

MEDIFAST INC  
Form 10-Q/A  
September 06, 2007

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

**FORM 10-Q/A**

**Amendment No. 1**

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

For the quarterly period ended March 31, 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

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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.

<b>Class</b>	<b>Outstanding at May 8, 2007</b>
Common stock, \$.001 par value per share	13,668,998 shares

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Explanatory Note

This Amendment No. 1 to our Form 10-Q for the period ended March 31, 2007 is being filed for the purpose of adding to or clarifying our Significant Accounting Policies, financial statements, footnotes, and Management Discussion and Analysis. In regard to our Significant Accounting Policies we have included detail on our deferred compensation plan. We have also provided additional information on intangible assets to include the useful lives each type of intangible asset is being amortized over as well as additional information on how the Company tests for impairment. The Company has also clarified its revenue recognition policy.

The Company has restated its financial statements to properly record amortization expense for the three months ended March 31, 2006 and March 31, 2007. See footnote 12 for additional detail.

In the footnotes, the Company has included segment reporting footnote disclosure per Financial Accounting Standards Board Statement No. 131, "Disclosures about Segments of an Enterprise and Related Information." The Company has added additional segment information to include 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.

Item 7, "Management Discussion and Analysis" has been updated to include additional detail on selling, general, and administrative expenses changes for the three months ended March 31, 2006 and March 31, 2007

Except as discussed above, we have not modified or updated the disclosure presented in the original quarterly filing. This Form 10-Q/A does not reflect events that have occurred after the filing of the original quarterly report or modify or update disclosures presented in the original quarterly filing affected by subsequent events. Accordingly, this Form 10-Q/A should be read in conjunction with our filings made with the Securities and Exchange Commission ("SEC") subsequent to the date of the filing of the original quarterly report.

In addition, in accordance with applicable SEC rules, this Form 10-Q/A includes updated certifications from our Chief Executive Officer and Chief Financial Officer.

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

	(Restated) March 31, 2007 (Unaudited)	(Restated) December 31, 2006 (Audited)
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash	\$ 1,857,000	\$ 1,085,000
Accounts receivable-net of allowance for doubtful accounts of \$100,000	525,000	448,000
Inventory	8,707,000	8,255,000
Investment securities	1,414,000	1,540,000
Deferred compensation	798,000	673,000
Prepaid expenses and other current assets	3,483,000	2,599,000
Note receivable - current	174,000	174,000
Deferred tax asset	92,000	90,000
<b>Total Current Assets</b>	<b>17,050,000</b>	<b>14,864,000</b>
Property, plant and equipment - net	14,575,000	14,020,000
Trademarks and intangibles - net	5,817,000	5,874,000
Deferred tax asset, net of current portion	603,000	517,000
Note receivable, net of current portion	1,314,000	1,355,000
Other assets	53,000	47,000
<b>TOTAL ASSETS</b>	<b>\$ 39,412,000</b>	<b>\$ 36,677,000</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current liabilities:</b>		
Accounts payable and accrued expenses	\$ 3,615,000	\$ 2,913,000
Income taxes payable	689,000	535,000
Line of credit	1,906,000	1,256,000
Current maturities of long-term debt	528,000	548,000
<b>Total current liabilities</b>	<b>6,738,000</b>	<b>5,252,000</b>
Long-term debt, net of current portion	3,392,000	3,509,000
<b>Total Liabilities</b>	<b>10,130,000</b>	<b>8,761,000</b>
<b>Stockholders' Equity:</b>		
Common stock; par value \$.001 per share; 20,000,000 authorized; 13,643,998 and 12,782,791 shares issued and outstanding, respectively	14,000	14,000
Additional paid-in capital	26,752,000	26,629,000
Accumulated other comprehensive income	348,000	334,000
Retained Earnings	7,354,000	5,981,000
	<b>34,468,000</b>	<b>32,958,000</b>
Less: cost of 274,184 and 210,902 shares of common stock in treasury	(1,994,000)	(1,686,000)
Less: unearned compensation	(3,192,000)	(3,356,000)
<b>Total Stockholders' Equity</b>	<b>29,282,000</b>	<b>27,916,000</b>

<b>TOTAL LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>	<b>\$</b>	<b>39,412,000</b>	<b>\$</b>	<b>36,677,000</b>
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See accompanying notes to condensed consolidated financial statement.

