MEDIFAST INC
Form 10-Q
August 06, 2009
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2009

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 x 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 x

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

Yes ¨ No x

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 August 6, 2009
Common stock, $.001 par value per share	15,220,960 shares

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MEDIFAST, INC AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	June 30, 2009	December 31, 2008
ASSETS		
Current assets:		
Cash and cash equivalents	$ 11,073,000	$ 1,841,000
Accounts receivable-net of allowance for doubtful accounts of $100,000	582,000	448,000
Inventory	11,188,000	13,856,000
Investment securities	1,339,000	1,099,000
Deferred compensation	535,000	531,000
Prepaid expenses and other current assets	1,723,000	2,034,000
Prepaid income tax	1,777,000	1,131,000
Note receivable - current	180,000	180,000
Deferred tax asset	100,000	100,000
Total Current Assets	28,497,000	21,220,000
Property, plant and equipment - net	21,880,000	21,709,000
Trademarks and intangibles - net	4,697,000	5,547,000
Deferred tax asset, net of current portion	1,351,000	1,131,000
Note receivable, net of current portion	1,012,000	1,080,000
Other assets	352,000	350,000
TOTAL ASSETS	$ 57,789,000	$ 51,037,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued expenses	$ 5,711,000	$ 5,130,000
Line of credit	2,693,000	3,164,000
Current maturities of long-term debt	257,000	257,000
Total Current liabilities	8,661,000	8,551,000
Long-term debt, net of current liabilities	4,185,000	4,313,000
Total liabilities	12,846,000	12,864,000
Stockholders' equity:		
Common stock; par value $.001 per share; 20,000,000 authorized; 15,220,960 and 14,585,960 shares issued and outstanding, respectively	15,000	15,000
Additional paid-in capital	34,705,000	30,787,000
Accumulated other comprehensive (loss)	(173,000)	(389,000)
Retained earnings	20,737,000	15,253,000
	55,284,000	45,666,000
Less: cost of 301,092 and 272,192 shares of common stock in treasury, respectively	(2,058,000)	(1,956,000)
Less: unearned stock compensation	(8,283,000)	(5,537,000)
Total Stockholders' Equity	44,943,000	38,173,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 57,789,000	$ 51,037,000

See accompanying notes to condensed consolidated financial statements.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Revenue	$ 40,713,000	$ 27,537,000	$ 74,393,000	$ 52,706,000
Cost of sales	9,751,000	6,677,000	17,805,000	12,777,000
Gross Profit	30,962,000	20,860,000	56,588,000	39,929,000
Selling, general, and administration	26,174,000	18,451,000	47,785,000	35,457,000
Income from operations	4,788,000	2,409,000	8,803,000	4,472,000
Other income/(expense)				
Interest expense	(37,000)	(87,000)	(74,000)	(191,000)
Interest income	40,000	43,000	73,000	82,000
Other income/expense	(32,000)	(41,000)	(67,000)	(6,000)
	(29,000)	(85,000)	(68,000)	(115,000)
Income before provision for income taxes	4,759,000	2,324,000	8,735,000	4,357,000
Provision for income tax (expense)	(1,760,000)	(752,000)	(3,251,000)	(1,420,000)
Net income	$ 2,999,000	$ 1,572,000	$ 5,484,000	$ 2,937,000
Basic earnings per share	$ 0.22	$ 0.12	$ 0.41	$ 0.22
Diluted earnings per share	$ 0.20	$ 0.11	$ 0.37	$ 0.21
Weighted average shares outstanding -				
Basic	13,417,667	13,138,202	13,277,293	13,119,497
Diluted	15,039,547	13,791,623	14,899,173	13,772,918

See accompanying notes to condensed consolidated financial statements.

