XOMA Corp
Form 10-K
March 16, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2016

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 No. 0-14710

XOMA CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	52-2154066
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2910 Seventh Street, Berkeley, California 94710	
(Address of principal executive offices, including zip code)	(Telephone number)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.0075 par value	The NASDAQ Stock Market, LLC
Preferred Stock Purchase Rights	

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

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

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 the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 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	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act of 1934). Yes No

The aggregate market value of voting common equity held by non-affiliates of the registrant is $64,718,498 as of June 30, 2016.

Number of shares of Common Stock outstanding as of March 14, 2017: 7,544,076

DOCUMENTS INCORPORATED BY REFERENCE:

Portions of the Company's Proxy Statement for the Company's 2017 Annual General Meeting of Stockholders are incorporated by reference into Part III of this Report.

XOMA Corporation

2016 FORM 10-K ANNUAL REPORT

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This annual report on Form 10-K includes trademarks, service marks and trade names owned by us or others. "XOMA," the XOMA logo and all other XOMA product and service names are registered or unregistered trademarks of XOMA Corporation or a subsidiary of XOMA Corporation in the United States and in other selected countries. All trademarks, service marks and trade names included or incorporated by reference in this annual report are the property of their respective owners.

PART I

Certain statements contained herein related to the anticipated size of clinical trials, the anticipated timing of initiation of clinical trials, the expected availability of clinical trial results, the results of clinical trials, the timing of any application for regulatory approval of our product candidates by the FDA or other regulatory authority, the sufficiency of our cash resources, the estimated costs of clinical trials and the amounts of certain revenues and certain costs in comparison to prior years, or that otherwise relate to future periods, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements, other than statements of historical fact are statements that could be deemed forward looking statements. The words "believe," "may," "estimate," "continue," "could," "anticipate," "assume," "int "expect," "predict," "potential" "should," "would," and similar expressions are intended to identify forward-looking statements These statements are based on assumptions that may not prove accurate. Actual results could differ materially from those anticipated due to certain risks inherent in the biotechnology industry and for companies engaged in the development of new products in a regulated market. Among other things: our product candidates are still being developed, and we will require substantial funds to continue development which may not be available; we have received negative results from certain of our clinical trials, and we face uncertain results of other clinical trials of our product candidates; if our therapeutic product candidates do not receive regulatory approval, neither our third-party licensees, our contract manufacturers nor we will be able to manufacture and market them; we may not obtain orphan drug exclusivity or we may not receive the full benefit of orphan drug exclusivity even if we obtain such exclusivity; even once approved, a product may be subject to additional testing or significant marketing restrictions, its approval may be withdrawn or it may be voluntarily taken off the market; we may not be successful in commercializing our products, which could also affect our development efforts; we are subject to various state and federal healthcare related laws and regulations that may impact the commercialization of our product candidates and could subject us to significant fines and penalties; and certain of our technologies are in-licensed from third parties, so our capabilities using them are restricted and subject to additional risks. These and other risks, including those related to current economic and financial market conditions, are contained principally in Item 1, Business; Item 1A, Risk Factors; Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations; and other sections of this Annual Report on Form 10-K. Factors that could cause or contribute to these differences include those discussed in Item 1A, Risk Factors, as well as those discussed elsewhere in this Annual Report on Form 10-K.

Forward-looking statements are inherently uncertain and you should not place undue reliance on these statements, which speak only as of the date that they were made. These cautionary statements should be considered in connection with any written or oral forward-looking statements that we may issue in the future. We do not undertake any obligation to release publicly any revisions to these forward-looking statements after completion of the filing of this Annual Report on Form 10-K to reflect later events or circumstances or to reflect the occurrence of unanticipated events.

Item 1. Business

Overview

XOMA Corporation ("XOMA"), a Delaware corporation, has an established history of discovering and developing innovative therapeutics derived from its unique platform of antibody technologies. We typically have sought to license these therapeutic assets to our licensees who take on the responsibilities of later stage development, approval and commercialization. In addition, we have licensed our antibody technologies on a non-exclusive basis to other companies who desire to access this platform for their own discovery efforts.

We are evolving our strategy to be focused on developing or acquiring revenue-generating assets and coupling them with a lean corporate infrastructure. Our goal is to create a sustainably profitable business and generate meaningful value for our stockholders. Since our business model is based on the goal of out-licensing to other pharmaceutical companies for them to commercialize and market any resultant products, we expect a significant portion of our future revenue will be based on payments we may receive from our licensees.

We have a portfolio of product candidates, programs, and technologies that are the subject of licenses we have in place with pharmaceutical and biotech companies including Novartis International Pharmaceutical Ltd. (“Novartis”), Novo Nordisk A/S (“Novo Nordisk”), Takeda Pharmaceutical Company Ltd. (“Takeda”), Johnson & Johnson, Five Prime Therapeutics, Inc. (“Five Prime”), and Alexion Pharmaceuticals, Inc. There are over 20 such programs that are funded by other companies and could produce milestone payments and royalty payments in the future.

Our asset base includes antibodies with unique properties including several that interact at allosteric sites on a specific protein rather than the orthosteric, or active, sites. These compounds are designed to either enhance or diminish the target protein's activity as desired. We believe allosteric-modulating antibodies may be more selective or offer a safety advantage in certain disease indications when compared to more traditional modes of action.

In February 2017, we achieved initial proof-of-concept ("POC") with our first-in-class X358 clinical program for patients with hypoglycemia due to congenital hyperinsulinism ("CHI") and patients with hypoglycemia post bariatric surgery ("PBS"). These two indications are rare conditions with very few therapeutic options. Consistent with the strategy outlined above, it is our intention to maximize the value of X358 for shareholders through a licensing agreement, either now or after continued investment to increase its value to a prospective partner. We believe this approach will expedite potential patient access for those in need of new treatment options in hyperinsulinemic hypoglycemia.

Organization

We were incorporated in Delaware in 1981 and became a Bermuda-exempted company in December 1998. Effective December 31, 2011, we changed our jurisdiction of incorporation from Bermuda to Delaware and changed our name from XOMA Ltd. to XOMA Corporation. When referring to a time or period before December 31, 1998 or after December 31, 2011, the terms "Company" and "XOMA" refer to XOMA Corporation, a Delaware corporation; when referring to a time or period between December 31, 1998 and December 31, 2011, such terms refer to XOMA Ltd., a Bermuda company.

Our principal executive offices are located at 2910 Seventh Street, Berkeley, California 94710, and we maintain a registered office located at Corporation Trust Center, 1209 Orange Street, Wilmington, Delaware 19801. Our telephone number at our principal executive offices is (510) 204-7200. Our website address is www.xoma.com.

Business Strategy

We have traditionally specialized in the discovery and development of innovative antibody-based therapeutics. In 2016, we dedicated our research and development efforts to advancing our portfolio of product candidates that have the potential to treat a variety of endocrine diseases, including advancing the development of X358 in CHI and PBS studies. We have recently refined our business strategy to prioritize out-licensing of our internally developed product candidates while reducing further internal expenditures for research and development.

Our business model is designed to create value for stockholders by assembling a diversified portfolio of biotech and pharmaceutical revenue streams and operating that business with an efficient and low corporate cost structure. Our goal is to become a sustainably profitable company that offers investors an opportunity to participate in the promise of the biotech industry in a diversified, lower-risk business investment than a typical biotech. Our business model is based on the concept of out-licensing product candidates that we have developed internally and partnering with other pharmaceutical companies to leverage their capabilities in the areas of late-stage development, regulatory management and commercialization to ultimately generate revenue for our company. Our revenue currently consists mostly of license fees and milestones from our licensees. In addition to advancing our early-stage proprietary drug candidates, we intend to use an acquisition strategy to add new assets, pipelines, and technologies that we anticipate will generate additional revenue streams in future years.

Proprietary Product Candidates

We have a portfolio of unique monoclonal antibodies and technologies that we intend to license to pharmaceutical and biotechnology companies to further their clinical development. A summary of these product candidates is provided below:

- X358 is a first-in-class fully human negative allosteric modulating insulin receptor antibody that was derived from our proprietary XMet platform. We are investigating this antibody as a novel treatment for non-drug-induced, endogenous hyperinsulinemic hypoglycemia (low blood glucose caused by excessive insulin produced by the body). There are two rare disease indications that may benefit from X358 that are of greatest interest to us: CHI, a hereditary disease resulting in lack of insulin regulation and profound hypoglycemia, and hypoglycemia in hyperinsulinemic PBS patients. In June 2015, we were granted Orphan Drug Designation for X358 by the Food and Drug Administration (“FDA”) for the treatment of CHI, and in June 2016, we received Orphan Drug Designation for X358 in the same indication from the European Union.

X358 has successfully completed Phase 1 testing in healthy volunteers, which showed the antibody reduced insulin sensitivity and decreased glucose after exogenous insulin injection and it appeared to be well tolerated, with no serious adverse events observed. The results were presented at the Endocrine Society's Annual Meeting in March 2015.

In October 2015, we initiated a single-dose Phase 2 POC study of X358 in patients with CHI and in April 2016, we initiated a single-dose Phase 2 POC study of X358 in PBS patients experiencing hypoglycemia after meals. In September 2016, we presented the initial data from nine patients who had enrolled in the CHI and PBS studies, together with safety data from 22 healthy volunteers. Shortly thereafter, we submitted a proposal to the United Kingdom's Medicines and Healthcare Products Regulatory Agency ("MHRA") to initiate a multi-dose Phase 2 clinical study of X358 in children two years and older diagnosed with CHI. The MHRA approved the protocol in principal, and the study is in now in review at local ethics committees. We anticipate the site to be ready for first dosing in the UK in the second quarter of 2017. Submissions of this study are underway in Germany, Denmark and Israel as well.

In January 2017, we announced that we have established POC for X358 in CHI and hypoglycemia PBS. The CHI acute studies met their objectives of establishing initial safety and X358 POC in CHI patients aged 12 and up across several dosing levels. We are nearing the launch of a multi-dose study in children with CHI aged two and up that will be conducted in the United Kingdom. The PBS study has completed dosing in the single-dose cohorts and has also met its objectives. In February 2017, we initiated a multi-dose study in PBS.

We believe a therapy that safely and effectively mitigates insulin-induced hypoglycemia has the potential to address a significant unmet therapeutic need for these rare medical conditions associated with hyperinsulinism.

- X213 (formerly LFA 102) is a first-in-class allosteric inhibitor of prolactin action. It is a humanized IgG1-Kappa monoclonal antibody that binds to the extracellular domain of the human prolactin receptor with high affinity at an allosteric site. The antibody has been shown to inhibit prolactin-mediated signaling, and it is potent and similarly active against several animal and human prolactin receptors. Prolactin is a protein that in normal post-partum females enables the production of milk. In some cases, including prolactinomas, which are benign tumors of the pituitary gland in both men and women, excess secretion can lead to various clinically significant abnormal signs and symptoms. We discovered X213 under our collaboration with Novartis AG (formerly Chiron Corporation), and we exercised our right to bring the product back into our portfolio to develop it for diseases of hyperprolactinemia. We have initiated a Phase 2A POC study in women who wish to suppress lactation.

X213 could be developed to treat hyperprolactinemia in prolactinomas, a condition of benign tumors on the pituitary gland that leads to sexual dysfunction, infertility, and osteoporosis. For ten percent of the 140,000 prolactinoma patients in the United States, existing therapies are poorly tolerated or not effective. It also could be developed for anti-psychotic-induced hyperprolactinemia, a side effect seen in patients treated with commonly used antipsychotics, antidepressants, and pain medications. These patients exhibit the same signs and symptoms as prolactinoma, and compliance with anti-psychotic therapies is poor. Currently available therapies to address these side effects can worsen psychosis.

- X129 is a highly potent fragment of a monoclonal antibody ("Fab") with negative allosteric modulation activity against the insulin receptor. In animal model testing, it appears to have a fast-onset of action and short half-life. Hypoglycemia is a serious medical condition in patients with Type 2 diabetes mellitus and Type 1 diabetes mellitus ("T1 DM") and can occur as a result of insulin therapy, accidental insulin overdose or treatment with sulfonylureas. Recurrent hypoglycemia leads to diminished recognition of the symptoms, which include palpitations, tremors, anxiety, sweating, and hunger. This reduced sensitivity to hypoglycemic symptoms can lead to more prolonged episodes and the advancement into acute severe hypoglycemia, which can result in confusion, loss of consciousness, and seizure. Acute severe hypoglycemia often presents during the nocturnal hours in patients who are treated aggressively for their T1 DM, which puts them at elevated risk for loss of consciousness and seizure. The medical community has long been challenged with how to prevent patients from experiencing nocturnal acute severe hypoglycemia, yet there have not been any significant breakthroughs in pharmaceutical development efforts or experiments in dietary practices.

We have conducted preclinical testing for X129. In vitro assays showed X129 decreases the activity of insulin on mammalian cells over-expressing human, rat and minipig insulin receptor ("INSR") in a dose-dependent manner.

Further studies confirmed X129 binds to the INSR and acts as a negative allosteric modulator. In animal studies, potential rescue of insulin or sulphonylurea-induced hypoglycemia was modeled in normal rats. Administration of insulin or glibenclamide (a sulfonylurea) produced abnormally low glucose levels. Intravenous administration of X129 at time points wherein the drug-induced glucose levels were falling below normal levels rapidly stabilized blood glucose levels thereby preventing hypoglycemia. In normal minipigs, intramuscular administration normalized the hypoglycemia induced by Vetsulin (an intermediate acting pig insulin) with the effect lasting for several hours, thereby confirming the activity in mammals. When tested in a nocturnal hypoglycemia model in minipigs, subcutaneous administration of X129 successfully prevented blood glucose drop through the eight-hour duration of the study. The results from the rat studies were presented at the Endocrine Society's Annual Meeting in April 2016. The results from the minipig studies will be presented at the Endocrine Society's Annual Meeting in April 2017. We believe X129 could potentially offer clinicians a therapy that has rapid onset, improved efficacy and optimal duration of therapy to treat patients with acute severe hypoglycemia where currently available therapies are inadequate.

- Gevokizumab is a potent humanized monoclonal antibody with unique allosteric properties that has the potential to treat patients with a wide variety of inflammatory diseases. Gevokizumab binds strongly to interleukin 1 ("IL-1") beta, a pro-inflammatory cytokine. By binding to IL-1 beta, gevokizumab modulates the activation of the IL-1 receptor, thereby preventing the cellular signaling events that produce inflammation.

In December 2010, we entered into a collaboration agreement with Les Laboratories Servier ("Servier") to jointly develop and commercialize gevokizumab in multiple indications. Under the terms of that collaboration agreement, Servier had worldwide rights to gevokizumab for cardiovascular disease and diabetes indications (cardiometabolic field) and rights outside the United States and Japan to all other indications.

On July 22, 2015, we announced the Phase 3 EYEGUARD-B study of gevokizumab in patients with Behçet's disease uveitis did not meet the primary endpoint of time to first acute ocular exacerbation. Due to these results and belief they would be predictive of results in our other EYEGUARD studies of gevokizumab in patients with non-infectious uveitis ("NIU"), in August 2015 we decided to end the EYEGUARD global Phase 3 program prior to its planned completion. Servier and we closed down the EYEGUARD clinical sites and, as anticipated, neither EYEGUARD-A nor EYEGUARD-C produced positive results.

In September 2015, Servier notified us of its intention to terminate the collaboration agreement, and return the worldwide gevokizumab rights to XOMA. The termination of the collaboration agreement became effective on March 25, 2016.

In March 2016, we closed our Phase 3 study of gevokizumab in pyoderma gangrenosum ("PG"). A preliminary review of the data from the study did not show a clear signal of activity in PG.

- Additional Preclinical Product Candidates: In November 2016, we unveiled two novel oncology and oncology-related product candidates.
  - The first targets interleukin 2, ("IL-2"), which has long been recognized as an effective therapy for metastatic melanoma and renal cell carcinoma, but it has serious dose-limiting toxicities that prevent broad clinical use. We have generated novel antibodies that, when given with IL-2, are intended to steer IL-2 to enhance its positive impact with less toxicity, potentially improving the therapeutic index over standard IL-2 therapy.
  - The other is an anti-parathyroid receptor ("PTH1R") portfolio that includes several unique functional antibody antagonists targeting PTH1R, a G-protein-coupled receptor involved in the regulation of calcium metabolism. These antibodies have shown promising efficacy in in vivo studies and could potentially address unmet medical needs, including primary hyperparathyroidism and humoral hypercalcemia of malignancy ("HHM"). HHM is present in many advanced cancers and is caused by high serum calcium due to increased levels of the PTH1R ligand PTH-related peptide ("PTHrP"). Current HHM treatments often fall short and many cancer patients die from 'metabolic death'. XOMA's PTH1R antibodies could be beneficial for the treatment of HHM.

Technologies Available for Non-Exclusive License

We have a unique set of antibody discovery, optimization and development technologies available for licensing, including:

- ADAPT™ (Antibody Discovery Advanced Platform Technologies): proprietary human antibody phage display libraries, integrated with yeast and mammalian display, which can be integrated into antibody discovery programs through license agreements. We believe access to ADAPT™ Integrated Display offers a number of benefits because it enables the diversity of phage libraries to be combined with accelerated discovery due to rapid immunoglobulin ("IgG") reformatting and fluorescence-activated cell sorting based screening using yeast and mammalian display. This increases the probability of technical and business success in finding rare and unique functional antibodies directed to targets of interest.

- ModulX™: technology which allows modulation of biological pathways using monoclonal antibodies and offers insights into regulation of signaling pathways, homeostatic control, and disease biology. Using ModulX™, XOMA has generated product candidates with novel mechanisms of action that specifically alter the kinetics of interaction between molecular constituents (e.g. receptor-ligand). ModulX™ technology enables expanded target and therapeutic options and offers a unique approach in the treatment of disease.

- OptimX™ technologies:
  - Human Engineering™ (“HE™”): a proprietary humanization technology that allows modification of non-human monoclonal antibodies to reduce or eliminate detectable immunogenicity and make them suitable for medical purposes in humans. The technology uses a unique method developed by us, based on analysis of the conserved structure-function relationships among antibodies. The method defines which residues in a non-human variable region are candidates to be modified. The result is an HE™ antibody with preserved antigen binding, structure and function that has eliminated or greatly reduced immunogenicity. HE™ technology was used in development of gevokizumab and certain other antibody products.
  - Targeted Affinity Enhancement™ (“TAE™”): a proprietary technology involving the assessment and guided substitution of amino acids in antibody variable regions, enabling efficient optimization of antibody binding affinity and selectivity. TAE™ generates a comprehensive map of the effects of amino acid mutations in the complementarity-determining region likely to impact binding. The technology has been licensed to a number of companies.
- Flexible Manufacturing: patented technology relating to a flexible arrangement of mobile clean rooms (“MCRs”) within a manufacturing facility, with each MCR providing a portable, self-contained environment that allows for drug development. The facility design allows MCRs to connect easily and quickly to a central supply of utilities such as air, water, and electricity. This unique arrangement facilitates flexible manufacturing and eliminates change-over downtime. This translates into significantly reduced capital expenditures, production costs, and maintenance costs while offering meaningful time advantages over conventional manufacturing facilities. When MCRs are not in use, they can be easily moved to cleaning/refurbishing areas and prepared MCRs can be "plugged in" for manufacturing. The flexible manufacturing system can be applied to fields as diverse as pharmaceuticals, biologics, and electronics.

Financial and Legal Arrangements of Product Collaborations, Licensing and Other Arrangements

Licensing and Collaboration Agreements

Historically, we have licensed with or provided research and development collaboration services to world-class organizations, including Novartis, Novo Nordisk and Takeda in pursuit of new antibody products, and we expect that we will continue to capitalize on partnered product arrangements as opportunities arise. Below is a list of such license arrangements:

Novartis – Anti-TGF Antibody

In September 2015, we and Novartis entered into a license agreement (the “License Agreement”) under which we granted Novartis an exclusive, worldwide, royalty-bearing license to our anti-TGF- antibody program. Novartis is solely responsible for the development and commercialization of the antibodies and products containing the antibodies arising from this program.

Under the License Agreement, we received a $37.0 million upfront fee, and are eligible to receive up to a total of $480.0 million in development, regulatory and commercial milestones. We also are eligible to receive royalties on sales of licensed products, which are tiered based on sales levels and range from a mid-single digit percentage rate to up to a low double-digit percentage rate. Novartis’ obligation to pay royalties with respect to a particular product and country will continue for the longer of the date of expiration of the last valid patent claim covering the product in that country, or ten years from the date of the first commercial sale of the product in that country.

Novartis – Anti-CD40 Antibody

In September 2015, we and Novartis Vaccines and Diagnostics, Inc. (“NVDI”), further amended our 2008 Amended and Restated Research, Development and Commercialization Agreement, relating to anti-CD40 antibodies. Under this agreement, NVDI is solely responsible for the development and commercialization of the antibodies and products

containing the antibodies arising from this program. The parties agreed to reduce the royalty rates that we are eligible to receive on sales of NVDI's clinical stage anti-CD40 antibodies. These royalties are tiered based on sales levels and now range from a mid-single digit percentage rate to up to a low double-digit percentage rate.

