Ruths Chris Steak House, Inc.
Form 10-K
March 12, 2008
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE FISCAL YEAR ENDED DECEMBER 30, 2007

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 000-51485

RUTH S CHRIS STEAK HOUSE, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**72-1060618**

(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
500 International Parkway, Suite 100 Heathrow, Florida	**32746**
(Address of Principal Executive Offices)	**(Zip Code)**

Registrant s Telephone Number, Including Area Code: (407) 333-7440

Securities Registered Pursuant to Section 12(b) of the Act:	**The NASDAQ Stock Market LLC**
Common stock, par value $0.01 per share	**(Name of exchange on which registered)**
(Title of class)	

Securities Registered Pursuant to Section 12(g) of the Act:

None

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if smaller reporting company)	Smaller reporting company ¨

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

As of July 1, 2007, the last day of the registrant s most recently completed second fiscal quarter, the aggregate market value of the registrant s common stock, par value $0.01 per share, held by non-affiliates of the registrant was approximately $307,270,300.

The number of shares outstanding of the registrant s common stock as of March 10, 2008, was 24,267,580.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III of Form 10-K, to the extent not set forth herein, is incorporated herein by reference to the registrant s Proxy Statement for the 2008 Annual Meeting of Shareholders to be held on May 22, 2008, to be filed with the Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the close of the registrant s fiscal year.

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FORWARD LOOKING STATEMENTS

This Annual Report on Form 10-K and the materials incorporated by reference herein contain forward-looking statements that reflect, when made, the Company s expectations or beliefs concerning future events that involve risks and uncertainties. Forward-looking statements frequently are identified by the words believe, anticipate, expect, estimate, intend, project, will be, will continue, will likely result, or other and phrases. Similarly, statements herein that describe the Company s objectives, plans or goals also are forward-looking statements. Actual results could differ materially from those projected, implied or anticipated by the Company s forward-looking statements. Some of the factors that could cause actual results to differ include: changes in economic conditions and general trends; changes in consumer preferences or discretionary spending; the effect of competition in the restaurant industry; the Company s ability to achieve and manage its planned expansion; the Company s ability to integrate the restaurants acquired in the Mitchell s acquisition; the Company s ability to execute its business strategy effectively; health concerns about beef or other food products; reductions in the availability of, or increases in the cost of, USDA Prime grade beef, fish and other food items; labor shortages or increases in labor costs; the impact of federal, state or local government regulations relating to Company employees, the sale or preparation of food, the sale of alcoholic beverages and the opening of new restaurants; the Company s ability to achieve market acceptance, particularly in new markets; harmful actions taken by the Company s franchisees; the Company s ability to protect its name and logo and other proprietary information; the impact of litigation; and the loss of key management personnel. For a discussion of these and other risks and uncertainties that could cause actual results to differ from those contained in the forward-looking statements, please see Item 1A. Risk Factors in this Annual Report on Form 10-K as well as the Company s other filings with the Securities and Exchange Commission (the SEC), all of which are available on the SEC s website at www.sec.gov. All forward-looking statements are qualified in their entirety by this cautionary statement, and the Company undertakes no obligation to revise or update this Annual Report on Form 10-K to reflect events or circumstances after the date hereof. Stockholders and other security holders or buyers of the Company s securities or its other creditors should not assume that material events subsequent to the date of this report have not occurred.

Unless the context otherwise indicates, all references in this report to the Company, Ruth s Chris, we, us or our or similar words are to Ruth Chris Steak House, Inc., and its wholly owned subsidiaries. Ruth s Chris Steak House, Inc. is a Delaware corporation, and was originally founded in 1965.

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PART I

Item 1. BUSINESS

Our Company

The Company believes that it is the largest upscale steakhouse company in the United States, based on total company- and franchisee-owned restaurants as published in the Technomic, Inc. 2007 Top 100 U.S. Chain Reference Guide. The Ruth s Chris menu features a broad selection of high-quality USDA Prime grade steaks and other premium offerings served in Ruth s Chris signature fashion sizzling and topped with seasoned butter complemented by other traditional menu items inspired by its New Orleans heritage. The Company s Ruth s Chris restaurants reflect its more than 40-year commitment to the core values instilled by its founder, Ruth Fertel, of caring for guests by delivering the highest quality food, beverages and service in a warm and inviting atmosphere. The Company believes that Ruth s Chris is currently one of the strongest brands in fine dining.

The Company s restaurants cater to families and special occasion diners, in addition to the business clientele traditionally served by upscale steakhouses, by providing a dining experience designed to appeal to a wide range of guests. The Company believes its focus on creating this broad appeal provides it with opportunities to expand into a wide range of markets, including many markets not traditionally served by upscale steakhouses.

The Company s Ruth s Chris restaurant offer USDA Prime grade steaks that are aged and prepared to exacting company standards and cooked in 1,800-degree broilers. The Company also offers veal, lamb, poultry and seafood dishes, and a broad selection of appetizers, including New Orleans-style barbequed shrimp, mushrooms stuffed with crabmeat, shrimp remoulade, Louisiana seafood gumbo, onion soup au gratin, crabtini and seven salad variations. The Company complements its distinctive food offerings with an award-winning core wine list, featuring bottles priced between $28 and $2,000 and many selections offered by the glass.

As of December 30, 2007, there were 118 Ruth s Chris restaurants, of which 61 were company-owned and 57 were franchisee-owned, including twelve international franchisee-owned restaurants in Mexico, China (Hong Kong), Taiwan, Japan and Canada.

On February 19, 2008, the Company acquired all of the operating assets and intellectual property of Columbus, Ohio based Mitchell s Fish Market, which operates 19 restaurants operating under the names Mitchell s Fish Market and Columbus Fish Market, and Cameron s Steakhouse, which operates three restaurants operating under the names Cameron s Steakhouse and Mitchell s Steakhouse from Cameron Mitchell Restaurants, LLC (CMR).

Our History

The Company was founded in 1965 when Ruth Fertel mortgaged her home for $22,000 to purchase the Chris Steak House, a 60-seat restaurant located near the New Orleans Fair Grounds racetrack. After a fire destroyed the original restaurant, Ruth relocated her restaurant to a new 160-seat facility nearby. As the terms of the original purchase prevented the use of the Chris Steak House name at a new location, Ruth added her name to that of the original restaurant thus creating the Ruth s Chris Steak House brand. The Company s expansion began in 1972, when Ruth opened a second restaurant in Metairie, a suburb of New Orleans. In 1976, the first franchisee-owned Ruth s Chris Steak House opened in Baton Rouge, Louisiana. In July 1999, affiliates of Madison Dearborn Partners LLC (Madison Dearborn) and certain unaffiliated investors acquired all of the Company s outstanding capital stock. On May 19, 2005, the Company reincorporated in Delaware by merging Ruth s Chris Steak House, Inc., a Louisiana corporation, into a newly formed Delaware subsidiary. In August 2005, the Company and certain selling shareholders completed an initial public offering of the Company s common stock, which is currently listed on the Nasdaq Global Select Market.

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Our Strengths

The Company believes that the key strengths of its business model are the following:

Premier Upscale Steakhouse Brand

The Company believes that Ruth s Chris is currently one of the strongest brands in the fine dining segment of the restaurant industry. The Company s Ruth s Chris restaurants continue to receive numerous awards at the local and national level. Many continue to be ranked best steakhouse by local publications in the areas in which they operate. In addition, the Company has been recognized for its award-winning core wine list, for which 72 of its restaurants received Awards of Excellence from *Wine Spectator* magazine in 2007.

Appealing Dining Experience

The Company seeks to exceed guests expectations by offering high-quality food with courteous, friendly service in the finest tradition of Southern hospitality. The Company s entire restaurant staff is dedicated to ensuring that guests enjoy a superior dining experience. The Company s team-based approach to table service is designed to enhance the frequency of guest contact and speed of service without intruding on the guest experience.

Broad Appeal

The Company believes that the combination of its high quality food offerings, friendly and attentive service and warm and inviting atmosphere creates a dining experience that appeals to a wide range of guests, including families, special occasion diners and business clientele. The Company believes its focus on creating this broad appeal gives it the opportunity to enter into many new markets, including markets not traditionally served by upscale steakhouses. In addition, the Company believes that the diversity of its customer base may reduce its exposure to fluctuations in the spending habits of any particular group of guests.

Attractive Unit Economics

The Company believes that it has successfully operated restaurants in a wide range of markets and achieved attractive rates of return on invested capital. The Company believes that this historical success provides it with negotiating leverage during the initial phase of new restaurant construction, and has permitted it to open new restaurants at what it believes to be favorable levels of investment. The strength of the Ruth s Chris brand has allowed the Company to generate high unit volumes within one to two years of opening in new markets. The Company s 13 newest company-owned Ruth s Chris restaurants that opened in 2005, 2006 and 2007 generated average unit volumes in excess of $5.3 million (on an annualized basis of 52 weeks) in fiscal 2007, compared to average unit volumes of approximately $5.6 million in fiscal 2007 for those restaurants, excluding acquired locations, in its existing Ruth s Chris company-owned restaurant base which have been open for at least fifteen months.

Experienced, Committed Management Team

The members of the Company s senior management team average nearly 20 years of restaurant industry experience. Craig S. Miller, its President, Chief Executive Officer and Chairman of the Board, has over 40 years of industry experience, including periods as the head of publicly traded restaurant corporations, most notably as President and Chief Executive Officer of Uno Restaurant Corporation. Mr. Miller served as Chairman of the National Restaurant Association, the leading business association for the restaurant industry, from May 2005 to May 2006. The Company s management team has a meaningful equity ownership stake in the Company and is committed to growing its business by building on the core strengths of its business model. As of December 30, 2007, the Company s management team collectively owned, through restricted stock and options subject to vesting, approximately 10.2% of the Company s common stock on a fully diluted basis.

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Our Strategy

The Company believes there are significant opportunities to grow its business, strengthen its competitive position and enhance its brand through the continued implementation of the following strategies:

Improve Profitability

The Company intends to improve profitability by continuing to implement key operating initiatives. These operating initiatives include:

- ensuring consistency of food quality through more streamlined preparation and presentation;
- increasing emphasis on wine sales by providing wine education for employees;
- enhancing brand awareness through increased marketing at the national, regional and local levels;
- enhancing and/or developing innovative marketing programs, such as its website, www.ruthschris.com, Ruth s Chris gift cards and a recognition program for frequent guests; and
- improving guest traffic through increased focus on table utilization and efficiency, including enhancement of its online reservation and table management system.

Expand Restaurant Base

The Company believes that the 50 most populous markets in the United States could support an additional 75 to 100 company-owned and franchisee-owned Ruth s Chris restaurants, based on its analysis of current demand and its competitors penetration of those markets. Further, the Company believes there is potential for an additional 25 to 50 Ruth s Chris restaurants in smaller markets in the United States. The Company continues to evaluate opportunities to open new Ruth s Chris restaurants in both new and existing markets.

Company-owned restaurants: The Company currently expects to open six to eight company-owned Ruth s Chris restaurants per year in each of the next several years. The Company opened eight new Ruth s Chris restaurants and acquired three Ruth s Chris restaurants during fiscal 2007. The Company also has outstanding lease commitments for nine new Ruth s Chris restaurant locations that are scheduled to open in fiscal 2008 and fiscal 2009 and continues to negotiate with potential lessors in several other locations in which the Company plans to open new restaurants.

Franchisee-owned restaurants: Ten new Ruth s Chris franchisee-owned restaurants opened during fiscal 2007, and the Company expects six to eight new franchisee-owned Ruth s Chris restaurants to open in each of the next several years. The Company s franchise income, which consists of a 5% royalty fee on all sales from franchisee-owned restaurants and franchise fees, totaled $12.9 million and comprised approximately 4.1% of its total revenues in fiscal 2007.

Expand Relationships with New and Existing Franchisees

The Company intends to grow its franchising business by developing relationships with a limited number of new franchisees and by expanding the rights of existing franchisees to open new restaurants. The Company believes that building relationships with quality franchisees is a cost-effective way to strengthen the Ruth s Chris brand and generate additional revenues. Franchisees opened twenty-one Ruth s Chris restaurants from 1999 to the end of 2006 and the Company granted ten new franchisee rights during that period. In fiscal 2007, existing and new franchisees opened seven and three restaurants, respectively. During fiscal 2007, the Company also entered into two development agreements with new franchisees. Overall, there are 26 outstanding franchise locations to be built as of December 30, 2007. The Company intends to continue to focus on providing operational guidance to its franchisees, including the sharing of best practices from company-owned Ruth s Chris restaurants.

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Site Selection, Development and Design

The Company s evaluation of prospective restaurant sites includes analysis of population density, potential population growth and demographic characteristics of the surrounding area, as well as research concerning accessibility, visibility, surrounding traffic patterns, the number and proximity of competitive restaurants and the potential return on invested capital.

The costs of opening a new Ruth s Chris Steak House restaurant depend upon, among other things, the location and size of the site and the extent of any renovation required. While the Company generally leases its company-owned restaurant sites, the Company owns the land and building for seven restaurants. The Company s future plans include both leasing and owning restaurant locations, depending upon which alternative provides the highest return on capital. For leased restaurants, the Company currently targets an average cash investment of approximately $2.5 million to $4.5 million per restaurant, net of tenant allowances but including pre-opening expenses.

The Company s designers use standard styles in its restaurant interiors, although each location is tailored to reflect local tastes and preferences. The Company s restaurants typically consist of an enhanced bar area and public seating, as well as most of the Company s restaurants also have dining rooms that are available for private dining functions.

Menu

The Ruth s Chris menu features a broad selection of high-quality USDA Prime grade steaks and other premium offerings served in Ruth s Chris signature fashion sizzling and topped with seasoned butter complemented by other traditional menu items inspired by its New Orleans heritage. USDA Prime is a meat grade label, which refers to the evenly distributed marbling that enhances the flavor of the steak. The Ruth s Chris menu also includes premium quality lamb chops, veal chops, fish, chicken and lobster. Steak and seafood combinations and a vegetable platter are also available at selected restaurants. Dinner entrees are generally priced from $19.95 to $45.95. While Ruth s Chris is predominantly open dinner hours only, four select locations open for lunch five days a week and an additional eleven locations open for lunch one day per week. The lunch menu offers entrees generally ranging in price from $12.95 to $33.95 and the Ruth s Chris core menu is similar at all of its restaurants. The Company occasionally introduces new items such as specials that allow it to give its guests additional choices while taking advantage of fresh sourcing and advantageous cost opportunities.

The Company s Ruth s Chris restaurants offer eleven to thirteen standard appetizer items, including New Orleans-style barbequed shrimp, mushrooms stuffed with crabmeat, shrimp remoulade, Louisiana seafood gumbo, onion soup au gratin, crabtini, as well as seven different salads. They also offer eight to ten types of potatoes and eight to twelve types of vegetables as side dishes ranging in price from $6.95 to $9.50. For dessert, creme brulee, bread pudding with whiskey sauce, chocolate sin cake, fresh seasonal berries with sweet cream sauce and other selections are available for $6.95 to $9.95 each.

The Company s core wine list features bottles typically ranging in price from $28 to $2,000. Individual restaurants supplement their 250-bottle core wine list with a minimum of 50 additional selections that reflect local market tastes. Most of the Company s Ruth s Chris restaurants also offer approximately 30 to 40 wines-by-the-glass and numerous beers, liquors and alcoholic dessert drinks. Bottled wines account for approximately 70% of total wine sales.

Purchasing

The Company s ability to maintain consistent quality throughout its Ruth s Chris restaurants depends in part upon its ability to acquire food and other supplies from reliable sources in accordance with its specifications. Purchasing at the restaurant level is directed primarily by the executive chef, who is trained in the Company s purchasing philosophy and specifications, and who works with its regional and corporate managers to ensure

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consistent sourcing of meat, fish, produce and other supplies. Each of the Company s restaurants also has an in-store beverage manager who is responsible for purchasing wines based on guest preferences, market availability and menu content and works directly with the Company s Vice President of Beverage to ensure quality and price efficiency.

During fiscal 2007 the Company purchased more than 82% of the beef it used in its company-owned Ruth s Chris restaurants from one vendor, New City Packing Company, Inc., with which it has no long-term contractual arrangement. In addition, the Company has a long-term distribution arrangement with a national food and restaurant supply distributor, Commissary Operations, Inc., which purchases products for the Company from various suppliers and through which 42 of its company-owned restaurants receive a significant portion of their food supplies.

Restaurant Operations and Management (Ruth s Chris Steak House)

The Company s Chief Operating Officer has primary responsibility for managing its company-owned restaurants and participates in analyzing restaurant-level performance and strategic planning. The Company has eight regional vice presidents that oversee restaurant operations at six to eight company-owned restaurants and two regional vice presidents that have oversight responsibility for franchise-owned restaurants.

The Company s typical company-owned restaurant employs five managers, including a general manager, two front-of-the-house managers, an executive chef and a sous chef. The Company s company-owned restaurants also typically have approximately 70 hourly employees. The general manager of each restaurant has primary accountability for ensuring compliance with the Company s operating standards. The front-of-the-house managers assist the general manager in the day-to-day operations of the restaurant and are directly responsible for the supervision of the bar, host, server, runner and service assistant personnel. The executive chef supervises and coordinates all back-of-the-house operations, including ensuring that its quality standards are being met and maintaining a safe, efficient and productive work environment.

The Company believes that the compensation it pays its managers and employees is comparable to that provided by other fine dining steakhouses, and because many of its restaurants are open during dinner hours only, it pays many of its employees hourly wages that exceed those of many of its competitors. The Company offers participation to eligible employees in its health and other benefit plans, including medical, dental, vision and 401(k) with matching. The Company believes that its compensation and benefits policies allow it to attract quality personnel and retain them at turnover rates considerably lower than those generally experienced by full service restaurants.

Quality Control

The Company strives to maintain quality and consistency in its company-owned Ruth s Chris restaurants through careful training and supervision of personnel and standards established for food and beverage preparation, maintenance of facilities and conduct of personnel. The primary goal of the Company s training and supervision programs is to encourage its employees to display the characteristics of its brand and values that distinguish it from its competitors. Restaurant managers in its company-owned restaurants must complete a training program that is typically seven weeks long, during which they are instructed in multiple areas of restaurant management, including food quality and preparation, guest service, alcoholic beverage service, liquor regulation compliance and employee relations. Restaurant managers also receive operations manuals relating to food and beverage preparation and restaurant operations. The Company instructs chefs and assistants on safety, sanitation, housekeeping, repair and maintenance, product and service specifications, ordering and receiving food products and quality assurance. General managers and certified coaches provide all other employee training at the restaurants. The Company requires that all restaurant-level employees be certified by the Company in order to be able to demonstrate knowledge of its systems, standards and operating philosophy.

