TIMKEN CO
Form 10-Q
August 05, 2010

Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

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

For the quarterly period ended June 30, 2010

OR

o **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: 1-1169

THE TIMKEN COMPANY

(Exact name of registrant as specified in its charter)

OHIO	**34-0577130**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1835 Dueber Ave., SW, Canton, OH	**44706-2798**
(Address of principal executive offices)	(Zip Code)

330.438.3000

(Registrant s telephone number, including area code)

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 þ 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

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

Class	Outstanding at June 30, 2010
Common Stock, without par value	96,740,681 shares

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION
- Item 1. Financial Statements
- Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations
- Item 3. Quantitative and Qualitative Disclosures about Market Risk
- Item 4. Controls and Procedures

Part II. Other Information
- Item 1. Legal Proceedings
- Item 1A. Risk Factors
- Item 2. Unregistered Sales of Equity Securities and Use of Proceeds
- Item 6. Exhibits

SIGNATURES
EX-3.1
EX-12
EX-31.1
EX-31.2
EX-32
EX-101 INSTANCE DOCUMENT
EX-101 SCHEMA DOCUMENT
EX-101 CALCULATION LINKBASE DOCUMENT
EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
THE TIMKEN COMPANY AND SUBSIDIARIES
Consolidated Statement of Income
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	**2010**	2009
(Dollars in millions, except per share data)				
Net sales	**$1,011.4**	$736.8	**$1,925.1**	$1,603.4
Cost of products sold	**743.1**	611.4	**1,434.1**	1,323.4
Gross Profit	**268.3**	125.4	**491.0**	280.0
Selling, general and administrative expenses	**140.7**	128.0	**273.7**	251.4
Impairment and restructuring charges	**1.0**	50.7	**6.5**	64.5
Operating Income (Loss)	**126.6**	(53.3)	**210.8**	(35.9)
Interest expense	**(10.0)**	(8.5)	**(19.6)**	(16.9)
Interest income	**0.9**	0.5	**1.5**	0.9
Other income (expense), net	**2.7**	(0.1)	**2.1**	7.9
Income (Loss) From Continuing Operations Before Income Taxes	**120.2**	(61.4)	**194.8**	(44.0)
Provision for (benefit from) income taxes	**38.2**	(23.0)	**84.1**	(4.2)
Income (Loss) From Continuing Operations	**82.0**	(38.4)	**110.7**	(39.8)
Income (loss) from discontinued operations, net of income taxes	**4.2**	(25.5)	**4.5**	(29.1)
Net Income (Loss)	**86.2**	(63.9)	**115.2**	(68.9)
Less: Net income (loss) attributable to noncontrolling interest	**0.6**	0.6	**1.0**	(5.3)
Net Income (Loss) Attributable to The Timken Company	**$ 85.6**	$ (64.5)	**$ 114.2**	$ (63.6)
Amounts Attributable to The Timken Company s Common Shareholders:				
Income (loss) from continuing operations, net of income taxes	**$ 81.4**	$ (39.0)	**$ 109.7**	$ (34.5)
Income (loss) from discontinued operations, net of income taxes	**4.2**	(25.5)	**4.5**	(29.1)
Net Income (Loss) Attributable to The Timken Company	**$ 85.6**	$ (64.5)	**$ 114.2**	$ (63.6)

Net Income (Loss) per Common Share Attributable to The Timken Company s Common Shareholders							
Earnings (loss) per share Continuing Operations	**$**	**0.84**	$ (0.40)	**$**	**1.13**	$	(0.36)
Earnings (loss) per share Discontinued Operations		**0.04**	(0.27)		**0.05**		(0.30)
Basic earnings (loss) per share	**$**	**0.88**	$ (0.67)	**$**	**1.18**	$	(0.66)
Diluted earnings (loss) per share Continuing Operations	**$**	**0.84**	$ (0.40)	**$**	**1.13**	$	(0.36)
Diluted earnings (loss) per share Discontinued Operations		**0.04**	(0.27)		**0.05**		(0.30)
Diluted earnings (loss) per share	**$**	**0.88**	$ (0.67)	**$**	**1.18**	$	(0.66)
Dividends per share	**$**	**0.13**	$ 0.09	**$**	**0.22**	$	0.27

See accompanying Notes to the Consolidated Financial Statements.

1

Table of Contents

Consolidated Balance Sheet

(Dollars in millions, except share data)	(Unaudited) June 30, 2010	December 31, 2009
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 796.2**	$ 755.5
Accounts receivable, less allowances: 2010 - $31.0 million; 2009 - $41.6 million	**500.3**	411.2
Inventories, net	**699.5**	671.2
Deferred income taxes	**60.3**	61.5
Deferred charges and prepaid expenses	**13.0**	11.8
Other current assets	**45.0**	111.3
Total Current Assets	**2,114.3**	2,022.5
Property, Plant and Equipment Net	**1,263.5**	1,335.2
Other Assets		
Goodwill	**218.3**	221.7
Other intangible assets	**127.5**	132.1
Deferred income taxes	**234.7**	248.6
Other non-current assets	**46.8**	46.7
Total Other Assets	**627.3**	649.1
Total Assets	**$4,005.1**	$4,006.8
LIABILITIES AND EQUITY		
Current Liabilities		
Short-term debt	**$ 5.0**	$ 26.3
Accounts payable	**220.5**	156.0
Salaries, wages and benefits	**183.4**	142.5
Deferred income taxes	**9.0**	9.2
Other current liabilities	**160.6**	189.3
Current portion of long-term debt	**12.3**	17.0
Total Current Liabilities	**590.8**	540.3
Non-Current Liabilities		
Long-term debt	**476.1**	469.2
Accrued pension cost	**568.2**	690.9
Accrued postretirement benefits cost	**597.6**	604.2
Deferred income taxes	**6.2**	6.1
Other non-current liabilities	**107.9**	100.4

Total Non-Current Liabilities	**1,756.0**	1,870.8
Shareholders Equity		
Class I and II Serial Preferred Stock without par value:		
Authorized - 10,000,000 shares each class, none issued		
Common stock without par value:		
Authorized - 200,000,000 shares		
Issued (including shares in treasury) (2010 - 98,153,317 shares; 2009 - 97,034,033 shares)		
Stated capital	**53.1**	53.1
Other paid-in capital	**874.5**	843.5
Earnings invested in the business	**1,495.8**	1,402.9
Accumulated other comprehensive loss	**(743.8)**	(717.1)
Treasury shares at cost (2010 - 1,412,636 shares; 2009 - 179,963 shares)	**(39.9)**	(4.7)
Total Shareholders Equity	**1,639.7**	1,577.7
Noncontrolling Interest	**18.6**	18.0
Total Equity	**1,658.3**	1,595.7
Total Liabilities and Equity	**$4,005.1**	$4,006.8

See accompanying Notes to the Consolidated Financial Statements.

