MEDIFAST INC
Form 10QSB
May 12, 2004

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

Form 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the quarter ended March 31, 2004 Commission File No. 0-23016

Medifast, Inc.

(Exact name of small business issuer in its charter)

Delaware	13-3714405
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
11445 Cronhill Drive, Owings Mills, MD	21117
(Address of principal offices)	(Zip Code)

Registrant's telephone number, including Area Code: (410) 581-8042

Indicate by check mark 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 [ ]

Number of shares outstanding of Registrant's Common Stock, as of March 31, 2004: 10,650,142 shares

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Medifast, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets

	March 31, 2004 (Unaudited)
ASSETS	
Current assets:	
Cash	$ 1,539,000
Accounts receivable-net of allowance for doubtful accounts of $55,000	788,000
Inventory	4,083,000
Investment Securities	3,974,000
Deferred Compensation	321,000
Prepaid expenses and other current assets	1,267,000
Deferred tax asset	350,000
Total Current Assets	12,322,000
Property, plant and equipment - net	7,379,000
Trademarks and Intangibles	4,389,000
Other assets	423,000
TOTAL ASSETS	$ 24,513,000
LIABILITIES AND STOCKHOLDERS' EQUITY	
Current liabilities:	
Accounts payable and accrued expenses	$ 1,500,000
Dividends payable	58,000
Line of credit	86,000
Current maturities of long term debt	745,000
Total Current Liabilities	2,389,000
Long-term debt, net of current portion	4,342,000
Total Liabilities	6,731,000
Stockholders' Equity:	
Series B Convertible Preferred Stock; par value $1.00; 600,000 shares authorized; 353,734 and 403,734 shares issued and outstanding, respectively	354,000

Series C Convertible Preferred Stock; stated value $1.00; 1,015,000 shares authorized; 267,000 and 267,000 shares issued and outstanding, respectively	267,000
Common stock; par value $.001 per share; 15,000,000 authorized; 10,650,142 and 10,482,609 shares issued and outstanding, respectively	10,000
Additional paid-in capital	20,214,000
Accumulated comprehensive loss	(20,000)
Accumulated deficit	(2,369,000)
	18,456,000
Less Cost of Common Stock in treasury; 88,500 and 83,863 shares, respectively	(674,000)
Total Stockholder's Equity	17,782,000
TOTAL LIABILITIES & STOCKHOLDER EQUITY	$ 24,513,000

Medifast, Inc. and Subsidiaries
Condensed Consolidated Statements of Operations

	Three Months Ended March 31, 2004	2003
	(Unaudited)	(Unaudited)
Revenue	$ 6,817,000	$ 6,347,000
Cost of sales	1,350,000	1,683,000
Gross Profit	5,467,000	4,664,000
Selling, general, and administration	4,548,000	3,220,000
Income from operations	919,000	1,444,000
Other income/(expense)		
Interest expense	(23,000)	(33,000)
Other income (expense)	(2,000)	(10,000)
Income before provision for income taxes	894,000	1,401,000
Provision for income tax benefit (expense) ...	(247,000)	(537,000)
Net income	647,000	864,000
Less: Stock dividend on preferred stock	--	19,000
Net income attributable to common shareholders	$ 647,000	$ 845,000
Basic earnings per share	$ .06	$ .11
Diluted earnings per share	$ .05	$ .08

Weighted average shares outstanding -		
Basic	10,610,391	7,940,238
Diluted	12,157,860	10,240,712

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Medifast, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows

	Three Months Ende 2004 (Unaudited)
Cash Flows from Operating Activities:	
Net income	$ 647,000
Adjustments to reconcile net income to net cash provided By (used in) operating activities from continuing Operations:	
Depreciation and amortization	303,000
Issuance of stock for services	47,000
Net change in other comprehensive (income) loss	5,000
Deferred income taxes	246,000
Changes in assets and liabilities:	
(Increase) decrease in accounts receivable	(147,000)
(Increase) decrease in inventory	(1,095,000)
(Increase) in prepaid expenses & other current assets	(331,000)
(Increase) in other assets	(48,000)
(Decrease) in accounts payable and accrued expenses	(214,000)
Net cash provided by (used in) operating activities	(587,000)
Cash Flows from Investing Activities	
Purchase of investment securities, net	9,000
Purchase of equipment / leasehold / improvements	(82,000)
Purchase of intangible assets	(121,000)
Net Cash (used in) investing activities	(194,000)
Cash Flows from Financing Activities:	
Increase in credit line	31,000
Issuance of common stock, options and warrants	6,000
Proceeds from long term debt	--
Principal repayments of long-term debt	(241,000)
Dividends paid on preferred stock	--
Net Cash provided by (used in) financing activities:	(204,000)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(985,000)
Cash and cash equivalents - beginning of period	2,524,000