In 2013, we received a $7.0 million milestone relating to one currently active program. Our right to milestone payments expires at such time as no collaboration product or former collaboration product is being developed or commercialized anywhere in the world and no royalty payments on these products are due. Our right to royalty payments expires on the later of the expiration of any licensed patent covering each product or 10 years from the launch of each product.

In connection with the collaboration between XOMA and Novartis AG (then Chiron Corporation), a secured note agreement was executed in May 2005. The note agreement is secured by our interest in the collaboration and was due and payable in full on June 21, 2015. On June 19, 2015, we and NVDI, who assumed the note agreement, agreed to extend the maturity date of our secured note agreement from June 21, 2015 to September 30, 2015, which was then subsequently extended to September 30, 2020. At December 31, 2016, the outstanding principal balance under this note agreement totaled $14.1 million and was included in our long-term portion of interest bearing obligations in our consolidated balance sheet as of December 31, 2016. Under the terms of the arrangement as restructured in November 2008, we will not make any additional borrowings on the Novartis note.

Novo Nordisk

In December 2015, we entered into a license agreement with Novo Nordisk under which we granted Novo Nordisk an exclusive, world-wide, royalty-bearing license to our XMetA program of allosteric monoclonal antibodies that positively modulate the insulin receptor (the "XMetA Program"), subject to our retained commercialization rights for rare disease indications. Novo Nordisk has an option to add these additional rights to its license upon payment of an option fee.

Novo Nordisk is solely responsible for its expenses for the development and commercialization of antibodies and products containing antibodies arising from the XMetA Program, subject to our retained rights described above. We have transferred certain proprietary know-how and materials relating to the XMetA Program to Novo Nordisk. Under the agreement, we received a $5.0 million, non-creditable, non-refundable, upfront payment. Based on the achievement of pre-specified criteria, we are eligible to receive up to $290.0 million in development, regulatory and commercial milestones. We are also eligible to receive royalties on sales of licensed products, which are tiered up to a high-single-digit percentage rate based on sales levels. Novo Nordisk's obligation to pay development and commercialization milestones will continue for so long as Novo Nordisk is developing or selling products under the agreement, subject to the maximum milestone payment amounts set forth above. Novo Nordisk's obligation to pay royalties with respect to a particular product and country will continue for the longer of the date of expiration of the last valid patent claim covering the product in that country, or ten years from the date of the first commercial sale of the product in that country.

The agreement contains customary termination rights relating to material breach by either party. Novo Nordisk also has a unilateral right to terminate the agreement in its entirety on ninety (90) days' notice.

Servier – Gevokizumab

In December 2010, we entered into a license and collaboration agreement (the "Collaboration Agreement") with Servier to jointly develop and commercialize gevokizumab in multiple indications. Under the terms of the Collaboration Agreement, Servier obtained worldwide rights to cardiovascular disease and diabetes indications (cardiometabolic field) and rights outside the United States and Japan to all other indications, including NIU, Behçet's disease uveitis and other inflammatory and oncology indications. We retained development and commercialization rights in the United States and Japan for all indications other than cardiovascular disease and diabetes.

In December 2010, we also entered into a loan agreement with Servier (the "Servier Loan Agreement") that provided for an advance of up to €15.0 million. The loan was fully funded in January 2011, with the proceeds converting to approximately $19.5 million at the date of funding. The loan is secured by an interest in XOMA's intellectual property rights to all gevokizumab indications worldwide, excluding certain rights in the United States and Japan. Interest is calculated at a floating rate based on a Euro Inter-Bank Offered Rate and is subject to a cap. The interest rate is reset semi-annually in January and July of each year. The interest rate for the initial interest period was 3.22% and was reset semi-annually ranging from 1.81% to 3.83%. Interest for the six-month period from mid-July 2016 through

mid-January 2017 was reset to 1.81%. Interest is payable semi-annually and in January 2017, we paid $0.1 million in accrued interest to Servier.

On January 9, 2015, Servier and we entered into Amendment No. 2 (“Loan Amendment”) to the Servier Loan Agreement. The Loan Agreement was initially entered into on December 30, 2010 and subsequently amended by a Consent, Transfer, Assumption and Amendment Agreement entered into as of August 12, 2013, where the loan was transferred from XOMA Ireland Limited to XOMA (US) LLC. The Loan Amendment extended the maturity date of the loan from January 13, 2016 to three tranches of principal to be repaid as follows: €3.0 million on January 15, 2016, €5.0 million on January 15, 2017, and €7.0 million on January 15, 2018. In addition, the loan becomes immediately due and payable upon certain customary events of default. In January 2016, we paid the principal amount of €3.0 million. At December 31, 2016, the outstanding principal balance under this loan was $12.6 million using the December 31, 2016 Exchange Rate of 1.052. In January 2017, we entered into Amendment No. 3 to the Servier Loan Agreement (“Amendment No. 3”). Amendment No. 3 extended the maturity date of the €5.0 million due on January 15, 2017 to July 15, 2017. The other terms of the loan remained unchanged.

On September 28, 2015, Servier notified us of its intention to terminate the Collaboration Agreement, as amended, and return the gevokizumab rights to us. The termination became effective on March 25, 2016, and did not result in a change to the then maturity date of our loan with Servier.

Takeda

In November 2006, we entered into a collaboration agreement with Takeda under which we agreed to discover and optimize therapeutic antibodies against multiple targets selected by Takeda.

Under the terms of this agreement, we may receive milestone payments aggregating up to $19.0 million relating to one undisclosed product candidate and low single-digit royalties on future sales of all products subject to this license. Our right to milestone payments expires on the later of the receipt of payment from Takeda of the last amount to be paid under the agreement or the cessation by Takeda of all research and development activities with respect to all program antibodies, collaboration targets or collaboration products. Our right to royalties expires on the later of 13.5 years from the first commercial sale of each royalty-bearing discovery product or the expiration of the last-to-expire licensed patent.

In February 2009, we expanded our existing collaboration to provide Takeda with access to multiple antibody technologies, including a suite of research and development technologies and integrated information and data management systems. We may receive milestones of up to $3.3 million per discovery product candidate and low single-digit royalties on future sales of all antibody products subject to this license. Our right to milestone payments expires on the later of the receipt of payment from Takeda of the last amount to be paid under the agreement or the cessation by Takeda of all research and development activities with respect to all program antibodies, collaboration targets or collaboration products. Our right to royalties expires on the later of 10 years from the first commercial sale of such royalty-bearing discovery product or the expiration of the last-to-expire licensed patent.

We have completed a technology transfer and do not expect to perform any further research and development services under this program. From 2011 through 2016, we received milestone payments totaling $2.3 million relating to one currently active program.

Pfizer

In August 2007, we entered into a license agreement (the “2007 Agreement”) with Pfizer Inc. (“Pfizer”) for non-exclusive, worldwide rights for our patented bacterial cell expression technology for research, development and manufacturing of antibody products. In December 2015, we entered into a settlement and amended license agreement with Pfizer, under which we granted Pfizer fully-paid, royalty-free, worldwide, irrevocable, non-exclusive license rights to our patented bacterial cell expression technology for phage display and other research, development and manufacturing of antibody products for cash payment by Pfizer of $3.8 million in full satisfaction of all obligations to us under the 2007 Agreement between XOMA (then XOMA Ireland Limited) and Pfizer Inc., including all potential milestone, royalty and other fees under the 2007 Agreement. As a result of the settlement with Pfizer, the 2007 Agreement was terminated.

In August 2005, we entered into a license agreement with Wyeth (subsequently acquired by Pfizer) for non-exclusive, worldwide rights for certain of our patented bacterial cell expression technology for vaccine manufacturing. In December 2016, we sold our rights to receive further royalties under this agreement for an upfront payment of $6.5 million and potential future payments of up to $4.0 million.

Dyax

In October 2006, we entered into an amended and restated license agreement with DYAX, Corp. (“Dyax”) for worldwide, non-exclusive licenses for our patented bacterial cell expression technology in phage display. In consideration for the rights granted to Dyax, we received an upfront fee of $3.5 million. In addition, we would be eligible to receive royalties equal to 0.5% on net sales of any products subject to this license. In December 2016, we sold our rights to receive further royalties under this agreement for a payment of $11.5 million.

Sale of Biodefense Assets and Manufacturing Facility

On November 4, 2015, we entered into an asset purchase agreement with Nanotherapeutics Inc. (the "Nanotherapeutics Purchase Agreement"), under which Nanotherapeutics agreed to acquire our biodefense business and related assets (including, subject to regulatory approval, certain contracts with the U.S. government), and to assume certain liabilities of XOMA. As part of that transaction, the parties, subject to the satisfaction of certain conditions, entered into an intellectual property license agreement (the "Nanotherapeutics License Agreement"), under which we agreed to license to Nanotherapeutics certain intellectual property rights related to the purchased assets. Under the Nanotherapeutics License Agreement, we are eligible for up to $4.5 million of cash payments and 23,008 shares of common stock of Nanotherapeutics, based upon Nanotherapeutics achieving certain specified future operational objectives. In addition, we are eligible to receive 15% royalties on net sales of products. In February 2017, we executed an Amendment and Restatement to both the Nanotherapeutics Purchase Agreement and Nanotherapeutics License Agreement primarily to (i) remove the obligation to issue 23,008 shares of common stock of Nanotherapeutics under the Nanotherapeutics Purchase Agreement, and (ii) revise the payment schedule related to the timing of the $4.5 million cash payments due to us under the Nanotherapeutics License Agreement. Of the $4.5 million, $3.0 million is contingent upon Nanotherapeutics achieving certain specified future operating objectives.

On November 5, 2015, we entered into an asset purchase agreement (the "Agenus Purchase Agreement") with Agenus West, LLC, a wholly-owned subsidiary of Agenus Inc. ("Agenus"), pursuant to which Agenus agreed to acquire our pilot scale manufacturing facility in Berkeley, California, together with certain related assets, including a license to certain intellectual property related to the purchased assets, and to assume certain liabilities of XOMA, in consideration for the payment to us of up to $5.0 million in cash and the issuance to us of shares of Agenus's common stock having an aggregate value of up to $1.0 million. The Agenus Purchase Agreement closed on December 31, 2015. At closing, we received cash of $4.7 million, net of the assumed liabilities of $0.3 million. In addition to the cash consideration, we received shares of common stock of Agenus with an aggregate value of $0.5 million, which we subsequently sold in August 2016. The remaining common stock of Agenus will only be received upon our satisfaction of certain operational matters, which we are unlikely to satisfy.

Sale of Future Revenue Streams

On December 21, 2016, we entered into two Royalty Interest Acquisition Agreements (together, the "Acquisition Agreements") with HealthCare Royalty Partners II, L.P. ("HCRP"). Under the first Acquisition Agreement, we sold our right to receive milestone payments and royalties on future sales of products subject to a license agreement, dated August 18, 2005, between XOMA and Pfizer for an upfront cash payment of $6.5 million, plus potential additional payments totaling $4.0 million in the event three specified net sales milestones are met by Pfizer in 2017, 2018 and 2019. Under the second Acquisition Agreement, we sold all rights to royalties under an Amended and Restated License Agreement dated October 27, 2006 between XOMA and Dyax for a cash payment of $11.5 million.

Financing Agreements

Hercules Loan and Security Agreement

In February 2015, we entered into a Loan and Security Agreement with Hercules Technology Growth Capital, Inc., (the "Hercules Loan Agreement") under which we borrowed $20.0 million. We used a portion of the proceeds received under the Hercules Loan Agreement to repay the outstanding principal, final payment fee, prepayment fee, and accrued interest of $5.5 million under a loan agreement with General Electric Capital Corporation.

The interest rate under the Hercules Loan Agreement is calculated at a rate equal to the greater of either (i) 9.40% plus the prime rate as reported from time to time in The Wall Street Journal minus 7.25%, and (ii) 9.40%. Payments under

the Hercules Loan Agreement were interest only until June 1, 2016, after which we have paid equal monthly payments of principal and interest amortized over a 30-month schedule through the scheduled maturity date of September 1, 2018 (the "Hercules Loan Maturity Date"). The entire principal balance, including a balloon payment of principal, will be due and payable on the Hercules Loan Maturity Date. In addition, a final payment of $1.2 million will be due on the Hercules Loan Maturity Date, or such earlier date specified in the Hercules Loan Agreement. If we prepay the loan prior to the Hercules Loan Maturity Date, we may pay Hercules a prepayment charge equal to 1.00% of the amount prepaid. Our obligations under the Hercules Loan Agreement are secured by a security interest in substantially all of our assets, other than our intellectual property.

The Hercules Loan Agreement includes customary affirmative and restrictive covenants, but does not include any financial maintenance covenants, and also includes standard events of default, including payment defaults. Upon the occurrence of an event of default, a default interest rate of an additional 5% may be applied to the outstanding loan balances, and Hercules may declare all outstanding obligations immediately due and payable and take such other actions as set forth in the Hercules Loan Agreement. On December 21, 2016, we entered into Amendment No. 1 (the "Hercules Amendment") to the Hercules Loan Agreement. Under the Hercules Amendment, Hercules agreed to release its security interest on the assets subject to the Acquisition Agreements with HCRP. In turn, in January 2017, we paid $10.0 million of the outstanding principal balance owed to Hercules. The $10.0 million payment was not subject to any prepayment charge. After taking into account the January 2017 payment, the principal balance of the Hercules Loan was $6.9 million.

In connection with the Hercules Loan Agreement, we issued a warrant to Hercules that is exercisable for an aggregate of up to 9,063 shares of our common stock at an exercise price of $66.20 per share (the "Hercules Warrant"). The Hercules Warrant may be exercised on a cashless basis and is exercisable for a term beginning on the date of issuance and ending on the earlier to occur of five years from the date of issuance or the consummation of certain acquisitions of XOMA as set forth in the Hercules Warrant. The number of shares for which the Hercules Warrant is exercisable and the associated exercise price are subject to certain proportional adjustments as set forth in the Hercules Warrant.

Research and Development

Our research and development expenses currently include costs of personnel, supplies, facilities and equipment, consultants, third-party costs and other expenses related to preclinical and clinical testing. In 2016, our research and development expenses were $44.2 million, compared with $70.9 million in 2015 and $80.7 million in 2014.

Our research and development activities can be divided into those related to our internal projects and those related to collaborative and contract arrangements, which are reimbursed by our collaborators. In 2016, research and development expenses relating to internal projects were $42.8 million, compared with $50.2 million in 2015 and $51.3 million in 2014. In 2016, research and development expenses related to collaborative and contract arrangements were $1.4 million, compared with $20.7 million in 2015 and $29.4 million in 2014. In December 2016, we initiated a corporate reorganization to eliminate all activities not directly in support of X358 clinical development.

Competition

The biotechnology and pharmaceutical industries are subject to continuous and substantial technological change. Competition in antibody-based technologies is intense and is expected to increase as new technologies emerge and established biotechnology firms and large chemical and pharmaceutical companies continue to advance in the field. A number of these large pharmaceutical and chemical companies have enhanced their capabilities by entering into arrangements with or acquiring biotechnology companies or entering into business combinations with other large pharmaceutical companies. Many of these companies have significantly greater financial resources, larger research and development and marketing staffs, and larger production facilities than ours. Moreover, certain of these companies have extensive experience in undertaking preclinical testing and human clinical trials. These factors may enable other companies to develop products and processes competitive with or superior to ours. In addition, a significant amount of research in biotechnology is being carried out in universities and other non-profit research organizations. These entities are becoming increasingly interested in the commercial value of their work and may become more aggressive in seeking patent protection and licensing arrangements. Furthermore, many companies and universities tend not to announce or disclose important discoveries or development programs until their patent position is secure or, for other reasons, later. As a result, we may not be able to track development of competitive products, particularly at the early stages. There can be no assurance that developments by others will not render our products or technologies obsolete or uncompetitive.

Without limiting the above, we are aware of the following competitors for our X358 product candidate: Biodel, Inc.; Eiger Biopharmaceuticals; Eli Lilly and Company; Locemia Solutions; S-cubed Limited; Xeris Pharmaceuticals and Zealand Pharma A/S. This list is not intended to be representative of all existing competitors in the market.

Government Regulation

The FDA and comparable regulatory agencies in state and local jurisdictions and in foreign countries impose substantial requirements upon the clinical development, pre-market approval, manufacture, marketing, import, export and distribution of biopharmaceutical products. These agencies and other regulatory agencies regulate research and development activities and the testing, approval, manufacture, quality control, safety, effectiveness, labeling, storage, recordkeeping, advertising and promotion of products and product candidates. Failure to comply with FDA or other regulatory requirements may result in Warning Letters, civil or criminal penalties, suspension or delays in clinical development, recall or seizure of products, partial or total suspension of production or withdrawal of a product from the market. The development and approval process requires substantial time, effort and financial resources, and we cannot be certain that any approvals for our product candidates will be granted on a timely basis, if at all. Our product candidates must be approved by the FDA before we can begin marketing them in the United States. Similar approvals are also required in other countries.

Product development and approval within this regulatory framework is uncertain, can take many years and requires the expenditure of substantial resources. The nature and extent of the governmental review process for our product candidates will vary, depending on the regulatory categorization of particular product candidates and various other factors.

The necessary steps before a new biopharmaceutical product may be sold in the United States ordinarily include:

- preclinical in vitro and in vivo tests, which must comply with Good Laboratory Practices (“GLP”);
- submission to the FDA of an Investigational New Drug application (“IND”) which must become effective before clinical trials may commence, and which must be updated annually with a report on development;
- completion of adequate and well controlled human clinical trials to establish the safety and efficacy of the product candidate for its intended use;
- submission to the FDA of a biologic license application (“BLA”), which must often be accompanied by payment of a substantial user fee;
- FDA pre-approval inspection of manufacturing facilities for current Good Manufacturing Practices (“GMP”), compliance and FDA inspection of select clinical trial sites for Good Clinical Practice (“GCP”), compliance; and
- FDA review and approval of the BLA and product prescribing information prior to any commercial sale.

The results of preclinical tests (which include laboratory evaluation as well as preclinical GLP studies to evaluate toxicity) for a particular product candidate, together with related manufacturing information and analytical data, are submitted as part of an IND to the FDA. The IND automatically becomes effective 30 days after receipt by the FDA, unless the FDA, within the 30-day time period, raises concerns or questions about the conduct of the clinical trial, including concerns that human research subjects will be exposed to unreasonable health risks. In such a case, the IND sponsor and the FDA must resolve any outstanding concerns before the clinical trial can begin. IND submissions may not result in FDA authorization to commence a clinical trial. A separate submission to an existing IND must also be made for each successive clinical trial conducted during product development. Further, an independent institutional review board (“IRB”), for each medical center proposing to conduct the clinical trial must review and approve the plan for any clinical trial before it commences at that center and it must monitor the study until completed. The FDA, the IRB, or the sponsor may suspend a clinical trial at any time on various grounds, including a finding that the subjects or patients are being exposed to an unacceptable health risk. Clinical testing also must satisfy extensive GCP regulations and regulations for informed consent and privacy of individually identifiable information.

Clinical trials generally are conducted in three sequential phases that may overlap or in some instances, be skipped. In Phase 1, the initial introduction of the product into humans, the product is tested to assess safety, metabolism, pharmacokinetics and pharmacological actions associated with increasing doses. Phase 2 usually involves trials in a

limited patient population to evaluate the efficacy of the potential product for specific, targeted indications, determine dosage tolerance and optimum dosage and further identify possible adverse reactions and safety risks. Phase 3 and pivotal trials are undertaken to evaluate further clinical efficacy and safety often in comparison to standard therapies within a broader patient population, generally at geographically dispersed clinical sites. Phase 4, or post-marketing, trials may be required as a condition of commercial approval by the FDA and may also be voluntarily initiated by us or our licensees. Phase 1, Phase 2 or Phase 3 testing may not be completed within any specific period of time, if at all, with respect to any of our product candidates. Similarly, suggestions of safety, tolerability or efficacy in earlier-stage trials do not necessarily predict findings of safety and effectiveness in subsequent trials. Clinical trials are subject to central registration and results reporting requirements, such as on www.clinicaltrials.gov.

The results of preclinical studies, pharmaceutical development and clinical trials, together with information on a product's chemistry, manufacturing, and controls, are submitted to the FDA in the form of a BLA, for approval of the manufacture, marketing and commercial shipment of the biopharmaceutical product. Data from clinical trials are not always conclusive and the FDA may interpret data differently than we or our licensees interpret data. The FDA also may convene an Advisory Committee of external advisors to answer questions regarding the approvability and labeling of an application. The FDA is not obligated to follow the Advisory Committee's recommendation. The submission of a BLA is required to be accompanied by a substantial user fee, with few exceptions or waivers. The user fee is administered under the Prescription Drug User Fee Act, which sets goals for the timeliness of the FDA's review. A standard review period is twelve months from submission of the application, while priority review is eight months from submission of the application. The testing and approval process is likely to require substantial time, effort and resources, and there can be no assurance that any approval will be granted on a timely basis, if at all. The FDA may deny review of an application by refusing to file the application or not approve an application by issuance of a complete response letter if applicable regulatory criteria are not satisfied, require additional testing or information, or require risk management programs and post-market testing and surveillance to monitor the safety or efficacy of the product. Approval may occur with significant Risk Evaluation and Mitigation Strategies ("REMS"), which limit the clinical use in the prescribing information, distribution or promotion of a product. Once issued, the FDA may withdraw product approval if ongoing regulatory requirements are not met or if safety problems occur after the product reaches the market.