Consolidated Statement of Cash Flows
(Unaudited)

	Six Months Ended June 30,	
	2010	2009
(Dollars in millions)		
CASH PROVIDED (USED)		
Operating Activities		
Net income (loss) attributable to The Timken Company	**$ 114.2**	$ (63.6)
(Earnings) loss from discontinued operations	**(4.5)**	29.1
Net income (loss) attributable to noncontrolling interest	**1.0**	(5.3)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	**95.2**	101.8
Impairment charges		34.9
Loss on disposals of property, plant and equipment	**2.3**	0.5
Deferred income tax provision (benefit)	**17.1**	(0.8)
Stock based compensation expense	**8.5**	8.2
Pension and other postretirement expense	**45.9**	47.7
Pension contributions and other postretirement benefit payments	**(133.6)**	(34.7)
Changes in operating assets and liabilities:		
Accounts receivable	**(103.8)**	143.1
Inventories	**(45.7)**	204.1
Accounts payable and accrued expenses	**82.9**	(186.3)
Income taxes	**66.1**	(22.1)
Other net	**13.9**	(3.9)
Net Cash Provided by Operating Activities Continuing Operations	**159.5**	252.7
Net Cash Provided by Operating Activities Discontinued Operations	**4.5**	0.7
Net Cash Provided By Operating Activities	**164.0**	253.4
Investing Activities		
Capital expenditures	**(39.0)**	(53.3)
Acquisitions		(0.3)
Proceeds from disposals of property, plant and equipment	**0.5**	3.5
Other	**1.1**	1.9
Net Cash Used by Investing Activities Continuing Operations	**(37.4)**	(48.2)
Net Cash Used by Investing Activities Discontinued Operations		(1.0)
Net Cash Used by Investing Activities	**(37.4)**	(49.2)
Financing Activities		
Cash dividends paid to shareholders	**(21.3)**	(26.1)
Net proceeds from common share activity	**19.4**	
Purchase of treasury shares	**(29.2)**	

Proceeds from issuance of long-term debt	**11.0**	
Payments on long-term debt	**(9.0)**	(10.3)
Short-term debt activity net	**(20.8)**	(32.1)
Net Cash Used by Financing Activities	**(49.9)**	(68.5)
Effect of exchange rate changes on cash	**(36.0)**	8.0
Increase In Cash and Cash Equivalents	**40.7**	143.7
Cash and cash equivalents at beginning of year	**755.5**	133.4
Cash and Cash Equivalents at End of Period	**$ 796.2**	$ 277.1

See accompanying the Notes to the Consolidated Financial Statements.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(Dollars in millions, except share and per share data)
Note 1 Basis of Presentation
The accompanying Consolidated Financial Statements (unaudited) for The Timken Company (the Company) have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and notes required by the accounting principles generally accepted in the United States (U.S. GAAP) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) and disclosures considered necessary for a fair presentation have been included. For further information, refer to the Consolidated Financial Statements and notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009. Certain amounts in the 2009 Consolidated Financial Statements have been reclassified to conform to the 2010 presentation.
During the first quarter of 2009, the Company recorded two adjustments related to its 2008 Consolidated Financial Statements. Net income (loss) attributable to noncontrolling interest increased by $6.1 million (after-tax) due to a correction of an error related to the $18.4 million goodwill impairment loss the Company recorded in the fourth quarter of 2008 for the Mobile Industries segment. In recording this goodwill impairment loss, the Company did not recognize that a portion of the loss related to two separate subsidiaries in India and South Africa of which the Company holds less than 100% ownership. In addition, income (loss) from continuing operations before income taxes decreased by $3.4 million, or $0.04 per share, ($2.0 million after-tax or $0.02 per share) due to a correction of an error related to $3.4 million of in-process research and development costs that were recorded in other current assets with the anticipation of being paid for by a third-party. However, the Company subsequently realized that the balance could not be substantiated through a contract with a third party. The net effect of these errors understated 2008 net income attributable to The Timken Company of $267.7 million by $4.1 million. Furthermore, the net effect of these errors overstated the Company s first quarter 2009 net income attributable to The Timken Company of $0.9 million by $4.1 million. Had these adjustments been recorded in the fourth quarter of 2008, rather than the first quarter of 2009, the results for the first quarter of 2009 would have been a net loss attributable to The Timken Company of $3.2 million. Management of the Company concluded the effect of the first quarter adjustments was immaterial to the Company s 2008 and first-quarter 2009 financial statements, as well as to the full-year 2009 financial statements.
Note 2 New Accounting Pronouncements
In June 2009, the Financial Accounting Standards Board (FASB) issued new accounting guidance that amended the accounting and disclosure requirements for the consolidation of variable interest entities. The implementation of the new accounting guidance related to variable interest entities, effective January 1, 2010, did not have a material impact on the Company s results of operations and financial condition.
Note 3 Inventories

	June 30, 2010	December 31, 2009
Inventories, net:		
Manufacturing supplies	**$ 54.8**	$ 53.0
Work in process and raw materials	**342.6**	269.1
Finished products	**302.1**	349.1
Total Inventories, net	**$699.5**	$ 671.2

An actual valuation of the inventory under the last-in, first-out (LIFO) method can be made only at the end of each year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations must be based on management s estimates of expected year-end inventory levels and costs. Because these calculations are subject to many factors beyond management s control, annual results may differ from interim results as they are subject to the

final year-end LIFO inventory valuation. The LIFO reserve at June 30, 2010 and December 31, 2009 was $244.3 million and $237.7 million, respectively. The Company recognized an increase in its LIFO reserve of $0.5 million and $6.6 million during the second quarter and first six months of 2010 compared to a decrease in its LIFO reserve of $1.5 million and $13.3 million during the second quarter and first six months of 2009.

Table of Contents

Note 4 Property, Plant and Equipment

	June 30, 2010	December 31, 2009
Property, Plant and Equipment:		
Land and buildings	$ 590.3	$ 611.7
Machinery and equipment	2,789.0	2,786.4
Subtotal	3,379.3	3,398.1
Less allowances for depreciation	(2,115.8)	(2,062.9)
Property, Plant and Equipment net	$ 1,263.5	$ 1,335.2

At June 30, 2010 and December 31, 2009, machinery and equipment included approximately $107.7 million and $104.3 million, respectively, of capitalized software. Depreciation expense for the three months ended June 30, 2010 and 2009 was $44.9 million and $48.0 million, respectively. Depreciation expense for the first six months ended June 30, 2010 and 2009 was $90.2 million and $94.8 million, respectively. Depreciation expense on capitalized software for the three months ended June 30, 2010 and 2009 was approximately $5.1 million and $5.8 million, respectively. Depreciation expense on capitalized software for the six months ended June 30, 2010 and 2009 was approximately $10.4 million and $10.9 million, respectively.