Cash and cash equivalents - end of period	$ 1,539,000
Supplemental disclosure of cash flow information:	
Interest paid	$ 23,000
Income taxes	$ --
Supplemental disclosure of non-cash activity:	
Conversion of preferred stock B and C to common stock	$ 50,000
Common stock for services	$ 47,000

Notes to Condensed Consolidated Financial Statements

General

1. Basis of Presentation

The information contained herein with respect to the three month periods ended March 31, 2004 and 2003 has been reviewed by the independent auditors and was prepared in conformity with accounting principles generally accepted in the United States of America for interim financial information and instructions for Form 10-QSB and Item 310(b) of Regulation S-B. Accordingly, the condensed consolidated financial statements do not include information and footnotes required by accounting principles generally accepted in the United States of America. Included are the adjustments, which in the opinion of management are necessary for a fair presentation of the financial information for the three-month periods ended March 31, 2004 and 2003. The results are not necessarily indicative of results to be expected for the year.

2. Income Per Common Share

Basic income per share is calculated by dividing net income attributable to common stockholders 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.

3. Stock-Based Compensation

The Company has adopted Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123"). The provisions of SFAS 123 allow companies to either expense the estimated fair value of stock options or to continue to follow the intrinsic value method set forth in Accounting Principles Bulletin Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25") but disclose the pro forma effects on net income (loss) had the fair value of the options been expensed. The Company has elected to continue to apply APB 25 in accounting for its employee stock option incentive plans.

If compensation expense for the Company's stock-based compensation plans had been determined consistent with SFAS 123, the Company's net income per share including pro forma results would have been the amounts indicated below:

	Three months ended March	
	2004	200
Net Income:		
As reported	$ 647,000	$ 864
Total stock based employee compensation Expense determined under fair value based Method for all awards, net of related tax effects	(169,725)	
Pro forma	$ 487,275	$ 864
Net Income per share:		
As reported:		
Basic	0.06	
Diluted	0.05	
Pro forma:		
Basic	0.05	
Diluted	0.04	

Management Discussion and Analysis of Financial Condition and Results of Operations

General

Three Months Ended March 31, 2004 Compared to March 31, 2003

Overall revenues for the first three months of 2004 were $6,817,000, representing an increase of $470,000 (7%) from the $6,347,000 reported for the three-month period ending March 31, 2003. During the first quarter of 2004, domestic sales increased by $1.4 million, or 26% versus the same period last year. The growth was a result of improved traction from the national advertising campaign, which has continued to increase brand awareness and generate significant revenue increases throughout all of the Company's distribution platforms. The recently acquired Hi-Energy Clinic model experienced incremental revenues, during the quarter. This was largely attributed to the increase in the number of licensed clinics nationwide, which at the end of the first quarter totaled over 100 clinics. Hi-Energy also expanded its product line to include Medifast disease management products, with a specific focus on nutritional intervention for diabetics. The Take Shape For Life division continues to experience increased sales due to the success of the newly implemented "Tasting Party Plan", which has proven to be very effective at generating revenues, as well recruiting new Health Advisors and customers. International sales during the first quarter of 2004 attributed to approximately $40,000, as compared to $1,010,000 for the same period last year. This large influx was due to the pipeline orders to its Asian distributor shipped in the first quarter of 2003. Medifast anticipates expansion into multiple foreign markets throughout 2004, potentially generating significant International sales during the second, third, and fourth quarter. Cost of sales for the first quarter of 2004 were $1,350,000, a decrease of $333,000 (20%) versus the same period last year. The decrease in cost of sales was attributable to an inventory buildup in the fourth quarter of 2003, allowing for more efficient production throughout the first quarter of 2004, and allowing the Company to benefit from economies of scale in inventory.

