

INTERLEUKIN GENETICS INC  
Form 10-Q  
May 14, 2013

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

**For the quarterly period ended March 31, 2013**

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-32715

INTERLEUKIN GENETICS, INC.

(Exact name of registrant in its charter)

Delaware

94-3123681

Edgar Filing: INTERLEUKIN GENETICS INC - Form 10-Q

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

**135 Beaver Street, Waltham, MA 02452**  
(Address of principal executive offices) (Zip Code)

Registrant's Telephone Number: **(781) 398-0700**

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

Indicate by check mark whether each registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

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   
Non-Accelerated filer  (Do not check if a 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

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

| Class  | Outstanding at April 30, 2013 |
|--|-------------------------------|
| <b>Common Stock, par value \$0.001 per share</b> | <b>36,814,488</b>             |

**INTERLEUKIN GENETICS, INC.**

**FORM 10-Q**

**FOR THE QUARTER ENDED March 31, 2013**

**Table of Contents**

|   | Page |
|---|------|
| <b><u>PART I—FINANCIAL INFORMATION</u></b>  |      |
| Item 1. Financial Statements  |      |
| Condensed Balance Sheets as of March 31, 2013 (Unaudited) and December 31, 2012               | 3    |
| Condensed Statements of Operations (Unaudited)  | 4    |
| Condensed Statements of Stockholders' Deficit (Unaudited)                                     | 5    |
| Condensed Statements of Cash Flows (Unaudited)  | 6    |
| Notes to Condensed Financial Statements (Unaudited)   | 7    |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations | 15   |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk                            | 18   |
| Item 4. Controls and Procedures   | 18   |
| <b><u>PART II—OTHER INFORMATION</u></b>   |      |
| Item 1. Legal Proceedings   | 19   |
| Item 1A. Risk Factors   | 19   |
| Item 2. Unregistered Sales of Equity Securities and Use of Proceeds                           | 19   |
| Item 3. Defaults Upon Senior Securities   | 19   |
| Item 4. Mine Safety Disclosures   | 19   |
| Item 5. Other Information   | 20   |
| Item 6. Exhibits  | 20   |

**Smaller Reporting Company – Scaled Disclosure**

Pursuant to Item 10(f) of Regulation S-K promulgated under the Securities Act of 1933, as amended, as indicated herein, we have elected to comply with the scaled disclosure requirements applicable to “smaller reporting companies”.

**PART I—FINANCIAL INFORMATION****Item 1. Financial Statements****INTERLEUKIN GENETICS, INC.****CONDENSED BALANCE SHEETS**

|   | March 31,<br>2013<br>(Unaudited) | December 31,<br>2012 |
|---|----------------------------------|----------------------|
| <b>ASSETS</b>   |                                  |                      |
| Current assets:   |                                  |                      |
| Cash and cash equivalents   | \$1,081,369                      | \$1,225,426          |
| Accounts receivable from related party  | 7,475                            | 552,572              |
| Trade accounts receivable   | 24,512                           | 47,560               |
| Inventory   | 116,480                          | 158,238              |
| Prepaid expenses  | 431,146                          | 417,772              |
| Other current assets  | 38,001                           | —                    |
| Total current assets  | 1,698,983                        | 2,401,568            |
| Fixed assets, net   | 101,204                          | 126,946              |
| Intangible assets, net  | 370,268                          | 399,131              |
| Other assets  | —                                | 38,001               |
| Total assets  | \$2,170,455                      | \$2,965,646          |
| <b>LIABILITIES AND STOCKHOLDERS' DEFICIT</b>  |                                  |                      |
| Current liabilities:  |                                  |                      |
| Accounts payable  | \$403,552                        | \$479,182            |
| Accrued expenses  | 189,681                          | 165,745              |
| Deferred revenue  | 2,050,369                        | 1,628,264            |
| Convertible debt  | 14,316,255                       | —                    |
| Total current liabilities   | 16,959,857                       | 2,273,191            |
| Convertible debt  | —                                | 14,316,255           |
| Total liabilities   | 16,959,857                       | 16,589,446           |
| Commitments and contingencies (Note 7)  |                                  |                      |
| Stockholders' deficit:  |                                  |                      |
| Convertible preferred stock, \$0.001 par value — 6,000,000 shares authorized;<br>5,500,000 shares issued and outstanding at March 31, 2013 and December 31, 2012;<br>aggregate liquidation preference of \$24,000,000 at March 31, 2013 | 5,500                            | 5,500                |
| Common stock, \$0.001 par value — 150,000,000 shares authorized; 36,782,208 and<br>36,761,864 shares issued and outstanding at March 31, 2013 and December 31,  | 36,782                           | 36,762               |

Edgar Filing: INTERLEUKIN GENETICS INC - Form 10-Q

|   |               |               |
|---|---------------|---------------|
| 2012, respectively                          |               |               |
| Additional paid-in capital                  | 94,066,561    | 94,030,603    |
| Accumulated deficit                         | (108,898,245) | (107,696,665) |
| Total stockholders' deficit                 | (14,789,402 ) | (13,623,800 ) |
| Total liabilities and stockholders' deficit | \$2,170,455   | \$2,965,646   |

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

**INTERLEUKIN GENETICS, INC.****CONDENSED STATEMENTS OF OPERATIONS****(Unaudited)**

|   | Three Months Ended March. 31, |                 |
|---|-------------------------------|-----------------|
|   | 2013                          | 2012            |
| Revenue:  |                               |                 |
| Genetic testing   | \$ 483,363                    | \$ 677,168      |
| Other   | 4,030                         | 716             |
| Total revenue   | 487,393                       | 677,884         |
| Cost of revenue   | 383,571                       | 376,211         |
| Gross profit  | 103,822                       | 301,673         |
| Operating expenses:   |                               |                 |
| Research and development                                      | 160,380                       | 446,274         |
| Selling, general and administrative                           | 1,002,172                     | 1,136,649       |
| Amortization of intangibles                                   | 28,863                        | 28,863          |
| Total operating expenses                                      | 1,191,415                     | 1,611,786       |
| Loss from operations  | (1,087,593 )                  | (1,310,113 )    |
| Other income (expense):                                       |                               |                 |
| Interest income   | 739                           | 743             |
| Interest expense  | (114,726 )                    | (105,336 )      |
| Total other expense   | (113,987 )                    | (104,593 )      |
| Loss before income taxes                                      | (1,201,580 )                  | (1,414,706 )    |
| Benefit for income taxes                                      | —                             | —               |
| Net loss  | \$ (1,201,580 )               | \$ (1,414,706 ) |
| Basic and diluted net loss per common share                   | \$ (0.03 )                    | \$ (0.04 )      |
| Weighted average common shares outstanding, basic and diluted | 36,775,504                    | 36,748,063      |