Note 5 Goodwill and Other Intangible Assets

The changes in the carrying amount of goodwill for the six months ended June 30, 2010 are as follows:

	Beginning Balance	Acquisitions	Other	Ending Balance
Segment:				
Process Industries	$ 49.5	$	$ (2.7)	$ 46.8
Aerospace and Defense	162.6		(0.7)	161.9
Steel	9.6			9.6
Total	$ 221.7	$	$ (3.4)	$ 218.3

Other primarily includes foreign currency translation adjustments.

Table of Contents

The following table displays intangible assets as of June 30, 2010 and December 31, 2009:

	As of June 30, 2010			As of December 31, 2009		
	Gross Carrying Amount	**Accumulated Amortization**	**Net Carrying Amount**	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Intangible assets subject to amortization:						
Customer relationships	**$ 79.1**	**$ 16.5**	**$ 62.6**	$ 79.1	$ 14.3	$ 64.8
Engineering drawings	**2.0**	**2.0**		2.0	2.0	
Know-how	**2.0**	**0.9**	**1.1**	2.1	0.9	1.2
Industrial license agreements	**0.2**	**0.1**	**0.1**			
Land-use rights	**8.0**	**3.1**	**4.9**	7.9	3.0	4.9
Patents	**4.4**	**3.1**	**1.3**	4.4	2.9	1.5
Technology use	**35.6**	**5.2**	**30.4**	35.6	4.2	31.4
Trademarks	**6.0**	**4.8**	**1.2**	6.0	4.7	1.3
PMA licenses	**8.8**	**2.4**	**6.4**	8.8	2.2	6.6
Non-compete agreements	**2.7**	**1.6**	**1.1**	2.7	1.2	1.5
Unpatented technology	**7.7**	**5.8**	**1.9**	7.6	5.3	2.3
	$156.5	**$ 45.5**	**$111.0**	$156.2	$ 40.7	$115.5
Intangible assets not subject to amortization:						
Goodwill	**218.3**		**218.3**	221.7		221.7
Tradename	**1.4**		**1.4**	1.4		1.4
Industrial license agreements	**0.9**		**0.9**	1.0		1.0
FAA air agency certificates	**14.2**		**14.2**	14.2		14.2
	$234.8	**$**	**$234.8**	$238.3	$	$238.3
Total intangible assets	**$391.3**	**$ 45.5**	**$345.8**	$394.5	$ 40.7	$353.8

Amortization expense for intangible assets for the three months and six months ended June 30, 2010 was $2.4 million and $4.8 million, respectively. Amortization expense for intangible assets is estimated to be approximately $11.4 million for 2010; $11.0 million in 2011; $10.6 million in 2012; $8.1 million in 2013 and $7.7 million in 2014.

Note 6 Financing Arrangements

Short-term debt at June 30, 2010 and December 31, 2009 was as follows:

	June 30, 2010	December 31, 2009
	$5.0	$ 26.3

Variable-rate lines of credit for certain of the Company s foreign subsidiaries with various banks with interest rates ranging from 2.17% to 4.71% and 1.98% to 5.05% at June 30, 2010 and December 31, 2009, respectively		
Short-term debt	**$5.0**	$ 26.3

The lines of credit for certain of the Company s foreign subsidiaries provide for borrowings up to $280.6 million. At June 30, 2010, the Company had borrowings outstanding of $5.0 million, which reduced the availability under these facilities to $275.6 million.

The Company has a $100 million Accounts Receivable Securitization Financing Agreement (Asset Securitization Agreement), which expires November 15, 2010. Under the terms of the Asset Securitization Agreement, the Company sells, on an ongoing basis, certain domestic trade receivables to Timken Receivables Corporation, a wholly-owned consolidated subsidiary that in turn uses the trade receivables to secure borrowings, which are funded through a vehicle that issues commercial paper in the short-term market. Borrowings under the agreement are limited to certain borrowing base calculations. Any amounts outstanding under this Asset Securitization Agreement would be reported on the Company s Consolidated Balance Sheet in Short-term debt. As of June 30, 2010, there were no outstanding borrowings under the Asset Securitization Agreement. The cost of this credit facility, which is the commercial paper rate plus program fees, is considered a financing cost and is included in Interest expense in the Consolidated Statement of Income.

Table of Contents

Long-term debt at June 30, 2010 and December 31, 2009 was as follows:

	June 30, 2010	December 31, 2009
Fixed-rate Medium-Term Notes, Series A, due at various dates through May 2028, with interest rates ranging from 6.74% to 7.76%	**$175.0**	$ 175.0
Fixed-rate Senior Unsecured Notes, due September 15, 2014, with an interest rate of 6.0%	**249.7**	249.7
Variable-rate State of Ohio Water Development Revenue Refunding Bonds, maturing on November 1, 2025 (0.25% at June 30, 2010)	**12.2**	12.2
Variable-rate State of Ohio Air Quality Development Revenue Refunding Bonds, maturing on November 1, 2025 (0.42% at June 30, 2010)	**9.5**	9.5
Variable-rate State of Ohio Pollution Control Revenue Refunding Bonds, maturing on June 1, 2033 (0.35% at June 30, 2010)	**17.0**	17.0
Variable-rate credit facility with US Bank for Advanced Green Components, LLC, maturing on July 17, 2011 (1.41% at June 30, 2010)	**4.7**	6.1
Variable-rate credit facility with US Bank for Advanced Green Components, LLC, guaranteed by The Timken Company, maturing on July 17, 2011 (4.08% at June 30, 2010)	**3.8**	5.6
Other	**16.5**	11.1
	488.4	486.2
Less current maturities	**12.3**	17.0
Long-term debt	**$476.1**	$ 469.2

On September 9, 2009, the Company completed a public offering of $250 million of fixed-rate 6.0% unsecured Senior Notes, due in 2014. The net proceeds from the sale of the notes were used for the repayment of the Company s fixed-rate 5.75% unsecured Senior Notes, which were due to mature on February 15, 2010.

On July 10, 2009, the Company entered into a new $500 million Amended and Restated Credit Agreement (Senior Credit Facility). At June 30, 2010, the Company had no outstanding borrowings under its Senior Credit Facility but had letters of credit outstanding totaling $32.2 million, which reduced the availability under the Senior Credit Facility to $467.8 million. This Senior Credit Facility matures on July 10, 2012. Under the Senior Credit Facility, the Company has three financial covenants: a consolidated leverage ratio, a consolidated interest coverage ratio and a consolidated minimum tangible net worth test. At June 30, 2010, the Company was in full compliance with the covenants under the Senior Credit Facility.

