011 compared to \$60.6 million in the first quarter of 2010, an increase of \$13.7 million or 23%. The Take Shape for Life sales channel accounted for 63% of total revenue; Medifast Direct channel accounted for 26%, and Weight Control Centers and Medifast Wholesale Physicians accounted for 11% of total revenue. Take Shape for Life sales, which are fueled by increased customer product sales as a result of an increase in active health coaches increased by 25% as compared to the first three months of 2010. As compared to the first three months of 2010, the Medifast Direct Response sales channel, which is fueled primarily by consumer advertising, increased revenues by approximately 18% year-over year. The Medifast Weight Control Centers and Medifast Wholesale Physicians increased sales by 23% due to the opening of new corporate and franchise locations and year over year improvement in same store sales.

Take Shape for Life revenue increased 25% to \$46.8 million compared with \$37.6 million in the comparable quarter of 2010. Growth in revenues for the distribution channel was driven by increased customer product sales as a result of an increase in active health coaches. The number of active health coaches during the first quarter increased to approximately 10,000 compared with 7,100 during the period a year ago, an increase of 41%. In today's environment where trust and personal recommendations are becoming a more important component in consumer purchasing decisions, the Take Shape for Life model of one-on-one communication continues to excel. Take Shape for Life customers who have utilized the Medifast products and programs and successfully have addressed their body weight and health issues are increasingly choosing to become active health coaches. Becoming a health coach is a business

opportunity that has a low cost of start-up and requires no holding of inventory as all orders are shipped to the end consumer. In the current economic environment, many people are looking for supplemental income to assist in paying bills such as the car payment, rent, or mortgage, and becoming a health coach allows for supplemental income in the form of a commission compensation on product sales and supporting the customer needs by providing education on the program and support to customers ordering through Take Shape for Life and most importantly the ability to help others regain their health through the use of clinically proven Medifast products.

The Medifast Direct Response Sales division sales increased 18% to \$19.3 million as compared with \$16.4 million in the first quarter of 2010, an increase of \$3 million. Due to a more effective advertising message, more targeted advertising through extensive analytical analysis, and improved call center closing rates the company experienced a 2.8 to 1 return on advertising spend during the first quarter of 2011 and 2010. The Company spent approximately \$6.8 million on direct response advertising in the first quarter of 2011, an increase of 18% from the first quarter of 2010.

The Medifast Weight Control Centers and Medifast Wholesale Physicians channel represent approximately 11% of the Company's overall revenues. At March 31, 2011, Medifast Weight Control Centers were operating in forty corporate locations in Austin, Dallas, Houston, Orlando, Baltimore, and Washington, D.C., and twenty two franchise centers were in operation. In the first quarter of 2011, the Company experienced revenue growth of 23% versus the same time period last year. In the first quarter of 2011, same store sales increased by 7% for corporate Centers open greater than one year. Throughout 2011, the Company anticipates opening an additional 25-30 corporately owned Medifast Weight Control Centers.

Costs of Sales: Cost of sales increased \$2.8 million in the first three months of 2011 to \$17.6 million as compared to \$14.8 million in first three months of 2010. As a percentage of sales, gross margin increased to 76.3% from 75.5% in the first quarter of 2010. The 80 bps improvement in gross margin percentage resulted in a \$600,000 improvement in gross margin based on first quarter 2011 sales volume of \$74.3 million. The gross margin improvement was primarily the result of decreased shipping cost as a percentage of sales as well as improved labor and overhead absorption.