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

	Six Months Ended June 30, 2009	2008
Cash flows from operating activities:		
Net income	$ 5,484,000	$ 2,937,000
Adjustments to reconcile net income to net cash provided by operating activities from continuing operations:		
Depreciation and amortization	2,536,000	2,243,000
Realized loss on investment securities	67,000	38,000
Common stock issued for services	104,000	70,000
Stock options cancelled during period	-	(77,000)
Vesting of unearned compensation	1,068,000	296,000
Net change in other comprehensive gain (loss)	217,000	(162,000)
Deferred income taxes	(220,000)	-
	-	
Changes in assets and liabilities:		
Decrease (Increase) in accounts receivable	(134,000)	18,000
Decrease (Increase) in inventory	2,667,000	(1,857,000)
Decrease (Increase) in prepaid expenses & other current assets	312,000	(347,000)
(Increase) in deferred compensation	(4,000)	(11,000)
(Increase) in prepaid taxes	(646,000)	(987,000)
(Increase) in other assets	(2,000)	(251,000)
Increase in accounts payable and accrued expenses	582,000	2,033,000
(Decrease) in income taxes payable	-	(592,000)
Net cash provided by operating activities	12,031,000	3,351,000
Cash Flow from Investing Activities:		
(Purchase) of investment securities, net	(308,000)	(4,000)
(Purchase) of property and equipment	(1,857,000)	(4,546,000)
Net cash (used in) investing activities	(2,165,000)	(4,550,000)
Cash Flow from Financing Activities:		
Issuance of common stock, options and warrants	-	17,000
(Repayment) of long-term debt, net	(128,000)	(136,000)
Increase (decrease) in line of credit, net	(471,000)	1,103,000
Decrease in note receivable	68,000	66,000
(Purchase) of treasury stock	(102,000)	-
Net cash provided by (used in) financing activities	(633,000)	1,050,000
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	9,233,000	(149,000)
Cash and cash equivalents - beginning of the period	1,841,000	2,195,000
Cash and cash equivalents - end of period	$ 11,074,000	$ 2,046,000
Supplemental disclosure of cash flow information:		
Interest paid	$ 37,000	$ 191,000
Income taxes	$ 4,132,000	$ 3,008,000
Supplemental disclosure of non cash activity:		

Common stock issued to Executives and Directors over 2-6 year vesting periods	$	1,068,000	$	296,000
Common shares issued for options or warrants	$	-	$	42,000
Options cancelled during period	$	-	$	(77,000)
Common stock issued for services	$	104,000	$	70,000

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, 2008 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. Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles ("SFAS 168"). SFAS 168 will become the single source of authoritative nongovernmental U.S. generally accepted accounting principles ("GAAP"), superseding existing FASB, American Institute of Certified Public Accountants ("AICPA"), Emerging Issues Task Force ("EITF"), and related accounting literature. SFAS 168 reorganizes the thousands of GAAP pronouncements into roughly 90 accounting topics and displays them using a consistent structure. Also included is relevant Securities and Exchange Commission guidance organized using the same topical structure in separate sections. SFAS 168 will be effective for financial statements issued for reporting periods that end after September 15, 2009. All future references to authoritative accounting literature in our financial statements issued for reporting periods that end after September 15, 2009 will be referenced in accordance with SFAS 168.

In May 2009, the FASB issued Statement of Financial Accounting Standards No. 165, Subsequent Events ("SFAS 165"). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS 165 applies prospectively to both interim and annual financial periods ending after June 15, 2009. The adoption of SFAS 165 did not result in any material change to our policies.

In April 2009, the FASB issued FSP No. 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments ("FSP 107-1"). FSP 107-1 amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, and Accounting Principles Board Opinion No. 28, Interim Financial Reporting, to require disclosures about fair value of financial instruments for interim periods of publicly traded companies as well as in annual financial statements. FSP 107-1 is effective for interim reporting periods ending after June 15, 2009. The adoption of FSP 107-1 had no material effect on our disclosures in our financial statements.

From time to time, new accounting pronouncements are issued by the FASB or other standards setting bodies that we adopt as of the specified effective date. Unless otherwise discussed in these financial statements and notes or in our financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2008, we believe the impact of any other recently issued standards that are not yet effective are either not applicable to us at this time or will not have a material impact on our consolidated financial statements upon adoption.

4. 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.

5. Inventories

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

6. 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.