Orphan drugs are those intended for use in rare diseases or conditions. As a result of the high cost of development and the low return on investment for rare diseases, certain governments provide regulatory and commercial incentives for the development of drugs for small disease populations. In the United States, the term ''rare disease or condition'' means any disease or condition that affects fewer than 200,000 people in the United States. Applications for U.S. orphan drug status are evaluated and granted by the Office of Orphan Products Development ("OOPD") of the FDA and must be requested before submitting a BLA. In the United States, orphan drugs are subject to the standard regulatory process for marketing approval but are exempt from the payment of user fees for licensure, may receive market exclusivity for a period of seven years and some tax benefits, and are eligible for OOPD grants. If a product with orphan designation subsequently receives the first FDA approval for the disease or condition for which it has such designation, the product is entitled to orphan product exclusivity, which means the FDA may not approve any other applications to market the same drug or biological product for the same indication, except in very limited circumstances, for seven years. Competitors, however, may receive approval of different products for the indication for which the orphan product has exclusivity or obtain approval for the same product but for a different indication for which the orphan product has exclusivity. Orphan product exclusivity also could block the approval of one of our products for seven years if a competitor obtains approval of the same drug or biological product as defined by the FDA or if our product candidate is determined to be contained within the competitor's product for the same indication or disease. If a drug or biological product designated as an orphan product receives marketing approval for an indication broader than what is designated, it may not be entitled to orphan product exclusivity.

International Regulation

In addition to regulations in the United States, we are subject to a variety of foreign regulations governing clinical trials and commercial sales and distribution of any future products. Whether or not we obtain FDA approval for a product, we must obtain approval by the comparable regulatory authorities of foreign countries before we can commence clinical trials or market the product in those countries. The approval process varies from country to country, and the time may be longer or shorter than that required for FDA approval. The requirements governing the conduct of clinical trials, product licensing, pricing and reimbursement vary greatly from country to country.

Patents and Trade Secrets

Patent and trade secret protection are important to our business and our future will depend in part on our ability to obtain patents, maintain trade secret protection and operate without infringing on the proprietary rights of others. As a result of our ongoing activities, we hold and have filed applications for a number of patents in the United States and internationally to protect our products and important processes. We also have obtained or have the right to obtain licenses to certain patents and applications filed by others. However, the patent position of biotechnology companies generally is highly uncertain and consistent policy regarding the breadth of allowed claims has not emerged from the actions of the U.S. Patent and Trademark Office ("Patent Office") with respect to biotechnology patents. Accordingly, no assurance can be given that our patents will afford protection against competitors with similar technologies or others will not obtain patents claiming aspects similar to those covered by our patent applications.

We have established a portfolio of patents in the United States, Europe and certain other countries for our insulin receptor antibody programs. European Patent 2 480 254 and Japanese patent 5849050 cover insulin receptor-modulating antibodies having the functional properties of X358. U.S. Patent No. 8,926,976 covering insulin receptor-activating antibodies having the functional properties of the lead antibody in our XMetA program, subsequently licensed to Novo Nordisk. WO2016/141111 relates to methods of treating or preventing post-prandial hypoglycemia after gastric bypass surgery using a negative modulator antibody to the insulin receptor. WO2017/024285 relates to methods of treating or preventing hypoglycemia using a negative modulator antibody fragment that binds to the insulin receptor. Additional patent applications covering our insulin receptor antibody programs are pending in the U.S. and certain other countries.

We have exclusive worldwide rights to a family of patents relating to our prolactin receptor antibody program, X213, following return of the program by Novartis. Issued patents in the family include US Patent No. 7,867,493 and EP 2 059 535.

We have established a portfolio of patents in the United States, Europe and certain other countries for our gevokizumab program. U.S. Patent Nos. 7,531,166 (which expires in 2027) and 7,582,742 cover gevokizumab and other antibodies and antibody fragments with similar binding properties for IL-1 beta, as well as nucleic acids, expression vectors and production cell lines for the manufacture of such antibodies and antibody fragments. U.S. Patent Nos. 7,695,718, 8,101,166, 8,586,036, 8,545,846, 8,377,429 and 9,163,082 relate to methods of treating Type 2 diabetes or Type 2 diabetes-induced diseases or conditions with high affinity antibodies and antibody fragments that bind to IL-1 beta, including gevokizumab. U.S. Patent No. 8,637,029 relates to methods of treating gout with certain doses of IL-1 beta binding antibodies or binding fragments. Additional U.S. Patents relate to methods of treating certain IL-1 related inflammatory diseases, TI DM, certain cancers, certain IL-1 beta related coronary conditions, inflammatory eye disease or uveitis, with gevokizumab or other IL-1 beta antibodies and fragments having similar binding properties. U.S. Patent Nos. 8,551,487 and 9,139,646 relate to methods of treating refractory uveitis with IL-1 beta binding antibodies and binding fragments. Also, patents have been granted by the European Patent Office and certain other countries for gevokizumab, as well as nucleic acids, expression vectors and production cell lines for the manufacture of gevokizumab.

In October 2015, we announced that we had exclusively licensed the global development and commercialization rights to our TGF antibody program to Novartis. The licensed intellectual property includes US Patent Nos. 8,569,464 and 9,145,458 covering our lead TGF antibodies and methods of use thereof, and WO2016/161410 relating to combination therapy using an inhibitor of TGFb and an inhibitor of PD-1 for treating or preventing recurrence of cancer.

We established a portfolio of patents related to our bacterial expression technology, including claims to methods for expression and secretion of recombinant proteins from bacteria, including immunoglobulin gene products, and improved methods and cells for expression of recombinant protein products. We have granted more than 60 licenses to biotechnology and pharmaceutical companies to use the Company’s patented and proprietary technologies relating to bacterial expression of recombinant pharmaceutical products. The last-to-expire patent licensed under the majority of these license agreements is Canadian patent 1,341,235, which is expected to expire in May 2018.

If certain patents issued to others are upheld or if certain patent applications filed by others issue and are upheld, we may require certain licenses from others in order to develop and commercialize certain potential products incorporating our technology. There can be no assurance that such licenses, if required, will be available on acceptable terms.

Where appropriate, we also rely on trade secrets to protect aspects of our technology. However, trade secrets are difficult to protect. We protect our proprietary technology and processes, in part, by confidentiality agreements with

our employees, consultants and collaborators. These parties may breach these agreements, and we may not have adequate remedies for any breach. Our trade secrets may otherwise become known or be independently discovered by competitors. To the extent that we or our consultants or collaborators use intellectual property owned by others, we may have disputes with our collaborators or consultants or other third parties as to the rights in related or resulting know-how and inventions.

Financial Information about Geographic Areas

When and if we are able to generate income, a portion of that income may be derived from product sales and other activities outside the United States.

We have determined that we operate in one business segment as we only report operating results on an aggregate basis to the chief operating decision maker of XOMA. Our property and equipment is held in the United States.

Financial information regarding the geographic areas in which we operate and segment information is included in Note 14 to the December 31, 2016, Financial Statements: Concentration of Risk, Segment and Geographic Information.

Concentration of Risk

Five Prime, Servier, and National Institute of Allergy and Infectious Diseases ("NIAID") accounted for 27 percent, 22 percent, and 19 percent, respectively, of our total revenue in 2016. In 2015, Novartis accounted for 67 percent of our total revenue. NIAID and Servier accounted for 51 percent and 28 percent, respectively, of our total revenue in 2014. At December 31, 2016, NIAID accounted for 85 percent of the accounts receivable balance. At December 31, 2015, Five Prime, NIAID, Servier and Centocor accounted for 39 percent, 25 percent, 18 percent and 10 percent, respectively, of the accounts receivable balance. None of these parties represent a related party to XOMA and the loss of one or more of these customers could have a material effect on our business and financial condition.

Employees

As of March 14, 2017, we employed 18 full-time employees at our headquarters in Berkeley, California. In addition, there are seven employees who will terminate employment on either March 31, 2017 or June 30, 2017 in connection with the restructuring activities in December 2016. None of our employees are unionized. Our employees are primarily engaged in clinical operations and in executive, business development, finance and administrative positions.

Available Information

For information on XOMA's investment prospects and risks, please contact Pure Communications at (910) 726-1372 or by sending an e-mail message to investorrelations@xoma.com.

The following information can be found on our website at http://www.xoma.com or can be obtained free of charge by contacting our Investor Relations Department:

- Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished under Section 13(a) or 15(d) of the Exchange Act will be available as soon as reasonably practicable after such material is electronically filed with the SEC. All reports we file with the SEC also can be obtained free of charge via EDGAR through the SEC's website at http://www.sec.gov.
- Our policies related to corporate governance, including our Code of Ethics applying to our directors, officers and employees (including our principal executive officer and principal financial and accounting officer) that we have adopted to meet the requirements set forth in the rules and regulations of the SEC and its corporate governance principles.
- The charters of the Audit, Compensation and Nominating & Governance Committees of our Board of Directors.

We intend to satisfy the applicable disclosure requirements regarding amendments to, or waivers from, provisions of our Code of Ethics by posting such information on our website.

Item 1A. Risk Factors

The following risk factors and other information included in this annual report should be carefully considered. The risks and uncertainties described below are not the only ones we face. Additional risks and uncertainties not presently known to us also may impair our business operations. If any of the following risks occur, our business, financial condition, operating results and cash flows could be materially adversely affected.

Risks Related to our Financial Results and Capital Requirements

We have sustained losses in the past, and we expect to sustain losses in the foreseeable future.

We had a net loss of $53.5 million, $20.6 million, and $38.3 million for the years ended December 31, 2016, 2015 and 2014, respectively. As of December 31, 2016, we had an accumulated deficit of $1.2 billion.

Our product candidates are still being developed, and we do not know whether we will ever achieve sustained profitability or whether cash flow from future operations will be sufficient to meet our needs.

We have devoted most of our financial resources to research and development, including our non-clinical development activities and clinical trials. To date, we have financed our operations primarily through the sale of equity securities and debt, and collaboration and licensing arrangements. Our total debt currently exceeds our total cash and cash equivalents. The size of our future net losses will depend, in part, on the rate of future expenditures and our ability to generate revenues. We expect to continue to incur substantial expenses as we continue our development and licensing activities for our product candidates. If our product candidates are not successfully developed or commercialized by our licensees, or if revenues are insufficient following marketing approval, we will not achieve profitability and our business may fail. Our ability to achieve profitability is dependent in large part on the success of our ability to license our product candidates, and the success of our licensees' development programs, both of which are uncertain. Our success is also dependent on our licensees obtaining regulatory approval to market our product candidates which may not materialize or prove to be successful.

Because our product candidates are still being developed, we will require substantial funds to continue; we cannot be certain that funds will be available, and if they are not available, we may be forced to delay, reduce, or eliminate our product development programs or to take actions that could adversely affect an investment in our common stock and we may not be able to continue operations.

We will need to commit substantial funds to continue development of our product candidates, and we may not be able to obtain sufficient funds on acceptable terms, or at all. Any additional debt financing or additional equity that we raise may contain terms that are not favorable to our stockholders or us. If we raise additional funds through collaboration and licensing arrangements with third parties, we may be required to relinquish some rights to our technologies or our product candidates, grant licenses on terms that are not favorable to us or enter into a collaboration arrangement for a product candidate at an earlier stage of development or for a lesser amount than we might otherwise choose.

Additional funds may not be available when we need them on terms that are acceptable to us, or at all. If adequate funds are not available on a timely basis, we may:

- terminate or delay clinical trials for one or more of our product candidates;
- reduce or eliminate certain product development efforts; or
- further reduce our capital or operating expenditures; or
- curtail our spending on protecting our intellectual property.

We finance our operations primarily through our multiple revenue streams resulting from discovery and development collaborations, the licensing of our antibody technologies, debt and through sales of our common stock.

Based on our cash and cash equivalents of $25.7 million at December 31, 2016, plus the $24.9 million in net proceeds received from an equity financing in February 2017, and taking into consideration our anticipated spending levels and scheduled debt payments, without the receipt of funds from new license agreements or milestone payments based on development achievements of our licensees, we will be unable to fund our operations through the next 12 months following the issuance of our consolidated financial statements. Based on our current projections, we expect our current cash and cash equivalents will not be sufficient to fund our operations and pay scheduled debt payments beyond February of 2018. Therefore, we determined there is substantial doubt regarding our ability to continue as a going concern within one year from the date the consolidated financial statements are issued. Our independent registered public accounting firm has included in its auditor's report on our consolidated financial statements, included in this Annual Report on Form 10-K, a "going concern" explanatory paragraph, meaning that we have recurring losses from operations and negative cash flows from operations that raise substantial doubt regarding our ability to continue as a going concern. We may not be able to obtain sufficient additional funding through monetizing certain of our existing assets, entering into new license agreements, issuing additional equity or debt instruments or any other means, and if we are able to do so, they may not be on satisfactory terms. Consistent with the actions we have taken in the

past, we will take steps intended to enable the continued operation of the business which may include out-licensing or sale of assets and reducing other expenditures that are within our control. These reductions in expenditures may have a material adverse impact on our ability to achieve certain of our planned objectives. Progress or setbacks by potentially competing products also may affect our ability to raise new funding on acceptable terms.

We do not know when or whether:

- operations will generate meaningful funds;
- additional agreements for product development funding can be reached;
- we will be able to repay our current debt or negotiate new debt arrangements;

- strategic alliances can be negotiated; or
- adequate additional financing will be available for us to finance our own development on acceptable terms, or at all.

If adequate funds are not available, we will be required to delay, reduce the scope of, or eliminate one or more of our product development programs and further reduce costs. Even if we are able to source additional funding, we may be forced to significantly reduce our operations if our business prospects do not improve. If we are unable to source additional funding, we may be forced to shut down operations altogether.

We may not realize the expected benefits of our cost-saving initiatives.

Reducing costs is a key element of our current business strategy. On August 21, 2015, in connection with our efforts to lower operating expenses and preserve capital while continuing to focus on our product pipeline, we implemented a workforce reduction, which led to the termination of 52 employees during the second half of 2015. On December 19, 2016, we approved a restructuring of our business based on our decision to focus our efforts on advancing our X358 clinical programs. The restructuring included a reduction-in-force in which we terminated 57 employees.

During the year ended December 31, 2016, we recorded an aggregate restructuring charge of approximately $4.6 million related to severance, other termination benefits and outplacement services in connection with the workforce reduction implemented in December 2016. During the year ended December 31, 2015, we recorded an aggregate restructuring charge of approximately $2.9 million related to severance, other termination benefits and outplacement services in connection with the workforce reduction implemented in August 2015. In addition, we recognized an additional restructuring charge of $0.8 million in total contract termination costs in the second half of 2015, which primarily include costs in connection with the discontinuation of the EYEGUARD studies.

If we experience excessive unanticipated inefficiencies or incremental costs in connection with restructuring activities, such as unanticipated inefficiencies caused by reducing headcount, we may be unable to meaningfully realize cost savings and we may incur expenses in excess of what we anticipate. Either of these outcomes could prevent us from meeting our strategic objectives and could adversely impact our results of operations and financial condition.

Risks Related to the Development and Commercialization of our Current and Future Product Candidates

We may not be successful in entering into out-license agreements for our product candidates, which may adversely affect our liquidity and business.

We intend to pursue a strategy to out-license some of our product candidates in order to provide for potential payments, funding and/or royalties on future product sales. The out-license agreements may also be structured to share in the proceeds received by a licensee as a result of further development or commercialization of the product candidates. We may not be successful in entering into out-licensing agreements with favorable terms as a result of factors, many of which are outside of our control. These factors include:

- research and spending priorities of potential licensing partners;
- willingness of, and the resources available to, pharmaceutical and biotechnology companies to in-license drug candidates to fill their clinical pipelines; or
- our inability to generate proof-of-concept data and to agree with a potential partner on the value of our product candidates, or on the related terms.

If we are unable to enter into out-licensing agreements for our product candidates and realize license, milestone and royalty fees when anticipated, it may adversely affect our liquidity and we may be forced to curtail or delay development of our product candidates, which in turn may harm our business.

If our therapeutic product candidates do not receive regulatory approval, our licensees will be unable to market them.

Our product candidates cannot be manufactured and marketed in the United States or any other countries without required regulatory approvals. The U.S. government and governments of other countries extensively regulate many aspects of our product candidates, including:

- clinical development and testing;
- manufacturing;

- labeling;
- storage;
- record keeping;
- promotion and marketing; and
- importing and exporting.

In the United States, the Food and Drug Administration ("FDA") regulates pharmaceutical products under the Federal Food, Drug, and Cosmetic Act and other laws, including, in the case of biologics, the Public Health Service Act. At the present time, we believe all of our product candidates will be regulated by the FDA as biologics.

Initiation of clinical trials requires approval by health authorities. Clinical trials involve the administration of the investigational new drug to healthy volunteers or to patients under the supervision of a qualified principal investigator. Clinical trials must be conducted in accordance with FDA and International Conference on Harmonization Good Clinical Practices and the European Clinical Trials Directive, as applicable, under protocols that detail the objectives of the study, the parameters to be used to monitor safety and the efficacy criteria to be evaluated. Other national, foreign and local regulations also may apply. The developer of the drug must provide information relating to the characterization and controls of the product before administration to the patients participating in the clinical trials. This requires developing approved assays of the product to test before administration to the patient and during the conduct of the trial. In addition, developers of pharmaceutical products must provide periodic data regarding clinical trials to the FDA and other health authorities, and these health authorities may issue a clinical hold upon a trial if they do not believe, or cannot confirm, that the trial can be conducted without unreasonable risk to the trial participants.

Based on regulatory restrictions, X358 clinical testing is currently limited to studies in adults in the U.S, and patients 12 and over in continental Europe. We submitted a proposal to the United Kingdom's Medicines and Healthcare Products Regulatory Agency ("MHRA") to initiate a multi-dose Phase 2 clinical study of X358 in children two years and older diagnosed with CHI. The MHRA approved the protocol in principal, and the study is in now in review at local ethics committees. We anticipate the site to be ready for first dosing in the UK in the second quarter of 2017. We cannot assure you that our proposed protocols for such testing will be approved, or that U.S. and foreign health authorities will not issue a clinical hold with respect to these or any of our other clinical trials in the future.

The results of the preclinical studies and clinical testing, together with chemistry, manufacturing and controls information, are submitted to the FDA and other health authorities in the form of a New Drug Application ("NDA") for a drug, and in the form of a Biologic License Application ("BLA") for a biological product, requesting approval to commence commercial sales. In responding to an NDA or BLA, the FDA or foreign health authorities may grant marketing approvals, request additional information or further research, or deny the application if they determine the application does not satisfy regulatory approval criteria. Regulatory approval of an NDA, BLA, or supplement is never guaranteed. The approval process can take several years, is extremely expensive and can vary substantially based upon the type, complexity, and novelty of the products involved, as well as the target indications. FDA regulations and policies permit applicants to request accelerated approval or priority review pathways for products intended to treat certain serious or life-threatening illnesses in certain circumstances. If granted by the FDA, these pathways can provide a shortened timeline to commercialize the product, although the shortened timeline is often accompanied by additional post-market requirements. Although we may pursue the FDA's accelerated approval or priority review programs, we cannot guarantee the FDA will permit us to utilize these pathways or the FDA's review of our application will not be delayed. Moreover, even if the FDA agrees to an accelerated approval or priority review of any of our applications, we ultimately may not be able to obtain approval of our application in a timely fashion or at all.

The FDA and foreign health authorities have substantial discretion in the drug and biologics approval processes. Despite the time and expense incurred, failure can occur at any stage, and we could encounter problems that cause us to abandon clinical trials or to repeat or perform additional preclinical, clinical or manufacturing-related studies.

Changes in the regulatory approval policy during the development period, changes in, or the enactment of additional regulations or statutes, or changes in regulatory review for each submitted product application may cause delays in the approval or rejection of an application. State regulations may also affect our proposed products.

The FDA and other regulatory agencies have substantial discretion in both the product approval process and manufacturing facility approval process, and as a result of this discretion and uncertainties about outcomes of testing, we cannot predict at what point, or whether, the FDA or other regulatory agencies will be satisfied with our or our licensees' submissions or whether the FDA or other regulatory agencies will raise questions that may be material and delay or preclude product approval or manufacturing facility approval. In light of this discretion and the complexities of the scientific, medical and regulatory environment, our interpretation or understanding of the FDA's or other regulatory agencies' requirements, guidelines or expectations may prove incorrect, which also could delay further or increase the cost of the approval process. As we accumulate additional clinical data, we and our licensees will submit it to the FDA and other regulatory agencies, as appropriate, and such data may have a material impact on the approval process.

We have received negative results from certain of our clinical trials, and we face uncertain results of other clinical trials of our product candidates.

