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Zacks Small-Cap Research

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Interleukin Genetics (ILIU-OTC)

ILIU: Q1 Results, No Surprises

OUTLOOK

Enrollment of the key UofM PST (periodontal disease) test study just completed. Assuming positive results, this study data could lead to dental insurance reimbursement of the test, offering a potentially huge opportunity for ILIU.

An investment in ILIU is not without significant risk and our financial model assumes favorable outcomes of a number of current "unknowns" (including successfully addressing an impending debt maturity). No surprises in Q1. Our $1.30 price target and Outperform rating remain intact.

Current Recommendation	**Outperform**
Prior Recommendation	N/A
Date of Last Change	03/28/2011
Current Price (05/11/12)	$0.29
Target Price	**$1.30**

SUMMARY DATA

52-Week High	**$0.49**
52-Week Low	**$0.17**
One-Year Return (%)	**-2.78**
Beta	**1.82**
Average Daily Volume (sh)	**14,970**
Shares Outstanding (mil)	**37**
Market Capitalization ($mil)	**$11**
Short Interest Ratio (days)	**3.49**
Institutional Ownership (%)	**0**
Insider Ownership (%)	**6**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**-33.3**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2012 Estimate	**N/A**
P/E using 2013 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**High,**
Type of Stock	**N/A**
Industry	**Med-Biomed/Gene**

ZACKS ESTIMATES

Revenue
(in '000s of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	719 A	797 A	765 A	575 A	2,857 A
2012	677 A	829 E	898 E	1,121 E	3,545 E
2013					7,917 E
2014					23,113 E

Earnings per Share

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2011	-$0.03 A	-$0.04 A	-$0.03 A	-$0.04 A	-$0.14 A
2012	-$0.04 A	-$0.03 E	-$0.03 E	-$0.03 E	-$0.11 E
2013					-$0.05 E
2014					$0.04 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

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Q1 2012 RESULTS

Interleukin reported financial results for the first quarter ending March 31, 2012 on May 10th. There were no material surprises. Revenue came in lighter than our estimate although some of this may be due to timing as deferred revenue jumped by more than $300k from the end of Q4 - which we would expect to benefit Q2. As has been the theme in the recent past, ILIU continues to trim expenses which helped operating expenses come in slightly below our estimate. Net income and EPS were both in-line with our numbers.

On the operational front, enrollment was completed for the University of Michigan PST study earlier this year and ILIU has close to 100% of patient genotyping done. UofM is then responsible for the data analysis. Management believes they could have interim results in the coming months. This PST test is the major catalyst driving our revenue growth assumptions in our model, particularly in the out-years.

Q1 RESULTS

Revenue
Q1 revenue of $678k came in lighter than our $798k estimate, but as noted, deferred revenue spiked by over $300k. ILIU records deferred revenue when they receive payment for a genetic test and but doesn't book the revenue on the income statement until the test report is issued. The spike in deferred revenue indicates Q2 could be significantly stronger.

Gross Margin / Operating Expenses / EPS
Gross margin was 45% versus our 50% estimate. 45% is still in-line with the full-year 2011. Operating expenses again showed solid expense management, coming in at $1.58MM compared to our $1.62MM estimate. Net loss and EPS were $1.41MM and ($0.04) compared to our $1.34MM and ($0.04) numbers.

Cash
What the company is going to do about the impending debt maturity and raising more cash remains the big question mark. Cash used in operations was $998k in the quarter (in-line with the recent quarterly averages). Cash balance at the end of Q1 was $732k. Subsequent to Q1 quarter end (in April) ILIU drew down the remaining $1.3MM available under the Pyxis credit facility. This credit facility is now fully tapped at $14.3 million and comes due on June 30, 2012. Management could not provide specifics on the call but assured that they are addressing the impending maturity and fully expects to have a resolution before the end of June.

OUTLOOK / RECOMMENDATION

As there were no surprises relative to our expectations in the Q1 10-Q or on the earnings call, we have made no material changes to our model following Q1 results. Our outlook is obviously predicated on the assumptions that ILIU sufficiently addresses the impending debt maturity, raises additional operating capital and remains a going concern. We think, given the potential of the PST test, that it's a reasonable assumption that there is capital on the sidelines.

We continue to model only modest revenue growth until after substantial commercialization of the PST test. We look for revenue and EPS of $3.5MM / ($0.11) and $8.0MM / ($0.05) in 2012 and 2013, respectively. Our $1.30 price target and Outperform rating also remain intact.

U of M PST Study Enrollment Completed (*per our 3/30/12 report*)

Completion of enrollment of the key University of Michigan PST study was announced on March 28th.

