

MEDIFAST INC  
Form 10-K  
March 16, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

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FORM 10-K

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

For the fiscal year ended December 31, 2008

Commission File No. 000-23016

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MEDIFAST, INC.

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DELAWARE  
Incorporation State

13-3714405  
Tax Identification number

11445 CRONHILL DRIVE, OWINGS  
MILLS, MD  
Principal Office Address

21117

Phone (410) 581-8042

SECURITIES REGISTERED PURSUANT TO SECTION 12(B) OF THE ACT: NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(G) OF THE ACT:

COMMON STOCK, PAR VALUE \$.001 PER SHARE

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New York Stock Exchange

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes  No

The aggregate market value of the voting common equity held by non-affiliates of the registrant as of June 30, 2008, based upon the closing price of \$5.26 per share on the New York Stock Exchange on that date, was \$64,000,000.

As of March 13, 2009, the Registrant had 14,585,960 shares of Common Stock outstanding.

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PART I

ITEM 1. BUSINESS.

SUMMARY

Medifast, Inc. (the "Company" or "Medifast") is a Delaware corporation, incorporated in 1993. The Company's operations are primarily conducted through five of its wholly owned subsidiaries, Jason Pharmaceuticals, Inc. ("Jason"), Take Shape for Life, Inc. ("TSFL"), Jason Enterprises, Inc., Jason Properties, LLC and Seven Crondall, LLC. The Company is engaged in the production, distribution, and sale of weight management and disease management products and other consumable health and diet products. Medifast, Inc.'s product lines include weight and disease management, meal replacement, and vitamins primarily manufactured in its modern, FDA approved facility in Owings Mills, Maryland.

MARKETS

Throughout the past 30 years, obesity in the United States has dramatically increased. The obesity epidemic shows no signs of slowing down and recently, the condition has worsened among Americans rather than improved. Approximately 1.7 billion people worldwide are overweight; however the percentage of overweight adults is the highest in the United States, with two-thirds of all Americans being overweight or obese.

According to a recent study, "Prevalence of Obesity and Overweight in the United States", published in April 2006 in the Journal of American Medical Association, almost 7 out of 10 adults in the U.S. are overweight or obese, with 60 million (or about thirty percent) American adults suffering from obesity. The obesity epidemic raises concern among Americans because of the implications associated with their health. The most common health conditions associated with obesity are type II diabetes, coronary heart disease, hypertension and stroke, sleep apnea and respiratory problems, gallbladder disease, depression and certain forms of cancer.

The Centers for Disease Control and Prevention show that obesity is not only affects adults, but children and adolescents as well. According to the CDC, the obesity prevalence in children and adolescents has tripled since 1976. Overweight and obesity in children and adolescents increases the risk of health problems such as high blood pressure, high cholesterol and Type 2 Diabetes.

Type 2 Diabetes is expected to increase by 165% between 2000 and 2050 according to a study "Projection of diabetes burden through 2050: impact of change demography and disease prevalence in the U.S.", published 2001 in Diabetes Care. In addition, a study published by the CDC in October 2007 shows how children are now being affected by Type 2 diabetes. Obese children suffering from Type 2 diabetes are at increased risk of suffering significant morbidities in the form of amputations, kidney problems, and blindness.

Obesity is defined as a Body Mass Index (BMI) of 30 kg/m<sup>2</sup> or greater, whereas overweight is defined as a BMI ranging between 25 and 30 kg/m<sup>2</sup>. According to a recent study conducted by the Centers for Disease Control and Prevention in 2006, only four (4) states in the U.S.A. had a prevalence of obesity less than twenty percent (20%). Twenty-two states showed a prevalence equal to or greater than twenty-five percent (25%), and two of those states had a prevalence of obesity equal to or greater than thirty percent (30%).

The primary obesity causing factors are preventable and well known in the United States. These factors are unhealthy diet and physical inactivity. It's estimated that poor nutrition and physical inactivity account for more than 300,000 premature deaths per year in the U.S. According to the United States Department of Health and Human Services, only 25% of adults and less than 25% of teenagers include the suggested 5 or more servings of vegetables and fruits in their daily meal. More than half of American adults fail to engage in the suggested amount of physical activity, and more than 1/3 of young Americans do not engage in regular vigorous physical activity at all.

The United States Department of Human and Health Services states that Americans spend \$117 billion in costs associated with overweight and obesity. Direct medical and healthcare costs total \$93 billion. The U.S. weight loss market is estimated to be a \$55 billion/ year industry. This includes consumer spending on diet foods, health clubs, commercial weight loss centers, low-calorie prepared foods, medically supervised and commercial weight loss programs, diet books, appetite suppressants, artificial sweeteners, diet sodas, videos and cassettes, children's weight loss camps and more.

## Distribution Channels

Medifast Direct – In the direct to consumer channel, customers order Medifast product directly through the Company’s website, [www.choosemedifast.com](http://www.choosemedifast.com), or our in-house call center. The product is shipped directly to the customer’s house. Customers have access to support from qualified nutritional practitioners and customer care representatives via telephone, e-mail and online chats. Medifast Direct offers a robust online web community and library for support, information and meal planning for weight loss and weight maintenance. This business is driven by an aggressive multi-media customer acquisition strategy that includes print, television, radio, direct mail and web advertising as well as public relations initiatives. The Medifast Direct division focuses on targeted marketing initiatives and providing customer support through its in-house call center and nutrition support teams to better serve its clients. In addition, Medifast also continued to promote its use of leading web technology featuring customized meal planning and community components.

Take Shape for Life™ - Take Shape for Life is a physician led network of independent health coaches who are trained to provide coaching and support to clients on Medifast programs. Health coaches are conduits to give clients the strategies and skills to successfully reach a healthy weight and then provide a road map to empower the individual to take control of their health. Take Shape for Life offers the exclusive BeSlim™ philosophy, which encourages long-term weight maintenance. Take Shape for Life also moves beyond the scope of weight loss to show customers how to achieve optimal health through the balance of body, mind, and finances. Take Shape for Life uses the high quality, medically validated products of Medifast as the platform to launch integrity based lifelong health optimization program.

Program entrants are encouraged to consult with their primary care physician and a Take Shape for Life Health Coach to determine the Medifast program that is right for them. Health Coaches are supported, educated and qualified by The Health Institute, a training group staffed by Medifast professionals. Health Advisors obtain Medifast qualification based upon testing of their knowledge on Medifast products and programs.

Take Shape for Life is a member of the Direct Selling Association (DSA), a national trade association representing over 200 direct selling companies doing business in the United States. To become a member of the DSA Take Shape for Life, like other active DSA member companies, underwent a comprehensive and rigorous one-year company review by DSA legal staff that included a detailed analysis of its company business plan materials. This review is designed to ensure that a company’s business practices do not contravene DSA’s Code of Ethics. Compliance with the requirements of the Code of Ethics is paramount to become and remain a member in good standing of DSA.

Accordingly, Membership in DSA by Take Shape for Life demonstrates its commitment to the highest standards of ethics and a pledge not to engage in any deceptive, unlawful, or unethical business practices. Among those Code of Ethics proscriptions are pyramid schemes or endless chain schemes as defined by federal, state, or local laws. Moreover, Take Shape for Life, like other DSA member companies in good standing, has pledged to provide consumers with accurate and truthful information regarding the price, grade, quality, and performance of the products Take Shape for Life markets.

Medifast Weight Control Centers – The Medifast Weight Control Center is the brick and mortar clinic channel of Medifast located in Texas and Florida. In 2008, the Company opened ten new Medifast Weight Control Centers and had a total of twenty locations in operation at year-end. The centers offer a supervised model and a nationally advertised brand which encourages walk-ins and referrals from other Medifast business channels. In addition to offering a comprehensive Medifast program, the clinics offer customized patient counseling programs, and the Inbody™ composition analysis.

In 2008, the Company began offering the clinic model as a franchise opportunity. On February 18, 2008, the Company announced that it has sold its first franchise of Medifast Weight Control Centers. The Company sold the

rights to open four clinics in the Greater Baltimore Metropolitan Area. The franchisee also has the rights to open four additional Medifast Weight Control Centers in the Baltimore area over the next two years, bringing the total to eight locations. On June 3, 2008 the Company announced that it sold the rights to open four Medifast Weight Control Centers in Southern California and three Medifast Weight Control Centers in Central California to two different local business operators. On October 8, 2008, the Company announced the opening of its first franchise clinic in the Baltimore, MD area. In December 2008, three Medifast Weight Control Center franchise locations opened in Southern California and one location opened in Central California. At December 31, 2008, five franchise locations were operating.

The Company continues to support its controlled label licensee model, Hi-Energy, by providing marketing materials, ads, on-site trainings, fitness programs, nutritional programs and clinical operation materials and forms.

Medifast Physicians –Medifast physicians have implemented the Medifast program within their practice. These physicians carry an inventory of Medifast products and resell them to patients. They also provide appropriate medical monitoring, testing, and support for patients on the program. Management estimates that more than 15,000 physicians nationwide have recommended Medifast as a treatment for their overweight patients since 1980, and over an estimated 1 million patients have used its' products to lose and maintain their weight.

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

#### THE MEDIFAST® BRAND

Medifast enriches lives by providing innovative choices for lasting health through products and programs. Medifast is physician recommended and clinically proven offering programs for weight management, weight maintenance and long term health through multiple channels of distribution. Medifast products are high quality, portion controlled meal replacement foods. In recent years, Medifast's core products and programs have continued to expand over a wellness spectrum to include health management products such as those specially formulated for people with diabetes as well as products for women's health, joint health and coronary health.

While all Medifast products are suitable for individuals with type 2 diabetes, Medifast also has a line of products specially designed to meet the needs of people with diabetes – Medifast Plus for Diabetics. Medifast Plus for Diabetics products consist of three delicious, patented shakes that have been certified 'low glycemic' by the Glycemic Research Institute.

Over 40 Medifast products qualify for the FDA's heart healthy claim, "May Reduce the Risk of Heart Disease." In order to make this claim, a product must contain at least 6.25 grams of soy protein per serving and be low in fat, saturated fat, sodium, and cholesterol. Unlike popular fad diets and herbal supplements, Medifast products are a safe, nutritionally balanced choice, offering gender specific formulas containing high protein and low carbohydrates, a soy protein source rather than animal protein source, and vitamin and mineral fortification. It is very difficult to meet the minimum recommended nutritional requirements on a low-calorie diet, but a dieter can easily meet these requirements using the nutrient dense Medifast brand of meal replacement food supplements.

Portion controlled, meal replacement weight management programs are continuing to gain popularity, as consumers search for a safe and effective solution that provides balanced nutrition, quick weight loss and valuable behavior modification education. In addition, consumers are becoming more aware of chronic diseases such as diabetes and coronary health.

#### Clinical Research Overview

Medifast uses both clinical research studies and retrospective analysis data from its Medifast clinics as the basis of its claim, "clinically proven." The following abstracts include both peer-reviewed research (consisting of prospective controlled clinical trials and retrospective studies) and in-house clinical data (studies 7 & 8).

##### Study 1

##### Reference

Haddock CK, Poston WSC, Foreyt JP, DiBartolomeo JJ. "Effectiveness of Medifast supplements combined with obesity pharmacotherapy: A clinical program evaluation." *Eating and Weight Disorders*. 13:95-101; 2008.

##### Purpose

To evaluate the long-term impact of Medifast meal-replacement supplements (MMRS) combined with appetite-suppressant medication (ASM) among participants who received 52 weeks of treatment as part of a medically supervised weight-control program.

##### Results



Participants who completed 52 weeks of treatment experienced substantial weight losses at 12 (-9.4 + 5.7kg), 24 (-12.0 + 8.1kg), and 52 weeks (12.4 + 9.2kg), and all measures were significantly different from baseline weight ( $p < 0.001$  for all contrasts) for both true completers ( $n=324$ ) and for ITT analysis ( $n=1,351$ ). Fifty percent of patients remained in the program at 24 weeks and nearly 25% were still participating at one year. Results were better than those typically reported for obesity pharmacotherapy in both short- and long-term studies, and also better than those reported for partial meal-replacement programs.

This study was published in the June 2008 issue of *Eating and Weight Disorders*. Results of this study were presented at the American Society of Bariatric Physicians' annual meeting in May 2007.

#### Study 2

#### Reference

Davis LM, Coleman CD, Andersen WS, Cheskin LJ. "The effect of metabolism-boosting beverages on 24-hr energy expenditure." *The Open Nutrition Journal*. 2:37-41; 2008.

#### Purpose

To test the effect of thermogenic meal-replacement beverages (TMRB) containing 90 mg of EGCG and 100 mg of caffeine on resting energy expenditure (REE). Thirty adults (19 women, 11 men) were stratified into 3 groups: lean (n=10, BMI 21.5 + 2.1); overweight/obese (OW) (n=10, BMI 29.8 + 2.7); or weight maintainers (WM) (n=10, BMI 28.8 + 4.0). Following an overnight fast, baseline measurements, including REE via indirect calorimetry, were performed. REE was repeated at 30, 60, 90, and 120 minutes after consuming a TMRB. Appetite was assessed via visual analogue scale at baseline, 30 minutes, and 120 minutes after consuming the TMRB.

#### Results

Mean 24-hour REE was increased 5.9 + 2.5% overall (p=0.000), 5.7 + 3.1% among lean subjects (p=0.0002), 5.3 + 1.4% among OW subjects (p=0.000), and 6.8 + 2.7% among WM subjects (p=0.0007). Appetite was significantly reduced 30 minutes after consuming the TMRB (p=0.0002). TMRBs appear to be a promising weight-control tool.

This study was presented as a poster session at Experimental Biology, 2008.

#### Study 3

##### Reference

Cheskin LJ, et al. "Efficacy of meal replacements versus a standard food-based diet for weight loss in type 2 diabetes." *The Diabetes Educator*. 34(1):118-127; Jan/Feb 2008.

#### Purpose

To compare the efficacy of a portion-controlled meal-replacement diet (PCD) to a standard diet (SD) (based on recommendations by the American Diabetes Association) in achieving and maintaining weight loss among 119 obese men and women with type 2 diabetes mellitus.

#### Results

Using intention-to-treat analyses, weight loss at 34 weeks and weight maintenance at 86 weeks was significantly better on PCD versus SD. Approximately 40% of the PCD participants lost >5% of their initial weight compared with 12% of those on the SD. Significant improvements in biochemical and metabolic measures were observed at 34 weeks in both groups. The retention rate and self-reported ease of adherence in the PCD group were significantly higher throughout the study.

This study was published in the January/February 2008 issue of *The Diabetes Educator*. The peer-reviewed journal is the official journal of the American Association of Diabetes Educators. The study was also presented at the American Diabetes Association's 65th Annual Scientific Session, 2005.

#### Study 4

##### Reference

Cheskin LJ, et al. "A RCT comparing balanced energy deficit diets with or without meal replacements for weight loss and maintenance among children dieting alone or with a parent." Johns Hopkins Bloomberg School of Public Health, Center for Human Nutrition, Department of International Health.

#### Purpose

To compare the safety and efficacy of supplemental Medifast portion-controlled meal replacements (MRs) to a USDA Food Guide Pyramid-based diet. Both weight-loss diets were 20% energy-restricted (~500 kcal deficit). Eighty children (8-15 y.o.), BMI>95th%ile, were screened and randomized to either a MR diet (3 MRs/d during active weight loss and 2 MRs/d during maintenance) or to the food-based diet. Subjects were further randomized to dieting alone or with a parent.

## Results

By ITT analysis, dieting alone vs. with a parent or food vs. MR made no difference in weight outcome. However, following initial weight loss (6 mos) and 1 yr maintenance (18 mos), significant benefits were seen in the MR group in BMI%ile (0 mos=98.8 + 1.0, 6 mos=96.6 + 3.2, 18 mos=96.4 + 3.4); body fat ( 5.9% @ 6 mos, 5.3% @ 18 mos); total cholesterol ( 6.7% @ 6 mos, 5.6% @ 18 mos); LDL ( 19.8% @ 6 mos, 7.9% @ 18 mos); and triglycerides ( 23.6% @ 6 mos, 22.3% @ 18 mos). No significant between-group differences, differences in growth rates, or adverse events were observed. Conclusions: Among overweight 8-15 y.o. children, dieting with or without a parent, meal replacements were as safe and effective as a food-based diet for weight loss and maintenance.

This study was presented as a poster session at Experimental Biology, 2007.

## Study 5

### Reference

Matalon V. "Impaired capacity to lose visceral adipose tissue during weight reduction in obese postmenopausal women with the Trp64Arg B3-adrenoceptor gene variant." *Diabetes*. 49:1709-1713; 2000.

#### Purpose

To examine the effect of the Trp64Arg gene variant on total and visceral adipose tissue loss, and cardiovascular risk factors in response to weight reduction among 24 obese women (age 57 + 4 yrs) in a 13 + 3 mos weight reduction program of 1,200 kcal with or without the inclusion of Medifast.

#### Results

Whether women were carriers or noncarriers of the Trp64Arg allele, significant weight loss (-16.4 + 5.0kg vs. -14.1 + 6.2kg, NS) and reductions in body fat (-10.0 + 5.2 vs. -11.5 + 3.9kg, NS) were observed in response to a calorie-restricted program with or without Medifast. Loss of visceral adipose tissue was 43% lower in carriers of the Trp64Arg allele compared with noncarriers (-46 + 27 vs. -81 + 51cm<sup>2</sup>, p=0.05). The study concluded that older women carrying the Trp64Arg B3-adrenoceptor gene variant have an impaired capacity to lose visceral adipose tissue in response to a calorie-restricted diet.

#### Study 6

##### Reference

Matalon V. "An evaluation of weight loss following a carbohydrate and fat restricted diet with appetite suppressant and dietary supplementation." *The Bariatrician*. 10-13; 2000.

#### Purpose

To assess the safety and effectiveness of a weight-loss regimen consisting of a carbohydrate- and fat restricted diet supplemented with an appetite suppressant, a dietary supplement, and a liquid protein drink (Medifast) in an open label trial. Baseline and 6-mos evaluations of body weight (lbs), body fat (%), BMI (kg/m<sup>2</sup>), lean body mass, water weight, and blood pressure were performed. At 6 mos, statistically significant differences were found for body weight (p<0.001), percent body fat (p<0.001), BMI (p<0.001), lean body mass (p<0.001), water weight (p=0.01), and body systolic (p=0.003) and diastolic (p<0.001) blood pressure.

#### Results

Of 47 patients enrolled, 24 (51%) completed six months using the dietary regimen prescribed. Data was analyzed for all patients who were treated with the diet, as well as for the subset of patients who completed the entire study period. The dietary regimen showed that a carbohydrate- and fat restricted program supplemented by a natural appetite suppressant can lead to progressive weight loss of comparable value to prescribed pharmacologic agents at the time of study. Patients in the study experienced statistically significant decreases in overall body weight, percent body fat, BMI, lean body mass, total body water, and both systolic and diastolic blood pressure.

#### Study 7

##### Reference

Crowell MD, Cheskin LJ. "Multicenter evaluation of health benefits and weight loss on the Medifast weight management program." *The Johns Hopkins University School of Medicine*.

#### Purpose

To retrospectively evaluate the efficacy of a medically supervised, protein-supplemented modified program (Medifast) for weight reduction and to evaluate the impact of weight reduction on coexisting health problems.

#### Results

The results of the study concluded that medically supervised, protein-sparing meal-replacement programs offer a safe and effective means of weight reduction and are accompanied by significant improvements in coexisting health problems. Of samples taken, males lost an average of 67 lbs and females lost an average of 47 lbs during fasting. The study found significant reductions in total cholesterol and triglycerides, systolic and diastolic blood pressure, and normalized blood pressure in hypertensive patients.

Study 8

Reference

Davis LM, Cheskin LJ. "Dietary intervention using Medifast meal replacements in pre-bariatric surgery patients." Johns Hopkins Weight Management Center; 2006.

Purpose

N=14 severely obese patients—13 females (11 African Americans, 2 Caucasians) and 1 male (Caucasian)—with a mean BMI of 64.14 kg/m<sup>2</sup> (range 40.2kg/m<sup>2</sup> to 91.7kg/m<sup>2</sup>) entered a 6-month weight-control program at the Johns Hopkins Weight Management Center. All patients were Medicaid (Priority Partners) recipients. The program provided a comprehensive approach to weight control focused on diet, behavior, and physical activity. Portion-controlled meal replacements (MRs) supplied by Medifast were utilized as part of the dietary-behavior intervention. All subjects met with a licensed dietitian and were prescribed a 1,000-1,200 kcal/day diet plan incorporating up to 6 MRs/day. Only 1 subject chose not to incorporate meal replacements as part of a low-calorie diet plan. The average intake of meal replacements was 2.5-3 per day through the duration of the study.

## Results

After 6 months on the program, patients lost an average of 26.73 lbs (-2.86kg/m<sup>2</sup>) and 6.96% body weight, and reported a high level of satisfaction with their diet plan. Program completers at 1 month were N=13, at 3 months N=12, and 6 months N=10.

A statistical review of patient charts, unpublished data on file. 2006.

Scientific Advisory Board

In September 2008, Medifast announced the formation of its Scientific Advisory Board.

The role of the Board is to continually review the effectiveness, safety, and nutritional benefits of Medifast's products and programs. The team of specialists will also assist in the development of new Meals and supplements, as well as weight-loss approaches for specific medical needs (i.e., patients with heart disease) or lifestyles (vegetarians, etc.).

The work of this cross-disciplinary group builds on Medifast's heritage of medically sound approaches to weight loss, and the incorporation of leading-edge clinical research into the company's products and programs.

Lawrence Cheskin, M.D.

Director of the Johns Hopkins Weight Management Center in Baltimore, MD

Miriam Cohen, M.D., F.A.C.C.

Cardiologist and Assistant Professor at the University of Maryland Medical School

Scott Kahan, M.D., M.P.H.

Instructor at the Johns Hopkins Bloomberg School of Public Health

Varsha Vaidya, M.D.

Assistant Professor of Psychiatry and General Internal Medicine at Johns Hopkins University School of Medicine, Director of the Obesity Psychiatry program at Johns Hopkins Bayview Medical Center

Alison Duncan, Ph.D., RD

Associate Professor, Department of Human Health and Natural Sciences at University of Guelph, Functional Foods Expert

Debra L. Miller, Ph.D.

Director of Nutrition at the Hershey Company

## COMPETITION

There are many different kinds of diet products and programs within the weight loss industry. These include a wide variety of commercial weight loss programs, pharmaceutical products, weight loss books, self-help diets, dietary supplements, appetite suppressants and meal replacement shakes and bars. Some of Medifast's top competitors are Jenny Craig, Nutrisystems, EDiets, Herbalife, and Weight Watchers.

The Company has proven it can compete in this competitive market because its products have been clinically tested and proven in clinical studies conducted by researchers from Johns Hopkins University and other major institutions, the Medifast products have been safely and effectively used by customers and recommended by physicians for over 28 years. Medifast has been on the cutting edge of product development with soy based nutritional and weight management products since 1980. These products are formulated with high-quality, low-calorie, low-fat ingredients

that provide alternatives to fad diets or medicinal weight loss remedies.

The Company's diverse multi-channel distribution strategy makes the Medifast brand available through multiple support channels, which target different customer needs. Medifast practitioners offer Medifast to patients through wholesale or an innovative home delivery model and some practitioners choose to prescribe appetite suppression diet drugs to patients in conjunction with a Medifast based diet. Medifast Direct via the website and call center serves customers with free online support and community tools and access to nutritionists and customer service representatives. The Take Shape for Life division offers the personal support of a health coach that is often a person who has achieved success on the Medifast program and has turned their success into a business opportunity generating incremental revenue for the company through relationship marketing. Medifast Weight Control Centers offer a medically supervised and structured model for customers who prefer more accountability and personalized counseling on the program. The Medifast program alone is a mild ketogenic diet that naturally suppresses appetite and eliminates hunger without other therapies for most people.