On a daily basis at our Ruth s Chris restaurants, the executive chef, together with the restaurant managers, oversees a line check system of quality control and must complete a quality assurance checklist verifying the flavor, presentation and proper temperature of the food and beverages. The Company retains outside consultants to perform quality assessments not less than four times per year of the front-of-the-house operations of company-owned and franchisee-owned restaurants. During these assessments, unidentified two-person teams dine in its restaurants and evaluate food quality, customer service and general restaurant operations through alternating weekday and weekend visits. The consultants complete a standard checklist and provide us with a written critique. Outside consultants are also utilized to perform random visits to all company- and franchisee-owned restaurants throughout the year to perform health inspections that are above and beyond local health inspections. In addition, the Company s regional vice presidents perform system-wide quality assessments of all aspects of restaurant operations, with a focus on back-of-the-house functions, on a regular basis.

Mitchell s Fish Market

On February 19, 2008, the Company acquired 19 Mitchell s Fish Market restaurants, located in the Midwest, Northeast, Florida and Connecticut, and three Cameron s Steakhouse restaurants located in Columbus, Ohio and Birmingham, Michigan.

Mitchell s Fish Market is an award-winning, upscale, yet comfortable, seafood restaurant and bar recognized for its high quality food, contemporary dining atmosphere, and excellent service. Mitchell s Fish Market is committed to fresh seafood and all of its seafood is flown in daily. Although the menu changes frequently based on availability and season, it includes more than 80 seafood choices, including fish from all over the world. The current average check is $22 at lunch and $39 at dinner. The Cameron s Steakhouses are a sophisticated 21st century update of the upscale American steakhouse.

The Company believes that Mitchell s is an innovative concept that is compatible with Ruth s Chris. Its focus on upscale casual restaurants with a sophisticated yet comfortable atmosphere and emphasis on fresh seafood is a wonderful complement to our own brand. The Company believes that Mitchell s Fish Market shares many characteristics of the Ruth s Chris model, including strong unit economics, broad guest appeal, a focus on banquet sales, and a robust bar business.

Marketing and Promotions

The goals of the Company s marketing efforts are to increase comparable restaurant sales by attracting new guests, increase the frequency of visits by current guests, improve brand recognition in new markets or markets where it intends to open a restaurant and to communicate the overall uniqueness, value and quality exemplified by the Ruth s Chris brand. The Company uses multiple media channels to accomplish these goals and complements its national advertising with targeted local media such as outdoor and airport directional posters and tourist publications.

Advertising

In fiscal 2007, the Company spent $8.4 million, or 2.6% of its revenues, in total advertising expenditures compared to $8.3 million in fiscal 2006. Of its total advertising expenditures in fiscal 2007, $6.1 million, or 72%, was spent on local media and events, compared to $5.0 million, or 60%, spent locally in fiscal 2006. This local media and events spending was split between tourist, entertainment and business magazines, outdoor billboards and airport dioramas, radio, internet media and community events such as golf tournaments, arts gatherings and charitable organizations. Direct mail was utilized to highlight specific market incentives. In fiscal 2007, the Company spent approximately $2.3 million, or 28% of total advertising expenditures, on national media, consisting primarily of national radio, national newspapers (USA Today) and online initiatives. In fiscal 2006, the Company spent $3.3 million, or 40% of its total advertising expenditures, on national media.

In fiscal 2007, the Company enhanced its online marketing efforts with online advertisements and banner ads placed on highly visited sites. The Company also utilized sponsored searches through such media as Google,

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Ask.com and Yahoo. The Company also used local online advertising for sites targeted to company and franchise geographic locations. The Company s online strategy also included an increased emphasis on targeted emails with special offers and announcements as well as a promotional e-certificate to its email marketing database. Communication also included seasonal specials, holiday offers, and personalized birthday and anniversary invitations.

The Company s current advertising campaign is integrated into all marketing communications including radio, print and outdoor advertisement. In addition, the Company uses its website, **www.ruthschris.com** to help increase brand identity and facilitate online reservations and gift card sales. Many of the Company s locations also schedule events to strengthen community ties and increase local market presence. The Company s franchisees also conduct their own local advertising campaigns. The Company will continue the existing advertising for its Mitchell s restaurants and will review potential enhanced strategies in the future.

Gift Cards

The Company sells Ruth s Chris gift cards at its restaurants, through its toll-free reservation system and on its website. Ruth s Chris patrons frequently purchase gift cards for holidays, including Christmas, Hanukkah, Valentine s Day, Mothers Day and Fathers Day, and other special occasions such as birthdays, graduations and anniversaries. These gift cards are popular as holiday gifts and among business professionals celebrating promotions. In fiscal 2007, system-wide gift card sales were approximately $36.4 million. Ruth s Chris gift cards are redeemable at both company- and franchise-owned Ruth s Chris restaurants.

Franchise Program and Relationship

The Company s 57 franchise-owned Ruth s Chris restaurants are owned by 23 franchisees with the three largest franchisees owning six, six and five restaurants, respectively. Currently, the Company has open agreements with franchisees for an aggregate of 26 additional Ruth s Chris restaurants. Prior to 2004, each franchisee entered into a ten-year franchise agreement with three ten-year renewal options for each restaurant. Each agreement grants the franchisee territorial protection, with the option to develop a certain number of restaurants in their territory. The Company s franchise agreements generally include termination clauses in the event of nonperformance by the franchisee and non-compete clauses if the agreement is terminated. To date, only two franchisees have had the Company s franchise agreement terminated or a restaurant closed as a result of nonperformance.

Under the Company s franchise program, the Company offers certain services and licensing rights to the franchisee to help maintain consistency in system-wide operations. The Company s services include training of personnel, site selection and construction assistance, providing the new franchisee with standardized operating procedures and manuals, business and financial forms, consulting with the new franchisee on purchasing and supplies and performing supervisory quality control services. The Company conducts reviews of its franchisee-owned restaurants on an ongoing basis, in order to ensure compliance with its standards.

Under the Company s franchise program, each franchise arrangement consists of a development agreement and a separate franchise agreement for each restaurant. The Company s new form of development agreement grants exclusive rights to a franchisee to develop a minimum number of restaurants in a defined area, typically during a five-year period. Individual franchise agreements govern the operation of each restaurant opened and have a 20-year term with two renewal options each for additional 10-year terms if certain conditions are met. The Company s new form of franchise agreement requires franchisees to pay a 5% royalty on gross revenues plus up to a 1% advertising fee applied to national advertising expenditures. Under the Company s prior form of franchise agreement, franchisees pay a 5% royalty on gross revenues, of which the Company has applied 1% to national advertising.

Under the Company s form of development agreement, and unless agreed otherwise, the Company collects a $50,000 development fee for each restaurant the franchisee has rights to develop. Under the Company s new

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form of the franchise agreement, it collects up to $100,000 of the franchise fee at the time of executing the franchise agreement for each restaurant. To date, the Company has used its form of agreement with eleven new franchisees (three of whom are located outside of the United States) and three existing franchisees.

The Company s existing franchise agreements signed before 2004 generally limit the number of restaurants each franchisee can develop to two. The Company expanded its domestic franchise base in 2004 by first offering existing franchisees the opportunity to open additional restaurants in its existing territories. In order to obtain these new rights, existing franchisees were provided a new Uniform Franchise Offering Circular (UFOC) and were required to sign the Company s new form of development and franchise agreement which commits the franchisee to a store development schedule. New franchise rights will be sold pursuant to the new UFOC and franchise agreement described above, which enables the Company to better manage the growth of its franchise system. The Company anticipates opening six to eight franchise restaurants per year over the next several years.

The Company currently does not have any plans to franchise Mitchell s Fish Market or Cameron s Steakhouse restaurants.

Information Systems and Restaurant Reporting

All of the Company s restaurants use computerized point-of-sale systems, which are designed to improve operating efficiency, provide corporate management timely access to financial and marketing data and reduce restaurant and corporate administrative time and expense. These systems record each order and print the food requests in the kitchen for the cooks to prepare. The data captured for use by operations and corporate management includes gross sales amounts, cash and credit card receipts and quantities of each menu item sold. Sales and receipts information is generally transmitted to the corporate office daily, where it is reviewed and reconciled by the accounting department before being recorded in the accounting system.

The Company s corporate systems provide management with operating reports that show company-owned restaurant performance comparisons with budget and prior year results. These systems allow the Company to monitor company-owned restaurant sales, food and beverage costs, labor expense and other restaurant trends on a regular basis.

Service Marks

The Company has registered the main service marks Ruth s Chris and its Ruth s Chris Steak House, U.S. Prime & Design logo, as well as other service marks used by its restaurants with the United States Patent and Trademark Office and in the foreign countries in which its restaurants operate. The Company has also registered in other foreign countries on anticipation of new store openings within those countries. The Company is not aware of any infringing uses that could materially affect its business. The Company believes that its service marks are valuable to the operation of its restaurants and are important to its marketing strategy.

As part of the Mitchell s acquisition, which was completed on February 19, 2008, we acquired the federally registered service mark Mitchell s Fish Market and the common law service marks Mitchell s Steakhouse , Cameron s Steakhouse , Columbus Fish Market and Cameron s Steak together with any and all other trade names, common law trade and service marks, state registered trade and service marks, and trade dress owned or used by the seller in connection with the steakhouse and seafood restaurants so acquired.

Seasonality

The Company s business is subject to seasonal fluctuations. Historically, the percentage of its annual revenues earned during the first and fourth fiscal quarters have been higher due, in part, to increased restaurant sales during the year-end holiday season.

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Employees

As of December 30, 2007, the Company employed 4,693 persons, of whom 464 were salaried and 4,229 were hourly personnel, who were employed in the positions set forth in the table below. None of the Company s employees are covered by a collective bargaining agreement. The Company believes that it has good relations with its employees.

Functional Area	Number of Employees
Senior Officers / Corporate VPs / Operations VPs	34
General Managers	60
Managers	163
Regional Corporate Chefs / Executive Chefs	64
Sous Chefs	57
Non-salaried restaurant staff	4,224
Corporate salaried	85
Corporate non-salaried	6
Total number of employees	4,693

Executive Officers of the Registrant

Certain information regarding our executive officers is provided below:

Name	Age	Position
Craig S. Miller	58	President, Chief Executive Officer and Chairman of the Board
Geoffrey D. K. Stiles	54	Executive Vice President, Operations and Chief Operating Officer
David L. Cattell	58	Senior Vice President, Chief Development Officer
Sarah C. Jackson	49	Senior Vice President, Human Resources
Damon M. Liever	53	Senior Vice President, Marketing
Thomas E. O Keefe	47	Senior Vice President, General Counsel and Secretary
Thomas J. Pennison, Jr	40	Senior Vice President, Chief Financial Officer and Assistant Secretary

Craig S. Miller has served as the Company s President and Chief Executive Officer and Chairman of the Board since September 2006. From March 2004 to September 2006, Mr. Miller served as the President and Chief Executive Officer and as a member of the board of directors. Prior to that, from October 2002 to March 2004, Mr. Miller was the founder and Chairman of Miller Partners Restaurant Solutions, Inc. From October 2001 to October 2002, Mr. Miller served as President and Chief Executive Officer of Furr s Restaurant Group. In January 2003, Furr s Restaurant Group filed for bankruptcy protection under chapter 11 of the U.S. Bankruptcy Code. From October 1996 to October 2001, Mr. Miller served as President and Chief Executive Officer of Uno Restaurant Corporation. Prior to October 1996, Mr. Miller held various executive level positions with Uno Restaurant Corporation. Mr. Miller is a member of the Board of the National Restaurant Association (the Association). Mr. Miller served as Chairman of the Association from May 2005 to May 2006.

Geoffrey D. K. Stiles has served as the Company s Executive Vice President, Operations and Chief Operating Officer since November 2003. From April 2003 to November 2003, Mr. Stiles was employed as a consultant by one of the Company s franchisees. Mr. Stiles previously served as the Company s Director of Operations from January 2001 to April 2003. Prior to joining the Company, Mr. Stiles served in executive and senior management positions at several restaurant groups, including Capitol Restaurant Concepts, Inc., Bertolini s Restaurants Inc., Romano s Macaroni Grill and the Olive Garden.

David L. Cattell has served as the Company s Senior Vice President and Chief Development Officer since November 2005. From September 2004 to November 2005, Mr. Cattell served as the Vice President,

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Development and Construction and Chief Development Officer. Prior to joining the Company, from January 2000 to January 2004, Mr. Cattell served as Vice President of Restaurant Development at Metromedia Restaurant Group. From 1981 to 1995, Mr. Cattell directed and managed real estate, construction, architecture and engineering functions for Kentucky Fried Chicken as Vice President of Restaurant Development.

Sarah C. Jackson has served as the Company s Senior Vice President, Human Resources since December 2006. From August 2006 to December 2006, Ms. Jackson served as the Vice President of Human Resources. Prior to joining the Company, from April 2004 to July 2006, Ms. Jackson served as the Vice President of Human Resources and Training for Romacorp, Inc. In November 2005, Romacorp, Inc. filed for bankruptcy protection under Chapter 11 of the U.S. Bankruptcy Code. From May 1989 to April 2004, Ms. Jackson held various leadership positions with Darden Restaurants, Inc.

Damon M. Liever has served as the Company s Senior Vice President and Chief Marketing Officer since July 2007. From July 1999 to July 2007, Mr. Liever progressed from the Senior Vice President of Marketing for Wood Dining Services, to the President of the Retail Brand Group of Sodexho USA, when Sodexho USA acquired Wood Dining in January 2002. Prior to that, Mr. Liever held senior leadership positions in marketing with Uno Restaurant Corporation, Black-eyed Pea Restaurants, Taco Bell, Inc. and Frito-Lay, Inc.

Thomas E. O Keefe has served as the Company s Senior Vice President, General Counsel and Assistant Secretary since November 2005. From March 2005 to November 2005, Mr. O Keefe served as the Vice President and General Counsel. Prior to joining the Company, from October 2003 to March 2005, Mr. O Keefe was engaged in the private practice of law as a sole practitioner practicing in the areas of franchise, product distribution, antitrust and general corporate law. From August 1993 to September 2003, Mr. O Keefe was Vice President and General Counsel to G.C. & K. B. Investments, Inc. d/b/a SpeeDee Oil Change & Tune-Up, an international franchisor of automobile service centers. From 1991 to 1993, Mr. O Keefe served as Corporate Counsel to AFCE, Inc. d/b/a Popeyes and Church s Chicken, an international franchisor of quick-service restaurants. Mr. O Keefe relinquished his position as Assistant Secretary effective December 2006 and assumed the position of Secretary for the Company.

Thomas J. Pennison, Jr. has served as the Company s Senior Vice President, Chief Financial Officer and Secretary since November 2005. From April 2004 to November 2005, Mr. Pennison served as Vice President, Finance and Chief Financial Officer, and from February 1998 to April 2004, Mr. Pennison served as Vice President, Finance. From October 1996 to January 1998, Mr. Pennison served as the Director of Finance. Prior to joining the Company, from April 1994 to October 1996, Mr. Pennison served as Assistant Corporate Controller of Casino Magic Corp., with primary responsibilities for corporate finance and SEC reporting. From January 1991 to April 1994, Mr. Pennison was at the public accounting firm KPMG LLP. Mr. Pennison relinquished his position as Secretary effective December 2006 and assumed the position of Assistant Secretary for the Company. In December 2007, Mr. Pennison announced that he will be leaving the Company to pursue other business and personal interests.

Government Regulation

The Company is subject to extensive federal, state and local government regulation, including regulations relating to public health and safety, zoning and fire codes and the sale of alcoholic beverages and food. The Company maintains the necessary restaurant, alcoholic beverage and retail licenses, permits and approvals. The development and construction of additional restaurants will also be subject to compliance with applicable zoning, land use and environmental laws. Federal and state laws govern the Company s relationship with its employees, including laws relating to minimum wage requirements, overtime, tips, tip credits and working conditions. A significant number of the Company s hourly employees are paid at rates related to the federal or state minimum wage.

The offer and sale of franchises is subject to regulation by the U.S. Federal Trade Commission (FTC) and many states. The FTC requires that the Company furnish to prospective franchisees a franchise offering circular containing prescribed information. A number of states also regulate the sale of franchises and require state registration of franchise offerings and the delivery of a franchise offering circular to prospective franchisees. The Company s noncompliance could result in governmental enforcement actions seeking a civil or criminal penalty, rescission of a franchise, and loss of its ability to offer and sell franchises in a state, or a private lawsuit seeking rescission, damages and legal fees.

Competition

The restaurant business is highly competitive and highly fragmented, and the number, size and strength of the Company s competitors vary widely by region. The Company believes that restaurant competition is based on, among other things, quality of food products, customer service, reputation, restaurant location, name recognition and price. The Company s restaurants compete with a number of fine dining steakhouses and upscale seafood restaurants within their markets, both locally owned restaurants and restaurants within regional or national chains. The principal fine dining steakhouses with which the Company competes are Fleming s, The Capital Grille, Smith & Wollensky, The Palm, Del Frisco s and Morton s of Chicago. The principal upscale seafood restaurants with which the Company competes are McCormick & Schmick s. Legal Seafood, Bonefish Grill and The Oceanaire Seafood Room. Many of the Company s competitors are better established in certain of its existing markets and/or markets into which it intends to expand.

Available Information

The Company maintains a website on the Internet at **www.ruthschris.com**. The Company makes available free of charge, through the investor relations section of its website, its Annual Reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports electronically filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act of 1934. Such information is available as soon as reasonably practicable after it files such reports with the SEC. Additionally, its Code of Ethics may be accessed within the Investor Relations section of its website. Information found on its website is not part of this Annual Report on Form 10-K or any other report filed with the SEC.

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Item 1A. RISK FACTORS

In addition to the other information in this Annual Report on Form 10-K, the following risk factors should be considered carefully in evaluating the Company and its business. The risks and uncertainties described below are not the only ones the Company faces. Additional risks and uncertainties not presently known to us or that the Company currently deems immaterial may also impair its business operations. If any of these certain risks and uncertainties were to actually occur, the Company s business, financial condition or results of operations could be materially adversely affected. In such case, the trading price of the Company s common stock could decline and its investors may lose all or part of their investment. These risks and uncertainties include, but are not limited to, the following:

The restaurant industry in general and the fine dining segment in particular are vulnerable to fluctuations in economic conditions, including volatility in levels of consumer discretionary spending.