As a reminder, in August 2010 Interleukin announced an agreement with the University of Michigan for a large study to test whether certain risk factors, including genetic variations, can help guide better medical intervention of periodontal disease and improve patient outcomes. Funding for the study is being provided by Renaissance Health Service, parent company of a large and diverse set of insurance companies focused on dental health. A new

version of Interleukin's PST test was used in the study for identification of predictive risk factors of periodontal disease - the study is expected to confirm results of earlier studies. The prospective study examined 15 years worth of patient data taken from a large dental claims database and is comparing that to information from patients obtained from using the PST test. Total enrollment was expected to be about 4,000 individuals - final enrollment ended up being over 5,400 patients. The hypothesis for the study is to determine whether more than one dental cleaning per year is value-added for gene-negative (i.e. – low risk) patients and how many cleanings are optimal for gene-positive (i.e. – high risk) patients. Primary endpoint of the study is tooth loss at 10 and 15 years. The study, which commenced in late 2010, is the largest ever done to evaluate the application of genetic information for the prevention of periodontal disease.

The most recent announcement that enrollment is completed is right on with management's timeline. Top-line look at the data analysis, being done by UofM, could come in the third quarter. If the study results show what Interleukin believes it will (i.e. – that PST can predict periodontal disease based on genotyping), it could be a useful tool in determining optimal dental care for each individual patient – which includes the "correct" number of cleanings each year. This will hopefully support reimbursement for the PST test from dental insurance providers. Currently cost of the PST test (~ $150) is borne by the consumer as no insurers provide reimbursement for it. As such, gaining reimbursement will be key to driving demand for it.

Timelines for release of the full data set and (assuming positive results) submission for publication are substantially less clear, although it's possible this could be a current year event. Until then, there may be only limited demand for test.

Meta-Analysis Supports Link Between IL-1 Gene Variation and Periodontal Disease (*per our 3/30/12 report*)

A meta-analysis of 13 studies showed a statistically significant association between the presence of variations of the interluekin-1 (IL-1) gene and the risk of periodontal disease. The IL-1 genetic variations used in the study are the same as those in Interleukin Genetics' PST test - which could bode well for supporting use of ILIU's PST test. Results of the peer-reviewed study will be published in the Journal of Periodontology and were included in the online version of the publication in March.

FINANCIAL MODEL

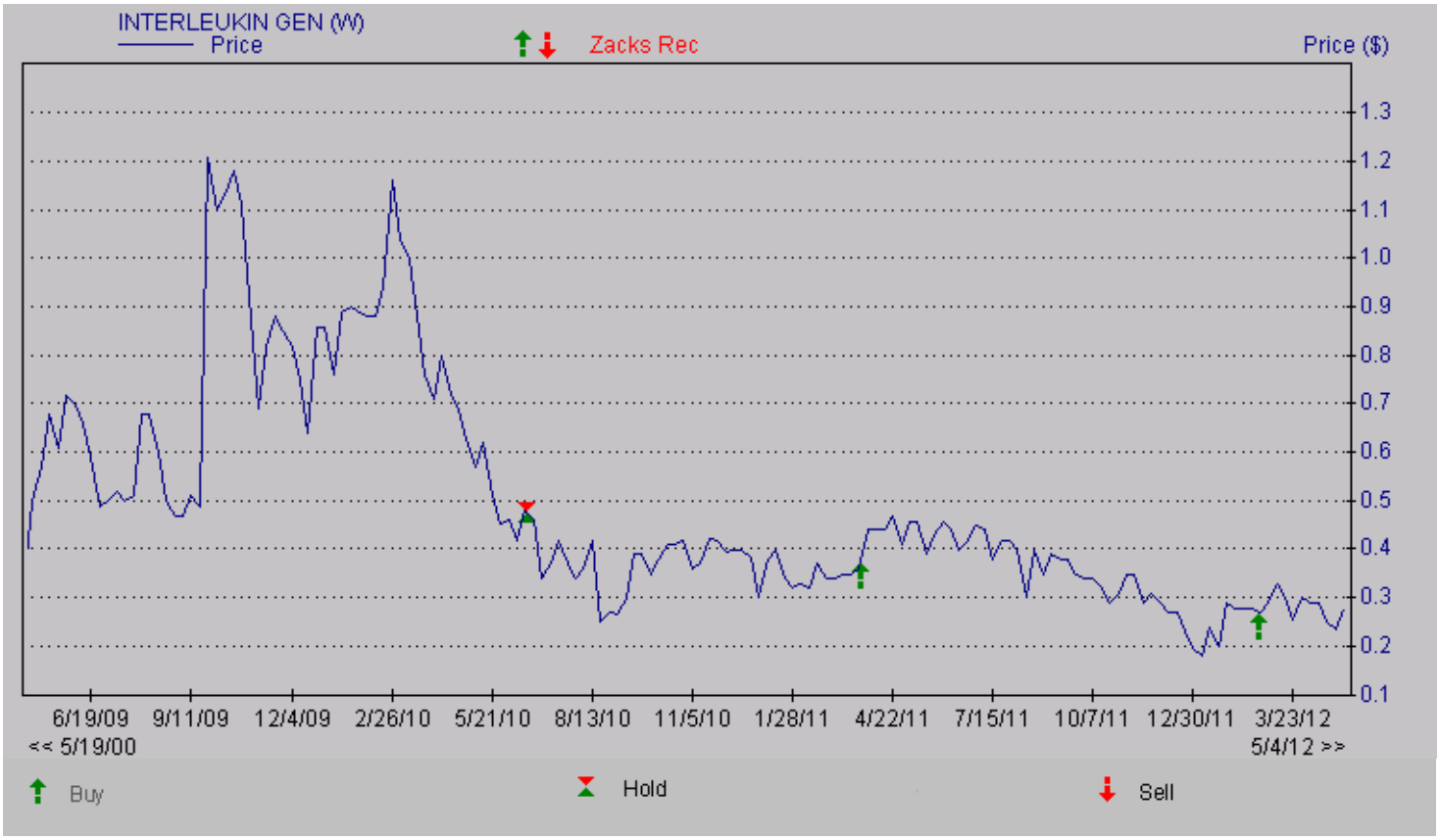
Interleukin Genetics, Inc.