Gross profit for the first three months of 2004 increased by $803,000 (17%) from 2003 due to the growth in multiple distribution platforms throughout the Company, in addition to the efficiencies in production shown by the decrease in the cost of sales. Selling, general and administrative expenses for the first quarter of 2004 increased $1,328,000 (41%) over the same quarter of 2003 due to expansion of its commissioned sales organization, overall corporate infrastructure improvements such as customer service and information technology, as well as industry wide increases in expenses, such as insurance and legal fees.

Income from operations was $919,000 for the first quarter of 2004, which decreased by 36% or $525,000 for the same period last year. The decrease was due to the difference from international sales in 2004 versus 2003. International sales in 2003 were in excess of $1 million, of which the cost of building inventory occurred primarily in the fourth quarter of 2002. Income before income taxes was $894,000, ($0.07 per share on a fully diluted basis) a decrease of $507,000 or $0.07 a share on a fully diluted basis.

Net income for the three month period was $647,000 which is a $217,000 decrease from the $864,000 reported in the first quarter of 2003. Net income attributable to common shareholders decreased due to the timing of International shipments in 2003 versus 2004 and the pipeline orders in the 1st quarter of last year, which lead to a significant increase in revenues and profit. The Company had fully diluted earnings per share of $0.05 in the first quarter of 2004, versus $0.08 in 2003, with a dilution increase of 1.9 million shares, primarily from conversions of preferred stock, the exercise of options and warrants, and the sale of common stock in a capital raising completed in July 2003. The Company has made substantial investments in growing infrastructure and revenues during

the 1st Quarter that will have a significant impact on improving revenues, cash flow and operating results in the future. In late 2003 the Company completed a test campaign to track the effectiveness of promoting the Company's products through television commercials. The test proved to be a success, prompting the Company to launch a television ad campaign in January 2004. The campaign was modulated at low levels until the call center processes were matched with the large influx of incoming calls, which provided closing rates similar to the test in 2003. The company recently turned up its planned advertising campaign in late April, featuring national and cable television commercials and print advertising. The Company still showed a $1.4 million increase in domestic sales with significantly less advertising expenditures in the 1st Quarter of 2004 versus 2003.

Seasonality

The Company's weight management products and programs are subject to seasonality. Traditionally the holiday season in November/December of each year is considered poor for diet control products and services. The first quarter of the year generally shows increases in sales, as these months are considered the commencement of the "diet season."

Liquidity and Capital Resources

On March 5, 2004 the Company entered into a joint venture agreement with XL Health, Inc., one of the leading diabetic management companies in the United States. Medifast, Inc.'s Medifast Plus for Diabetics line will be the exclusive nutritional product for XL Health's CMS Medicare Demonstration Project. The pilot project will use Medifast Plus for Diabetics as the exclusive nutritional intervention program to prove the cost effectiveness of disease management programs for Medicare beneficiaries. Take Shape For Life, Inc, through its' parent Medifast, Inc, provided a one million dollar corporate guarantee of XL's revolving credit line secured by the assets of the Company through Mercantile Safe-Deposit and Trust company, the Company's lender.

The Company is continuing its marketing agreement with NovaCare Rehabilitation, a division of Select Medical Corporation, however the venture has failed to meet anticipated revenues. The lack of sales is due to certain states not permitting physical therapists to promote private weight loss products, therefore not allowing the joint venture to have an impact at the center level.

The Company had stockholders' equity of $17,782,000 and working capital of $9,933,000 on March 31, 2004 compared with $6,589,000 and $2,517,000 at March 31, 2003, respectively. The $11,193,000 net increase in stockholder's equity and the $7,416,000 net increase in working capital, reflects the profits during the year from operations, acquisition of assets, execution of options and warrants, conversion of Preferred Stock, and sales of additional shares.

Inflation

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

Item 5. Other Information

Litigation: On December 16, 2003 John Donavin, on behalf of the General Public, filed suit, against Jason Pharmaceuticals, Inc. in the Superior Court of the State of California, City and County of San Francisco. The suit alleges that Medifast bars contain Vitamin D3 or Vitamin D in violation of Federal laws and regulations, and asks for equitable relief and damages. The Company's general council believes that the Company's formulation used in its "meal replacement" bars for over 20 years has been and is in conformity with current and past FDA regulations. The Company believes that the plaintiff's claim lacks merit and may even be considered frivolous.