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

## INTERLEUKIN GENETICS, INC.

## CONDENSED STATEMENTS OF STOCKHOLDERS' DEFICIT

For the Three Months Ended March 31, 2013 and 2012

(Unaudited)

|                                    | Convertible Preferred Stock |          | Common Stock |          | Additional Paid-in Capital | Accumulated Deficit | Total          |
|------------------------------------|-----------------------------|----------|--------------|----------|----------------------------|---------------------|----------------|
|                                    | Shares                      | Amount   | Shares       | Amount   |                            |                     |                |
| Balance as of December 31, 2011    | 5,000,000                   | \$ 5,000 | 36,709,706   | \$36,710 | \$91,111,640               | \$(102,576,581)     | \$(11,423,231) |
| Net loss                           | —                           | —        | —            | —        | —                          | (1,414,706 )        | (1,414,706 )   |
| Common stock issued:               |                             |          |              |          |                            |                     |                |
| Employee stock purchase plan       | —                           | —        | 46,530       | 46       | 7,864                      | —                   | 7,910          |
| Stock-based compensation expense   | —                           | —        | —            | —        | 35,103                     | —                   | 35,103         |
| Balance as of March 31, 2012       | 5,000,000                   | \$ 5,000 | 36,756,236   | \$36,756 | \$91,154,607               | \$(103,991,287)     | \$(12,794,924) |
| Balance as of December 31, 2012    | 5,500,000                   | \$ 5,500 | 36,761,864   | \$36,762 | \$94,030,603               | \$(107,696,665)     | \$(13,623,800) |
| Net loss                           | —                           | —        | —            | —        | —                          | (1,201,580 )        | (1,201,580 )   |
| Common stock issued:               |                             |          |              |          |                            |                     |                |
| Exercise of employee stock options | —                           | —        | 2,000        | 2        | 518                        | —                   | 520            |
| Employee stock purchase plan       | —                           | —        | 18,344       | 18       | 4,751                      | —                   | 4,769          |
| Stock-based compensation expense   | —                           | —        | —            | —        | 30,689                     | —                   | 30,689         |
| Balance as of March 31, 2013       | 5,500,000                   | \$ 5,500 | 36,782,208   | \$36,782 | \$94,066,561               | \$(108,898,245)     | \$(14,789,402) |

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





**INTERLEUKIN GENETICS, INC.****CONDENSED STATEMENTS OF CASH FLOWS****(Unaudited)**

|   | For the Three Months Ended March 31, |                 |
|---|--------------------------------------|-----------------|
|   | 2013                                 | 2012            |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>                                    |                                      |                 |
| Net loss  | \$ (1,201,580                        | ) \$ (1,414,706 |
| Adjustments to reconcile net loss to net cash used in operating activities:     |                                      |                 |
| Depreciation and amortization   | 57,314                               | 89,451          |
| Stock-based compensation expense  | 30,689                               | 35,103          |
| Changes in operating assets and liabilities:                                    |                                      |                 |
| Accounts receivable from related party  | 545,097                              | (7,725          |
| Trade accounts receivable   | 23,048                               | (39,117         |
| Inventory   | 41,758                               | 30,626          |
| Prepaid expenses and other current assets                                       | (13,374                              | ) (42,318       |
| Accounts payable  | (75,630                              | ) (33,404       |
| Accrued expenses  | 23,936                               | 42,222          |
| Deferred revenue  | 422,105                              | 341,126         |
| Net cash used in operating activities   | (146,637                             | ) (998,742      |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>                                    |                                      |                 |
| Purchases of fixed assets   | (2,709                               | ) (5,000        |
| Net cash used in investing activities   | (2,709                               | ) (5,000        |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                                    |                                      |                 |
| Proceeds from employee stock purchase plan                                      | 4,769                                | 7,910           |
| Proceeds from exercise of employee stock options                                | 520                                  | —               |
| Net cash provided by financing activities                                       | 5,289                                | 7,910           |
| Net decrease in cash and cash equivalents                                       | (144,057                             | ) (995,832      |
| Cash and cash equivalents, beginning of period                                  | 1,225,426                            | 1,728,222       |
| Cash and cash equivalents, end of period  | \$ 1,081,369                         | \$ 732,390      |
| <b>Supplemental disclosures of cash flow information:</b>                       |                                      |                 |
| Cash paid for income taxes  | \$ —                                 | \$ —            |
| Cash paid for interest  | \$ 117,276                           | \$ 99,548       |
| <b>Supplemental disclosures of non-cash investing and financing activities:</b> |                                      |                 |
| Reclassification of convertible debt to current liabilities                     | \$ 14,316,255                        | \$ —            |

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



**INTERLEUKIN GENETICS, INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

**March 31, 2013**

**(UNAUDITED)**

Note 1—Basis of Presentation

Interleukin Genetics, Inc. (“the Company”) develops genetic tests for sale into the emerging personalized health market and performs testing services that can help individuals improve and maintain their health through preventive or therapeutic measures. The Company’s principal operations and markets are located in the United States.

The accompanying condensed financial statements include the accounts of the Company as of March 31, 2013 and December 31, 2012 and for the three months ended March 31, 2013 and 2012.

The financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America for interim financial reporting. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. These unaudited condensed financial statements, which, in the opinion of management, reflect all adjustments (including normal recurring adjustments) necessary for a fair presentation, should be read in conjunction with the financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012. Operating results are not necessarily indicative of the results that may be expected for any future interim period or for the entire fiscal year.

For information regarding our critical accounting policies and estimates, please refer to “Management’s Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Estimates” contained in our Annual Report on Form 10-K for the year ended December 31, 2012 and Note 3 to our condensed financial statements contained herein.

Note 2—Operating Matters, Liquidity and Going Concern

The Company has experienced net operating losses since its inception through March 31, 2013. The Company had net losses of \$5.1 million and \$5.0 million for the years ended December 31, 2012 and 2011, respectively, and \$1.2 million for the three months ended March 31, 2013, contributing to an accumulated deficit of \$108.9 million as of March 31, 2013. The Company has increased its borrowings to \$14.3 million, the maximum amount that can be borrowed, under its line of credit with Pyxis Innovations, Inc. ("Pyxis"). All outstanding amounts under this line of credit are due on March 31, 2014. Management expects that its current financial resources are adequate to maintain current and planned operations through May 2013.

The Company continues to take steps to reduce operating costs, including genetic test processing costs as well as general and administrative expenses. Cost savings are achieved through test process improvements, reductions in personnel and the subleasing of underutilized rental space. Management believes that the current laboratory space is adequate to process high volumes of genetic tests.

The Company's financial statements have been prepared assuming that it will continue as a going concern which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company expects to incur additional losses in 2013 and, accordingly, is dependent on finding additional sources of liquidity to fund its operations. We are currently in discussions with potential investors to fund the Company through the commercial launch of the PST<sup>®</sup> test with Renaissance Health Services Corporation, an affiliation of eight Delta Dental corporations (RHSC). This funding will not occur prior to the acceptance of the PST<sup>®</sup> study results in a peer reviewed publication. If this funding is completed, we believe that RHSC will be in a position to begin selling new insurance policies that utilize our PST<sup>®</sup> test to employer groups for policy years beginning in 2014. Management's plans include identifying sources of debt and/or equity financing. However, no assurance can be given at this time as to whether management will be able to achieve these plans. If the Company is not successful in doing so it will not be able to fund operations beyond May 31, 2013. These uncertainties raise substantial doubt about the Company's ability to continue as a going concern and to realize its assets and satisfy its liabilities in the normal course of business. The financial statements do not include any adjustment relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue its existence.

