MEDIFAST INC
Form 10-Q
May 04, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2018

OR

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

For the transition period from to .

Commission File Number: 001-31573

Medifast, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**13-3714405**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

100 International Drive
Baltimore, Maryland 21202
Telephone Number: (410) 581-8042

(Address of Principal Executive Offices, Zip Code and Telephone Number, Including Area Code)

Indicate by checkmark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer o   Accelerated filer x   Non-accelerated filer o   Smaller reporting company o

Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

Yes o No x

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

The number of shares of the registrant's common stock outstanding at April 27, 2018 was 12,062,532.

Medifast, Inc. and subsidiaries

Index

Part 1 – Financial Information:

MEDIFAST, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

(in thousands, except per share amounts & dividend data)

	Three months ended March 31, 2018	2017
Revenue	$98,596	$70,622
Cost of sales	23,788	17,730
Gross profit	74,808	52,892
Selling, general, and administrative	60,125	44,283
Income from operations	14,683	8,609
Other income (expense)		
Interest income, net	249	63
Other income (expense)	(1)	39
	248	102
Income from operations before income taxes	14,931	8,711
Provision for income taxes	2,709	2,566
Net income	$12,222	$6,145
Earnings per share - basic	$1.02	$0.52
Earnings per share - diluted	$1.01	$0.51
Weighted average shares outstanding -		
Basic	12,030	11,901
Diluted	12,139	12,009
Cash dividends declared per share	$0.48	$0.32

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

MEDIFAST, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

(in thousands)

	Three months ended March 31, 2018	2017
Net income	$12,222	$6,145
Other comprehensive income (loss), net of tax:		
Foreign currency translation	-	2
Unrealized gains (losses) on marketable securities:		
Change in fair value of marketable securities	(84)	124
Adjustment for net losses realized and included in net income	-	10
Total change in unrealized gains (losses) on marketable securities	(84)	134
Other comprehensive income (loss)	(84)	136
Comprehensive income	$12,138	$6,281

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

MEDIFAST, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

(in thousands, except par value)

	March 31, 2018	December 31, 2017
ASSETS		
Current Assets		
Cash and cash equivalents	$86,963	$75,077
Accounts receivable-net of doubtful accounts of $98 at March 31, 2018 and allowance for sales returns and doubtful accounts of $597 at December 31, 2017	1,025	576
Inventory	17,288	19,328
Investment securities	22,278	23,757
Income taxes, prepaid	-	2,272
Prepaid expenses and other current assets	3,577	4,188
Total current assets	131,131	125,198
Property, plant and equipment - net	18,358	18,611
Other assets	1,902	2,120
Deferred tax assets	426	-
TOTAL ASSETS	$151,817	$145,929
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Accounts payable and accrued expenses	$38,187	$37,140
Total current liabilities	38,187	37,140
Deferred tax liabilities	-	208
Total liabilities	38,187	37,348
Stockholders' Equity		
Common stock, par value $.001 per share: 20,000 shares authorized; 12,139 and 12,103 issued and 12,063 and 11,971 outstanding at March 31, 2018 and December 31, 2017, respectively	12	12
Additional paid-in capital	6,369	4,967
Accumulated other comprehensive loss	(244)	(160)
Retained earnings	108,243	103,762
Less: Treasury stock at cost, 9 shares at March 31, 2018	(750)	-
Total stockholders' equity	113,630	108,581
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$151,817	$145,929

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

MEDIFAST, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

(in thousands)