In January, Mr. Leonard Z. Sotomayor, former associate of Mr. David Scheffler, a financial consultant for the Company, filed a complaint against Medifast, Inc., David Scheffler and T-1 Holdings LLC. The Company's counsel has filed a motion to dismiss based on the facts of law. The Company believes the complaint has no merit and in fact has been drawn into a personal dispute between two former business associates.

On August 21, 2002 Food Sciences Corporation, Inc. trading as Robard Corporation, a competitor of the Company, filed a lawsuit in the U.S. District Court for the District of New Jersey Camden Vicinage, alleging, among other things, slanderous and libelous statements made to Plaintiff's customers. The Company filed a Counterclaim and Third Party Claims against other competitors, alleging, among other things, business defamation, trademark infringement and conspiracy. Plaintiff and Defendant both claim damages in excess of $75,000. The Company intends to vigorously defend its reputation of ethical integrity (integrity of its products and formulas) and its trademarks.

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.

Issuance of Common Stock: Due to the conversion of Series "B" preferred stock and the exercising of warrants and options by investors, consultants, directors and employees, the Company issued 167,533 shares of common stock throughout the first quarter of 2003. Of these shares issued, 100,000 were from the conversion of Series "B" convertible preferred stock.

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, insiders may purchase or sell MED securities if such purchase or sale is made within 30 days after an earnings or special announcement to include the 10-KSB, 10-QSB and 8-K in order to insure that investors have available the same information necessary to make investment decisions as insiders.

Internal Control Policy: In April 2003, the Company implemented an Internal Control Policy allowing for the confidential receipt and treatment of complaints in regards to the Company's internal accounting controls and auditing matters. A director, officer or employee may file a confidential and anonymous concern regarding questionable accounting or auditing maters to an independent representative of the Medifast Audit Committee. As of March 31, 2004, an evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on that evaluation, the Company's management, including the Chief Executive Officer and the Chief Financial Officer, concluded that the Company's disclosure controls and procedures were effective as of March 31, 2004. There have been no significant changes in the Company's internal controls or in other factors that could significantly affect internal controls subsequent to March 31, 2004.

Forward Looking Statements: This document contains forward-looking statements which may involve known and unknown risks, uncertainties and other factors that may cause Medifast, Inc. actual results and performance in future periods to be materially different from any future results or performance suggested by these statements. Medifast, Inc. cautions investors not to place undue reliance on forward-looking statements, which speak only to management's expectations on this date.

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.
(Registrant)

/s/ Bradley T. MacDonald

Bradley T. MacDonald

Chairman & CEO

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CEO Certification

I, Bradley T. MacDonald, the registrant, Chairman of the Board and Chief Executive Officer certify that:

1. The registrant's certifying officer has reviewed this Form 10-QSB of Medifast, Inc.

2. Based on the registrant's certifying officer's knowledge, this 10-QSB does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the Form 10-QSB.

3. Based on the registrant's certifying officer's knowledge, the financial statements, and other financial information included in the Form 10-QSB, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for the periods presented in this 10-QSB.

4. The registrant's certifying officer is responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

   a. Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period by which this Form 10-QSB is being prepared;

   b. Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this 10-QSB (the "Evaluation Date") and

   c. Presented in this 10-QSB our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date.

5. The registrant's certifying officer has disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors:

   a. All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrnat's auditors any material weaknesses in internal controls; and

   b. Any fraud, whether or not materials, that involves management or other employees who have a significant role in the registant's internal controls.

6. The registrant's certifying officer indicated in the Form 10-QSB whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective

actions with regard to significant deficiencies or material weaknesses, within the accounting system.

May 12, 2004

/s/ Bradley T. MacDonald

Bradley T. MacDonald
Chiarman of the Board & Chief Executive Officer

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CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Medifast, Inc. (the "Company") on Form 10-QSB for the quarter ended March 31, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I Bradley T. MacDonald, Chief Financial Officer of the Company, certify, pursuant ot 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, to the best of my knowledge, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the report fairly presents, in all material respects, the financial condition and results of the operations of the Company.

By: /s/ Bradley T. MacDonald

Bradley T. MacDonald
Chief Executive Officer
May 12, 2004

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