Drug development has inherent risk, and we are required to demonstrate through adequate and well-controlled clinical trials that our product candidates are effective, with a favorable benefit-risk profile for use in their target profiles before we can seek regulatory approvals for their commercial use. It is possible we or our licensees may never receive regulatory approval for any of our product candidates. Even if a product candidate receives regulatory approval, the resulting product may not gain market acceptance among physicians, patients, healthcare payors and the medical community.

In March 2014, we reported that despite early positive results in our gevokizumab proof-of-concept study in patients with erosive osteoarthritis of the hand ("EOA") and elevated C-reactive protein, the top-line data at Day 168 in that study, as well as data at Day 84 in patients with EOA and non-elevated CRP, were not positive. In July 2015, we announced that Servier's EYEGUARD-B Phase 3 study of gevokizumab in patients with Behçet's disease uveitis did not meet its primary endpoint. In addition, neither EYEGUARD-A nor EYEGUARD-C produced positive results. In March 2016, we decided to close our Phase 3 studies of gevokizumab in pyoderma gangrenosum ("PG"). A preliminary review of the available data did not show a clear signal of activity in PG.

Our product candidates require significant additional research and development, extensive preclinical studies and clinical trials and regulatory approval prior to any commercial sales. This process is lengthy and expensive, often taking a number of years. As clinical results frequently are susceptible to varying interpretations that may delay, limit or prevent regulatory approvals, the length of time necessary to complete clinical trials and to submit an application for marketing approval for a final decision by a regulatory authority varies significantly. As a result, it is uncertain whether:

- our future filings will be delayed;
- our preclinical and clinical studies will be successful;
- we will be successful in generating viable product candidates;
- we will be successful in finding collaboration and licensing partners to advance our product candidates on our behalf;
- we will be able to provide necessary data;
- results of future clinical trials will justify further development; or
- we ultimately will achieve regulatory approval for our product candidates.

The timing of the commencement, continuation and completion of clinical trials may be subject to significant delays relating to various causes, including failure to complete preclinical testing and earlier-stage clinical trials in a timely manner, engaging contract research organizations and other service providers, scheduling conflicts with participating clinicians and clinical institutions, changes in key personnel at clinical institutions, difficulties in identifying and enrolling patients who meet trial eligibility criteria and shortages of available drug supply. In addition, if we license our product candidates to others to fund and conduct clinical trials, we may have limited control over how quickly and

efficiently such licensees advance those trials. Patient enrollment is a function of many factors, including the size of the patient population, the proximity of patients to clinical sites, the concentration of patients in specialist centers, the eligibility criteria for the trial, the existence of competing clinical trials and the availability of alternative or new treatments. Regardless of the initial size or relative complexity of a clinical trial, the costs of such trial may be higher than expected due to increases in duration or size of the trial, changes in the protocol under which the trial is being conducted, additional or special requirements of one or more of the healthcare centers where the trial is being conducted, or changes in the regulatory requirements applicable to the trial or in the standards or guidelines for approval of the product candidate being tested or for other unforeseen reasons.

In addition, we and our licensees conduct clinical trials in foreign countries, which may subject us to further delays and expenses as a result of increased drug shipment costs, additional regulatory requirements and the engagement of foreign clinical research organizations, and may expose us to risks associated with foreign currency transactions to make contract payments denominated in the foreign currency where the trial is being conducted.

All of our product candidates are prone to the risks of failure inherent in drug development. Preclinical studies may not yield results that satisfactorily support the filing of an Investigational New Drug application ("IND") (or a foreign equivalent) with respect to our product candidates. Even if these applications would be or have been filed with respect to our product candidates, the results of preclinical studies do not necessarily predict the results of clinical trials. Similarly, early stage clinical trials may not predict the results of later-stage clinical trials, including the safety and efficacy profiles of any particular product candidates. For example, the Phase 3 EYEGUARD-B trial of gevokizumab failed to achieve success on its primary endpoint measures.

In addition, there can be no assurance the design of our or our licensees' clinical trials will be focused on appropriate indications, patient populations, dosing regimens or other variables that will result in obtaining the desired efficacy data to support regulatory approval to commercialize the drug. Moreover, FDA officials or foreign regulatory agency officials may question the integrity of our data or otherwise subject our or our licensees' clinical trials to additional scrutiny when the clinical trials are conducted by principal investigators who serve, or previously served, as scientific advisors or consultants to us and receive cash compensation in connection with such services. Preclinical and clinical data can also be interpreted in different ways. Accordingly, FDA officials or officials from foreign regulatory authorities could interpret the data differently than we or our collaboration or development partners do, which could delay, limit or prevent regulatory approval.

Administering any of our product candidates may produce undesirable side effects, also known as adverse effects. Toxicities and adverse effects that we have observed in preclinical studies for some compounds in a particular research and development program may occur in preclinical studies or clinical trials of other compounds from the same program. Such toxicities or adverse effects could delay or prevent the filing of an IND (or a foreign equivalent) with respect to such product candidates or cause us to cease clinical trials with respect to any drug candidate. In clinical trials, administering any of our product candidates to humans may produce adverse effects. These adverse effects could interrupt, delay or halt clinical trials of our products and product candidates and could result in the FDA or other regulatory authorities denying approval of our product candidates for any or all targeted indications. The FDA, other regulatory authorities, our development partners or we may suspend or terminate clinical trials at any time. Even if one or more of our product candidates were approved for sale, the occurrence of even a limited number of toxicities or adverse effects when used in large populations may cause the FDA or other regulatory authorities to impose restrictions on, or stop, the further marketing of such drugs. Indications of potential adverse effects or toxicities that may occur in clinical trials and that we believe are not significant during the course of such clinical trials may actually turn out later to constitute serious adverse effects or toxicities when a drug has been used in large populations or for extended periods of time. Any failure or significant delay in completing preclinical studies or clinical trials for our product candidates, or in receiving and maintaining regulatory approval for the sale of any drugs resulting from our product candidates, may severely harm our reputation and business.

Products and technologies of other companies may render some or all of our product candidates noncompetitive or obsolete.

Developments by others may render our product candidates or technologies obsolete or uncompetitive. Technologies developed and utilized by the biotechnology and pharmaceutical industries are changing continuously and substantially. Competition in antibody-based technologies is intense and is expected to increase in the future as a number of established biotechnology firms and large chemical and pharmaceutical companies advance in these fields. Many of these competitors may be able to develop products and processes competitive with or superior to our own for

many reasons, including that they may have:

- significantly greater financial resources;
- larger research and development staffs;
- entered into arrangements with, or acquired, biotechnology companies to enhance their capabilities; or
- extensive experience in preclinical testing and human clinical trials.

These factors may enable others to develop products and processes competitive with or superior to our own or those of our licensees. In addition, a significant amount of research in biotechnology is being carried out in universities and other non-profit research organizations. These entities are becoming increasingly interested in the commercial value of their work and may become more aggressive in seeking patent protection and licensing arrangements. Furthermore, many companies and universities tend not to announce or disclose important discoveries or development programs until their patent position is secure or, for other reasons, later. As a result, we may not be able to track development of competitive products, particularly at the early stages.

Positive or negative developments in connection with a potentially competing product may have an adverse impact on our ability to raise additional funding on acceptable terms. For example, if another product is perceived to have a competitive advantage, or another product's failure is perceived to increase the likelihood that our product will fail, then investors may choose not to invest in us on terms we would accept or at all.

The examples below pertain to competitive events in the market, but are not intended to be representative of all existing competitive events.

We are developing X358, a fully human negative allosteric modulating insulin receptor antibody, as a novel treatment for non-drug-induced, endogenous hyperinsulinemic hypoglycemia (low blood glucose caused by excessive insulin produced by the body) disorders including CHI and hypoglycemia post gastric bypass. Certain other companies are developing products based on improved versions of glucagon, a hormone naturally secreted by the pancreas that counteracts the effects of insulin by raising blood glucose levels.

- Biodel Inc. is developing a formulation of glucagon designed to remain stable in solution for a longer period than existing commercial formulations. FDA and European Medicines Agency ("EMA") have granted orphan drug designation for Biodel's glucagon for the prevention of hypoglycemia in the CHI population.

(49,183	)	
Other accrued expenses	2,628	(9,292)
Cash flows provided by operating activities	36,356	48,188
Cash flows from investing activities:		
Additions to property and equipment	(10,650)	(13,510)
Proceeds from sale of property and equipment and assets held for sale	21,500	55,494
Principal receipts from notes, equipment contracts and other long-term receivables	6,577	7,055
Other	(760)	(574)
Cash flows provided by investing activities	16,667	48,465
Cash flows from financing activities:		
Borrowings under revolving credit facilities	35,000	25,000
Repayments under revolving credit facilities	(35,000)	(25,000)
Repayment of long-term debt (including premiums)	(76,037)	(153,437)
Principal payments on capital lease and financing obligations	(6,125)	(6,764)
Payment of debt modification and issuance costs	—	(12,316)
Repurchase of restricted stock	(1,344)	(4,742)
Proceeds from stock options exercised	3,120	6,240
Excess tax benefit from share-based compensation	2,820	5,687
Change in restricted cash	(3,777)	1,492
Other	—	(600)
Cash flows used in financing activities	(81,343)	(164,440)
Net change in cash and cash equivalents	(28,320)	(67,787)
Cash and cash equivalents at beginning of period	60,691	102,309
Cash and cash equivalents at end of period	$32,371	$34,522
Supplemental disclosures:		
Interest paid in cash	$65,040	$79,482
Income taxes paid in cash	$34,061	$11,071

See the accompanying Notes to Consolidated Financial Statements.

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DineEquity, Inc. and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited)

1. General

The accompanying unaudited consolidated financial statements of DineEquity, Inc. (the "Company") have been prepared in accordance with United States generally accepted accounting principles ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The operating results for the six months ended June 30, 2012 are not necessarily indicative of the results that may be expected for the twelve months ending December 31, 2012.

The consolidated balance sheet at December 31, 2011 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

These consolidated financial statements should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

2. Basis of Presentation

The Company's fiscal quarters end on the Sunday closest to the last day of each quarter. For convenience, the fiscal quarters are reported as ending on March 31, June 30, September 30 and December 31. The first and second fiscal quarters of 2012 ended on April 1, 2012 and July 1, 2012, respectively; the first and second fiscal quarters of 2011 ended on April 3, 2011 and July 3, 2011, respectively.

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries that are consolidated in accordance with U.S. GAAP. All intercompany balances and transactions have been eliminated in consolidation.

The preparation of financial statements in conformity with U.S. GAAP requires the Company's 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 consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. On an ongoing basis, the Company evaluates its estimates, including those related to provisions for doubtful accounts, legal contingencies, income taxes, long-lived assets, goodwill and intangible assets. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

Restricted Assets

Restricted Cash
The Company receives funds from Applebee's franchisees pursuant to franchise agreements, usage of which is restricted to advertising activities. Cash balances restricted for this purpose as of June 30, 2012 and December 31, 2011 totaled $4.9 million and $1.2 million, respectively. The balances were included as other current assets in the consolidated balance sheets.
Other Restricted Assets

As of June 30, 2012 and December 31, 2011, restricted assets related to a captive insurance subsidiary totaled $3.8 million and $3.6 million, respectively, and were included in other assets in the consolidated balance sheets. The captive insurance subsidiary, which has not underwritten coverage since January 2006, was formed to provide insurance coverage to Applebee's and its franchisees. These restricted assets were primarily investments, use of which is restricted to the payment of insurance claims for incidents that occurred during the period coverage had been provided.

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

3. Accounting Policies

Recently Adopted Accounting Standards

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-05, Comprehensive Income — Presentation of Comprehensive Income (“ASU 2011-05”). ASU 2011-05 requires the presentation of the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 did not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income, nor did it affect how earnings per share is calculated or presented. The Company adopted ASU 2011-05 retrospectively in the first quarter of 2012 and adoption did not have a material impact on the Company’s consolidated financial statements.

Newly Issued Accounting Standards

The Company reviewed all significant newly issued accounting pronouncements and concluded that they either are not applicable to the Company’s operations or that no material effect is expected on the consolidated financial statements as a result of future adoption.

4. Assets Held for Sale

The Company classifies assets as held for sale and ceases the depreciation and amortization of the assets when there is a plan for disposal of the assets and those assets meet the held for sale criteria, as defined in applicable U.S. GAAP. The balance of assets held for sale at December 31, 2011 of $9.4 million was comprised of 17 Applebee's company-operated restaurants located in a six-state market area geographically centered around Memphis, Tennessee, one parcel of land on which a refranchised Applebee's formerly company-operated restaurant is situated and three parcels of land previously intended for future restaurant development.

During the six months ended June 30, 2012, the Company completed the refranchising and sale of related restaurant assets of the 17 Applebee's company-operated restaurants located in a six-state market area geographically centered around Memphis, Tennessee. In April 2012, the Company entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 39 Applebee's company-operated restaurants located in Virginia. In May 2012, the Company entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 33 Applebee's company-operated restaurants located primarily in Missouri and Indiana. Accordingly, $23.7 million, representing the net book value of the assets related to these 72 restaurants, was transferred to assets held for sale.

Assets held for sale at June 30, 2012 of $27.6 million was comprised of 72 Applebee's company-operated restaurants located primarily in Virginia, Missouri and Indiana, one parcel of land on which a refranchised Applebee's formerly company-operated restaurant is situated and three parcels of land previously intended for future restaurant development.

The following table summarizes changes in assets held for sale during the six months ended June 30, 2012:

	(In millions)
Balance, December 31, 2011	$9.4
Assets transferred to held for sale	23.7

Assets sold	(5.1)
Other	(0.4)
Balance, June 30, 2012	$27.6

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

5. Long-Term Debt

Long-term debt consisted of the following components:

	June 30, 2012	December 31, 2011
	(In millions)	
Senior Secured Credit Facility, due October 2017, at a variable interest rate of 4.25% as of June 30, 2012 and December 31, 2011	$612.0	$682.5
Senior Notes due October 2018, at a fixed rate of 9.5%	760.8	765.8
Discount	(26.6)	(29.5)
Total long-term debt	1,346.2	1,418.8
Less current maturities	(7.4)	(7.4)
Long-term debt, less current maturities	$1,338.8	$1,411.4

For a description of the respective instruments, refer to Note 8 of the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

Debt Modification Costs

On February 25, 2011, the Company entered into Amendment No. 1 (the "Amendment") to the Credit Agreement dated as of October 8, 2010. For a description of the Amendment, refer to Note 8 of the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2011. Fees of $4.1 million paid to third parties in connection with the Amendment were included as “Debt modification costs” in the Consolidated Statement of Income for the six months ended June 30, 2011.

Loss on Extinguishment of Debt

During the six months ended June 30, 2012 and 2011, the Company recognized the following losses on the extinguishment of debt:

Quarter Ended	Instrument Repaid/Retired	Face Amount Repaid/Retired	Cash Paid	Loss [1]
		(In millions)		
March 2012	Term Loans	$70.5	$70.5	$1.9
March 2012	Senior Notes	5.0	5.5	0.7
	Total 2012	75.5	76.0	2.6
March 2011	Term Loans	$110.0	$110.0	$2.7
March 2011	Senior Notes	32.3	35.3	4.3
June 2011	Senior Notes	7.5	8.2	0.9
	Total 2011	$149.8	$153.5	$7.9

[1] Including write-off of the discount and deferred financing costs related to the debt retired.

Compliance with Covenants and Restrictions

The Company was in compliance with all the covenants and restrictions related to its Senior Secured Credit Facility and Senior Notes as of June 30, 2012.

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

6. Financing Obligations

As of June 30, 2012, future minimum lease payments under financing obligations during the initial terms of the leases related to sale-leaseback transactions are as follows:

Fiscal Years	(In millions)	
Remainder of 2012	$7.2	(1)
2013	17.4	
2014	17.6	
2015	19.0	(1)
2016	17.6	
Thereafter	207.5	
Total minimum lease payments	286.3	
Less interest	(130.9)	
Total financing obligations	155.4	
Less current portion	(3.8)	(2)
Long-term financing obligations	$151.6	

(1) Due to the varying closing dates of the Company's fiscal years, 11 monthly payments will be made in fiscal 2012 and 13 monthly payments will be made in fiscal 2015.
(2) Included in "current maturities of capital lease and financing obligations" on the consolidated balance sheet.

During the six months ended June 30, 2012, the Company's continuing involvement with six properties subject to financing obligations was ended by assignment of the lease obligations to a qualified franchisee. As a result, the Company's financing obligations were reduced by $9.2 million.

7. Impairment and Closure Charges

The Company assesses tangible long-lived assets for impairment when events or changes in circumstances indicate that the carrying value of the assets may not be recoverable. The following table summarizes the components of impairment and closure charges for the three and six months ended June 30, 2012 and 2011:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In millions)			
Impairment and closure charges:				
Impairment	$—	$0.3	$0.3	$4.8
Lenexa lease termination	—	21.3	—	21.3
Closure charges	0.1	0.2	0.5	0.7
Total impairment and closure charges	$0.1	$21.8	$0.8	$26.8

Impairment and closure charges for the six months ended June 30, 2012 totaled $0.8 million. The impairment charge related to a parcel of land previously intended for future restaurant development. Closure charges related to several individually insignificant franchise restaurant closures.

Impairment and closure charges for the six months ended June 30, 2011 totaled $26.8 million and primarily related to termination of the Company's sublease of the commercial space previously occupied by the Applebee's Restaurant Support Center in Lenexa, Kansas. The Company recognized $21.3 million for the termination fee and other closing costs in the second quarter of 2011. The Company recognized a $4.5 million impairment charge in the quarter ended March 31, 2011 related to furniture, fixtures and leasehold improvements at the facility whose book value was not realizable as the result of the termination of the sublease. Closure charges related to several individually insignificant franchise restaurant closures.

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

8. Income Taxes

The effective tax rate was 36.9% for the six months ended June 30, 2012 as compared to 30.1% for the six months ended June 30, 2011. The effective tax rate in the prior year was lower due to the release of liabilities for unrecognized tax benefits related to gift card income deferral as a result of the issuance of guidance by the U.S. Internal Revenue Service.

At June 30, 2012, the Company had a liability for unrecognized tax benefits, including potential interest and penalties net of related tax benefit, totaling $7.9 million, of which approximately $1.2 million is expected to be paid within one year. For the remaining liability, due to the uncertainties related to these tax matters, the Company is unable to make a reasonably reliable estimate when cash settlement with a taxing authority will occur.

As of June 30, 2012, accrued interest and penalties were $2.6 million and $0.4 million, respectively, excluding any related income tax benefits. As of December 31, 2011, accrued interest and penalties were $3.0 million and $0.3 million, respectively, excluding any related income tax benefits. The decrease of $0.4 million of accrued interest is primarily related to the decrease of unrecognized tax benefits due to settlements with taxing authorities, partially offset by the accrual of interest during the six months ended June 30, 2012. The Company recognizes interest accrued related to unrecognized tax benefits and penalties as a component of income tax expense, which is recognized in the Consolidated Statements of Income.

The Company and its subsidiaries file federal income tax returns as well as income tax returns in various state and foreign jurisdictions. With few exceptions, the Company is no longer subject to federal, state or non-United States tax examinations by tax authorities for years before 2008. The Internal Revenue Service commenced examination of the Company's U.S. federal income tax return for the tax years 2008 to 2010 in the first quarter of 2012. The examination is anticipated to be completed by the first quarter of 2013.

9. Stock-Based Compensation

From time to time, the Company has granted nonqualified stock options, restricted stock, cash-settled and stock-settled restricted stock units and performance units to officers, other employees and non-employee directors of the Company. Currently, the Company is authorized to grant nonqualified stock options, stock appreciation rights, restricted stock, cash-settled and stock-settled restricted stock units and performance units to officers, other employees and nonemployee directors under the DineEquity, Inc. 2011 Stock Incentive Plan (the “2011 Plan”). The 2011 Plan was approved by stockholders on May 17, 2011 and permits the issuance of up to 1,500,000 shares of the Company’s common stock. The 2011 Plan will expire in May 2021.

The nonqualified stock options generally vest over a three-year period and have a term of ten years from the effective issuance date. Option exercise prices equal the closing price of the Company’s common stock on the New York Stock Exchange on the date of grant. Restricted stock and restricted stock units are issued at no cost to the holder and vest over terms determined by the Compensation Committee of the Company’s Board of Directors, generally three years.

The following table summarizes the components of the Company’s stock-based compensation expense included in general and administrative expenses in the consolidated financial statements:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011

	(In millions)			
Pre-tax compensation expense	$2.5	$3.3	$7.0	$6.4
Tax provision	(1.0)	(1.3)	(2.7)	(2.5)
Total stock-based compensation expense, net of tax	$1.5	$2.0	$4.3	$3.9

As of June 30, 2012, total unrecognized compensation cost (including estimated forfeitures) of $12.2 million related to restricted stock and restricted stock units and $10.6 million related to stock options is expected to be recognized over a weighted average period of 1.2 years for restricted stock and restricted stock units and 1.1 years for stock options.