	Three months ended March 31, 2018	2017
Operating Activities		
Net income	$12,222	$6,145
Adjustments to reconcile net income to cash provided by operating activities		
Depreciation and amortization	1,544	1,076
Share-based compensation	805	957
Loss (gain) on sale of disposal of property, plant and equipment	214	(49)
Realized loss on investment securities, net	57	60
Amortization of premium on investment securities	153	194
Deferred income taxes	(105)	(242)
Change in operating assets and liabilities:		
Accounts receivable	108	(102)
Inventory	2,942	(1,572)
Income taxes, prepaid	2,738	865
Prepaid expenses and other current assets	727	577
Other assets	(1)	(4)
Accounts payable and accrued expenses	(3,396)	(1,222)
Net cash flow provided by operating activities	18,008	6,683
Investing Activities		
Sale of investment securities	1,200	760
Purchase of investment securities	-	(1,365)
Sale of property and equipment	-	59
Purchase of property and equipment	(1,286)	(470)
Net cash flow used in investing activities	(86)	(1,016)
Financing Activities		
Options exercised by executives and directors	62	568
Net shares repurchased for employee taxes	(215)	(825)
Cash dividends paid to stockholders	(5,883)	(3,878)
Net cash flow used in financing activities	(6,036)	(4,135)
Foreign currency impact	-	2
Increase in cash and cash equivalents	11,886	1,534
Cash and cash equivalents - beginning of the period	75,077	52,436
Cash and cash equivalents - end of period	$86,963	$53,970

Supplemental disclosure of cash flow information:		
Income taxes paid	$-	$1,928
Dividends declared included in accounts payable	$5,943	$3,991

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

MEDIFAST, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (UNAUDITED)

(in thousands)

	Three months ended March 31, 2018						
	Number of Shares Issued	Common Stock	Additional Paid-In Capital	Accumulated other comprehensive loss	Retained Earnings	Treasury Stock	Total
Balance, January 1, 2018, as reported	12,103	$ 12	$ 4,967	$ (160)	$ 103,762	$ -	$ 108,581
Cumulative effect adjustments from changes in accounting standards (Note 1 and 2)	-	-	-	-	(2,018)	-	(2,018)
Balance January 1, 2018, as adjusted	12,103	12	4,967	(160)	101,744	-	106,563
Net income	-	-	-	-	12,222	-	12,222
Share-based compensation	16	-	805	-	-	-	805
Options exercised by executives and directors	14	-	62	-	-	-	62
Net shares repurchased for employee taxes	(3)	-	(215)	-	-	-	(215)
Treasury stock from cashless options	9	-	750	-	-	(750)	-
Other comprehensive income	-	-	-	(84)	-	-	(84)
Cash dividends declared to stockholders	-	-	-	-	(5,723)	-	(5,723)
Balance, March 31, 2018	12,139	$ 12	$ 6,369	$ (244)	$ 108,243	$ (750)	$ 113,630

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

MEDIFAST, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation - The accompanying unaudited condensed consolidated financial statements of Medifast, Inc. and its wholly-owned subsidiaries (the "Company," "we," "us," or "our") included herein have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP"), for interim information and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC") for reporting on Form 10-Q. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. However, in the opinion of management, all adjustments consisting of normal, recurring adjustments considered necessary for a fair presentation of the financial position and results of operations have been included and management believes the disclosures that are made are adequate to make the information presented not misleading. The condensed consolidated balance sheet at December 31, 2017 has been derived from the audited consolidated financial statements at that date.

The results of operations for the three months ended March 31, 2018 are not necessarily indicative of results that may be expected for the fiscal year ending December 31, 2018. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the 2017 audited consolidated financial statements and notes thereto, which are included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017 ("2017 Form 10-K").

Presentation of Financial Statements - The unaudited condensed consolidated financial statements included herein include the accounts of the Medifast, Inc. and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated.

Use of Estimates - The preparation of financial statements in conformity with GAAP 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 reported amounts of revenue and expenses during the reporting period. Actual results could differ materially from those estimates.

Accounting Pronouncements Adopted in 2018 –

In May 2014, the FASB issued ASU 2014-09*, Revenue from Contracts with Customers (Topic 606)*. The new revenue recognition standard requires the Company to recognize revenue for the transfer of goods or services to customers for the amount the Company expects to be entitled to receive in exchange for those goods or services. The Company is required to identify the contract, identify the relevant performance obligations, determine the transaction price, allocate the transaction price to the performance obligations in the contract, and recognize the revenue when the entity satisfies a performance obligation. Companies have the option of using either a full retrospective or a modified retrospective approach to adopt the guidance. On January 1, 2018, the Company adopted the new revenue standard on a modified retrospective basis and recorded an after-tax transition adjustment to reduce retained earnings as of January 1, 2018 by $2.0 million. This is comprised of $5.6 million of revenue offset by $3.6 million of inventory costs, deferred shipping expense, credit card fees and income taxes. The results of *ASU 606* primarily impact the Company's timing of revenue recognition for product shipments, as product revenue is recognized upon customer receipt in lieu of at the time of shipment. The new standard requires more extensive revenue-related disclosures.