	2011 A	Q1A	Q2E	Q3E	Q4E	2012 E	2013 E	2014 E	2015 E
Genetic testing	$2,757.4	$677.2	$805.0	$872.0	$1,088.0	$3,442.2	$7,686.0	$22,440.0	$41,558.0
YOY Growth	*42.1%*	*-5.9%*	*3.3%*	*19.3%*	*106.2%*	*24.8%*	*123.3%*	*192.0%*	*85.2%*
Other	$99.7	$0.7	$24.2	$26.2	$32.6	$103.3	$230.6	$673.2	$1,246.7
Total Revenues	$2,857.1	$677.9	$829.2	$898.2	$1,120.6	$3,545.4	$7,916.6	$23,113.2	$42,804.7
YOY Growth	*43.1%*	*-5.8%*	*4.1%*	*17.3%*	*94.8%*	*24.1%*	*123.3%*	*192.0%*	*85.2%*
Cost of Revenues	$1,527.2	$376.2	$439.4	$431.1	$571.5	$1,818.3	$3,720.8	$9,938.7	$17,121.9
Gross Income	$1,329.9	$301.7	$389.7	$467.0	$549.1	$1,727.1	$4,195.8	$13,174.5	$25,682.8
Gross Margin	*46.5%*	*44.5%*	*47.0%*	*52.0%*	*49.0%*	*48.7%*	*53.0%*	*57.0%*	*60.0%*
R&D	$1,376.4	$446.3	$372.0	$425.0	$440.0	$1,683.3	$2,254.0	$2,450.0	$3,144.0
% R&D	*48.2%*	*65.8%*	*44.9%*	*47.3%*	*39.3%*	*47.5%*	*28.5%*	*10.6%*	*7.3%*
R&D QTDP Grant	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
SG&A	$4,665.4	$1,136.6	$1,244.0	$1,285.0	$1,271.0	$4,936.6	$6,016.6	$7,396.2	$9,417.0
% SG&A	*163.3%*	*167.7%*	*150.0%*	*143.1%*	*113.4%*	*139.2%*	*76.0%*	*32.0%*	*22.0%*
Amortization	$115.4	$28.9	$28.9	$28.9	$28.9	$115.6	$140.0	$155.0	$180.0
Operating Income	($4,827.3)	($1,310.1)	($1,255.2)	($1,271.9)	($1,190.8)	($5,008.4)	($4,214.8)	$3,173.3	$12,941.8
Operating Margin	*-169.0%*	*-193.3%*	*-151.4%*	*-141.6%*	*-106.3%*	*-141.3%*	*-53.2%*	*13.7%*	*30.2%*
Total Other income	($356.2)	($104.6)	($96.0)	($96.0)	($96.0)	($384.0)	($110.0)	$0.0	$50.0
Pre-Tax Income	($5,183.5)	($1,414.7)	($1,351.2)	($1,367.9)	($1,286.8)	($5,392.4)	($4,324.8)	$3,173.3	$12,991.8
Taxes	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0	$0.0
Tax Rate	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*	*0.0%*
Net Income	($5,183.5)	($1,414.7)	($1,351.2)	($1,367.9)	($1,286.8)	($5,420.5)	($4,324.8)	$3,173.3	$12,991.8
YOY Growth	*-19.9%*	*12.7%*	*-1.4%*	*20.6%*	*-9.5%*	*4.6%*	*-20.2%*	*-173.4%*	*309.4%*
Net Margin	*-181.4%*	*-208.7%*	*-163.0%*	*-152.3%*	*-114.8%*	*-152.9%*	*-54.6%*	*13.7%*	*30.4%*
EPS (continuing ops)	($0.14)	($0.04)	($0.03)	($0.03)	($0.03)	($0.11)	($0.05)	$0.04	$0.15
YOY Growth	*-22.0%*					*-18.9%*	*-55.6%*	*-173.4%*	*309.4%*
Diluted Shares O/S	36,661	36,748	50,750	50,800	50,800	47,275	85,000	85,000	85,000

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