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

	<b>Three Months Ended March 31,</b>	
	(Restated)	(Restated)
	<b>2007</b>	<b>2006</b>
	(Unaudited)	(Unaudited)
Revenue	\$ 20,089,000	\$ 19,183,000
Cost of sales	5,058,000	4,778,000
<b>Gross Profit</b>	<b>15,031,000</b>	<b>14,405,000</b>
Selling, general, and administration	13,117,000	11,455,000
<b>Income from operations</b>	<b>1,914,000</b>	<b>2,950,000</b>
Other income/(expense)		
Interest expense	(95,000)	(89,000)
Interest income	33,000	98,000
Other expense	51,000	79,000
	(11,000)	88,000
<b>Net income before provision for income taxes</b>	<b>1,903,000</b>	<b>3,038,000</b>
Provision for income tax (expense)	(530,000)	(1,037,000)
<b>Net income</b>	<b>\$ 1,373,000</b>	<b>\$ 2,001,000</b>
Basic earnings per share	\$ 0.11	\$ 0.15
Diluted earnings per share	\$ 0.10	\$ 0.15
Weighted average shares outstanding -		
Basic	12,899,543	12,965,518
Diluted	13,690,788	13,474,411

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	(Restated) 2007 (Unaudited)	(Restated) 2006 (Unaudited)
<b>Cash flows from operating activities:</b>		
Net income	\$ 1,373,000	\$ 2,001,000
<b>Adjustments to reconcile net income to net cash provided by operating activities from continuing operations:</b>		
Depreciation and amortization	786,000	540,000
Realized (gain) loss on investment securities	32,000	(19,000)
Loss on sale of Consumer Choice Systems	-	323,000
Common stock issued for services	21,000	33,000
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	164,000	15,000
Net change in other comprehensive (loss) income	14,000	(55,000)
Deferred income taxes	(88,000)	(350,000)
<b>Changes in assets and liabilities:</b>		
(Increase) decrease in accounts receivable	(76,000)	79,000
(Increase) decrease in inventory	(452,000)	46,000
(Increase) decrease in prepaid expenses & other current assets	(885,000)	835,000
(Increase) in deferred compensation	(125,000)	(102,000)
Decrease in other assets	(6,000)	(1,000)
Increase in accounts payable and accrued expenses	701,000	652,000
(Decrease) in deferred tax liability	-	(191,000)
Increase (decrease) in income taxes payable	154,000	(416,000)
Net cash provided by operating activities	1,720,000	3,402,000
<b>Cash Flow from Investing Activities:</b>		
(Purchase) sale of investment securities, net	97,000	(44,000)
(Purchase) of property and equipment	(1,044,000)	(763,000)
(Purchase) of intangible assets	(240,000)	(150,000)
Net cash (used in) investing activities	(1,187,000)	(957,000)
<b>Cash Flow from Financing Activities:</b>		
Issuance of common stock, options and warrants	24,000	13,000
(Repayment) of long-term debt, net	(137,000)	(155,000)
Increase in line of credit	650,000	-
Decrease in note receivable	41,000	-
Excess tax benefits from share-based payment arrangements	(30,000)	6,000
(Purchase) of treasury stock	(309,000)	-
Net cash provided by (used in) financing activities	239,000	(136,000)
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>772,000</b>	<b>2,309,000</b>
Cash and cash equivalents - beginning of the period	1,085,000	1,484,000
Cash and cash equivalents - end of period	\$ 1,857,000	\$ 3,793,000



Supplemental disclosure of cash flow information:

Interest paid	\$	95,000	\$	89,000
Income taxes	\$	464,000	\$	1,231,000

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	\$	-	\$	384,000
Options vested during period	\$	77,000	\$	18,000
Common stock issued for services	\$	21,000	\$	33,000
Line of credit converted to long-term debt	\$	-	\$	369,000

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended March 31,	
	2007	2006
	(Restated)	(Restated)
	(Unaudited)	(Unaudited)
<b>Supplemental disclosure of non cash activity:</b>		
<b><u>Sale of Consumer Choice Systems</u></b>		
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 and 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.