As required by ASC 606, the impact of the adoption of the new revenue standard on our Condensed Consolidated Statements of Income and Condensed Consolidated Balance Sheets was as follows (in thousands):

	Three months ended March 31, 2018		
	As Reported	Balances without adoption of ASC 606	Effect of Change
Revenue	$98,596	$97,254	$1,342
Cost of sales	23,788	23,521	(267)
Gross profit	74,808	73,733	1,075
Selling, general, and administrative	60,125	59,523	(602)
Income from operations	14,683	14,210	473
Other income (expense)			
Interest income, net	249	249	-
Other income (expense)	(1)	(1)	-
	248	248	-
Income from operations before income taxes	14,931	14,458	473
Provision for income taxes	2,709	2,608	(101)
Net income	$12,222	$11,850	$372
Earnings per share - basic	$1.02	$0.99	$0.03
Earnings per share - diluted	$1.01	$0.98	$0.03
Weighted average shares outstanding -			
Basic	12,030	12,030	
Diluted	12,139	12,139	

	March 31, 2018		
	As Reported	Balances without adoption of ASC 606	Effect of Change
ASSETS			

Accounts receivable, net	$1,025	$92	$933
Inventory	17,288	16,624	664
Prepaid expenses and other current assets	3,577	3,491	86
Deferred tax assets	426	-	426
LIABILITIES			
Accounts payable and accrued expenses	38,187	34,416	3,771
Deferred tax liabilities	-	16	(16)
Stockholders' Equity			
Retained earnings	108,243	109,889	(1,646)

9

The cumulative effect of the changes made to our January 1, 2018 Condensed Consolidated Balance Sheet from the modified retrospective adoption of ASC 606 was as follows (in thousands):

	Balance at December 31, 2017	Adjustments due to ASC 606	Balance at January 1, 2018
ASSETS			
Accounts receivable, net	$ 576	$ 557	$ 1,133
Inventory	19,328	902	20,230
Prepaid expenses and other current assets	4,188	116	4,304
Deferred tax assets	-	336	336
LIABILITIES			
Accounts payable and accrued expenses	37,140	4,137	41,277
Deferred tax liabilities	208	(208)	-
Stockholders' Equity			
Retained earnings	103,762	(2,018)	101,744

Recent Accounting Pronouncements –

We have considered all new accounting pronouncements and have concluded that there are no new pronouncements that may have a material impact on our results of operations, financial condition, or cash flows, based on current information, except for:

ASU 2016-02, *Leases (Topic 842)* requires the rights and obligations of all leased assets with a term greater than 12 months to be presented on the balance sheet. The pronouncement is effective for fiscal years beginning after December 15, 2018. The Company currently expects that upon adoption of ASU 2016-02 right-to-use assets and lease liabilities will be recognized in the Company’s Consolidated Balance Sheet in amounts that will be material. Management is currently evaluating the effect that the provisions of ASU 2016-02 will have on the Company’s financial statements.

ASU 2018-02, *Income Statement Reporting - Comprehensive Income (Topic 220)* allows the reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from tax effects resulting from the Tax Cuts and Jobs Act and will improve the usefulness of information reported to financial statement users. However, because the amendments only relate to the reclassification of the income tax effects of the Tax Cuts and Jobs Act, the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations is not affected. The amendments in this Update are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Management is currently evaluating the effect that the provisions of ASU 2018-02 will have on the Company's financial statements.