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

The estimated fair values of the options granted during the six months ended June 30, 2012 were calculated using a Black-Scholes option pricing model. The following summarizes the assumptions used in the Black-Scholes model:

Risk-free interest rate	0.86	%
Weighted average historical volatility	83.6	%
Dividend yield	—	
Expected years until exercise	4.66	
Forfeitures	11.0	%
Weighted average fair value of options granted	$33.11	

Option balances as of June 30, 2012 and activity related to the Company's stock options during the six months then ended were as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
Outstanding at December 31, 2011	1,318,640	$32.06		
Granted	147,674	$51.63		
Exercised	(212,308)	$15.94		
Forfeited	(24,775)	$39.09		
Outstanding at June 30, 2012	1,229,231	$37.05	6.87	$13,145,000
Vested at June 30, 2012 and Expected to Vest	1,173,783	$36.48	6.76	$12,991,000
Exercisable at June 30, 2012	780,398	$31.89	5.8	$11,172,000

The aggregate intrinsic value in the table above represents the total pretax intrinsic value (the difference between the closing stock price of the Company's common stock on the last trading day of the second quarter of 2012 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2012. The aggregate intrinsic value will change based on the fair market value of the Company's common stock and the number of in-the-money options.

A summary of restricted stock activity for the six months ended June 30, 2012 is presented below:

	Restricted Stock	Weighted Average Grant Date Fair Value	Restricted Stock Units	Weighted Average Grant Date Fair Value
Outstanding at December 31, 2011	486,533	$31.25	18,000	$29.32
Granted	120,123	$51.85	19,152	$52.23
Released	(154,903)	$11.03	(3,910)	$40.58
Forfeited	(36,976)	$40.90	—	—
Outstanding at June 30, 2012	414,777	$43.72	33,242	$41.19

The Company has issued 44,957 shares of cash-settled restricted stock units to members of the Board of Directors, of which 37,184 were outstanding at June 30, 2012. As these instruments can only be settled in cash, they are recorded as liabilities based on the closing price of the Company's common stock as of June 30, 2012. For the six months ended June 30, 2012 and 2011, $0.2 million and $0.8 million, respectively, were included in pretax stock-based compensation expense for the cash-settled restricted stock units.

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

10. Segments

The Company's revenues and expenses are recorded in four segments: franchise operations, company restaurant operations, rental operations and financing operations.

As of June 30, 2012, the franchise operations segment consisted of (i) 1,858 restaurants operated by Applebee's franchisees in the United States, one U.S. territory and 15 countries outside the United States; and (ii) 1,540 restaurants operated by IHOP franchisees and area licensees in the United States, two U.S. territories and three countries outside the United States. Franchise operations revenue consists primarily of franchise royalty revenues, sales of proprietary products, certain franchise advertising fees and the portion of the franchise fees allocated to intellectual property. Franchise operations expenses include advertising expense, the cost of proprietary products, pre-opening training expenses and costs related to intellectual property provided to certain franchisees.

As of June 30, 2012, the company restaurant operations segment consisted of 160 Applebee's company-operated restaurants and 17 IHOP company-operated restaurants, all located in the United States. Company restaurant sales are retail sales at company-operated restaurants. Company restaurant expenses are operating expenses at company-operated restaurants and include food, labor, benefits, utilities, rent and other restaurant operating costs.

Rental operations revenue includes revenue from operating leases and interest income from direct financing leases. Rental operations expenses are costs of operating leases and interest expense on capital leases on franchisee-operated restaurants.
Financing operations revenue primarily consists of interest income from the financing of franchise fees and equipment leases, as well as sales of equipment associated with refranchised IHOP restaurants and a portion of franchise fees for restaurants taken back from franchisees not allocated to IHOP intellectual property. Financing expenses are primarily the cost of restaurant equipment.

Information on segments was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In millions)			
Revenues from External Customers				
Franchise operations	$102.5	$98.6	$210.9	$203.1
Company restaurants	93.8	134.6	194.7	289.3
Rental operations	29.1	31.6	61.2	63.8
Financing operations	4.0	3.5	8.2	12.3
Total	$229.4	$268.3	$475.0	$568.5
Interest Expense				
Company restaurants	$0.1	$0.1	$0.2	$0.3
Rental operations	4.3	4.5	8.6	9.2
Corporate	29.7	32.9	59.9	69.2
Total	$34.1	$37.5	$68.7	$78.7
Depreciation and amortization				
Franchise operations	$2.5	$2.6	$4.9	$5.1
Company restaurants	2.3	4.6	4.7	9.5
Rental operations	3.4	3.5	6.9	7.1
Corporate	2.3	2.4	4.5	4.6

Total	$10.5	$13.1	$21.0	$26.3
Income (loss) before income taxes				
Franchise operations	$76.2	$72.4	$156.9	$149.4
Company restaurants	14.2	17.3	30.9	40.3
Rental operations	4.8	7.0	12.3	14.6
Financing operations	3.1	3.6	6.7	6.7
Corporate	(70.9)	(98.5)	(130.3)	(168.0)
Total	$27.4	$1.8	$76.5	$43.0

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

11. Net Income (Loss) per Share

The computation of the Company's basic and diluted net income (loss) per share was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In thousands, except per share data)			
Numerator for basic and dilutive income - per common share:				
Net income	$16,938	$348	$48,282	$30,047
Less: Accretion of Series B Preferred Stock	(677)	(639)	(1,345)	(1,268)
Less: Net income allocated to unvested participating restricted stock	(388)	7	(1,169)	(846)
Net income (loss) available to common stockholders - basic	15,873	(284)	45,768	27,933
Effect of unvested participating restricted stock in two-class calculation	5	—	58	17
Accretion of Series B Preferred Stock	—	—	1,345	—
Net income (loss) available to common stockholders - diluted	$15,878	$(284)	$47,171	$27,950
Denominator:				
Weighted average outstanding shares of common stock - basic	17,890	18,072	17,786	17,884
Dilutive effect of:				
Stock options	248	—	282	396
Series B Preferred Stock	—	—	663	—
Weighted average outstanding shares of common stock - diluted	18,138	18,072	18,731	18,280
Net income (loss) per common share:				
Basic	$0.89	$(0.02)	$2.57	$1.56
Diluted	$0.88	$(0.02)	$2.52	$1.53

For the three months ended June 30, 2012 and the six months ended June 30, 2011, the diluted income per common share was computed excluding 662,500 and 624,000 shares, respectively, of common stock equivalents from the conversion of Series B Preferred Stock that were antidilutive. For the three months ended June 30, 2011, the diluted loss per common share was computed excluding 965,000 shares of common stock equivalents that were antidilutive.

12. Fair Value Measurements

The Company does not have a material amount of financial instruments that are required under U.S. GAAP to be measured on a recurring basis at fair value. The Company does not have a material amount of non-financial assets or non-financial liabilities that are required to be measured at fair value on a recurring basis. The Company has not elected to use fair value measurement, as provided under U.S. GAAP, for any assets or liabilities for which fair value measurement is not presently required.

The Company believes the fair values of cash equivalents, accounts receivable, accounts payable and the current portion of long-term debt approximate the carrying amounts due to their short duration.

The fair values of non-current financial liabilities at June 30, 2012 and December 31, 2011, determined based on Level 2 inputs, were as follows:

	June 30, 2012		December 31, 2011	
	Carrying	Fair Value	Carrying	Fair Value

	Amount (in millions)		Amount	
Long-term debt, less current maturities	$1,338.8	$1,438.4	$1,411.4	$1,486.2

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

13. Commitments and Contingencies

Litigation, Claims and Disputes

The Company is subject to various lawsuits, administrative proceedings, audits, and claims arising in the ordinary course of business. Some of these lawsuits purport to be class actions and/or seek substantial damages. The Company is required to record an accrual for litigation loss contingencies that are both probable and reasonably estimable. Legal fees and expenses associated with the defense of all of the Company's litigation are expensed as such fees and expenses are incurred. Management regularly assesses the Company's insurance deductibles, analyzes litigation information with the Company's attorneys and evaluates its loss experience in connection with pending legal proceedings. While the Company does not presently believe that any of the legal proceedings to which the Company is currently a party will ultimately have a material adverse impact upon the Company, there can be no assurance that the Company will prevail in all the proceedings the Company is party to, or that the Company will not incur material losses from them.

Gerald Fast v. Applebee's

The Company is currently defending a collective action in United States District Court for the Western District of Missouri, Central Division filed on July 14, 2006 under the Fair Labor Standards Act, Gerald Fast v. Applebee's International, Inc., in which named plaintiffs claim that tipped servers and bartenders in Applebee's company-operated restaurants spend more than 20% of their time performing general preparation and maintenance duties, or “non-tipped work,” for which they should be compensated at the minimum wage. On June 19, 2007, the court granted conditional certification of a nationwide class of servers and bartenders who had worked in Applebee's company-operated restaurants since June 19, 2004. As of February 2008, there were 5,540 potential class members who had opted into the collective action. Under this action, plaintiffs currently are seeking unpaid wages and other relief of up to $17 million plus plaintiffs' attorneys' fees and expenses. The bench trial is currently scheduled to begin on September 10, 2012.

The Company believes it has meritorious defenses and intends to vigorously defend this case. Due to the inherent uncertainty in litigation, however, there can be no guarantee that the Company ultimately will be successful. Substantial losses from or costs related to this legal proceeding could have a material impact on the Company. As of June 30, 2012, the Company had not accrued a loss contingency related to this matter. Given the uncertainty of the potential outcome, the Company is also unable to estimate, for financial reporting purposes, a reasonably possible loss or a range of reasonably possible losses for this matter.

Lease Guarantees

In connection with the sale of Applebee’s restaurants or previous brands to franchisees and other parties, the Company has, in certain cases, guaranteed or had potential continuing liability for lease payments totaling $370.4 million as of June 30, 2012. This amount represents the maximum potential liability for future payments under these leases. These leases have been assigned to the buyers and expire at the end of the respective lease terms, which range from 2012 through 2048. In the event of default, the indemnity and default clauses in our sale or assignment agreements govern our ability to pursue and recover damages incurred. No material liabilities have been recorded as of June 30, 2012.

14. Consolidating Financial Information

Certain of the Company's subsidiaries have guaranteed the Company's obligations under the Senior Secured Credit Facility. The following presents the condensed consolidating financial information separately for: (i) the parent Company, the issuer of the guaranteed obligations; (ii) the guarantor subsidiaries, on a combined basis, as specified in the Credit Agreement; (iii) the non-guarantor subsidiaries, on a combined basis; (iv) consolidating eliminations and reclassifications; and (v) DineEquity, Inc. and Subsidiaries, on a consolidated basis.

Each guarantor subsidiary is 100% owned by the Company at the date of each balance sheet presented. The notes are fully and unconditionally guaranteed on a joint and several basis by each guarantor subsidiary. Each entity in the consolidating financial information follows the same accounting policies as described in the consolidated financial statements.

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

Supplemental Condensed Consolidating Balance Sheet
June 30, 2012
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Assets					
Current Assets					
Cash and cash equivalents	$—	$31.9	$0.5	$—	$32.4
Receivables, net	0.9	84.9	0.1	(8.0)	77.9
Inventories	—	12.1	—	—	12.1
Prepaid expenses and other current assets	118.5	48.8	—	(111.1)	56.2
Deferred income taxes	2.3	22.4	0.3	—	25.0
Assets held for sale	—	25.8	1.8	—	27.6
Intercompany	(283.6)	278.0	5.6	—	—
Total current assets	(161.9)	503.9	8.3	(119.1)	231.2
Long-term receivables	—	219.4	—	—	219.4
Property and equipment, net	24.3	411.3	—	—	435.6
Goodwill	—	697.5	—	—	697.5
Other intangible assets, net	—	815.6	—	—	815.6
Other assets, net	20.9	93.7	—	—	114.6
Investment in subsidiaries	1,697.6	—	—	(1,697.6)	—
Total assets	$1,580.9	$2,741.4	$8.3	$(1,816.7)	$2,513.9
Liabilities and Stockholders' Equity					
Current Liabilities					
Current maturities of long-term debt	$15.4	$—	$—	$(8.0)	$7.4
Accounts payable	2.2	26.3	—	—	28.5
Accrued employee compensation and benefits	4.6	14.5	—		19.1
Gift card liability	—	91.3	—		91.3
Income taxes payable	(23.9)	135.0	—	(111.1)	—
Other accrued expenses	15.0	34.7	0.3		50.0
Total current liabilities	13.3	301.8	0.3	(119.1)	196.3
Long-term debt	1,338.8	—	—		1,338.8
Financing obligations	—	151.6	—		151.6
Capital lease obligations	—	129.1	—		129.1
Deferred income taxes	6.5	366.0	(0.3)	—	372.2
Other liabilities	5.5	102.9	0.9		109.3
Total liabilities	1,364.1	1,051.4	0.9	(119.1)	2,297.3
Total stockholders' equity	216.8	1,690.0	7.4	(1,697.6)	216.6
Total liabilities and stockholders' equity	$1,580.9	$2,741.4	$8.3	$(1,816.7)	$2,513.9

[1] Supplemental statements presented in millions may not add due to rounding from Consolidated Statements presented in thousands.

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

Supplemental Condensed Consolidating Balance Sheet
December 31, 2011
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Assets					
Current Assets					
Cash and cash equivalents	$9.9	$50.4	$0.4	$ —	$60.7
Receivables, net	0.6	121.0	0.1	(6.0)	115.7
Inventories	—	12.0	—	—	12.0
Prepaid expenses and other current assets	85.3	44.6	—	(71.3)	58.6
Deferred income taxes	1.5	19.0	0.1	—	20.6
Assets held for sale	—	7.3	2.1	—	9.4
Intercompany	(300.2)	294.5	5.7	—	—
Total current assets	(202.9)	548.7	8.4	(77.3)	276.9
Long-term receivables	—	226.5	—	—	226.5
Property and equipment, net	24.6	449.6	—	—	474.2
Goodwill	—	697.5	—	—	697.5
Other intangible assets, net	—	822.4	—	—	822.4
Other assets, net	23.2	93.5	0.1	—	116.8
Investment in subsidiaries	1,697.6	—	—	(1,697.6)	—
Total assets	$1,542.5	$2,838.2	$8.5	$ (1,774.9)	$2,614.3
Liabilities and Stockholders' Equity					
Current Liabilities					
Current maturities of long-term debt	$13.4	$—	$—	$ (6.0)	$7.4
Accounts payable	2.8	26.2	—	—	29.0
Accrued employee compensation and benefits	6.7	19.5	—	—	26.2
Gift card liability	—	147.0	—	—	147.0
Other accrued expenses	(61.6)	180.6	0.4	(71.3)	48.1
Total current liabilities	(38.7)	373.3	0.4	(77.3)	257.6
Long-term debt	1,411.4	—	—	—	1,411.4
Financing obligations	—	162.7	—	—	162.7
Capital lease obligations	—	134.4	—	—	134.4
Deferred income taxes	8.9	375.3	(0.4)	—	383.8
Other liabilities	5.4	102.6	1.1	—	109.1
Total liabilities	1,387.0	1,148.3	1.1	(77.3)	2,459.1
Total stockholders' equity	155.5	1,689.9	7.4	(1,697.6)	155.2
Total liabilities and stockholders' equity	$1,542.5	$2,838.2	$8.5	$ (1,774.9)	$2,614.3

[1] Supplemental statements presented in millions may not add due to rounding from Consolidated Statements presented in thousands.

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

Supplemental Condensed Consolidating Statement of Operations
For the Three Months Ended June 30, 2012
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Revenues					
Franchise revenues	$0.6	$101.6	$0.3	$—	$102.5
Restaurant sales	—	93.8	—	—	93.8
Rental revenues	—	29.2	—	—	29.1
Financing revenues	—	4.0	—	—	4.0
Total revenue	0.6	228.6	0.3	—	229.4
Franchise expenses	0.6	25.7	—	—	26.3
Restaurant expenses	—	79.6	—	—	79.6
Rental expenses	—	24.3	—	—	24.3
Financing expenses	—	0.9	—	—	0.9
General and administrative	6.1	30.6	0.5	—	37.2
Interest expense	27.0	2.7	—	—	29.7
Impairment and closure	—	0.1	—	—	0.1
Amortization of intangible assets	—	3.1	—	—	3.1
Loss (gain) on disposition of assets	—	1.2	(0.4)	—	0.7
Loss on extinguishment of debt	—	—	—	—	—
Intercompany dividend	(37.0)	—	—	37.0	—
Income (loss) before income taxes	3.9	60.4	0.2	(37.0)	27.4
Benefit (provision) for income taxes	12.8	(23.3)	—	—	(10.5)
Net (loss) income	$16.9	$36.9	$0.1	$(37.0)	$16.9
Total comprehensive income	$16.9	$36.9	$0.1	$(37.0)	$16.9

Supplemental Condensed Consolidating Statement of Operations
For the Three Months Ended June 30, 2011
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Revenues					
Franchise revenues	$0.6	$97.7	$0.2	$—	$98.6
Restaurant sales	—	134.3	0.4	—	134.6
Rental revenues	—	31.6	—	—	31.6
Financing revenues	—	3.5	—	—	3.5
Total revenue	0.6	267.1	0.6	—	268.3
Franchise expenses	0.5	25.7	—	—	26.2
Restaurant expenses	—	117.1	0.2	—	117.3

Rental expenses	—	24.6	—	—	24.6
Financing expenses	—	—	—	—	—
General and administrative	6.1	31.7	0.6	—	38.4
Interest expense	28.7	4.2	—	—	32.9
Impairment and closure	—	21.8	—	—	21.8
Amortization of intangible assets	—	3.1	—	—	3.1
Loss on disposition of assets	—	1.2	0.1	—	1.3
Loss on extinguishment of debt	0.9	—	—	—	0.9
Debt modification costs	—	—	—	—	—
Other (income) expense	30.4	43.8	(0.5)	(73.7)	—
Income (loss) before income taxes	(66.0)	(6.1)	0.2	73.7	1.8
Benefit (provision) for income taxes	13.8	(15.1)	(0.1)	—	(1.5)
Net (loss) income	$(52.2)	$(21.2)	$0.2	$73.7	$0.3
Total comprehensive income	$(52.2)	$(21.2)	$0.2	$73.7	$0.3

(1) Supplemental statements presented in millions may not add due to rounding from Consolidated Statements presented in thousands.

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

Supplemental Condensed Consolidating Statement of Operations
For the Six Months Ended June 30, 2012
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Revenues					
Franchise revenues	$1.3	$209.1	$0.5	$—	$210.9
Restaurant sales	—	194.7	—	—	194.7
Rental revenues	—	61.2	—	—	61.2
Financing revenues	—	8.2	—	—	8.3
Total revenue	1.3	473.2	0.5	—	475.0
Franchise expenses	1.2	52.8	—	—	54.0
Restaurant expenses	—	163.8	—	—	163.8
Rental expenses	—	48.8	—	—	48.9
Financing expenses	—	1.6	—	—	1.6
General and administrative	13.1	62.7	1.0	—	76.9
Interest expense	54.4	5.5	—	—	59.9
Impairment and closure	—	0.4	0.4	—	0.8
Amortization of intangible assets	—	6.2	—	—	6.2
Gain on disposition of assets	—	(15.2)	(0.8)	—	(16.0)
Loss on extinguishment of debt	2.6	—	—	—	2.6
Intercompany dividend	(91.1)	—	—	91.1	—
Income (loss) before income taxes	21.1	146.6	(0.1)	(91.1)	76.5
Benefit (provision) for income taxes	27.2	(55.3)	—	—	(28.2)
Net (loss) income	$48.3	$91.3	$(0.1)	$(91.1)	$48.3
Total comprehensive income	$48.2	$91.4	$(0.1)	$(91.1)	$48.4

Supplemental Condensed Consolidating Statement of Operations
For the Six Months Ended June 30, 2011
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Revenues					
Franchise revenues	$1.3	$201.3	$0.5	$—	$203.1
Restaurant sales	—	288.5	0.8	—	289.3
Rental revenues	—	63.8	—	—	63.8
Financing revenues	—	12.3	—	—	12.3
Total revenue	1.3	565.9	1.3	—	568.5
Franchise expenses	1.0	52.7	—	—	53.7
Restaurant expenses	—	248.6	0.4	—	249.0

Rental expenses	—	49.2	—	—	49.2
Financing expenses	—	5.6	—	—	5.6
General and administrative	13.6	61.6	1.2	—	76.4
Interest expense	61.0	8.1	—	—	69.2
Impairment and closure	—	26.7	0.1	—	26.8
Amortization of intangible assets	—	6.2		—	6.2
Gain on disposition of assets	—	(22.5)	—	—	(22.5)
Loss on extinguishment of debt	7.9	—		—	7.9
Debt modification costs	4.1	—	—	—	4.1
Other (income) expense	14.3	20.5	(0.9)	(33.9)	—
Income (loss) before income taxes	(100.6)	109.2	0.5	33.9	43.0
Benefit (provision) for income taxes	33.4	(46.2)	(0.2)	—	(13.0)
Net (loss) income	$(67.2)	$63.0	$0.3	$33.9	$30.0
Total comprehensive income	$(67.2)	$63.1	$0.3	$33.9	$30.0

(1) Supplemental statements presented in millions may not add due to rounding from Consolidated Statements presented in thousands.

