

FRANKLIN TEMPLETON LTD DURATION INCOME TRUST

Form N-CSR/A

August 07, 2013

Dear Shareholder:

We are pleased to bring you Franklin Templeton Limited Duration Income Trust's annual report for the fiscal year ended March 31, 2013.

Performance Overview

For the 12 months under review, Franklin Templeton Limited Duration Income Trust delivered cumulative total returns of +11.04% based on net asset value and +13.41% based on market price. Net asset value increased from \$13.82 per share on March 31, 2012, to \$14.30 at period-end, and the market price increased from \$14.01 to \$14.82 over the same period. You can find the Fund's long-term performance data in the Performance Summary on page 7.

Economic and Market Overview

During the 12 months under review, U.S. economic data remained mixed. The nation's gross domestic product (GDP) growth rate varied each quarter but

The dollar value, number of shares or principal amount, and names of all portfolio holdings are listed in the Fund's Statement of Investments (SOI). The SOI begins on page 20.

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overall expanded modestly. Large declines in federal and local government spending, business disruptions caused by Hurricane Sandy and the continuing effects of the Midwest drought on farm production initially offset the benefit of solid consumer spending. However, generally positive construction, housing, manufacturing, energy pricing and labor market trends seemed to suggest the U.S. economic recovery remained largely intact. Consumer sentiment rose to a five-year high, although potential U.S. tax hikes and spending cuts scheduled to take effect in 2013 contributed to fluctuations in consumer and business confidence.

In September, the Federal Reserve Board (Fed) acknowledged the need for further policy accommodation and announced a third round of quantitative easing (QE3). QE3 consists of additional \$40 billion monthly purchases of mortgage-backed securities until the labor market improves. The Fed also continued buying long-term Treasuries and selling short-term Treasuries in an effort to put downward pressure on long-term interest rates. In December, the Fed announced a 6.5% unemployment target as a guide to maintaining the historically low federal funds target rate. Although inflation rose slightly during the reporting period, the Fed noted little evidence of wage pressures. Economists, business leaders and market watchers were concerned about the U.S. fiscal cliff, which meant that unless Congress acted, automatic income tax increases and federal budget cuts would take effect in 2013. They feared these events could cause another U.S. recession. Lawmakers reached a late compromise on January 1, 2013, that maintained some tax cuts for most Americans but increased rates on the wealthiest. Congress, however, was unable to resolve differences related to a series of automatic federal spending cuts known as the sequester. The cuts will reduce funding for domestic and defense programs by \$85 billion in the current U.S. fiscal year.

Ongoing investor concerns about the fiscal cliff, eurozone uncertainty and mixed economic data lowered the 10-year U.S. Treasury note yield to 1.87% at year-end from 2.23% on March 31, 2012. During the 12 months under review, investors sought higher bond returns and were willing to assume some risk. Below-investment-grade corporate bonds, as measured by the Credit Suisse (CS) High Yield Index, delivered strong results and outperformed investment-grade fixed income markets, as measured by the Barclays U.S. Aggregate Index.

Investment Strategy

We invest in a diversified mix of fixed income securities, primarily high yield corporate bonds, senior secured floating rate corporate loans, and mortgage- and other asset-backed securities. Our top-down analysis of macroeconomic

trends combined with a bottom-up fundamental analysis of market sectors, industries and issuers drives our investment process. We seek to maintain a limited duration, or interest rate sensitivity, to moderate the impact that fluctuating interest rates might have on the Fund's fixed income portfolio. Within the corporate bond and corporate loan sectors, we seek securities trading at reasonable valuations from issuers with characteristics such as strong market positions, stable cash flows, reasonable capital structures, supportive asset values, strong sponsorship and improving credit fundamentals. In the mortgage- and other asset-backed securities sector, we look to capture an attractive income stream and total return through our analysis of security prepayment assumptions, potential pricing inefficiencies and underlying collateral characteristics.

Manager's Discussion

Performance of the Fund's primary asset classes was positive during the fiscal year under review. The U.S. economy continued to grow at a modest but uneven rate. Europe caused a period of risk aversion during the spring of 2012, but markets recovered after European Central Bank President Mario Draghi made it clear that he would do whatever it took to preserve the euro. Uncertainty regarding future fiscal policy and tax rates caused markets to fall again following the U.S. presidential election. Fears surrounding the fiscal cliff were ultimately overcome by mounting evidence of a housing market recovery and hopes that the overall economy would be buoyed by housing sector strength. Given the Fed's reiterated commitment to an accommodative monetary policy, including a prolonged period of ultra-low interest rates, investors continued to seek ways to enhance the yield of their investment portfolios. As a result, high yield bonds and term loans experienced healthy investment inflows.