Advanced Green Components, LLC (AGC) is a joint venture of the Company. The Company is the guarantor of $3.8 million of AGC s $8.5 million credit facility with US Bank. Effective as of July 17, 2010, AGC renewed its credit facility with US Bank for another 365 days.

Lines of credit for certain of the Company s foreign subsidiaries also provide for long-term borrowings up to $27.1 million. At June 30, 2010, the Company had borrowings outstanding of $12.5 million, which reduced the availability under these long-term facilities to $14.6 million.

Note 7 Product Warranty

The Company provides limited warranties on certain of its products. The Company accrues liabilities for warranty based upon specific claims and a review of historical warranty claim experience in accordance with accounting rules for contingent liabilities. Should the Company become aware of a specific potential warranty claim for which liability is probable and reasonably estimable, a specific charge is recorded and accounted for accordingly. Adjustments are

made quarterly to the accruals as claim data and historical experience change.

Table of Contents

The following is a rollforward of the warranty accruals for the six months ended June 30, 2010 and the twelve months ended December 31, 2009:

	June 30, 2010	December 31, 2009
Beginning balance, January 1	**$ 5.4**	$ 13.5
Expense	**1.3**	4.7
Payments	**(0.9)**	(12.8)
Ending Balance	**$ 5.8**	$ 5.4

The product warranty accrual at June 30, 2010 and December 31, 2009 was included in other current liabilities on the Consolidated Balance Sheet.

Note 8 Equity

		The Timken Company Shareholders											
					Accumulated								
				Earnings	Other								
			Other	Invested	Comp-		Non- TD STYLE="text-align:						
		Stated	Paid-In	in the	rehensive	Treasury	right">-	-	-	(106)	-	-	(106)
Cash dividends declared to stockholders	-	-	-	-	(17,279)	-	(17,279)						
Balance, September 30, 2018	12,145	$12	$8,040	$(266)	$124,601	$(20,746)	$ 111,641						

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 reporting and pursuant to the rules and regulations of the Securities and Exchange Commission (the "SEC"). Accordingly, certain information and footnotes that are normally required by GAAP have been condensed or omitted. 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 and nine months ended September 30, 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 *ASC 606* primarily impact the Company's timing of revenue recognition for product shipments, as product revenue is recognized upon customer receipt instead 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 September 30, 2018			Nine months ended September 30, 2018		
	As Reported	Balances without adoption of ASC 606	Effect of Change	As Reported	Balances without adoption of ASC 606	Effect of Change
Revenue	$ 139,239	$ 139,582	$ (343)	$ 355,159	$ 356,442	$ (1,283)
Cost of sales	32,038	32,071	33	84,351	84,544	193
Gross profit	107,201	107,511	(310)	270,808	271,898	(1,090)
Selling, general, and administrative	89,734	89,831	97	221,548	221,908	360
Income from operations	17,467	17,680	(213)	49,260	49,990	(730)
Other income (expense)						
Interest income, net	361	361	-	940	940	-
Other income (expense)	-	-	-	178	178	-
	361	361	-	1,118	1,118	-
Income from operations before income taxes	17,828	18,041	(213)	50,378	51,108	(730)
Provision for income taxes	4,047	4,092	45	10,242	10,396	154
Net income	$ 13,781	$ 13,949	$ (168)	$ 40,136	$ 40,712	$ (576)
Earnings per share - basic	$ 1.15	$ 1.17	$ (0.02)	$ 3.34	$ 3.39	$ (0.05)
Earnings per share - diluted	$ 1.14	$ 1.15	$ (0.01)	$ 3.31	$ 3.36	$ (0.05)
Weighted average shares outstanding -						
Basic	11,954	11,954		12,006	12,006	
Diluted	12,097	12,097		12,112	12,112	

September 30, 2018		
	Balances without	Effect of Change

	As Reported	adoption of ASC 606		
ASSETS				
Accounts receivable, net	$1,017	$ 118	$ 899	
Inventory	43,845	42,793	1,052	
Prepaid expenses and other current assets	3,851	3,711	140	
Deferred tax assets	2,355	1,656	699	
LIABILITIES				
Accounts payable and accrued expenses	62,806	57,422	5,384	
STOCKHOLDERS' EQUITY				
Retained earnings	124,601	127,195	(2,594	)

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 new guidance also changes the definition of a lease and requires expanded quantitative and qualitative disclosures for both lessees and lessors. The pronouncement is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. We plan to adopt ASU 2016-02 on January 1, 2019. 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 (TCJA) 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

TCJA, 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 pronouncement are effective for all entities for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. We plan to adopt ASU 2018-02 on January 1, 2019. 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. Revenue is 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 of 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 and nine month periods ended September 30, 2018 and 2017, respectively. Revenue on these contracts is recognized when obligations under the terms of the contract with our customers 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 based on our estimated expected returns 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 purchase additional products at a discount come in a variety of 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 the policies discussed above. In addition, effective January 1, 2018, we changed how we internally and externally report our revenues to simplify and better align with changes in how we manage our business, review operating performance and allocate resources as a result of the shift in our primary focus to the **OPTA**VIA business and the significance this business represents to the overall results of the Company. We considered the following factors in making 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, our disclosures as of January 1, 2018 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):

	September 30, 2018	December 31, 2017
Raw materials	$ 13,273	$ 4,348
Packaging	1,762	1,185
Non-food finished goods	2,028	920
Finished goods	27,480	13,407
Reserve for obsolete inventory	(698)	(532)
Total	$ 43,845	$ 19,328

11

4. EARNING PER SHARE

Basic earnings per share ("EPS") computations are calculated utilizing the weighted average number of shares of the Company's common stock outstanding during the periods presented. Diluted EPS is calculated utilizing the weighted average number of shares of the Company's 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 September 30,		Nine months ended September 30,	
	2018	2017	2018	2017
Numerator:				
Net income	$ 13,781	$ 6,686	$ 40,136	$ 20,415
Denominator:				
Weighted average shares of common stock outstanding	11,954	11,930	12,006	11,920
Effect of dilutive common stock equivalents	143	165	106	143
Weighted average shares of common stock outstanding	12,097	12,095	12,112	12,063
Earnings per share - basic	$ 1.15	$ 0.56	$ 3.34	$ 1.71
Earnings per share - diluted	$ 1.14	$ 0.55	$ 3.31	$ 1.69

The calculation of diluted EPS excluded 0 and 3,813 antidilutive options outstanding for the three months ended September 30, 2018 and 2017, respectively, and 214 and 6,780 antidilutive options outstanding for the nine months ended September 30, 2018 and 2017, respectively. The calculation for diluted EPS for the three and nine months ended, September 30, 2018 also excluded 43 and 297 antidilutive restricted stock awards, respectively. EPS is computed independently for each of the quarters presented; accordingly, the sum of the quarterly earnings per common share may not equal the year-to-date total computed.