## PRODUCTS

The Company offers a variety of weight and disease management products under the Medifast® brand and for select private label customers. The Medifast line includes Medifast® 55 Shakes, Medifast® 70 Shakes, Medifast® Plus for Appetite Suppression Shakes, Medifast® Plus for Women's Health Shakes, Medifast® Plus for Diabetics Shakes, Medifast® Plus for Joint Health Shakes, Medifast® Plus for Coronary Health Shakes, New! Medifast Momentum Drinks, New! Momentum Flavor Infusers, New! Antioxidant Shakes, New! Antioxidant Flavor Infusers, New! Super Omega 3, Medifast® Bars, New! Medifast Crispy Bars, Medifast® Creamy Soups, Medifast® Chicken Noodle Soup, Medifast® Chicken & Wild Rice Soup, Medifast® Beef Vegetable Stew, Medifast® Home-style Chili, Medifast® Oatmeal, Medifast® Pudding, Medifast® Scrambled Eggs, Medifast® Hot Cocoa, Medifast® Cappuccino, Medifast® Chai Latte, Medifast® Iced Teas, Medifast® Fruit Drinks, Medifast® Soy Crisps, and Medifast® Crackers.

Medifast nutritional products are formulated with high-quality, low-calorie, and low-fat ingredients. Many Medifast products are soy based and contain 24 vitamins and minerals, as well as other nutrients essential for good health. The Company uses Solae® brand soy protein, which is a high-quality complete protein derived from soybeans.

Medifast brand awareness continues to expand through the Company's marketing campaigns, product development, line extensions, and the Company's emphasis on quality customer service, technical support and publications developed by the Company's marketing staff. Medifast products have been proven to be effective for weight and disease management in clinical studies conducted by researchers from the U.S. government and Johns Hopkins University. The Company has continued to develop its sales and marketing operations with qualified management and innovative programs. The Company's facility in Owings Mills, MD manufactures all powders and subcontracts the production of its Ready-To-Drink products, meal replacement bars, crackers, soy crisps and omega 3 capsules.

## NEW PRODUCTS

In 2008, the Company expanded the Medifast product line in 2008 by introducing a new line of metabolic boosters. This product line includes shakes and flavor infusers (to flavor water) that includes a specific blend of caffeine and epigallocatechin gallate (EGCG), designed to help burn calories and fat. Consuming three of these products a day can help burn an extra 100 calories per day.

The Company also added new products aimed at optimizing health. The first of these products was a new supplement line- Super Omega 3. This product boasts one of the highest concentrations of docosahexanoic acid (DHA) and eicosapentanoic acid (EPA) on the market as well as organic Flax Seed for healthy hair, skin, and nails. This product services a variety of needs from decreasing body fat to improving satiety, to providing cardioprotection to prevention of cognitive decline. The Company also designed a special line of antioxidant infusers and shakes. Each Shake and Infuser gives you the antioxidant power of two full servings of fruits and vegetables.

Medifast also began its plan to expand the Medifast bar line to include Crispy bars that are fully interchangeable with all the other meals in the program. In the past, bars could only be enjoyed once a day because of the higher calorie and carbohydrate level. The new bars contain only 110 calories, 11g of protein, less than 13g of carbohydrates and are fully fortified with 20% of the RDI for 24 Essential Vitamins and Minerals. These new bars are available in Chocolate, Chocolate Mint, Peanut Butter, Oatmeal Raisin, Cinnamon Roll, Strawberry Crunch, Caramel, Lemon, Fruit & Nut, and Smores flavors.

## MARKETING

In 2008, the Company continued to build and leverage its core Medifast brand through multiple marketing strategies to its target audiences. Customer acquisition strategies include national advertising in print magazines, television



commercials, web advertising, direct mailings, radio commercials, and DJ testimonials. In addition, the Company executed strategic public relations efforts to secure local and national editorial placements to raise brand awareness. These mediums were used to target new customers by stressing Medifast's quick, easy and safe approach to weight management. The Company invested in two celebrity contracts with preliminary marketing and media campaigns launching in late 2007 and extending into 2009. Direct mail campaigns, e-mail newsletters and outbound calling programs were utilized to reactivate, encourage and support existing customers. Medifast continued to enhance the Medifast website including adding features in the "My Medifast" community which offers meal planning, community message boards, blogs and a robust library of information. The Company also continued to feature customer blogs on the website for potential customers to interact with loyal Medifast customers. Late in 2007, the Company launched an auto ship loyalty program where customers receive discounts and rewards with automatic shipments of Medifast Meals on a monthly basis. Both the MyMedifast community enhancements and Auto-ship programs contribute to the retention of Medifast customer through improved compliance with the program.

## SALES

The Company's Sales division handles three primary areas:

**Physician Sales** - The sales team is responsible for prospecting medical accounts, clinics, hospitals, and HMOs. During 2008, the sales team attended a number of medical professional trade shows, which expanded Medifast's penetration of the medical weight loss business segment.

**Medifast Weight Control Center Franchises** - The brick and mortar clinics have Counselors that sell Medifast products and full service programs which include weekly one-on-one counseling sessions, medical monitoring and physician oversight. Franchise sales seek qualified partners to develop defined market territories.

**International** - Sales manages our bulk export business and has responsibility to qualify and develop new international business partners.

## MANUFACTURING

Jason Pharmaceuticals, Inc., the Company's wholly owned manufacturing subsidiary, produces over 80% of the Medifast products in a state-of-the-art food and pharmaceutical-grade facility in Owings Mills, Maryland. Management purchased the plant in July 2002 for \$3.4 million. The Company has also invested in increasing production capacity with the purchase of two additional manufacturing lines and a larger capacity blender. The lines have significantly improved the Company's production capability, while also improving its overall efficiencies.

The manufacturing facility has the capacity for significant increases to its production output with minimal capital expenditures. Adding additional shifts will enable the Company to produce enough products to generate over \$250 million in sales.

Manufacturing processes, product labeling, quality control and equipment are subject to regulations and inspections mandated by the Food & Drug Administration (FDA), the Maryland State Department of Health and Hygiene, and the Baltimore County Department of Health. The plant strictly adheres to all GMP practices and has maintained its status as an "OU" (Orthodox Union) kosher-approved facility since 1982.

## GOVERNMENTAL REGULATION HISTORY

The formulation, processing, packaging, labeling and advertising of the Company's products are subject to regulation by several federal agencies, but principally by the Food and Drug Administration (the "FDA"). The Company must comply with the standards, labeling and packaging requirements imposed by the FDA for the marketing and sale of foods and nutritional supplements. Applicable regulations prevent the Company from representing in its literature and labeling that its products produce or create medicinal effects or possess drug-related characteristics. The FDA could, in certain circumstances, require the reformulation of certain products to meet new standards, require the recall or discontinuation of certain products not capable of reformulation, or require additional record keeping, expanded documentation of the properties of certain products, expanded or different labeling, and scientific substantiation. If the FDA believes the products are unapproved drugs or food additives, the FDA may initiate similar enforcement proceedings. Any or all such requirements could adversely affect the Company's operations and its financial condition.

To the extent that sales of foods and nutritional supplements may constitute improper trade practices or endanger the safety of consumers, the operations of the Company may also be subject to the regulations and enforcement powers of the Federal Trade Commission ("FTC"), and the Consumer Product Safety Commission. The Company's activities are

also regulated by various agencies of the states and localities in which the Company's products are sold. The Company's products are manufactured and packaged in accordance with customers' specifications and sold under their private labels both domestically and in foreign countries through independent distribution channels.

#### PRODUCT LIABILITY AND INSURANCE

The Company, like other producers and distributors of ingested products, faces an inherent risk of exposure to product liability claims in the event that, among other things, the use of its products results in injury. The Company maintains insurance against product liability claims with respect to the products it manufactures. With respect to the retail and direct marketing distribution of products produced by others, the Company's principal form of insurance consists of arrangements with each of its suppliers of those products to name the Company as beneficiary on each of such vendor's product liability insurance policies. The Company does not buy products from suppliers who do not maintain such coverage.

## EMPLOYEES

As of December 31, 2008, the Company employed 290 full-time employees, of whom 156 were engaged in manufacturing, warehouse management, and shipping, and 134 in marketing, administrative, call center and corporate support functions. None of the employees are subject to a collective bargaining agreement with the Company.

## INFORMATION SYSTEMS INFRASTRUCTURE

Our website, which is based on internally developed software and other third party software, is hosted in San Francisco, California at a ServePath co-location facility. This facility provides redundant network connections, an uninterruptible power supply, physical and fire security and diesel generated power back up for the equipment on which our website relies upon. Our servers and our network are monitored 24 hours a day, seven days a week.

We use a variety of security techniques to protect our confidential customer data. When our customers place an order or access their account information, we use a secure server (SSL) to transfer information. Our secure server software encrypts all information entered before it is sent to our server. All customer data is protected against unauthorized access. We use PayPal, VeriSign and HackerSafe software to secure our credit card transactions.

## OTHER MATTERS

An Independent Committee of the Board of Directors of Medifast was constituted to review the public allegations of a third party "Convicted Felon" on his website pertaining to alleged illegal activities of Take Shape for Life, a Direct Selling Subsidiary of Medifast Inc. Other public Direct Selling Companies have been attacked by this individual and his network of associates using the same blueprint of allegations. These public allegations were made in mid-February and were immediately followed by significant short selling and short selling option puts that shaved over \$30 million from the Market Capitalization of Medifast. The company has demanded that this third party take down its website information containing false information or be subject to appropriate legal action.

Medifast, in a press release on February 17th, 2009, responded to the False Claims in SEC File # 001-31573; Film #09617581. The Independent Committee appointed Chairman is Mr. Barry B. Bondroff, CPA, an officer and director with Gorfine, Schiller & Gardyn, PA. Members are: Mr. George J. Lavin Esq, founding Partner of the law firm, Lavin, O'Neil, Ricci, Ceprone & Dispicio, who is an expert in Product Liability Law, Lt. Gen. Dennis M. McCarthy USMC (Ret.), Executive Director of the Reserve Officers Association of the United States and a licensed attorney, Capt. Joseph D. Calderone USNR (Ret.), chaplain and counselor of the Villanova University Law School, and Mr. Charles P. Connolly, former President and CEO of First Union Corp.

After an investigation of the facts and information developed to date the committee unanimously agreed that the allegations were false, misleading and or without merit.

## AVAILABLE INFORMATION

All periodic and current reports, registration statements, code of conduct, code of ethics and other material that the Company is required to file with the Securities and Exchange Commission ("SEC"), including the Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934 (the "1934 Act Reports"). These materials are available free of charge through the Company's investor relations page at [www.ChooseMedifast.com](http://www.ChooseMedifast.com). Such documents are available as soon as reasonably practicable after electronic filing of the material with the SEC. The Company's Internet web site and the information contained therein or connected thereto are not intended to be incorporated into this Annual Report on Form 10-K. The Company will furnish without

charge a copy of the Company's Annual Report on Form 10-K, including the financial statements and schedules thereto, to any person requesting in writing and stating that he or she is the beneficial owner of Common Shares of the Company.

Requests and inquiries should be addressed to:

Investor Relations  
Medifast, Inc.  
11445 Cronhill Dr.  
Owings Mills, MD 21117

## CERTIFICATIONS

The Company's Chief Executive Officer and Chief Financial Officer have filed their certifications as required by the Securities and Exchange Commission (the "SEC") regarding the quality of the Company's public disclosure for each of the periods ended during the Company's fiscal year ended December 31, 2008 and the effectiveness of internal control over financial reporting as of December 31, 2008 and 2007. Further the Company's Chief Executive Officer has certified to the New York Stock Exchange ("NYSE") that he is not aware of any violation by the Company of the NYSE corporate governance listing standards, as required by Section 303A.12(a) of the NYSE listing standards.

## EXECUTIVE OFFICERS OF THE COMPANY

| Name                       | Age | Position  |
|----------------------------|-----|---|
| Bradley T. MacDonald       | 61  | Chairman of the Board of Directors                  |
| Michael S. McDevitt        | 30  | Chief Executive Officer and Chief Financial Officer |
| Leo V. Williams            | 61  | Executive Vice President                            |
| Margaret MacDonald- Sheetz | 31  | Chief Operating Officer and President               |
| Brendan N. Connors         | 31  | Vice President of Finance                           |

## Bradley T. MacDonald

Mr. MacDonald became Chairman of the Board of Medifast, Inc. on January 28, 1998. Mr. MacDonald was previously employed by the Company as its Chief Executive Officer from September 1996 to March 2007. In 2006, Mr. MacDonald was named "Entrepreneur of the Year" in consumer products for the State of Maryland. Prior to joining the Company, he was appointed as Program Director of the U.S. Olympic Coin Program of the Atlanta Centennial Olympic Games. From 1991 through 1994, Colonel MacDonald returned to active duty to be Deputy Director and Chief Financial Officer of the Retail, Food, Hospitality and Recreation Businesses for the United States Marine Corps. Prior thereto, Mr. MacDonald served as Chief Operating Officer of the Bonneau Sunglass Company, President of Pennsylvania Optical Co., Chairman and CEO of MacDonald and Associates, which had major financial interests in retail drug, consumer candy, and pilot sunglass companies. Mr. MacDonald was national president of the Marine Corps Reserve Officers Association and retired from the United States Marine Corps Reserve as a Colonel in 1997, after 27 years of service. He was appointed and served on the Defense Advisory Board for Employer Support of the Guard and Reserve (ESGR.) Mr. MacDonald serves on the Board of Directors of Stevenson University in Maryland, and the Institute of Notre Dame High School, Baltimore, Maryland. He is also the Vice-Chairman on the Board of Directors of the Marine Corps Reserve Toys for Tots Foundation.

## Michael S. McDevitt

Mr. McDevitt joined Medifast in 2002 as the Controller and was promoted to Vice President of Finance in January 2004. In March 2005, he was promoted to President and in January of 2006 was also named Chief Financial Officer. In March of 2007, Mr. McDevitt was promoted to CEO of the Company. Prior to joining Medifast, Mr. McDevitt worked as a Financial Analyst for the Blackstone Group, an investment advisory firm based in New York, NY.

## Leo V. Williams

Mr. Williams became Executive Vice President of Medifast, Inc. in January of 2004. Prior to joining Medifast, he was a Future Vehicles Marketing Plans Director for Ford Division sport utility vehicles and pickup trucks. A retired Marine Corps Reserve major general, he was ordered to active duty from October 2002 to September 2003 to serve as Deputy Director of the Marine Corps Combat Development Command. Mr. Williams served as the Vice-Chairman of the Board, Marine Corps Toys for Tots Foundation. Currently, he serves on the Board of Directors of the Direct Selling Association, U.S. Naval Academy Foundation, Maryland Chapter of the American Diabetes Association, Naval Academy Alumni Association Board of Trustees, Board of Trustees for the University of the District of Columbia, and on the Navy Mutual Aid Association Board.

Margaret MacDonald - Sheetz, MBA

Ms. Sheetz joined Medifast in 2000 as the Director of Sales and Administration. In 2002 she was promoted to VP of Operations and in 2004 promoted to Senior VP of Operations. In May of 2006, Ms. Sheetz received an Executive MBA from Loyola University. In March 2007, she was promoted to President and Chief Operating Officer of Medifast Inc.

Brendan N. Connors, CPA

Mr. Connors joined Medifast as the Vice President of Finance in April of 2005. Prior to joining Medifast, Mr. Connors worked as a Senior Accountant at Wolf & Company P.C., a certified public accounting and consulting firm in Boston, MA.

## ITEM 1A. RISK FACTORS

The following risk factors should be considered when reading this Annual Report on Form 10-K. If any of the events described below occurs, the Company's financial condition and operating results could be adversely affected.

Much of our growth and future profitability depends on the effectiveness of our advertising spent in the Direct to consumer channel.

Our marketing expenditures may not result in increased revenue or generate sufficient awareness of the program or the brand to the consumer. We may not be able to manage our advertising spend in a cost effective manner thereby increasing the cost to acquire a new customer to an elevated level that will decrease profits.

We may be subject to health related claims from our customers

A customer that suffers health problems may allege that the Medifast program contributed to the ailment. The Company is not currently the subject of any such claims; however, we would defend ourselves vigorously against such accusations. Regardless of the ultimate outcome, defending against such claims would be costly and could adversely affect our results of operations.

A competitor or new entrant into the market may develop a product and program similar to ours

Many of our competitors are significantly larger than us and have more financial resources to develop new products and programs. Our business could be affected if one of our competitors or a new entrant to the market develops similar products and programs through similar marketing channels. This could result in lower sales as well as pricing competition which could adversely affect the Company's results from operations.

New fad diets or pharmaceutical solutions could put us at a competitive disadvantage

The weight loss industry is subject to fad diets. The Atkins craze hit the U.S. several years ago and had an impact on many weight loss companies. Another fad diet could sweep the nation or consumer preferences could change. Our failure to adapt or respond quickly enough to these changes could have an adverse affect on our results of operations. In addition, pharmaceutical companies are constantly trying to develop safe, effective, drugs that lead to weight loss. If successful, many dieters could perceive this to be easier than the Medifast program and this would put us at a competitive disadvantage.

Our ability to compete could be negatively affected in the event we fail to protect our brand names, trademarks or other intellectual property

Because our business relies heavily on direct to consumer models, brand awareness is an important factor in our sales strategy. Failure to protect our brand or maintain an image of good standing with the public could result in a negative effect on our operations. Additionally, failure to protect our intellectual property could result in the arrival of a similar competitor which could reduce our competitive edge or decrease our market share.

The business may grow too quickly for the current infrastructure to handle

If our advertising is extremely successful and our Take Shape for Life relationship marketing division sees a large uptick in recruitment we may be unable to handle the growth from an operational perspective. Increasing demands on our infrastructure could cause long hold times in the call center as well as delays on our website. In addition, there could be delays in order processing, packaging and shipping. We could run out of a majority of our inventory if growth exceeded our production capacity. If these difficulties are encountered in a period of hyper-growth then our



operating results could suffer.

Any deficiencies or shortcomings in our information technology could prevent an efficient execution of routine business procedures

We rely heavily on our IT infrastructure to support major business components. Any disruption to the integrity of this support structure including but not limited to; software, telecommunications, Electronic Resource Platform, or the Information Technology architecture as a whole could severely limit our ability to provide customers and vendors with adequate service and operating responses. In addition, our financial reporting is directly correlated with our company-wide software Microsoft Navision 4.0. Any compromise in the veracity of this system could severely alter the accuracy of our tracking, volumes, and general reporting including financial statements.

A disruption in the supply of raw materials or the inability of third party manufacturing for certain products could affect operating results

We rely heavily on our vendors to provide quality raw materials for us to utilize in our on-site manufacturing processes. Any disruption in the availability of these materials could potentially interrupt our ability to provide certain products to customers in a timely manner. Also certain products are currently manufactured through a third party. The availability of these products is prone to fluctuations dependent on the manufacturer's ability to secure and produce a quality product that satisfies our satisfaction standards.

Our stock price may experience volatility due to fluctuations in our operating results

Our stock price is subject to fluctuations in response to our operating results, a competitor's operating results, or our ability to meet stock analysts forecasts and our yearly revenue and EPS guidance. In addition, general trends in the weight-loss industry as a whole can have an affect on our stock price. These factors may have an adverse affect on the market price of our stock and cause it to fluctuate significantly.

Since we cannot exert the same level of influence or control over our independent health coaches as we could were they our own employees, our health coaches could fail to comply with our policies and procedures, which could result in claims against us that could harm our financial condition and operating results.

Our health coaches are independent contractors and, accordingly, we are not in a position to directly provide the same direction, motivation and oversight as we would if health coaches were our own employees. As a result, there can be no assurance that our health coaches will participate in our marketing strategies or plans, accept our introduction of new products, or comply with our health coach policies and procedures.

Extensive federal, state and local laws regulate our business, products and direct selling program. While we have implemented health coach policies and procedures designed to govern their conduct and to protect the trademarks and brand of the Company it can be difficult to enforce these policies and procedures because of the large number of health coaches and their independent status. Violations by our independent health coaches of applicable law or of our policies and procedures in dealing with customers could reflect negatively on our products and operations and harm our business reputation. In addition, it is possible that a court could hold us civilly or criminally accountable based on vicarious liability because of the actions of our independent health coaches.

We may be subject to claims that our employees are unqualified to provide weight loss counseling

Our Medifast Weight Control center division provides medical assessments and counseling to our customers. We may be subject to claims that our employees lack the proper training and qualifications to provide proper advice regarding weight loss. We could be subject to claims if an employee in one of our clinics gives inappropriate weight loss advice that results in health problems. Such claims could result in damage to our reputation and could have an affect on our operating results.

Adverse publicity associated with our products, ingredients, or sales channels, or those of similar companies, could harm our financial condition, operating results, and stock price.

Adverse publicity, whether or not accurate, relating to the Company, our products or our operations, our sales channels and independent health coaches could adversely impact the Company's financial condition, operating results, and stock price. In addition, it could lead to lawsuits or other legal challenges and could negatively impact our reputation, the market demand for our products, or our general business.

Negative publicity in the weight loss industry could adversely affect our business

If the press were to come out with negative media about low-calorie diets, meal replacements, or soy protein this could harm our business. Even if not directed at Medifast, this perception could be instilled in our target market and cause harm to our operating results.

The loss of key personnel could adversely affect our ability to operate and result in a negative financial condition

Certain members of our Company oversee integral components of our Company. Although we do not anticipate the departure of any key employees including but not limited to the executive management team, we cannot guarantee their tenure indefinitely in the future.

Our results of operations may decline as a result of a downturn in general economic conditions or consumer confidence

Our results of operations are highly dependent on product sales and program fees. A downturn in general economic conditions or consumer confidence and spending in any of our major markets could result in people curtailing their discretionary spending, which, in turn, could lead to a decrease in product sales in our Medifast Direct and Take Shape for Life divisions and a decrease in product and program fees at our Medifast Weight Control Centers and Internet product subscriptions. Any such reduction would adversely affect our results of operations.

Our Business is subject to regulatory and legislative restrictions

A number of laws and regulations govern our production, operation, and advertising. The FTC and certain states regulate advertising, disclosures to consumers, privacy, consumer pricing or billing arrangements, and other consumer matters. Our direct selling distribution channel is subject to risk of interpretation of certain laws pertaining to the prevention of "pyramid" or "chain sale" schemes. Although we believe we are in full compliance, should the governing body alter or enforce the law in an unanticipated way, there may be a negative result on the company's operations. The Company's financial reporting is subject to various laws and regulations as well, specifically, the Sarbanes-Oxley Act of 2002 and the SEC. These requirements demand the Company disclose certain information and maintain specific controls to ensure fair and legal accounting practices as outlined therein. The Company has taken substantial measures to ensure compliance through routine internal and external audits. Failure to correct any flaws in internal controls may constitute a public notification of weakness and could have an adverse effect on our stock price. Additionally, the Company is required to maintain a position of good standing in regards to taxation on both a Federal and State level. Failure to comply with federal and state regulations could result in additional taxes, fines, or interest due that could financially strain the company. Future laws and regulations could be unforeseen and potentially have a material negative impact on the Company. Failure to comply with any regulations of current or future authoritative entities could have a detrimental effect on the Company's financial standing or operating results

#### ITEM 1B. UNRESOLVED STAFF COMMENTS

None

#### ITEM 2. DESCRIPTION OF PROPERTY

The Company owns a 49,000 square-foot facility in Owings Mills, Maryland, which contains its Corporate Headquarters and manufacturing plant. In 2003, the Company purchased a state-of-the-art 119,000 square-foot distribution facility in Ridgely, Maryland. The facility gives the Company the ability to distribute over \$250 million of Medifast product sales per year. In 2004, the Company purchased a 3,000 square foot conference and training facility in Ocean City, Maryland. The facility will be used to conduct corporate training meetings, Board of Director Meetings and employee morale and wellness programs. The Company has twenty leases for its corporately owned Medifast Weight Control clinics throughout Florida and Texas. In addition, the Company leases a building in Owings Mills, MD for corporate offices. The leases range in terms from one to six years.