Selling, General and Administrative: Overall, selling, general and administrative expenses increased by \$9.1 million as compared to the first quarter of 2010. As a percentage of sales, selling, general and administrative expenses increased to 62.8% versus 62.0% in the first quarter of 2010. Take Shape for Life commission expense, which is completely variable based upon product sales, increased by approximately \$3.2 million as the Company showed sales growth of 25% as compared to the first quarter of 2010. Take Shape for Life health coaches are independent contractors that are paid commissions on product sales referred to the Company. Health coaches earn commissions by referring product sales through their own replicated website or through the Company's in-house call center. The clients of health coaches are responsible for order and payment of product and their order is shipped directly to their home or designated address. Health coaches are not required to purchase product in order to receive a commission. In addition, health coaches do not receive a commission on their personal product orders. Salaries and benefits increased by approximately \$2.7 million in the first quarter of 2011 as compared to last year. The increase includes the hiring of additional expertise in critical areas such as the Medifast Weight Control Centers division that hired additional expertise in regional trainers, regional managers, operations, and marketing to support the growth of 25-30 new corporate center openings in 2011 as well as the forty corporate centers and 22 franchise centers in operation as of March 31, 2011. Areas that also experienced additional staffing due to the 23% sales growth in the first quarter of 2011 include manufacturing, distribution, call center, and IT. The opening of the Company's new Dallas, TX distribution center in July of 2010 also led to the hiring of additional personnel in both distribution and the call center. Sales and marketing expense increased by \$1.3 million in the first quarter of 2011 as compared to prior year, primarily due to the \$1 million increase in Medifast Direct advertising. Communication expense increased \$175,000 and other expenses increased by \$450,000 which included items such as depreciation, amortization, credit card processing fees, charitable contributions, and property taxes. Operating expenses were flat as compared to the first quarter of 2010. Office expense increased by \$1.2 million which included items such as accounting fees, legal fees, insurance expense, and rent expense. Stock compensation expense increased by \$73,000.

Income taxes: In the first quarter of 2011, the Company recorded \$3.9 million in income tax expense, which represents an effective rate of 38.2%. For the first quarter of 2010, we recorded income tax expense of \$3.3 million which reflected an estimated effective tax rate of 40.3%. The Company anticipates a tax rate of approximately 38-39% in 2011.

Net income: Net income was approximately \$6.4 million for the first quarter of 2011 as compared to approximately \$4.9 million for the first quarter of 2010, an increase of 30%. Pre-tax profit as a percent of sales increased to 13.8% in the first quarter of 2011 as compared to 13.6% in 2010. The improved profitability in the first quarter of 2011 is due to sales growth in the Take Shape for Life division, Medifast Weight Control Centers and Medifast Wholesale Physicians, and Direct Response sales channels, gross margin improvement, and leveraging the fixed costs associated with our vertically-integrated support structure.

SEGMENT RESULTS OF OPERATIONS

Net Sales by Segment for the Three Months Ended March 31,

| Segments | 2011 | | 2010 | |
|--------------------|---------------|------------|---------------|------------|
| | Sales | % of Total | Sales | % of Total |
| Medifast | \$ 66,097,000 | 89 % | \$ 53,840,000 | 89 % |
| MWCC and Wholesale | 8,198,000 | 11 % | 6,745,000 | 11 % |
| Total Sales | \$ 74,295,000 | 100 % | \$ 60,585,000 | 100 % |

Three Months Ended March 31, 2011 and March 31, 2010

Medifast Segment: The Medifast segment consists of the sales of Medifast Direct Marketing and Take Shape for Life. As this represents the majority of our business this is referenced to the “Overview of the Three Months Ended March 31, 2011 compared to Three Months Ended March 31, 2010” above.

MWCC and Wholesale Segment: The MWCC and Wholesale segment consists of the sales of Medifast Corporate and Franchise Weight Control Centers as well as Medifast Wholesale Physicians. Sales increased by \$1.5 million, or 22% year-over year due to the opening of twelve new corporately-owned centers throughout 2010, a 7% increase in the same store sales for Centers open for greater than one year, and increased sales to the Company’s franchise centers. The Company is continuing to focus on improved advertising effectiveness, improved on trends generated through advertising and improved consumer lifetime value through value and service, developing a new operating system to enhance the customer experience and store operations as well as the hiring of more experienced clinic personnel. At the end of the first quarter of 2011, there were forty corporately owned centers opened as compared to twenty seven centers at the end of the first quarter of 2010. The company had twenty-two franchise centers in operation as of March 31, 2011 as compared to 18 franchise centers in the same period in prior year. In 2011, the Company plans on opening an additional 25-30 corporately owned Medifast Weight Control Centers.