Overall, despite being another somewhat volatile year in the markets, financial investments generally posted positive returns. The broad U.S. stock market, as measured by the Standard & Poor's[®] 500 Index returned +13.96%.¹ During the Fund's fiscal year, 10-year Treasury yields fell from 2.23% to 1.87%. In this environment, high yield corporate bonds returned +12.43%, followed by +8.27% for leveraged loans and +1.97% for mortgage-backed securities, as measured by the CS High Yield, CS Leveraged Loan and Barclays U.S.

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Mortgage-Backed Securities Indexes, respectively.¹ Over the course of the year, we increased our exposure to leveraged loans and mortgage-backed securities while reducing our exposure to high yield corporate bonds.

High Yield Corporate Bonds

High yield bonds generated a total return of +12.43% for the year, driven by a combination of solid credit fundamentals and robust flows into the asset class.¹ The modest decline in Treasury yields provided a slight boost to returns, but a bigger impact came from the spread over Treasuries tightening from 6.2 to 5.1 percentage points during the year. The spread tightening was supported by a continued low default rate, as only 1.7% of high yield bonds defaulted in 2012, the third consecutive year with defaults below 2%.² The default rate remained below 2% through the first three months of 2013.² In general, the moderate pace of economic growth supported credit profiles, while high yield market strength enabled companies to refinance debt at lower borrowing costs and extend maturities. Given below-average valuations and a record-high average dollar price for high yield bonds, we reduced our initially overweighted position in high yield corporate bonds to end the year at a more neutral position. We remained positive toward the high yield asset class, particularly given expectations for a continued below-average default rate.

Floating Rate Corporate Loans

For the one-year period, the corporate loan asset class returned +8.27%.¹ Lower credit quality corporate loans rated CCC or distressed outperformed higher quality corporate loans rated split BB or higher as steady inflows and new collateralized loan obligations (CLOs) helped drive demand.³ The average loan price increased to 100.0 cents on the dollar on March 31, 2013, from 98.6 cents on March 31, 2012, and the discounted spread to maturity was LIBOR +429 basis points (100 basis points equal one percentage point).⁴

During the reporting period the loan market remained strong, supported by technical factors. CLO issuance accelerated throughout the period, reaching a

2. Source: Copyright © 2013 CREDIT SUISSE GROUP AG and/or its affiliates. All Rights Reserved.

3. Split BB means for credit rating agencies Standard & Poor's and Moody's Investors Service, a BB or equivalent rating by one agency and a B rating by the other.

4. Source: Standard & Poor's Leveraged Commentary & Data.

post-credit crisis high at the end of the period. Inflows into loan mutual funds also increased during the period, as corporate fundamentals remained supportive and investors looked to the relative attractiveness of loans as well as potential interest rate protection offered by the loan asset class. As a result of increased investor demand that outpaced primary market supply, investors sought opportunities in the secondary market, causing loan prices to rise, which led to a larger volume of repricing transactions and lower overall credit spreads. Although refinancing dominated the market, many opportunistic transactions took place to fund dividends to equity sponsors. In addition, mergers and acquisitions activity and leveraged buyouts moderately increased. Overall loan default rates remained below the historical average as the loan default rate increased to 2.21% by principal amount at the end of the period.⁴

Mortgage-Backed and Asset-Backed Securities

During the period, high-quality agency mortgage-backed securities (MBS) and asset-backed securities (ABS) generally underperformed Treasuries with similar duration. As Treasuries rallied, mortgages and spread products could not keep pace. MBS sector valuations were generally fairly valued, in our analysis, and the Fed remained the largest source of demand and provided support for the sector. Expectations were for prepayments to remain around their recent levels with the potential for gradual increases as homeowners sought to take advantage of extremely low mortgage rates. However, the factors such as tighter underwriting standards and originator processing capacity that kept prepayment rates from reaching the elevated levels of past prepayment cycles remained in place.

We shifted our MBS allocation to lower coupons during the period. Our heaviest exposure was in 3.0% and 5.0% coupons, as we decreased exposure to 4.0% and 4.5% coupons and increased allocation to 3.0% and 3.5% coupons, concentrating on specified pools. We continued to invest in bonds from higher quality securitized sectors as we found bonds we considered fundamentally sound at attractive yields in these markets. We maintained our allocations to higher quality ABS and collateralized mortgage-backed securities.