The ability of the Company to realize the carrying value of its fixed assets and intangible assets is especially dependent on management's ability to successfully execute on its plan. As noted in the preceding paragraph, the Company needs to generate additional funds in order to meet its financial obligations beyond May 31, 2013. If it is unsuccessful in doing so, the Company may not be able to realize the carrying value of its fixed assets and intangible assets

### **Note 3—Significant Accounting Policies**

#### *Revenue Recognition*

Revenue from genetic testing services is recognized when there is persuasive evidence of an arrangement, service has been rendered, the sales price is determinable and collectability is reasonably assured. Service is deemed to be rendered when the results have been reported to the individual who ordered the test. To the extent that tests have been prepaid but results have not yet been reported, recognition of all related revenue is deferred. As of March 31, 2013 and December 31, 2012, the Company has deferred genetic test revenue of \$2.1 million and \$1.6 million, respectively. Included in deferred revenue at March 31, 2013 are \$651,000 in customer payments in excess of one year old. Management continues to evaluate steps it may take in resolving these older payments.

#### *Sales Commission*

The Company accounts for sales commissions due to Amway Global under the Merchant Channel and Partner Agreement in accordance with SEC Staff Accounting Bulletin ("SAB") 104. Commissions are recorded as an expense at the time they become due which is at the point of sale. The cost of commissions was \$142,000 and \$262,000 for the three months ended March 31, 2013 and 2012, respectively.

#### *Accounts Receivable*

Accounts receivable is stated at estimated net realizable value, which is generally the invoiced amount less any estimated discount related to payment terms. The Company offers its commercial genetic test customers a 2% cash discount if payment is made by bank wire transfer within 10 days of the invoice date. No accounts receivable reserve is required at March 31, 2013 as all accounts receivable are expected to be collected.

*Inventory*

Inventory is carried at lower of cost (first-in, first-out method) or market and no inventory reserve is deemed necessary at March 31, 2013. As the Company does not manufacture any products, no overhead costs are included in inventory. When a kit is sold, the corresponding cost of the kit is recorded as cost of goods sold and removed from inventory.

Inventory consisted of the following at March 31, 2013 and December 31, 2012:

|                      | March 31, 2013 | December 31, 2012 |
|----------------------|----------------|-------------------|
| Raw materials        | \$ 111,671     | \$ 154,485        |
| Finished goods       | 4,809          | 3,753             |
| Total inventory, net | \$ 116,480     | \$ 158,238        |

*Income Taxes*

The Company accounts for income taxes in accordance with FASB ASC 740, *Income Taxes*, which requires the recognition of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in the financial statements or tax returns. The measurement of current and deferred tax liabilities and assets is based on provisions of the enacted tax law; the effects of future changes in tax laws or rates are not anticipated. The Company records a valuation allowance to reduce its deferred tax assets to the amount that is more likely than not to be realized.

Significant management judgment is required in determining the Company's provision (benefit) for income taxes, its deferred tax assets and liabilities and any valuation allowance recorded against deferred tax assets. The Company has recorded a full valuation allowance against its deferred tax assets of approximately \$31.5 million as of March 31, 2013, due to uncertainties related to its ability to utilize these assets. The valuation allowance is based on management's estimates of taxable income by jurisdiction in which the Company operates and the period over which the deferred tax assets will be recoverable. In the event that actual results differ from these estimates or management adjusts these estimates in future periods, the Company may need to adjust its valuation allowance, which could materially impact its financial position and results of operations.

Due to changes in Massachusetts corporate income tax regulations enacted in 2009, the Company began filing a combined tax return with certain Alticor affiliated entities, referred to herein as "the unitary group". The law requires corporations with net operating loss carryforwards to go back to each year in which the loss was generated and recompute the loss as if it occurred on a combined basis. The Company was required to include data from the newly formed unitary group as if the unitary group was in place during the loss years. As a result, the losses generated by the Company were significantly reduced through this required computation. Due to a change in common ownership, the Company is no longer qualified to join in a combined filing of the unitary group as of June 29, 2012. Accordingly, the Company ceased filing combined Massachusetts tax returns with the unitary group in 2012. The combined and separate filings had no impact on the Company's payment of state income taxes or state portion of the provision.

On January 2, 2013, President Obama signed The American Taxpayer Relief Act of 2012 (H.R. 8) legislation which extended many of the tax provisions that expired in 2011 or 2012. For financial reporting purposes, the tax impact of this legislation is taken into account in the quarter in which the legislation is enacted by Congress and signed into law by the President. President Obama signed the bill on January 2, 2013, the financial reporting for these legislative changes occurred in the first quarter of 2013. Therefore, for 2012, no deferred tax asset with respect to the federal R&D tax credit was recorded. In the first quarter of 2013, the full deferred tax asset for the 2012 federal R&D tax credit has been recorded as a discrete item. The total impact to the first quarter 2013 is a deferred tax asset of approximately \$60,000.

The Company reviews its recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. The Company reviews all material tax positions for all years open to statute to determine whether it is more likely than not that the positions taken would be sustained based on the technical merits of those positions. The Company did not recognize any adjustments for uncertain tax positions as of and during the three months ended March 31, 2013. However, if the Company incurred interest and penalties they would be recorded in general and administrative expenses.

#### *Research and Development*

Research and development costs are expensed as incurred.

*Basic and Diluted Net Loss per Common Share*

The Company applies the provisions of FASB ASC 260, *Earnings per Share*, which establishes standards for computing and presenting earnings per share. Basic and diluted net loss per share was determined by dividing net loss applicable to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted net loss per share is the same as basic net loss per share for all the periods presented, as the effect of the potential common stock equivalents is anti-dilutive due to the loss in each period. Potential common stock equivalents excluded from the calculation of diluted net loss per share consists of stock options, warrants, convertible preferred stock and convertible debt as set forth in the table below:

|                             | As of March 31, |            |
|-----------------------------|-----------------|------------|
|                             | 2013            | 2012       |
| Options outstanding         | 2,435,500       | 2,135,667  |
| Warrants outstanding        | 2,187,158       | 2,150,000  |
| Convertible preferred stock | 39,089,161      | 28,160,200 |
| Convertible debt            | 2,521,222       | 2,289,418  |
| Total                       | 46,233,041      | 34,735,285 |



### *Fair Value of Financial Instruments*

The Company, using available market information, has determined the estimated fair values of financial instruments. The stated values of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the nature of these instruments. The fair value of our convertible debt is inherently difficult to determine as a result of the Company's financial condition and history of operating losses. For financial reporting purposes, the Company has estimated the fair value of its debt as the difference between the book value of its assets less liabilities to third parties other than the debt holder (see Note 5).

### *Cash and Cash Equivalents*

The Company maintains its cash and cash equivalents with domestic financial institutions that the Company believes to be of high credit standing. The Company believes that, as of March 31, 2013, its concentration of credit risk related to cash and cash equivalents was not significant. Cash and cash equivalents are available on demand and at times may be in excess of FDIC insurance limits.