A significant deterioration in economic conditions in any of the Company s markets would reduce guest traffic or require its affected restaurants to lower their prices, either of which would reduce the Company s total revenues and operating income. For example, the Company s total revenues fell 4.9% and 0.1% in fiscal 2001 and fiscal 2002, respectively, which were years of declining discretionary consumer spending in the United States due in part to the September 11, 2001 attacks. In addition, we cannot predict the length or severity of the current economic downturn. Comparable company-owned restaurant sales decreased 1.0% in fiscal 2007 versus fiscal 2006 due primarily to declining discretionary spending with the economic downturn. In addition, natural disasters, including extreme weather events such as hurricanes, occurring within any of the Company s market territories could cause reductions in revenues and/or disruptions in operations, such as restaurant closures. Any changes in economic conditions, or a continuation or increase in the severity of the current economic downturn would affect the Company s ability to attract guests or price its menu items at favorable levels, which would result in significant reductions in revenue and/or operating income.

Competitive conditions, consumer tastes and unexpected operating expenses could adversely affect the profitability of restaurants that the Company opens in new markets.

The Company s growth strategy includes opening restaurants in markets where it has little or no meaningful operating experience and in which its brand may not be well known. Competitive conditions, consumer tastes and discretionary spending patterns in these new markets may differ from those in its existing markets. The Company may be unable to generate similar acceptance of our brands due to these factors, which may require it to incur significant additional promotion costs in order to increase restaurant sales at these locations. The Company s ability to operate new restaurants profitably will depend on numerous factors, some of which are beyond its control, including, but not limited to, the following:

- locating and securing suitable new restaurant sites on acceptable lease terms;
- construction and development costs;
- obtaining adequate construction financing;
- securing governmental approvals and permits, including liquor licenses;
- hiring, training and retaining skilled management, chefs and other personnel;
- successfully promoting new restaurants and competing in the markets in which new restaurants are located; and
- general economic conditions and conditions specific to the restaurant industry.

Any one of these factors could preclude the Company from operating new restaurants successfully, which could adversely affect growth and profitability.

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The Company s growth may strain its infrastructure and resources, which could delay the opening of new restaurants and adversely affect its ability to manage existing restaurants.

The Company currently plans to continue its accelerated pace of new restaurant growth. This growth will place increased demands on management resources as well as human resources, purchasing and site management teams. The Company s planned growth in franchisee-owned restaurants will also require additional infrastructure for the development and maintenance of franchise relationships, as well as for the monitoring of those restaurants. In addition, if the Company s current restaurant management systems, financial and management controls and information systems are insufficient to support this expansion, its ability to open new restaurants and to manage existing restaurants would be adversely affected. If the Company fails to continue to improve its infrastructure, the Company may be unable to implement its growth strategy and/or maintain current levels of operating performance in existing restaurants.

We may not be able to successfully integrate into our business the operations of restaurants that we have acquired, which may adversely affect our business, financial condition and results of operations.

On February 19, 2008, the Company completed the acquisition of the Mitchell s Fish Market, operating under the names Mitchell s Fish Market and Columbus Fish Market, and Cameron s Steakhouse, operating under the names Cameron s Steakhouse and Mitchell s Steakhouse from Cameron Mitchell Restaurants, LLC (CMR). These restaurants will be the first the Company owns that focus primarily of serving seafood and that do not have the Ruth s Chris brand. Achieving the expected benefits of these restaurants and any other restaurants that the Company acquires will depend in a large part on our ability to successfully integrate the operations of the acquired restaurants and personnel in a timely and efficient manner and develop their brands. The risks involved in the integration of this acquisition include:

- the development of a new brand and the operation of restaurants that serve a seafood-based menu as opposed to the Company s current steak-based menu;

- challenges and costs associated with the acquisition and integration of restaurant operations located in markets where Ruth s Chris has limited or no experience;

- possible disruption to the Company s business as a result of the diversion of management s attention from its normal operational responsibilities and duties; and

- consolidation of the corporate, information technology, accounting and administrative infrastructure and resources of the acquired restaurants into the Company s business.

If Ruth s Chris cannot overcome the challenges and risks that we face in integrating the operations of newly acquired restaurants, our business, financial condition and results of operations could be adversely affected.

Negative publicity surrounding the Company s restaurants or the consumption of beef generally, or shifts in consumer tastes, could reduce sales in one or more of its restaurants and make its brand less valuable.

The Company s success depends, in large part, upon the popularity of its menu offerings. Negative publicity resulting from poor food quality, illness, injury or other health concerns (including e-coli, Bovine Spongiform Encephalopathy (mad cow disease), Hepatitis A and foot and mouth disease), whether related to one of the Company s restaurants or to the beef or seafood industries in general, or operating problems related to one or more restaurants, could make the Company s menu offerings less appealing to consumers and reduce demand in its restaurants. In addition, any other shifts in consumer preferences away from the kinds of food the Company offers, particularly beef and seafood, whether because of dietary or other health concerns or otherwise, would make its restaurants less appealing and adversely affect revenues.

In addition, some types of seafood have been subject to adverse publicity due to certain levels of contamination at their source, which can adversely affect both supply and market demand. The Company s Mitchell s restaurants maintain an in-house inspection program for our seafood purchases and, in the past, have

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not experienced any detriment from contaminated seafood. However, in the future seafood contamination or inadequate supplies of seafood could have a significant and materially adverse effect on the Company s operating results and profitability.

The Company may not be able to compete successfully with other restaurants, which could reduce its revenues.

The restaurant industry is intensely competitive with respect to price, service, location, food quality, atmosphere and overall dining experience. The Company s competitors include a large and diverse group of well-recognized fine dining and upscale casual restaurant chains, including fine dining steakhouse and seafood chains as well as restaurants owned by independent local operators. Some of the Company s competitors may have substantially greater financial, marketing and other resources, and may be better established in the markets where its restaurants are or may be located. If the Company cannot compete effectively in one or more of its markets, the Company may be unable to maintain recent levels of comparable restaurant sales growth and/or may be required to close existing restaurants.

If the Company s vendors or distributors do not deliver food and beverages in a timely fashion it may experience short-term supply shortages and/or increased food and beverage costs.

The Company s ability to maintain consistent quality throughout company-owned restaurants depends in part upon its ability to purchase USDA Prime and Choice grade beef, seafood and other food products in accordance with its rigid specifications. During fiscal 2007, the Company purchased more than 82% of the beef it used in company-owned restaurants from one vendor, New City Packing Company, Inc., with which the Company has no long-term contractual arrangement. In addition, the Company currently has a long-term arrangement with a distributor, Commissary Operations, Inc., which purchases products for it from various suppliers, and through which 42 of its company-owned restaurants receive a significant portion of their food supplies. If these or other vendors or distributors cease doing business with the Company, it could experience short-term supply shortages in certain company-owned restaurants and could be required to purchase supplies at higher prices until the Company is able to secure an alternative supply source. Any delay the Company experiences in replacing vendors or distributors on acceptable terms could increase food costs or, in extreme cases, require it to temporarily remove items from the menu of one or more restaurants.

Increases in the prices of, or reductions in the availability of, any of our core food products could reduce the Company s operating margins and revenues.

The Company purchases large quantities of beef, particularly USDA Prime grade beef, which is subject to extreme price fluctuations due to seasonal shifts, climate conditions, industry demand and other factors. The Company s beef costs represented approximately 51.3% of its food and beverage costs during fiscal 2007 and the Company historically has not had any long-term contractual arrangements, nor does it use future contracts or other financial risk management strategies to reduce exposure to potential price fluctuations. For fiscal 2008, the Company expects to enter into contracts with beef suppliers to establish set pricing on a portion of its anticipated beef purchases. The market for USDA Prime grade beef is particularly volatile. For example, in late 2003, increased demand, together with the impact of supply rationalization during late 2001 and 2002, resulted in shortages of USDA Prime grade beef, requiring the Company to pay significantly higher prices for the USDA Prime grade beef it purchased. If prices for the types of beef the Company uses in its restaurants increase in the future and it chooses not to pass, or cannot pass, these increases on to its guests, the Company s operating margins would decrease. If certain kinds of beef become unavailable for the Company to purchase, its revenues would decrease as well.

In the recent past, certain types of seafood have experienced fluctuations in availability. Seafood is also subject to fluctuations in price based on availability, which is often seasonal. If certain types of seafood are unavailable, or if our costs increase, our results of operations could be adversely affected.

Labor shortages or increases in labor costs could slow the Company s growth or harm its business.

The Company s success depends in part upon its ability to continue to attract, motivate and retain employees with the qualifications to succeed in its industry and the motivation to apply the Company s core service philosophy, including regional operational managers, restaurant general managers and chefs. If the Company is unable to continue to recruit and retain sufficiently qualified individuals, its business and growth could be adversely affected. Competition for these employees could require the Company to pay higher wages, which could result in higher labor costs. In addition, the Company has a substantial number of hourly employees who are paid wage rates at or based on the federal or state minimum wage and who rely on tips as a large portion of their income. Increases in the minimum wage or decreases in allowable tip credits would increase the Company s labor costs. The Company may be unable to increase its prices in order to pass these increased labor costs on to its guests, in which case its margins would be negatively affected.

Regulations affecting the operation of the Company s restaurants could increase operating costs and restrict growth.

Each of the Company s restaurants must obtain licenses from regulatory authorities allowing it to sell liquor, beer and wine, and each restaurant must obtain a food service license from local health authorities. Each restaurant s liquor license must be renewed annually and may be revoked at any time for cause, including violation by the Company or its employees of any laws and regulations relating to the minimum drinking age, advertising, wholesale purchasing and inventory control. In certain states, including states where the Company has a large number of restaurants or where it plans to open restaurants in the near term, the number of liquor licenses available is limited and licenses are traded at market prices. If the Company is unable to maintain existing licenses, or if it chooses to open a restaurant in those states, the cost of a new license could be significant. Obtaining and maintaining licenses is an important component of each of the Company s restaurant s operations, and the failure to obtain or maintain food and liquor licenses and other required licenses, permits and approvals would materially adversely impact existing restaurants or the Company s growth strategy.

The Company is also subject to a variety of federal and state labor laws, such as minimum wage and overtime pay requirements, unemployment tax rates, workers compensation rates and citizenship requirements. Government-mandated increases in minimum wages, overtime pay, paid leaves of absence and mandated health benefits, or increased tax reporting and tax payment requirements for employees who receive gratuities, or a reduction in the number of states that allow tips to be credited toward minimum wage requirements could increase the Company s labor costs and reduce its operating margins. In addition, the Federal Americans with Disabilities Act prohibits discrimination on the basis of disability in public accommodations and employment. Although the Company s restaurants are designed to be accessible to the disabled, it could be required to make modifications to its restaurants to provide service to, or make reasonable accommodations for, disabled persons.

The Company s strategy to open additional company-owned and franchisee-owned restaurants subjects it to extensive government regulation, compliance which might increase its investment costs and restrict its growth.

The Company is subject to the rules and regulations of the FTC, and various state laws regulating the offer and sale of franchises. The FTC requires that the Company furnish to prospective franchisees a franchise offering circular containing prescribed information and can restrict its ability to sell franchises. A number of states also regulate the sale of franchises and require the obtaining of a permit and/or registration of the franchise offering circular with state authorities and the delivery of the franchise offering circular to prospective franchisees. Noncompliance with those laws could result in governmental enforcement actions seeking a civil or criminal penalty, rescission of a franchise, and loss of the Company s ability to offer and sell franchises in a state, or a private lawsuit seeking rescission, damages and legal fees, which could have a material adverse effect on its business.

The Company s development and construction of additional restaurants must comply with applicable zoning, land use and environmental regulations. More stringent and varied requirements of local government

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bodies with respect to zoning, land use and environmental factors could delay construction of new restaurants and add to their cost in the future which could adversely affect the Company s future operating results. In addition, difficulties or failure in obtaining the required licenses and approvals could delay, or result in its decision to cancel, the opening of new restaurants.

The Company s franchisees could take actions that harm its reputation and reduce its royalty revenues.

The Company does not exercise control over the day-to-day operations of its franchisee-owned restaurants. While the Company attempts to ensure that franchisee-owned restaurants maintain the same high operating standards that it demands of company-owned restaurants, one or more of these restaurants may fail to maintain these standards. Any operational shortcomings of the Company s franchisee-owned restaurants are likely to be attributed to its system-wide operations and could adversely affect its reputation and damage its brand as well as have a direct negative impact on the royalty income it receives from those restaurants.

You should not rely on past increases in the Company s average unit volumes or its comparable restaurant sales as an indication of future operating results, because they may fluctuate significantly, which could have an adverse effect on the market price of its stock.

For a number of reasons, including but not limited to, those described below and elsewhere in this Annual Report on Form 10-K, the Company s operating results, revenues and expenses have in the past varied and may in the future vary significantly from quarter-to-quarter or year-to-year. These fluctuations could have an adverse effect on the market price of the Company s common stock. A number of factors historically have affected, and are likely to continue to affect, the Company s average unit volumes and/or comparable restaurant sales, including, among other factors:

the Company s ability to emes New Roman, Times, Serif; margin: 0pt 0; text-align: justify; text-indent: 0.5pt">The weight management industry is subject to changing consumer demands based, in large part, on the efficacy and popular appeal of weight management programs. The popularity of weight management programs is dependent, in part, on their ease of use, cost and channels of distribution as well as consumer trends, and, on an ongoing basis, many existing and potential providers of weight loss solutions, including many pharmaceutical firms with significantly greater financial and operating resources than we have, are developing new products and services. The creation of a weight loss solution, such as a drug therapy, that is perceived to be safe, effective and "easier" than a portion-controlled meal plan would put us at a disadvantage in the marketplace and our results of operations could be negatively affected.

If we do not continue to develop innovative new services and products or if our services and products do not continue to appeal to the market, or if we are unable to successfully expand into new channels of distribution or respond to consumer trends, our business may suffer.

The increasing focus of consumers on more integrated lifestyle and fitness approaches rather than just food, nutrition and diet could adversely impact the popularity of our programs. Our future success depends on our ability to continue to develop and market new, innovative services and products and to enhance our existing services and products, each on a timely basis to respond to new and evolving consumer demands, achieve market acceptance and keep pace with new nutritional, weight management, technological and other developments. We may not be successful in developing, introducing on a timely basis or marketing any new or enhanced services and products, and we cannot assure you that any new or enhanced services or products will appeal to the market. Our failure to develop new products and services and to enhance our existing products and services, and the failure of our products and services to continue to appeal to the market could have an adverse impact on our ability to attract and retain customers and thus adversely affect our business, financial condition or results of operations.

We may be subject to litigation from our competitors.

Our competitors may pursue litigation against us based on our advertising or other marketing practices regardless of merit and chances of success, especially if we engage in competitive advertising, which includes advertising that directly or indirectly mentions a competitor or a competitor's weight loss program in comparison to our program. While we would defend ourselves against any such claims, our defense may ultimately be unsuccessful. Also, defending against such claims, regardless of merit and ultimate outcome, may be lengthy and costly, strain our resources and divert management's attention from their core responsibilities, which would have a negative impact on our business.

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Our business is subject to online security risks, including security breaches and identity theft.

Unauthorized users who penetrate our information security could misappropriate proprietary or customer information or data or cause interruptions to the product offerings on our website. As a result, it may become necessary to expend significant additional amounts of capital and resources to protect against, or to alleviate, problems caused by unauthorized users. These expenditures, however, may not prove to be a timely remedy against unauthorized users who are able to penetrate our information security. In addition to purposeful security breaches, the inadvertent transmission of computer viruses could adversely affect our computer systems and, in turn, harm our business.

A significant number of states require that customers be notified if a security breach results in the disclosure of their personal financial account or other information. Additional states and governmental entities are considering such "notice" laws. In addition, other public disclosure laws may require that material security breaches be reported. If we experience a security breach and .such notice or public disclosure is required in the future, our reputation and our business may be harmed.

In the ordinary course of our business, we collect and utilize proprietary and customer information and data. Privacy concerns among prospective and existing customers regarding our use of such information or data collected on our website or through our services and products, such as weight management information, financial data, email addresses and home addresses, could keep them from using our website or purchasing our services or products. We currently face certain legal obligations regarding the manner in which we treat such information and data. Businesses have been criticized by privacy groups and governmental bodies for their use and handling

of such information and data. We rely on third-party software products to secure our credit card transactions. Although we have developed systems and processes that are designed to protect consumer information and prevent fraudulent payment transactions and other security breaches, failure to prevent or mitigate such fraud or breaches or changes in industry standards or regulations may adversely affect our business and operating results or cause us to lose our ability to accept credit cards as a form of payment and result in chargebacks of the fraudulently charged amounts. Furthermore, widespread credit card fraud may lessen our customers' willingness to purchase our products on our website.

Third parties may infringe on our brand, trademarks and other intellectual property rights, which may have an adverse impact on our business.

We currently rely on a combination of trademark and other intellectual property laws and confidentiality procedures to establish and protect our proprietary rights, including our brand. Because our business relies heavily on a direct-to-consumer business model, our brand is an important element of our business strategy. If we fail to successfully enforce our intellectual property rights, the value of our brand, services and products could be diminished and our business may suffer. Additionally, failure to protect our intellectual property could result in the entry of a competitor to the market. Our precautions may not prevent misappropriation of our intellectual property. Any legal action that we may bring to protect our brand and other intellectual property could be unsuccessful and expensive and could divert management's attention from other business concerns. In addition, legal standards relating to the validity, enforceability and scope of protection of intellectual property, especially in Internet-related businesses, are uncertain and evolving. We cannot assure you that these evolving legal standards will sufficiently protect our intellectual property rights in the future.

We may in the future be subject to intellectual property rights claims.

Third parties may in the future make claims against us alleging infringement of their intellectual property rights. Any intellectual property claims, regardless of merit, could be time-consuming and expensive to litigate or settle and could significantly divert management's attention from other business concerns. In addition, if we were unable to successfully defend against such claims, we may have to pay damages, stop selling the service or product or stop using the software, technology or content found to be in violation of a third party's rights, seek a license for the infringing service, product, software, technology or content or develop alternative non-infringing services, products, software, technology or content. If we cannot license on reasonable terms, develop alternatives or stop using the service, product, software, technology or content for any infringing aspects of our business, we may be forced to limit our service and product offerings. Any of these results could reduce our revenue and our ability to compete effectively, increase our costs or harm our business.

We may not be able to successfully implement new strategic initiatives, which could adversely impact our business.