#### ITEM 3. LEGAL PROCEEDINGS

Leonard Z. Sotomeyor, on December 30, 2003, filed an action in the Supreme Court of the State of New York, County of New York, against his former business partner, David Scheffler, and T-1 Holdings, LLC, and included Medifast, Inc., formerly Heathrite, Inc., as a Defendant, Case 604076-03, seeking monetary damages for failure of his former business partner to compensate him under several consulting agreements with Medifast, Inc. made with H-T Capital, Inc. and derivatively on behalf of T-1 Holdings, LLC. All parties, including Medifast, Inc. recently reached a global

settlement including dismissal of the litigation with prejudice and general releases. On October 17, 2008, Medifast agreed to pay legal fees in the amount of \$130,000 in cash, and 14,286 shares of Medifast treasury stock valued at \$70,000 to settle the case. Mr. Sotomayor also received 29,647 Medifast, Inc. warrants with a strike price of \$4.80 a share from Mr. David Scheffler. The Board of Directors approved a settlement that was considered significantly less costly than the future litigation costs for defense. Medifast vehemently denied the alleged charges in the complaint and had fortuitous defenses that it believes would have prevailed in a trial. The total impact of the settlement to Medifast, Inc. was a one time charge to earnings of approximately \$200,000 in the fourth quarter of 2008.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable

## PART II

## ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

(a) The Company's Common Stock has been quoted under the symbol MED since December 20, 2002. The old symbol, MDFT, had been traded since February 5, 2001. The common stock is traded on the New York Stock Exchange. The following is a list of the low and high closing prices by fiscal quarters for 2008 and 2007:

|                                  | 2008 |      |
|----------------------------------|------|------|
|                                  | Low  | High |
| Quarter ended March 31, 2008     | 3.68 | 4.99 |
| Quarter ended June 30, 2008      | 4.35 | 6.68 |
| Quarter ended September 30, 2008 | 4.80 | 8.85 |
| Quarter ended December 31, 2008  | 3.52 | 6.79 |

|                                  | 2007 |       |
|----------------------------------|------|-------|
|                                  | Low  | High  |
| Quarter ended March 31, 2007     | 6.03 | 12.40 |
| Quarter ended June 30, 2007      | 6.32 | 9.25  |
| Quarter ended September 30, 2007 | 5.58 | 8.83  |
| Quarter ended December 31, 2007  | 3.79 | 6.24  |

(b) The quotations reflect inter-dealer prices, without retail mark-up, markdown or commissions and may not represent actual transactions.

(c) There were approximately 208 record holders of the Company's Common Stock as of March 13, 2009. This number does not include beneficial owners of our securities held in the name of nominees. The Company had no preferred holders of the Company's stock as of December 31, 2008.

(d) No dividends on common stock were declared by the Company during 2008 or 2007.

## ITEM 6. SELECTED FINANCIAL DATA

The selected condensed consolidated financial data set forth below should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” included as Part II, Item 7 of this Annual Report on Form 10-K, and the consolidated financial statements and notes thereto of the company included in Part II Item 8 of this Annual Report on Form 10-K. The historical results provided below are not necessarily indicative of future results.

|   | 2008        | 2007       | 2006       | 2005       | 2004       |
|---|-------------|------------|------------|------------|------------|
| Revenue   | 105,445,000 | 83,779,000 | 74,086,000 | 40,129,000 | 27,340,000 |
| Operating income  | 8,199,000   | 5,715,000  | 7,381,000  | 3,549,000  | 3,004,000  |
| Income from continuing operations                                 | 7,850,000   | 5,543,000  | 7,463,000  | 3,405,000  | 2,906,000  |
| EPS - basic   | 0.41        | 0.30       | 0.41       | 0.17       | 0.16       |
| EPS - diluted   | 0.38        | 0.28       | 0.38       | 0.17       | 0.14       |
| Total assets  | 51,037,000  | 43,724,000 | 36,677,000 | 30,120,000 | 25,968,000 |
| Current portion of long-term debt and revolving credit facilities | 3,421,000   | 1,863,000  | 1,804,000  | 1,194,000  | 827,000    |
| Total long-term debt  | 4,313,000   | 4,570,000  | 3,509,000  | 3,977,000  | 4,256,000  |
| Weighted average shares outstanding                               |             |            |            |            |            |
| Basic   | 13,126,534  | 12,960,930 | 12,699,066 | 12,258,734 | 10,832,360 |
| Diluted   | 14,329,525  | 13,644,149 | 13,482,894 | 12,780,959 | 12,413,424 |

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

### 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.

### 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.

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CONSOLIDATED RESULTS OF OPERATIONS  
2008 COMPARISON WITH 2007

OPERATING

Revenue: Revenue increased to \$105.4 million in 2008 as compared to \$83.8 million in 2007, an increase of \$21.6 million or 26%. The Take Shape for Life sales channel accounted for 47% of total revenue, direct response marketing 42%, brick-and-mortar clinics 8%, and doctors 3%. Take Shape for Life sales, which are fueled by person-to-person recruiting and support increased by 79% year-over-year. The Company's Medifast Weight Control Center clinic division, increased sales by 68% as compared to 2007 due to the opening of new clinics in 2008. The direct marketing sales channel, which is fueled primarily by consumer advertising, decreased revenues by approximately 6% year-over-year on less advertising spend. The Company's doctor's sales decreased by 24% compared to 2007 due to certain doctors transitioning to the professional division of Take Shape for Life.

The Take Shape for Life division grew 79% year-over-year. This growth can largely be attributed to the tools and training that led to an increase in the ability of the division to both promote growth in recruiting of health coaches and acquisition of clients, as well as better supporting this growth as it occurs. This continued investment proved to be a large part of the current growth trends in Take Shape for Life sales, as well as the number of active health coaches and clients. The growth in this segment correlates directly to the increase in health coaches, which began to accelerate following our National Convention in July 2008. The number of active health coaches grew 84% to 3,400 at the end of the fourth quarter of 2008 as compared to 1,850 for the same time period in 2007. The Company completed our 2008 National Convention in Orlando, FL on July 26th, 2008 where approximately 750 health coaches participated, an increase of nearly 88% from prior year. The individuals that attended the event attended workshops and heard lectures by accredited individuals in the areas of recruiting, product and nutrition knowledge, and business skills.

The Medifast Weight Control Centers, which represent approximately 8% of the Company's overall revenues, are currently operating in twenty locations in Dallas, Houston, and Orlando. In 2008, the Company experienced revenue growth of 68% versus the same time period last year. The average monthly revenue per clinic also witnessed growth of 6%, averaging \$38,000 per clinic in 2008 as compared to \$36,000 in 2007. In the expanding Dallas, TX market, the average monthly revenue per clinic is approximately \$50,000. In the estimated \$40 billion weight loss and health living industry, the brick and mortar clinic model has always made up a significant portion of overall sales. The recent growth in the Medifast Weight Control Centers has proven that the model is in high demand from a select portion of the weight loss consumers. Throughout the year, the Company invested in the infrastructure of its clinic model. The major aspects of the investment in this division included an expanded support team, the creation of a point of sale system, a robust customer data tracking system, and finalizing the franchise opportunity documentation. During 2008, the Company opened eight additional corporately owned clinics in the Houston, TX market and two additional centers in the Dallas, TX market.

On February 18, 2008, the Company announced that it has sold its first franchise of Medifast Weight Control Centers. The Company sold the rights to open four clinics in the Greater Baltimore Metropolitan Area. The franchisee also has the rights to open four additional Medifast Weight Control Centers in the Baltimore area over the next two years, bringing the total to eight locations. On June 3, 2008 the Company announced that it sold the rights to open four Medifast Weight Control Centers in Southern California and three Medifast Weight Control Centers in Central California to two different local business operators. On October 8, 2008, the Company announced the opening of its first franchise clinic in the Baltimore, MD area. In December 2008, three Medifast Weight Control Center franchise locations opened in Southern California and one location opened in Central California. At December 31, 2008, five franchise locations were in operation.

Overall, selling, general and administrative expenses increased by \$15.3 million as compared to 2007. Take Shape for Life commission expense, which is completely variable based upon revenue, increased by approximately \$10.1

million as the Company showed sales growth of 79% as compared to 2007. Salaries and benefits increased by approximately \$2 million in 2008. The increase includes the hiring of additional expertise in critical areas such as Take Shape for Life and the Medifast Weight Control Centers to support the strong growth in 2008 and beyond. Also, additional personnel were hired in the call center during the first and second quarters of 2008 as the Company brought the outsourced Take Shape for Life call center in-house early in the second quarter of 2008. Going forward, savings will be realized on communication expense as a result of bringing the call center in-house. The opening of eight new corporately owned clinics in the Houston, TX market and two in the Dallas, TX market also required the hiring of additional center managers and support staff. Advertising expense in 2008 was approximately \$17.8 million compared to approximately \$18.4 million for the same period last year, a decrease of \$600,000. Communication expense decreased by \$200,000 as a result of the Take Shape for Life call center moving in-house during the second quarter of 2008. Other expenses increased by \$2.4 million which included items such as depreciation, amortization, credit card processing fees, charitable contributions, and property taxes. Operating expenses increased by \$950,000 which primarily resulted from additional printing expense for our direct to consumer postcard mailings and Take Shape for Life printed material, as well as maintenance, repairs, and supplies for our manufacturing and distribution facilities. Office expenses increased by \$300,000 and stock compensation expense increased by \$225,000 as additional restricted shares were issued to key executives and Board members in the third and fourth quarters of 2008.

**Costs and Expenses** Cost of revenue increased \$3.9 million to \$25.3 million in 2008 from \$21.5 million in 2007. As a percentage of sales, gross margin increased to 75.9% in 2008 from 74.4% in 2007. The margin improved due to efficiencies gained from new machinery purchases in prior year, new shipping rules that resulted in additional shipping revenue from customers netting against shipping expense, as well as a price increase on July 1, 2008.

**Other Income/Expense:** Other expense increased from a \$172,000 in 2007 to \$349,000 at December 31, 2008. The \$177,000 increase in other expense resulted primarily from realized losses of \$216,000 on the Company's equity investment portfolio managed by Merrill Lynch due to the weakness of the stock market in 2008. Other income/expense consists of interest expense on debt, gains or losses on the sale of equity investments, dividends and interest on equity and bond investments, and interest payments received on the CCS note receivable. In 2007, the Company also realized other income when it exercised a stock warrant from a former business partner, and realized a loss on disposal of assets relating to the closing of three Medifast Weight Control Centers.

**Income taxes:** In 2008, we recorded \$2,415,000 in income tax expense which represents an effective rate of 30.8%. In the fourth quarter of 2008, the Company amended prior year tax returns to properly roll forward prior net operating losses for tax purposes which resulted in a \$162,000 tax refund receivable at December 31, 2008. The effective rate would have been 32.8% without the benefit of the tax refund. In 2007, we recorded \$1,706,000 in income tax expense, which represents an annual effective rate of 30.8%. The Company anticipates a tax rate of approximately 35-37% in 2009.

**Net income:** Net income was \$5.4 million in 2008 as compared to \$3.8 million in 2007, an increase of 42%. The improved profitability during 2008 is due to sales growth in the Take Shape for Life division and Medifast Weight Control Centers, and gross margin improvement.

## SEGMENT RESULTS OF OPERATIONS

### Net Sales by Segment as of December 31,

| Segments     | 2008        |            | 2007       |            | 2006       |            |
|--------------|-------------|------------|------------|------------|------------|------------|
|              | Sales       | % of Total | Sales      | % of Total | Sales      | % of Total |
| Medifast     | 97,116,000  | 92%        | 78,861,000 | 94%        | 70,181,000 | 95%        |
| All Other    | 8,329,000   | 8%         | 4,918,000  | 6%         | 4,015,000  | 5%         |
| Eliminations |             | 0%         |            | 0%         | (110,000)  | 0%         |
| Total Sales  | 105,445,000 | 100%       | 83,779,000 | 100%       | 74,086,000 | 100%       |

### 2008 vs. 2007

**Medifast Segment:** The Medifast reporting segment consists of the sales of Medifast Direct, Take Shape for Life, and Doctors. As this represents the majority of our business this is referenced to the "Consolidated Results of Operations" management discussion for 2008 vs. 2007 above.

**All Other Segment:** The All Other reporting segment consists of the sales from Hi-Energy and Medifast Weight Control Centers. Sales increased by \$3,411,000 year-over year due to the opening of ten new centers throughout 2008, including eight centers in Houston, TX and two centers in Dallas, TX. The Dallas, TX market continues to mature with the average clinic generating approximately \$50,000 per month in sales. The Company is continuing to focus on improved advertising effectiveness, improved closing rates on walk-in sales, as well as the hiring of more experienced clinic. At the end of 2008, there were twenty corporately owned centers opened as compared to ten centers at the end of 2007. In addition, the Company began franchising the Medifast Weight Control Center model in

2008. At the end of 2008, there were five franchise centers in operation.

2007 vs. 2006

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

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All Other Segment: The All Other reporting segment consists of the sales from Hi-Energy and Medifast Weight Control Centers. Sales increased by \$903,000 year-over year as a result of an increase in Medifast Weight Control Centers sales of \$1,013,000. Sales to Hi-Energy licensees decreased by \$110,000 as fewer Hi-Energy licensee clinics remain in operation as clinics convert to Medifast Weight Control Centers. The increase in Medifast Weight Control Center's sales was due to a renewed focus on the expansion of the corporate clinics, 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. There were ten clinics open at the end of 2007 as compared to twelve at the end of 2006.

## Net Profit by Segment as of December 31,

| Segments     | 2008        |            | 2007        |            | 2006      |            |
|--------------|-------------|------------|-------------|------------|-----------|------------|
|              | Profit      | % of Total | Profit      | % of Total | Profit    | % of Total |
| Medifast     | 8,104,000   | 149%       | 5,937,000   | 155%       | 6,218,000 | 121%       |
| All Other    | (2,669,000) | -49%       | (2,100,000) | -55%       | (952,000) | -18%       |
| Eliminations |             | 0%         |             | 0%         | (110,000) | -2%        |
| Net Profit   | 5,435,000   | 100%       | 3,837,000   | 100%       | 5,156,000 | 100%       |

## 2008 vs. 2007

Medifast Segment: The Medifast reporting segment consists of the profits of Medifast Direct, Take Shape for Life, and Doctors. As this represents the majority of our business this is referenced to the "Consolidated Results of Operations" management discussion for 2008 vs. 2007 above. See footnote 17, "Business Segments" for a detailed breakout of expenses.

All Other Segment: The All Other reporting segment consists of the losses of Hi-Energy, 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 \$569,000. The Hi-Energy and Medifast Weight Control Centers showed an increase in net profitability year-over-year of \$339,000. The increase in profitability was due to improved profitability in established centers. During the year, ten new centers were opened and should have a positive impact on 2009 earnings. Medifast Corporate expenses increased by \$908,000 year-over-year. Corporate expenses include items such as auditors' fees, attorney's fees, Board of Director expenses, investor relations, corporate consulting, and corporate outings. In 2008, the Company had additional legal expenses associated with the Sotomayor legal action that resulted in a \$200,000 one time charge to earnings in the fourth quarter of 2008. See Item 3 – Legal Proceedings on page 16 for more detail. In addition, the Company had an increase in realized losses on equity securities in its investment account in the fourth quarter of 2008 due to the weakness in the stock market. See footnote 17, "Business Segments" for a detailed breakout of expenses.

## 2007 vs. 2006

Medifast Segment: The Medifast reporting segment consists of the profits of Medifast Direct, Take Shape for Life, and Doctors. As this represents the majority of our business this is referenced to the "Consolidated Results of Operations" management discussion for 2007 vs. 2006 above. See footnote 17, "Business Segments" for a detailed breakout of expenses

All Other Segment: The All Other reporting segment consists of the losses of Hi-Energy, 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 \$1,148,000. Corporate expenses increased by \$401,000, as a result of increased fees due to increased reporting requirements for the Company as a whole. These fees include, but are not limited to auditors' fees, attorneys' fees, board of director expenses, investor relations, corporate consulting, education and training, and corporate outings. Hi-Energy and Medifast Weight Control Center expenses increased by \$726,000 due to increased focus on opening new Medifast Weight Control clinics, hiring of experienced personnel, increased advertising and developing the Franchise model. See footnote 17, "Business Segments" for a detailed breakout of expenses.

## Contractual Obligations and Commercial Commitments

As of December 31, 2008, our principal commitments consisted of obligations for variable and fixed rate loans detailed in Note 12 of the financial statements, operating leases for corporately owned Medifast Weight Control Centers detailed in Note 9 of the financial statements, and copier equipment contracts for our printing operation that support our marketing efforts.

The Company has the following contractual obligations as of December 31, 2008

|                                      | Payments due by period |                  |                  |                  |                |                  | Total             |
|--------------------------------------|------------------------|------------------|------------------|------------------|----------------|------------------|-------------------|
|                                      | 2009                   | 2010             | 2011             | 2012             | 2013           | Thereafter       |                   |
| <b>Contractual Obligations</b>       |                        |                  |                  |                  |                |                  |                   |
| Total Debt                           | 3,420,000              | 257,000          | 494,000          | 225,000          | 225,000        | 3,113,000        | 7,734,000         |
| Operating Leases                     | 926,000                | 819,000          | 776,000          | 676,000          | 227,000        | -                | 3,424,000         |
| <b>Copier Equipment</b>              |                        |                  |                  |                  |                |                  |                   |
| Service Contracts                    | 399,000                | 355,000          | 334,000          | 283,000          | -              | -                | 1,371,000         |
| <b>Total contractual obligations</b> | <b>4,745,000</b>       | <b>1,431,000</b> | <b>1,604,000</b> | <b>1,184,000</b> | <b>452,000</b> | <b>3,113,000</b> | <b>12,529,000</b> |

## LIQUIDITY AND CAPITAL RESOURCES

The Company had stockholders' equity of \$38,173,000 and working capital of \$12,669,000 on December 31, 2008 compared with \$32,420,000 and \$10,395,000 at December 31, 2007, respectively. The \$5.8 million net increase in stockholder's equity reflects \$5.4 million in 2008 profits as well as equity transactions as outlined in the "Consolidated Statement of Changes in Stockholders' Equity and accumulated other comprehensive income (loss)." The Company's cash and cash equivalents position decreased from \$2.2 million at December 31, 2007 to \$1.8 million at December 31, 2008. The decrease is due to large inventory purchases in the fourth quarter of 2008 to include ten new meal replacement bars as well as an increase in inventory levels in preparation for the "diet" season beginning in January 2009. In addition, the Company's capital expenditures increased by approximately \$2.3 million in 2008 as compared to 2007. In 2008, capital expenditures included the opening of ten new Medifast Weight Control Centers, development of a point-of-sale system for the Clinics, development of a new web shopping platform for the direct response segment, new software system for our Take Shape for Life division, ERP enhancements, and phone system upgrades.

In September 2007, Medifast, Inc.'s wholly owned subsidiary Jason Pharmaceuticals, Inc. increased its Secured Line of Credit from \$5 million to \$7.5 million and moved the line of credit from Mercantile Safe-Deposit and Trust to Merrill Lynch. The line of credit is at LIBOR plus 1.3 percent. The increased line may be used to finance fixed assets, advertising, and inventory of Medifast, Inc. The Company currently has no off-balance sheet arrangements.

In the year ended December 31, 2008 the Company generated cash flow of \$5,496,000 from operations, primarily attributable to higher operating income. This was offset by net changes in operating assets and liabilities that decreased cash flow by \$4,781,000. The total use of cash from operations was \$6,649,000. The largest use of cash was for the purchase of inventory. During 2008, inventory increased by \$4.7 million. Inventory increased due to our increased sales, introduction of ten new meal replacement bars late in the fourth quarter of 2008 as well as the typical fourth quarter inventory build-up in order to prepare for "diet season" in the first quarter of 2009. Additional uses of cash included an increase in prepaid taxes of \$1.1 million, increase in other assets of \$251,000, and a reduction in income taxes payable of \$592,000. This was offset by sources of cash from a decrease in accounts receivable -



\$43,000, decrease in prepaid expenses - \$693,000, decrease in deferred compensation - \$282,000, and an increase in accounts payable - \$850,000.

In the year ended December 31, 2008, net cash used in investing activities was \$7,313,000, which primarily consisted of the purchase of property and equipment. The increase in property and equipment relates to the building of a large amount of infrastructure in 2008 to support growth. This included the opening of ten new Medifast Weight Control Center locations, development of a point-of-sale system for the Medifast Weight Control Centers, development of a new web shopping platform for the direct response segment, new software system for our Take Shape for Life division, ERP enhancements, IT infrastructure to support new systems, phone system upgrades, and leasehold improvements to manufacturing and distribution facilities to support future growth.

In the year ended December 31, 2008, financing activities generated \$1,463,000 in cash flow. Sources of cash included funds drawn from the line of credit - \$1.6 million, a decrease in notes receivable - \$132,000, and issuances of warrants and options exercised with cash - \$32,000. This was offset by a use of cash in the repayment of long term debt - \$264,000.

In pursuing its business strategy, the Company may require additional cash for operating and investing activities. The Company expects future cash requirements, if any, to be funded from operating cash flow and cash flow from financing activities.

There are no current plans or discussions in process relating to any material acquisition that is probable in the foreseeable future.

## 2007 COMPARISON WITH 2006

### OPERATING

Revenue: Revenue increased to \$83.8 million in 2007 as compared to \$74.1 million in 2006, an increase of \$9.7 million or 13%. The direct marketing sales channel accounted for 56% of total revenue, Take Shape for Life 33%, doctors 5%, and brick and mortar clinics 6%. The direct marketing sales channel, which is fueled primarily by consumer advertising, increased revenues by approximately 3% year-over-year. Take Shape for Life sales, which are fueled by person-to-person recruiting and support increased by 23% year-over-year. The Company's doctor's sales increased by 8% compared to 2006. The Company's clinic division which began operating under the Medifast Weight Control Center name in late 2006, increased sales by 37% as compared to 2006.

The Take Shape for Life division grew 23% year-over-year. This growth can largely be attributed to the tools and training that led to an increase in the ability of the division to both promote growth in recruiting of health coaches, as well as better supporting this growth as it occurs. This continued investment proved to be a large part of the current growth trends in Take Shape for Life sales, as well as the number of active health coaches. The number of active health coaches grew to 1,850 at the end of the fourth quarter 2007 compared to 1,200 at the same time period in 2006, an increase of 54%. This recent growth in health coaches was recently observed in July of 2007, with over 80% attendance growth at the 2007 National Convention compared to the attendance at the 2006 Convention. The Company believes that the growth in health coach activity is a positive trend that should continue, and will lead to significant revenue growth in the near future

The Medifast Weight Control Centers, which represent approximately 6% of the Company's overall revenues, are currently operating in ten locations in Dallas and Orlando. In 2007, the Company experienced revenue growth of 37% versus the same time period last year. The average monthly revenue per clinic also witnessed significant growth of 64%, averaging \$36,000 per clinic in 2007 as compared to \$22,000 in 2006. In the expanding Dallas, TX market, the average monthly revenue per clinic is approximately \$50,000. In the estimated \$40 billion weight loss and health living industry, the brick and mortar clinic model has always made up a significant portion of overall sales. Medifast has incorporated this model with the creation of the Medifast Weight Control Centers. The recent growth in this division has proven that the model is in high demand from a select portion of the weight loss consumers. The Company believes that with the recent industry launches of over-the-counter and anticipated launches of prescription appetite suppressant medications that this model will continue to grow. Therefore, throughout 2007, the Company invested in the infrastructure of its clinic model. The major aspects of the investment in this division included an expanded executive team, the creation of a point of sale system, a robust customer data tracking system, finalizing the franchise opportunity documentation, and the beginning stages of expansion into several new locations. The Company believes this business will be a major driver of revenues and profits for the Medifast business as it continues to expand. The Company plans to continue the expansion of the Medifast Weight Control Centers with both

additional corporate locations as well as offering the model through a franchise opportunity. The Company is opening four additional corporately owned clinics in the Houston, TX market by the end of the first quarter of 2008. In addition on February 18, 2008, the Company announced that it has sold its first franchise of Medifast Weight Control Centers. The Company sold the rights to open four clinics in the Greater Baltimore Metropolitan Area. The franchisee also has the rights to open four additional Medifast Weight Control Centers in the Baltimore area over the next two years, bringing the total to eight locations.