### *Recent Accounting Pronouncements*

No recently issued updates or other guidance issued by the FASB through the issuance of these financial statements are expected to have a material impact on the Company's financial reporting.

### **Note 4—Strategic Alliance with Alticor Inc. (A Related Party)**

Since March 2003, the Company has maintained a broad strategic alliance with several affiliates of the Alticor family of companies, a related party through its role as both significant shareholder and lender to the Company, to develop and market novel nutritional and skin care products. The alliance initially included an equity investment, a multi-year research and development agreement, a licensing agreement with royalties on marketed products, the deferment of outstanding loan repayment and the refinancing of bridge financing obligations.

On October 20, 2009, the Company entered into a Merchant Network and Channel Partner Agreement with Amway Corp., d/b/a/ Amway Global ("Amway Global"), a subsidiary of Alticor Inc. Pursuant to this Agreement, Amway Global sells the Company's Inherent Health® brand of genetic tests through its e-commerce website via a hyperlink to our

e-commerce site. We paid Amway Global \$142,000 and \$262,000 in commissions for the three months ended March 31, 2013 and 2012, respectively, representing a percentage of net sales to their customers. The Company expenses commissions owed to Amway Global at the point of sale with the customer.

On September 14, 2012, the Company received a purchase order from Access Business Group, LLC (“ABG”), an affiliate of Pyxis, the Company’s largest stockholder and a subsidiary of Alticor. The order consists of kits of the Company’s Weight Management genetic test to be included in a promotional product bundle to be offered by ABG to the Amway sales channel in 2013. The total amount of the order was \$1.0 million. The Company shipped \$0.5 million in December 2012 and the balance in the first quarter of 2013. All payments due have been paid for this order. Tests are being processed from the order at March 31, 2013.

On September 21, 2012, the Company entered into a License Agreement with Access Business Group International LLC (“ABGI”), an affiliate of Pyxis. Pursuant to the License Agreement, the Company has granted ABGI and its affiliates a non-exclusive license to use the technology related to Interleukin’s Weight Management genetic test and to sell the Weight Management test in Europe, Russia and South Africa (the “Territories”). ABGI, or a laboratory designated by ABGI, will be responsible for processing the tests, and the Company will receive a royalty for each test sold, which royalty will increase if certain pending patent applications are issued. The License Agreement has an initial term of five years from the date of first commercial sale of the Weight Management test under the agreement. Thereafter, the term will automatically renew for additional one-year periods unless at least 60 days prior notice is delivered by either party. At March 31, 2013, no license fees have been earned from this agreement.

In connection with the execution of the License Agreement, the Company and ABGI also entered into a Professional Services Agreement (the “PSA”) pursuant to which the Company has agreed to provide services to ABGI in connection with its sale and processing of the tests within the Territories. Services will be provided pursuant to a statement of work to be entered into from time to time between the parties. Such statements of work will also specify the fees to be paid by ABGI to Interleukin for such services. The PSA has no set term and may be terminated by either party, subject to certain conditions. To date, \$5,250 in fees had been earned from this agreement.

**Note 5—Convertible Debt**

On August 17, 2006, our existing credit facility with Pyxis was amended to provide the Company with access to approximately \$14.3 million of additional working capital borrowings. Any amounts borrowed thereunder bear interest at the prime rate and require quarterly interest payments. On April 1, 2013, we executed a consent with Pyxis which allows us to defer the payment of interest on our convertible debt beginning on April 1, 2013, and continues to the earlier of the completion of a financing or July 1, 2013. At March 31, 2013, accrued interest expense was \$114,726 and recorded in accounts payable. The principal amount of any borrowing under this credit facility is convertible at Pyxis’ election into a maximum of 2,521,222 shares of common stock, reflecting a conversion price of \$5.6783 per share.

On April 13, 2012, the Company borrowed the remaining \$1,316,255 of available credit. This credit facility has been modified several times, including on November 29, 2012, to extend the due date to March 31, 2014.

The fair value of convertible debt is estimated to approximate \$0 at March 31, 2013.

**Note 6—Intangible Assets**

Intangible assets at March 31, 2013 and December 31, 2012 consisted of the following:

|                                 | March 31, 2013 | December 31, 2012 |
|---------------------------------|----------------|-------------------|
| Patent costs                    | \$ 1,154,523   | \$ 1,154,523      |
| Less — Accumulated amortization | (784,255 )     | (755,392 )        |
| Total                           | \$ 370,268     | \$ 399,131        |

Patent amortization expense was \$28,863 for the quarters ended March 31, 2013 and 2012, respectively.

Patent costs which are amortized on a straight-line basis over a 10-year life, are scheduled to amortize as follows:

Year ended December 31,

|                              |           |
|------------------------------|-----------|
| 2013 (remaining nine months) | 80,403    |
| 2014.                        | 94,100    |
| 2015.                        | 77,656    |
| Thereafter.                  | 118,109   |
|                              | \$370,268 |

**Note 7—Commitments and Contingencies**

*Employment Agreements*

On April 25, 2012, the Company executed an amendment, effective as of March 31, 2012, to the Employment Agreement dated as of November 12, 2008 by and between the Company and Kenneth S. Kornman, its then President and Chief Scientific Officer to extend the term through November 30, 2012. In connection with the resignation of its former Chief Executive Officer on August 23, 2012, the Board of Directors appointed Dr. Kornman as Chief Executive Officer in addition to his role as President and Chief Scientific Officer. The Board of Directors also appointed Dr. Kornman as a director to fill the vacancy created by the former Chief Executive Officer’s resignation. On November 29, 2012, the Company entered into a second amendment to Dr. Kornman’s employment agreement to extend the term through November 30, 2015.

On December 21, 2012, The Compensation Committee of the Board of Directors of the Company approved a Bonus Plan the “Bonus Plan”) for the Company’s executives. The Bonus Plan, which currently applies to Dr. Kornman, Eliot M. Lurier, the Company’s Chief Financial Officer, and Scott Snyder, the Company’s Chief Marketing Officer, has the following terms:

1. Executives are not entitled to a non-discretionary bonus for the year ending December 31, 2013.

Provided the Company meets certain earnings and revenue targets for the six months ending June 30, 2014 and an executive is employed by the Company as of June 30, 2014, executive shall receive a bonus equal to 30% of such executive's base salary.

Provided the Company meets certain earnings and revenue targets for the year ending December 31, 2014 and an executive is employed by the Company as of December 31, 2014, executive shall receive a bonus equal to 15% of such executive's base salary.

On December 21, 2012, Dr. Kornman was granted an option to purchase 300,000 shares of the Company's common stock at an exercise price of \$0.34, the fair value of the Company's stock on the grant date of the option. The option will vest in three installments of 75,000, 100,000 and 125,000 shares on each of the first three anniversaries of the grant date. Also on December 21, 2012, The Company's Chief Financial Officer, Eliot M. Lurier, was granted an option to purchase 200,000 shares of the Company's common stock at an exercise price of \$0.34, the fair value of the Company's stock on the grant date of the option. The option will vest in three installments of 50,000, 66,000 and 84,000 shares on each of the first three anniversaries of the grant date.