We are continuously evaluating changing consumer preferences and the competitive environment of our industry and seeking out opportunities to improve our performance through the implementation of selected strategic initiatives. The goal of these efforts is to develop and implement a comprehensive and competitive business strategy which addresses the continuing changes in the weight management industry environment and our position within the industry. For example, as the healthcare industry continues to evolve its response to the obesity epidemic so do the requirements, both regulatory and business, for providers. If we do not successfully meet these requirements, we may not be perceived as an appropriate partner for certain purposes. We may not be able to successfully implement our strategic initiatives and realize the intended business opportunities, growth prospects, including new business channels, and competitive advantages. Our efforts to capitalize on business opportunities may not bring the intended results. Assumptions underlying expected financial results or consumer demand may not be met or economic conditions may deteriorate. We also may be unable to attract and retain highly qualified and skilled personnel to implement our strategic initiatives. If these or other factors limit our ability to successfully execute our strategic initiatives, our business activities, financial condition and results of operations may be adversely affected.

The sale of our products in markets outside of the United States may subject us to risks.

We have entered into certain arrangements for the sale of our products in international markets and we plan to expand our international sales, marketing and distribution activities on our own and through arrangements with partners located in other countries. The sale, marketing and distribution of our products and programs in such locations is subject to a number of uncertainties, including, but not limited to, the following:

- Economic and political instability;
- Import or export licensing requirements;
- Trade restrictions;
- Product registration requirements;
- Longer payment cycles;
- Changes in regulatory requirements and tariffs;
- Potentially adverse tax consequences; and
- Potentially weak protection of intellectual property rights.

We are dependent on our key executive officers for future success. If we lose the services of any of our key executive officers and we are unable to timely retain a qualified replacement, our business could be harmed.

Our future success depends to a significant degree on the skills, experience and efforts of our key executive officers. The loss of the services of any of these individuals could harm our business. We have not obtained life insurance on any key executive officers. If any key executive officers left us or were seriously injured and became unable to work, our business could be harmed.

Provisions in our certificate of incorporation may deter or delay an acquisition of us or prevent a change in control, even if an acquisition or a change of control would be beneficial to our stockholders.

Provisions of our certificate of incorporation (as amended) may have the effect of deterring unsolicited takeovers or delaying or preventing a third party from acquiring control of us, even if our stockholders might otherwise receive a premium for their shares over then current market prices. In addition, these provisions may limit the ability of stockholders to approve transactions that they may deem to be in their best interests.

Our certificate of incorporation (as amended) permits our Board of Directors to issue preferred stock without stockholder approval upon such terms as the Board of Directors may determine. The rights of the holders of our common stock will be junior to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The issuance of preferred stock could have the effect of making it more difficult for a third party to acquire, or discouraging a third party from acquiring, a majority of our outstanding common stock. The issuance of a substantial number of preferred shares could adversely affect the price of our common stock.

Risks Related to Our Industry

Changes in consumer preferences could negatively impact our operating results.

Our program features pre-packaged food selections, which we believe offer convenience and value to our customers. Our continued success depends, to a large degree, upon the continued popularity of our program versus various other weight loss, weight management and fitness regimens, such as low carbohydrate diets, appetite suppressants and diets featured in the published media. Changes in consumer tastes and preferences away from our pre-packaged food and support and counseling services, and any failure to provide innovative responses to these changes, may have a materially adverse impact on our business, financial condition, operating results, cash flows and prospects. Our success is also dependent on our food innovation including maintaining a robust array of food items and improving the quality of existing items. If we do not continually expand our food items or provide customers with items that are desirable in taste and quality, our business could be harmed.

The weight loss industry is subject to adverse publicity, which could harm our business.

The weight loss industry receives adverse publicity from time to time, and the occurrence of such publicity could harm us, even if the adverse publicity is not directly related to us. Congressional hearings about practices in the weight loss industry have also resulted in adverse publicity and a consequent decline in the revenue of weight loss businesses. Future research reports or publicity that is perceived as unfavorable or that question certain weight loss programs, products or methods could result in a decline in our revenue. Because of our dependence on consumer perceptions, adverse publicity associated with illness or other undesirable effects resulting from the consumption of our products or similar products by competitors, whether or not accurate, could also damage customer confidence in our weight loss program and result in a decline in revenue. Adverse publicity could arise even if the unfavorable effects associated with weight loss products or services resulted from the user’s failure to use such products or services appropriately.

Our industry is subject to governmental regulation that could increase in severity and hurt results of operations.

Our industry is subject to federal, state and other governmental regulation. Certain federal and state agencies, such as the Federal Trade Commission (the "FTC"), regulate and enforce laws relating to advertising, disclosures to consumers, privacy, consumer pricing and billing arrangements and other consumer protection matters. A determination by a federal or state agency, or a court, that any of our practices do not meet existing or new laws or regulations could result in liability, adverse publicity, and restrictions of our business operations. Some advertising practices in the weight loss industry have led to investigations from time to time by the FTC and other governmental agencies. Many companies in the weight loss industry, including our predecessor businesses, have entered into consent decrees with the FTC relating to weight loss claims and other advertising practices. In October 2009, the FTC published its revised Guides concerning the Use of Endorsements and Testimonials in Advertising which now requires us to use a statement as to what the typical weight loss customers can expect to achieve on our program when using a customer's weight loss testimonial in advertising. Federal and state regulation of advertising practices generally, and in the weight loss industry in particular, may increase in scope or severity in the future, which could have a material adverse impact on our business.

Other aspects of our industry are also subject to government regulation. For example, the labeling and distribution of food products, including dietary supplements, are subject to strict USDA and FDA requirements and food manufacturers are subject to rigorous inspection and other requirements of the USDA and FDA, and companies operating in foreign markets must comply with those countries' requirements for proper labeling, controls on hygiene, food preparation and other matters. If federal, state, local or foreign regulation of our industry increases for any reason, then we may be required to incur significant expenses, as well as modify our operations to comply with new regulatory requirements, which could harm our operating results. Additionally, remedies available in any potential administrative or regulatory actions may include product recalls and requiring us to refund amounts paid by all affected customers or pays other damages, which could be substantial.

Laws and regulations directly applicable to communications, operations or commerce over the Internet such as those governing intellectual property, privacy, libel and taxation, are more prevalent and remain unsettled. If we are required to comply with new laws or regulations or new interpretations of existing laws or regulations, or if we are unable to comply with these laws, regulations or interpretations, our business could be adversely affected.

Future laws or regulations, including laws or regulations affecting our marketing and advertising practices, relations with consumers, employees, service providers, or our services and products, may have an adverse impact on us.

The manufacture and sale of ingested products involves product liability and other risks.

Like other manufacturers and distributors of products that are ingested, we face an inherent risk of exposure to product liability claims if the use of our products results in illness or injury. The foods and products that we manufacture and sell in the U.S. are subject to laws and regulations, including those administered by the USDA and FDA that establish manufacturing practices and quality standards for food products. Product liability claims could have a material adverse effect on our business as existing insurance coverage may not be adequate. Distributors of weight loss food products, including dietary supplements, have been named as defendants in product liability lawsuits from time to time. The successful assertion or settlement of an uninsured claim, a significant number of insured claims or a claim exceeding the limits of our insurance coverage would harm us by adding costs to the business and by diverting the attention of senior management from the operation of the business. We may also be subject to claims that our products contain contaminants, are improperly labeled; include inadequate instructions as to use or inadequate warnings covering interactions with other substances. Additionally, the manufacture and sale of these products involves the risk of injury to consumers due to tampering by unauthorized third parties or product contamination. To date, we have not been a party to any product liability litigation and we are not aware of any instance in which any of our products have been defective in any way that could give rise to product liability claims. Product liability litigation, even if not meritorious, is very expensive and could also entail adverse publicity for us and reduce our revenue. Any negative publicity associated with these actions would adversely affect our brand and may result in decreased product sales and, as a result, lower revenue and profits.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None

ITEM 2. DESCRIPTION OF PROPERTY

In Owings Mills, Maryland, the Company owns a 49,000 square-foot manufacturing facility and leases two buildings which serve as corporate headquarters which are set to expire on August 31, 2016 and October 31, 2017. The Company owns a 119,000 square-foot distribution facility in Ridgley, Maryland and leases a second distribution center in Dallas, Texas which includes a call center. This lease is set to expire on March 31, 2018. Both distribution facilities give the Company adequate product distribution capacity for the foreseeable future. The Company owned a 3,000 square-foot conference and training facility in Ocean City, Maryland that was sold in February 2016. The Company leases a raw materials warehouse in Arbutus, Maryland that expires in May 2018. The Company also has 41 leases for what were its corporate owned Medifast Weight Control Centers. The 41 leases include 3 agreements for Centers that were closed in December 2013 and 7 agreements for Centers that were closed in December 2014 that the Company is in the process of negotiating lease terminations or sublease arrangements, if possible. The remaining 31 agreements are for Centers that were sold to franchise partners during 2014 and the Company entered into sublease agreements with the franchisees. All corporate leases range in terms from one to ten years.

ITEM 3. LEGAL PROCEEDINGS

Medifast entered into a number of Franchise and Development Agreements with Team Wellness, Inc. and Team Wellness Louisiana, LLC for the operation of Medifast Centers in the States of Alabama, Tennessee, and Louisiana. The primary owner and representative of the Team Wellness companies personally guaranteed the companies' obligations.

Team Wellness, Inc. failed to make payments required under the terms of a Loan Agreement that Team Wellness, Inc. had entered into with Bank of America and for which Medifast provided a limited guarantee. As a result, Medifast served Team Wellness, Inc. with a Notice of Default and Opportunity to Cure. After Team Wellness, Inc. failed to cure and pay the outstanding amounts, and was otherwise in default under the Franchise and Development Agreements, Medifast served Team Wellness, Inc. with a Notice of Termination. In addition, Medifast terminated Team Wellness Louisiana LLC's franchises, alleging that Team Wellness Louisiana LLC and its guarantor never disclosed to Medifast that RMS Management LLC was an owner of

Team Wellness Louisiana LLC but rather represented to Medifast that the guarantor was the sole owner.

When the companies and the primary guarantor failed to pay the monies owed or comply with their post-termination obligations, Medifast filed a lawsuit on November 21, 2014 against the primary guarantor and the companies in the United States District Court for the District of Maryland (Medifast Franchise Systems, Inc. v. Team Wellness, Inc., et al., No. 14-03668 (D. Md.) for breach of contract (nonpayment) and fraud (relating to Medifast's allegation that Team Wellness LLC and its guarantor failed to disclose that RMS Management LLC was an owner of Team Wellness Louisiana LLC). The complaint seeks damages, enforcement of the termination of the Franchise and Development Agreements, and an injunction ordering the defendants to comply with their post-termination obligations under the Franchise and Development Agreements. Medifast moved for a default judgment against the companies after they failed to answer the complaint. The court granted the motion on June 24, 2015. The Court's Order requires the companies to pay $2,100,927.53 million to Medifast, which includes the following: outstanding royalties and receivables on food purchases in the amount of $141,239.89, reimbursement for loan payments in the amount of $1,892,834.44, and interest and fees on those loan payments in the amount of $66,853.20. In addition, the court awarded Medifast its attorneys' fees and costs in the amount of $45,231.05. The Court's Order also requires the companies to abide by their post-termination obligations under the Franchise Agreements, including that they cease using Medifast's confidential information. The case against the primary guarantor remains ongoing. Medifast recently filed for summary judgment against the guarantor for nonpayment and fraud – the remaining counts in the complaint on February 2, 2016. The guarantor filed a motion for summary judgment on the fraud claim and on February 2, 2016. Those motions are currently pending before the court.

Medifast granted franchise rights to operate 16 weight loss control Centers to franchisee TransformU, LLC ("TransformU") in Virginia and Maryland in May and December, 2014. In connection with those transactions, Jason Properties, LLC ("Jason Properties") assigned certain real estate leases and other liabilities in connection with the Centers, which were assumed by TransformU and guaranteed by TransformU's principals, Ronald M. Fields, Jr. and James Smith. TransformU ceased operating the Centers, ceased paying fees pursuant to the governing franchise agreements, and ceased paying rent under the operative leases prior to the expiration of the lease terms.

On January 12, 2016, Medifast and Jason Properties filed suit against TransformU, Mr. Fields, and Mr. Smith in the United States District Court for the Eastern District of Virginia in a case entitled *Jason Properties, LLC, et al. v. TransformU*, *et al.*, Case No. 1:16-cv-35 AHH/JFA alleging that TransformU and Messrs. Fields and Smith defaulted on their obligations pursuant to the above-mentioned agreements and seeking in excess of $650,000 in damages. The action was dismissed with prejudice on February 5, 2016 by joint stipulation in accordance with the terms of a settlement agreement reached between the parties.

In addition to the above matters, 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 4. MINE SAFETY DISCLOSURES

Not applicable

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Company's common stock trades on the New York Stock Exchange ("NYSE") under the symbol MED. The following table sets forth the low and high closing prices for the Company's common stock as reported by the NYSE by fiscal quarters for 2015 and 2014:

	2015	
	Low	High
Quarter Ended March 31, 2015	29.64	33.40
Quarter Ended June 30, 2015	29.66	33.34
Quarter Ended September 30, 2015	26.67	32.66
Quarter Ended December 31, 2015	26.70	31.99

	2014	
	Low	High
Quarter Ended March 31, 2013	24.23	29.57
Quarter Ended June 30, 2013	28.88	34.08
Quarter Ended September 30, 2013	26.15	34.98
Quarter Ended December 31, 2013	29.39	33.79

Holders

There were approximately 112 record holders of the Company's common stock as of March 1, 2016. This number does not include beneficial owners of our securities held in the name of nominees.

Dividends

Prior to the fourth quarter of 2015, the Company had not declared or paid any dividend since inception. On December 16, 2015, the Company's board of directors declared a dividend of $0.25 per share to stockholders of record as of the close of business on December 28, 2015. Subsequent to December 31, 2015, the Company's board of directors declared a dividend of $0.25 per share to stockholders of record as of the close of business on March 21, 2016, payable on May 10, 2015. The declaration and payment of dividends in the future will be determined by the Company's board of directors in light of conditions then existing, including the Company's earnings, financial condition, capital requirements and other factors. See "Management's Discussion and Analysis of Financial Condition and Results of Operations- Liquidity and Capital Resources."

Securities Authorized for Issuance Under Equity Compensation Plans

The information under the heading "Securities Authorized for Issuance Under Equity Compensation Plans" will be filed in the Company's definitive proxy statement for the 2015 annual meeting of stockholders and is incorporated herein by reference.

Issuer Purchases of Equity Securities

At the outset of the quarter ended December 31, 2015, there were 847,567 shares of the Company's common stock eligible for repurchase under the repurchase authorization dated September 16, 2014.

No repurchases were made during the fourth quarter of 2015; however throughout the year 40,368 shares of common stock, at an average purchase price of $31.89, were surrendered by employees to the Company during 2015 for the payment of the minimum tax liability withholding obligations upon the vesting of shares of restricted stock.

Performance Graph

The following graph compares the Company's cumulative total stockholder return (Common Stock price appreciation plus dividends, on a reinvested basis) over the last five fiscal years with the Standard & Poor's S&P 500 Index and the Company's selected peer group, including NutriSystem Inc., Herbalife Ltd., USANA Health Sciences, and Weight Watchers International, Inc.

	12/10	**12/11**	**12/12**	**12/13**	**12/14**
Medifast, Inc.	100.00	47.51	91.38	90.48	116.17
S&P 500	100.00	102.11	118.45	156.82	178.29
Peer Group	100.00	138.28	108.88	184.28	117.72

ITEM 6. SELECTED FINANCIAL DATA

The selected condensed consolidated financial data set forth below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" included in Part II, Item 7 of this Report, and the consolidated financial statements and notes thereto of the Company included in Part II, Item 8 of this Report. The historical results provided below are not necessarily indicative of future results.

	2015	2014	2013	2012	2011
(In thousands, except per share data)					
Revenue	$272,773	$285,285	$324,054	$318,571	$272,467
Income from Operations	28,684	30,246	38,410	27,140	33,768
Income from Continuing Operations before Income Taxes	29,671	31,693	39,043	28,356	34,067
Basic EPS from continuing operations	$1.64	$1.66	$1.97	$1.34	$1.63
Basic EPS	1.68	1.04	1.74	1.16	1.33
Diluted EPS from continuing operations	1.62	1.65	1.96	1.34	1.60
Diluted EPS	1.66	1.03	1.73	1.16	1.31
Cash dividends declared per share	0.25	-	-	-	-
Total Assets	$117,326	$115,910	$132,650	$130,251	$105,665
Current Portion of long-term debt and capital lease facilities	219	232	222	528	1,426
Total long-term debt and capital leases	-	242	474	3,809	4,251
Weighted average shares outstanding					
Basic	11,959	12,670	13,774	13,722	13,965
Diluted	12,071	12,778	13,818	13,740	14,198

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

Critical Accounting Policies and Estimates

Our consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). Our significant accounting policies are described in Note 2 to the consolidated financial statements.

The preparation of our consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reporting period. Management develops, and changes periodically, these estimates and assumptions based on historical experience and on various other factors that are believed to be reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions. Management considers the following accounting policies to be the most critical in preparing our consolidated financial statements. These critical accounting policies have been discussed with our Audit Committee, as appropriate.

Revenue Recognition: Revenue is recognized net of discounts, rebates, promotional adjustments, price adjustments, and estimated returns and upon transfer of title and risk to the customer which occurs at shipping (F.O.B. terms). Upon shipment, the Company has no further performance obligations and collection is reasonably assured as the majority of sales are paid for prior to shipping. Medifast Weight Control Centers' program fees were recognized over the estimated service period.

Impairment of Fixed Assets and Long-Lived Assets: We continually assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. Judgments regarding the existence of impairment indicators are based on legal factors, market conditions and our operating performance. Future events could cause us to conclude that impairment indicators exist and the carrying values of fixed and intangible assets may be impaired. Any resulting impairment loss would be limited to the value of net fixed and intangible assets.

Income Taxes: The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more-likely-than-not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

We evaluated our tax positions and determined that we did not have any material uncertain tax positions. Our policy is to recognize interest and penalties accrued on uncertain tax positions as part of income tax expense. For the twelve months ended December 31, 2015 and 2014, no material estimated interest or penalties were recognized for the uncertainty of certain tax positions. We file income tax returns in the United States, Canada and various states jurisdictions. We are currently under audit by the IRS for 2010, but do not anticipate it to have a significant impact on previously reported results as well as benefits realized under our current tax structure. Other than 2010, we are no longer subject to U.S. federal, state, and local income tax examinations by tax authorities for the years before 2012.

Reserves for Returns: We review the reserves for customer returns at each reporting period and adjust them to reflect data available at that time. To estimate reserves for returns, we consider actual return rates in preceding periods. To the extent the estimate of returns changes, we will adjust the reserve, which will impact the amount of product sales revenue recognized in the period of the adjustment. Our estimates for returns have not differed materially from our actual returns. The provision for estimated returns as of December 31, 2015 and 2014 were $323,000 and $290,000, respectively.