In addition, the Company has acquired other intangible assets, which include: customer lists, trademarks, patents, and copyrights. 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 June 30, 2009		As of December 31, 2008	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Customer lists	$ 8,332,000	$ 5,379,000	$ 8,332,000	$ 4,649,000
Trademarks, patents, and copyrights				
finite life	1,640,000	805,000	1,640,000	685,000
infinite life	909,000	-	909,000	-
Total	$ 10,881,000	$ 6,184,000	$ 10,881,000	$ 5,334,000

Amortization expense for the six months ended June 30, 2009 and 2008 was as follows:

	2009	2008
Customer lists	$ 730,000	$ 804,000
Trademarks and patents	120,000	122,000
Total Trademarks and Intangibles	$ 850,000	$ 926,000

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

7. 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.

8. 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.

9. 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.

10. 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.

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11. 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.

12. Fair Value Measurements

On January 1, 2008, the Company adopted SFAS No. 157 "Fair Value Measurements" ("SFAS 157"). SFAS 157 defines fair value, provides a consistent framework for measuring fair value under Generally Accepted Accounting Principles and expands fair value financial statement disclosure requirements. SFAS 157's valuation techniques are based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect our market assumptions. SFAS 157 classifies these inputs into the following hierarchy:

Level 1 Inputs– Quoted prices for identical instruments in active markets.

Level 2 Inputs– Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Inputs– Instruments with primarily unobservable value drivers.

The following table represents the fair value hierarchy for those financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2009.

Fair Value Measurements on a Recurring Basis as of June 30, 2009

Assets	Level I	Level II	Level III	Total
Investment securities	$ 1,339,000	-	-	$ 1,339,000
Cash equivalents	11,073,000	-	-	11,073,000
Total Assets	$ 12,412,000	$ -	$ -	$ 12,412,000
Liabilities	-	-	-	-
Total Liabilities	$ -	$ -	$ -	$ -

Effective this quarter, we implemented Statement of Financial Accounting Standards No. 157, Fair Value Measurements, or SFAS 157, for our nonfinancial assets and liabilities that are remeasured at fair value on a non-recurring basis. The adoption of SFAS 157 for our nonfinancial assets and liabilities that are remeasured at fair value on a non-recurring basis did not impact our financial position or results of operations; however, could have an impact in future periods. In addition, we may have additional disclosure requirements in the event we complete an acquisition or incur impairment of our assets in future periods.

13. 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.

Unearned compensation represents shares issued to executives and Board members that will be vested over a 2-6 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 $1,068,000 and $296,000 at June 30, 2009 June 30, 2008, respectively. There was no expense related to vesting of options under FASB 123R at June 30, 2009 and 2008.

The Medifast Board of Directors on May 7, 2009 approved restricted common stock grants to key executives and Board members with a 5 year vesting period, beginning on the grant date. Key executives were granted 460,000 shares of restricted common stock to retain their services over the next five years and recognize continued sales and profit growth in accordance with targets set by the Board of Directors. The Board of Directors received a total of 71,000 shares with a two year vesting period, beginning on the grant date for their participation and guidance in Medifast's strong sales and profit growth.

The Compensation Committee of Medifast, Inc. has utilized vested stock grants as a major source of compensation for its senior executive team so that their interests are aligned with Shareholders by building value in the Medifast Brand and increasing shareholder value. The Senior Executive Team continues to earn stock grants over the next five years and must pay an increasingly higher tax rate on their illiquid restricted stock grants. Therefore, over the next 12 months, the CEO, President and the VP of Finance plan on selling shares of Medifast Common Stock up to approximately 200,000 shares for tax and estate purposes in accordance with the Medifast, Inc. Insider Trading Policy as outlined below in "Item 5 – Other Information." In addition, over the next 18 months Shirley Mac Donald, the wife of the Chairman of the Board, may sell up to approximately 100,000 shares of Medifast, Inc. common stock for estate planning and retirement purposes. The Chairman of the Board, Bradley T. Mac Donald may donate 75,000 shares to the MacDonald Charitable Remainder Trust and/or the Mac Donald Family foundation in 2009 and 2010 to support the Company's and the family's charitable giving program.

The following summarizes the stock option activity for the Six Months ended June 30, 2009:

	Shares	Weighted Average Exercise Price	Weighted Average Contractual Term (Years)
Outstanding, December 31, 2008	143,334	3.00	
Options granted			