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

Supplemental Condensed Consolidating Statement of Cash Flows
For the Six Months Ended June 30, 2012
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Cash flows provided by (used in) operating activities	$(64.9)	$101.1	$0.2	—	$36.4
Investing cash flows					
Additions to property and equipment	(3.0)	(7.7)	—		(10.7)
Principal receipts from long-term receivables	—	6.6	—	—	6.6
Proceeds from sale of assets	—	21.5	—	—	21.5
Other	—	(0.8)	—	—	(0.8)
Cash flows provided by (used in) investing activities	(3.0)	19.6	—	—	16.6
Financing cash flows					
Revolving credit borrowings	35.0	—	—	—	35.0
Revolving credit repayments	(35.0)	—	—	—	(35.0)
Payment of debt	(76.0)	(6.1)	—	—	(82.2)
Payment of debt issuance costs	—	—	—	—	—
Purchase of common stock	—	—	—	—	—
Restricted cash	—	(3.8)	—	—	(3.8)
Other	3.9	0.7	—	—	4.6
Intercompany transfers	130.1	(130.0)	(0.1)	—	—
Cash flows provided by (used in) financing activities	58.0	(139.2)	(0.1)	—	(81.3)
Net change	(9.9)	(18.5)	0.1	—	(28.3)
Beginning cash and equivalents	9.9	50.4	0.4	—	60.7
Ending cash and equivalents	$—	$31.9	$0.5	—	$32.4

Supplemental Condensed Consolidating Statement of Cash Flows
For the Six Months Ended June 30, 2011
(In millions[1])

	Parent	Combined Guarantor Subsidiaries	Combined Non-guarantor Subsidiaries	Eliminations and Reclassification	Consolidated
Cash flows provided by (used in) operating activities	$(79.7)	$127.4	$0.5	—	$48.2
Investing cash flows					
Additions to property and equipment	(4.0)	(9.5)	—	—	(13.5)
Principal receipts from long-term receivables	—	7.1	—	—	7.1

Proceeds from sale of assets	—	55.5	—	—	55.5
Other	—	(0.6)	—	—	(0.6)
Cash flows provided by (used in) investing activities	(4.0)	52.5	—	—	48.5
Financing cash flows					
Revolving credit borrowings	25.0	—	—	—	25.0
Revolving credit repayments	(25.0)				(25.0)
Payment of debt	(153.4)	(6.8)	—	—	(160.2)
Payment of debt issuance costs	(12.3)	—	—	—	(12.3)
Restricted cash	—	1.5	—	—	1.5
Other	6.2	0.3	—	—	6.5
Intercompany transfers	226.6	(225.0)	(1.6)	—	—
Cash flows provided by (used in) financing activities	67.1	(230.0)	(1.6)	—	(164.5)
Net change	(16.6)	(50.1)	(1.1)	—	(67.8)
Beginning cash and equivalents	23.4	77.3	1.6	—	102.3
Ending cash and equivalents	$6.8	$27.2	$0.5	—	$34.5

(1) Supplemental statements presented in millions may not add due to rounding from Consolidated Statements presented in thousands.

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DineEquity, Inc. and Subsidiaries
Notes to the Consolidated Financial Statements (Continued)

15. Subsequent Events

On July 20, 2012, the Company entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 65 Applebee's company-operated restaurants located in Michigan. This transaction is expected to close by the end of fiscal 2012. A gain will be recognized upon the close of the transaction.

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

Cautionary Statement Regarding Forward-Looking Statements

Statements contained in this report may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements involve known and unknown risks, uncertainties and other factors, which may cause actual results to be materially different from those expressed or implied in such statements. You can identify these forward-looking statements by words such as "may," "will," "should," "expect," "anticipate," "believe," "estimate," "intend," "plan" and other similar expressions. You should consider our forward-looking statements in light of the risks discussed under the heading "Risk Factors" in our most recent Annual Report on Form 10-K, as well as our consolidated financial statements, related notes, and the other financial information appearing elsewhere in this report and our other filings with the United States Securities and Exchange Commission. The forward-looking statements contained in this report are made as of the date hereof and the Company assumes no obligation to update or supplement any forward-looking statements.

You should read the following Management's Discussion and Analysis of Financial Condition and Results of Operations in conjunction with the consolidated financial statements and the related notes that appear elsewhere in this report.

Overview

The following discussion and analysis provides information we believe is relevant to an assessment and understanding of our consolidated results of operations and financial condition. The discussion should be read in conjunction with the consolidated financial statements and the notes thereto included in Item 1 of Part I of this Quarterly Report and the audited consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2011. Except where the context indicates otherwise, the words "we," "us," "our" and the "Company" refer to DineEquity, Inc., together with its subsidiaries that are consolidated in accordance with United States generally accepted accounting principles ("U.S. GAAP").

The Company was incorporated under the laws of the State of Delaware in 1976. The first International House of Pancakes® ("IHOP") restaurant opened in 1958 in Toluca Lake, California. Since that time, the Company or its predecessors have engaged in the development, operation, franchising and licensing of IHOP restaurants. In November 2007, we acquired Applebee's International, Inc. ("Applebee's"), which became a wholly-owned subsidiary of the Company. Through various IHOP and Applebee's subsidiaries, we own, operate and franchise two restaurant concepts in the casual dining and family dining categories of the food service industry: Applebee's Neighborhood Grill and Bar® and IHOP®. DineEquity, Inc. is the parent of the IHOP and Applebee's subsidiaries. References herein to Applebee's and IHOP restaurants are to these two restaurant concepts, whether operated by franchisees, area licensees or the Company. References herein to "system sales" include retail sales at restaurants that are owned by franchisees and area licensees and are not attributable to the Company, as well as retail sales at company-operated restaurants.

Domestically, IHOP restaurants are located in all 50 states and the District of Columbia while Applebee's restaurants are located in every state except Hawaii. Internationally, IHOP restaurants are located in two United States territories and three foreign countries; Applebee's restaurants are located in one United States territory and 15 foreign countries. With over 3,500 franchised and company-operated restaurants combined, we are one of the largest full-service restaurant companies in the world.

Franchise Business Model

As of June 30, 2012, our system-wide restaurant portfolio was 95.0% franchised and consisted of the following:

	June 30, 2012		
	Applebee's	IHOP	Total
Domestic:			
Franchise/area license restaurants	1,710	1,503	3,213
Company-operated restaurants	160	17	177
International:			
Franchise/area license restaurants	148	37	185
Total	2,018	1,557	3,575
Percentage franchised	92.1 %	98.9 %	95.0 %

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Since the completion of the Applebee’s acquisition, we have been pursuing a strategy to transition Applebee's from a system that was 74% franchised at the time of the acquisition to a 99% franchised Applebee's system, similar to IHOP’s 99% franchised system. We believe a highly franchised business model requires less capital investment, generates higher gross profit margins and reduces the volatility of free cash flow performance over time, as compared to a model based on operating a significant number of company restaurants.

During the six months ended June 30, 2012, we completed the refranchising and sale of related restaurant assets of 17 Applebee's company-operated restaurants in a six-state market area geographically centered around Memphis, Tennessee. In April 2012, we entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 39 Applebee's company-operated restaurants located in Virginia. In May 2012, we entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 33 Applebee's company-operated restaurants located primarily in Missouri and Indiana. In July, 2012, we entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 65 Applebee's company-operated restaurants located in Michigan. All of these transactions are expected to close by the end of fiscal 2012. Upon consummation of these transactions, we will have refranchised all Applebee's company-operated restaurants, except for 23 restaurants in the Kansas City area that will be retained as a Company market; upon consummation of these transactions, 99% of DineEquity's restaurants will be franchised.

Key Performance Indicators

In evaluating and assessing the performance of our business units, we consider our key operating performance indicators to be: (i) percentage change in domestic system-wide same-restaurant sales for Applebee's and IHOP; (ii) net franchise restaurant development and restaurants refranchised for Applebee's and IHOP; and (iii) Applebee's company-operated restaurant operating margin. An overview of these metrics for the six months ended June 30, 2012 is as follows:

	Applebee's	IHOP
Percentage change in system-wide domestic same-restaurant sales	1.0%	(0.9)%
Net Franchise restaurant development	(1)	7
Restaurants refranchised	17	4
Restaurant operating margin	17.3%	n/a

n/a - not applicable given relatively small number and test-market nature of IHOP company restaurants

We consider cash from operations and free cash flow (cash provided by operating activities, plus receipts from notes, equipment contracts and other long-term receivables, less additions to property and equipment) to be key indicators of consolidated performance. Cash from operations and free cash flow for the six months ended June 30, 2012 were $36.4 million and $32.3 million, respectively.

Additional information on each of these metrics is presented under the captions "Restaurant Data," "Restaurant Development Activity," "Company Restaurant Operations" and "Liquidity and Capital Resources" that follow.

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Restaurant Data

The following table sets forth, for the three and six months ended June 30, 2012 and 2011, the number of effective restaurants in the Applebee's and IHOP systems and information regarding the percentage change in sales at those restaurants compared to the same periods in the prior year. "Effective restaurants" are the number of restaurants in a given period, adjusted to account for restaurants open for only a portion of the period. Information is presented for all effective restaurants in the Applebee's and IHOP systems, which includes restaurants owned by the Company, as well as those owned by franchisees and area licensees. Sales at restaurants that are owned by franchisees and area licensees are not attributable to the Company. However, we believe that presentation of this information is useful in analyzing our revenues because franchisees and area licensees pay us royalties and advertising fees that are generally based on a percentage of their sales, as well as rental payments under leases that are usually based on a percentage of their sales. Management also uses this information to make decisions about future plans for the development of additional restaurants as well as evaluation of current operations.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012 (unaudited)	2011	2012	2011
Applebee's Restaurant Data				
Effective restaurants(a)				
Franchise	1,859	1,767	1,857	1,753
Company	160	244	161	257
Total	2,019	2,011	2,018	2,010
System-wide(b)				
Sales percentage change(c)	1.2 %	3.8 %	1.4 %	4.1 %
Domestic same-restaurant sales percentage change(d)	0.7 %	3.1 %	1.0 %	3.5 %
Franchise(b)(f)				
Sales percentage change(c)	5.5 %	13.5 %	6.4 %	13.3 %
Domestic same-restaurant sales percentage change(d)	0.5 %	3.5 %	0.8 %	3.9 %
Average weekly domestic unit sales (in thousands)	$46.9	$46.8	$48.5	$48.5
Company (f)				
Sales percentage change(c)	(31.8)%	(36.9)%	(34.2)%	(34.1)%
Same-restaurant sales percentage change(d)	3.1 %	0.7 %	3.5 %	0.7 %
Average weekly domestic unit sales (in thousands)	$42.7	$41.1	$43.9	$41.8

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012 (unaudited)	2011	2012	2011
IHOP Restaurant Data				
Effective restaurants(a)				
Franchise	1,377	1,339	1,375	1,334
Area license	164	163	164	164
Company	14	10	13	10
Total	1,555	1,512	1,552	1,508
System-wide(b)				

Sales percentage change(c)	1.9	%	1.1	%	2.4	%	1.2	%
Domestic same-restaurant sales percentage change(d)	(1.4	)%	(2.9	)%	(0.9	)%	(2.8	)%
Franchise(b)								
Sales percentage change(c)	1.7	%	0.9	%	2.2	%	1.2	%
Domestic same-restaurant sales percentage change(d)	(1.3	)%	(2.8	)%	(0.8	)%	(2.8	)%
Average weekly domestic unit sales (in thousands)	$33.8		$34.2		$34.4		$34.7	
Company (e)	n/a		n/a		n/a		n/a	
Area License(b)								
Sales percentage change(c)	3.2	%	3.0	%	3.3	%	1.6	%

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(a) "Effective restaurants" are the number of restaurants in a given fiscal period adjusted to account for restaurants open for only a portion of the period. Information is presented for all effective restaurants in the Applebee's and IHOP systems, which includes restaurants owned by the Company as well as those owned by franchisees and area licensees.

(b) "System-wide" sales are retail sales at Applebee's restaurants operated by franchisees and IHOP restaurants operated by franchisees and area licensees, as reported to the Company, in addition to retail sales at company-operated restaurants. Sales at restaurants that are owned by franchisees and area licensees are not attributable to the Company. Applebee's domestic franchise restaurant sales, IHOP franchise restaurant sales and IHOP area license restaurant sales for the three and six months ended June 30, 2012 and 2011 were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(In millions)			
Reported sales (unaudited)				
Applebee's franchise restaurant sales	$1,042.5	$987.7	$2,154.0	$2,024.5
IHOP franchise restaurant sales	$604.8	$594.8	$1,229.8	$1,202.8
IHOP area license restaurant sales	$58.5	$56.6	$120.8	$116.9

(c) "Sales percentage change" reflects, for each category of restaurants, the percentage change in sales in any given fiscal period compared to the prior fiscal period for all restaurants in that category.

(d) "Domestic same-restaurant sales percentage change" reflects the percentage change in sales, in any given fiscal period, compared to the same weeks in the prior year for restaurants that have been operated throughout both fiscal periods that are being compared and have been open for at least 18 months. Because of new unit openings and restaurant closures, the restaurants open throughout both fiscal periods being compared may be different from period to period. Same-restaurant sales percentage change does not include data on IHOP restaurants located in Florida.

(e) Sales percentage change and same-restaurant sales percentage change for IHOP company-operated restaurants are not applicable ("n/a") due to the relatively small number and test-market nature of the restaurants, along with the periodic inclusion of restaurants reacquired from franchisees that are temporarily operated by the Company in the sales percentage change.

(f) The sales percentage change for the three and six months ended June 30, 2012 and 2011 for Applebee's franchise and company-operated restaurants was impacted by the refranchising of 17 company-operated restaurants in 2012 and 132 company-operated restaurants during 2011.

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Restaurant Development Activity

The following table summarizes Applebee’s restaurant development and franchising activity:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
	(unaudited)			
Applebee’s Restaurant Development Activity				
Beginning of period	2,021	2,011	2,019	2,010
New openings				
Franchise	3	5	9	8
Total new openings	3	5	9	8
Closings				
Franchise	(6)	(4)	(10)	(6)
Total closings	(6)	(4)	(10)	(6)
End of period	2,018	2,012	2,018	2,012
Summary - end of period				
Franchise	1,858	1,768	1,858	1,768
Company	160	244	160	244
Total	2,018	2,012	2,018	2,012
Restaurant Franchising Activity				
Domestic franchise openings	2	3	3	6
International franchise openings	1	2	6	2
Refranchised	—	—	17	65
Total restaurants franchised	3	5	26	73
Closings				
Domestic franchise	(2)	(1)	(4)	(2)
International franchise	(4)	(3)	(6)	(4)
Total franchise closings	(6)	(4)	(10)	(6)
Net franchise restaurant (reductions) additions	(3)	1	16	67

In 2012, we expect Applebee's franchisees to open a total of 30 to 40 new Applebee's restaurants, approximately half of which are expected to be opened domestically. We currently do not plan to open any company-operated restaurants. The actual number of openings may differ from both our expectations and development commitments due to various factors, including economic conditions, franchisee access to capital, and the impact of currency fluctuations on our international franchisees. The timing of new restaurant openings also may be affected by various factors including weather-related and other construction delays and difficulties in obtaining regulatory approvals.

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The following table summarizes IHOP restaurant development and franchising activity:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012 (unaudited)	2011	2012	2011
IHOP Restaurant Development Activity				
Beginning of period	1,554	1,513	1,550	1,504
New openings				
Franchise	5	12	15	23
Area license	1	—	1	2
Total new openings	6	12	16	25
Closings				
Franchise	(2)	—	(7)	(3)
Area license	(1)	(3)	(2)	(4)
Total closings	(3)	(3)	(9)	(7)
End of period	1,557	1,522	1,557	1,522
Summary - end of period				
Franchise	1,375	1,349	1,375	1,349
Area license	165	162	165	162
Company	17	11	17	11
Total	1,557	1,522	1,557	1,522
Restaurant Franchising Activity				
Domestic franchise openings	5	9	14	17
International franchise openings	—	3	1	6
Area license openings	1	—	1	2
Refranchised	1	—	4	1
Total restaurants franchised	7	12	20	26
Closings				
Domestic franchise	(2)	—	(7)	(3)
International franchise	—	—	—	—
Area license	(1)	(3)	(2)	(4)
Total franchise closings	(3)	(3)	(9)	(7)
Reacquired by the Company	(6)	(1)	(6)	(1)
Net franchise restaurant (reductions) additions	(2)	8	5	18

In 2012, we expect IHOP franchisees to open a total of 45 to 55 new IHOP restaurants, primarily in the domestic market. The actual number of openings in any period may differ from both our expectations and the number of signed commitments. Historically, the actual number of restaurants developed in a particular year has been less than the total number committed to be developed due to various factors including weather-related delays, other construction delays, difficulties in obtaining timely regulatory approvals, franchisee noncompliance with development agreements and various economic factors. We currently do not plan to open any new IHOP company-operated restaurants. The number of IHOP company-operated restaurants increased during the second quarter of 2012 due to the takeback of six franchise restaurants whose franchise agreements were terminated.

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Significant Known Events, Trends or Uncertainties Impacting or Expected to Impact Comparisons of Reported or Future Results

Sales Trends

	Domestic System-wide Same-restaurant Sales Increase (Decrease)																			
	2010				2011				2012											
	Q1		Q2		Q3		Q4		Q1		Q2		Q3		Q4		Q1		Q2	
Applebee’s																				
Quarter	(2.7	)%	(1.6	)%	3.3	%	2.9	%	3.9	%	3.1	%	(0.3	)%	1.0	%	1.2	%	0.7	%
YTD	(2.7	)%	(2.2	)%	(0.5	)%	0.3	%	3.9	%	3.5	%	2.3	%	2.0	%	1.2	%	1.0	%
IHOP																				
Quarter	(0.4	)%	(1.0	)%	0.1	%	1.1	%	(2.7	)%	(2.9	)%	(1.5	)%	(1.0	)%	(0.5	)%	(1.4	)%
YTD	(0.4	)%	(0.7	)%	(0.4	)%	0.0	%	(2.7	)%	(2.8	)%	(2.4	)%	(2.0	)%	(0.5	)%	(0.9	)%

Applebee’s domestic system-wide same-restaurant sales increased 0.7% for the three months ended June 30, 2012, the seventh positive quarter of the most recent eight quarters. The increase in the second quarter of 2012 was driven primarily by an increase in system-wide guest check, partially offset by a decline in guest traffic at franchise restaurants. The higher guest check came from an increase in menu pricing and from favorable product mix changes.

We are focusing our efforts on driving sales and traffic growth while improving the guest experience by providing value and variety that is unique to Applebee's. Our signature "2 for $20" menu offerings continue to resonate with our guests, especially when we update this value proposition with new menu items. In addition to menu innovation, we are focusing on both excellence and execution at the restaurant level in every aspect of operations. In July, we launched Applebee's new campaign, “See You Tomorrow℠,” which communicates that we are doing whatever it takes to make sure our guests return. The campaign includes TV, radio, online, and outdoor ads to encourage repeat visits by highlighting Applebee's new Fresh Flavors of Summer menu and the everyday value our guests have come to expect. Our remodel program continued to progress at a steady pace as, when combined with new openings, 42% of Applebee's domestic system restaurants have the revitalized look.

IHOP’s domestic system-wide same-restaurant sales decreased 1.4% for the three months ended June 30, 2012. The decrease was primarily due to a decline in guest traffic, partially offset by an increase in average guest check.

We are addressing the traffic decline with a rollout of programs aimed at improving guest satisfaction and driving sales. We completed the rollout of two key components of our "Operations Improvement Plan": Service Excellence and Operations Evaluations. These programs are designed to work in tandem to both raise the bar on providing guests with an exceptional dining experience and set high operating standards. In May, we launched a new advertising campaign, “IHOP. Everything You Love About Breakfast℠,” refocusing on what we do best and what we know is our heritage - breakfast. Our brand positioning is to redefine the American breakfast experience, making IHOP the destination of choice for breakfast any time of day.

With respect to both brands, same-restaurant sales for the first six months of 2012 are not necessarily indicative of results expected for the full year.

Financial Statement Effect of Refranchising Company-Operated Restaurants

As discussed under “Franchise Business Model” above, we have been pursuing a strategy to transition Applebee's to a system that is 99% franchised. As the number of company-operated restaurants declines, the amount reported in future

periods for company-operated restaurant revenues and expenses will also decline while franchise royalty revenues and expenses will increase, as compared to amounts reported in previous periods. Segment profit will also decline as company-operated restaurants are refranchised because associated royalties from franchised restaurants are a smaller percentage of restaurant revenues than the restaurant operating profit margin percentage of company-operated restaurants. In addition, changes in same-restaurant sales will create less of an impact on changes in operating income once the Applebee's system is 99% franchised. Refranchising of additional Applebee’s company-operated restaurants will result in the reduction of interest expense as proceeds from the sale of related restaurant assets must be used to retire debt (subject to certain exclusions). Refranchising of additional Applebee’s company-operated restaurants also will result in a reduction of both general and administrative expenses ("G&A") and capital investment in restaurant assets.