Operating leases: Medifast leases retail stores, distribution facilities, and office space under operating leases. Many lease agreements contain tenant improvement allowances, rent holidays, rent escalation clauses and contingent rent provisions. The Company recognizes incentives and minimum rental expenses on a straight-line basis over the terms of the leases. We commence recording rent expense on the date of initial possession, which is generally when we enter the space and begin to make improvements to properties for our intended use. For tenant improvement allowances and rent holidays, we record a deferred rent liability on the consolidated balance sheets and amortize the deferred rent over the terms of the leases as reductions to rent expense on the consolidated statements of income.

For scheduled rent escalation clauses during the lease terms or for rental payments commencing at a date other than the date of initial occupancy, we record minimum rental expenses on a straight-line basis over the terms of the leases on the consolidated statements of income. Several leases provide for contingent rents, which are determined as a percentage of gross sales in excess of specified levels. We record a contingent rent liability on the consolidated balance sheets and the corresponding rent expense when we determine achieving specified levels is probable.

Background

The Company is engaged in the production, distribution, and sale of weight loss, weight management, and healthy living products and other consumable health and diet 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 97% of our revenues in 2015 and 98% of our revenues in 2014.

We review and analyze a number of key operating and financial metrics to manage our business, including revenue to advertising spend, number of active Health Coaches and average monthly revenue generated per Health Coach in the Take Shape For Life® channel.

In 2014, the Company exited the MWCC corporate center model with the sale of 41 Centers to existing franchise partners and the closure of the remaining 34 corporate Centers. The assets, liabilities, operating results, and cash flows of the MWCC corporate center channel have been presented separately as discontinued operations in the consolidated financial statements for all periods presented.

CONSOLIDATED RESULTS OF OPERATIONS

2015 COMPARISON WITH 2014

Overview of the Twelve Months Ended December 31, 2015 Compared to the Twelve Months Ended December 31, 2014

	Twelve Months Ended December 31,			
	2015	2014	$ Change	% Change
Revenue	$272,773,000	$285,285,000	$(12,512,000)	-4 %
Cost of sales	71,458,000	76,078,000	(4,620,000)	-6 %
Gross Profit	201,315,000	209,207,000	(7,892,000)	-4 %
Selling, general, and administrative costs	172,631,000	178,961,000	(6,330,000)	-4 %
Income from operations	28,684,000	30,246,000	(1,562,000)	-5 %
Other income				
Interest income, net	661,000	716,000	(55,000)	-8 %
Other income	326,000	731,000	(405,000)	-55 %
	987,000	1,447,000	(460,000)	-32 %
Income from continuing operations before income taxes	29,671,000	31,693,000	(2,022,000)	-6 %
Provision for income tax expense	10,104,000	10,664,000	(560,000)	-5 %
Income from continuing operations	19,567,000	21,029,000	(1,462,000)	-7 %
Income (Loss) from discontinued operations, net of tax	491,000	(7,848,000)	8,339,000	-106 %
Net income	$20,058,000	$13,181,000	$6,877,000	52 %
% of revenue				
Gross Profit	73.8 %	73.3 %		
Selling, general, and administrative costs	63.3 %	62.7 %		
Income from Operations	10.5 %	10.6 %		

Revenue: Revenue decreased to $272.8 million in 2015 compared to $285.3 million in 2014, a decrease of $12.5 million. The Take Shape For Life® sales channel accounted for 74.1%, the Medifast Direct channel accounted for 17.8%, the Franchise Medifast Weight Control Centers channel accounted for 6.3%, and the

Medifast Wholesale channel accounted for 1.8% of total revenue. The year to date revenue to spend ratio for continuing operations for 2015 was 17.9-to-1 compared to 16.8-to-1 for 2014. Total advertising spend, inclusive of broker fees, for continuing operations was $15.3 million in 2015 compared to $17.0 million in 2014.

Take Shape For Life® revenue decreased 2% to $202.2 million in 2015 compared with $206.7 million in 2014. The decline in revenue for Take Shape For Life® was caused by the Company having less active Health Coaches and clients coming out of 2014 as compared to 2013, driving down revenues in the first three quarters of 2015. This impact was partially offset by a price increase in the first quarter of 2015.

In 2014, the Company defined active Health Coaches as Health Coaches earning income from a product sale in the last month of the quarter. However, in order to provide a more accurate depiction of the number of Health Coaches contributing to Take Shape For Life revenues, the Company began reporting a new active Health Coach count and average revenue per active Health Coach in the first quarter of 2015. The number of active Health Coaches is now reported as the number of earning coaches each quarter instead of the number of earning Health Coaches in the last month of the quarter. The average revenue per Health Coach will now be calculated on a quarterly basis instead of an average month within the quarter. These new quarterly measurements provide a more consistent metric for quarterly comparison. The number of active Health Coaches and quarterly revenue per Health Coach rebounded in the quarter ended December 31, 2015, in which the number of active Health Coaches increased to 11,900 compared with 11,700 for the quarter ended December 31, 2014, an increase of 2%. For the same period, the average quarterly revenue per Health Coach increased to $4,039 in 2015 from $3,896 in 2014.

The new and historical metrics for the prior period are as follows:

Reporting Period	New Active Health Coaches	Historical Active Health Coaches	New Revenue per Health Coach	Historical Revenue per Health Coach
Q4 2014	11,700	9,300	$ 3,896	$ 1,401

Medifast Direct Sales revenue decreased 15% to $48.7 million in 2015 as compared with $57.2 million in 2014, a decrease of $8.5 million. Revenues in this channel are driven primarily by targeted customer marketing and advertising. Sales were down in comparison to 2014 as new customer acquisition continues to be challenging. To optimize profitability, we decreased our advertising spend in 2015 by 10.1% in comparison to 2014.

Franchise Medifast Weight Control Centers channel revenue increased 11% year-over-year, with revenue of $17.1 million in 2015 compared to $15.4 million in 2014. Sixty-one franchise centers were in operation as of December 31, 2015, as compared to 73 Centers as of December 31, 2014. Twelve Centers were closed during the year, including 10 corporate centers that were transitioned to the franchise model in June of 2014. The increase in revenue was the result of sales derived from corporate centers that were transitioned to the franchise model in June 2014 and December 2014, partially offset by decreased sales per Center and the closure of two Centers opened greater than a year.

Medifast Wholesale revenue decreased 20%, or $1.2 million, to $4.8 for the year ended December 31, 2015 compared to $6.0 million for the year ended December 31, 2014. The decrease was due to the loss of certain accounts resulting from Medifast’s enforcement of business partner compliance distribution requirements.

Costs of Sales: Cost of sales decreased $4.6 million in 2015 to $71.5 million as compared to $76.1 million in 2014, primarily due to decreased sales volumes. As a percentage of sales, gross margin increased to 73.8% in 2015 from $73.3% in 2014. The gross margin improvement was primarily driven by price increases and shipping efficiencies recognized during the year.

Selling, General and Administrative Costs: Selling, general and administrative expenses decreased by $6.3 million compared to 2014. As a percentage of sales, selling, general and administrative expenses increased to 63.3% versus 62.7% in 2014. Selling general and administrative costs include $2.1 million and $2.6 million for 2015 and 2014, respectively, of extraordinary legal expenses resulting from certain Schedule 13D filings. Fiscal year 2014 also includes a $2.0 million accrual for a franchise loan default guaranteed by Medifast. Excluding these items, selling, general, and administrative expense decreased $3.8 million. Adjusted selling, general, and administrative expenses as a percentage of sales increased to 62.5% of sales in 2015 as compared to 61.1% in 2014.

Take Shape For Life® commission expense, which is variable based upon product sales, decreased by approximately $2.1 million, or 2.5%, which is in line with the 2% decrease in revenue year-over-year. Health Coaches are compensated on product sales referred to the Company. Health Coaches can earn compensation under the Integrated Compensation Plan in two ways:

- Commissions: The primary way a Health Coach is compensated is through earning commissions on product sold to their clients. Health Coaches earn commissions by selling products through their own replicated website or through the Company's in-house call center. The clients of Health Coaches are responsible for ordering and paying for products, and their order is shipped directly from the Company to the client's home or designated address. Our Health Coaches do not handle payments and are not required to purchase or store products in order to receive a commission. In addition, Health Coaches do not receive a commission on their own personal product orders. Health Coaches pay the same price for products as their clients. The Company pays retail commissions to qualified Health Coaches on a weekly basis.
- Bonuses: Health Coaches are offered several bonus opportunities for acquiring clients, sponsoring Health Coaches and helping them to build their business, and sponsoring Health Coaches who become higher ranking leaders. The purposes of these bonuses are to reward Health Coaches for successfully growing and supporting their clients and to incentivize Health Coaches to further support and develop other Health Coaches within their team.

Health Coaches do not earn a commission or bonus when they recruit a new Health Coach into the Take Shape For Life® network. Fees paid by new Health Coaches for start-up materials are at the Company's approximate cost.

Salaries and benefits increased by approximately $0.6 million in 2015 as compared to 2014. The year-over-year increase was driven by higher bonus expenses and medical costs, partially offset by a reduction in salaries and benefits resulting from lower headcount and a decrease in stock compensation expense.

Sales and marketing expense decreased by $1.3 million in 2015 as compared to the prior year as a result of lower advertising spend and a decrease in expenses associated with the Take Shape For Life® annual convention. Total advertising spend was $15.3 million in 2015 versus $17.0 million in 2014. The decrease in spending was offset by an increase in production costs for the Medifast commercials that aired in the first quarter of 2015 and an increase in the Company's research and development costs related to an ongoing study.

General expenses decreased $2.2 million in 2015 as compared to 2014. Included in 2014, was the recording of a $2.0 million default of a franchise loan agreement. Excluding this, the year-over-year change would have been $0.2 million and was driven by a decrease in legal expenses. The decrease in legal fees is largely due to the settlement agreement with Engaged Capital, LLC that was reached during the first quarter, limiting the extraordinary legal fees incurred during 2015. These savings were partially offset by an increase in accounting expenses and costs associated with retaining GKV as the Company's marketing and advertising agency.

Other expenses decreased by $1.1 million for the year ended December 31, 2015 compared to the year ended December 31, 2014. The improvement was due to a decrease in depreciation expense and a reduction in credit card fees due to reduced revenues. These improvements were partially offset by an increase in licenses and fees.

Income taxes: In 2015, the Company recorded $10.1 million in income tax expense, an effective tax rate of 34.1%. In 2014, the Company recorded 10.7 million in income tax expense, an effective tax rate of 33.6%. The increase in the effective tax rate in 2015 over 2014 was the result of benefits realized in 2014 from research and development credits that were retroactive to 2010. The Company anticipates a tax rate of approximately 33 – 34% in 2016.

Income from continuing operations: Income from continuing operations was $19.6 million in 2015 as compared to $21.0 million in 2014, a decrease of $1.4 million. Pre-tax profit as a percent of sales decreased to 10.9% for the year ended December 31, 2015 compared to 11.1% for the year ended December 31, 2014. The year to date decrease in income is a result of the reduced sales offset by the Company’s efforts to manage expenses. Excluding the extraordinary legal expenses in 2015 and 2014 and the accrued franchise loan obligation in 2014, income from continuing operations would have been $20.9 million, or $1.73 per share, for the year ended December 31, 2015 and $24.1 million, or $1.89 per share, for the year ended December 31, 2014.

Loss from discontinued operations: In 2014, the Company exited the MWCC corporate center model with the sale of 41 Centers to existing franchise partners and the closure of the remaining 34 corporate centers. The Company had $0.5 million in income from discontinued operations in 2015 compared to a $7.8 loss from discontinued operations in 2014. The income generated in 2015 was primarily the result of the settlement of lease agreements offset by incremental closure costs incurred during the year.

Net income: Net income was $20.1 million in 2015 compared to $13.2 million in 2014. The year-over-year change was driven by the factors described above in the explanations for income from continuing operations and loss from discontinued operations.

CONSOLIDATED RESULTS OF OPERATIONS

2014 COMPARISON WITH 2013

Overview of the Twelve Months Ended December 31, 2014 Compared to Twelve Months Ended December 31, 2013

	Twelve Months Ended December 31,			
	2014	2013	$ Change	% Change
Revenue	$285,285,000	$324,054,000	$(38,769,000)	-12 %
Cost of sales	76,078,000	83,488,000	(7,410,000)	-9 %
Gross Profit	209,207,000	240,566,000	(31,359,000)	-13 %
Selling, general, and administrative costs	178,961,000	202,156,000	(23,195,000)	-11 %
Income from operations	30,246,000	38,410,000	(8,164,000)	-21 %
Other income				
Interest income, net	716,000	509,000	207,000	41 %
Other income	731,000	124,000	607,000	490 %
	1,447,000	633,000	814,000	129 %
Income from continuing operations before income taxes	31,693,000	39,043,000	(7,350,000)	-19 %
Provision for income tax expense	10,664,000	11,908,000	(1,244,000)	-10 %
Income from continuing operations	21,029,000	27,135,000	(6,106,000)	-23 %
Income (Loss) from discontinued operations, net of tax	(7,848,000)	(3,166,000)	(4,682,000)	148 %
Net income	$13,181,000	$23,969,000	$(10,788,000)	-45 %

% of revenue		
Gross Profit	73.3 %	74.2 %
Selling, general, and administrative costs	62.7 %	62.4 %
Income from Operations	10.6 %	11.9 %

Revenue: Revenue decreased to $285.3 million in 2014 compared to $324.1 million in 2013, a decrease of $38.8 million. The Take Shape For Life® sales channel accounted for 72.5%, the Medifast Direct channel accounted for 20.0%, the Franchise Medifast Weight Control Centers channel accounted for 5.4%, and the Medifast Wholesale channel accounted for 2.1% of total revenue. The year to date revenue to spend ratio for continuing operations for 2014 was 16.8-to-1 compared to 14.7-to-1 for 2013. Total advertising spend, inclusive of broker fees, for continuing operations was $17.0 million in 2014 compared to $22.1 million in 2013.

Take Shape For Life® revenue decreased 10% to $206.7 million in 2014 compared with $228.7 million in 2013. The decrease in revenue for Take Shape For Life® was driven by a decrease in the number of active Health Coaches and revenue per Health Coach along with the accrued impact from the creation of the new BeSlim Club loyalty program. Utilizing the new quarterly metrics, the number of active Health Coaches at the end of 2014 decreased to 11,700 compared with 12,800 during the period a year ago, a decrease of 11%. The average revenue per Health Coach per quarter decreased to $3,896 in 2014 from $4,047 in 2013. Approximately half of the decrease of the Health Coach count was due to having less pay periods used in the calculation versus the number of pay periods used in the prior year.

As discussed above, the Company redefied the active Health Coach and revenue per active Health Coach metrics in the first quarter of 2015. The new and historical metrics for the two periods presented are as follows:

Reporting Period	New Active Health Coaches	Historical Active Health Coaches	New Revenue per Health Coach	Historical Revenue per Health Coach
Q4 2014	11,700	9,300	$ 3,896	$ 1,401
Q4 2013	12,800	10,500	$ 4,047	$ 1,477

Medifast Direct Sales revenue decreased 24% to $57.2 million as compared with $75.5 million in 2013, a decrease of $18.3 million. Revenues in this channel are primarily driven by targeted customer advertising on-line, across local radio, via email and direct mail campaigns, and by highlighting customer successes in large national publications and on television. The Company experienced lower marketing efficiencies and new customer acquisition during the year; and therefore, reduced marketing spending to optimize profitability. The Company's decision to reduce spending impacted the year-over-year revenue for the channel. As compared to 2013, the Company increased fourth quarter spending in an effort to drive 2015 sales.

Franchise Medifast Weight Control Centers channel revenue increased 1% year-over-year, with revenue of $15.4 million in 2014 compared to $15.3 million in 2013. There were 73 franchise centers in operation as of December 31, 2014, including 19 corporate centers that were transitioned in June 2014 and 17 corporate centers that were transitioned in December 2014. There were 17 franchise centers that closed during 2014, including 5 Centers transitioned to the franchise model in June 2014 and 7 Centers opened during 2014. There were 41 franchise centers in operation as of December 31, 2013. The increase in revenue was driven by the conversion of corporate centers over to Franchise Centers offset by franchise center closures as well as a decrease in sales of franchise centers open greater than one year.

Medifast Wholesale revenue increased 30%, or $1.4 million, to $6.0 for the year ended December 31, 2014 compared to $4.6 million for the year ended December 31, 2013. The increase was driven by a reallocation of internal sales resources to improve revenue in the channel for both domestic and international customers.

Costs of Sales: Cost of sales decreased $7.4 million in 2014 to $76.1 million as compared to $83.5 million in 2013. As a percentage of sales, gross margin decreased from 74.2% in 2013 to $73.3% in 2014, which was the result of increased year-over-year product costs primarily driven by a reduction in manufacturing volumes.

Selling, General and Administrative Costs: Selling, general and administrative expenses decreased by $23.2 million compared to 2013. As a percentage of sales, selling, general and administrative expenses increased to 62.7% versus 62.4% in 2013. Included in selling general and administrative costs for 2014 are $2.6 million in extraordinary legal expenses resulting from certain Schedule 13D filings and a $2.0 million accrual for a franchise loan default guaranteed by Medifast. Excluding these items, selling, general, and administrative expense as a percentage of sales would have been 61.1%, a decrease of 130 basis points compared to 2013.

Take Shape For Life® commission expense, which is variable based upon product sales, decreased by approximately $15.6 million, or 15.4%, as a result of a new compensation plan introduced in late 2013 and a 10% decrease in sales for the channel.

Salaries and benefits decreased by approximately $3.5 million in 2014 as compared to 2013. The year-over-year decrease was driven by reductions in bonuses, salaries, and medical expenses resulting from the Company’s continued focus on headcount. These improvements were partially offset by an increase in stock compensation expense.

Sales and marketing expense decreased by $5.1 million in 2014 as compared to the prior year as a result of lower advertising expenses. The Company continues to focus on efficiency improvements and balancing sales and marketing expense in an effort to drive profitability. The Company increased year-over-year fourth quarter revenue spending in an effort to drive 2015 sales.

General expenses increased $3.0 million in 2014 as compared to 2013. The year-over-year change was driven by a $2.0 million accrual relating to a default on a franchise loan guaranteed by Medifast and an increase in legal expenses, inclusive of $2.6 million in extraordinary expenses resulting from certain Schedule 13D filings. These were partially offset by a decrease in information technology consulting fees.