Overall, selling, general and administrative expenses increased by \$8.1 million as compared to 2006. The majority of the increase was due to investments in the Company's future advertising campaigns, along with the necessary infrastructure support tools to allow the future campaigns to improve in effectiveness. Advertising expense for 2007 was approximately \$18.4 million compared to approximately \$14.3 million for the same period last year, an increase of \$4.1 million. In the prior year, the Company benefited from a substantial editorial placement in a major consumer publication at no cost to the Company. During 2007, the Company has invested in multiple celebrity endorsement contracts as well as increased public relations expense to focus on increasing brand awareness that will benefit our future advertising campaigns. Salaries and benefits increased by approximately \$1,500,000 in 2007 as the Company hired additional expertise in critical areas in order to assist in future growth and meet regulatory needs. This primarily includes IT, nutrition and product development, marketing, Medifast Weight Control Centers, and Take Shape for Life. Take Shape for Life commission expense, which is completely variable based upon revenue, increased by approximately \$2,400,000. Communication expense which includes outsourced call centers decreased by \$50,000. The Company has spent a significant amount of time and materials in 2007 building the future call center infrastructure with related technology and personnel. This investment will allow the call center to increase the percentage of advertising calls to be handled in-house. It is believed that this initiative will amount to significant savings and improved closing rates in the future. The reduction in outsourced call center expenses will continue in stages throughout 2008. Other expenses increased by \$550,000, which included items such as depreciation, amortization, credit card processing fees, charitable contributions, and property taxes. Stock compensation expense increased by \$192,000 as compared to 2006 as stock awards vest over 5 and 6 year terms for executives. These increases were offset by an approximately \$250,000 decrease in office expense and the absence of a \$323,000 loss resulting from the sale of the Consumer Choice Systems division in the first quarter of 2006.

Costs and Expenses: Cost of revenue increased \$3.3 million to \$21.5 million in 2007 from \$18.2 million in 2006. As a percentage of sales, gross margin remained at approximately 75% in 2007 and 2006.

Other Income/Expense: Other income/expense decreased from \$82,000 in other income in 2006 to \$172,000 in other expense at December 31, 2007. Other income/expense consists of interest expense on debt, gains on the sale of equity investments, interest payments received on the CCS note receivable, and overpayments of taxes. In 2007, the Company also realized other income when it exercised a stock warrant from a former business partner, and realized a loss on disposal of assets relating to the closing of three Medifast Weight Control Centers.

Income taxes: In 2007, we recorded \$1,706,000 in income tax expense, which represents an annual effective rate of 30.8%. In 2006, we recorded income tax expense of \$2,307,000 which reflected an estimated annual effective tax rate of 30.9%. The Company anticipates a tax rate of approximately 32-34% in 2008.

Net income: Net income was \$3.8 million in 2007 as compared to \$5.2 million in 2006, which reflected a decrease of \$1.4 million or 26%. The decrease was directly related to the initiatives of the Company to create its new advertising campaign and improve future capabilities to increase advertising effectiveness. Additionally, the Company did not have the benefit of the no cost editorial publication that occurred in the first quarter of 2006 that led to significant profits.

## LIQUIDITY AND CAPITAL RESOURCES

The Company had stockholders' equity of \$32,420,000 and working capital of \$10,395,000 on December 31, 2007 compared with \$27,916,000 and \$9,612,000 at December 31, 2006, respectively. The \$4.5 million net increase in stockholder's equity reflects \$3.8 million in 2007 profits as well as equity transactions as outlined in the "Consolidated Statement of Changes in Stockholders' Equity and accumulated other comprehensive income (loss)." The Company's cash and cash equivalents position increased from \$1.1 million at December 31, 2006 to \$2.2 at December 31, 2006. The increase is due to improved sales in fourth quarter 2007 versus 2006 as well as timing of accounts payable.

In September 2007, Medifast, Inc.'s wholly owned subsidiary Jason Pharmaceuticals, Inc. increased its Secured Line of Credit from \$5 million to \$7.5 million and moved the line of credit from Mercantile Safe-Deposit and Trust to Merrill Lynch. The line of credit is at LIBOR plus 1.3 percent. The increased line may be used to finance fixed assets, advertising, and inventory of Medifast, Inc. The Company currently has no off-balance sheet arrangements.

In the year ended December 31, 2007, the Company generated cash flow of \$7,954,000 from operations, primarily attributable to higher operating income. This was offset by net changes in operating assets and liabilities that decreased cash flow by \$1,289,000. The largest use of cash was for the purchase of inventory. The Company builds up inventory each year in the fourth quarter in order to prepare for "diet season" in the first quarter of 2008. Additional uses of cash included the funding of the Chairman of the Boards deferred compensation plan outlined in Note 1 of the financial statements as well as prepaid advertising for January of 2008. This was offset by an increase in accounts payable and income taxes payable of \$1,367,000 and \$57,000, respectively.

In the year ended December 31, 2007, net cash used in investing activities was \$7,969,000, which primarily consisted of the purchase of intangible assets and purchases of property and equipment. The increase in intangible assets relates to the acquisition of customer lists in 2007 which are used in direct response marketing campaigns. These campaigns consist of postcards and e-mails that are sent to customers with a special offer or discount coupon to order on our website, choosemedifast.com, or through our in-house call center. In the fourth quarter of 2007, the Company leased an additional Xerox Igen3 printer in order to increase its direct mailing capabilities. Large customer mailings will be sent out bi-weekly throughout 2008. The increase in property and equipment relates to the building of a large amount of infrastructure in 2007. This included the purchase of a state of the art Avaya phone system, additional

enhancements to our Enterprise Resource Planning System, IT server and networking upgrades, the build out of our new Medifast Weight Control Centers as well as leasehold improvements to our distribution facility in Ridgely, MD.

In the year ended December 31, 2007, financing activities generated \$1,125,000 in cash flow, representing principal repayments of long-term debt, and the purchase of 25,000 shares of treasury stock. This was offset by an increase in the line of credit, decrease in the CCS note receivable, and issuances of warrants and options exercised with cash.

In pursuing its business strategy, the Company may require additional cash for operating and investing activities. The Company expects future cash requirements, if any, to be funded from operating cash flow and cash flow from financing activities.

There are no current plans or discussions in process relating to any material acquisition that is probable in the foreseeable future.

#### 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." The Company did not experience the same degree of seasonality in 2008. 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 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates and a decline in the stock market. The Company does not enter into derivatives, foreign exchange transactions or other financial instruments for trading or speculative purposes. The Company has limited exposure to market risks related to changes in interest rates. The principal risks of loss arising from adverse changes in market rates and prices to which the Company and its subsidiaries are exposed relate to interest rates on debt. Since nearly all of our debt is variable rate based, any changes in market interest rates will cause an equal change in our net interest expense. At December 31, 2008, there was \$7.7 million of variable interest loans outstanding which is subject to interest rate risk. Interest rates on our variable rate loans ranged from 1.74% to 2.94% for the year ended December 31, 2008. Each 100 basis point increase in the bank's LIBOR rates relative to these borrowings would impact interest expense by \$77,000 over a 12-month period.

#### ITEM 8. FINANCIAL STATEMENTS.

The information required by this item is set forth on pages 48 to 70 hereto and incorporated by reference herein.

#### ITEM 9. CHANGES AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES.

There were no disagreements with the Company's independent auditors, regarding accounting and financial disclosures for the fiscal year ending December 31, 2008.

#### ITEM 9A. CONTROLS AND PROCEDURES

##### Disclosure Controls and Procedures

The Securities and Exchange Commission defines the term "disclosure controls and procedures" to mean a company's controls and other procedures that are designed to ensure that information required to be disclosed in the reports that it

files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Based on the evaluation of the effectiveness of our disclosure controls and procedures by our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, as of the end of the period covered by this report, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures at the end of the period covered by this report were effective to ensure that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms, and (ii) accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding disclosure.

#### Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over the Company's financial reporting. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of consolidated financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes policies and procedures that: (i) pertain to maintaining records that, in a reasonable detail, accurately and fairly reflect our transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary for preparation of our financial statements in accordance with generally accepted accounting principles and that the receipts and expenditures of the Company are being made in accordance with management and board of director authorization; and (iii) provide reasonable assurance that unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on our financial statements would be prevented or detected on a timely basis.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management evaluated the effectiveness of the Company's internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO"). Based upon that evaluation, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2008.

#### Changes in our Internal Control

There was no change in our internal control over financial reporting during the quarter ended December 31, 2008 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

#### Limitations on the Effectiveness of Controls

Our management, including our CEO and CFO, does not expect that our disclosure controls or our internal controls will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Medifast, Inc. have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with associated policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.



## PART III

## ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The Board of Directors currently consists of 10 persons. The directors, their ages, and the year in which they first became director are provided in the table below:

| Name and Experience   | Director<br>Since |
|---|-------------------|
| <p>Barry B. Bondroff, CPA, age 60, is an officer and director with Gorfine, Schiller &amp; Gardyn, PA, a full-service certified public accounting firm offering a wide range of accounting and consulting services. Previously, he was a Senior Managing Director with SMART. Bondroff brings over 35 years of experience providing companies of all sizes and industries with practical and cost-effective accounting, assurance, tax, business, technology and financial advisory services. Prior to managing SMART, Bondroff was the Managing Director for Grabush, Newman &amp; Co., P.A., which combined with SMART in May 2003. Bondroff began his career with Grabush Newman in 1970, and in 1976 became Officer and was promoted to Managing Director in 1982. He earned his Bachelor of Science degree in Accounting from the University of Baltimore. Additionally, Bondroff serves on the Board of Directors for the publicly traded First Mariner Bank of Maryland, a NASDAQ listed SEC registrant. He is active with First Mariner serving on the Executive Committee, Loan Committee, Audit Committee and as Chairman of the Compensation Committee. In addition to his professional affiliations, Bondroff served on the Executive Committee for Israel Bonds and was a Director of Cycle Across Maryland. He has served the National Jewish Medical and Research Center, the Jewish Center for Business Development and has assisted the Baltimore Symphony Orchestra in its fundraising efforts. In addition, Barry was a past President and Treasurer of the Edward A. Meyerberg Northwest Senior Center, and also served as a Member of the Board of Directors for the Levindale Hebrew Geriatric Center and Hospital. He currently serves as Treasurer for Special Olympics of Maryland, and as a Trustee for Stevenson University in Maryland.</p> | 2008              |
| <p>Joseph D. Calderone, age 60, is the chaplain and counselor at the Villanova University School of Law. He most recently served as the interim President at Merrimack College in North Andover, MA. He formerly spent over eight years with the Loyola University Medical Center as the hospital Chaplain and taught multiple courses including Introduction to the Practice of Medicine and Business Ethics. Rev. Calderone recently retired as a Captain in the US Navy Reserves. He served as the Wing Chaplain for the 4th Marine Aircraft Wing.</p>   | 2003              |
| <p>Charles P. Connolly, age 60, is currently an independent director focusing on bank relationships, debt refinancing, merger and acquisition strategy and executive compensation design. Mr. Connolly spent 29 years at First Union Corp. that merged with Wachovia Bank in 2001. He retired in 2001 as the President and CEO of First Union Corp. Mr. Connolly serves on the Boards of numerous non-profit organizations. He holds an MBA from the University of Chicago and AB from Villanova University.</p>  | 2006              |
| <p>George J. Lavin, Jr., Esq., age 80, is a senior partner at Lavin, O'Neil, Ricci, Ceprone &amp; Disipio. Mr. Lavin is a 1951 graduate of Bucknell University. He attended the University of</p>   | 2005              |

Pennsylvania School of Law, receiving an LL.B. in 1956, and then served as a Special Agent, Federal Bureau of Investigation, United States Department of Justice, until 1959. Mr. Lavin is one of the dominant product liability defense attorneys in the nation. He has had regional responsibilities in several automotive specialty areas, and has been called upon to try matters throughout the county on behalf of his clients. Mr. Lavin's present practice and specialty emphasizes his commitment to defending the automotive industry. Mr. Lavin is admitted to practice before the Supreme Court of Pennsylvania, the United States Court of Appeals for the Third Circuit and the United States District Courts for the Eastern and Middle Districts of Pennsylvania. He is a member of the Faculty Advisory Board of the Academy of Advocacy, the Association of Defense Counsel, The Defense Research Institute, The American Board of Trial Advocates, and the Temple University Law School faculty. He has also been elected a fellow of the American College of Trial Lawyers. On March 1, 1994, Mr.Lavin assumed the title of Counsel to The Firm.

Bradley T. MacDonald, age 61, is the Executive Chairman of the Board of Medifast, Inc. 1996  
Mr. MacDonald has been Chairman of the Board of Medifast, Inc. since January 1998 and was also Chief Executive officer until March of 2007. He was the principal architect of the turnaround of Medifast and formulated the “Direct to Consumer” business models that are the primary drivers of Revenue to this day. He also was the co-founder of Take Shape for Life and acquired the Clinic operations in 2002. During his time as CEO, he managed the company to 29 consecutive quarters of profits and improved shareholders equity from negative \$4 million to over \$27 million in less than seven years. He also increased the Company’s market cap from less than \$1 million to over \$100 million and listed the company on the NYSE. In 2006, Mr. MacDonald received the prestigious and audited Ernst and Young award of “Entrepreneur of the Year” for the state of Maryland in the consumer products category. Also, he helped lead the Company to national recognition in Forbes Magazine ranking Medifast 28th of the top 200 small companies in America. Mr. MacDonald was previously employed by the Company as its Chief Executive Officer from September 1996 to August 1997. From 1991 through 1994, Colonel MacDonald returned to active duty to be Deputy Director and Chief Financial Officer of the Retail, Food, Hospitality and Recreation Businesses for the United States Marine Corps. Prior thereto, Mr. MacDonald served as Chief Operating Officer of the Bonneau Sunglass Company, President of Pennsylvania Optical Co., Chairman and CEO of MacDonald and Associates, which had major financial interests in retail drug, consumer candy, and pilot sunglass companies. Mr. MacDonald was national president of the Marine Corps Reserve Officers Association and retired from the United States Marine Corps Reserve as a Colonel in 1997, after 27 years of service. He was appointed and served on the Defense Advisory Board for Employer Support of the Guard and Reserve (ESGR.) He also served on the Board of Directors of the Baltimore County Chamber of Commerce. Currently, Mr. MacDonald serves on the Board of Directors of Stevenson University in Maryland, and the Institute of Notre Dame High School, Baltimore, Maryland. He is also the Vice-Chairman of the Board of Directors of the Marine Corps Reserve Toys for Tots Foundation. Mr. MacDonald is the father of Margaret MacDonald who performs the role of President and Chief Operating Officer at Medifast, Inc. Mr. Michael C. MacDonald is the brother of Mr. Bradley T. MacDonald.

Michael C. MacDonald, age 56, is senior vice president, operational effectiveness for Xerox Corporation. He leads a corporate initiative to review the company's core functions including marketing, learning, human resources and other key areas to ensure the Company is maximizing the effectiveness of its resources and delivering a solid return on investment. Previously, he was president of global accounts and marketing operations for Xerox Corporation responsible for corporate marketing, xerox.com, advertising, brand, public relations, and corporate communications. He was named to this position in October 2004 and was appointed a corporate senior vice president in July 2000. MacDonald is on the board of directors of PAETEC and the Jimmy V Foundation. Mr. MacDonald completed executive business and management programs at Columbia University in 1992 and the International Senior Management Program at Harvard University in 1998. 1998

Dennis M. McCarthy, age 64, practiced law for 21 years as a civil litigator in tort and contract cases. He was the founding member and managing partner of a Columbus, Ohio based law firm. Additionally, he served active duty in the U.S. Marine Corps for 23 years and served 18 years in reserve service. Mr. McCarthy retired from the Marine Corps in 2005 in the grade of Lieutenant General after four years in command of all Marine Reserve forces. Mr. McCarthy is currently the Executive Director of the Reserve Officers Association, a 2006

congressionally chartered association devoted to national defense. In addition to Medifast, he is a member of the Board of Directors of Rivada Networks.

Michael S. McDevitt, age 30, joined Medifast in 2002 as the Controller and was promoted to Vice President of Finance in January 2004. In March 2005, he was promoted to President and in January of 2006 was also named Chief Financial Officer. In March of 2007, Mr. McDevitt was promoted to Chief Executive Officer of the Company. Prior to joining Medifast, Mr. McDevitt worked as a Financial Analyst for the Blackstone Group, an investment advisory firm based in New York, NY.

2007

Jeannette M. Mills, age 42, currently serving as senior vice president with the Baltimore Gas and Electric Company, a subsidiary of Constellation Energy. A Baltimore, Md. native, Mills earned her Bachelor of Science in Electrical Engineering from Virginia Polytechnic Institute (Virginia Tech) and she currently serves on the Advisory Board of the Bradley Department of Electrical and Computer Engineering. In 2006, Mills earned her Masters of Business Administration from Loyola College. Ms. Mills also works in the community includes serving as Chair of the Board of Directors for Voices for Children, Howard County's Court Appointed Special Advocate Program. Additionally, she serves on the Board of the Creative Alliance, a Program that builds communities by bringing together artists and audiences from diverse backgrounds to experience spectacular arts programs and engage in the creative process. 2008

Donald F. Reilly, OSA, age 61, holds a Doctorate in Ministry (Counseling) from New York Theological and an M.A. from Washington Theological Union as well as a B.A. from Villanova University. Reverend Don Reilly was ordained a priest in 1974. His assignments included Associate Pastor, Pastor at St. Denis, Havertown, Pennsylvania, Staff at Villanova University, Personnel Director of the Augustinian Province of St. Thomas of Villanova, Provincial Counselor, Co-Founder of SILOAM Ministries where he ministers and counsels HIV/AIDS patients and caregivers. He is currently on the Board of Directors of Villanova University. He also serves on the Board of Trustees of Merrimack College, MA, St. Augustine Prep, NJ, and Malvern Prep, PA. Fr. Reilly was recently re-elected Provincial of the Augustinian Order at Villanova, PA. He oversees more than 220 Augustinian Friars and their service to the Church, teaching at universities and high schools, ministering to parishes, serving as chaplain in the Armed Forces and hospitals, ministering to AIDS victims, and serving missions in Japan, Peru, and South Africa. 1998

Margaret MacDonald-Sheetz, age 31, joined Medifast in 2000 as the Director of Sales and Administration. In 2002, she was promoted to VP of Operations and in 2004 promoted to Senior VP of Operations. In May of 2006, Ms. MacDonald received an Executive MBA from Loyola University. In March 2007, she was promoted to President and Chief Operating Officer of Medifast Inc. 2008

Mary T. Travis, age 57, is currently employed with Eagle National Bank in Pennsylvania as the Senior Vice President of wholesale operations and was formerly the Vice President of operations for the Financial Mortgage Corporation. Mrs. Travis is an expert in mortgage banking with over 40 years of diversified experience. She is an approved instructor of the Mortgage Bankers Association Accredited School of Mortgage Banking. Mrs. Travis was also formally a delegate and 2nd Vice President of the Mortgage Bankers Association of Greater Philadelphia and the Board of Governors of the State of Pennsylvania. Mrs. Travis is currently on Board of Governors of the Mortgage Bankers Association of Greater Philadelphia. 2002

## ADDITIONAL INFORMATION ABOUT THE BOARD OF DIRECTORS AND COMMITTEES

### Director Independence

The Board consists of 12 members of which 9 are non-management directors. Determination as to the qualifications of an independent directors are determined under section 303A.02 of the New York Stock Exchange, or the NYSE, Listed Company Manual and the Company's Categorical Standards of Independence. The NYSE's independence guidelines and the Company's categorical standards include a series of objective tests, such as the director is not an

employee of the Company and has not engaged in various types of business dealings involving the Company, which would prevent a director from being independent. The Board of Directors has affirmatively determined that none of the Company's independent directors had any relationships with the Company.

The Board, in applying the above referenced standards has affirmatively determined the Company's current independent directors are: Barry B. Bondroff, Joseph D. Calderone, Charles P. Connolly, George J. Lavin, Jr. Esq., Dennis M. McCarthy, Jeannette M. Mills, Donald F. Reilly, and Mary T. Travis.

## Board Meetings

For the fiscal year ended December 31, 2008 (“Fiscal 2008”), the Board of Directors held five meetings. All Board members attended at least 75% of the aggregate number of Board meetings and applicable committee meetings held while such individuals were serving on the Board of Directors, or such committees. Under the Company’s Principles of Corporate Governance, which is available on the Company’s website [www.choosemedifast.com](http://www.choosemedifast.com), by following the link through “Investor Relations” to “Corporate Governance,” each director is expected to dedicate sufficient time, energy and attention to ensure the diligent performance of his or her duties, including attending meetings of the shareholders of the Company, the Board of Directors and committees of which he or she is a member. Twelve directors attended the 2008 annual general meeting.

## Committees of the Board

Our Board of Directors has a standing audit committee, nominating and corporate governance committee, compensation committee, and executive committee.

## Audit Committee

Our audit committee consists of Barry B. Bondroff, Charles P. Connolly, George J. Lavin, and Mary T. Travis, each of whom are independent as discussed above under “Director Independence.” As required by Rule 303A.07 of the NYSE Listed Company Manual, the Board of Directors has affirmatively determined that each audit committee member is financially literate, and that Mr. Connolly is an “audit committee financial expert,” as defined in Item 407(d)(5) of Regulation S-K.

The principal duties of the audit committee are as follows:

- Have the sole authority and responsibility to hire, evaluate and, where appropriate, replace the independent auditors;
- Meet and review with management and the independent auditors the interim financial statements and the Company’s disclosures under Management’s Discussion and Analysis of Financial Condition and Results of Operations prior to the filing of the Company’s Quarterly Reports on Form 10-Q;
- Meet and review with management and the independent auditors the financial statements to be included in the Company’s Annual Report on Form 10-K (or the annual report to shareowners) including (i) their judgment about the quality, not just acceptability, of the Company’s accounting principles, including significant financial reporting issues and judgments made in connection with the preparation of the financial statements; (ii) the clarity of the disclosures in the financial statements; and (iii) the Company’s disclosures under Management’s Discussion and Analysis of Financial Condition and Results of Operations, including critical accounting policies;
- Review and discuss with management, the internal auditors and the independent auditors the Company’s policies with respect to risk assessment and risk management;
- Review and discuss with management, the internal auditors and the independent auditors the Company’s internal controls, the results of the internal audit program, and the Company’s disclosure controls and procedures, and quarterly assessment of such controls and procedures;
- Establish procedures for handling complaints regarding accounting, internal accounting controls and auditing matters, including procedures for confidential, anonymous submission of concerns by employees regarding accounting and auditing matters; and

Review and discuss with management, the internal auditors and the independent auditors the overall adequacy and effectiveness of the Company's legal, regulatory and ethical compliance programs.