Operating Profit by Segment for the Three Months Ended
March 31,

| Segments | 2011 | | 2010 | |
|------------------------|---------------|------------|--------------|------------|
| | Profit | % of Total | Profit | % of Total |
| Medifast | \$ 10,414,000 | 102 % | \$ 7,517,000 | 92 % |
| MWCC & Wholesale | \$ 1,143,000 | 11 % | \$ 1,881,000 | 23 % |
| All Other | (1,276,000) | -12 % | (1,184,000) | -14 % |
| Total Operating Profit | \$ 10,281,000 | 100 % | \$ 8,214,000 | 100 % |

Three Months Ended March 31, 2011 and March 31, 2010

Medifast Segment: The Medifast reporting segment consists of the profits of Medifast Direct Marketing and Take Shape for Life. As this represents the majority of our business this is referenced to the “Overview of the Three Months Ended March 31, 2011 compared to Three Months Ended March 31, 2010” above. See footnote 11, “Business Segments” for a detailed breakout of expenses.

MWCC and Wholesale Segment: This segment decreased net profitability for the first three months of 2011 as compared to the same period in prior year by \$738,000. The decrease in net profitability is primarily due to the hiring of expertise in key areas to build the internal infrastructure to open 25-30 new corporately owned Medifast Weight Control Centers in 2011. Hires included regional trainers, regional managers, operations support, and marketing. Seven new corporate centers were opened at the end of 2010 which also resulted in decreased profitability as the stores were in the start-up phase during the first quarter of 2011. The Company is continuing to focus on improved advertising effectiveness, improved on trends generated through advertising and improved consumer lifetime value through value and service, developing a new operating system to enhance the customer experience and store operations as well as the hiring of more experienced clinic personnel. See footnote 11, "Business Segments" for a detailed breakout of expenses.

All Other Segment: The All other segment consists of corporate expenses related to the parent company operations. Compared to the first quarter of 2011, parent company expenses increased by \$92,000. Corporate expenses include items such as auditors' fees, attorney's fees, stock compensation expense and corporate governance related to NYSE, Sarbanes Oxley, and SEC regulations. See footnote 11, "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 2011, 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.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates and a decline in the stock market. The Company does not enter into derivatives, foreign exchange transactions or other financial instruments for trading or speculative purposes. The Company has limited exposure to market risks related to changes in interest rates. The principal risks of loss arising from adverse changes in market rates and prices to which the Company and its subsidiaries are exposed relate to interest rates on debt. Since nearly all of our debt is variable rate based, any changes in market interest rates will cause an equal change in our net interest expense. At March 31, 2011, there was \$5.2 million of variable interest loans outstanding which is subject to interest rate risk. Interest rates on our variable rate loans ranged from 1.56% to 2.76% for the period ended March 31, 2011. Each 100 basis point increase in the bank's LIBOR rates relative to these borrowings would impact interest expense by \$52,000 over a 12-month period.

We are exposed to market risk related to changes in interest rates and market pricing impacting our investment portfolio. Our current investment policy is to maintain an investment portfolio consisting mainly of U.S. money market and high-grade corporate securities, directly or through managed funds. Our cash is deposited in and invested through highly rated financial institutions in North America. Our marketable securities are subject to interest rate risk and market pricing risk and will fall in value if market interest rates increase or if market pricing decreases. If market interest rates were to increase and market pricing were to decrease immediately and uniformly by 10% from levels at March 31, 2011, we estimate that the fair value of our investment portfolio would decline by an immaterial amount and therefore we would not expect our operating results or cash flows to be affected to any significant degree by the effect of a change in market conditions on our investments.

Item 4. Controls and Procedures

Management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of March 31, 2011. Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported accurately and on a timely basis.

Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were not effective as of March 31, 2011, because of the material weaknesses in internal control over financial reporting discussed in the fiscal 2010 Form 10-K. As a result of the Company's rapid growth, there has been a strain on internal resources to effectively monitor the financial close process. The material weaknesses related to certain expenses not being accounted for in the proper period in accordance with generally accepted accounting principles in the United States ("GAAP"). Historically, our accounts payable and accrued expense accounts were evaluated on a quarterly and annual basis based upon whether the corresponding expenses were fairly stated (e.g. by analyzing whether our operating results included twelve months of expenses for the yearly periods or three months of expenses for the quarterly periods). However, our procedures did not include a detailed review of ending liability balances for these specific costs and expenses, which resulted in certain expenses being recorded when they were paid rather than incurred. In addition, management determined that our remediation efforts of prior year's material weakness surrounding the income tax process, as disclosed in the 2009 Form 10-K, had not been in place for a sufficient period of time to demonstrate that their effectiveness is sustainable. We concluded that a material weakness still existed in the preparation and review process for the calculation of the tax provision due to the complexities of accounting for income taxes and applying tax law to our tax positions and the lack of internal tax expertise.