Other expenses consisting primarily of depreciation and credit card processing fees, decreased by $1.7 million. The decrease in expenses for the period was the result of a reduction in credit card fees due to reduced revenues and the final settlement of Voluntary Disclosure Agreement's (VDA) accrued in 2012 and issued in 2013.

Income taxes: In 2014, the Company recorded $10.7 million in income tax expense, an effective rate of 33.6%. In 2013, the Company recorded $11.9 million in income tax expense, an effective rate of 30.5%. The increase in the effective tax rate in 2014 over 2013 was a result of benefits realized in 2013 from research and development credits of $0.5 million that were retroactive to 2012, as well as realizing benefits of $0.8 million from extensive state income tax restructuring (to take advantage of apportionment methodology) which also related to prior years. As a manufacturing entity based in Maryland, in 2013 the Company adopted the single sales factor apportionment method in addition to claiming new state jobs credits and research and development credits. The Company anticipates a tax rate of approximately 33 – 34% in 2015.

Income from continuing operations: Income from continuing operations was $21.0 million in 2014 as compared to $27.1 million in 2013, a decrease of $6.1 million. Income from operations decreased by $8.2 million, or 21%, versus 2013 with the percent of sales decreasing to 10.6% in 2014 as compared to 11.9% in 2013. The year-over-year decrease in profitability was primarily driven by the 11.9% reduction in sales coupled with an increase in product costs, a $1.8 million after tax extraordinary legal and advisory expenses incurred in relation to the certain Schedule 13D filings and a $1.3 million after tax accrual relating to a default on a franchise loan guaranteed by Medifast. These negative impacts to profits were partially offset by the Company's continued efforts to closely monitor spending as demonstrated in the decrease in selling, general, and administrative expenses outlined above.

Loss from discontinued operations: In 2014, the Company exited the MWCC corporate center model by selling 41 Centers to existing franchise partners (24 Centers were sold in June 2014 and the remaining 17 Centers were sold in December 2014) and closing the remaining 34 corporate centers. Loss from discontinued operations was $7.8 million in 2014 as compared to $3.1 million in 2013, a decrease of $4.7 million. The year-over-year decrease includes the $8.6 million pre-tax, $5.2 million after-tax, charge for the closure of 34 Centers in December 2014. This charge includes $0.6 million for one-time termination benefits, $4.4 million for closed clinic lease obligations, $3.3 million for impaired assets, and $0.5 million in other facility related closure costs. These exit activity costs were partially offset by a gain of $0.2 million on the sale of Centers.

Net income: Net income was $13.2 million in 2014 compared to $24.0 million in 2013. The year-over-year change was driven by the factors described above in the explanations for income from continuing operations and loss from discontinued operations.

Non-GAAP Financial Measures

In addition to providing results that are determined in accordance with GAAP, the Company provides certain non-GAAP financial measures. The Company's 2015 and 2014 non-GAAP financial measures of adjusted net income and adjusted diluted earnings per share exclude the charges the Company incurred in relation to extraordinary legal expenses in connection with the Schedule 13D filings. The 2014 results also exclude a franchise loan default guaranteed by Medifast. Because all of these charges are unique events, not directly related to the Company's normal operations, the Company believes these non-GAAP financial measures may help investors better understand and compare our operating results and trends by eliminating this component.

The reconciliations of these non-GAAP financial measures are as follows:

	Years Ended December 31,		
	2015	2014	2013
Income from operations	$28,684,000	$30,246,000	$38,410,000
Adjustments			
Franchise loan guarantee accrual	-	1,980,000	-
Legal expenses- 13D	2,084,000	2,597,000	-
Adjusted Income from operations	$30,768,000	$34,823,000	$38,410,000

	Years Ended December 31,		
	2015	2014	2013
Income from continuing operations	$19,567,000	$21,029,000	$27,135,000
Adjustments			
Franchise loan guarantee accrual	-	1,342,000	-
Legal expenses- 13D	1,374,000	1,761,000	-
Adjusted income from continuing operations	$20,941,000	$24,132,000	$27,135,000
Loss on discontinued operations, net of tax	491,000	(7,848,000)	(3,166,000)
Adjusted Net Income	$21,432,000	$16,284,000	$23,969,000
Diluted earnings per share from continuing operations	$1.62	$1.65	$1.96
Impact for adjustments	0.11	0.24	-

Adjusted diluted earnings per share continuing operations	$1.73	$1.89	$1.96
Diluted Loss per share from discontinued operations	$0.04	$(0.62)	$(0.23)
Adjusted diluted earnings per share	$1.77	$1.27	$1.73

The weighted-average diluted shares outstanding used in the calculation of theses non-GAAP financial measures are the same as the weighted-average shares outstanding used in the calculation of the reported per share amounts.

Excluding the impact of the $2.1 million extraordinary legal expenses incurred in connection with the Schedule 13D filings for the year ended December 31, 2015 and the impact of the $2.0 million franchise loan guarantee and the $2.6 extraordinary legal expenses incurred in connection with the 13D filings for the year ended December 31, 2014, income from operations decreased $4.0 million to $30.8 million from $34.8 million. Adjusted income from continuing operations for the year ended December 31, 2015 decreased to $20.9 million from income from adjusted continuing operations of $24.1 million for the year ended December 31, 2014. Adjusted net income for the year ended December 31, 2015 increased to $21.4 million from net income of $16.3 million for the year ended December 31, 2014. Adjusted diluted earnings per share from continuing operations for the year ended December 31, 2015 decreased to $1.73 as compared to adjusted diluted earnings per share from continuing operations of $1.89 for the same period in 2014. Adjusted diluted earnings per share for the year ended December 31, 2015 increased to $1.77 as compared to adjusted diluted earnings per share of $1.27 for the same period in 2014.

LIQUIDITY AND CAPITAL RESOURCES

The Company had stockholders' equity of $88.6 million and working capital of $64.5 million on December 31, 2015 compared with $80.5 million and $55.0 million at December 31, 2014, respectively. The $8.1 million net decrease in stockholder's equity reflects $20.1 million in 2015 profits offset by the $10.5 million used to purchase shares of the Company's common stock as well as other equity transactions as outlined in the "Consolidated Statement of Changes in Stockholders' Equity" included in our consolidated financial statements. The Company also declared a dividend of $0.25 per share to its common stockholders during the fourth quarter of 2015 which was paid in the first quarter of 2016. Subsequent to December 31, 2015, the Company's board of directors declared a dividend of $0.25 per share to stockholders of record as of the close of business on March 21, 2016, payable on May 10, 2015. While we intend to continue the dividend program and believe we will have sufficient liquidity to do so, we can provide no assurance we will be able to continue the declaration and payment of dividends. The Company's cash and cash equivalents position increased from $24.5 million at December 31, 2014 to $42.0 million at December 31, 2015.

In the year ended December 31, 2015 the Company generated cash flow of $33.1 million from continuing operations, partially attributable to $19.6 million in income from continuing operations. Cash provided by operating activities of $16.5 million primarily includes depreciation and amortization of $7.1 million, a $3.6 million decrease in prepaid income taxes, share-based compensation of $3.1 million, a decrease in inventory of $2.4 million, and a $0.3 million decrease in other assets. This was offset by cash used by operating activities of $3.0 million including a $2.4 million decrease in accounts payable and accrued expenses, a $0.5 million net realized gain on investment securities, and deferred income taxes of $0.1 million.

Net cash used in operating activities from discontinued operations was $3.7 million including income from discontinued operations of $0.5 million. Cash provided by operating activities from discontinued operations totaled $2.6 million and includes a non-cash benefit of $2.4 million for deferred taxes and a $0.1 decrease in inventory. Cash used by operating activities from discontinued operations of $6.8 million include a $6.5 million decrease in accounts payable and accrued expenses and a $0.3 million increase in accounts receivable.

In the year ended December 31, 2015, net cash used in investing activities from continuing operations was $0.2 million, which was due to $9.3 million for the purchase of investment securities offset by $11.9 million of cash generated by the sale of investment securities and $2.8 million for the purchase of property and equipment.

In the year ended December 31, 2015, financing activities from continuing operations used $11.7 million in cash. The Company used $10.5 million to purchase shares of the Company's common stock in the open market, to repurchase shares of the Company's common stock to cover employee taxes of $1.3 million, and to repay $0.3 million in capital leases. The Company realized a cash benefit for excess tax benefits from share-based compensation in the amount of $0.2 million. As of December 31, 2015, there are 847,567 shares of the Company's common stock eligible for repurchase under the repurchase authorization dated September 16, 2014.

In the year ended December 31, 2015, the Company had a non-cash benefit of $0.1 million related to foreign currency translation.

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.

Contractual Obligations and Commercial Commitments

The Company has the following contractual obligations as of December 31, 2015:

	Less Than 1 Year	1 - 3 Years	Total
Operating Leases (a)	$ 1,330,000	$ 1,026,000	$ 2,356,000
Operating Leases for Closed MWCC Centers (b)	409,000	252,000	661,000
Operating Leases for Sold MWCC Centers (c)	1,090,000	866,000	1,956,000
Capital Leases (d)	225,000	-	225,000
Total contractual obligations	$ 3,054,000	$ 2,144,000	$ 5,198,000

(a) The Company has operating leases in place for leased corporate offices, our Texas Distribution center, our raw materials warehouse, and the Company's printers.

(b) The Company has 10 operating leases in place that extend beyond December 31, 2015 for closed Medifast Corporate Weight Control Centers. The Company is actively seeking to reach lease termination agreements on these obligations and settled three termination agreements during the first quarter of 2016. These Centers made up $143,000, and $162,000 of the costs above for the periods less than 1 year and 1-3 years, respectively.

(c) The Company has 31 operating leases in place that extend beyond December 31, 2015 for previous Medifast Corporate Weight Control Centers sold to franchise partners. The Company remains named on the leases, however the obligations have been subleased to the franchisees.

(d) The Company leases large commercial printers for our printing operations that are accounted for as capital leases, these obligations are detailed in Note 7 of the consolidated financial statements.

INFLATION

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

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk is the potential loss arising from adverse changes in market rates and prices, such as interest rates and a decline in the stock market. The Company does not enter into derivatives, foreign exchange transactions or other financial instruments for trading or speculative purposes. The Company paid off its outstanding debt during the first quarter of 2013, eliminating our current exposure to interest rate risk.

We are exposed to market risk related to changes in interest rates and market pricing impacting our investment portfolio. Our current investment policy is to maintain an investment portfolio consisting mainly of U.S. money market and high-grade corporate securities, directly or through managed funds. Our cash is deposited in and invested through highly rated financial institutions in North America. Our 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 December 31, 2015, we estimate that the fair value of our investment portfolio would decline by an immaterial amount and therefore we would not expect our operating results or cash flows to be affected to any significant degree by the effect of a change in market conditions on our investments.

ITEM 8. FINANCIAL STATEMENTS

The information required by this item is set forth on pages 33 to 50 hereto and incorporated by reference herein.

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

There were no disagreements with the Company’s independent auditors, regarding accounting and financial disclosures for the fiscal year ending December 31, 2015.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

In accordance with Exchange Act Rule 13a-15(e), we carried out an evaluation, under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as required by Exchange Act Rule 13a-15(b) as of the end of the period covered by this report. Based upon that evaluation, our management has concluded that our disclosure controls and procedures are effective as of December 31, 2015.

Management’s Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes maintaining records that in reasonable detail accurately and fairly reflect our transactions, providing reasonable assurance that transactions are recorded as necessary for preparation of our financial statements, providing reasonable assurance that receipts and expenditures of Company assets are made in accordance with management authorization, and providing reasonable assurance that unauthorized acquisition, use or disposition of Company assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. Based on this evaluation, our management concluded that the Company’s internal control over financial reporting was effective as of December 31, 2015.

The effectiveness of the Company’s internal control over financial reporting as of December 31, 2015, was audited by RSM US LLP, our independent registered public accounting firm, as stated in their report appearing below.

Changes in our Internal Control

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fourth quarter ended December 31, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Limitations on the Effectiveness of Controls

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

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of

Medifast, Inc.

We have audited Medifast, Inc. and subsidiaries' (the "Company") internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying *"Management's Report on Internal Control Over Financial Reporting"*. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (*a*) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (*b*) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (*c*) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control — Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2015 of the Company and our report dated March 15, 2016 expressed an unqualified opinion.

/s/ RSM US LLP

Baltimore, Maryland

March 15, 2016

ITEM 9B. OTHER INFORMATION

Not applicable

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information required by this item is incorporated herein by reference from the Company's definitive proxy statement for the 2016 annual meeting of stockholders.

ITEM 11. EXECUTIVE COMPENSATION

Information required by this item is incorporated herein by reference from the Company's definitive proxy statement for the 2016 annual meeting of stockholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information required by this item is incorporated herein by reference from the Company's definitive proxy statement for the 2016 annual meeting of stockholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information required by this item is incorporated herein by reference from the Company's definitive proxy statement for the 2016 annual meeting of stockholders.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information required by this item is incorporated herein by reference from the Company’s definitive proxy statement for the 2016 annual meeting of stockholders.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The following documents are filed as part of this Report

(a) 1. Financial Statements

See Index to the Consolidated Financial Statements on page 33 of this Report

2. Financial Statement Schedules

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

3. Exhibits

Reference is made to the Exhibit Index on page 51 of this Report for a list of exhibits required by Item 601 of Registration S-K to be filed as part of this Report.

MEDIFAST, INC. AND SUBSIDIARIES

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

Medifast, Inc.

We have audited the consolidated balance sheets of Medifast, Inc. and subsidiaries (the “Company”) as of December 31, 2015 and 2014, and the related consolidated statements of income, comprehensive income, stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2015. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Medifast, Inc. and subsidiaries as of December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015, in conformity with U.S. generally accepted accounting principles.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of December 31, 2015, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission in 2013, and our report dated March 15, 2016 expressed an unqualified opinion on the effectiveness of the Company’s internal control over financial reporting.

/s/ RSM US LLP

Baltimore, Maryland

March 15, 2016

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MEDIFAST, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

As of December 31, 2015 and 2014

	2015	2014
ASSETS		
Current assets:		
Cash and cash equivalents	$42,037,000	$24,459,000
Accounts receivable-net of allowance for sales returns and doubtful accounts of $417,000 and $354,000	1,633,000	1,650,000
Inventory	13,335,000	15,735,000
Investment securities	25,072,000	28,185,000
Income taxes, prepaid	1,549,000	5,099,000
Prepaid expenses and other current assets	2,886,000	2,875,000
Deferred tax assets	1,208,000	3,727,000
Current assets of discontinued operations	353,000	184,000
Total current assets	88,073,000	81,914,000
Property, plant and equipment - net	29,029,000	33,477,000
Other assets	205,000	497,000
Long-term assets of discontinued operations	19,000	22,000
TOTAL ASSETS	$117,326,000	$115,910,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$22,504,000	$21,854,000
Current maturities of capital leases	219,000	232,000
Current liabilities of discontinued operations	841,000	4,858,000
Total current liabilities	23,564,000	26,944,000
Other liabilities:		
Capital leases, net of current portion	-	242,000
Deferred tax liabilities	4,890,000	5,492,000
Long-term liabilities of discontinued operations	288,000	2,756,000
Total liabilities	28,742,000	35,434,000
Stockholders' Equity:		
Common stock; par value $.001 per share; 20,000,000 shares authorized; 12,013,952 and 12,365,690 issued 11,796,774 and 12,075,764 issued and outstanding	12,000	12,000
Additional paid-in capital	-	1,132,000

Accumulated other comprehensive income/(loss)	(62,000)	435,000
Retained earnings	88,634,000	78,897,000
Total stockholders' equity	88,584,000	80,476,000
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$117,326,000	$115,910,000

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

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MEDIFAST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 2015, 2014, and 2013

	2015	2014	2013
Revenue	$272,773,000	$285,285,000	$324,054,000
Cost of sales	71,458,000	76,078,000	83,488,000
Gross Profit	201,315,000	209,207,000	240,566,000
Selling, general, and administrative	172,631,000	178,961,000	202,156,000
Income from operations	28,684,000	30,246,000	38,410,000
Other income			
Interest and dividend income, net	661,000	716,000	509,000
Other income	326,000	731,000	124,000
	987,000	1,447,000	633,000
Income from continuing operations before income taxes	29,671,000	31,693,000	39,043,000
Provision for income taxes	10,104,000	10,664,000	11,908,000
Income from continuing operations	19,567,000	21,029,000	27,135,000
Income (loss) from discontinued operations, net of tax	491,000	(7,848,000)	(3,166,000)
Net income	$20,058,000	$13,181,000	$23,969,000
Basic earnings per share			
Earnings per share from continuing operations	$1.64	$1.66	$1.97
Earnings (Loss) per share from discontinued operations	$0.04	$(0.62)	$(0.23)
Earnings per share	$1.68	$1.04	$1.74
Diluted earnings per share			
Earnings per share from continuing operations	$1.62	$1.65	$1.96
Earnings (Loss) per share from discontinued operations	$0.04	$(0.62)	$(0.23)
Earnings per share	$1.66	$1.03	$1.73
Weighted average shares outstanding -			
Basic	11,959,252	12,670,387	13,774,083
Diluted	12,070,730	12,778,277	13,817,693
Cash dividends declared per share	$0.25	$-	$-

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

MEDIFAST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended December 31, 2015, 2014, and 2013

	2015	2014	2013
Net income	$20,058,000	$13,181,000	$23,969,000
Other comprehensive income, net of tax			
Change in foreign currency translation, net of tax	64,000	-	-
Change in unrealized gains/losses on marketable securities:			
Change in fair value of marketable securities, net of tax	(245,000)	207,000	257,000
Adjustment for net (gains)/losses realized and included in net income, net of tax	(316,000)	(475,000)	(107,000)
Total change in unrealized (gains)/losses on marketable securities, net of tax	(561,000)	(268,000)	150,000
Other comprehensive income/(loss)	(497,000)	(268,000)	150,000
Comprehensive income	$19,561,000	$12,913,000	$24,119,000

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

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MEDIFAST, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years Ended December 31, 2015, 2014, and 2013