On December 26, 2012, the Company entered into an employment agreement with Scott Snyder for the position of Chief Marketing Officer beginning on January 2, 2013. The agreement provides for a minimum annual base salary of \$265,000, and for 2013 and 2014 he is eligible for a bonus pursuant to the Bonus Plan as set forth above. For 2015 and any subsequent year in which he is employed, he is eligible for a bonus of up to 30% of his base salary, based on factors such as the Company's evaluation of individual performance, the Company's financial performance, economic conditions generally, and the policy terms applicable to such bonus. Mr. Snyder is entitled to a maximum of \$34,000 in expense reimbursement in calendar year 2013, and an additional \$16,000 for the six months ending June 30, 2014, for travel and housing expenses from his residence to the Company's offices. Upon hire, Mr. Snyder was granted an option to purchase 200,000 shares of the Company's common stock at an exercise price of \$0.29 on January 2, 2013, the grant date of the option. The option will vest in three installments of 50,000, 66,000 and 84,000 shares on each of the first three anniversaries of the grant date.

Mr. Snyder's agreement is terminable at will by the Company or Mr. Snyder. If the Company terminates Mr. Snyder without cause, then the Company will pay Mr. Snyder, in addition to any accrued, but unpaid compensation prior to termination, an amount equal to six months of his base salary in effect at the time of the termination

#### *Operating Lease*

The Company leases its office and laboratory space under a non-cancelable operating lease expiring on March 31, 2014. In May 2010, the Company completed a sublease of approximately 6,000 square feet of underutilized office and laboratory space which successfully reduced our total space operating costs. The sublease also expires on March 31,

2014. Rent expense, net of the benefit of the sublease, was \$80,000 and \$82,000 for the three months ended March 31, 2013 and 2012, respectively.

Note 8—Capital Stock

*Authorized Preferred and Common Stock*

At March 31, 2013, the Company had authorized 6,000,000 shares of \$0.001 par value preferred stock, of which 5,000,000 shares, designated as Series A-1 Convertible Preferred Stock, were issued and outstanding and 500,000 shares, designated as Series B Convertible Preferred Stock, were issued and outstanding (collectively, the “Preferred Stock”). At March 31, 2013, the Company had authorized 150,000,000 shares of \$0.001 par value common stock of which 85,590,685 shares were outstanding or reserved for issuance. Of those, 36,782,208 shares were outstanding; 39,089,161 shares were reserved for the conversion of the outstanding Preferred Stock to common stock; 2,521,222 shares were reserved for the conversion of the \$14,316,255 of debt outstanding under the credit facility with Pyxis; 4,279,280 shares were reserved for the potential exercise of outstanding stock options and for shares of common stock available for future grants under our stock plan; 731,656 shares were reserved for the potential exercise of rights held under the Employee Stock Purchase Plan; 1,750,000 shares were reserved for the exercise of outstanding warrants to purchase common stock at an exercise price of \$1.30 per share which are exercisable currently until the expiration date of March 5, 2015; and 437,158 shares were reserved for the exercise of outstanding warrants to purchase common stock at an exercise price of \$0.2745 per share which are exercisable currently until the expiration date of June 29, 2017.

On June 29, 2012, the Company entered into an agreement with Pyxis to exchange the 5,000,000 shares of Series A Convertible Preferred Stock held by Pyxis for 5,000,000 shares of Series A-1 Convertible Preferred Stock (the “Series A-1 Preferred Stock”) and filed a new Certificate of Designation, Preferences and Rights of Preferred Stock with the State of Delaware for the Series A-1 Preferred Stock and Series B Convertible Preferred Stock (the “Series B Preferred Stock” and, with the Series A-1 Preferred Stock, the “Preferred Stock”). Concurrently therewith, the Company completed a financing with Delta Dental of Michigan, Inc. (“Delta Dental”) pursuant to which Delta Dental purchased 500,000 shares of Series B Preferred Stock for gross proceeds of \$3,000,000. Net proceeds to the Company after fees and expenses were approximately \$2.7 million. In addition, fully vested warrants to purchase 437,158 shares of common stock at an exercise price of \$0.2745 per share were issued to the placement agent in the transaction. These warrants expire in five years. For purposes of determining the fair value of these warrants, the Black-Scholes pricing model was used with the following assumptions:

|                         |        |       |
|-------------------------|--------|-------|
| Risk-free interest rate | 1      | %     |
| Expected life           | 5      | years |
| Expected volatility     | 142.36 | %     |
| Dividend yield          | 0      | %     |

Using these assumptions, the fair value of the warrants is \$104,907.

The Preferred Stock accrues dividends at the rate of 8% of the original purchase price per year, payable only when, as and if declared by the Board of Directors and are non-cumulative. To date, no dividends have been declared on these shares. If the Company declares a distribution, with certain exceptions, payable in securities of other persons, evidences of indebtedness issued by the Company or other persons, assets (excluding cash dividends) or options or rights to purchase any such securities or evidences of indebtedness, then, in each such case the holders of the Preferred Stock shall be entitled to a proportionate share of any such distribution as though the holders of the Preferred Stock were the holders of the number of shares of common stock into which their respective shares of Preferred Stock are convertible as of the record date fixed for the determination of the holders of common stock entitled to receive such distribution.

In the event of any liquidation, dissolution or winding up of the Company, whether voluntary or involuntary, the holders of the Preferred Stock shall be entitled to receive on a *pari passu* basis, prior and in preference to any distribution of any of the Company’s assets or surplus funds to the holders of its common stock by reason of their ownership thereof, the amount of two times the then-effective purchase price per share, as adjusted for any stock dividends, combinations or splits with respect to such shares, plus all declared but unpaid dividends on such shares for each share of Preferred Stock then held by them. The liquidation preference for the Preferred Stock at March 31, 2013 was \$24,000,000 in the aggregate, reflecting a liquidation preference of \$18,000,000 for the Series A-1 Preferred Stock and \$6,000,000 for the Series B Preferred Stock. After receiving this amount, the holders of the Preferred Stock are entitled to participate on an as-converted basis with the holders of common stock in any of the remaining assets.

Each share of Series A-1 Preferred Stock is convertible at any time at the option of the holder into a number of shares of the Company's common stock determined by dividing the then-effective purchase price (\$1.80, and subject to adjustment) by the conversion price in effect on the date the certificate is surrendered for conversion. As of March 31, 2013, the Series A-1 Preferred Stock was convertible into 28,160,200 shares of common stock reflecting a current conversion price of \$0.3196 per share. Each share of Series B Preferred Stock is convertible at any time at the option of the holder into a number of shares of the Company's common stock determined by dividing the then-effective purchase price (\$6.00, and subject to adjustment) by the conversion price in effect on the date the certificate is surrendered for conversion. As of March 31, 2013, the Series B Preferred Stock was convertible into 10,928,961 shares of common stock reflecting a current conversion price of \$0.2745 per share.

Each holder of Preferred Stock is entitled to vote its shares of Preferred Stock on an as-converted basis with the holders of common stock as a single class on all matters submitted to a vote of the stockholders, except as otherwise required by applicable law. This means that each share of Preferred Stock will be entitled to a number of votes equal to the number of shares of common stock into which it is convertible on the applicable record date.