Our Board of Directors has adopted a written charter for the audit committee which is available on the Company's website at [www.choosemedifast.com](http://www.choosemedifast.com) by following the links through "Investor Relations" to "Corporate Governance." In fiscal 2008, the audit committee met four times.



#### Nominating and Corporate Governance Committee

The nominating and corporate governance committee consists of Joseph D. Calderone, Jeannette M. Mills, Donald F. Reilly, and George J. Lavin, all of whom are independent as discussed above under “— Director Independence.”

The principal duties of the nominating and corporate governance committee are as follows:

- to recommend to our Board of Directors proposed nominees for election to the Board of Directors both at annual general meetings and to fill vacancies that occur between general meetings; and
- To make recommendations to the Board of Directors regarding the Company’s corporate governance matters and practices.

Our Board of Directors has adopted a written charter for the nominating and corporate governance committee, which is available on the Company’s website at [www.choosemedifast.com](http://www.choosemedifast.com) by following the links through “Investor Relations” to “Corporate Governance” or in print to any shareholder who requests it as set forth under “Additional Information — Annual Report, Financial and Additional Information.” In fiscal 2008, the nominating and corporate governance committee met four times.

#### Compensation Committee

The compensation committee currently consists of Joseph D. Calderone, Dennis M. McCarthy, Esq. Jeannette M. Mills, and Mary T. Travis, all of whom were independent as discussed above under “— Director Independence.”

The principal duties of the compensation committee are as follows:

- Measure the Chief Executive Officer’s performance against his goals and objectives pursuant to the Company plans;
- Determine the compensation of the Chief Executive Officer after considering the evaluation by the Board of Directors of his performance;
- Review and approve compensation of elected officers and all senior executives based on their evaluations, taking into account the evaluation by the Chief Executive Officer;
- Review and approve any employment agreements, severance arrangements, retirement arrangements, change in control agreements/provisions, and any special or supplemental benefits for each elected officer and senior executive of the Company;
- Approve, modify or amend all non-equity plans designed and intended to provide compensation primarily for elected officers and senior executives of the Company;
- make recommendations to the Board regarding adoption of equity plans; and
- Modify or amend all equity plans.

Our Board of Directors has adopted a written charter for the compensation committee which is available on the Company’s website at [www.choosemedifast.com](http://www.choosemedifast.com) by following the links through “Investor Relations” to “Corporate Governance.” In fiscal 2008, the compensation committee met four times.

Executive Committee

Messrs. Bradley T. MacDonald, Michael C. MacDonald, Michael S. McDevitt, Dennis M. McCarthy, Esq., and Jeannette M. Mills are members of the Executive Committee. The Executive Committee has all the authority of the Board of Directors, except with respect to certain matters that by statute may not be delegated by the Board of Directors. The Committee meets periodically during the year to develop and review strategic operational and management polices for the Company. The Committee held two meetings during fiscal 2008.

## ADDITIONAL INFORMATION

### Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires the Company's directors and executive officers and persons who beneficially own more than ten percent of a registered class of the Company's equity securities to file with the SEC and the NYSE initial reports of ownership and reports of changes in ownership of equity securities of the Company. Directors, officers and greater-than-ten-percent beneficial owners are required by SEC regulations to furnish the Company with copies of all Section 16(a) forms filed by them. In 2008, to the Company's knowledge, based solely on a review of the copies of such filings on file with the Company and written representations from the Company's directors and executive officers, no Section 16(a) filing requirements were applicable to the Company's directors, executive officers and greater-than-ten-percent beneficial owners in fiscal 2008.

### Codes of Business Conduct and Ethics and Corporate Governance Guidelines

Our Board of Directors has adopted a corporate Code of Business Conduct and Ethics applicable to our directors, officers, including our principal executive officer, principal financial officer and principal accounting officer, and employees, as well as Corporate Governance Guidelines, in accordance with applicable rules and regulations of the SEC and the NYSE. Each of our Code of Business Conduct and Ethics and Corporate Governance Guidelines are available on our website at [www.choosemedifast.com](http://www.choosemedifast.com) by following the links through "Investor Relations" to "Corporate Governance."

Any amendment to, or waiver from, a provision of the Company's Code of Business Conduct and Ethics with respect to the Company's principal executive officer, principal financial officer, principal accounting officer or controller will be posted on the Company's website, [www.choosemedifast.com](http://www.choosemedifast.com).

## ITEM 11. EXECUTIVE COMPENSATION.

### COMPENSATION DISCUSSION AND ANALYSIS

#### Overview of Compensation Program

Our Compensation Committee of the Board of Directors has responsibility for establishing, implementing and continually monitoring adherence with the Company's compensation philosophy. The Compensation Committee ensures that the total compensation paid to our named executive officers is fair, reasonable and competitive. Generally, the types of compensation and benefits provided to our named executive officers are similar to those provided to other officers and employees of the Company.

Throughout this discussion, the individuals who served as our CEO, CFO, and President during Fiscal 2008, as well as the other individuals included in the Summary Compensation Table on page 35, are referred to as the "named executive officers."

#### Objectives of Compensation Program

The main objective of our executive compensation program is to create a competitive total rewards package based on the attainment of short-term performance objectives and long-term strategic goals. Accordingly, our executive compensation program consists of the following three principal elements: base salary, cash bonus and equity grants in the form of stock options and restricted stock, with an emphasis on incentive compensation rather than base salary. Our executives are also eligible to participate in employee benefit and retirement plans offered by the Company,

which currently include defined contribution, and 401(k) plans, and health care and other insurance programs. The benefit programs available to executives are the same as those available to all other eligible employees.

#### Decision-Making; Role of Executive Officers in Compensation Decisions

The Compensation Committee of our Board of Directors is comprised solely of non-affiliate independent Directors who meet the independence requirements of the NYSE. Our Compensation Committee makes all decisions regarding the compensation of our CEO, including establishing the performance goals and objectives for our CEO, evaluating our CEO's performance in light of the goals and objectives that were set and determining and recommending to our Board the CEO's compensation based on that evaluation.

Our CEO makes recommendations to our Compensation Committee for the compensation of all other named executive officers. Our Compensation Committee and Board may accept or adjust such recommendations as they determine in the best interests of the Company and its stockholders and has final approval over all such compensation decisions. To the extent not established by our Board of Directors, our Compensation Committee is also authorized to establish compensation and benefits for our Chairman and for new and existing non-affiliate independent Directors.

Our Chairman, CEO, and Vice President of Human Resources provide advice, analysis and recommendations to our Compensation Committee.

#### Elements of Executive Compensation

Our Compensation Committee also evaluates the achievement of corporate, individual and organizational objectives for each executive officer during the prior fiscal year. Each element of compensation is chosen in order to attract and retain the necessary executive talent, reward corporate performance and provide incentive for the attainment of long-term strategic goals. The allocation of each element of compensation is determined by our Compensation Committee for each executive based on the following factors:

- Performance against corporate, individual and organizational objectives for the fiscal year;
- Importance of particular skill sets and professional abilities to the achievement of long-term strategic goals; and
- Contribution as a leader, corporate representative and member of the senior management team.

These elements support our overall compensation philosophy by creating a balanced focus on shorter-term corporate performance and the achievement of longer-term business goals and stockholder value. While we believe in structuring executive compensation plans that give our executives incentive to deliver certain objective elements of corporate financial performance over specified time periods, we do not believe in a purely mechanical approach. Instead, part of our executive compensation philosophy includes an element of reward for non-quantitative achievements demonstrated by our executives in the actions and decisions they have taken throughout the year. When establishing our executive compensation plans for a given year, it is not possible to foresee all of the challenges and demands that will be made of our executives, both as a management team and in their areas of individual responsibility. We believe that by rewarding the quality of our decision-making and leadership, in addition to the achievement of quantifiable results, we are building a management team capable of creating stockholder value over the longer-term, while remaining disciplined in delivering shorter-term financial results. Accordingly, there is no pre-established policy or target for the allocation between either cash and non-cash or short-term and long-term incentive compensation. Rather, the Compensation Committee reviews information provided by industry surveys and peer company data to determine appropriate level and mix of incentive compensation. Income from such incentive compensation is realized as a result of the performance of the Company and the individual, depending on the type of award, compared to established goals.

#### Base Salary

Our base salary determinations principally reflect the skills and performance levels of individual executives, the needs of the Company, and pay practices of comparable public companies. It is not our policy to pay our executive officers at the highest base salary level. Instead, we establish executive base salaries conservatively at or below a midpoint level relative to an appropriate set of peers. We believe this policy sets a prudent and fiscally responsible tone for the Company's overall base salary compensation programs.

#### Target Bonus

Cash bonuses principally reflect the Company's financial performance and achievement of corporate objectives established by our Board prior to the fiscal year. The executive bonus plan is designed to reward our executives for the achievement of shorter-term financial goals, predominantly revenue growth and profitability, with cash flow and other operating ratios also considered. The allocation of the bonus pool among the employees, including senior executives, is at the discretion of the Compensation Committee. The Chief Executive Officer, Chief Financial Officer and other

senior executives discuss and jointly develop recommended bonus allocations among the staff within the various functional areas of the Company. In addition, the Chief Executive Officer prepares an allocation of bonus payments among the senior executive group. In consultation with the Chief Executive Officer, the Compensation Committee evaluates, adjusts and approves the amount and allocation of the bonus pool. In determining the cash bonus allocation among senior executives, the Compensation Committee and the Chief Executive Officer consider each executive's a) contribution to current and long-term corporate goals, and b) value in the labor market.

## Equity Compensation

Stock option and restricted stock awards principally reflect the responsibilities to be assumed by each executive in the upcoming fiscal year, the responsibilities of each executive in prior periods, the size of awards made to each executive in prior years relative to the Company's overall performance, available stock for issuance under our Option Plan, and potential grants in future years. The Committee believes that stock option and restricted stock grants (1) align the interests of executives with long-term stockholder interests, (2) give executives a significant, long-term interest in the Company's success, and (3) help retain key executives in a competitive market for executive talent. The Company does not intend to issue stock options as part of compensation in 2009 and beyond.

## Equity Ownership by Executives

We do not currently have a formal equity ownership requirement for our executives. However, we encourage our executives to own equity in the Company on a voluntary basis. All of our named executive officers own stock, restricted stock and vested and unvested stock options. We periodically review the vested and unvested equity holdings of our executives and evaluate whether these holdings sufficiently align the interests of our executives with the long-term interests of our stockholders. We may consider adopting equity ownership requirements in the future.

## 2008 Summary Compensation Table

The following table sets forth the annual and long-term compensation for the fiscal year ended December 31, 2008, of the Company's Chief Executive Officer and Chief Financial Officer and each of the three other most highly compensated executive officers. These individuals, including the Chief Executive Officer and Chief Financial Officer are collectively referred to as the Named Executive Officers.

| Name and Principal Position  | Year | Salary<br>(\$) | Stock Awards<br>\$(1) | Option Awards<br>\$(1) | Bonus<br>\$(2) | Nonqualified Deferred Compensation Contributions<br>(\$) | All Other<br>\$(3) | Total<br>(\$) |
|--|------|----------------|-----------------------|------------------------|----------------|--|--------------------|---------------|
| Bradley T. MacDonald<br>Chairman of the Board                        | 2008 | \$ 225,000     | 107,000               | -                      | -              | \$ 100,000   | \$ 6,700           | \$ 438,700    |
| Michael S. McDevitt<br>Chief Executive and CFO                       | 2008 | 135,000        | 450,000               | -                      | 75,000         |  | 2,700              | 662,700       |
| Leo V. Williams<br>Executive Vice President                          | 2008 | 132,500        | -                     | -                      | 25,000         |  | 2,900              | 160,400       |
| Margaret MacDonald -<br>Sheetz<br>Chief Operating Officer, President | 2008 | 100,000        | 372,000               | -                      | 50,000         |  | 3,000              | 525,000       |
| Brendan N. Connors<br>VP of Finance                                  | 2008 | 99,000         | 101,000               | -                      | 20,000         |  | 3,000              | 223,000       |

(1) Amounts are calculated based on provisions of SFAS, No 123R, "Share Based Payments." See note 2 of the consolidated financial statements of the Company's Annual

Report on Form 10-K for the year ended December 31, 2008 regarding assumptions underlying valuation of equity awards.

- (2) Bonus amounts determined as more specifically discussed above under “—Compensation Discussion and Analysis”
- (3) The amounts represent the Company’s matching contributions under the 401(K) plan.

#### 2008 Grants of Plan-Based Awards

On January 25, 2008, the Board of Directors modified Bradley T. MacDonald’s compensation package for his role in the succession plan and business development initiatives as outlined in the December 31, 2006 10-K. The Board cancelled the 100,000 options granted to Mr. MacDonald on February 8, 2006 and replaced them with a restricted stock grant of 42,000 shares. The restricted shares will vest over a period of 3 years beginning on January 25, 2009.



The Medifast Board of Directors on July 24, 2008 approved restricted common stock grants to the Named Executives with a 5 year vesting period, beginning on the grant date. Named Executive Officers were granted 425,000 shares of restricted common stock to retain their services over the next five years, reward their efforts in the participation of the successful succession and transition of the company operations to the new senior management team, and incentivize continued sales and profit growth in accordance with targets set by the Board of Directors.

The Medifast Board of Directors on November 24, 2008 approved restricted common stock grants to key executives as a 2008 performance bonus for exceeding internal sales and profit forecasts. Key executives were granted 150,000 shares of restricted common stock over a five year vesting period, beginning on January 1, 2009.

Outstanding Equity Awards at Fiscal Year-End Table

| Name  | Option Awards   |  |                            |                        | Stock Awards  |   |   |  | Equity Incentive Plan Awards: |  |
|---|---|--|----------------------------|------------------------|---|---|---|--|-------------------------------|--|
|   | Number of Securities Underlying Unexercised Options (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Un-Exercisable | Option Exercise Price (\$) | Option Expiration Date | Number Shares or Units of Stock That Have Not Vested (#)(1) | Market Value of Shares or Units of Stock that have not Vested (\$)(2) | Plan Award Unearned Shares, Units or Other rights (#) | Market or Payout Value of Unearned Shares, Units or Other rights That Have Not Vested (\$) |                               |  |
| Bradley T. MacDonald<br>Chairman of the Board                     | -   | -  | -                          |                        | 107,000   | 590,640   | -   | -  |                               |  |
| Michael S. McDevitt<br>Chief Executive Officer, CFO               | 100,000   | -  | 2.87                       | 3/31/2010              | 307,085   | 1,695,109   | -   | -  |                               |  |
| Leo V. Williams<br>Executive Vice President                       | 10,000  | -  | 3.83                       | 10/28/2010             | -   | -   | -   | -  |                               |  |
| Margaret MacDonald - Sheetz<br>Chief Operating Officer, President | -   | -  | -                          |                        | 255,000   | 1,407,600   | -   | -  |                               |  |
| Brendan N. Connors<br>VP of Finance                               | 23,334  | -  | 2.87                       | 3/31/2010              | 83,000  | 458,160   | -   | -  |                               |  |

Each option has a five year life and an exercise price per share equal to 100% of the estimated fair value of our common stock on the date of grant.

(1)The restricted stock grants vest over five and six years of service as described below under “Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards”

(2) The market value of shares of stock that have not vested is based on the closing price of our common stock on December 31, 2008, or \$5.52 per share.

## 2008 Option Exercises and Stock Vested Table

The following table sets forth information regarding option exercises and stock vesting for the Named Executive Officers during 2008.

| Name  | Option Awards                                      |  | Stock Awards   |  |
|---|--|--|--|--|
|   | Number of<br>Shares Acquired<br>on Exercise<br>(#) | Value Realized<br>on Exercise<br>(\$)(1) | Number of<br>Shares<br>Acquired on<br>Vesting<br>(#) | Value<br>Realized on<br>Vesting<br>(\$)(2) |
| Bradley T. MacDonald<br>Executive Chairman of the Board           | -  | -  | -  | -  |
|   | -  | -  | 20,000   | 107,400                                    |
| Michael S. McDevitt<br>Chief Executive Officer, CFO               | -  | -  | 15,000   | 81,000                                     |
|   | -  | -  | 33,333   | 208,331                                    |
|   |  |  | 30,000   | 161,100                                    |
| Leo V. Williams<br>Executive Vice President                       | -  | -  | -  | -  |
|   | -  | -  | -  | -  |
| Margaret MacDonald - Sheetz<br>Chief Operating Officer, President | -  | -  | 15,000   | 81,000                                     |
|   | -  | -  | 25,000   | 156,250                                    |
|   |  |  | 25,000   | 134,250                                    |
| Brendan N. Connors<br>VP of Finance                               | -  | -  | 3,000  | 16,200                                     |
|   | -  | -  | 5,000  | 31,250                                     |
|   |  |  | 10,000   | 53,700                                     |

(1) Represents the difference between the exercise price and the fair market value of the common stock on the date of exercise, multiplied by the number of options exercised.

(2) Represents the number of restricted shares vested, and the number of shares vested multiplied by the fair market value of the common stock on the vesting date.

## Equity Compensation Plan Information at Fiscal Year Ended December 31, 2008

| Plan category  | Number of securities to be issued upon exercise of outstanding options, warrants and rights<br>(a) | Weighted average exercise price of outstanding options, warrants and rights<br>(b) | Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))<br>(c) |
|--|--|--|--|
| Equity compensation plans approved by security holders     | 223,334(1)   | \$ 3.65  | 1,229,166  |
| Equity compensation plans not approved by security holders | -  | -  | -  |

(1) Consists of 143,334 shares of common stock issuable upon the exercise of outstanding options and 80,000 shares of common stock issuable upon the exercise of outstanding warrants.

## 2008 Non-Qualified Deferred Compensation Table

The following table sets forth all non-qualified deferred compensation of the Named Executive Officers for the fiscal year ended December 31, 2008.

|   | Executive Contributions in Last FY<br>(\$) | Company Contributions in Last FY<br>(\$)(1) | Aggregate Earnings in Last FY<br>(\$) | Aggregate Withdrawals/<br>Distributions<br>(\$) | Aggregate Balance at Last FYE<br>(\$) |
|---|--|---|---------------------------------------|---|---------------------------------------|
| Bradley T. MacDonald<br>Chairman of the Board                     |  | \$ 100,000                                  | (381,000)                             | \$ 0  | \$ 792,000                            |
| Michael S. McDevitt<br>Chief Executive Officer, CFO               | -  | -   | -                                     | -   | -                                     |
| Leo V. Williams<br>Executive Vice President                       | -  | -   | -                                     | -   | -                                     |
| Margaret MacDonald - Sheetz<br>Chief Operating Officer, President | -  | -   | -                                     | -   | -                                     |
| Brendan N. Connors<br>VP of Finance                               | -  | -   | -                                     | -   | -                                     |

(1) All amounts are reported in compensation on the "2008 Summary Compensation Table"

#### Deferred Compensation Plans

We maintain a non-qualified deferred compensation plan, effective September 10, 2003, 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, including the Named Executive Officers, 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 amount of compensation in any given fiscal year that is deferred by each Named Executive Officer is included in the Summary Compensation Table under the column headings "Salary" or "Non-Equity Incentive Plan Compensation", as appropriate.

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.

In 2008, the Company made a \$100,000 contribution to Bradley MacDonald's deferred compensation plan as a performance bonus.

#### Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards

We have entered into employment agreements with certain Named Executive Officers, certain terms of which are summarized below.

**Bradley T. MacDonald.** Mr. MacDonald entered into a five year employment agreement effective February 8, 2006. Mr. MacDonald was granted 100,000 options over a five year vesting period beginning on February 8, 2007 in consideration for his five year commitment and to align his interest with the interests of long-term shareholders. On January 25, 2008, the Board of Directors modified Bradley T. MacDonald's compensation package for his role in the succession plan and business development initiatives as outlined in the December 31, 2006 10-K. The Board cancelled the 100,000 options granted to Mr. MacDonald on February 8, 2006 and replaced them with a restricted stock grant of 42,000 shares. The restricted shares will vest over a period of 3 years beginning on January 25, 2009. Upon termination of Mr. MacDonald's employment by the Company without cause, or upon his resignation for good reason, he would be entitled to receive an amount equal to one and a half times the sum of his highest annualized salary payable in equal monthly installments 30 days after his termination of employment for a period of one year.

**Michael S. McDevitt.** Mr. McDevitt entered into a six year employment agreement effective February 8, 2006. Mr. McDevitt was granted 200,000 shares of Medifast, Inc. restricted common stock over a six year vesting period beginning on February 8, 2006 in consideration for his six year commitment and to align his interests with the interests of long-term shareholders. Upon termination of Mr. McDevitt's employment by the Company without cause, or upon his resignation for good reason, he would be entitled to receive an amount equal to one and a half times the sum of his highest annualized salary payable in equal monthly installments 30 days after his termination of

employment for a period of one year.

Margaret MacDonald - Sheetz. Ms. MacDonald - Sheetz entered into a six year employment agreement effective February 8, 2006. Ms. MacDonald - Sheetz was granted 150,000 shares of Medifast, Inc. restricted common stock over a six year vesting period beginning on February 8, 2006 in consideration for his six year commitment and to align her interests with the interests of long-term shareholders. Upon termination of Ms. MacDonald - Sheetz's employment by the Company without cause, or upon her resignation for good reason, she would be entitled to receive an amount equal to one and a half times the sum of his highest annualized salary payable in equal monthly installments 30 days after her termination of employment for a period of one year.

Brendan N. Connors. Mr. Connors entered into a six year employment agreement effective February 8, 2006. Mr. Connors was granted 30,000 shares of Medifast, Inc. restricted common stock over a six year vesting period beginning on February 8, 2006 in consideration for his six year commitment and to align his interests with the interests of long-term shareholders. Upon termination of Mr. Connors' employment by the Company without cause, or upon his resignation for good reason, he would be entitled to receive an amount equal to one and a half times the sum of his highest annualized salary payable in equal monthly installments 30 days after his termination of employment for a period of one year.

## Potential Payments upon Termination or Change in Control

As of December 31, 2008, the Company had entered into employment agreements with each of the Named Executive Officers. As described in more detail above under “Narrative Disclosure to Summary Compensation Table and Grants of Plan-Based Awards” The employment agreements with the Named Executive Officers generally provide for the payment of benefits if the executive’s employment with the Company is terminated either by the Company without Cause or by the executive for Good Reason. The employment agreements with the Named Executive Officers do not provide for any additional payments or benefits upon a termination of employment by the Company for Cause, upon the executive’s resignation other for Good Reason, as applicable, or upon the executive’s death or disability. Upon termination by the Company without cause, or upon his or her resignation for good reason, all of the Named Executive officers are entitled to receive an amount equal to one and a half times his or her highest annualized base salary payable in equal monthly installments 30 days after his or her termination of employment. If a named executive had been terminated without cause on December 31, 2008 they would have received the following amounts:

|                             | Severance (\$)<br>(1) |
|-----------------------------|-----------------------|
| Bradley T. MacDonald        | \$ 337,500            |
| Michael S. McDevitt         | \$ 202,500            |
| Margaret MacDonald - Sheetz | \$ 150,000            |
| Brendan N. Connors          | \$ 148,500            |

(1) Based on 2008 salary

If there were a change in control, which is defined as a sale of the majority of the assets of the company or a change of control of the Board of Directors as a result of a third party shareholder acquiring or holding over 10% of the common stock and attempting to nominate a majority of the Board of Directors in favor of his/her shareholder block, the executives would have received the following amounts as of December 31, 2008:

|                             | Severance<br>(\$)(1) | Accelerated<br>Vesting of<br>Stock<br>Awards<br>(\$)(2) | Total      |
|-----------------------------|----------------------|---|------------|
| Bradley T. MacDonald        | \$ 337,500           | \$ 590,640  | \$ 928,140 |
| Michael S. McDevitt         | 202,500              | 1,695,109   | 1,897,609  |
| Margaret MacDonald - Sheetz | 150,000              | 1,407,600   | 1,557,600  |
| Brendan N. Connors          | 148,500              | 458,160   | 606,660    |

(1) Based on 2008 salary.