	Number of Shares Issued	Par Value $0.001 Amount	Additional Paid-In Capital	Retained Earnings	Accumulated other comprehensive income	Treasury Stock	Total
Balance, December 31, 2012	15,525,955	$16,000	$40,191,000	$76,534,000	$553,000	$(26,508,000)	$90,786,000
Share-based compensation	16,163		3,209,000				3,209,000
Share-based compensation tax benefit			383,000				383,000
Treasury stock purchases						(20,081,000)	(20,081,000)
Treasury stock retirement	(2,398,809)	(3,000)	(43,783,000)	(2,803,000)		46,589,000	-
Net income				23,969,000			23,969,000
Other comprehensive income					150,000		150,000
Balance, December 31, 2013	13,143,309	13,000	-	97,700,000	703,000	-	$98,416,000
Share-based compensation	387,107		3,918,000				3,918,000
Net shares repurchased for employee taxes	(37,634)		(1,152,000)				(1,152,000)
Share-based compensation tax benefit			275,000				275,000
Treasury stock purchases						(33,894,000)	(33,894,000)
Treasury stock retirement	(1,127,092)	(1,000)	(1,909,000)	(31,984,000)		33,894,000	-
Net income				13,181,000			13,181,000

Other comprehensive loss					(268,000)		(268,000)
Balance, December 31, 2014	12,365,690	12,000	1,132,000	78,897,000	435,000	-	80,476,000
Options exercised by executives and directors	1,666		44,000				44,000
Share-based compensation	51,305		3,081,000				3,081,000
Net shares repurchased for employee taxes	(40,368)		(1,296,000)				(1,296,000)
Share-based compensation tax benefit			247,000				247,000
Cash dividends declared to stockholders				(3,013,000)			(3,013,000)
Treasury stock purchases						(10,516,000)	(10,516,000)
Treasury stock retirement	(364,341)		(3,208,000)	(7,308,000)		10,516,000	-
Net income				20,058,000			20,058,000
Other comprehensive loss					(497,000)		(497,000)
Balance, December 31, 2015	12,013,952	12,000	-	88,634,000	(62,000)	-	$88,584,000

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

MEDIFAST, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2015, 2014 & 2013

	2015	2014	2013
Cash flows from operating activities:			
Net income	$20,058,000	$13,181,000	$23,969,000
Income (loss) from discontinued operations, net of tax	491,000	(7,848,000)	(3,166,000)
Income from continuing operations	19,567,000	21,029,000	27,135,000
Adjustments to reconcile net income to net cash provided by operating activities from continuing operations:			
Depreciation and amortization	7,115,000	8,052,000	7,901,000
Realized (gain) on investment securities, net	(458,000)	(771,000)	(74,000)
Share-based compensation	3,081,000	3,918,000	3,209,000
Deferred income taxes	(106,000)	286,000	428,000
(Gain)/loss on disposal of fixed assets	81,000	(29,000)	392,000
Changes in assets and liabilities which provided (used) cash:			
Accounts receivable	17,000	(708,000)	87,000
Inventory	2,400,000	1,802,000	2,615,000
Prepaid expenses and other current assets	(56,000)	(349,000)	204,000
Other assets	292,000	(318,000)	746,000
Accounts payable and accrued expenses	(2,363,000)	(376,000)	(1,427,000)
Income taxes	3,550,000	(5,198,000)	972,000
Net cash provided by operating activities- continuing operations	33,120,000	27,338,000	42,188,000
Net cash provided by (used in) operating activities- discontinued operations	(3,709,000)	(1,802,000)	172,000
Net cash provided by operating activities	29,411,000	25,536,000	42,360,000
Cash Flow from Investing Activities:			
Sale of investment securities	11,880,000	29,636,000	14,359,000
Purchase of investment securities	(9,250,000)	(26,080,000)	(25,355,000)
Purchase of property and equipment	(2,819,000)	(7,024,000)	(11,386,000)
Net cash used in investing activities- continuing operations	(189,000)	(3,468,000)	(22,382,000)
Net cash provided by (used in) investing activities- discontinued operations	-	950,000	(220,000)
Net cash used in investing activities	(189,000)	(2,518,000)	(22,602,000)
Cash Flow from Financing Activities:			
Repayment of long-term debt and capital leases	(255,000)	(222,000)	(3,641,000)
Decrease in note receivable	45,000	52,000	26,000
Net shares repurchased for employee taxes	(1,296,000)	(1,152,000)	-
Options exercised by executives and directors	44,000	-	-
Excess tax benefits from share-based compensation	247,000	275,000	383,000
Purchase of treasury stock	(10,516,000)	(33,894,000)	(20,081,000)

Net cash used in financing activities- continuing operations	(11,731,000)	(34,941,000)	(23,313,000)
Net cash used in financing activities- discontinued operations	-	-	-
Net cash used in financing activities	(11,731,000)	(34,941,000)	(23,313,000)
Foreign currency impact	87,000	-	-
NET CHANGE IN CASH AND CASH EQUIVALENTS	17,578,000	(11,923,000)	(3,555,000)
Cash and cash equivalents - beginning of the period	24,459,000	36,382,000	39,937,000
Cash and cash equivalents - end of period	$42,037,000	$24,459,000	$36,382,000
Supplemental disclosure of cash flow information:			
Interest paid	$22,000	$131,000	$57,000
Income taxes paid	$4,182,000	$12,721,000	$9,983,000

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

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Medifast, Inc. and Subsidiaries

Notes to Consolidated Financial Statements

For the Years Ended December 31, 2015, 2014 and 2013

1. Nature of the Business

Medifast, Inc. (the "Company" or "Medifast") is a Delaware corporation, incorporated in 1989. The Company's operations are primarily conducted through seven of its wholly owned subsidiaries, Jason Pharmaceuticals, Inc., Take Shape For Life, LLC, Jason Enterprises, Inc., Jason Properties, LLC, Medifast Franchise Systems, Medifast Nutrition, Inc. and Seven Crondall, LLC. The Company is engaged in the production, distribution, and sale of weight loss, weight management, and healthy living products and other consumable health and diet products. Medifast product lines include weight loss, weight management, and healthy living meal replacements, snacks, hydration products and vitamins. The Company has one modern, Food and Drug Administration ("FDA")-approved manufacturing facility located in Owings Mills, Maryland.

These products are sold through various channels of distribution, including the internet, call center, independent health advisors, medical professionals, franchise weight loss clinics, and direct consumer marketing supported via the phone and internet. The processing, formulation, packaging, labeling and advertising of the Company's products are subject to regulation by one or more federal agencies, including the FDA, the Federal Trade Commission ("FTC"), the Consumer Product Safety Commission, the United States Department of Agriculture, and the United States Environmental Protection Agency.

2. Summary of Significant Accounting Policies

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

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

Reclassification – Certain amounts reported for prior periods have been reclassified to be consistent with the current period presentation. No reclassification in the consolidated financial statements had a material impact on the presentation.

Use of Estimates – The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. Actual results could differ materially from those estimates.

Cash and Cash Equivalents - Cash and cash equivalents consist of cash on deposit in financial institutions, institutional money funds and other short-term investments with a maturity of 90 days or less at the time of purchase.

Concentration of Credit Risk – Our cash and cash equivalents and available-for-sale securities are maintained at several financial institutions, and the balances with these financial institutions often exceed the amount of insurance provided on such accounts by the Federal Deposit Insurance Corporation. The cash and cash equivalents generally are maintained with financial institutions with reputable credit, and therefore bear minimal credit risk. Historically, we have not experienced any losses due to such concentration of credit risk.

Fair Value of Financial Instruments - Our financial instruments include cash and cash equivalents, investment in available-for-sale securities, trade receivables and debt. The carrying amounts of cash and cash equivalents, and trade receivables approximate fair value due to their short maturities. The fair values of investment in available-for-sale securities are based on dealer quotes. The Company believes that its indebtedness approximates fair value based on current yields for debt instruments with similar terms.

Accounts Receivable and Allowance for Sales Returns and Doubtful Accounts - Accounts receivable are recorded net of reserves for sales returns and allowances, and net of provisions for doubtful accounts.

We review the reserves for customer returns at each reporting period and adjust them to reflect data available at that time. To estimate reserves for returns, we consider actual return rates in preceding periods. To the extent the estimate of returns changes, we will adjust the reserve, which will impact the amount of product sales revenue recognized in the period of the adjustment. Our estimates for returns have not differed materially from our actual returns. The provision for estimated returns as of December 31, 2015 and 2014 was $323,000 and $290,000, respectively.

Allowances for doubtful accounts are based primarily on an analysis of aged accounts receivable balances and the credit worthiness of our customers as determined by credit checks and analysis, as well as customer payment history. The allowance for doubtful accounts as of December 31, 2015 and 2014 was $94,000 and $64,000, respectively.

Inventory - Inventories consist principally of packaged meal replacements held in the Company's warehouses. Inventory is stated at the lower of cost or market, utilizing the first-in, first-out method. The cost of finished goods includes the cost of raw materials, packaging supplies, direct and indirect labor and other indirect manufacturing costs. On a quarterly basis, management reviews inventory for unsalable or obsolete inventory.

Investment Securities –The Company's investments consist of debt and equity securities classified as available-for-sale securities. Available-for-sale securities are stated at fair value, and unrealized holding gains and losses, net of the related deferred tax effect, are reported as a separate component of accumulated other comprehensive income in stockholders' equity. Interest and dividends on marketable debt and equity securities are recognized in income when declared. Realized gains and losses, including losses from declines in value of specific securities determined by management to be other-than-temporary, if any, are included in income.

Income Taxes – The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more-likely-than-not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. Tax positions taken are not offset or aggregated with other positions. Tax positions that meet the more-likely-than-not recognition threshold are measured as the largest amount of tax benefit that is more than 50 percent likely of being realized upon settlement with the applicable taxing authority. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for unrecognized tax benefits in the accompanying balance sheet along with any associated interest and penalties that would be payable to the taxing authorities upon examination.

We evaluated our tax positions and determined that we did not have any material uncertain tax positions. Our policy is to recognize interest and penalties accrued on uncertain tax positions as part of income tax expense. For the years ending December 31, 2015 and 2014, no material estimated interest or penalties were recognized for the uncertainty of certain tax positions. We file income tax returns in the United States, Canada and various states jurisdictions. We are currently under audit by the IRS for 2010, but do not anticipate it to have a significant impact on previously reported results as well as benefits realized under our current tax structure. Other than 2010, we are no longer subject to U.S. federal, state, and local income tax examinations by tax authorities for the years before 2012.

Deferred tax assets are recognized for deductible temporary differences and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Advertising Costs - Advertising costs are expensed as incurred, except for the preparation, layout, design and production of advertising costs which are expensed when the advertisement is first used. Advertising expense for continuing operations, excluding broker fees, for the years ended December 31, 2015, 2014, and 2013, amounted to $15 million, $17 million, and $21 million, respectively.

Operating Leases - Medifast leases retail stores, distribution facilities, and office space under operating leases. Many of our lease agreements contain tenant improvement allowances, rent holidays, rent escalation clauses, and contingent rent provisions. The Company recognizes incentives and minimum rental expenses on a straight-line basis over the terms of the leases. We commence recording rent expense on the date of initial possession, which is generally when we enter the space and begin to make improvements to properties for our intended use. For tenant improvement allowances and rent holidays, we record a deferred rent liability on the consolidated balance sheets and amortize the deferred rent over the terms of the leases as reductions to rent expense on the consolidated statements of income.

For scheduled rent escalation clauses during the lease terms or for rental payments commencing at a date other than the date of initial occupancy, we record minimum rental expenses on a straight-line basis over the terms of the leases on the consolidated statements of income. Several leases provide for contingent rents, which are determined as a percentage of gross sales in excess of specified levels. We record a contingent rent liability on the consolidated balance sheets and the corresponding rent expense when we determine achieving the specified levels is probable.

Clinic Opening Costs - Clinic opening costs were expensed as incurred.

Clinic Closure Costs- Clinic closure costs are expensed and recognized as a liability at their fair value when incurred. One-time employee severance costs are expensed and recognized as a liability when the plan is finalized by management, approved and committed to by management, and communicated to the employee. Contractual costs that will continue to be incurred (operating leases) are recognized at the cease use date. The fair value of operating lease contracts is determined based on the present value of the remaining lease payments. Other costs associated with closing the clinic or relocating employees are expensed as incurred.

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

Building and building improvements	10 - 35 years
Equipment and fixtures	3 - 15 years
Leasehold Improvements	Lease term
Vehicles	5 years

The depreciation life for leasehold improvements is the lesser of the estimated useful life of the addition or the term of the related lease.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

Revenue Recognition - Revenue is recognized net of discounts, rebates, promotional adjustments, price adjustments, and estimated returns and upon transfer of title and risk to the customer which occurs at shipping (F.O.B. terms). Upon shipment, the Company has no further performance obligations and collection is reasonably assured as the majority of sales are paid prior to shipping. Medifast Weight Control Centers program fees were recognized over the estimated service period.

Shipping and Handling Costs - Our shipping and handling costs for shipments of our product to our customers are included in cost of sales. All shipping and handling charges that are billed to customers are included in net revenue. All other shipping and handling costs are included in selling, general and administration expenses.

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

The following table sets forth the computation of basic and diluted EPS for the fiscal years ended December 31:

	2015	2014	2013
Numerator:			
Income from continuing operations	$19,567,000	$21,029,000	$27,135,000
Income (loss) from discontinued operations	491,000	(7,848,000)	(3,166,000)
Net income	$20,058,000	$13,181,000	$23,969,000
Denominator:			
Weighted average shares of common stock outstanding	11,959,252	12,670,387	13,774,083
Effect of dilutive common stock equivalents	111,478	107,890	43,610
Weighted average shares of common stock outstanding	12,070,730	12,778,277	13,817,693
EPS:			
Basic earnings per share			
Earnings per share from continuing operations	$1.64	$1.66	$1.97
Earnings (loss) per share from discontinued operations	$0.04	$(0.62)	$(0.23)
Earnings per share	$1.68	$1.04	$1.74
Diluted earnings per share			
Earnings per share from continuing operations	$1.62	$1.65	$1.96
Earnings (loss) per share from discontinued operations	$0.04	$(0.62)	$(0.23)
Earnings per share	$1.66	$1.03	$1.73

The calculation of diluted earnings per share excluded 69,375, 67,375 and 0 options outstanding for the years ended December 31, 2015, 2014, and 2013, respectively, that could potentially dilute base earnings per share in the future.

Share-Based Compensation - Share-based compensation, primarily restricted stock awards and options granted to employees and directors. Restricted stock awards are measured at the grant date, based on the calculated fair value of the award, and are recognized as an expense over the requisite service period. The fair value of the incentive stock options and non-qualified stock options is calculated using the Black-Scholes option pricing model as of the grant date and recognized over the service period. The Company issues new shares upon the exercise of stock options and granting of restricted stock awards.

Comprehensive Income - Other comprehensive income refers to revenues, expenses, gains and losses that are not included in net income but rather are recorded directly in stockholders' equity. Comprehensive income consists of net income, unrealized gains and losses on available-for-sale securities, and foreign currency translation adjustments.

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. Management is current evaluating the effect that the provisions of ASU 2016-02 will have on the Company's financial statements.

ASU 2016-01, *Financial Instruments- Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, most notably requires the changes in fair value of equity investments to be recognized in net income. The pronouncement also requires the use of the exit price notion, the separate presentation of financial assets and liabilities by measurement category and form of asset, and the separate presentation in other comprehensive income of changes in fair value resulting from a change in the instrument-specific credit risk. The pronouncement is effective for fiscal years beginning after December 15, 2017. Management is currently evaluating the effect that the provisions of ASU 2016-01 will have on the Company's financial statements.

ASU 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes* requires the Company to classify all deferred tax assets and deferred tax liabilities as noncurrent. The pronouncement is effective for fiscal years beginning after December 15, 2016. Management is currently evaluating the effect that the provisions of ASU 2015-17 will have on the Company's financial statements.

ASU 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*, requires the Company to recognize inventory at the lower of cost and net realizable value. Net realizable value is defined as the estimated selling price in the ordinary course of business less costs of completion, disposal, and transportation. The pronouncement is effective for fiscal years beginning after December 31, 2016. Management is currently evaluating the effect that the provisions of ASU 2015-11 will have on the Company's financial statements.

ASU 2015-09, *Revenue from Contracts with Customers (Topic 606)*, 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 in exchange for those goods or services. The Company will be 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. The provisions of this ASU are effective for interim and annual periods beginning after December 15, 2017. Management is currently evaluating the effect that the provisions of ASU 2015-09 will have on the Company's financial statements.

3. 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 table represents cash and the available-for-sale securities adjusted cost, gross unrealized gains, gross unrealized losses and fair value by significant investment category recorded as cash and cash equivalents or investment securities as of December 31, 2015 and 2014:

	December 31, 2015						
	Cost	Unrealized Gains	Unrealized Losses	Accrued Interest	Estimated Fair Value	Cash & Cash Equivalents	Investment Securities
Cash	$38,276,000	$-	$-	$-	$38,276,000	$38,276,000	$-
Level 1:							
Money Market Accounts	3,761,000	-	-	-	3,761,000	3,761,000	-
Mutual Funds	9,654,000	37,000	(444,000)	-	9,247,000	-	9,247,000
Corporate Equity Securities	1,332,000	246,000	(76,000)	-	1,502,000	-	1,502,000
Government & Agency Securities	5,425,000	25,000	(19,000)	17,000	5,448,000	-	5,448,000
	20,172,000	308,000	(539,000)	17,000	19,958,000	3,761,000	16,197,000
Level 2:							
Municipal Bonds	2,735,000	42,000	(3,000)	20,000	2,794,000	-	2,794,000
Corporate Bonds	6,054,000	22,000	(41,000)	46,000	6,081,000	-	6,081,000
	8,789,000	64,000	(44,000)	66,000	8,875,000	-	8,875,000
Total	$67,237,000	$372,000	$(583,000)	$83,000	$67,109,000	$42,037,000	$25,072,000

	December 31, 2014						
	Cost	Unrealized Gains	Unrealized Losses	Accrued Interest	Estimated Fair Value	Cash & Cash Equivalents	Investment Securities
Cash	$23,894,000	$-	$-	$-	$23,894,000	$23,894,000	$-
Level 1:							
Money Market Accounts	565,000	-	-	-	565,000	565,000	-
Mutual Funds	10,733,000	63,000	(129,000)	-	10,667,000	-	10,667,000
Corporate Equity Securities	3,408,000	695,000	(31,000)	-	4,072,000	-	4,072,000

Government & Agency Securities	4,559,000	49,000	(5,000)	15,000	4,618,000	-	4,618,000
	19,265,000	807,000	(165,000)	15,000	19,922,000	565,000	19,357,000
Level 2:							
Municipal Bonds	3,652,000	78,000	(7,000)	28,000	3,751,000	-	3,751,000
Corporate Bonds	5,022,000	29,000	(12,000)	38,000	5,077,000	-	5,077,000
	8,674,000	107,000	(19,000)	66,000	8,828,000	-	8,828,000
Total	$51,833,000	$914,000	$(184,000)	$81,000	$52,644,000	$24,459,000	$28,185,000

The Company had realized gains of $458,000, $771,000 and $74,000 for the years ended December 31, 2015, 2014 and 2013, respectively. As of December 31, 2014 and 2015, 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 from 1 to 30 years for corporate bonds, 1 to 5 years for municipal bonds, and 1 to 7 years for government and agency securities.