	As of March 31, 2007		As of December 31, 2006	
	(Restated) Gross Carrying Amount	(Restated) Accumulated Amortization	(Restated) Gross Carrying Amount	(Restated) Accumulated Amortization
Customer lists	\$ 5,791,000	\$ 2,207,000	\$ 5,587,000	\$ 1,969,000
Non-compete agreements	840,000	840,000	840,000	840,000
Trademarks, patents, and copyrights				
finite life	1,592,000	268,000	1,557,000	210,000
infinite life	909,000		909,000	
Total	\$ 9,132,000	\$ 3,315,000	\$ 8,893,000	\$ 3,019,000

**Amortization expense for the three months ended March 31, 2007 and 2006 was as follows:**

	(Restated) 2007	(Restated) 2006
Customer lists	\$ 239,000	193,000
Non-compete agreements	-	97,000
Trademarks and patents	58,000	27,000
Total Trademarks and Intangibles	\$ 297,000	\$ 317,000

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 \$183,000 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 \$77,000 and \$18,000 at March 31, 2007 and March 31, 2006, respectively.

SFAS No. 123(R) requires disclosure of pro-forma information for periods prior to the adoption. The pro-forma disclosures are based on the fair value of awards at the grant date, amortized to expense over the service period. The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock-Based Compensation", for the period prior to the adoption of SFAS No. 123(R), and the actual effect on net income and earnings per share for the period after the adoption of SFAS No. 123(R).

	Three Months Ended	
	(Restated) 03/31/07	(Restated) 03/31/06
Net income, as reported	\$ 1,373,000	\$ 2,001,000
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	77,000	11,000
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(77,000)	(11,000)
Net income, pro forma	\$ 1,373,000	\$ 2,001,000
Earning per share:		
Basic, as reported	\$ 0.11	\$ 0.15
Basic, pro forma	\$ 0.11	\$ 0.15
Diluted, as reported	\$ 0.10	\$ 0.15
Diluted, pro forma	\$ 0.10	\$ 0.15

For the purpose of the above table, the fair value of each option granted is estimated as of the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	Three Months Ended	
	March 31, 2007	March 31, 2006
Dividend yield	0.0%	0.0%
Expected volatility	0.70	0.70
Risk-free interest rate	4.70%	4.5%
Expected life in years	1-5	1-5

The following summarizes the stock option activity for the Three Months ended March 31, 2007:

	Shares	March 31, 2007	
		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 March 31, 2007	294,079	4.16	3.01
Options exercisable, March 31, 2007	204,077	2.75	2.63
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 financial position, results of operations or cash flows.

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 its 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 is not expected to have a material impact on the Company’s consolidated financial position, results of operations, or cash flows.

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 March 31, 2006 financial statements have been restated to decrease amortization expense on customer lists by \$219,000. Pre-tax income increased by \$219,000 for the quarter-ended March 31, 2006 from \$2,819,000 to \$3,038,000. Net income for the quarter-ended March 31, 2006 increased by \$307,000 from \$1,694,000 to \$2,001,000 and retained earnings increased from \$2,519,000 to \$2,826,000.

The March 31, 2007 financial statements have been restated to increase amortization expense on customer lists by \$84,000. Pre-tax income decreased by \$84,000 for the quarter-ended March 31, 2007 from \$1,987,000 to \$1,903,000. Net income for the quarter-ended March 31, 2007 decreased by \$49,000 from \$1,422,000 to \$1,373,000 and retained earnings decreased from \$7,403,000 to \$7,354,000.

13. 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.

The following tables present segment information for the three months ended March 31, 2007 and 2006:

	<b>Three Month Ended March 31, 2007 (Restated)</b>			<b>Consolidated</b>
	<b>Medifast</b>	<b>All Other</b>	<b>Eliminations</b>	
Revenues, net	18,183,000	1,906,000		20,089,000
Cost of Sales	4,829,000	229,000		5,058,000
Other Selling, General and Administrative Expenses	10,254,000	2,026,000		12,280,000
Depreciation and Amortization	657,000	129,000		786,000
Interest (net)	(8,000)	70,000		62,000
Provision for income taxes	530,000			530,000
Net income (loss)	1,921,000	\$ (548,000)		1,373,000
Segment Assets	23,831,000	15,581,000		39,412,000

	<b>Three Month Ended March 31, 2006 (Restated)</b>			<b>Consolidated</b>
	<b>Medifast</b>	<b>All Other</b>	<b>Eliminations</b>	
Revenues, net	18,366,000	817,000		19,183,000
Cost of Sales	4,648,000	130,000		4,778,000
Other Selling, General and Administrative Expenses	9,510,000	1,326,000		10,836,000
Depreciation and Amortization	354,000	186,000		540,000
Interest (net)	(67,000)	58,000		(9,000)
Provision for income taxes	1,037,000	0		1,037,000
Net income (loss)	2,884,000	\$ (883,000)		2,001,000
Segment Assets	18,585,000	13,571,000		32,156,000

## **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 the consolidated financial statements.

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.