(2) Accelerated vesting of stock awards were based on NYSE close price of the Common Shares on December 31, 2008 of \$5.52 per share, and for option awards the difference between \$5.52 and the exercise or base price of the award.

## 2008 Director Compensation

The table below summarizes the compensation paid by the Company to non-employee directors for the fiscal year ended December 31, 2008.

| Name                          | Fees<br>Earned<br>or Paid in<br>Cash (\$) | Stock<br>Awards<br>(\$)(1) | Change in Pension Value  |   |  |   | Total (\$) |
|-------------------------------|---|----------------------------|--------------------------|---|--|---|------------|
|                               |   |                            | Option<br>Awards<br>(\$) | Non-Equity<br>Incentive<br>Compensation<br>(\$) | Deferred<br>Compensation<br>Earnings<br>(\$) | Nonqualified<br>All other<br>Compensation<br>(\$) |            |
| Barry B. Bondroff             | \$ -                                      | \$ 5,370                   |                          |   |  |   | \$ 5,370   |
| Joseph D. Calderone,<br>OSA   | -   | 21,570                     | -                        | -   | -  | -   | 26,940     |
| Charles P. Connolly           | 16,000                                    | 21,570                     | -                        | -   | -  | -   | 37,570     |
| George Lavin, Jr., Esq.       | -   | 21,570                     | -                        | -   | -  | -   | 21,570     |
| Michael C. MacDonald          | -   | 21,570                     | -                        | -   | -  | -   | 26,940     |
| Dennis M. McCarthy            | -   | 21,570                     | -                        | -   | -  | -   | 21,570     |
| Jeannette M. Mills            |   | 5,370                      |                          |   |  |   | 5,370      |
| Rev. Donald F. Reilly,<br>OSA | -   | 21,570                     | -                        | -   | -  | -   | 26,940     |
| Mary T. Travis                | -   | 21,570                     | -                        | -   | -  | -   | 26,940     |

Employee Directors do not receive any additional compensation for their services as director.

Additional fees are paid to the Audit Committee Chairman. In 2008, the Chairman received an additional \$16,000 in cash compensation.

(1) Amounts are calculated based on provisions of Statement of Financial Accounting Standards, or SFAS, No 123R, "Share Based Payments." See note 2 of the consolidated financial statement of the Company's Annual Report on Form 10-K for the year ended December 31, 2008 regarding assumptions underlying valuation of equity awards.



The table below summarizes the equity based awards held by the Company's non-employee directors as of December 31, 2008.

| Name                       | Option Awards   |  |                            |                        | Stock Awards   |  |
|----------------------------|---|--|----------------------------|------------------------|--|--|
|                            | Number of Securities Underlying Unexercised Options (#) Exercisable | Number of Securities Underlying Unexercised Options (#) Un-Exercisable | Option Exercise Price (\$) | Option Expiration Date | Number Shares or Units of Stock That Have Not Vested (#) | Market Value of Shares or Units of Stock that have not Vested (\$) |
| Barry B. Bondroff          | -   | -  | -                          | -                      | 5,000  | 27,600   |
| Joseph D. Calderone, OSA   | -   | -  | -                          | -                      | 14,000   | 77,280   |
| Charles P. Connolly        | -   | -  | -                          | -                      | 9,000  | 49,680   |
| George J. Lavin, Jr., Esq. | -   | -  | -                          | -                      | 9,000  | 49,680   |
| Michael C. MacDonald       | -   | -  | -                          | -                      | 14,000   | 77,280   |
| Dennis M. McCarthy         | -   | -  | -                          | -                      | 9,000  | 49,680   |
| Jeannette M. Mills         | -   | -  | -                          | -                      | 5,000  | 27,600   |
| Rev. Donald F. Reilly, OSA | -   | -  | -                          | -                      | 15,000   | 82,800   |
| Mary T. Travis             | -   | -  | -                          | -                      | 15,000   | 82,800   |

The Medifast Board of Directors on July 24, 2008 approved restricted common stock grants to Board members with a 5 year vesting period, beginning on the grant date. The grant was to tenured Board members that successfully implemented the Senior Management Succession Plan over the last four years through advice, counsel, and mentorship. A total of 55,000 shares of restricted common stock were granted to tenured Directors.

The Medifast Board of Directors on November 24, 2008 approved restricted common stock grants to key executives and Board members as a 2008 performance bonus for exceeding internal sales and profit forecasts. Non-management Board members were each granted 5,000 shares of restricted common stock vesting over two years, beginning on January 1, 2009.

#### Compensation Committee Report

We have reviewed and discussed with management certain Compensation Discussion and Analysis provisions to be included in this Form 10-K. Based on the reviews and discussions referred to above, we recommend to the Board of Directors that the Compensation Discussion and Analysis referred to above be included on the Form 10-K for the year-ended December 31, 2008.

#### COMPENSATION COMMITTEE OF THE BOARD OF DIRECTORS

Mary T. Travis, Chairman  
Joseph D. Calderone  
Dennis M. McCarthy, Esq.  
Jeannette M. Mills

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The following table shows as of December 31, 2008, the amount and percentage of our outstanding common stock beneficially owned by each person who is known by us to beneficially own more than 5% of our outstanding common stock.

| Name and Address of<br>5% Beneficial Owner  | Shares<br>Beneficially<br>Owned (1) | Percent of<br>Outstanding<br>Common Stock |
|---|-------------------------------------|---|
| Renaissance Technologies, LLC and James H. Simons<br>800 Third Avenue<br>New York, NY 10022 | 732,700                             | 5.0%                                      |
| Berg and Berg Enterprises, LLC<br>10050 Bandlely Drive<br>Cupertino, CA 94014               | 900,480                             | 6.2%                                      |

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The following table shows as of March 13, 2009 the amount and percentage of our outstanding common stock beneficially owned (unless otherwise indicated) by each of our (i) directors and nominees for directors, (ii) Named Executive Officers and (iii) our directors, nominees for director and executive officers as a group.

| Name of Beneficial Owner  | Shares                              |                                     | Percent of<br>Outstanding<br>Common Stock (%) |
|---|-------------------------------------|-------------------------------------|---|
|   | Shares Beneficially<br>Owned (1)(2) | Acquirable<br>Within 60 days<br>(3) |   |
| Bradley T. MacDonald (4)  | 903,550                             | -                                   | 6.19%   |
| Michael S. McDevitt   | 399,784                             | -                                   | 2.74%   |
| Margaret MacDonald  | 252,900                             | -                                   | 1.73%   |
| Brendan N. Connors, CPA   | 81,509                              | -                                   | 0.56%   |
| Donald F. Reilly  | 67,183                              | -                                   | *   |
| Michael C. MacDonald  | 63,697                              | -                                   | *   |
| Charles P. Connolly   | 29,075                              | -                                   | *   |
| Mary T. Travis  | 29,033                              | -                                   | *   |
| Joseph D. Calderone, OSA  | 17,700                              | -                                   | *   |
| Dennis M. McCarthy, Esq.  | 13,075                              | -                                   | *   |
| Leo V. Williams   | 11,770                              | -                                   | *   |
| George J. Lavin, Jr., Esq.  | 10,700                              | -                                   | *   |
| Barry B. Bondroff, CPA  | 3,500                               | -                                   | *   |
| Jeannette M. Mills  | 3,500                               | -                                   | *   |
| All directors, nominees for directors and executive officers as a group<br>(14 persons) | 1,886,976                           | -                                   | 12.94%  |

\*

Less than 1%.

- (1) Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission. Under those rules and for purposes of the table above (a) if a person has decision making power over either the voting or the disposition of any shares, that person is generally deemed to be a beneficial owner of those shares; (b) if two or more persons have decision making power over either the voting or the disposition of any shares, they will be deemed to share beneficial ownership of those shares, in which case the same shares will be included in share ownership totals for each of those persons; and (c) if a person held options to purchase shares that were exercisable on, or became exercisable within 60 days of, March 13, 2009, that person will be deemed to be the beneficial owner of those shares and those shares (but not shares that are subject to options held by any other stockholder) will be deemed to be outstanding for purposes of computing the percentage of the outstanding shares that are beneficially owned by that person. Information supplied by officers and directors.
- (2) Unless otherwise noted, reflects the number of shares that could be purchased by exercise of options available at March 13, 2009, or within 60 days thereafter under our stock option plans.
- (3) The shares set forth as beneficially owned by Mr. Bradley T. MacDonald include 396,402 shares owned by his wife Shirley MacDonald, and 65,667 shares owned by the MacDonald Family Trust. His daughter, Margaret MacDonald, beneficially owns 252,900 shares which added to Bradley T. MacDonald's 903,550 beneficially owned shares results in 1,156,450 shares owned by the MacDonald family.



ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

As of December 31, 2008, there were no related party transactions.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Fees to Independent Registered Public Accountants for Fiscal 2008 and 2007

The following services were provided by Bagell, Josephs, Levine & Co during fiscal 2008 and 2007:

|                | 2008              | 2007              |
|----------------|-------------------|-------------------|
| Audit Fees(1)  | \$ 154,000        | \$ 199,000        |
| Tax fees(2)    | 29,000            | 30,000            |
| All other fees | -                 | -                 |
| <b>Total</b>   | <b>\$ 183,000</b> | <b>\$ 229,000</b> |

(1) Audit fees consist of fees for professional services rendered for the audit of the Company's consolidated financial statements included in the Company's Annual Report on Form 10-K, including the audit of internal controls required by Section 404 of the Sarbanes-Oxley Act of 2002, and the review of financial statements included in the Company's Quarterly Reports on Form 10-Q, and for services that are normally provided by the auditor in connection with statutory and regulatory filings or engagements.

(2) Tax fees were billed for tax compliance services

Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors  
The Audit Committee pre-approves all audit and permissible non-audit services provided by the independent auditors. These services may include audit services, audit-related services, tax services and other services. The Audit Committee has adopted a policy for the pre-approval of services provided by the independent auditors.

Under the policy, pre-approval is generally provided for work associated with the following:

• registration statements under the Securities Act of 1933 (for example, comfort letters or consents);

• due diligence work for potential acquisitions or dispositions;

• attest services not required by statute or regulation;

• adoption of new accounting pronouncements or auditing and disclosure requirements and accounting or regulatory consultations;

• internal control reviews and assistance with internal control reporting requirements;

• review of information systems security and controls;

• tax compliance, tax planning and related tax services, excluding any tax service prohibited by regulatory or other oversight authorities; expatriate and other individual tax services; and

ÿ Assistance and consultation on questions raised by regulatory agencies.

For each proposed service, the independent auditors are required to provide detailed back-up documentation at the time of approval to permit the Audit Committee to make a determination whether the provision of such services would impair the independent auditors' independence.

The Audit Committee has approved in advance certain permitted services whose scope is routine across business units, including statutory or other financial audit work for non-U.S. subsidiaries that is not required for the 1934 Act audits.

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PART IV

ITEM 15. EXHIBITS AND FINACIAL STATEMENT SCHEDULES

(a) 1. Financial Statements

See Index to the Consolidated Financial Statements on page 47 of this Annual Report

2. Financial Statement Schedules

None, as all information required in these schedules is included in the Notes to the Consolidated Financial Statements.

3. Exhibits

Reference is made to the Exhibit Index on page 47 of this Annual Report for a list of exhibits required by Item 601 of Registration S-K to be filed as part of this Annual Report.

MEDIFAST, INC. AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and  
Stockholders of Medifast, Inc.  
Owing Mills, Maryland 21117

We have audited the accompanying consolidated balance sheets of Medifast, Inc. as of December 31, 2008 and 2007, and the related consolidated statements of income, changes in stockholders' equity and accumulated other comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2008. Medifast, Inc.'s management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Medifast, Inc. as of December 31, 2008 and 2007, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2008 in conformity with accounting principles generally accepted in the United States of America.

/s/Bagell, Josephs, Levine & Company, L.L.C.  
Bagell, Josephs, Levine & Company, L.L.C.  
Marlton, NJ 08053

March 6, 2009

MEDIFAST, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
As of December 31, 2008 and 2007

|   | 2008                 | 2007                 |
|---|----------------------|----------------------|
| <b>ASSETS</b>   |                      |                      |
| Current assets:   |                      |                      |
| Cash and cash equivalents   | \$ 1,841,000         | \$ 2,195,000         |
| Accounts receivable-net of allowance for doubtful accounts of \$100,000   | 448,000              | 493,000              |
| Inventory   | 13,856,000           | 9,181,000            |
| Investment securities   | 1,099,000            | 1,439,000            |
| Deferred compensation   | 531,000              | 814,000              |
| Prepaid expenses and other current assets   | 2,034,000            | 2,727,000            |
| Prepaid income tax  | 1,131,000            | -                    |
| Note receivable - current   | 180,000              | 180,000              |
| Current portion of deferred tax asset   | 100,000              | 100,000              |
| Total current assets  | 21,220,000           | 17,129,000           |
| Property, plant and equipment - net   | 21,709,000           | 17,031,000           |
| Trademarks and intangibles - net  | 5,547,000            | 7,356,000            |
| Deferred tax asset, net of current portion  | 1,131,000            | 897,000              |
| Note receivable, net of current assets  | 1,080,000            | 1,212,000            |
| Other assets  | 350,000              | 99,000               |
| <b>TOTAL ASSETS</b>   | <b>\$ 51,037,000</b> | <b>\$ 43,724,000</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                      |                      |
| Current liabilities:  |                      |                      |
| Accounts payable and accrued expenses   | \$ 5,130,000         | \$ 4,279,000         |
| Income taxes payable  | -                    | 592,000              |
| Line of credit  | 3,164,000            | 1,599,000            |
| Current maturities of long-term debt  | 257,000              | 264,000              |
| Total current liabilities   | 8,551,000            | 6,734,000            |
| Other liabilities   |                      |                      |
| Long-term debt, net of current portion  | 4,313,000            | 4,570,000            |
| Total liabilities   | 12,864,000           | 11,304,000           |
| Stockholders' Equity:   |                      |                      |
| Preferred stock, \$.001 par value (1,500,000 authorized, no shares issued and outstanding)                                      | -                    | -                    |
| Common stock; par value \$.001 per share; 20,000,000 shares authorized; 14,585,960 and 13,709,098 shares issued and outstanding | 15,000               | 14,000               |
| Additional paid-in capital  | 30,787,000           | 26,953,000           |
| Accumulated other comprehensive income (loss)   | (389,000)            | 321,000              |
| Retained earnings   | 15,253,000           | 9,818,000            |
|   | 45,666,000           | 37,106,000           |
| Less: cost of 272,192 and 270,534 shares of common stock in treasury  | (1,956,000)          | (1,971,000)          |

|   |                      |                      |
|---|----------------------|----------------------|
| Less: Unearned compensation                       | (5,537,000)          | (2,715,000)          |
| Total stockholders' equity                        | 38,173,000           | 32,420,000           |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY</b> | <b>\$ 51,037,000</b> | <b>\$ 43,724,000</b> |

The accompanying notes are an integral part of these consolidated financial statements

MEDIFAST, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME

|  | Years Ended December 31, |               |                    |
|--|--------------------------|---------------|--------------------|
|  | 2008                     | 2007          | (Restated)<br>2006 |
| Revenue  | \$ 105,445,000           | \$ 83,779,000 | \$ 74,086,000      |
| Cost of sales                                  | (25,332,000)             | (21,464,000)  | (18,237,000)       |
| Gross profit                                   | 80,113,000               | 62,315,000    | 55,849,000         |
| Selling, general, and administration           | (71,914,000)             | (56,600,000)  | (48,468,000)       |
| Income from operations                         | 8,199,000                | 5,715,000     | 7,381,000          |
| Other income (expense):                        |                          |               |                    |
| Interest expense                               | (366,000)                | (387,000)     | (369,000)          |
| Interest income                                | 149,000                  | 105,000       | 175,000            |
| Other income (expense)                         | (132,000)                | 110,000       | 276,000            |
|  | (349,000)                | (172,000)     | 82,000             |
| Income before provision for income taxes       | 7,850,000                | 5,543,000     | 7,463,000          |
| Provision for income taxes                     | (2,415,000)              | (1,706,000)   | (2,307,000)        |
| Net income attributable to common shareholders | \$ 5,435,000             | \$ 3,837,000  | \$ 5,156,000       |
| Basic earnings per share                       | \$ 0.41                  | \$ 0.30       | \$ 0.41            |
| Diluted earnings per share                     | \$ 0.38                  | \$ 0.28       | \$ 0.38            |
| Weighted average shares outstanding -          |                          |               |                    |
| Basic  | 13,126,534               | 12,960,930    | 12,699,066         |
| Diluted  | 14,329,525               | 13,644,149    | 13,482,894         |

The accompanying notes are an integral part of these consolidated financial statements

MEDIFAST, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY AND ACCUMULATED  
OTHER COMPREHENSIVE INCOME (LOSS)  
Years Ended December 31, 2008, 2007, and 2006

|  | Number<br>of Shares | (Restated)<br>Common Stock        |                                  | Retained<br>Earnings | Accumulated<br>other<br>comp<br>income/(loss) | Total         | Treasury<br>Stock | Unearned<br>Compensation |
|--|---------------------|-----------------------------------|----------------------------------|----------------------|---|---------------|-------------------|--------------------------|
|  |                     | Par<br>Value<br>\$0.001<br>Amount | Additional<br>Paid-In<br>Capital |                      |   |               |                   |                          |
| Balance,<br>December 31,<br>2005                                       | 12,782,791          | \$ 13,000                         | \$ 21,759,000                    | \$ 825,000           | \$ 282,000                                    | \$ 22,879,000 | \$ (1,075,000)    | \$ (107,000)             |
| Warrants<br>converted to<br>common stock                               | 142,810             | 200                               | 762,000                          |                      |   | 762,200       | (137,000)         |                          |
| Common<br>stock issued to<br>Directors                                 | 10,750              | 100                               | 69,000                           |                      |   | 69,100        |                   |                          |
| Common<br>stock issued to<br>consultants                               | 2,500               | 100                               | 17,000                           |                      |   | 17,100        |                   |                          |
| Dividend paid<br>in stock  |                     |                                   |                                  |                      |   |               |                   |                          |
| Options<br>exercised to<br>common stock                                | 128,047             | 100                               | 240,000                          |                      |   | 240,100       | (490,000)         |                          |
| Options<br>granted to<br>CEO   |                     |                                   | 383,000                          |                      |   | 383,000       |                   | (383,000)                |
| FASB 123R<br>vesting   |                     |                                   | 41,000                           |                      |   | 41,000        |                   |                          |
| Shares issued<br>to executives<br>with 5 & 6<br>year vesting<br>period | 565,000             | 600                               | 3,374,000                        |                      |   | 3,374,600     |                   | (3,374,000)              |
| Vesting of<br>unearned<br>compensation                                 |                     |                                   |                                  |                      |   |               |                   | 508,000                  |
| Treasury<br>shares issued<br>to employees                              |                     | (100)                             | (16,000)                         |                      |   | (16,100)      | 16,000            |                          |
| Net income   | 13,631,898          | 14,000                            | 26,629,000                       | 5,156,000            | 52,000  | 5,208,000     | (1,686,000)       | (3,356,000)              |

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Balance,  
December 31,  
2006

|                                     |        |       |          |           |          |           |         |
|-------------------------------------|--------|-------|----------|-----------|----------|-----------|---------|
| Warrants converted to common stock  | 40,000 | 100   | 192,000  |           | 192,100  |           |         |
| Common stock issued to Directors    | 9,700  | 100   | 31,000   |           | 31,100   |           |         |
| Options exercised to common stock   | 27,500 | 100   | 24,000   |           | 24,100   |           |         |
| FASB 123R vesting                   |        |       | 101,000  |           | 101,000  |           |         |
| Vesting of unearned compensation    |        |       |          |           |          |           | 641,000 |
| Repurchase of treasury stock        |        |       |          |           |          | (309,000) |         |
| Treasury shares issued to employees |        | (300) | (24,000) |           | (24,300) | 24,000    |         |
| Net income                          |        |       |          | 3,837,000 | (13,000) | 3,824,000 |         |

Balance,  
December 31,  
2007

13,709,098 \$ 14,000 \$ 26,953,000 \$ 9,818,000 \$ 321,000 \$ 37,106,000 \$ (1,971,000) \$ (2,715,000)

|  |         |     |           |  |           |          |             |
|--|---------|-----|-----------|--|-----------|----------|-------------|
| Common stock issued to Directors                                   | 37,000  | 100 | 152,000   |  | 152,100   |          |             |
| Options exercised to common stock                                  | 61,112  | 100 | 72,000    |  | 72,100    | (43,000) |             |
| Shares issued to Executives and Directors with 2 to 5 year vesting | 736,750 | 700 | 3,493,000 |  | 3,493,000 |          | (3,493,000) |
| Vesting of unearned compensation to executives and directors       |         |     |           |  |           |          | 852,000     |
| Cancellation of options and reissuance of restricted shares        | 42,000  | 100 | 105,000   |  | 105,800   |          | (182,000)   |
| Treasury shares issued   |         |     | 12,000    |  | 12,000    | 58,000   |             |

|                            |            |           |               |               |              |               |                |                |  |
|----------------------------|------------|-----------|---------------|---------------|--------------|---------------|----------------|----------------|--|
| in legal settlement        |            |           |               |               |              |               |                |                |  |
| Net income                 |            |           |               | 5,435,000     | (710,000)    |               | 4,725,000      |                |  |
| Balance, December 31, 2008 | 14,585,960 | \$ 15,000 | \$ 30,787,000 | \$ 15,253,000 | \$ (389,000) | \$ 45,666,000 | \$ (1,956,000) | \$ (5,538,000) |  |

The accompanying notes are an integral part of these consolidated financial statements.