5. SHARE-BASED COMPENSATION

Stock Options:

The Company has issued non-qualified and incentive stock options to employees and nonemployee directors. The fair value of these options are estimated on the date of grant using the Black-Scholes option pricing model, which requires estimates of the expected term of the option, the risk-free interest rate, the expected volatility of the price of the Company's common stock, and dividend yield. Options outstanding as of September 30, 2018 generally vest over a period of three years and expire ten years from the date of grant. The exercise price of these options ranges from $26.52 to $157.30. Due to the Company's lack of option exercise history, the expected term is calculated using the simplified method defined as the midpoint between the vesting period and the contractual term of each option. The risk free interest rate is based on the U.S. Treasury yield curve in effect on the date of grant that most closely corresponds to the expected term of the option. The expected volatility is based on the historical volatility of the Company's common stock over the period of time equivalent to the expected term for each award. The weighted average input assumptions used were as follows:

	Nine months ended September 30,			
	2018		2017	
Expected term (in years)	6.4		6.0	
Risk-free interest rate	2.64	%	2.05	%
Expected volatility	33.30	%	38.33	%
Dividend yield	2.87	%	2.40	%

The following table is a summary of our stock option activity:

	Nine months ended September 30,			
	2018		2017	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
(shares in thousands)				
Outstanding at beginning of period	106	$ 31.18	129	$ 28.22
Granted	51	67.50	38	44.73
Exercised	(23)	28.87	(21)	27.38
Forfeited	(8)	31.09	(17)	37.09
Expired	-	-	(1)	28.59
Outstanding at end of the period	126	$ 46.51	128	$ 32.00
Exercisable at end of the period	54	$ 30.21	62	$ 28.14

As of September 30, 2018, the weighted-average remaining contractual life was 8.07 years with an aggregate intrinsic value of $22.1 million for outstanding stock options and the weighted-average remaining contractual life was 6.91 years with an aggregate intrinsic value of $10.4 million for exercisable options. The weighted-average grant date fair value of options granted during the nine months ended September 30, 2018 and 2017 was $18.08 and $13.73, respectively. The unrecognized compensation expense calculated under the fair value method for shares expected to vest as of September 30, 2018 was $0.9 million and is expected to be recognized over a weighted average period of 3.46 years. The Company received $220 thousand and $568 thousand in cash proceeds from the exercise of stock options during the nine months ended September 30, 2018 and 2017, respectively. Upon exercising of options, the Company withheld shares for employee taxes of 3 thousand and 19 thousand for the nine months ended September 30, 2018 and 2017, respectively. The total intrinsic value for stock options exercised during the nine months ended September 30, 2018 and 2017 was $1.4 million and $325 thousand, respectively.

Restricted Stock:

The Company has issued restricted stock to employees and nonemployee directors generally with vesting terms up to five years after the date of grant. The fair value of the restricted stock is equal to the market price of the Company’s common stock on the date of grant. Expense for restricted stock is amortized ratably over the vesting period. The following table summarizes our restricted stock activity:

	Nine months ended September 30,			
	2018		2017	
	Shares	Weighted-Average Grant Date	Shares	Weighted-Average Grant Date

		Fair Value		Fair Value
(shares in thousands)				
Outstanding at beginning of period	129	$ 32.15	215	$ 27.69
Granted	18	79.80	44	44.73
Vested	(86)	31.61	(58)	26.09
Forfeited	-	-	(8)	36.37
Outstanding at end of the period	61	$ 46.90	193	$ 31.65

The total fair value of restricted stock awards vested during the nine months ended September 30, 2018 and 2017 was $7.5 million and $2.5 million, respectively.

The total share-based compensation charged against income was $717 thousand and $1.2 million during the three months ended September 30, 2018 and 2017, respectively, and $2.4 million and $3.4 million during the nine months ended September 30, 2018 and 2017, respectively. The total costs of the options and restricted stock awards charged against income was $488 thousand and $912 thousand during the three months ended September 30, 2018 and 2017, respectively, and $1.7 million and $2.6 million during the nine months ended September 30, 2018 and 2017, respectively. Also included for the three and nine months ended September 30, 2018 was $77 thousand and $229 thousand, respectively, for 63,300 performance-based deferred shares and for the three and nine months ended September 30, 2017 was $139 thousand and $357 thousand, respectively, for 113,395 performance-based deferred shares in expense for certain key executives. Included for the three and nine months ended September 30, 2018 and 2017 was $152 thousand and $455 thousand, respectively, in expense for 210,000 performance-based deferred shares granted to our CEO that will vest based on the achievement of certain Company performance targets.

The total income tax benefit recognized in the condensed consolidated statements of income for restricted stock awards was $167 thousand and $451 thousand for the three months ended September 30, 2018 and 2017, respectively, and $1.6 million and $1.5 million for the nine months ended September 30, 2018 and 2017, respectively.

There was $2.1 million of total unrecognized compensation cost related to restricted stock awards as of September 30, 2018, which is expected to be recognized over a weighted-average period of 1.88 years. There was $1.1 million of unrecognized compensation cost related to the 273,300 performance based deferred shares discussed above as of September 30, 2018, which is expected to be recognized over a weighted-average period of 1.25 years.

6. ACCUMULATED OTHER COMPREHENSIVE LOSS

The following table sets forth the components of accumulated other comprehensive income (loss), net of tax where applicable (in thousands):

	September 30, 2018	December 31, 2017
Foreign currency translation	$ (2)	$ -
Unrealized losses on marketable securities	(264)	(160)
Accumulated other comprehensive loss	$ (266)	$ (160)

7. FINANCIAL INSTRUMENTS

Certain financial assets and liabilities are accounted for at fair value, which is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The following fair value hierarchy prioritizes the inputs used to measure fair value:

Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reporting date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies.

Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value from the perspective of a market participant.

The following tables represent cash and the available-for-sale securities adjusted cost, gross unrealized losses and fair value by significant investment category recorded as cash and cash equivalents or investment securities (in thousands):

	September 30, 2018					
	Cost	Unrealized Losses	Accrued Interest	Estimated Fair Value	Cash & Cash Equivalents	Investment Securities
Cash	$22,841	$ -	$ -	$22,841	$ 22,841	$ -
Level 1:						
Certificate of deposit	55,000	-	-	55,000	55,000	-
Money market accounts	4,466	-	-	4,466	4,466	-
Government & agency securities	4,135	(116)	24	4,043	-	4,043
	63,601	(116)	24	63,509	59,466	4,043
Level 2:						
Municipal bonds	16,932	(248)	185	16,869	-	16,869
Total	$103,374	$ (364)	$ 209	$103,219	$ 82,307	$ 20,912

	December 31, 2017					
	Cost	Unrealized Losses	Accrued Interest	Estimated Fair Value	Cash & Cash Equivalents	Investment Securities
Cash	$28,630	$ -	$ -	$ 28,630	$ 28,630	$ -
Level 1:						
Certificate of deposit	45,000	-	-	45,000	45,000	-
Money market accounts	1,447	-	-	1,447	1,447	-
Government & agency securities	5,342	(67)	13	5,288	-	5,288
	51,789	(67)	13	51,735	46,447	5,288
Level 2:						
Municipal bonds	18,404	(201)	266	18,469	-	18,469
Total	$98,823	$ (268)	$ 279	$ 98,834	$ 75,077	$ 23,757

The Company had a realized loss of $91 and $16 thousand for the three months ended September 30, 2018 and 2017, respectively, and a realized loss of $70 and $73 thousand for the nine months ended September 30, 2018 and 2017, respectively. As of September 30, 2018 and 2017, gross unrealized losses related to individual securities that had been in a continuous loss position for 12 months or longer were not significant. The maturities of the Company's investment securities generally range up to 5 years for municipal bonds and for government and agency securities.