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General and Administrative Expenses

In addition to a reduction in G&A resulting from the refranchising and sale of related assets of Applebee's company-operated restaurants, a comprehensive review of our organizational structure as a 99% franchised company has identified further potential G&A savings, primarily resulting from headcount reductions. We anticipate that these savings will begin to be realized in the fourth quarter of 2012.

Comparison of the Three Months ended June 30, 2012 and 2011

Results of Operations

Key components of changes in our financial results for the three months ended June 30, 2012 compared to the same period of 2011 are summarized below and discussed in the sections that follow:

- Revenue decreased $38.9 million, primarily due to the refranchising of Applebee's company-operated restaurants and a 1.4% decrease in IHOP domestic same-restaurant sales, partially offset by higher franchise royalty revenues resulting from the increase in Applebee’s and IHOP effective franchise restaurants and a 0.7% increase in Applebee's domestic same-restaurant sales;

- Segment profit decreased $2.0 million, comprised as follows:

	Three Months Ended June 30,		Favorable (Unfavorable) Variance
	2012	2011	
	(In millions)		
Franchise operations	$76.2	$72.4	$3.8
Company restaurant operations	14.2	17.3	(3.1)
Rental operations	4.8	7.0	(2.2)
Financing operations	3.1	3.6	(0.5)
Total	$98.3	$100.3	$(2.0)

The decline in segment profit was primarily due to the refranchising of Applebee’s company-operated restaurants and the write-off of $2.0 million of deferred rental revenue associated with franchisee-operated restaurants whose lease agreements were prematurely terminated, partially offset by an increase in effective Applebee’s and IHOP franchise restaurants and a 0.7% increase in Applebee's domestic same-restaurant sales;

- Impairment and closure charges decreased $21.7 million as costs of $21.3 million recorded in the second quarter of 2011 related to the termination of our sublease of commercial space previously occupied by the Applebee's Restaurant Support Center in Lenexa, Kansas did not recur;

- Interest expense decreased $3.2 million due to our reduction of debt balances over the past 12 months; and
- General and administrative ("G&A") expenses decreased $1.2 million, primarily due to lower personnel costs and professional services expenses, partially offset by higher occupancy costs.

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Franchise Operations

	Three Months Ended June 30,		Favorable (Unfavorable)	
	2012	2011	Variance	% Change [1]
	(In millions)			
Franchise Revenues				
Applebee's	$46.2	$42.9	$ 3.3	7.8 %
IHOP	37.3	37.0	0.3	0.8 %
IHOP advertising	19.0	18.7	0.3	1.4 %
Total franchise revenues	102.5	98.6	3.9	4.0 %
Franchise Expenses				
Applebee's	1.1	1.0	(0.1)	(22.2)%
IHOP	6.2	6.5	0.3	5.1 %
IHOP advertising	19.0	18.7	(0.3)	(1.4)%
Total franchise expenses	26.3	26.2	(0.1)	(0.5)%
Franchise Segment Profit				
Applebee's	45.1	41.9	3.2	7.5 %
IHOP	31.1	30.5	0.6	2.0 %
Total franchise segment profit	$76.2	$72.4	$ 3.8	5.2 %
Segment profit as % of revenue [1]	74.3 %	73.4 %		

[1] Percentages calculated on actual amounts, not rounded amounts presented above

The $3.3 million increase in Applebee's franchise revenue was primarily attributable to increased royalty revenue resulting from the refranchising of 84 Applebee's company-operated restaurants in the past 12 months, franchise fees from franchise extension agreements and a 0.5% increase in domestic same-restaurant sales. The $0.3 million increase in IHOP franchise revenue (other than advertising) was primarily attributable to a 2.8% increase in effective franchise restaurants partially offset by a decrease of 1.3% in IHOP domestic franchise same-restaurant sales. The $0.3 million decrease in IHOP franchise expenses was primarily due to lower bad debt expense.

IHOP's franchise expenses are substantially larger than Applebee's due to advertising expenses. Franchise fees designated for IHOP's national advertising fund and local marketing and advertising cooperatives are recognized as revenue and expense of franchise operations; however, Applebee's national advertising fund activity constitutes an agency transaction and therefore is not recognized as franchise revenue and expense. The increase in IHOP advertising revenue and expense is primarily due to the increase in effective franchise restaurants partially offset by the decrease in domestic franchise same-restaurant sales.

The increase in franchise segment profit is primarily due to an increase in effective franchise restaurants due to the refranchising of Applebee's company-operated restaurants and IHOP franchise development.

Company Restaurant Operations

	Three Months Ended June 30,		Favorable (Unfavorable)	
	2012	2011	Variance	% Change [1]
	(In millions)			
Company restaurant sales	$93.8	$134.6	$ (40.8)	(30.3)%
Company restaurant expenses	79.6	117.3	37.7	32.1 %
Company restaurant segment profit	$14.2	$17.3	$ (3.1)	(18.0)%

Segment profit as % of revenue [1]	15.2	%	12.9	%

[1] Percentages calculated on actual amounts, not rounded amounts presented above

As of June 30, 2012, company restaurant operations were comprised of 160 Applebee's company-operated restaurants and 17 IHOP company-operated restaurants. The impact of the IHOP company-operated restaurants on all comparisons of the three months ended June 30, 2012 with the same period of 2011 was negligible.

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Consolidated company restaurant sales decreased $40.8 million. Applebee's company restaurant sales decreased $41.6 million, primarily due to the refranchising of 84 company-operated restaurants in the past 12 months (one in the third quarter of 2011, 66 in the fourth quarter of 2011 and 17 in the first quarter of 2012), partially offset by an increase in company same-restaurant sales of 3.1%. The change in same-restaurant sales was driven by an increase in average guest check due to an increase of approximately 2.3% in pricing and favorable product mix changes.

Consolidated company restaurant expenses decreased $37.7 million. Applebee's company restaurant expenses decreased $39.0 million, of which $38.7 million was due to the refranchising of the 84 Applebee's company-operated restaurants noted above. The restaurant operating profit for Applebee's company restaurant operations increased to 16.9% for the first quarter of 2012 compared to 13.4% for the same period of last year, as shown below:

			Favorable (Unfavorable)		
	Three Months Ended			Components of Total Variance	
Applebee's Company-Operated Expenses As Percentage of Restaurant Sales	June 30, 2012	2011	Total Variance	Refranchising and Closures	Current Restaurants
Revenue	100.0 %	100.0 %			
Food and beverage	26.2 %	26.1 %	(0.1)%	(0.1)%	0.0 %
Labor	32.7 %	33.7 %	1.0 %	0.2 %	0.8 %
Direct and occupancy	24.2 %	26.8 %	2.6 %	0.6 %	2.0 %
Restaurant Operating Profit Margin [1]	16.9 %	13.4 %	3.5 %	0.6 %	2.8 %

[1] Percentages may not add due to rounding

The restaurant refranchising and closures discussed above had a net favorable impact of 0.6% on margins, primarily because the refranchised markets had higher-than-average labor costs; there was also a favorable impact resulting from the cessation of depreciation charges on restaurant assets held for sale. Other margin changes in specific cost categories were as follows:

- Food and beverage costs as a percentage of company restaurant sales were basically flat. Changes in commodity costs impacting most products were offset by improved control of waste and a favorable mix shift.

- Labor costs as a percentage of restaurant sales decreased by 0.8% due to improved productivity in hourly labor partially offset by increased costs of bonus expense, management staffing and merit increases.

- Direct and occupancy costs as a percent of restaurant sales decreased 2.0% primarily due to lower depreciation expense as the result of a block of assets that became fully depreciated in 2011 and favorable general liability insurance costs, partially offset by incremental investment in local media advertising.

Rental Operations

	Three Months Ended June 30,		Favorable (Unfavorable)	
	2012	2011	Variance	% Change [1]
	(In millions)			
Rental revenues	$29.1	$31.6	$ (2.5)	(7.8)%
Rental expenses	24.3	24.6	0.3	1.1 %
Rental operations segment profit	$4.8	$7.0	$ (2.2)	(205.8)%
Segment profit as % of revenue	16.7 %	22.3 %		

(1) Percentages calculated on actual amounts, not rounded amounts presented above

Rental operations relate primarily to IHOP franchise restaurants. Rental income includes revenue from operating leases and interest income from direct financing leases. Rental expenses are costs of prime operating leases and interest expense on prime capital leases on franchisee-operated restaurants.

The decrease in rental revenue and rental segment profit is primarily due to the write-off of $2.0 million of deferred lease rental revenue associated with franchise restaurants whose lease agreements were prematurely terminated.

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Financing Operations

	Three Months Ended June 30,		Favorable (Unfavorable)	
	2012	2011	Variance	% Change [1]
	(In millions)			
Financing revenues	$4.0	$3.6	$0.4	12.2%
Financing expenses	0.9	0.0	(0.9)	n.m.
Financing operations segment profit	$3.1	$3.6	$(0.5)	(13.7)%
Segment profit as % of revenue	76.9 %	100.0 %		

[1] Percentages calculated on actual amounts, not rounded amounts presented above
n.m. - not meaningful

All of our financing operations relate to IHOP franchise restaurants. The increase in financing revenues is primarily due to refranchising transactions related to IHOP restaurants previously taken back from franchisees, partially offset by a decrease in interest revenue due to the progressive decline in note balances as a result of repayments. The increase in financing expenses is due to the cost of refranchising transactions related to IHOP restaurants.

Other Expense and Income Components

	Three Months Ended June 30,		Favorable (Unfavorable)	
	2012	2011	Variance	% Change [1]
	(In millions)			
General and administrative expenses	$37.2	$38.4	$1.2	3.1 %
Interest expense	29.7	32.9	3.2	9.8 %
Impairment and closure charges	0.1	21.8	21.7	99.4 %
Amortization of intangible assets	3.1	3.1	—	0.0 %
Loss on disposition of assets	0.7	1.3	0.6	42.6 %
Loss on extinguishment of debt	—	0.9	0.9	100.0 %
Income tax provision	10.5	1.5	(9.0)	(604.4)%

[1] Percentages calculated on actual amounts, not rounded amounts presented above

General and Administrative Expenses

General and administrative expenses decreased by $1.2 million compared to the same period of the prior year, primarily due to lower personnel costs and lower professional services expenses, partially offset by higher occupancy costs. The decrease in personnel costs was primarily lower stock-based compensation expense and lower salaries and wages, in addition to payroll credits related to the relocation of the Applebee's Restaurant Support Center.

Interest Expense

Interest expense decreased by $3.2 million compared to the same period of the prior year due to our reduction of debt balances. Average interest-bearing debt outstanding (our Term Loans, Senior Notes, capital lease obligations and financing obligations) during the three months ended June 30, 2012 was approximately $200 million lower than the same period of the prior year.

Impairment and Closure Charges

Impairment and closure charges decreased by $21.7 million compared to the same period of the prior year. The charges for the second quarter of 2012 were insignificant. Impairment and closure charges for the second quarter of 2011 were primarily comprised of $21.3 million related to the termination of our sublease of the commercial space previously occupied by the Applebee's Restaurant Support Center in Lenexa, Kansas, in addition to $0.5 million in impairment and closure charges related to individually insignificant items.

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During the quarter ended June 30, 2012, we performed our quarterly assessment of whether events or changes in circumstances have occurred that potentially indicate the carrying value of tangible long-lived assets may not be recoverable. No significant impairments were noted in performing that assessment. We also considered whether there were any indicators of potential impairment to our goodwill and indefinite-lived intangible assets that primarily consist of our trade name. No such indicators were noted.

Loss on Disposition of Assets

We recognized a loss on disposition of assets of $0.7 million for the three months ended June 30, 2012 compared to a loss of $1.3 million in the same period of 2011. There were no individually significant dispositions in either period.

Loss on Extinguishment of Debt

We did not recognize any loss on extinguishment of debt during the three months ended June 30, 2012. During the three months ended June 30, 2011, we recognized a loss on the extinguishment of debt of $0.9 million, comprised as follows:

Instrument Repaid/Retired	Face Amount Repaid/Retired	Cash Paid	Loss [1]
Senior Notes	$7.5	$8.2	$0.9
Three months ended June 30, 2011	$7.5	$8.2	$0.9

[1] Including write-off of the discount and deferred financing costs related to the debt retired.

We may continue to dedicate a portion of excess cash flow towards opportunistic debt retirement. Any retirement of debt results in a non-cash write-off of a pro rata portion of the discount and deferred financing costs related to the debt retired. Additionally, our Senior Notes are currently priced at a premium to their face value. Accordingly, future retirement of debt will likely result in losses associated with the retirement of either Term Loans or Senior Notes.

Provision for Income Taxes

The effective tax rate was 38.2% for the three months ended June 30, 2012 compared to 81.1% for the three months ended June 30, 2011.The effective tax rate in the prior year was higher due to an increase in unrecognized tax benefits and certain adjustments related to state deferred taxes.

Comparison of the Six Months Ended June 30, 2012 and 2011

Results of Operations

Key components of changes in our financial results for the six months ended June 30, 2012 compared to the same period of 2011 are as follows:

- Revenue decreased $93.6 million, primarily due to the refranchising of Applebee's company-operated restaurants and a 0.9% decrease in IHOP domestic same-restaurant sales, partially offset by higher franchise royalty revenues resulting from the increase in Applebee’s and IHOP effective franchise units and a 1.0% increase in Applebee's domestic system-wide same-restaurant sales.

- Segment profit decreased $4.2 million, comprised as follows:

	Six Months Ended June 30,		Favorable (Unfavorable)
	2012	2011	Variance
	(In millions)		
Franchise operations	$156.9	$149.4	$7.5
Company restaurant operations	30.9	40.3	(9.4)
Rental operations	12.3	14.6	(2.3)
Financing operations	6.7	6.7	—
Total	$206.8	$211.0	$(4.2)

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The decline in segment profit was primarily due to the refranchising of Applebee’s company-operated restaurants and the write-off of $2.5 million of deferred rental revenue associated with franchisee-operated restaurants whose lease agreements were prematurely terminated, partially offset by an increase in effective Applebee’s and IHOP franchise restaurants and a 1.0% increase in Applebee's domestic system-wide same-restaurant sales.

- Impairment and closure charges decreased $26.0 million as costs of $26.8 million recorded in the first six months of 2011 related to the termination of our sublease of commercial space previously occupied by the Applebee's Restaurant Support Center in Lenexa, Kansas and the impairment of furniture, fixtures and leasehold improvements at that facility did not recur.

- Interest expense decreased $9.3 million due to our reduction of debt balances as well as the February 2011 amendment to our Credit Agreement dated as of October 8, 2010 (the "Credit Agreement"), which reduced the interest rate on term loan borrowings by 1.75%.

Franchise Operations

	Six Months Ended June 30,		Favorable (Unfavorable)	
	2012	2011	Variance	% Change [1]
	(In millions)			
Franchise Revenues				
Applebee’s	$93.8	$88.2	$5.6	6.4 %
IHOP	78.4	77.1	1.3	1.7 %
IHOP advertising	38.7	37.8	0.9	2.3 %
Total franchise revenues	210.9	203.1	7.8	3.8 %
Franchise Expenses				
Applebee’s	1.9	1.6	(0.3)	(21.9)%
IHOP	13.4	14.3	0.9	6.3 %
IHOP advertising	38.7	37.8	(0.9)	(2.3)%
Total franchise expenses	54.0	53.7	(0.3)	(0.6)%
Franchise Segment Profit				
Applebee’s	91.8	86.6	5.3	6.1 %
IHOP	65.1	62.8	2.2	3.5 %
Total franchise segment profit	$156.9	$149.4	$7.5	5.0 %
Segment profit as % of revenue [1]	74.4 %	73.6 %		

[1] Percentages calculated on actual amounts, not rounded amounts presented above

The $5.6 million increase in Applebee’s franchise revenue was primarily attributable to increased royalty revenue resulting from the refranchising of 149 Applebee’s company-operated restaurants in the last eighteen months and a 0.8% increase in domestic same-restaurant sales. The $1.3 million increase in IHOP franchise revenue (other than advertising) was primarily attributable to a 3.1% increase in effective franchise restaurants partially offset by a decrease of (0.8)% in IHOP domestic franchise same-restaurant sales. The $0.9 million decrease in IHOP franchise expenses was due to lower bad debt expense.

IHOP’s franchise expenses are substantially larger than Applebee’s due to advertising expenses. Franchise fees designated for IHOP’s national advertising fund and local marketing and advertising cooperatives are recognized as revenue and expense of franchise operations; however, Applebee’s national advertising fund activity constitutes an

agency transaction and therefore is not recognized as franchise revenue and expense. The increase in IHOP advertising revenue and expense is primarily due to the increase in effective franchise restaurants partially offset by the decrease in domestic franchise same-restaurant sales.

The increase in franchise segment profit is primarily attributable to an increase in effective franchise restaurants due to the refranchising of Applebee’s company-operated restaurants and IHOP franchise development and an increase in Applebee's domestic franchise same-restaurant sales.

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Company Restaurant Operations

	Six Months Ended June 30,		Favorable (Unfavorable)	
	2012	2011	Variance	% Change [1]
	(In millions)			
Company restaurant sales	$194.7	$289.3	$(94.6)	(32.7)%
Company restaurant expenses	163.8	249.0	85.2	34.2 %
Company restaurant segment profit	$30.9	$40.3	$(9.4)	(18.0)%
Segment profit as % of revenue [1]	15.9 %	13.9 %		

[1] Percentages calculated on actual amounts, not rounded amounts presented above

As of June 30, 2012, company restaurant operations were comprised of 160 Applebee's company-operated restaurants and 17 IHOP company-operated restaurants. The impact of the IHOP company-operated restaurants on all comparisons of the six months ended June 30, 2012 with the same period of 2011 was negligible.

Consolidated company restaurant sales decreased $94.6 million. Applebee's company restaurant sales decreased $96.1 million, primarily due to the refranchising of 149 company-operated restaurants in the last 18 months (65 in the first quarter 2011, one in the third quarter 2011, 66 in the fourth quarter 2011 and 17 in the first quarter 2012), partially offset by an increase in company same-restaurant sales of 3.5%.The change in same-restaurant sales was driven by an increase in average guest check due to an increase of approximately 2.2% in pricing and favorable product mix changes and an increase in customer ticket counts.

Consolidated company restaurant expenses decreased $85.2 million. Applebee's company restaurant expenses decreased $87.6 million, of which $88.7 million was due to the refranchising of the 149 Applebee's company-operated restaurants noted above, partially offset by increased food and beverage expense. The restaurant operating profit for Applebee's company restaurant operations increased to 17.3% for the first quarter of 2012 compared to 14.5% for the same period of last year, as shown below:

			Favorable (Unfavorable)		
	Six Months Ended			Components of Total Variance	
Applebee's Company-Operated Expenses	June 30,		Total	Refranchising	Current
As Percentage of Restaurant Sales	2012	2011	Variance	and Closures	Restaurants
Revenue	100.0 %	100.0 %			
Food and beverage	26.0 %	25.5 %	(0.5)%	0.0 %	(0.5)%
Labor	32.2 %	33.0 %	0.8 %	0.2 %	0.6 %
Direct and occupancy	24.5 %	27.0 %	2.5 %	0.6 %	1.9 %
Restaurant Operating Profit Margin [1]	17.3 %	14.5 %	2.8 %	0.8 %	2.0 %

[1] Percentages may not add due to rounding

The restaurant refranchising discussed above had a net favorable impact of 0.8% on margins, primarily because the markets sold had higher-than-average labor costs along with favorability due to cessation of depreciation on restaurants held for sale. Other margin changes in specific cost categories were as follows:

- Food and beverage costs as a percentage of company restaurant sales increased 0.5% due to higher commodity costs impacting most products, partially offset by a reduction in waste.

- Labor costs as a percentage of restaurant sales decreased by 0.6% due to improved productivity in hourly labor partially offset by increased bonus expense and management staffing.

- Direct and occupancy costs as a percent of restaurant sales decreased 1.9% primarily due to lower depreciation expense resulting from a block of assets that became fully depreciated in 2011, favorable general liability insurance costs and favorable gift card discounts, partially offset by incremental investment in local media advertising.

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Rental Operations

	Six Months Ended June 30,		Favorable (Unfavorable)	
	2012	2011	Variance	% Change [1]
	(In millions)			
Rental revenues	$61.2	$63.8	$(2.6)	(4.2)%
Rental expenses	48.9	49.2	0.3	0.8 %
Rental operations segment profit	$12.3	$14.6	$(2.3)	(15.6)%
Segment profit as % of revenue	20.2 %	22.9 %		

[1] Percentages calculated on actual amounts, not rounded amounts presented above

Rental operations relate primarily to IHOP franchise restaurants. Rental revenues include income from operating leases and interest income from direct financing leases. Rental expenses consist of costs of prime operating leases and interest expense on prime capital leases on franchisee-operated restaurants.

The decrease in rental revenue and rental segment profit is primarily due to the write-off of $2.5 million of deferred lease rental revenue associated with franchise restaurants whose lease agreements were prematurely terminated.