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MEDIFAST, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

|   | Years Ended December 31, |              |              |
|---|--------------------------|--------------|--------------|
|   | 2008                     | 2007         | 2006         |
|   | (Audited)                | (Audited)    | (Restated)   |
| <b>Cash flows from operating activities:</b>  |                          |              |              |
| Net income  | \$ 5,435,000             | \$ 3,837,000 | \$ 5,156,000 |
| <b>Adjustments to reconcile net income to net cash provided by operating activities from continuing operations:</b> |                          |              |              |
| Depreciation and amortization   | 4,574,000                | 3,471,000    | 2,271,000    |
| Realized(gain) loss on investment securities  | 216,000                  | 103,000      | (79,000)     |
| Loss on sale of Consumer Choice Systems   |                          |              | 323,000      |
| Common stock issued for services  | 152,000                  | 31,000       | 86,000       |
| Treasury stock issued in legal settlement   | 70,000                   | -            | -            |
| Stock options vested during period  | -                        | 100,000      | 40,000       |
| Stock options cancelled during period   | (77,000)                 | -            | -            |
| Excess tax benefits from share-based payment arrangements   | -                        | 39,000       | 16,000       |
| Vesting of unearned compensation  | 852,000                  | 641,000      | 509,000      |
| Net change in other comprehensive (loss) income   | (711,000)                | (13,000)     | 52,000       |
| Deferred income taxes   | (234,000)                | (390,000)    | (597,000)    |
| <b>Changes in assets and liabilities:</b>   |                          |              |              |
| (Increase) Decrease in accounts receivable  | 43,000                   | (43,000)     | 379,000      |
| (Increase) in inventory   | (4,675,000)              | (926,000)    | (3,138,000)  |
| (Increase) Decrease in prepaid expenses & other current assets  | 693,000                  | (128,000)    | 675,000      |
| (Increase) Decrease in deferred compensation  | 282,000                  | (140,000)    | (148,000)    |
| (Increase) in prepaid taxes   | (1,131,000)              | -            | -            |
| (Increase) Decrease in other assets   | (251,000)                | (52,000)     | 13,000       |
| Increase in accounts payable and accrued expenses   | 850,000                  | 1,367,000    | 651,000      |
| Increase (Decrease) in income taxes payable   | (592,000)                | 57,000       | (364,000)    |
| Net cash provided by operating activities   | 5,496,000                | 7,954,000    | 5,845,000    |
| <b>Cash Flow from Investing Activities:</b>   |                          |              |              |
| Sale of investment securities, net  | 129,000                  | (4,000)      | 1,237,000    |
| (Purchase) of property and equipment  | (7,429,000)              | (5,151,000)  | (5,557,000)  |
| (Purchase) of intangible assets   | (13,000)                 | (2,814,000)  | (2,427,000)  |
| Net cash (used in) investing activities   | (7,313,000)              | (7,969,000)  | (6,747,000)  |
| <b>Cash Flow from Financing Activities:</b>   |                          |              |              |
| Issuance of common stock, options and warrants  | 30,000                   | 216,000      | 795,000      |
| (Repayment) of long-term debt, net  | (264,000)                | (586,000)    | (481,000)    |
| Increase in line of credit  | 1,565,000                | 1,706,000    | 623,000      |
| Decrease in note receivable   | 132,000                  | 137,000      | -            |
| Excess tax benefits from share-based payment arrangements   | -                        | (39,000)     | (14,000)     |
| (Purchase) of treasury stock  | -                        | (309,000)    | (420,000)    |
| Net cash provided by financing activities   | 1,463,000                | 1,125,000    | 503,000      |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS  | (354,000)                | 1,110,000    | (399,000)    |
| Cash and cash equivalents - beginning of the year   | 2,195,000                | 1,085,000    | 1,484,000    |
| Cash and cash equivalents - end of year   | \$ 1,841,000             | \$ 2,195,000 | \$ 1,085,000 |

Supplemental disclosure of cash flow information:



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|   |              |              |              |
|---|--------------|--------------|--------------|
| Interest paid   | \$ 367,000   | \$ 387,000   | 369,000      |
| Income taxes  | \$ 3,661,000 | \$ 1,790,000 | \$ 3,403,000 |
| Supplemental disclosure of non cash activity:               |              |              |              |
| Common stock issued to Directors over 6-year vesting period | \$ 852,000   | \$ -         | \$ 3,373,000 |
| Options vested during period                                | \$ -         | \$ 100,000   | \$ 40,000    |
| Options cancelled during period                             | \$ 77,000    | \$ -         |              |
| Common stock issued for services                            | \$ 152,000   | \$ 31,000    | \$ 86,000    |
| Common shares issued for options or warrants                | \$ 30,000    | \$ -         | \$ 591,000   |
| Treasury stock issued in legal settlement                   | \$ 70,000    | \$ -         | \$ -         |
| Line of credit converted to long-term debt                  | \$ -         | \$ 2,156,000 | \$ -         |

The accompanying notes are an integral part of these consolidated financial statements

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

|  | Years Ended December 31, |      |                    |
|--|--------------------------|------|--------------------|
|  | 2008                     | 2007 | (Restated)<br>2006 |
| <b>Supplemental disclosure of non cash activity:</b> |                          |      |                    |
| <b>Sale of Consumer Choice Systems</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)          |
|  | \$ -                     | \$ - | \$ -               |

The accompanying notes are an integral part of these consolidated financial statements

Medifast, Inc. and Subsidiaries  
Notes to Consolidated Financial Statements  
December 31, 2008, 2007, 2006

## 1. BACKGROUND

### Nature of the Business

Medifast, Inc. (the "Company" or "Medifast" is a Delaware corporation, incorporated in 1980. The Company's operations are primarily conducted through six of its wholly owned subsidiaries, Jason Pharmaceuticals, Inc. ("Jason"), Take Shape for Life, Inc. ("TSFL"), Jason Enterprises, Inc., Jason Properties, LLC and Seven Crondall, LLC, and Medifast Franchise Systems. The Company is engaged in the production, distribution, and sale of weight management and disease management products and other consumable health and diet products. Medifast, Inc.'s product lines include weight and disease management, and meal replacement products manufactured in a modern, FDA approved facility in Owings Mills, Maryland.

The Company is engaged in the manufacturing and distribution of Medifast® branded and private label weight and disease management products. These products are sold through various channels of distribution, to include web, call center, independent health advisors, medical professionals, weight loss clinics, direct consumer marketing supported via the phone and the web. The processing, formulation, packaging, labeling and advertising of the Company's products are subject to regulation by one or more federal agencies, including the Food and Drug Administration, the Federal Trade Commission, the Consumer Product Safety Commission, the United States Department of Agriculture, and the United States Environmental Protection Agency.

## 2. Summary of Significant Accounting Policies

Significant accounting policies followed in the preparation of the consolidated financial statements are as follows:

### Principles of Consolidation and Basis of Presentation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, Jason Pharmaceuticals, Inc., Take Shape For Life, Inc., Seven Crondall Associates, LLC, Jason Properties, LLC Medifast Franchise Systems, and Jason Enterprises, Inc. All inter-company accounts have been eliminated.

### Cash and Cash Equivalents

For the purposes of the consolidated statements of cash flow, the Company considers all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. At December 31, 2008, the Company had \$923,000 in miscellaneous short-term investments through Merrill Lynch that are considered cash equivalents due to terms of maturity, and \$918,000 in operating checking accounts.

At December 31, 2007, the Company had \$1,224,000 in miscellaneous short-term investments through Merrill Lynch that are considered cash equivalents due to terms of maturity, and \$971,000 in operating checking accounts.

### Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable are recorded net of reserves for sales returns and allowances, and net of provisions for doubtful accounts. Allowances for sales returns and discounts are based on an analysis of historical trends, and allowances for doubtful accounts are based primarily on an analysis of aging accounts receivable balances and on the

creditworthiness of the customer as determined by credit checks and analysis, as well as the customer's payment history.

#### Inventory

Inventories consist principally of packaged meal replacements held in the Company's warehouse. Inventory is stated at the lower of cost or market, utilizing the first-in, first-out method. The cost of finished goods includes the cost of raw materials, packaging supplies, direct and indirect labor and other indirect manufacturing costs. On a quarterly basis, management reviews inventory for unsalable or obsolete inventory. Obsolete or unsalable inventory write-offs have been immaterial to the financial statements as our products have useful lives ranging from 14-24 months.

## Advertising

Advertising costs such as preparation, layout, design and production of advertising are deferred. They are expensed when the advertisement is first used, except for the costs of executory contracts, which are amortized as performance under the contract is received. Advertising costs deferred at December 31, 2008 and 2007, were \$557,000 and \$1,014,000 respectively. Advertising expense for the years ended December 31, 2008, 2007, and 2006 amounted to \$17,800,000, \$18,400,000, and \$14,300,000, respectively.

## Property, Plant, and Equipment

Property, plant and equipment are stated at cost less accumulated depreciation and amortization. The Company computes depreciation and amortization using the straight-line method over the estimated useful lives of the assets acquired as follows:

|                                    |                 |
|------------------------------------|-----------------|
| Building and building improvements | 39 years        |
| Equipment and fixtures             | 3 - 15<br>years |
| Vehicles                           | 5 years         |

The carrying amount of all long-lived assets is evaluated periodically to determine whether adjustment to the useful life or to the unamortized balance is warranted. Such evaluation is based principally on the expected utilization of the long-lived assets and the projected undiscounted cash flows of the operations in which the long-lived assets are used.

In accordance with SFAS No. 144, "Long-Lived Assets", property, plant and equipment and other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

## Income Taxes

The Company accounts for income taxes in accordance with Statements of Financial Accounting Standards No. 109, "Accounting for Income Taxes," which requires an asset and liability approach to financial accounting and reporting for income taxes. Deferred income taxes and liabilities are computed annually for differences between the financial statement and the tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

## Earnings per Common Share

Basic earnings per share is calculated by dividing net profit attributable to common stockholders by the weighted average number of outstanding common shares during the year. Basic earnings per share exclude any dilutive effects of options, warrants and other stock-based compensation, which are included in diluted earnings per share.

## 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.

#### 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.

#### Fair Value of Financial Instruments

The carrying amounts reported in the consolidated balance sheets for cash, certificates of deposit, accounts receivable, accounts payable and accrued liabilities approximate fair value because of the immediate or short-term maturity of the financial instruments.

The Company believes that its indebtedness approximates fair value based on current yields for debt instruments with similar terms.

### Concentration of Credit Risk

Financial instruments that potentially subject the Company to credit risk consist of cash, certificates of deposit, investment securities and trade receivables. Cash, money markets and investments exceed the federal insurance coverage by \$944,000 and \$1,551,000 respectively. The Company securities at December 31, 2008 and 2007, include amounts deposited with multiple financial institutions. The Company markets its products primarily to medical professionals, clinics, and Internet medical sales and has no substantial concentrations of credit risk in its trade receivables.

As of December 31, 2008 the Company had two customers that individually represented over 10% of the accounts receivable and in the aggregate, approximately 43% of the accounts receivable. In 2007, the Company had three customers that individually represented over 10% of the accounts receivable and in the aggregate, approximately 70% of the accounts receivable.

### 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.

### Stock-Based Compensation

Effective January 1, 2006, 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.

On January 25, 2008, the Board of Directors modified Bradley T. MacDonald's compensation package for his role in the succession plan and business development initiatives as outlined in the December 31, 2006 10-K. The Board cancelled the 100,000 options granted to Mr. MacDonald on February 8, 2006 and replaced them with a restricted

stock grant of 42,000 shares. The restricted shares will vest over a period of 3 years beginning on January 25, 2009.

The Medifast Board of Directors on July 24, 2008 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 425,000 shares of restricted common stock to retain their services over the next five years, reward their efforts in the participation of the successful succession and transition of the company operations to the new senior management team, and incentivize continued sales and profit growth in accordance with targets set by the Board of Directors. Tenured Board members that successfully implemented the Senior Management Succession Plan over the last four years through advice, counsel, and mentorship were awarded 55,000 shares of restricted common stock.

The Medifast Board of Directors on November 24, 2008 approved restricted common stock grants to key executives and Board members as a 2008 performance bonus for exceeding internal sales and profit forecasts. Key executives were granted 150,000 shares of restricted common stock over a five year vesting period, beginning on January 1, 2009. Non-management Board members were each granted 5,000 shares of restricted common stock vesting over two years, beginning on January 1, 2009.

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 \$852,000 and \$641,000 at December 31, 2008 and December 31, 2007, respectively. Expense related to vesting of options under FASB 123R was \$0, \$100,000, and \$40,000 at December 31, 2008, 2007, and 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).

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

|   | Years Ended December 31, |                     |                     |
|---|--------------------------|---------------------|---------------------|
|   | 2008                     | 2007                | 2006<br>(Restated)  |
| <b>Net income:</b>  |                          |                     |                     |
| As reported   | \$ 5,435,000             | \$ 3,837,000        | \$ 5,156,000        |
| Add: Stock-based employee compensation expense included in net income, net of related tax effects                                   | -                        | 61,000              | 24,000              |
| Deduct: Total stock-based employee compensation determined under fair value based method for all awards, net of related tax effects | -                        | (61,000)            | (24,000)            |
| <b>Net income, pro forma</b>  | <b>\$ 5,435,000</b>      | <b>\$ 3,837,000</b> | <b>\$ 5,156,000</b> |
| <b>Net income per share:</b>  |                          |                     |                     |
| as reported:  |                          |                     |                     |
| Basic   | \$ 0.41                  | \$ 0.30             | \$ 0.41             |
| Diluted   | \$ 0.38                  | \$ 0.28             | \$ 0.38             |
| Pro forma:  |                          |                     |                     |
| Basic   | \$ 0.41                  | \$ 0.30             | \$ 0.41             |
| Diluted   | \$ 0.38                  | \$ 0.28             | \$ 0.38             |

The pro forma effect on net income may not be representative of the pro forma effect on net income of future years due to, among other things: (i) the vesting period of the stock options and the (ii) fair value of additional stock options in future years.

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:

|                         | 2008 | 2007 | 2006  |
|-------------------------|------|------|-------|
| Dividend yield          | 0.0% | 0.0% | 0.0%  |
| Expected volatility     | 0.71 | 0.54 | 0.70  |
| Risk-free interest rate | 1.0% | 4.0% | 4.50% |
| Expected life in years  | 1-5  | 1-5  | 1-5   |

## Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"), which clarifies the definition of fair value whenever another standard requires or permits assets or liabilities to be measured at fair value. Specifically, the standard clarifies that fair value should be based on the assumptions market participants would use when pricing the asset or liability, and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS No. 157 does not expand the use of fair value to any new circumstances, and must be applied on a prospective basis except in certain cases. The standard also requires expanded financial statement disclosures about fair value measurements, including disclosure of the methods used and the effect on earnings.

In February 2008, FASB Staff Position ("FSP") FAS No. 157-2, "Effective Date of FASB Statement No. 157" ("FSP No. 157-2") was issued. FSP No. 157-2 defers the effective date of SFAS No. 157 to fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, for all nonfinancial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Examples of items within the scope of FSP No. 157-2 are nonfinancial assets and nonfinancial liabilities initially measured at fair value in a business combination (but not measured at fair value in subsequent periods), and long-lived assets, such as property, plant and equipment and intangible assets measured at fair value for an impairment assessment under SFAS No. 144.

The partial adoption of SFAS No. 157 on January 1, 2008 with respect to financial assets and financial liabilities recognized or disclosed at fair value in the financial statements on a recurring basis did not have a material impact on the Company's consolidated financial statements. See Note 15 for the fair value measurement disclosures for these assets and liabilities. The Company is in the process of analyzing the potential impact of SFAS No. 157 relating to its planned January 1, 2009 adoption of the remainder of the standard.

On January 1, 2008 (the first day of fiscal 2008), the Company adopted SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115" ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value, which are not otherwise currently required to be measured at fair value. Under SFAS No. 159, the decision to measure items at fair value is made at specified election dates on an instrument-by-instrument basis and is irrevocable. Entities electing the fair value option are required to recognize changes in fair value in earnings and to expense upfront costs and fees associated with the item for which the fair value option is elected. The new standard did not impact the Company's Consolidated Financial Statements as the Company did not elect the fair value option for any instruments existing as of the adoption date. However, the Company will evaluate the fair value measurement election with respect to financial instruments the Company enters into in the future.

In December 2007, the FASB issued SFAS No. 141 (revised 2007), "Business Combinations" ("SFAS No. 141(R)"). SFAS No. 141(R) changes how an entity accounts for the acquisition of a business. While it retains the requirement to account for all business combinations using the acquisition method, the new rule will apply to a wider range of transactions or events and requires, in general, acquisition-date fair value measurement of identifiable assets acquired, liabilities assumed and non-controlling ownership interests held in the acquire, among other items. The Company is beginning to review the provisions of SFAS No. 141(R), which applies prospectively to business combinations with an acquisition date on or after the beginning of its 2009 fiscal year.

In December 2007, the FASB issued SFAS No. 160, "Non-controlling Interests in Consolidated Financial Statements: an amendment of ARB No. 51" ("SFAS No. 160"). SFAS No. 160 replaces the term minority interests with the newly-defined term of non-controlling interests and establishes this line item as an element of stockholders' equity, separate from the parent's equity. SFAS No. 160 also includes expanded disclosure requirements regarding the

interests of the parent and its non-controlling interest. The Company is continuing to review the provisions of SFAS No. 160, which is effective the first quarter of fiscal 2009, and currently does not expect this new accounting standard to have a significant impact on the Consolidated Financial Statements.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities: an amendment of FASB Statement No. 133" ("SFAS No. 161"). SFAS No. 161 changes the disclosure requirements for derivative instruments and hedging activities. The Company is reviewing the provisions of SFAS No. 161, which is effective the first quarter of fiscal 2009, and currently does not anticipate that this new accounting standard will have a significant impact on the Consolidated Financial Statements.

In May 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles" (SFAS No. 162). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting principles used in the preparation of financial statements. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles". The implementation of this standard will not have a material impact on Consolidated Financial Statements.

In June 2008, the FASB issued FASB Staff Position ("FSP") Emerging Issues Task Force ("EITF") No. 03-6-1, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities." Under the FSP, unvested share-based payment awards that contain rights to receive nonforfeitable dividends (whether paid or unpaid) are participating securities, and should be included in the two-class method of computing EPS. The FSP is effective for fiscal years beginning after December 15, 2008 and for interim periods within those years. The implementation of this standard will not have a material impact on Consolidated Financial Statements.

## Investments

In accordance with FAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities", securities are classified into three categories: held-to-maturity, available-for-sale and trading. The Company's investments consist of debt and equity securities classified as available-for-sale securities. Accordingly, they are carried at fair value in accordance with FAS No. 115. Further, according to FAS No. 115 the unrealized holding gains and losses for available-for-sales securities are excluded from earnings and reported, net of deferred income taxes, as a separate component of stockholders' equity, unless the loss is classified as other than a temporary decline in market value.

## 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, non-compete agreements, trademarks, patents, and copyrights. The non-compete agreements were fully amortized as of December 31, 2007. 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.

## Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources, including unrealized gains and losses on marketable securities. The Company presents comprehensive income in its consolidated statements of stockholders equity.

## Reclassifications

Certain amounts for the years ended December 31, 2007 and 2006 have been reclassified to conform to the presentation of the December 31, 2008 amounts. The reclassifications have no effect on net income for the years ended December 31, 2007 and 2006.

## 3. CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES

The following summarizes cash, cash equivalents, and marketable securities:

|                                  | Cost         | Accrued interest | Fair value   |
|----------------------------------|--------------|------------------|--------------|
| <b>Cash and cash equivalents</b> |              |                  |              |
| Demand deposits                  | \$ 918,000   | \$ -             | \$ 918,000   |
| Money market accounts            | 923,000      | -                | 923,000      |
| December 31, 2008                | \$ 1,841,000 | \$ -             | \$ 1,841,000 |
| <b>Investment Securities</b>     |              |                  |              |
| Investment Securities            | \$ 1,088,000 | \$ 11,000        | \$ 1,099,000 |
| December 31, 2008                | \$ 1,088,000 | \$ 11,000        | \$ 1,099,000 |
| <b>Cash and cash equivalents</b> |              |                  |              |
| Demand deposits                  | \$ 971,000   | \$ -             | \$ 971,000   |
| Money market accounts            | 1,224,000    | -                | 1,224,000    |
| December 31, 2007                | \$ 2,195,000 | \$ -             | \$ 2,195,000 |
| <b>Investment Securities</b>     |              |                  |              |
| Investment Securities            | \$ 1,428,000 | \$ 11,000        | \$ 1,439,000 |
| December 31, 2007                | \$ 1,428,000 | \$ 11,000        | \$ 1,439,000 |

The Company had a net unrealized loss of \$711,000 as of December 31, 2008, a net unrealized loss of \$13,000 as of December 31, 2007, and a net unrealized gain of \$52,000 as of December 31, 2006. The Company had a realized loss of \$216,000, realized loss of \$103,000 and realized gain of \$79,000 for the years ended December 31, 2008, 2007, and 2006, respectively.

## 4. INVENTORY

Inventory consists of the following at December 31, 2008 and 2007:

|                | 2008          | 2007         |
|----------------|---------------|--------------|
| Raw materials  | \$ 2,810,000  | \$ 2,136,000 |
| Packaging      | 2,234,000     | 2,656,000    |
| Finished goods | 8,812,000     | 4,389,000    |
| Total          | \$ 13,856,000 | \$ 9,181,000 |

## 5. PREPAID EXPENSES AND OTHER CURRENT ASSETS

Prepaid expense and other current assets as of December 31, 2008 and 2007, consist of the following:

|                           | 2008         | 2007         |
|---------------------------|--------------|--------------|
| Marketing and advertising | \$ 1,531,000 | \$ 1,978,000 |
| Supplies                  | 413,000      | 377,000      |
| Insurance                 | 90,000       | 353,000      |
| Other                     | -            | 19,000       |
|                           | \$ 2,034,000 | \$ 2,727,000 |



## 6. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment as of December 31, 2008 and 2007, consist of the following:

|  | 2008          | 2007          |
|--|---------------|---------------|
| Land   | \$ 650,000    | \$ 650,000    |
| Building and building improvements             | 8,603,000     | 7,949,000     |
| Equipment and fixtures                         | 21,810,000    | 15,093,000    |
| Vehicle  | 43,000        | 43,000        |
|  | 31,106,000    | 23,735,000    |
| Less accumulated depreciation and amortization | 9,397,000     | 6,704,000     |
| Property, plant and equipment - net            | \$ 21,709,000 | \$ 17,031,000 |

Substantially all of the Company's property, plant and equipment are pledged as collateral for various loans (see Note 12).

Depreciation expense for the years ended December 31, 2008, 2007, and 2006 were \$2,751,000, \$2,139,000 and \$1,072,000, respectively. In 2007, the Company disposed of assets with an accumulated depreciation of \$95,000 relating to the closing of three corporately owned Medifast Weight Control Centers.

## 7. TRADEMARKS AND INTANGIBLES

|                                     | As of December 31, 2008 |                          | As of December 31, 2007 |                          |
|-------------------------------------|-------------------------|--------------------------|-------------------------|--------------------------|
|                                     | Gross Carrying Amount   | Accumulated Amortization | Gross Carrying Amount   | Accumulated Amortization |
| Customer lists                      | \$ 8,332,000            | \$ 4,649,000             | \$ 8,332,000            | \$ 3,065,000             |
| Non-compete agreements              | 840,000                 | 840,000                  | 840,000                 | 840,000                  |
| Trademarks, patents, and copyrights |                         |                          |                         |                          |
| finite life                         | 1,640,000               | 685,000                  | 1,626,000               | 446,000                  |
| infinite life                       | 909,000                 | -                        | 909,000                 | -                        |
| Total                               | \$ 11,721,000           | \$ 6,174,000             | \$ 11,707,000           | \$ 4,351,000             |

Amortization expense for the years ended December 31, 2008, 2007 and 2006 was as follows:

|                                     | 2008         | 2007         | (Restated)   |
|-------------------------------------|--------------|--------------|--------------|
|                                     |              |              | 2006         |
| Customer lists                      | \$ 1,584,000 | \$ 1,096,000 | \$ 774,000   |
| Non-compete agreements              | -            | -            | 273,000      |
| Trademarks, patents, and copyrights | 239,000      | 236,000      | 152,000      |
| Total trademarks and intangibles    | \$ 1,823,000 | \$ 1,332,000 | \$ 1,199,000 |

On January 17, 2006 the Consumer Choice Systems division of the Company was sold which included the sale of \$1,601,000 in gross intangible assets and \$265,000 in accumulated amortization.

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

The estimated future amortization expense of trademarks and intangible assets is as follows:

| For the years ending<br>December 31, | Amount    |
|--------------------------------------|-----------|
| 2009                                 | 1,675,000 |
| 2010                                 | 1,104,000 |
| 2011                                 | 1,101,000 |
| 2012                                 | 666,000   |
| 2013                                 | 57,000    |



## 8. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses as of December 31, 2008 and 2007 consist of the following:

|                                   | 2008         | 2007         |
|-----------------------------------|--------------|--------------|
| Trade payables                    | \$ 3,658,000 | \$ 3,181,000 |
| Accrued payroll and related taxes | 168,000      | 562,000      |
| Sales commissions payable         | 1,303,000    | 536,000      |
| Total                             | \$ 5,130,000 | \$ 4,279,000 |

## 9. COMMITMENTS AND CONTINGENCIES

The Company leases office space for Corporate offices as well as twenty-one corporately owned Medifast Weight Control Centers under lease terms ranging from three to five years with leases commencing in 2004, 2005, 2006, 2007 and 2008. Monthly payments under the Medifast Weight Control Centers leases range in price from \$2,000 to \$4,200. The Company is required to pay property taxes, utilities, insurance and other costs relating to the leased facilities.