## Note 9—Stock-Based Compensation Arrangements

Total compensation cost that has been charged against income for stock-based compensation arrangements is as follows:

|   | Three Months Ended March 31, |           |
|---|------------------------------|-----------|
|   | 2013                         | 2012      |
| Stock option grants beginning of period     | \$ 26,722                    | \$ 21,434 |
| Stock-based arrangements during the period: |                              |           |
| Stock option grants                         | 3,050                        | 12,506    |
| Employee stock purchase plan                | 917                          | 1,163     |
|   | \$ 30,689                    | \$ 35,103 |

*Stock option and restricted stock grants*

The following table details stock option and restricted stock activity for the three months ended March 31, 2013 and 2012:

|                                  | Three Months Ended March 31,<br>2013 |                                      | Three Months Ended March 31,<br>2012 |                                      |
|----------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
|                                  | Shares                               | Weighted<br>Avg<br>Exercise<br>Price | Shares                               | Weighted<br>Avg<br>Exercise<br>Price |
| Outstanding, beginning of period | 2,302,000                            | \$ 1.06                              | 2,228,067                            | \$ 1.14                              |
| Stock options granted            | 200,000                              | 0.29                                 | —                                    | —                                    |
| Stock options exercised          | (2,000 )                             | 0.12                                 | —                                    | —                                    |
| Restricted stock exercised       | (2,500 )                             | 0.00                                 | (2,500 )                             | 0.00                                 |
| Canceled/Expired                 | (62,000 )                            | 1.89                                 | (89,900 )                            | 0.62                                 |
| Outstanding, end of period       | 2,435,500                            | \$ .98                               | 2,135,667                            | \$ 1.16                              |
| Exercisable, end of period       | 1,371,725                            | \$ 1.43                              | 1,346,767                            | \$ 1.51                              |

During the three-month period ended March 31, 2013, the Company granted 200,000 stock options under the 2004 Employee, Director & Consultant Stock Plan. At March 31, 2013, the Company had an aggregate of 1,843,780 shares of Common Stock available for grant under this plan.

It is the Company's policy to grant stock options with an exercise price equal to the fair market value of the Company's common stock at the grant date, and stock options to employees generally vest over four years based upon continuous service. Historically, the majority of the Company's stock options have been granted in connection with the employee's start date with the Company. In addition, the Company may grant stock options in recognition of promotion and/or performance.

#### *Employee Stock Purchase Plan*

Purchases made under the Company's Employee Stock Purchase Plan are deemed to be compensatory because employees may purchase stock at a price equal to 85% of the fair market value of the Company's common stock on either the first day or the last day of a calendar quarter, whichever is lower. During the three months ended March 31, 2013 and 2012, employees purchased 18,766 and 5,628 shares, respectively, of common stock at a weighted-average purchase price of \$0.26 and \$0.16, respectively, while the weighted-average market value was \$0.31 and \$0.19 per share, respectively, resulting in compensation expense of \$917 and \$1,163, respectively.

#### *Restricted Stock Awards*

Holders of restricted stock awards participate fully in the rewards of stock ownership of the Company, including voting and dividend rights. Recipients of restricted stock awards are generally not required to pay any consideration to the Company for these restricted stock awards. The Company measures the fair value of the shares based on the last reported price at which the Company's common stock traded on the date of the grant and compensation cost is recognized over the remaining service period. During each of the three months ended March 31, 2013 and 2012, the Company granted no restricted stock awards.

At March 31, 2013, there was approximately \$287,000 of total unrecognized compensation related to non-vested share-based compensation arrangements granted under the Company's stock plans.

#### **Note 10—Industry Risk and Concentration**

The Company develops genetic risk assessment tests and performs research for its own benefit. As of March 31, 2013, the Company has introduced four genetic risk assessment tests commercially. Commercial success of the Company's genetic risk assessment tests will depend on their success at being deemed to be scientifically credible and cost-effective by consumers and the marketing success of the Company and its collaborative partner.

Research in the field of disease predisposing genes and genetic markers is intense and highly competitive. The Company has many competitors in the United States and abroad that have considerably greater financial, technical, marketing, and other resources available. If the Company does not discover disease predisposing genes or genetic markers and develop risk assessment tests and launch such services or products before its competitors, then the potential for significant revenues may be reduced or eliminated.

During the three months ended March 31, 2013, approximately 80% of our revenue came from sales through our Merchant Network and Channel Partner Agreement with Amway Global, a subsidiary of Alticor.

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

*The following discussion of our financial condition and results of operations should be read in conjunction with the unaudited condensed financial statements and the notes thereto included elsewhere in this document.*

#### **General Overview and Trends**

Interleukin Genetics, Inc. is a personalized health company that develops specific, health area focused, unique genetic tests. Our overall mission is to provide test products that can help individuals improve or maintain their health through preventive measures or lifestyle changes. Our vision is to use the science of applied genetics to empower individuals and physicians to better understand the set of actions and steps necessary to guide the best lifestyle and treatment options. We believe that the science of applied genetics can help companies provide improved services to their consumers, and assist in improving outcomes in drug development and use.

During the three months ended March 31, 2013, we continued to focus our resources on commercializing our PST® test following completion of the large validation study (referred to herein as the “PDPS”) with the University of Michigan and Renaissance Health Services Corporation (RHSC) and on the sales of our Inherent Health® brand of genetic tests and related programs. The objective of the PDPS is to improve dental care by identifying and using certain risk factors to set preventative treatment regimens.

On February 25, 2013, we entered into a Preferred Participation Agreement with RHSC, for itself and on behalf of certain of its affiliates and subsidiaries. Pursuant to this agreement, affiliates of RHSC have agreed to reimburse us a fixed price for each PST® genetic test that we process for a customer of affiliates of RHSC. In addition, if during the term of the agreement we offer the PST® test to any other person or party for a lower price, such lower price shall then be applicable to tests processed for a customer of such affiliates of RHSC for the remainder of the term of the agreement. The pricing arrangement is subject to the satisfaction of certain milestones, including that (1) within a specified timeframe, RHSC affiliates must develop and offer dental benefit plans for which a significant portion of such affiliate's clients are eligible that provides for use of the PST® test and reimbursement of the test at the agreed upon price (each such plan, hereinafter referred to as a “Reimbursed Dental Plan”) and (2) prior to a specified date, RHSC affiliates shall have sold policies for Reimbursed Dental Plans for the year beginning January 1, 2014. We have agreed that for a one year period beginning on the date on which RHSC affiliates first offer a Reimbursed Dental Plan, we will make the PST® test available solely to RHSC affiliates and not to any other third party or person. This agreement has a term of three years beginning on February 25, 2013, but may be terminated earlier (1) upon the mutual written agreement of us and RHSC, (2) if either party becomes the subject of bankruptcy, insolvency, liquidation or other similar proceedings, or (3) in the event of an uncured breach of the Agreement by either party.

The timing of any revenues that we may receive under this agreement is dependent upon the timing of the offering of Reimbursed Dental Plans, which timing is very uncertain at this time. We do not expect to receive any significant revenues under this agreement until the first quarter of 2014 at the earliest, and the timing of any such revenues may be substantially later.