2. REVENUE

Revenue recognition

Our revenue is derived primarily from point of sale transactions executed over an e-commerce platform for weight loss, weight management, and other consumable health and nutritional products and recognized upon receipt by customer and net of discounts, rebates, promotional adjustments, price adjustments, allocated consideration to loyalty programs and estimated returns.

Revenue is recognized when control of the promised products are transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for transferring those products. When determining whether the customer has obtained control the products, we consider any future performance obligations.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in ASC 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. Our contracts have performance obligations to fulfill and deliver products from the point of sale transaction along with the related customer reward programs.

Our performance obligations are satisfied at a point in time. Revenue from products transferred to customers at a point in time accounted for substantially all of our revenue for the three-month periods ended March 31, 2018 and 2017, respectively. Revenue on these contracts is recognized when obligations under the terms of the contract with our customer are satisfied. Generally, this occurs with the transfer of control upon receipt of products by our customers. Any consideration received prior to the fulfillment of the Company performance obligation is deferred and recognized as a liability.

Sales returns

Our return policy allows for customer returns within 30 days of purchase and upon our authorization. We adjust revenues for the products expected to be returned and a liability is recognized for expected refunds to customers. We estimate expected returns based on historical levels and project this experience into the future.

Customer reward programs and sales incentives

Our sales contracts may give customers the option to purchase additional products priced at a discount. Options to acquire additional products at a discount can come in many forms, such as customer reward programs and incentive offerings including pricing arrangements, and promotions.

We reduce the transaction price for certain customer reward programs and incentive offerings including pricing arrangements, promotions, incentives that represent variable consideration and separate performance obligations. The Company accounts for sales rewards as a separate performance obligation of the transactions, and therefore allocates consideration between the initial sale of products and the customer reward program and incentive offering.

Shipping and handling costs

Amounts billed to customers for shipping and handling activities are treated as a promised service performance obligation and recorded in revenue in the accompanying Condensed Consolidated Statements of Income upon fulfillment of the performance obligation. Shipping and handling costs incurred by the Company for the delivery of products to customers are considered a cost to fulfill the contract and are included in cost of sales in the accompanying Condensed Consolidated Statements of Income.

Contract costs

We expense sales commissions and credit card fees during the period in which the corresponding revenue is earned. These costs are deferred along with the revenues for goods that are in transit and not received by customers by period end. These costs are recorded in selling, general and administrative expense in the Condensed Consolidated Statements of Income.

Disaggregated revenue and entity-wide revenue disclosures

The nature, amount, timing, and uncertainty of revenue and cash flows from our revenues amongst contracts, product offerings and customers do not differentiate and are recognized consistently based on policies discussed above. In addition, effective January 1, 2018, we changed how we internally and externally report our revenues to simplify and align with changes in how we manage our business, review operating performance and allocate resources as a result of our primary focus on the **OPTA**VIA business and the significance this business represents to the overall results of the Company. We considered the following factors in determining this decision: the nature of business activities overlapping amongst previous defined sales channels, the management structure directly accountable to our chief operating decision maker for operating and administrative activities, and information presented to the Board of Directors and investors. We previously disclosed entity-wide disclosures for sales by channel: **OPTA**VIA, Medifast Direct, Franchise Medifast Weight Control Centers and Medifast Wholesale. Due to the interchangeable nature of these customers amongst sale channels, sales migration to **OPTA**VIA, and realignment of internal operations as discussed, future disclosure will not include revenues by sales channel.

3. INVENTORIES

Inventories consist principally of packaged meal replacements held in the Company’s warehouses. Inventory is stated at the lower of cost or net realizable value, 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.

Inventories consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Raw materials	$ 4,283	$ 4,348
Packaging	1,247	1,185
Non-food finished goods	1,034	920
Finished goods	10,958	13,407
Reserve for obsolete inventory	(234)	(532)
Total	$ 17,288	$ 19,328

4. EARNING PER SHARE

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

The following table sets forth the computation of basic and diluted EPS (in thousands, except per share data):

	Three months ended March 31,	
	2018	2017
Numerator:		
Net income	$12,222	$6,145
Denominator:		
Weighted average shares of common stock outstanding	12,030	