The Company leases large commercial printers for our printing operation that supports our sales channels. The leases extend through December 2012. The annual lease payments are \$399,000, \$355,000, \$334,000, and \$283,000 for the years ended December 31, 2009, 2010, 2011 and 2012, respectively.

The following is a schedule by years of future minimum rental and lease payments required under operating lease that have initial or remaining non-cancelable lease terms in excess of one year as of December 31, 2008:

For the Years Ending  
December 31,

|                                 |              |
|---------------------------------|--------------|
| 2009                            | \$ 1,325,000 |
| 2010                            | 1,174,000    |
| 2011                            | 1,110,000    |
| 2012                            | 959,000      |
| 2013                            | 227,000      |
| Thereafter                      | -            |
| Total minimum payments required | \$ 4,795,000 |

Rent expense for the years ended December 31, 2008, 2007, and 2006 was \$956,000, \$464,000, and \$274,000, respectively.

There is no pending or threatened legal action that would have material adverse on the Company's consolidated financial position, results or operations or cash flows in future years.

## 10. INCOME TAXES

Significant components of the income tax benefit for the years ended December 31 are as follows:

|                    | 2008         | 2007         | (Restated)<br>2006 |
|--------------------|--------------|--------------|--------------------|
| <b>Current:</b>    |              |              |                    |
| Federal            | \$ 1,244,000 | \$ 926,000   | \$ 1,073,000       |
| State              | 467,000      | 307,000      | 327,000            |
| Total Current      | \$ 1,711,000 | \$ 1,233,000 | \$ 1,400,000       |
| <b>Deferred:</b>   |              |              |                    |
| Federal            | \$ 563,000   | \$ 371,000   | \$ 786,000         |
| State              | 141,000      | 102,000      | 121,000            |
| Total deferred     | 704,000      | 473,000      | 907,000            |
| Income tax expense | \$ 2,415,000 | \$ 1,706,000 | \$ 2,307,000       |

A reconciliation between the provisions for income taxes calculated at the U.S. federal statutory income tax rate and the consolidated income tax benefit in the consolidated statements of income for the years ended December 31 is as follows:

|  | 2008         | 2007         | (Restated)<br>2006 |
|--|--------------|--------------|--------------------|
| Provision at the U.S. federal statutory rate | \$ 2,681,000 | \$ 1,884,000 | \$ 2,537,000       |
| State taxes, net of federal benefit          | 473,000      | 277,000      | 371,000            |
| Intangible assets                            | (479,000)    | (377,000)    | (297,000)          |
| Other temporary differences                  | -            | -            | -                  |
| Amended tax return refund receivable         | (162,000)    | -            | -                  |
| Cost segregation study                       | -            | -            | (275,000)          |
| Permanent differences                        | (98,000)     | (78,000)     | (29,000)           |
| Income tax expense                           | \$ 2,415,000 | \$ 1,706,000 | \$ 2,307,000       |

Medifast, Inc.'s deferred income taxes reflect the net tax effect of temporary differences between the bases of assets and liabilities for financial reporting purposes and their bases for income tax purposes. Significant components of the Company's deferred tax liabilities and assets as of December 31 are as follows:

|                                    | 2008         | 2007       |
|------------------------------------|--------------|------------|
| <b>Deferred tax assets</b>         |              |            |
| Intangible assets                  | \$ 1,106,000 | \$ 872,000 |
| Accounts receivable                | 40,000       | 40,000     |
| Inventory overhead and write downs | 44,000       | 44,000     |
| Deferred compensation              | 41,000       | 41,000     |
| Total deferred tax assets          | \$ 1,231,000 | \$ 997,000 |
| <b>Deferred Tax Liabilities</b>    |              |            |
| Intangible assets                  | \$ -         | \$ -       |
| Accounts receivable                | -            | -          |
| Inventory overhead and write downs | -            | -          |
| Total deferred tax liabilities     | \$ -         | \$ -       |

The 2008 effective income tax rate of 30.8% differed from the federal statutory rate of 34% due to the amortization of intangible assets, timing differences for other temporary and permanent differences, and state income taxes.

The 2007 effective income tax rate of 30.8% differed from the federal statutory rate of 34% due to the amortization of intangible assets, timing differences for other temporary and permanent differences, and state income taxes.

The 2006 effective income tax rate of 30.9% differed from the federal statutory rate of 34% due to the amortization of intangible assets, a cost segregation study performed on fixed assets, as well as timing differences for other temporary and permanent differences, and state income taxes.

## 11. STOCK OPTION PLAN

On October 9, 1993 and as amended in May 1995, the Company adopted a stock option plan ("Plan") authorizing the grant of incentive and non-incentive options for an aggregate of 500,000 shares of the Company's common stock to officers, employees, directors and consultants. Incentive options are to be granted at fair market value. Options are to be exercisable as determined by the stock option committee.

In November 1997, June 2002 and July 2004, the Company amended the Plan by increasing the number of shares of the Company's common stock subject to the Plan by an aggregate of 200,000 shares, 300,000 shares and 250,000 shares respectively.

The following summarizes the stock option activity for the years ended December 31:

|                                  | 2008    |                                 | 2007    |                                 | 2006    |                                 |
|----------------------------------|---------|---------------------------------|---------|---------------------------------|---------|---------------------------------|
|                                  | Shares  | Weighted Average Exercise Price | Shares  | Weighted Average Exercise Price | Shares  | Weighted Average Exercise Price |
| Outstanding at beginning of year | 291,300 | \$ 4.19                         | 321,579 | \$ 3.88                         | 359,727 | \$ 2.71                         |

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|                                 |           |         |          |         |           |    |        |
|---------------------------------|-----------|---------|----------|---------|-----------|----|--------|
| Options granted                 | -         |         | -        |         | 100,000   |    | 6.25   |
| Options reinstated              | -         |         | -        |         | 16,666    |    | 6.36   |
| Options exercised               | (28,334)  | 0.50    | (27,500) | 0.89    | (128,147) |    | (2.11) |
| Options forfeited or expired    | (119,632) | 6.39    | (2,779)  | 1.60    | (26,667)  |    | (8.36) |
| Outstanding at end of year      | 143,334   | \$ 3.00 | 291,300  | \$ 4.19 | 321,579   | \$ | 3.88   |
| Options exercisable at year end | 143,334   | \$ 3.00 | 211,300  | \$ 3.35 | 211,577   | \$ | 2.77   |

The weighted average fair value at date of grant for options granted during the year 2006 was \$6.25. No stock options were granted in 2007 and 2008.

In 2005, the Company incorrectly cancelled 75,000 options to a former consultant. The options were correctly added back to the 2006 option schedule above. The omission from the schedule in prior year had no impact on earnings per share. During 2007, the former consultant exercised 25,000 options and during 2008 the consultant exercised the remaining 25,000 options.

The following table summarizes information about stock options outstanding and exercisable at December 31, 2008:

| Range of Exercise Prices | Options Outstanding |  |                                 | Options Exercisable |                                 |  |
|--------------------------|---------------------|--|---------------------------------|---------------------|---------------------------------|--|
|                          | Number Outstanding  | Weighted Average Contractual Life Remaining (in Years) | Weighted Average Exercise Price | Number Exercisable  | Weighted Average Exercise Price |  |
| \$ 2.87                  | 123,334             | 1.25   | \$ 2.87                         | 123,334             | \$ 2.87                         |  |
| \$ 3.83                  | 20,000              | 1.83   | \$ 3.83                         | 20,000              | \$ 3.83                         |  |
|                          | 143,334             |  | \$ 3.00                         | 143,334             | \$ 3.00                         |  |

## 12. LONG-TERM DEBT AND LINE OF CREDIT

Long-term debt as of December 31, 2008 and 2007, consist of the following:

|   | 2008         | 2007         |
|---|--------------|--------------|
| \$200,000 five-year term loan secured by equipment fixed rate was 3% at December 31, 2008. Due 2008   | -            | 7,000        |
| \$475,000 seven-year loan secured by the building and land at a variable rate at LIBOR plus 250 bps, which was 2.94% on December 31, 2008. Due 2011 | 332,000      | 364,000      |
| \$7,500,000 revolving line of credit at the LIBOR rate plus 1.3%, which was 1.74% at December 31, 2008  | 3,164,000    | 1,599,000    |
| \$3,000,000 ten-year term loan, with Merrill Lynch at LIBOR plus 1.3%, this was 1.74% at December 31, 2008. Due 2017                                | 2,825,000    | 2,975,000    |
| \$1,500,000 ten-year term loan, with Merrill Lynch at LIBOR plus 1.3%, this was 1.74% at December 31, 2008. Due 2017                                | 1,413,000    | 1,488,000    |
|   | 7,734,000    | 6,433,000    |
| Less current portion  | 3,421,000    | 1,863,000    |
|   | \$ 4,313,000 | \$ 4,570,000 |

Future principal payments on long-term debt for the next 5 years are as follows:

|      |              |
|------|--------------|
| 2009 | \$ 3,420,000 |
|------|--------------|

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|            |              |
|------------|--------------|
| 2010       | 257,000      |
| 2011       | 494,000      |
| 2012       | 225,000      |
| 2013       | 225,000      |
| Thereafter | 3,113,000    |
|            | \$ 7,734,000 |

The Company has established a \$7.5 million revolving line of credit at LIBOR plus 1.30% with Merrill Lynch. The outstanding balance on our line of credit was \$3,164,000 and \$1,599,000 at December 31, 2008 and 2007, respectively. Effective September 27, 2007, the 10-year term loan with an original balance of \$3,539,000; the 3-year loan with an original balance of \$366,000; and the line of credit balance with Mercantile Safe Deposit and Trust Company was refinanced by Merrill Lynch into two ten year term loans for \$1,500,000 and \$3,000,000. These loans are at LIBOR plus 1.3%, which was 1.74% on December 31, 2008. The loans are secured by two buildings, together with an assignment of rents and security interest upon all fixtures now or hereafter located in the two buildings.

### 13. EMPLOYMENT AGREEMENTS

The Board of Directors of Medifast, Inc. implemented a management succession plan which occurred over the last 24 months. In doing so, they had 3 key executive officers sign 6-year employment contracts to ensure that there will be minimal turnover in selected key management positions. The Executives associated with this succession plan include Michael S. McDevitt, Chief Executive Officer and Chief Financial Officer, Margaret MacDonald, Chief Operating Officer and President, and Brendan Connors, CPA, VP of Finance. Bradley T. MacDonald, the Executive Chairman of the Board of Directors has signed and executed a new 5 year employment agreement as the Executive Chairman of the Board of Directors and will provide on-going executive mentoring, financial and M&A advice, and new business development for the Company.

On February 8, 2006, three executive officers of the Company signed 6-year employment contracts. The officers received shares of common stock in varying amounts totaling 380,000 shares at \$6.25 per share that will be vested over 6 years. In addition, Bradley T. MacDonald, Chairman and CEO signed a new 5-year employment agreement and was granted 100,000 stock options at \$6.25 that will vest over 5 years beginning on February 8, 2007. The Board of Directors cancelled the 100,000 options granted to Mr. MacDonald on February 8, 2006 and replaced them with a restricted stock grant of 42,000 shares. The restricted shares will vest over a period of 3 years beginning on January 25, 2009.

### 14. WARRANTS

During 2003, the Company issued 200,000 warrants to James Paradis and Anthony Burrascono, both affiliated with Villanova University and 200,000 warrants to an investment banker, for advisory and consulting services provided to the Company. The warrants vest in five equal installments of 40,000 warrants per year over a five-year period. These are five-year warrants to purchase common shares at an exercise price of \$4.80 per share. These warrants may be cancelled, with a 90-day notice, if the consultants fail to perform to the satisfaction of the Company. During 2005, 120,000 unvested warrants issued to James Paradis and Anthony Burrascono were cancelled. In 2006, James Paradis and Anthony Burrascono exercised 80,000 warrants at \$4.80. In 2005, the Company incorrectly cancelled 80,000 warrants to a former consultant. The warrants were correctly added back to the 2006 warrant schedule. The omission from the schedule in prior year had no impact on earnings per share. During 2007, the former consultant exercised 40,000 warrants and 80,000 remain outstanding.

During 2003, the Company issued 50,000 warrants to Consumer Choices Systems, Inc. ("CCS") as part of the payment for the purchase of the assets of CCS. These warrants are three-year warrants to purchase common shares at an exercise price of \$10.00 per share. Of this amount, 25,000 warrants were exercised in 2004. Of the remaining 25,000 warrants, 22,810 were exercised in 2006 and the remaining 2,190 expired.

During 2003, the Company issued 63,750 warrants and 18,750 warrants to Mainfield Enterprises, Inc. and Portside Growth & Opportunity Fund. These warrants are five-year warrants to purchase common shares at exercise prices of \$16.78 per share, which was equal to one hundred fifteen percent (115%) of the five-day volume weighted average price, all pursuant to the terms of that certain Securities Purchase Agreement by and between the Company and

Mainfield Enterprises, Inc. and Portside Growth & Opportunity Fund dated as of July 24, 2003.

During 2008, there were no warrants exercised.

The Company has the following warrants outstanding for the purchase of its common stock:

| Exercise Price | Expiration Date                 | Years Ended |                      |         |
|----------------|---------------------------------|-------------|----------------------|---------|
|                |                                 | 2007        | December 31,<br>2007 | 2006    |
| \$ 4.80        | January, 2009                   | 80,000      | 80,000               | 120,000 |
| \$ 16.78       | July, 2008                      | -           | 82,500               | 82,500  |
|                |                                 | 80,000      | 162,500              | 202,500 |
|                | Weighted average exercise price | 4.80        | 10.88                | 9.68    |

As of December 31, 2008, 40,000 of the warrants are exercisable. The weighted average exercise price of exercisable warrants is \$4.80.



## 15. 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 December 31, 2008.

Fair Value Measurements on a Recurring Basis as of December 31, 2008

| Assets                   | Level I             | Level II    | Level III   | Total               |
|--------------------------|---------------------|-------------|-------------|---------------------|
| Investment securities    | \$ 1,099,000        | -           | -           | \$ 1,099,000        |
| Cash equivalents         | 1,841,000           | -           | -           | 1,841,000           |
| <b>Total Assets</b>      | <b>\$ 2,940,000</b> | <b>\$ -</b> | <b>\$ -</b> | <b>\$ 2,940,000</b> |
| Liabilities              | -                   | -           | -           | -                   |
| <b>Total Liabilities</b> | <b>\$ -</b>         | <b>\$ -</b> | <b>\$ -</b> | <b>\$ -</b>         |

## 16. RESTATEMENT

The December 31, 2006 financial statements have been restated to decrease amortization expense on customer lists by \$125,000. Pre-tax income increased by \$125,000 from \$7,338,000 to \$7,463,000 for the year-ended December 31, 2006. Net income for the year ended December 31, 2006 increased by \$74,000 from \$5,082,000 to \$5,156,000 and retained earnings increased from \$5,907,000 to \$5,981,000.

## 17. 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. 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.



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The following tables' present segment information for the years ended December 31, 2008, 2007, and 2006:

|  | Year Ended December 31, 2008 |                |              | Consolidated   |
|--|------------------------------|----------------|--------------|----------------|
|  | Medifast                     | All Other      | Eliminations |                |
| Revenues, net                                      | \$ 97,116,000                | \$ 8,329,000   |              | \$ 105,445,000 |
| Cost of Sales                                      | 23,611,000                   | 1,721,000      |              | 25,332,000     |
| Other Selling, General and Administrative Expenses | 59,334,000                   | 8,138,000      |              | 67,472,000     |
| Depreciation and Amortization                      | 3,613,000                    | 961,000        |              | 4,574,000      |
| Interest (net)                                     | 39,000                       | 178,000        |              | 217,000        |
| Provision for income taxes                         | 2,415,000                    | -              |              | 2,415,000      |
| Net income (loss)                                  | \$ 8,104,000                 | \$ (2,669,000) | -            | \$ 5,435,000   |
| Segment Assets                                     | \$ 34,754,000                | \$ 16,282,000  |              | \$ 51,036,000  |

|  | Year Ended December 31, 2007 |                |              | Consolidated  |
|--|------------------------------|----------------|--------------|---------------|
|  | Medifast                     | All Other      | Eliminations |               |
| Revenues, net                                      | \$ 78,861,000                | \$ 4,918,000   |              | \$ 83,779,000 |
| Cost of Sales                                      | 20,364,000                   | 1,100,000      |              | 21,464,000    |
| Other Selling, General and Administrative Expenses | 48,248,000                   | 4,769,000      |              | 53,017,000    |
| Depreciation and Amortization                      | 2,527,000                    | 944,000        |              | 3,471,000     |
| Interest (net)                                     | 78,000                       | 205,000        |              | 283,000       |
| Provision for income taxes                         | 1,707,000                    | -              |              | 1,707,000     |
| Net income (loss)                                  | \$ 5,937,000                 | \$ (2,100,000) | -            | \$ 3,837,000  |
| Segment Assets                                     | \$ 26,023,000                | \$ 17,701,000  |              | \$ 43,724,000 |

|  | Year Ended December 31, 2006 (Restated) |               |              | Consolidated  |
|--|---|---------------|--------------|---------------|
|  | Medifast                                | All Other     | Eliminations |               |
| Revenues, net                                      | \$ 70,181,000                           | \$ 4,015,000  | \$ (110,000) | \$ 74,086,000 |
| Cost of Sales                                      | 17,290,000                              | 947,000       |              | 18,237,000    |
| Other Selling, General and Administrative Expenses | 42,418,000                              | 3,503,000     |              | 45,921,000    |
| Depreciation and Amortization                      | 1,811,000                               | 460,000       |              | 2,271,000     |
| Interest (net)                                     | 146,000                                 | 48,000        |              | 194,000       |
| Provision for income taxes                         | 2,298,000                               | 9,000         |              | 2,307,000     |
| Net income (loss)                                  | \$ 6,218,000                            | \$ (952,000)  | (110,000)    | \$ 5,156,000  |
| Segment Assets                                     | \$ 21,978,000                           | \$ 14,949,000 |              | \$ 36,927,000 |

## 18. QUARTERLY RESULTS (Unaudited)

|                                     | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|-------------------------------------|---------------|----------------|---------------|----------------|
| <b>2008</b>                         |               |                |               |                |
| Revenue                             | \$ 25,169,000 | \$ 27,537,000  | \$ 27,281,000 | \$ 25,458,000  |
| Gross Profit                        | 19,069,000    | 20,860,000     | 20,759,000    | 19,425,000     |
| Operating Income                    | 2,062,000     | 2,409,000      | 2,396,000     | 1,332,000      |
| Net Income                          | 1,365,000     | 1,572,000      | 1,549,000     | 949,000        |
| Earnings per common share - diluted | 0.10          | 0.11           | 0.11          | 0.07           |
| <b>2007</b>                         |               |                |               |                |
| Revenue                             | \$ 20,089,000 | \$ 22,041,000  | \$ 21,846,000 | \$ 19,803,000  |
| Gross Profit                        | 15,031,000    | 16,678,000     | 16,323,000    | 14,283,000     |
| Operating Income                    | 1,914,000     | 1,445,000      | 1,557,000     | 799,000        |
| Net Income                          | 1,373,000     | 909,000        | 954,000       | 601,000        |
| Earnings per common share - diluted | 0.10          | 0.07           | 0.07          | 0.04           |

(1) -Earnings per common share is computed independently for each of the quarters presented; accordingly, in the sum of the quarterly earnings per common share may not equal the total computed for the year.

INDEX TO EXHIBITS

- No.
- 3.1 Certificate of Incorporation of the Company and amendments thereto\*
- 3.2 By-Laws of the Company\*
- 10.1 1993 Stock Option Plan of the Company as amended\*
- 10.3 Lease relating to the Company's Owings Mills, Maryland facility\*\*
- 10.4 Employment agreement with Bradley T. MacDonald\*\*\*
- 10.5 Employment agreement with Bradley T. MacDonald signed February 8, 2006
- 10.6 Employment agreement with Michael S. McDevitt signed February 8, 2006
- 10.7 Employment agreement with Margaret MacDonald signed February 8, 2006
- 10.8 Employment agreement with Brendan N. Connors signed February 8, 2006
- 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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\*Filed as an exhibit to and incorporated by reference to the Registration Statement on Form SB-2 of the Company, File No. 33-71284-NY.

\*\*Filed as an exhibit to and incorporated by reference to the Registration Statement on Form S-4 of the Company, File No. 33-81524.

\*\*\* Filed as an exhibit to 10KSB, dated April 15, 1999 of the Company, file No. 000-23016.

(b) Reports on Form 8-K

January 17, 2006, to report the sale of Consumer Choice Systems assets, the promotion of Michael S. McDevitt to Chief Financial Officer, and 2006 financial guidance

August 14, 2006, to report the acceptance by the New York Stock Exchange to list common shares on the NYSE

September 25, 2006, to report the results of the Annual Meeting of Shareholder on September 8, 2006

October 2, 2006, to announce the election of two new Board of Directors

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March 1, 2007, to announce Michael S. McDevitt promoted to CEO, Margaret MacDonald promoted to President and COO, and Bradley T. MacDonald named Executive Chairman of the Board.

March 7, 2007, to announce full-year 2007 revenue and diluted earnings per share guidance

June 12, 2007, to announce the election of a new Board member

September 24, 2007, to announce the results of the Annual Meeting of Shareholders on September 7, 2007

October 4, 2007, to announce updated full-year 2007 revenue and diluted earnings per share guidance

December 26, 2007, to announce receipt of notice from New York Stock Exchange concerning listing criteria

March 12, 2008, to announce financial results for the quarter and year ended December 31, 2007

May 9, 2008, to announce the election of a new Board member

June 25, 2008, to announce the election of a new Board member

December 17, 2008, to announce updated 2008 revenue guidance

February 19, 2009, Company response to false claims

March 5, 2009, to announce the election of two new Board members

March 12, 2009, to announce 2008 revenue and earnings and provided 2009 sales trending YTD

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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)

BRADLEY T.  
MACDONALD  
Bradley T.  
MacDonald  
Executive  
Chairman of the  
Board  
Dated: March  
16, 2009

Pursuant to the requirements of the Securities Exchange Act of 1934, the following persons on behalf of the Registrant and in the capacities and on the dates indicated have signed this Report below.

| Name   | Title                              | Date           |
|--|------------------------------------|----------------|
| /s/ BRADLEY T. MACDONALD<br>Bradley T. MacDonald             | Chairman of the Board,<br>Director | March 16, 2009 |
| /s/ GEORGE J. LAVIN, ESQ.<br>George J. Lavin, Esq.           | Director                           | March 16, 2009 |
| /s/ MICHAEL C. MACDONALD<br>Michael C. MacDonald             | Director                           | March 16, 2009 |
| /s/ MARY T. TRAVIS<br>Mary T. Travis                         | Director                           | March 16, 2009 |
| /s/ REV. DONALD F. REILLY, OSA<br>Rev. Donald F. Reilly, OSA | Director                           | March 16, 2009 |
| /s/ MICHAEL S. MCDEVITT<br>Michael S. McDevitt               | Director                           | March 16, 2009 |
| /s/ JOSEPH D. CALDERONE<br>Joseph D. Calderone               | Director                           | March 16, 2009 |
| /s/ CHARLES P. CONNOLLY<br>Charles P. Connolly               | Director                           | March 16, 2009 |
| /s/ DENNIS M. MCCARTHY, ESQ.                                 | Director                           | March 16, 2009 |

Dennis M. McCarthy

/s/ BARRY B. BONDROFF, CPA  
Barry B. Bondroff, CPA

Director

March 16, 2009

/s/ JEANNETTE M. MILLS  
Jeannette M. Mills

Director

March 16, 2009

/s/ MARGARET MACDONALD - SHEETZ  
Margaret MacDonald Sheetz

Director

March 16, 2009

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