Our Inherent Health® brand of genetic tests includes the first-of-its-kind test for weight management that identifies an individual's genetic tendencies for weight gain related to either fat or carbohydrates in the diet. The Inherent Health® brand also offers customers a full suite of affordable, easy-to-use and meaningful genetic tests in heart health, bone health and nutritional needs. In addition, we launched additional products under the name Wellness Select that allows our e-commerce customers to purchase any combination of our Inherent Health® genetic tests at a discounted price.

In September 2012, Access Business Group LLC, an affiliate of Alticor, placed a purchase order totaling \$1.0 million consisting of weight management kits. The kits are included as part of a promotional bundle of products that Amway is now selling to their Individual Business Owners (IBOs). The total order has been shipped and account receivable fully paid as of March 31, 2013. Cash received from the order will remain in deferred revenue until the tests are returned and processed. We are now processing tests from the program in our laboratory. The program has an end date of December 31, 2013, and we expect to recognize revenue from the program throughout 2013.

Our research and development expenses are focused on our own development and commercialization efforts related primarily to our PST® and Osteoarthritis genetic tests. We are also focusing on seeking potential commercial partners to validate our technology within their specific business model as a collaboration with little or no cost to us. This is different than in prior years when our development focus was concentrated in research and development to bring new test configurations to market.

In the genetic test business, competition is in flux and the markets and customer base are not well established. Adoption of new technologies by consumers requires substantial market development and customer education. Historically, we have focused on our relationship with our primary customer, Alticor, a significant direct marketing company, in order to assist us in developing the market for our products and educating our potential customers. Our challenge in 2013 and beyond will be to develop the market for our other personalized health products, in particular our PST® test. We continue to allocate considerable resources to commercialization of our PST® and Inherent Health® brands of genetic tests. Due to the early stage of these initiatives, we cannot predict with certainty fluctuations we may experience in our genetic test revenues or whether revenues derived from the Preferred Participation Agreement with RHSC and its affiliates and the Merchant Network and Channel Partner Agreement with Amway Global will ever be material or if material, will be sustained in future periods.

*Three Months Ended March 31, 2013 and March 31, 2012*

## Edgar Filing: INTERLEUKIN GENETICS INC - Form 10-Q

Total revenue for the three months ended March 31, 2013 was \$487,000, compared to \$678,000 for the three months ended March 31, 2012. The decrease of \$191,000, or 28.1%, is primarily attributable to decreased testing revenue from genetic tests processed as a result of sales of our Inherent Health® brand of genetic tests through the Amway Global sales channel. Genetic testing revenue is derived from tests sold and processed, which is driven by consumer demand. Deferred revenue, which consists of genetic tests sold and not yet processed, increased \$422,000 to \$2.1 million at March 31, 2013 as compared to \$1.6 million on December 31, 2012.

During the three months ended March 31, 2013, 80% of our sales revenue came through our Merchant Network and Channel Partner Agreement with Amway Global, compared to 64% during the three months ended March 31, 2012. Pursuant to this agreement, Amway Global sells our genetic tests through its e-commerce web site via a hyperlink to our e-commerce site.

Cost of revenue for the three months ended March 31, 2013 was \$384,000 or 78.7% of revenue, compared to \$376,000, or 55.5% of revenue, for the three months ended March 31, 2012. The increase in the cost of revenue as a percentage of revenue is primarily attributable to the higher absorption rate associated with fixed laboratory costs due to the decrease in revenues.

Research and development expenses were \$160,000 for the three months ended March 31, 2013, compared to \$446,000 for the three months ended March 31, 2012. The decrease of \$286,000, or 64% is primarily attributable to decreases in compensation, consulting and clinical trial costs. In the first quarter of 2013 our Chief Scientific Officer had fully transitioned to his role as Chief Executive Officer and, accordingly, related compensation costs were classified as part of selling, general and administrative expenses in the 2013 period whereas such costs had previously been classified as research and development expenses.

Selling, general and administrative expenses were \$1.0 million for the three months ended March 31, 2013, compared to \$1.1 million for the three months ended March 31, 2012. The decrease of \$0.1 million, or 11.8% is primarily attributable to decreased patent related legal fees and corporate legal and accounting fees as well as lower sales commissions paid to Amway Global as part of our Merchant Channel and Partner Store Agreement partially offset by higher compensation and consulting expenses.

Interest expense was \$114,000 for the three months ended March 31, 2013, as compared to \$105,000 for the three months ended March 31, 2012. The increase in interest expense of \$9,000 is attributable to higher borrowings on our credit facility with Pyxis.

### **Liquidity and Capital Resources**

As of March 31, 2013, we had cash and cash equivalents of \$1.1 million. The due date of our credit facility with Pyxis has been extended numerous times, most recently to March 31, 2014. The aggregate principal amount of \$14,316,255, plus interest, is due and payable in full on March 31, 2014.

Cash used in operations was \$147,000 for the three months ended March 31, 2013, as compared to \$1.0 million for the three months ended March 31, 2012. Cash used in operations is primarily impacted by operating results and changes in working capital, particularly the timing of the collection of receivables, inventory levels, receipt of orders and the timing of payments to suppliers. In the three months ended March 31, 2013, approximately \$0.5 million was received as payment for Weight Management kits ordered as part of Amway's promotional product bundle incorporating our weight management genetic test. Cash received from genetic test sales which is reflected in deferred revenue until the test report is issued, increased by \$422,000 to \$2.1 million during the three months ended March 31, 2013.

Cash used in investing activities was \$2,709 for the three months ended March 31, 2013, compared to \$5,000 for the three months ended March 31, 2012. These amounts represent capital additions. We believe that based on current and projected volumes, our laboratory equipment is sufficient to process genetic tests and no additional material capital purchases will be needed in the foreseeable future.

Cash provided by financing activities was \$5,289 for the three months ended March 31, 2013, compared to \$7,910 for the three months ended March 31, 2012, due primarily to the exercise of stock purchases through the employee stock purchase plan.

The amount of cash we generate from operations is not sufficient to continue to fund operations and grow our business. We expect that our current and anticipated financial resources, including the full amount drawn under our credit facility with Pyxis, will be adequate to maintain our current and planned operations only through May 2013. We need significant additional capital to fund our continued operations, including for the commercial launch of our PST<sup>®</sup> genetic test, continued research and development efforts, obtaining and protecting patents and administrative expenses. We believe our success depends on our ability to have sufficient capital and liquidity to fund operations at least until we begin to receive significant revenues under the Preferred Participation Agreement with RHSC and its affiliates. The timing of any revenues that we may receive under this agreement is dependent upon the timing of the offering of Reimbursed Dental Plans by RHSC affiliates, which timing is very uncertain at this time. While our current intent is to market our PST<sup>®</sup> test through Reimbursed Dental Plans offered and sold by RHSC's affiliates to employer groups for plan years starting in January 2014, RHSC affiliates will not begin marketing Reimbursed Dental Plans until positive results of the PDPS are published in a peer review journal. While an article has been submitted to a peer reviewed journal, there is no assurance that the article will be accepted for publication, or, even if accepted, when the article will be published. RHSC has informed us that in order for its affiliates to begin marketing Reimbursed Dental Plans for plan years beginning in January 2014, the article must be accepted for publication in a peer review journal by May 31, 2013. Accordingly, the earliest that we may receive any significant revenues under this agreement is in the first quarter of 2014, and the timing of any such revenues may be substantially later.