## General

### Three Months Ended March 31, 2007 and March 31, 2006

Revenue: Revenue increased to \$20.1 million for the first three months of 2007 as compared to \$19.2 million for the first three months of 2006, an increase of \$900,000 or 5%. The direct marketing sales channel accounted for 60% of total revenue, Take Shape for Life 30%, doctors 5%, and clinics 5%. As compared to the first three months of 2006, the direct response sales channel revenue increased by 4%. Direct response is normally fueled primarily by consumer advertising; 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 6% year-over-year. The Company's clinic division which began operating under the Medifast Weight Control Center name in late 2006, increased sales by 21% as compared to the first quarter of 2006.

Throughout the fourth quarter of 2006, the Company expanded the direct response marketing department to evaluate and analyze the past year's media effectiveness and to more effectively spend the Company's increased advertising budget in 2007. In the fourth quarter of 2006, the Company analyzed the past years overall campaign metrics such as response rates, closing rates and media costs in order to improve on these metrics moving forward. The first quarter of 2007 was largely spent applying knowledge gained from this analysis to utilize the most effective aspects of the 2006 advertising campaigns. This was done to both show the improvements in the campaigns execution, while also utilizing the first quarter to create new advertising campaigns that were launched at the end of the first quarter and will continue to roll out with larger spend throughout the remainder of 2007. This strategy, led to improved month-to-month return on advertising dollars throughout the first quarter of 2007. As compared to our 2006 advertising campaign, the 2007 campaign includes long-form television infomercials, new 60 second TV commercials, an expanded presence on the web, and new creative for our print and radio advertisements. The Company anticipates the quarterly advertising budget to increase throughout the second and third quarter of 2007. In the first quarter of 2007, the Company spent \$4.3 million on direct response marketing.

The Take Shape for Life network grew 6% year-over-year as the Company continues focusing on providing tools to help the network recruit additional health coaches. The Company made substantial investment in 2006 to provide the health coaches with a comprehensive business tool that will drive recruiting within the Organization as well as lead to a higher lifetime value of customers and health coaches. In Q1 of 2007, the Take Shape for Life Network was in the beginning stages of recruiting growth and this will remain a focus throughout the remainder of 2007.

Medifast Weight Control Centers are currently operating in 10 locations in Texas and Florida. In Q1 of 2007, the Clinics realized sales growth of 21% compared to Q1 of 2006. Additional clinics will be opened in Florida and Texas throughout Q2 and Q3. This model will be available for franchise opportunities toward the end of the second quarter.

Throughout the fourth quarter of 2006 and the first quarter of 2007, the Company has continued to invest in the executive expertise necessary to drive the Medifast direct response and Take Shape for Life models, which represent 90% of the total business revenue, along with the Information Technology infrastructure expertise to support both of these hi-tech business models. The hiring of Richard Zeeb, VP of Direct Response Marketing, Rodman Heckman, EVP Take Shape for Life, and John Hamilton, Chief Information Officer, who each have extensive years of specific industry experience has provided the Company the expertise needed in each of these critical areas. The timing of these hires did not allow them to have their full potential impact on the business in the first quarter of 2007, however, we expect based on current Company trends and these individuals industry histories, that the Company will recognize significant improvements in their division's effectiveness in both the short and long term.

Overall, selling, general and administrative expenses increased by \$1,662,000 in the first quarter of 2007 as compared to the first three months of 2006. The majority of the increase was due to advertising expense increasing by approximately \$1.3 million as compared to the prior year. In prior year, the advertising proved more cost-effective due to a substantial editorial placement in a major consumer publication at no cost to the Company. Personnel expenses increased by approximately \$400,000 compared to prior year as the Company hired additional expertise in critical areas in order to assist in future growth. This primarily includes IT, nutrition and product development, marketing, and Take Shape for Life. Take Shape commission expense, which is completely variable in relation to sales, increased by approximately \$100,000. Stock compensation expense increased by \$208,000 as stock awards vested over 5 and 6 year terms for executives. The expense increases were offset by a decrease in office expense of approximately \$50,000, a decrease in other expense, which includes items such as depreciation, amortization, bank charges, charitable contributions, and property taxes, of approximately \$50,000 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 \$280,000 to \$5.1 million in the first three months of 2007 from \$4.8 million in 2006. As a percentage of sales, gross margin remained at approximately 75% for the first quarter of 2007 and 2006.