8. INCOME TAXES

The Company reflected the effects of the TCJA in its 2017 financial statements, including the effects of the change in the U.S. Corporate tax rate from 35% to 21% on deferred tax assets and liabilities. The Company's tax expense for the three and nine month periods ended September 30, 2018 was $4.0 million and $10.2 million, respectively. This includes the reduction in the U.S. federal tax rate from 35% to 21%, effective for the Company's 2018 tax year.

The Company recognized the income tax effects of the TCJA in the financial statements included in its 2017 Annual Report on Form 10-K in accordance with Staff Accounting Bulletin No. 118, which provides SEC staff guidance for the application of ASC 740, Income Taxes, in the reporting period in which the TCJA was signed into law. During the three months ended September 30, 2018, the Company finalized its accounting for the income tax effects of the TCJA. There were no material adjustments to the provisional amounts recorded in the Company's financial statements included in its 2017 Annual Report on Form 10-K.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

Note Regarding Forward-Looking Statements

This report contains information that may constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Generally, the words "believe," "expect," "intend," "estimate," "anticipate," "project," "will," and similar expressions, which historical in nature, identify forward-looking statements. However, the absence of these words or expressions does not necessarily mean that a statement is not forward-looking. All statements that address operating performance, events or developments that we expect or anticipate will occur in the future, including statements relating to future operating results, are forward-looking statements. Management believes that these forward-looking statements are reasonable as and when made. However, caution should be taken not to place undue reliance on any such forward-looking statements because such statements speak only as of the date when made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. In addition, forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or projections. These risks and uncertainties include, but are not limited to, those described in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 (the "2017 Annual Report"), and those described from time to time in our future reports filed with the SEC.

The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and related notes appearing elsewhere herein.

Overview

Medifast, Inc. (together with its consolidated subsidiaries, "we," "us," "our," the "Company," or "Medifast") is a leading manufacturer and distributor of clinically proven healthy living products and programs. We produce, distribute and sell a variety of weight loss, weight management, and other consumable health and nutritional products. The

Company’s product lines include weight loss, weight management, and healthy living meal replacements, snacks, hydration products, and vitamins. Our product sales accounted for 98% and 97% of our revenues for the nine months ended September 30, 2018 and 2017, respectively.

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 our policies. In addition, effective January 1, 2018, we changed how we internally and externally report our revenues to simplify and better align with changes in how we manage our business, review operating performance and allocate resources as a result of the shift in our primary focus to the **OPTA**VIA business and the significance this business represents to the overall results of the Company. We considered the following factors in making 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, our disclosure as of January 1, 2018 will not include revenues by sales channel.

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with United States generally accepted accounting principles (“GAAP”). Our significant accounting policies are described in Note 1 and Note 2 to the condensed consolidated financial statements included in this report.

The preparation of our 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.

Overview of Results of Operations

The following tables reflect our income statements (in thousands, except percentages):

	Three months ended September 30, 2018	2017	$ Change	% Change
Revenue	$ 139,239	$ 77,205	$ 62,034	80.3 %
Cost of sales	32,038	19,022	(13,016)	-68.4 %
Gross profit	107,201	58,183	49,018	84.2 %
Selling, general, and administrative	89,734	47,956	(41,778)	-87.1 %
Income from operations	17,467	10,227	7,240	70.8 %
Other income (expense)				
Interest income, net	361	148	213	143.9 %
Other income (expense)	-	(4)	4	-100.0 %
	361	144	217	150.7 %
Income from operations before income taxes	17,828	10,371	7,457	71.9 %
Provision for income tax	4,047	3,685	(362)	-9.8 %
Net income	$ 13,781	$ 6,686	$ 7,095	106.1 %
% of revenue				
Gross profit	77.0 %	75.4 %		
Selling, general, and administrative costs	64.4 %	62.1 %		
Income from operations	12.5 %	13.2 %		

17

	Nine months ended September 30,				
	2018		2017		$ Change	% Change
Revenue	$ 355,159		$ 223,556		$131,603	58.9 %
Cost of sales	84,351		54,870		(29,481)	-53.7 %
Gross Profit	270,808		168,686		102,122	60.5 %
Selling, general, and administrative	221,548		138,540		(83,008)	-59.9 %
Income from operations	49,260		30,146		19,114	63.4 %
Other income (expense)						
Interest income, net	940		352		588	167.0 %
Other income (expense)	178		32		146	456.3 %
	1,118		384		734	191.1 %
Income from operations before income taxes	50,378		30,530		19,848	65.0 %
Provision for income tax expense	10,242		10,115		(127)	-1.3 %
Net income	$ 40,136		$ 20,415		$19,721	96.6 %
% of revenue						
Gross Profit	76.2	%	75.5	%		
Selling, general, and administrative costs	62.4	%	62.0	%		
Income from Operations	13.9	%	13.5	%		

Revenue: Revenue increased $62.0 million, or 80.3%, to $139.2 million for the three months ended September 30, 2018 from $77.2 million for the three months ended September 30, 2017. This is the sixth consecutive quarter of year-over-year growth and the seventh consecutive quarter of sequential revenue improvement. The number of active earning **OPTA**VIA Coaches for the three months ended September 30, 2018 increased to 22,600 from 14,200 for the corresponding period in 2017, an increase of 59.2%. The quarterly revenue per **OPTA**VIA Coach increased 23.2% to $5,781 for the three months ended September 30, 2018 from $4,693 for the three months ended September 30, 2017. This growth in revenue resulted in part from business initiatives accelerating new **OPTA**VIA Coach conversions, increased **OPTA**VIA client acquisition rates and the transition of clients to higher priced **OPTA**VIA branded products. Total advertising spend, inclusive of broker fees, was $1.3 million for the three months ended September 30, 2018 as compared to $1.7 million for the corresponding period in 2017. Revenue increased $131.6 million, or 58.9%, to $355.2 million for the nine months ended September 30, 2018 from $223.6 million for the nine months ended September 30, 2017. Total advertising spend, inclusive of broker fees, was $4.9 million for the nine months ended September 30, 2018 as compared to $6.1 million for the corresponding period in 2017.