As a consequence of that determination, we are in the process of implementing procedures designed to detect or prevent these errors from occurring in the future that we expect to have in place by June 30, 2011. We are completing the recruiting process for a key management level finance employee with the technical accounting knowledge and expertise to effectively monitor the financial close process. We have also specifically reviewed our expense recognition policy to identify control enhancements that ensure expenses are recognized in the proper period and that we are in compliance with generally accepted accounting principles in the United States (“GAAP”). Although our formalized controls are not yet in place, a detailed review was performed by Internal Audit to verify that the financial statements were materially accurate in relation to the recognition of expenses as of March 31, 2011.

In addition, in March 2011 we engaged an expert tax consultant with experience in ASC740, “Accounting for Income Taxes,” who is responsible for managing the tax provision process until a point at which management determines an in-house expert would be preferred. The tax provision will also be reviewed by management on a quarterly basis.

Because of the material weaknesses in internal control over financial reporting described in the fiscal 2010 Form 10-K, we performed additional analyses and other post-closing procedures to ensure that our consolidated financial statements were prepared in accordance with generally accepted accounting principles in the United States (“GAAP”). Accordingly, management, including our Chief Executive Officer and Chief Financial Officer, believes the consolidated financial statements included in this report fairly presented, in all material respects, our financial conditions, results of operations and cash flows for the periods presented.

Changes in Internal Control over Financial Reporting:

There were changes in the Company’s internal controls over financial reporting (as such term is defined in Rules 13a-15(f) or 15d-15(f) under the Exchange Act) during the last fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting. We identified a material weakness in our internal control over financial reporting and have described the changes to our internal controls over financial reporting designed to remediate this material weakness. Additionally, as a consequence of that determination, we are in the process of implementing procedures designed to detect or prevent these errors from occurring in the future that we expect to have in place as of June 30, 2011. We are completing the recruiting process for a key management level finance employee with the technical accounting knowledge and expertise to effectively monitor the financial close process. We have also specifically reviewed our expense recognition policy to identify control enhancements that ensure expenses are recognized in the proper period and that we are in compliance with generally accepted accounting principles in the United States (“GAAP”). Although our formalized controls are not yet in place, a detailed review was performed by Internal Audit to verify that the financial statements were materially accurate in relation to the recognition of expenses as of March 31, 2011.

In addition, in March 2011 we engaged an expert tax consultant with experience in ASC740, “Accounting for Income Taxes” who is responsible for managing the tax provision process until a point at which management determines an in-house expert would be preferred. The tax provision is also reviewed by management on a quarterly basis.

Part II Other Information

Item 1. Legal Proceedings

Medifast, Inc. filed a civil complaint on February 17, 2010 in the U.S. District Court (SD, Cal) against Barry Minkow, his Fraud Discovery Institute, Inc., its subsidiary iBusiness Reporting, its editor William Lobdell, Tracy Coenen, her Sequence, Inc., “Zee Yourself”, and Robert L. Fitzpatrick for defamation, violations of California Corporation Code Sections 25400 et seq, and 17200 et seq alleging a scheme of market manipulation of Medifast, Inc. stock by damaging the business reputation of Medifast, Inc. (MED-NYSE) and its meal replacement weight loss products and

organization for Defendants monetary gain. Bradley T. MacDonald, Executive Chairman, Medifast, Inc. who is also a large shareholder joined the lawsuit individually. The suit seeks at least \$270 Million in compensatory damages, punitive damages, and ancillary relief. Medifast, Inc. also continues to pursue its pending complaints filed in March, 2009 with the SEC, Maryland Securities Commissioner, and the U.S. Attorney against most of these same named Defendants.

The Chapter 7 Bankruptcy Trustee for Go Fig, Inc et al Debtors filed in early 2010 an adversary civil proceeding in the US Bankruptcy Court (ED, Missouri) against Jason Pharmaceuticals, Inc., a subsidiary of Medifast, Inc. (MED-NYSE) and other unrelated entities seeking to recover as to each alleged preferential payments. Jason sold product received by the Debtors and has previously filed a pending claim in the same bankruptcy. Medifast, Inc. disputes the Trustee's allegations and intends to vigorously defend through its local counsel. Medifast, Inc believes any likely result would not materially affect its operations. This action is currently in the discovery stage.