**Income taxes:** For the first three months of 2007, we recorded \$530,000 in income tax expense, which represents an annual effective rate of 28%. For the first three months of 2006, we recorded income tax expense of \$1 million which reflected an estimated annual effective tax rate of 34%. The Company anticipates a tax rate of approximately 36-38% in 2007.

**Net income:** Net income was \$1.4 million in the first three months of 2007 as compared to \$2 million in the first three months of 2006, which reflected a decrease of \$600,000 or 30%. The decrease in profit is primarily the result of an editorial placement in a major consumer magazine in the prior year first quarter which resulted in a material increase in sales that resulted in the increased profits.



**SEGMENT RESULTS OF OPERATIONS****Net Sales by Segment as of March 31,**

Segments	2007		2006	
	Sales	% of Total	Sales	% of Total
Medifast	19,249,000	96%	18,366,000	96%
All Other	840,000	4%	817,000	4%
Total Sales	20,089,000	100%	19,183,000	100%

**Three Months Ended March 31, 2007 and March 31, 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 March 31, 2007 and 2006 above.

All Other Segment: The All Other reporting segment consists of the sales of Hi-Energy and Medifast Weight Control Centers. Sales increased by \$23,000 year-over year as a result of an increase in Hi-Energy and Medifast Weight Control Centers sales to \$840,000. The increase in the Hi-Energy and Medifast Weight Control Centers sales were due to spending increases for advertising, increased advertising effectiveness, improved closing rates on walk-in 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.

**Net Profit by Segment as of March 31,**

Segments	2007		2006	
	Profit	% of Total	Profit	% of Total
Medifast	2,071,000	151%	2,581,000	129%
All Other	(698,000)	-51%	(580,000)	-29%
Total Net Profit	1,373,000	100%	2,001,000	100%

**Three Months Ended March 31, 2007 and March 31, 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 “Consolidated Results of Operations” management discussion for the three months ended March 31, 2007 and 2006 above. See footnote 13, “Business Segments” for a detailed breakout of expenses

All Other Segment: The All Other reporting segment consists of the losses of Hi-Energy and Medifast Weight Control Centers, and corporate expenses related to the parent company operations. Year-over-year, the loss in the All Other segment increased by \$118,000 Stock compensation expense to officers of the company resulted in an increased expense of \$241,000, which if taken out of the All Other segment expense, leads to an overall improvement in profitability over the previous year of \$123,000. The Hi-Energy and Medifast Weight Control Centers showed an increase in net profitability year-over-year of \$14,000. The remaining increase in net profitability for the All Other segments was due to the decrease in expenses in Jason Enterprises as a result of the sale of CCS. See footnote 13, “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:**

There was no material pending or threatened litigation as of 3/31/07.

**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.

### **Evaluation of Disclosure Controls and Procedures:**

In connection with the aforementioned restatement of our financial statements, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we reevaluated, as of March 31, 2007, 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 (the "Act"). Based upon that reevaluation, as a result of a material weakness in internal control over financial reporting with respect to amortization expense on a customer list, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures were not effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Act is (i) recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms; and (ii) accumulated and communicated to our management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosures. In connection with the

Original Filing and prior to our discovery of the error relating to amortization expense on a customer list, our principal executive officer and principal financial officer had concluded that our disclosure controls and procedures were effective as of March 31, 2007 to a reasonable assurance level.

Changes in Internal Control over Financial Reporting:

There was no change in our internal control over financial reporting during the quarter ended March 31, 2007 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting. As disclosed in our annual report for the year ended December 31, 2006 on Form 10-K/A filed with the Securities and Exchange Commission on September 6, 2007, we determined that as of December 31, 2006 there was a material weakness in our internal controls over financial reporting with respect to amortization expense on a customer list. We have determined that this material weakness still existed as of March 31, 2007.

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 2003 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.

**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

September 6,  
2007

Michael S. McDevitt  
Chief Executive Officer and Chief Financial Officer  
(principal executive officer and principal financial officer)

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

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