Costs of sales: Cost of sales increased $13.0 million, or 68.4%, to $32.0 million for the three months ended September 30, 2018 from the corresponding period in 2017 and increased $29.5 million, or 53.7%, to $84.4 million for the nine months ended September 30, 2018 from the corresponding period in 2017. The increase in cost of sales

for the three and nine months ended September 30, 2018 was primarily driven by increased product sales.

Gross profit: For the three months ended September 30, 2018, gross profit increased $49.0 million, or 84.2%, to $107.2 million from the corresponding period in 2017. As a percentage of sales, gross margin increased 160 basis points to 77.0% for the three months ended September 30, 2018 from 75.4% for the corresponding period in 2017. For the nine months ended September 30, 2018, gross profit increased $102.1 million, or 60.5%, to $270.8 million from the corresponding period in 2017. As a percentage of sales, gross margin increased 70 basis points to 76.2% for the nine months ended September 30, 2018 from 75.5% for the corresponding period in 2017. The increase in gross margin percentage for the quarter and year-to-date periods was driven by higher production volumes yielding favorable manufacturing absorption as the Company increased inventory to meet expected consumer demand. The Company anticipates this absorption benefit to be temporary as inventory levels normalize. In addition, the increase in the gross margin percentage resulted from reduced inventory obsolescence and lower shipping expense.

Selling, general and administrative: Selling, general and administrative (“SG&A”) expenses were $89.7 million for the three months ended September 30, 2018, an increase of $41.7 million, or 87.1%, as compared to $48.0 million from the corresponding period in 2017. As a percentage of sales, SG&A expenses were 64.4% as compared to 62.1% for the three months ended September 30, 2018 and 2017, respectively. This increase was primarily the result of higher **OPTA**VIA commissions paid as a result of increased product sales. As **OPTA**VIA revenue increased as a portion of the Company’s total sales mix, the commission rate as a percentage of revenue increased 470 basis points to 40.5% for the third quarter of 2018 compared to 35.8% for the third quarter last year. This is an outcome of the success we are experiencing with our **OPTA**VIA integrated Coach Model. SG&A expenses included research and development costs of $621 thousand and $343 thousand for the three months ended September 30, 2018 and 2017, respectively.

For the nine months ended September 30, 2018, SG&A expenses increased $83.0 million, or 59.9%, to $221.5 million from $138.5 million for the corresponding period in 2017. As a percentage of sales, SG&A expenses was 62.4% for the nine months ended September 30, 2018 as compared to 62.0% for the corresponding period in 2017. SG&A expenses included $1.6 million and $1.1 million in research and development costs for the nine months ended September 30, 2018 and 2017, respectively.

OPTAVIA commission expense, which is variable based upon product sales, increased $28.8 million, or more than 100.0%, for the three months ended September 30, 2018 from the corresponding period in 2017 and increased $62.0 million, or 79.2%, for the nine months ended September 30, 2018 from the corresponding period in 2017.

Coach event and incentive program costs increased $6.0 million and $6.7 million during the three and nine months ended September 30, 2018, respectively, from the corresponding periods in 2017 due to higher annual convention costs as more coaches attended this event and increased incentive program costs related to coaches who qualified during 2018 for our 2019 International Leadership Advancement Trip, an event designed to recognize and provide training to rising leaders and those who mentor them.

General and administrative expenses increased $4.8 million and $11.1 million during the three and nine months ended September 30, 2018, respectively, from the corresponding periods in 2017 primarily as a result of startup costs associated with the move of our distribution center from Texas to Nevada, as well as consulting costs related to information technology projects, and increased credit card fees resulting from higher sales.

Salaries and benefits increased $2.3 million and $4.2 million during the three and nine months ended September 30, 2018, respectively, from the corresponding periods in 2017 primarily as a result of higher contract labor costs related to the winding down of our internal call center and increased compensation costs.

Income from operations: For the three months ended September 30, 2018, income from operations increased $7.3 million to $17.5 million from $10.2 million for the corresponding period in 2017 primarily as a result of increased gross profits partially offset by increased SG&A expenses. For the nine months ended September 30, 2018, income from operations increased $19.2 million to $49.3 million from $30.1 million for the corresponding period in 2017 primarily as a result of increased gross profits partially offset by increased SG&A expenses.

Interest income, net: For the three and nine months ended September 30, 2018, interest income was $361 thousand and $940 thousand, respectively, and for the three and nine months ended September 30, 2017, interest income was $148 thousand and $352 thousand, respectively.

Other income (expense): For the three months ended September 30, 2018 and 2017, other income (expense) was $0 and an expense of $4 thousand, respectively. For the nine months ended September 30, 2018 and 2017, other income (expense) was income of $178 thousand and $32 thousand, respectively.

Income from operations before income taxes: Income from operations before income taxes was $17.8 million for the three months ended September 30, 2018 as compared to $10.4 million for the three months ended September 30, 2017, an increase of $7.4 million. Pre-tax profit as a percentage of sales decreased to 12.8% for the three months ended September 30, 2018 from 13.4% for the three months ended September 30, 2017. Income from operations before income taxes was $50.4 million for the nine months ended September 30, 2018 as compared to $30.5 million for the nine months ended September 30, 2017, an increase of $19.9 million. Pre-tax profit as a percentage of sales increased to 14.2% for the nine months ended September 30, 2018 from 13.7% for the nine months ended September 30, 2017.

Provision for income tax: For the three months ended September 30, 2018, the Company recorded $4.0 million in income tax expense, an effective rate of 22.7%, as compared to $3.7 million in income tax expense, an effective rate of 35.5%, for the three months ended September 30, 2017. The decrease in the effective tax rate for the three month ended September 30, 2018 as compared to the three months ended September 30, 2017 was driven by a decrease in the Federal statutory rate of 14.0% pursuant to the TCJA, a decrease in the state rate of 1.7% and a rate reduction of 0.4% attributable to the discrete accounting for taxes associated with share-based compensation. The total decrease in the effective tax rate was offset by a 2.1% increase to our effective tax rate resulting from to the elimination of the Domestic Manufacturer Deduction and a 1.2% increase to our effective tax rate resulting from changes to the limitations imposed by Section 162(m) of the Internal Revenue Code pursuant to TCJA. For the nine months ended September 30, 2018, the Company recorded $10.2 million in income tax expense, an effective rate of 20.3%, as compared to $10.1 million in income tax expense, an effective rate of 33.1%, for the nine months ended September 30, 2017. The decrease in the effective tax rate for the nine month ended September 30, 2018 as compared to the nine months ended September 30, 2017 was driven by a decrease in the Federal statutory rate of 14.0% pursuant to the TCJA, a rate reduction of 1.1% attributable to the discrete accounting for taxes associated with share-based compensation and a decrease in the state rate of 0.4%. The total decrease in the effective tax rate was offset by a 2.2% increase to our effective tax rate resulting from the elimination of the Domestic Manufacturer Deduction and a 0.5% increase to our effective tax rate primarily resulting from changes to the limitations imposed by Section 162(m) of the Internal Revenue Code pursuant to the TCJA. The Company anticipates a full year tax rate of 21% to 23% in 2018.