Financing Operations

	Six Months Ended June 30,		Favorable (Unfavorable)	
	2012	2011	Variance	% Change [1]
	(In millions)			
Financing revenues	$8.3	$12.3	$(4.0)	(32.8)%
Financing expenses	1.6	5.6	4.0	71.8 %
Financing operations segment profit	$6.7	$6.7	$—	(0.2)%
Segment profit as % of revenue	80.9 %	54.5 %		

[1] Percentages calculated on actual amounts, not rounded amounts presented above

All of our financing operations relate to IHOP franchise restaurants. The variance in both revenue and expense is primarily related to a 2011 transaction in which 40 restaurants operated by a former franchisee that defaulted on its obligations under the franchise agreement were refranchised to an affiliate of an existing IHOP franchisee. Certain equipment related to the refranchised restaurants was sold to the new operator. Financing revenues and expenses in the six months ended June 30, 2011 included $5.0 million and $5.2 million, respectively, related to that single equipment sale. Financing revenues and expenses in the six months ended June 30, 2012 included $1.6 million related to several individually insignificant equipment and franchise sales.

Other Expense and Income Components

	Six Months Ended June 30,		Favorable (Unfavorable)	
	2012	2011	Variance	% Change [1]
	(In millions)			
General and administrative expenses	$76.9	$76.4	$(0.5)	(0.6)%
Interest expense	59.9	69.2	9.3	13.4 %
Impairment and closure charges	0.8	26.8	26.0	96.8 %
Amortization of intangible assets	6.2	6.2	—	0.0 %

Gain on disposition of assets	(16.0	)	(22.5	)	(6.5	)	(28.8)%
Loss on extinguishment of debt	2.6		7.9		5.3		66.9 %
Debt modification expenses	—		4.1		4.1		100.0 %
Income tax provision	28.2		13.0		(15.2	)	(117.4)%

(1) Percentages calculated on actual amounts, not rounded amounts presented above

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General and Administrative Expenses

General and administrative expenses increased by $0.5 million compared to the same period of the prior year, primarily due to higher personnel costs (including stock-based compensation, severance, and bonuses), partially offset by payroll credits related to the relocation of the Applebee's Restaurant Support Center and lower salaries and wages because of lower headcount due to refranchising.

Interest Expense

Interest expense decreased by $9.3 million compared to the same period of the prior year due to our reduction of debt balances. Average interest-bearing debt outstanding (our Term Loans, Senior Notes, capital lease obligations and financing obligations) during the six months ended June 30, 2012 was approximately $260 million lower than the same period of the prior year, which resulted in a decrease in interest expense of approximately $9.0 million. The additional decrease in interest expense resulted from an amendment to our Credit Agreement that reduced the interest rate on term loan borrowings by 1.75% (see Debt Modification Expenses below).

Impairment and Closure Charges

Impairment and closure charges decreased by $26.0 million compared to the same period of the prior year. The charges for the first six months of 2012 related to a parcel of land previously intended for future restaurant development and several individually insignificant franchise restaurant closures. Impairment and closure charges for the first six months of 2011 were primarily comprised of $21.3 million related to the termination of our sublease of the commercial space previously occupied by the Applebee's Restaurant Support Center in Lenexa, Kansas and a $4.5 million impairment charge related to the furniture, fixtures and leasehold improvements at that facility.

During the quarter ended June 30, 2012, we performed our quarterly assessment of whether events or changes in circumstances have occurred that potentially indicate the carrying value of tangible long-lived assets may not be recoverable. No significant impairments were noted. We also considered whether there were any indicators of potential impairment to our goodwill and indefinite-lived intangible assets that primarily consist of our trade name. No such indicators were noted.

Gain on Disposition of Assets

We recognized a gain on disposition of assets of $16.0 million for the six months ended June 30, 2012 compared to a gain of $22.5 million in the same period of 2011. The gain in 2012 was primarily due to the refranchising and sale of related restaurant assets of 17 Applebee's company-operated restaurants located in a six-state market area geographically centered around Memphis, Tennessee. The majority of the gain in 2011 was due to the refranchising and sale of related restaurant assets of 36 Applebee's company-operated restaurants in the St. Louis area market and 29 Applebee's company-operated restaurants in the Washington, D.C. area market.

Loss on Extinguishment of Debt

During the six months ended June 30, 2012 and June 30, 2011, the Company recognized the following losses on the extinguishment of debt:

Instrument Repaid/Retired	Face Amount Repaid/Retired	Cash Paid	Loss [1]
	(In millions)		
Term Loans	$70.5	$70.5	$1.9

Senior Notes	5.0	5.5	0.7
Six months ended June 30, 2012	75.5	76.0	2.6
Term Loans	$110.0	$110.0	$2.7
Senior Notes	39.8	43.5	5.2
Six months ended June 30, 2011	$149.8	$153.5	$7.9

(1) Including write-off of the discount and deferred financing costs related to the debt retired.

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We may continue to dedicate a portion of excess cash flow towards opportunistic debt retirement. Any retirement of debt results in a loss due to the non-cash write-off of a pro rata portion of the discount and deferred financing costs related to the debt retired. Additionally, our Senior Notes are currently priced at a premium to their face value. Should that remain the case, future retirement of Senior Notes will also result in losses associated with any premium paid.

Debt Modification Expenses

On February 25, 2011, the Company entered into Amendment No. 1 (the "Amendment") to the Credit Agreement under which a senior secured credit facility was established among the Company, lenders and the agents named therein. Costs paid to third parties of $4.1 million in connection with the Amendment were expensed in accordance with U.S. GAAP guidance for debt modifications.

Provision for Income Taxes

The effective tax rate was 36.9% for the six months ended June 30, 2012 compared to 30.1% for the six months ended June 30, 2011.The effective tax rate in the prior year was lower due to the release of liabilities for unrecognized tax benefits related to gift card income deferral as a result of the issuance of guidance by the U.S. Internal Revenue Service.

Liquidity and Capital Resources

Credit Facilities

We have a $75.0 million Revolving Credit Facility (the "Revolving Facility") under our Credit Agreement. During the first six months of 2012, we borrowed and repaid a cumulative total of $35.0 million under the Revolving Facility. The highest balance outstanding under the Revolving Facility at any point during the first six months of 2012 was $25.0 million and there were no amounts outstanding under the Revolving Facility as of June 30, 2012. Our available borrowing capacity under the Revolving Facility is reduced by outstanding letters of credit, which totaled $13.8 million as of June 30, 2012.

Based on our current level of operations, we believe that our cash flow from operations, available cash on hand and available borrowing capacity under our Revolving Facility will be adequate to meet our investing and financing cash outflows over the next twelve months.

Debt Covenants

Pursuant to our Credit Agreement, we are required to comply with a maximum consolidated leverage ratio and a minimum consolidated cash interest coverage ratio. Our current required maximum consolidated leverage ratio of total debt (net of unrestricted cash not to exceed $75 million) to adjusted EBITDA is 7.25x. Our current required minimum ratio of adjusted EBITDA to consolidated cash interest is 1.5x. Compliance with each of these ratios is required quarterly, on a trailing four-quarter basis. The ratio thresholds become more rigorous over time. The maximum consolidated leverage ratio, which began at 7.5x, declines in annual 25-basis-point decrements beginning with the first quarter of 2012 to 6.5x by the first quarter of 2015, then to 6.0x for the first quarter of 2016 until the Credit Agreement expires in October 2017. The minimum consolidated cash interest coverage ratio began at 1.5x and will increase to 1.75x beginning with the first quarter of 2013 and to 2.0x beginning with the first quarter of 2016 and remain at that level until the Credit Agreement expires in October 2017. These thresholds are subject to step-downs or step-ups, as applicable, over time. There are no financial maintenance covenants associated with our Senior Notes due October 2018 (the "Senior Notes").

For the trailing four quarters ended June 30, 2012, our consolidated leverage ratio was 5.3x and our consolidated cash interest coverage ratio was 2.4x (see Exhibit 12.1).

The EBITDA used in calculating these ratios is considered to be a non-U.S. GAAP measure. The reconciliation between our loss before income taxes, as determined in accordance with U.S. GAAP, and EBITDA used for covenant compliance purposes is as follows:

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Trailing Twelve Months Ended June 30, 2012

	(In thousands)
U.S. GAAP income before income taxes	$138,460
Interest charges	141,386
Loss on retirement of debt	5,885
Depreciation and amortization	44,837
Non-cash stock-based compensation	11,002
Impairment and closure charges	3,110
Other	4,833
Gain on sale of assets	(36,783)
EBITDA	$312,730

We believe this non-U.S. GAAP measure is useful in evaluating our results of operations in reference to compliance with the debt covenants discussed above. This non-U.S. GAAP measure is not defined in the same manner by all companies and may not be comparable to other similarly titled measures of other companies. Non-U.S. GAAP measures should be considered in addition to, and not as a substitute for, the U.S. GAAP information contained within our financial statements.

The Senior Notes, our term loans under the Credit Agreement (the "Term Loans") and the Revolving Facility are also subject to affirmative and negative covenants considered customary for similar types of facilities, including, but not limited to, covenants with respect to incremental indebtedness, liens, restricted payments (including dividends), investments, affiliate transactions, and capital expenditures. These covenants are subject to a number of important limitations, qualifications and exceptions. Certain of these covenants will not be applicable to the Senior Notes during any time that the Senior Notes maintain investment grade ratings.

Refranchising of Applebee’s Company-Operated Restaurants

During the six months ended June 30, 2012, we completed the refranchising and sale of related assets of 17 Applebee’s company-operated restaurants located in a six-state market area geographically centered around Memphis, Tennessee. Proceeds from asset dispositions, primarily from the sale of restaurant assets associated with the 17 restaurants refranchised, totaled $21.5 million for the six months ended June 30, 2012, of which $16.0 million was used to retire debt.

As previously discussed under “Overview - Franchise Business Model,” since the completion of the Applebee’s acquisition, we have been pursuing a strategy to transition Applebee's from a system that was 74% franchised at the time of the acquisition to a 99% franchised Applebee's system, similar to IHOP’s 99% franchised system. We believe a highly franchised business model requires less capital investment, generates higher gross and operating profit margins (as a percentage of sales) and reduces the volatility of free cash flow performance over time, as compared to a model based on operating a significant number of company restaurants, while also providing cash proceeds from the sale of assets of Applebee’s company-operated restaurants that have been refranchised for the retirement of debt.

During the six months ended June 30, 2012, we completed the refranchising and sale of related restaurant assets of 17 Applebee's company-operated restaurants in a six-state market area geographically centered around Memphis, Tennessee. In April 2012, we entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 39 Applebee's company-operated restaurants located in Virginia. In May 2012, we entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 33 Applebee's company-operated restaurants located primarily in Missouri and Indiana. In July, 2012, we entered into an asset purchase agreement for the refranchising and sale of related restaurant assets of 65 Applebee's company-operated restaurants located in Michigan. All of these transactions are expected to close by the end of fiscal 2012. Upon

consummation of these transactions, we will have refranchised all Applebee's company-operated restaurants, except for 23 restaurants in the Kansas City area that will be retained as a Company market; upon consummation of these transactions, 99% of DineEquity's restaurants will be franchised.

Under the terms of the Credit Agreement, all of the after-tax proceeds (with certain exceptions) of future asset dispositions must be used to repay Term Loans and under certain conditions, we may be required to repurchase Senior Notes with excess proceeds of assets sales, as defined in the Indenture under which the Senior Notes were issued. We estimate the three transactions discussed above will generate after-tax proceeds of approximately $105 million that will be used to retire debt. Retirement of debt will result in the reduction of interest expense. Refranchising of additional Applebee’s company-operated restaurants also will result in a reduction of general and administrative expenses and reduced requirements for capital investment.

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Cash Flows

In summary, our cash flows were as follows:

	Six Months Ended June 30,		
	2012	2011	Variance
	(In millions)		
Net cash provided by operating activities	$36.4	$48.2	$(11.8)
Net cash provided by investing activities	16.6	48.5	(31.9)
Net cash used in financing activities	(81.3)	(164.5)	83.2
Net decrease in cash and cash equivalents	$(28.3)	$(67.8)	$39.5

Operating Activities

Cash provided by operating activities decreased $11.8 million to $36.4 million for the six months ended June 30, 2012 from $48.2 million for the six months ended June 30, 2011. The main reasons for the decrease in cash from operations is a decline in segment profit resulting from the refranchising of 149 Applebee’s company-operated restaurants during the last 18 months, and an increase in income taxes paid in cash, partially offset by a decrease in cash payments for interest. Our net income tax payments increased during the first six months of 2012 compared with the comparable prior year period primarily because we had received a tax refund of approximately $20 million in January 2011. Our interest payments are lower because of lower debt balances. Net changes in working capital used cash of $16.4 million in the first six months of 2012 compared to a use of $26.1 million in the first six months of 2011, a favorable change of $9.6 million.

Investing Activities

Net cash provided by investing activities of $16.6 million for the six months ended June 30, 2012 was primarily attributable to $21.5 million in proceeds from sales of property and equipment and $6.6 million in principal receipts from notes, equipment contracts and other long-term receivables, partially offset by $10.7 million in capital expenditures. Capital expenditures are expected to range between approximately $18 million and $20 million in fiscal 2012.

Financing Activities

Financing activities used net cash of $81.3 million for the six months ended June 30, 2012. Cash used in financing activities primarily consisted of $76.0 million in repayments of long-term debt and repayments of capital lease and financing obligations of $6.1 million. Of the long-term debt repayments, $70.5 million related to the repayment of Term Loans and $5.5 million related to the repurchase of $5.0 million face amount of Senior Notes at a $0.5 million premium to face value. Cash provided by financing activities primarily consisted of $3.1 million in proceeds from the exercise of stock options. We may continue to dedicate a portion of cash flow to opportunistic debt retirement and purchases of treasury stock.

Free Cash Flow

We define "free cash flow" for a given period as cash provided by operating activities, plus receipts from notes, equipment contracts and other long-term receivables (collectively, "long-term receivables"), less additions to property and equipment. We believe this information is helpful to investors to determine our cash available for general corporate and strategic purposes, including the retirement of long-term debt.

Free cash flow is considered to be a non-U.S. GAAP measure. Reconciliation of the cash provided by operating activities to free cash flow is as follows:

	Six Months Ended June 30,		
	2012	2011	Variance
	(In millions)		
Cash flows provided by operating activities	$36.4	$48.2	$(11.8)
Principal receipts from long-term receivables	6.6	7.1	(0.5)
Additions to property and equipment	(10.7)	(13.5)	2.8
Free cash flow	$32.3	$41.8	$(9.5)

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This non-U.S. GAAP measure is not defined in the same manner by all companies and may not be comparable to other similarly titled measures of other companies. Non-U.S. GAAP measures should be considered in addition to, and not as a substitute for, the U.S. GAAP information contained within our financial statements.

Dividends

Dividends representing the change in accreted value of our Series B Convertible Preferred Stock were $1.3 million for the six months ended June 30, 2012.

Off-Balance Sheet Arrangements

As of June 30, 2012, we had no off-balance sheet arrangements, as defined in Item 303(a)(4) of SEC Regulation S-K.

Contractual Obligations and Commitments

There were no material changes to the contractual obligations table as disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011, other than the repayments of long-term debt noted under "Financing Activities" above.

Critical Accounting Policies and Estimates

The preparation of financial statements in accordance with U.S. GAAP requires we make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net revenues and expenses in the reporting period. We base our estimates and assumptions on current facts, historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the accrual of costs and expenses that are not readily apparent from other sources. We continually review the estimates and underlying assumptions to ensure they are appropriate for the circumstances. Accounting assumptions and estimates are inherently uncertain and actual results may differ materially from our estimates.

A summary of our critical accounting estimates is included in Management’s Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2011. During the first six months of 2012, there were no significant changes in our estimates and critical accounting policies.

See Note 3, “Accounting Policies,” in the Notes to Consolidated Condensed Financial Statements for a discussion of recently adopted accounting standards and newly issued accounting standards.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

There were no material changes from the information contained in the Company’s Annual Report on Form 10-K as of December 31, 2011.

Item 4. Controls and Procedures.

Disclosure Controls and Procedures.

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting.

There have been no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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Part II. OTHER INFORMATION

Item 1. Legal Proceedings.

We are subject to various lawsuits, administrative proceedings, audits, and claims arising in the ordinary course of business. Some of these lawsuits purport to be class actions and/or seek substantial damages. We are required to record an accrual for litigation loss contingencies that are both probable and reasonably estimable. Legal fees and expenses associated with the defense of all of our litigation are expensed as such fees and expenses are incurred. Management regularly assesses our insurance deductibles, analyzes litigation information with our attorneys and evaluates our loss experience in connection with pending legal proceedings. While we do not presently believe that any of the legal proceedings to which we are currently a party will ultimately have a material adverse impact upon us, there can be no assurance that we will prevail in all the proceedings we are party to, or that we will not incur material losses from them.

Gerald Fast v. Applebee’s

We are currently defending a collective action in United States District Court for the Western District of Missouri, Central Division filed on July 14, 2006 under the Fair Labor Standards Act, Gerald Fast v. Applebee's International, Inc., in which named plaintiffs claim that tipped servers and bartenders in Applebee's company-operated restaurants spend more than 20% of their time performing general preparation and maintenance duties, or “non-tipped work,” for which they should be compensated at the minimum wage. On June 19, 2007, the court granted conditional certification of a nationwide class of servers and bartenders who had worked in Applebee's company-operated restaurants since June 19, 2004. As of February 2008, there were 5,540 potential class members who had opted into the collective action. Under this action, plaintiffs currently are seeking unpaid wages and other relief of up to $17 million plus plaintiffs' attorneys' fees and expenses. The bench trial is currently scheduled to begin on September 10, 2012.

We believe we have meritorious defenses and intend to vigorously defend this case. Due to the inherent uncertainty in litigation, however, there can be no guarantee that we ultimately will be successful. Substantial losses from or costs related to this legal proceeding could have a material impact on us.

Item 1A. Risk Factors.

There were no material changes from the risk factors set forth under Item 1A of Part I of the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2011.

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

Purchases of Equity Securities by the Company

Period	Total number of shares purchased	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs (b)	Approximate dollar value of shares that may yet be purchased under the plans or programs (b)

April 2 – April 29, 2012 (a)	1,068	$46.87	—	$23,830,346
April 30 – May 27, 2012	—	$—	—	$23,830,346
May 28 – July 1, 2012 (a)	9,903	$44.01	—	$23,830,346
Total	10,971	$44.29	—	$23,830,346

(a) These amounts represent shares owned and tendered by employees to satisfy tax withholding obligations on the vesting of restricted stock awards.

(b) On August 15, 2011 we announced that our Board of Directors authorized the repurchase of up to $45.0 million of DineEquity common stock. Repurchases are subject to prevailing market prices and may take place in open market transactions and in privately negotiated transactions, based on business, market, applicable legal requirements and other considerations. The program does not require the repurchase of a specific number of shares and may be terminated at any time.

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Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not Applicable.

Item 5. Other Information.

None.

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Item 6. Exhibits.

3.1	Restated Certificate of Incorporation of DineEquity, Inc. (Exhibit 3.1 to DineEquity, Inc.'s Report on Form 8-K filed June 2, 2008 is incorporated herein by reference).
3.2	Amended Bylaws of DineEquity, Inc. (Exhibit 3.2 to DineEquity, Inc.'s Report on Form 8-K filed June 2, 2008 is incorporated herein by reference).
10.1	Asset Purchase Agreement dated as of July 20, 2012 by and among Restaurants Mid-Atlantic, LLC, Applebee's Restaurants, Inc., and TSFR Apple Venture LLC.* (Schedules and exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The registrant hereby undertakes to furnish copies of any of the omitted schedules and exhibits upon request by the U.S. Securities and Exchange Commission.)
12.1	Computation of Consolidated Leverage Ratio and Cash Interest Coverage Ratio for the trailing twelve months ended June 30, 2012.*
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.*
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
101.INS	XBRL Instance Document.***
101.SCH	XBRL Schema Document.***
101.CAL	XBRL Calculation Linkbase Document.***
101.DEF	XBRL Definition Linkbase Document.***
101.LAB	XBRL Label Linkbase Document.***
101.PRE	XBRL Presentation Linkbase Document.***

* Filed herewith.

** The certifications attached as Exhibits 32.1 and 32.2 accompany this Quarterly Report pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 and shall not, except to the extent required by the Sarbanes-Oxley Act of 2002, be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

*** Pursuant to Rule 406T of Regulation S-T, the interactive data files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

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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.

DineEquity, Inc.
(Registrant)

July 31, 2012	BY:	/s/ Julia A. Stewart
		Julia A. Stewart
(Date)		Chairman and Chief Executive Officer
		(Principal Executive Officer)
July 31, 2012		/s/ Thomas W. Emrey
		Thomas W. Emrey
(Date)		Chief Financial Officer
		(Principal Financial Officer)
July 31, 2012		/s/ Greggory Kalvin
		Greggory Kalvin
(Date)		Senior Vice President, Corporate Controller
		(Principal Accounting Officer)