We have retained a financial advisor and are actively seeking additional funding, however, based on current economic conditions, additional financing may not be available, or, if available, it may not be available on favorable terms. In addition, the terms of any financing may adversely affect the holdings or the rights of our existing shareholders. For example, if we raise additional funds by issuing equity securities, further dilution to our then-existing shareholders will result. Debt financing, if available, may involve restrictive covenants that could limit our flexibility in conducting future business activities. We also could be required to seek funds through arrangements with collaborators or others that may require us to relinquish rights to some of our technologies, tests or products in development. Our common stock was delisted from the NYSE Amex in 2010 and is currently trading on the OTCQB<sup>™</sup>. As a result, our access to capital through the public markets may be more limited. If we cannot obtain additional funding on acceptable terms, we may have to discontinue operations and seek protection under U.S. bankruptcy laws.



We have taken and continue to explore additional steps to reduce our operating costs. We are sub-leasing approximately 6,000 square feet, or one-third of our total office space. The space includes offices and a laboratory that was being underutilized. Our remaining office and laboratory space is adequate for our current business needs. We are able to process high volumes of genetic tests in our current laboratory. We have reduced our cost of processing samples in our laboratory by working with our raw material vendors to make our genetic testing process more efficient resulting in lower processing costs. We have significantly reduced our research and development programs to only focus on our PST<sup>®</sup> and osteoarthritis technologies. We have taken steps to reduce our corporate administrative expenses by working with or seeking new vendors who offer the same service for a lower cost.

Our financial statements have been prepared assuming that we will continue as a going concern which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. We expect to incur further losses in the development of our business and have been dependent on funding operations through the issuance of convertible debt and the sale of equity securities. These conditions raise substantial doubt about our ability to continue as a going concern. Management's plans include continuing to finance operations through the private or public placement of debt and/or equity securities, increasing revenue through new arrangements with commercial distribution partners and the reduction of expenditures. However, no assurance can be given at this time as to whether we will be able to achieve these objectives. The financial statements do not include any adjustment relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should we be unable to continue as a going concern.

### **Critical Accounting Policies and Estimates**

Our discussion and analysis of our financial condition and results of operations are based upon our financial statements. The preparation of these financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires us to (i) make judgments, assumptions and estimates that affect the reported amounts of assets, liabilities, revenue and expenses; and (ii) disclose contingent assets and liabilities. A critical accounting estimate is an assumption that could have a material effect on our financial statements if another, also reasonable, amount were used or a change in the estimates is reasonably likely from period to period. We base our accounting estimates on historical experience and other factors that we consider reasonable under the circumstances. However, actual results may differ from these estimates. To the extent there are material differences between our estimates and the actual results, our future financial condition and results of operations will be affected. Our most critical accounting policies and estimates upon which our financial condition depends, and which involve the most complex or subjective decisions or assessments are set forth in Note 4 to our financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2012. There have been no significant changes in our accounting policies or changes from the methodology applied by management for critical accounting estimates previously disclosed in our most recent Annual Report on Form 10-K.

### **Recent Accounting Pronouncements**

Please see the discussion of “Recent Accounting Pronouncements” in Note 3, Significant Accounting Policies contained in the Notes to Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2012. No new updates or other guidance issued to date by the FASB in 2013 are expected to have a material impact on our financial statements.

**Item 3. *Quantitative and Qualitative Disclosures about Market Risk***

As a smaller reporting company, we have elected scaled disclosure reporting obligations and therefore are not required to provide the information required by this Item 3.

**Item 4. *Controls and Procedures***

(a) *Evaluation of Disclosure Controls and Procedures.* Our principal executive officer and principal financial officer, after evaluating the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15(d)-15(e)) as of the end of the period covered by this Quarterly Report on Form 10-Q, have concluded that, based on such evaluation, our disclosure controls and procedures were adequate and effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms, and is accumulated and communicated to our management, including our principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) *Changes in Internal Control Over Financial Reporting.* No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15(d)-15(f)) occurred during the quarter ended March 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II—OTHER INFORMATION**

### Item 1. Legal Proceedings

Not applicable.

### Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2012, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks that we face. In addition, risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. There have been no material changes in or additions to the risk factors included in our Annual Report on Form 10-K for the year ended December 31, 2012.

### ***SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS***

This Quarterly Report on Form 10-Q and, in particular, our Management’s Discussion and Analysis of Financial Condition and Results of Operations set forth in Part I – Item 2, contains or incorporates a number of forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Exchange Act. Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in our discussion in this Quarterly Report on Form 10-Q will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may vary materially.

Without limiting the foregoing, the words “believes,” “anticipates,” “plans,” “expects” and similar expressions are intended to identify forward-looking statements. There are a number of factors that could cause actual events or results to differ materially from those indicated by such forward-looking statements, many of which are beyond our control, including

the factors set forth under “Item 1A. Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2012 and under “Item 1A. Risk Factors” above in this Quarterly Report on Form 10-Q. In addition, the forward-looking statements contained herein represent our estimates and expectations only as of the date of this filing and should not be relied upon as representing our estimates and expectations as of any subsequent date. While we may elect to update these forward-looking statements at some point in the future, we specifically disclaim any obligation to do so to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements.

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

Not applicable.

Item 3. Defaults Upon Senior Securities.

Not applicable.

Item 4 Mine Safety Disclosures

Not applicable.

Item 5. Other Information.

Not applicable.

Item 6. Exhibits.

Exhibit  
Number Exhibit

- 10.1\*<sup>@</sup> Preferred Participation Agreement, dated February 25, 2013, by and between Interleukin Genetics, Inc. and Renaissance Health Service Corporation and its affiliates and subsidiaries
- 10.2\* Consent under the Note Purchase Agreement, effective as of the 1<sup>st</sup> day of April, 2013, by and between Interleukin Genetics, Inc. and Pyxis Innovations Inc.
- 31.1\* Certification by Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2\* Certification by Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1\* Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101\*\* The following materials from Interleukin Genetics Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Balance Sheets, (ii) the Condensed Statements of Operations, (iii) the Condensed Statements of Stockholders' Deficit, (iv) the Condensed Statements of Cash Flows, and (v) Notes to Condensed Financial Statements.

\*

Filed herewith.

<sup>@</sup> Confidential portions of such document have been filed separately with the SEC pursuant to a request for confidential treatment.

Users of XBRL data are advised pursuant to Rule 406T of Regulation S-T that this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

SIGNATURES

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

Interleukin Genetics, Inc.

Date: May 14, 2013      By: /s/ Kenneth S.  
Kornman  
Kenneth S. Kornman  
  
Chief Executive  
Officer  
  
(Principal Executive  
Officer)

Date: May 14, 2013      By: /s/ Eliot M. Lurier  
Eliot M. Lurier  
  
Chief Financial  
Officer  
  
(Principal Financial  
Officer)