Net income: Net income was $13.8 million and $40.1 million, or $1.14 and $3.31 per diluted share, for the three and nine months ended September 30, 2018 as compared to $6.7 million and $20.4 million, or $0.55 and $1.69 per diluted share, for the three months and nine months ended September 30, 2017. The period-over-period changes were driven by the factors described above.

Liquidity and Capital Resources

The Company had stockholders' equity of $111.6 million and working capital of $89.1 million at September 30, 2018 as compared with $108.6 million and $88.1 million at December 31, 2017, respectively. The $3.0 million net increase in stockholder's equity reflects $40.1 million in net income for the nine months ended September 30, 2018 offset by $20.0 million spent on repurchases of common stock, and $17.3 million for declared dividends paid to our common stock holders as well as the other equity transactions described in the "Condensed Consolidated Statements of Changes in Stockholders' Equity" included in our condensed consolidated financial statements included in this report. The Company declared a dividend of $6.0 million, or $0.48 per share, to common stockholders as of September 21, 2018 that will be paid in the fourth quarter of 2018. While we intend to continue the dividend program and believe we will have sufficient liquidity to do so, we can provide no assurance that we will be able to continue to declare and pay dividends. The Company's cash, cash equivalents, and investment securities increased from $98.8 million at December 31, 2017 to $103.2 million at September 30, 2018.

Net cash provided by operating activities increased $12.2 million to $45.5 million for the nine months ended September 30, 2018 from $33.3 million for the nine months ended September 30, 2017 primarily as a result of increased net income partially offset by an increase in working capital.

Net cash used in investing activities was $817 thousand for the nine months ended September 30, 2018 as compared to $3.4 million for the nine months ended September 30, 2017. This change resulted primarily from cash provided by net investment securities for the nine months ended September 30, 2018 as compared to cash used in net investment securities for the corresponding period in 2017. This was partially offset by an increase in cash used in capital expenditures for the nine months ended September 30, 2018 from the corresponding period in 2017.

Net cash used in financing activities increased $25.6 million to $37.4 million for the nine months ended September 30, 2018 from $11.8 million for the nine months ended September 30, 2017. This increase was primarily due to stock repurchases and an increase in cash dividends paid to stockholders.

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 financing activities.

The Company evaluates acquisitions from time to time as presented.

Item 3. 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 is exposed to market risk related to changes in interest rates and market pricing impacting our investment portfolio. Its current investment policy is to maintain an investment portfolio consisting of municipal bonds, U.S. money market securities, and high-grade corporate securities, directly or through managed funds. Its cash is deposited in and invested through highly rated financial institutions in North America. Its marketable securities are subject to interest rate risk and market pricing risk and will fall in value if market interest rates increase or if market pricing decreases. If market interest rates were to increase and market pricing were to decrease immediately and uniformly by 10% from levels at September 30, 2018, the Company estimates that the fair value of its investment portfolio would decline by an immaterial amount and therefore it would not expect its operating results or cash flows to be affected to any significant degree by the effect of a change in market conditions on our investments.

There have been no material changes to our market risk exposure since December 31, 2017.

Item 4. Controls and Procedures

Management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of September 30, 2018. Our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported accurately and on a timely basis. Based on this evaluation performed in accordance with the criteria established in the 2013 Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, our management concluded that the Company’s disclosure controls and procedures are effective at the reasonable assurance level as of the end of the period covered by this report.

Changes in Internal Control over Financial Reporting:

There have been no material changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Act) during the fiscal quarter ended September 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. We implemented additional internal controls to ensure we properly assessed and accounted for the impact of the new accounting standard related to revenue recognition on our financial statements which became effective on January 1, 2018. There were no significant changes to our internal control over financial reporting related to the adoption of the new standard.

Part II Other Information

Item 1. Legal Proceedings

The Company is, from time to time, subject to a variety of litigation and similar proceedings incidental to its business. Based upon the Company's experience, current information and applicable law, it does not believe that these proceedings and claims will have a material adverse effect on its results of operations, financial position or liquidity.

Item 1A. Risk Factors

There have been no material changes to the risk factors set forth in Part I, Item 1A of the 2017 Annual Report.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

2018	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of a Publicly Announced Plan or Program	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
July 1 - July 31	-	$ -	-	728,881
August 1 - August 31	200	169.47	-	728,881
September 1 - September 30	-	-	-	728,881

The Company, in accordance with, and as part of, the repurchase program adopted in September 2014 (the "Stock Repurchase Program") implemented a Rule 10b5-1 repurchase plan to facilitate repurchases of the Company's common stock under the Stock Repurchase Program. As of September 30, 2018, there were 728,881 shares of the Company's common stock eligible for repurchase under the Stock Repurchase Program. There is no guarantee as to the exact number of shares of the Company's common stock, if any, that will be purchased under the Stock Repurchase Plan.

Item 6. Exhibits

Exhibit Number	Description of Exhibit
3.1	Restated and Amended Certificate of Incorporation of Medifast, Inc. (incorporated by reference to Exhibit 3.1 of the Company's Current Report on Form 8-K (File No. 001-31573) filed February 27, 2015).
3.2	Amended and Restated Bylaws of Medifast, Inc. (incorporated by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K (File No. 001-31573) filed on April 6, 2015).
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer 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.

101	The following financial statements from Medifast, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2018 filed November 7, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) Condensed Consolidated Statements of Income, (ii) Condensed Consolidated Statements of Comprehensive Income, (iii) Condensed Consolidated Balance Sheets, (iv) Condensed Consolidated Statements of Cash Flows, (v) Condensed Consolidated Statements of Changes in Stockholders' Equity, and (vi) Notes to the Condensed Consolidated Financial Statements (filed herewith).

In accordance with SEC Release No. 33-8238, Exhibit 32.1 is being furnished and not filed.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Medifast, Inc.

By:	/s/ DANIEL R. CHARD Daniel R. Chard Chief Executive Officer (Principal Executive Officer)
Dated:	November 7, 2018
	/s/ TIMOTHY G. ROBINSON Timothy G. Robinson Chief Financial Officer (Principal Financial and Accounting Officer)
Dated:	November 7, 2018