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4. INVENTORY

Inventories consisted of the following as of:

	December 31, 2015	December 31, 2014
Raw Materials	$ 3,666,000	$ 4,410,000
Packaging	788,000	920,000
Non-food Finished Goods	635,000	1,108,000
Finished Goods	8,545,000	9,689,000
Reserve for Obsolete Inventory	(299,000)	(392,000)
	$ 13,335,000	$ 15,735,000

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant, and equipment consisted of the following as of:

	December 31, 2015	December 31, 2014
Land	$ 650,000	$ 650,000
Building and leasehold improvements	13,122,000	13,346,000
Equipment and fixtures	61,573,000	59,501,000
Vehicle	149,000	149,000
	$ 75,494,000	$ 73,646,000
Less accumulated depreciation and amortization	46,465,000	40,169,000
Property, plant and equipment- net	$ 29,029,000	$ 33,477,000

Depreciation and amortization expense for continuing operations for the years ended December 31, 2015, 2014 and 2013 was $7,115,000, $8,052,000, and $7,810,000, respectively. Depreciation and amortization expense for discontinued operations related to the Medifast Corporate Weight Control Centers for the years ended December 31, 2015, 2014 and 2013 was $0, $1,699,000, and $3,144,000, respectively. As a result of the sale and closure of the Medifast Weight Control Centers, the Company incurred an asset impairment loss of $3.3 million in 2014 that is included in discontinued operations.

6. ACCOUNTS PAYABLE AND ACCRUED EXPENSES

	December 31, 2015	December 31, 2014
Trade payables	$ 11,264,000	$ 12,178,000
Sales commissions payable	4,245,000	3,890,000
Accrued payroll and related taxes	3,440,000	3,000,000
Dividends payable	3,013,000	-
Sales tax payable	542,000	806,000
Accrued loan guarantee	-	1,980,000
	$ 22,504,000	$ 21,854,000

7. LEASES

Operating and Capital Leases:

As of December 31, 2015, the Company leases office space for corporate offices, a distribution facility in Texas, a raw materials warehouse in Maryland, as well as 41 leases for previously corporate-operated Medifast Weight Control Centers under lease terms ranging from five to ten years. The 41 leases include 3 Centers closed in December 2013, 7 Centers that were closed in December 2014, and 31 leases for Centers that were sold to franchise partners during 2014 and entered into sublease agreements with the franchisees. The Company accrued for the remaining lease obligations net of any sublease income in 2014, see Note 12 for exit activity and clinic obligations. Monthly payments under the Medifast Weight Control Centers leases range in price from $1,800 to $5,000. The Company is additionally required to pay property taxes, utilities, insurance and other costs relating to the leased facilities.

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The Company leases large commercial printers for our printing operation that supports our sales channels and network equipment for information technology that are accounted for as capital leases. The leases extend through December 2016.

The following table summarizes our future minimum rental and lease payments required under non-cancelable original lease terms in excess of one year as of December 31, 2015:

	Operating Leases	Capital Leases
2016	$ 2,829,000	$ 225,000
2017	1,758,000	-
2018	355,000	-
2019	31,000	-
Total minimum lease payments	$ 4,973,000	$ 225,000
Less amount representing interest		6,000
Present value of minimum lease payments (current)		$ 219,000
Current portion		219,000
Long-term portion		$ -

Total minimum lease payments have not been reduced by minimum sublease rent income of approximately $2.0 million due under future non-cancelable subleases.

The following is a summary of the Company's rent expense for the years ended December 31, 2015, 2014 and 2013:

	2015	2014	2013
Continuing Operations	1,506,000	1,460,000	1,400,000
Discontinued Operations	(1,002,000)	7,189,000	5,233,000
	$504,000	$8,649,000	$6,633,000

For the period ended December 31, 2015, the positive impact to rent expense is due to lease termination agreements that resulted in the reversal of rent obligations estimates that were expensed in 2014. For the periods ended December 31, 2014 and 2013, the discontinued operations rent expense includes an accrual of $4.4 million and $1.1 million, respectively, for continuing obligations for operating leases related to centers closed during the periods.

Equipment lease expense for continuing operations for the years ended December 31, 2015, 2014, and 2013 was $1.0 million, $1.2 million, and $1.4 million, respectively.

8. CONTINGENCIES

The Company has entered into guarantee agreements with key franchisee partners in order to support them obtaining additional funding to expand their business into new markets. All of the loans associated with these agreements have been paid in full and the Company incurred a charge of $2 million in 2014 to fulfill its guarantee obligation on one of the loans. The guarantee with Team Wellness, Inc. provided financial coverage for a $1.0 million loan and a $1.0 million line of credit. The franchisee associated with these loans failed to pay the monthly obligations and the Company paid off the loans in April 2015, which was fully accrued and expensed in the amount of $2.0 million as of December 31, 2014. The Company was a secondary guarantor on the loan and line of credit and has pursued personal recourse against the franchise owner.

9. INCOME TAXES

The components of the income tax expense from continuing operations are as follows:

	2015	2014	2013
Current			
Federal	$9,814,000	$10,282,000	$11,682,000
State	396,000	96,000	(202,000)
Total Current	10,210,000	10,378,000	11,480,000
Deferred			
Federal	(125,000)	176,000	365,000
State	39,000	206,000	63,000
Foreign	(20,000)	(96,000)	-
Total Deferred	(106,000)	286,000	428,000
Total Income Tax Expense from Continuing Operations	$10,104,000	$10,664,000	$11,908,000

The total tax provision for the years ended December 31, 2015, 2014, and 2013 was $9.9 million, $4.9 million, $10.0 million, respectively. Those amounts have been allocated to the following financial statement items:

	2015	2014	2013
Income from continuing operations	$10,104,000	$10,664,000	$11,908,000
Income/(loss) from discontinued operations	387,000	(5,302,000)	(1,690,000)
Stockholders' equity, unrealized gain (loss) on investment securities & foreign currency	(357,000)	(182,000)	143,000
Additional paid in capital, share-based compensation tax benefit	(247,000)	(275,000)	(383,000)
Total Income Tax Expense	$9,887,000	$4,905,000	$9,978,000

Deferred tax assets (liabilities) consisted of the following at December 31,

	2015	2014	2013
Reserves on inventory and sales	$199,000	$291,000	$332,000

Credit and loss carryforwards	735,000	699,000	413,000
Stock compensation	1,149,000	1,283,000	896,000
Accrued expenses and deferred costs	1,068,000	3,170,000	1,260,000
Inventory capitalization	49,000	142,000	337,000
Sales tax accrual	-	8,000	337,000
Unrealized gain/loss on investments	85,000	-	-
Total deferred tax assets	3,285,000	5,593,000	3,575,000
Unrealized gain/loss on investments	-	(294,000)	(476,000)
Prepaid expenses	(755,000)	(779,000)	(710,000)
Depreciation	(6,189,000)	(6,285,000)	(7,091,000)
Foreign currency	(23,000)	-	-
Total deferred tax liabilities	(6,967,000)	(7,358,000)	(8,277,000)
Net deferred tax liabilities	$(3,682,000)	$(1,765,000)	$(4,702,000)

The differences between the United States federal statutory tax rate and the Company's effective tax rate are as follows:

	2015		2014		2013	
Statutory federal tax	$10,381,000	35.0%	$11,093,000	35.0%	$13,665,000	35.0%
State income taxes, net of federal benefit	414,000	1.4 %	314,000	1.0 %	393,000	1.0 %
Foreign Taxes	15,000	0.1 %	73,000	0.2 %	-	0.0 %
Domestic manufacturer deduction	(824,000)	-2.8 %	(811,000)	-2.6 %	(979,000)	-2.5 %
Other permanent differences	4,000	0.0 %	200,000	0.6 %	173,000	0.4 %
Research and development and jobs credits	(247,000)	-0.8 %	(203,000)	-0.6 %	(459,000)	-1.2 %
Other state income tax benefits	114,000	0.4 %	(113,000)	-0.4 %	(707,000)	-1.8 %
Other	247,000	0.8 %	111,000	0.4 %	(178,000)	-0.4 %
	$10,104,000	34.1%	$10,664,000	33.6%	$11,908,000	30.5%

The 2015, 2014 and 2013 effective tax rates were impacted by the Company’s extensive state income tax planning. This planning includes taking advantage of Maryland’s apportionment methodology. As a manufacturing entity based in Maryland, the Company utilizes the single sales factor apportionment method in addition to claiming new state jobs credits and research & development credits. In 2013 the Company benefited from research and development credits effective January 1, 2013, applicable retroactively to 2012 activity. In 2014 the Company benefited from research and development credits effective January 1, 2014 in addition to filing an amended federal return to claim 2010 research and development credits due to changes in Federal regulations.

The Company has separate company state net operating loss carry forwards totaling $10.9 million start expiring in 2031. Maryland state credits carry forwards totaling $201,000 will begin to expire in 2018.

10. 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 expected volatility of the price of the Company's common stock, dividend yield and the risk-free interest rate. Options outstanding as of December 31, 2015 generally vest over a period of three years with an expiration term of ten years. The exercise price of these options ranges from $24.26 to $31.55. 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. 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 award. The risk free interest rate is based on the U.S. Treasury yield curve in effect on the date of grant which most closely corresponds to the expected term of the option. All of the options were issued prior to the Company declaring its first dividend in December 2015; and therefore, a dividend yield is not utilized in the calculation. The weighted average input assumptions used and resulting fair values were as follows:

	2015	2014
Expected life (in years)	6	6
Risk-free interest rate	1.71 %	1.61 %
Expected volatility	50.91%	63.15%
Dividend yield	-	-

The following table summarizes the stock option activity:

	Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Life (Yrs)	Aggregate Intrinsic Value
Outstanding at December 31, 2014	67,375	$ 26.05		
Granted	66,000	30.99		
Exercised	(1,666)	26.52		
Forfeited	(33,336)	29.54		

Outstanding at December 31, 2015	98,373	$ 28.17	8.52	256,175
Exerciseable at December 31, 2015	34,615	$ 26.27	7.92	145,052

The weighted-average grant date fair value of options granted was $15.24. The unrecognized compensation expense calculated under the fair value method for shares expected to vest as of December 31, 2015 was approximately $0.6 million and is expected to be recognized over a weighted average period of 1.9 years. The Company received $44,000 in cash proceeds from the exercise of stock options during 2015. No options were exercised in 2014 or 2013.

Restricted Stock:

The Company has issued restricted stock to employees and nonemployee directors generally with terms ranging up to seven years. The fair value 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 the restricted stock activity:

	Shares	Weighted-Average Grant Date Fair Value
Unvested at December 31, 2014	333,676	$ 25.31
Granted	58,685	31.39
Vested	(124,053)	25.68
Forfeited	(4,600)	31.55
Unvested at December 31, 2015	263,708	$ 26.38

The total share-based compensation expense charged against income during the years ended December 31, 2015, 2014, and 2013 were $3,081,000, $3,918,000, and $3,209,000, respectively. Included in share-based compensation expense for 2015 is $734,000 for 46,530 shares of performance awards to be issued to certain key employees based on achieving 2015 financial plan that will vest on December 31, 2016. The Company intends to issue additional performance awards in 2016 to certain key employees if certain 2016 financial plans are met. During 2015, the Company issued 12,155 shares to members of the Board of Directors including 4,600 shares that were later forfeited. The total income tax benefit recognized in the consolidated statement of income for these restricted stock awards was approximately $1,012,000, $1,398,000 and $1,123,000 for the years ending December 31, 2015, 2014, and 2013, respectively. The tax benefit recognized in additional paid-in capital upon vesting of restricted stock awards and exercise of stock options was approximately $247,000, $275,000 and $383,000 for the years ending December 31, 2015, 2014, 2013, respectively. There was approximately $4.6 million of total unrecognized compensation cost related to restricted stock awards as of December 31, 2015. The cost is expected to be recognized over a weighted-average period of approximately 2.2 years.

11. BUSINESS SEGMENTS

Operating segments are components of an enterprise about which separate financial information is available that is regularly reviewed by the chief operating decision maker about how to allocate resources and in assessing performance. The consolidated operating profit of the Company is reviewed by the chief operating decision maker as a single segment and sales are reviewed at the channel level.

The following table represents sales by channel for the years ended:

	December 31, 2015	December 31, 2014	December 31, 2013
Take Shape For Life	$ 202,218,000	$ 206,657,000	$ 228,729,000
Medifast Direct	48,658,000	57,159,000	75,521,000

Medifast Weight Control Centers- Franchise	17,072,000	15,424,000	15,336,000
Medifast Wholesale	4,825,000	6,045,000	4,468,000
Net Revenue	$ 272,773,000	$ 285,285,000	$ 324,054,000

12. DISCONTINUED OPERATIONS, EXIT ACTIVITIES, AND CLINIC OBLIGATIONS

In 2014, the Company exited the MWCC corporate center model by selling 41 centers to existing franchise partners (24 centers were sold in June 2014 and the remaining 17 centers were sold in December 2014) and closing the remaining 34 corporate centers. In accordance with ASU 2014-08, *Presentation of Financial Statements (Topic 205) and Property Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity* the assets, liabilities, operating results, and cash flows of the MWCC corporate center channel have been presented separately as discontinued operations in the Consolidated Financial Statements for all periods presented.

The following is a summary of the Company’s operating results for discontinued operations for the years ended:

	December 31, 2015	December 31, 2014	December 31, 2013
Revenue	$ -	$ 22,509,000	$ 32,832,000
Income/(loss) before income taxes from discontinued operations	878,000	(13,150,000)	(4,856,000)
Income tax/(benefit) provision	387,000	(5,302,000)	(1,690,000)
Income/(loss) from discontinued operations, net of tax	$ 491,000	$ (7,848,000)	$ (3,166,000)

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The following table presents the aggregate carrying amounts of the major classes of assets and liabilities included in discontinued operations as of:

	December 31, 2015
ASSETS	
Current assets:	
Receivables, net	$ 353,000
Total current assets	353,000
Other assets	19,000
Total assets	$ 372,000
LIABILITIES	
Current liabilities:	
Accounts payable and accrued expenses	841,000
Total current liabilities	$ 841,000
Long-term lease obligations	288,000
Total liabilities	**$ 1,129,000**

The following table summarizes the exit obligations primarily consisting of closed clinic lease obligations, severance accruals, and customer refunds incurred for the years ended December 31, 2014 and 2015:

Ending accrued balance as of December 31, 2013	$1,361,000
Charges incurred during the period	6,006,000
Payments during the period	(833,000)
Ending accrued balance as of December 31, 2014	$6,534,000
Adjustments recorded during the period (1)	(1,483,000)
Payments during the period	(3,922,000)
Ending accrued balance as of December 31, 2015	$1,129,000

(1)- The adjustments to the accrual recorded in 2015 relate primarily to favorable termination agreements reached with landlords of closed Corporate Medifast Weight Control Centers.

These charges were recorded in the balance sheet as of December 31, 2015 as follows:

Total current liabilities of discontinued operations	$841,000
Total long-term liabilities of discontinued operations	288,000
Ending accrued balance as of December 31, 2015	$1,129,000

13. SUBSEQUENT EVENTS

On March 9, 2016, the Company’s board of directors declared a $0.25 cash dividend to its stockholders, valued at $3.0 million. The dividend is payable on May 10, 2016 to stockholders of record as of the close of business on March 21, 2016.

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INDEX TO EXHIBITS

No.	
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).
10.1	Amended and Restated 2012 Share Incentive Plan (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 001-31573) filed on June 20, 2014).*
10.2	Form of Restricted Share Award Agreement (filed herewith).*
10.3	Form of Incentive Stock Option Agreement (incorporated by reference to Exhibit 99.1 of the Company's Current Report on Form 8-K (File No. 001-31573) filed on February 4, 2014). *
10.4	Form of Non-Qualified Stock Option Agreement (filed herewith). *
10.5	Form of Performance-Based Deferred Share Award Agreement (filed herewith). *
10.6	Lease relating to the Company's Owings Mills, Maryland facility incorporated by reference to the Registration Statement on Form S-4 of the Company (File No. 33-81524).
10.7	Cooperation Agreement dated April 3, 2015, by and among the Company, Engaged Capital LLC, and the persons set forth on the signature pages thereto (incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K (File No. 001-31573) filed on April 6, 2015.
21.1	Subsidiaries of Medifast, Inc. (filed herewith).
23.1	Consent of RSM US LLP (filed herewith).
31.1	Certification of Chief Executive Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
31.2	Certification of Chief Financial Officer pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (filed herewith).
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes- Oxley Act of 2002 (furnished herewith).
101	The following financial statements from Medifast, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2015, filed March 15, 2016, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Changes in Stockholders' Equity

(v) Consolidated Statements of Cash Flows, and (vi) Notes to the Consolidated Financial Statements (filed herewith).

* Indicates a management contract or compensatory plan.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

MEDIFAST, INC.

(Registrant)

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

MEDIFAST, INC.

(Registrant)

/s/ MICHAEL C. MACDONALD

Michael C. MacDonald
Chief Executive Officer
(Principal Executive Officer)
Dated: March 15, 2016

/s/ TIMOTHY G. ROBINSON

Timothy G. Robison
Chief Financial Officer
(Principal Financial and Accounting Officer)
Dated: March 15, 2016

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

Name	Title	Date
/s/ JEFFREY J. BROWN	Lead Director	March 15, 2016
Jeffrey J. Brown		
/s/ KEVIN G. BYRNES	Director	March 15, 2016
Kevin G. Byrnes		
/s/ CHARLES P. CONNOLLY	Director	March 15, 2016
Charles P. Connolly		
/s/ CONSTANCE J. HALLQUIST	Director	March 15, 2016
Constance J. Hallquist		
/s/ JORGENE K. HARTWIG	Director	March 15, 2016
Jorgene K. Hartwig		
/s/ JOSEPH P. KELLEMAN	Vice President of Finance	March 15, 2016
Joseph P. Kelleman		
/s/ MICHAEL C. MACDONALD	Chairman and Chief Executive Officer	March 15, 2016
Michael C. Macdonald		
/s/ CARL E. SASSANO	Director	March 15, 2016
Carl. E. Sassano		
/s/ SCOTT SCHLACKMAN	Director	March 15, 2016
Scott Schlackman		
/s/ GLENN W. WELLING	Director	March 15, 2016
Glenn W. Welling		

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