In 2010 and to date, Jason Pharmaceuticals received four (4) Notices of Charge of Discrimination alleging discrimination filed with the US EEOC by 3 current employees and 1 former employee. The Company intends to investigate and vigorously defend against these claims. Any potential adverse result based on what is presently known would not be material to Company operations.

On March 17, 2011, a class action complaint titled Oren Proter, et al v. Medifast, Inc., et al. (Civil Action 2011-CV-720[BEL]), alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act and Rule 10b-5 promulgated under Section 10(b) of the Securities Exchange Act, was filed for an unspecified amount of damages in the United States District Court, District of Maryland. The complaint alleges that the defendants made false and/or misleading statements and failed to disclose material adverse facts regarding the Company's business, operations and prospects. On March 24, 2011, a class action complaint titled Fred Greenberg v Medifast, Inc. et al (Civil Action 2011-CV776{BEL}), alleging violations of Sections 10(b)5 and 20(a) of the Securities Exchange Act and Rule 10(b)5 promulgated under Section 10(b)5 of the Securities Exchange Act, was filed for an unspecified amount of damages in the United States District Court, District of Maryland. The complaint alleges that the defendants made false and/or misleading statements and failed to disclose material adverse facts regarding the Company's business, operations and prospects. The Company believes that it has meritorious defenses to each complaint and intends to vigorously defend each proceeding. Accordingly, the Company believes that either proceeding is not likely to have a material adverse effect upon its business or operations.

On April 1, 2011 a shareholder derivative complaint titled Shane Rothenberger, derivatively on behalf of Medifast, Inc. v Bradley T. MacDonald et al. (Civil Action 2011-CV 863 [BEL]); and on April 11, 2011 a shareholder derivative complaint titled James A. Thompson, derivatively on behalf of Medifast, Inc. v Bradley T. MacDonald et al. (Civil Action 2011-CV934 [BEL]) were filed in the United States District Court, District of Maryland. The identically worded Complaints allege breach of fiduciary duties, unjust enrichment, abuse of control, gross mismanagement, and waste of corporate assets. Each requests an unspecified amount of damages, a Court Order directing reformation of corporate governance, restitution to Medifast, Inc. and payment of costs and disbursements. The Company is named as a nominal Defendant. The Company intends to investigate the allegations made in the Complaints.

Item 1A. Risk Factors

Information about risk factors for the three months ended March 31, 2011, does not differ materially from those in set forth in Part I, Item 1A, of our Annual Report on Form 10-K for the year ended December 31, 2010.

Item 5. Other Information

On September 3, 2004, our Board of Directors authorized the repurchase of up to 500,000 shares of our common stock. Depending upon market conditions, shares may be repurchased from time to time at prevailing market prices through open market or privately negotiated transactions.

We are not obligated to purchase any shares. Subject to applicable securities laws repurchases may be made at such times and in such amounts, as our management deems appropriate. The share repurchase program may be discontinued or terminated at any time and we have not established a date for completion of the share repurchase program. The repurchases will be funded from our available cash. As of March 31, 2011, we had purchased 135,000 shares as treasury stock through the repurchase program noted above.

Subsequent to March 31, 2011, the Company purchased 200,000 shares of its common stock on April 7th and April 8, 2011 at an average price of \$17.22 per share, aggregating \$3,444,000. There are 165,000 shares remaining beyond the above noted purchase under the Board repurchase plan originally approved and authorized on June 3, 2004 and reaffirmed by recent unanimous Board consent on April 6, 2011. The stock repurchase program may be limited or

terminated at any time without prior notice.

The following is a summary of our common stock purchases during the quarter ended March 31, 2011:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs |
|--------------------------------|----------------------------------|------------------------------|--|--|
| January 1 - January 31, 2011 | - | - | - | 365,000 |
| February 1 - February 28, 2011 | - | - | - | 365,000 |
| March 1 - March 31, 2011 | - | - | - | 365,000 |

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
(principal executive officer)

May 10, 2011

BY: /S/ BRENDAN N. CONNORS
Brendan N. Connors
Chief Financial Officer
(principal financial officer)

May 10, 2011

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 |

27