Thank you for your continued participation in Franklin Templeton Limited Duration Income Trust. We look forward to serving your future investment needs.

Sincerely,

CFA[®] is a trademark owned by CFA Institute.

The foregoing information reflects our analysis, opinions and portfolio holdings as of March 31, 2013, the end of the reporting period. The way we implement our main investment strategies and the resulting portfolio holdings may change depending on factors such as market and economic conditions. These opinions may not be relied upon as investment advice or an offer for a particular security. The information is not a complete analysis of every aspect of any market, country, industry, security or the Fund. Statements of fact are from sources considered reliable, but the investment manager makes no representation or warranty as to their completeness or accuracy. Although historical performance is no guarantee of future results, these insights may help you understand our investment management philosophy.

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Performance Summary as of 3/31/13

Your dividend income will vary depending on dividends or interest paid by securities in the Fund's portfolio, adjusted for operating expenses. Capital gain distributions are net profits realized from the sale of portfolio securities. Total return reflects reinvestment of the Fund's dividends and capital gain distributions, if any, and any unrealized gains or losses. Total returns do not reflect any sales charges paid at inception or brokerage commissions paid on secondary market purchases. The performance table does not reflect any taxes that a shareholder would pay on Fund dividends, capital gain distributions, if any, or any realized gains on the sale of Fund shares.

Performance data represent past performance, which does not guarantee future results. Investment return and principal value will fluctuate, and you may have a gain or loss when you sell your shares. Current performance may differ from figures shown.

Endnotes

All investments involve risks, including possible loss of principal. Interest rate movements and mortgage prepayments will affect the Fund's share price and yield. Bond prices generally move in the opposite direction of interest rates. As the prices of bonds in a fund adjust to a rise in interest rates, the Fund's share price may decline. Investments in lower rated bonds include higher risk of default and loss of principal. The Fund is actively managed but there is no guarantee that the manager's investment decisions will produce the desired results.

1. Figures are for common shares. As of 3/31/13, the Fund had leverage in the amount of 31.32% of the Fund's total assets. The Fund employs leverage through the issuance of Auction Preferred Shares and purchase of Mortgage Dollar Rolls. The use of financial leverage creates an opportunity for increased income but, at the same time, creates special risks (including the likelihood of greater volatility of net asset value and market price of common shares). The cost of leverage rises and falls with changes in short-term interest rates. Such increases/decreases in the cost of the Fund's leverage may be offset by increased/decreased income from the Fund's floating rate investments.
2. Total return calculations represent the cumulative and average annual changes in value of an investment over the periods indicated.
3. Assumes reinvestment of distributions at net asset value.
4. Assumes reinvestment of distributions based on the dividend reinvestment plan.

Important Notice to Shareholders

Effective June 1, 2013, Madeline Lam and Justin Ma, CFA, joined the Fund's portfolio management team, replacing Richard Hsu, CFA, who is no longer a Fund portfolio manager.

Collateralized Debt Obligations

The Fund may invest in any tranche (other than the equity tranche) of collateralized debt obligations.

Collateralized debt obligations and similarly structured securities, sometimes known generally as CDOs, are interests in a trust or other special purpose entity (SPE) and are typically backed by a diversified pool of bonds, loans or other debt obligations. CDOs are not limited to investments in one type of debt and, accordingly, a CDO may be collateralized by corporate bonds, commercial loans, asset-backed securities, residential mortgage-backed securities, real estate investment trusts (REITs), commercial mortgage-backed securities, emerging market debt, and municipal bonds. Certain CDOs may use derivatives contracts, such as credit default swaps, to create synthetic exposure to assets rather than holding such assets directly, which entails the risks of derivative instruments.

Common varieties of CDOs include the following:

Collateralized loan obligations. Collateralized loan obligations (CLOs) are interests in a trust typically collateralized substantially by a pool of loans, which may include, among others, domestic and foreign senior secured loans, senior unsecured loans, and subordinate corporate loans made to domestic and foreign borrowers, including loans that may be rated below investment grade or equivalent unrated loans.

Collateralized bond obligations. Collateralized bond obligations (CBOs) are interests in a trust typically backed substantially by a diversified pool of high risk, below investment grade fixed income securities.

Structured finance CDOs. Structured finance CDOs are interests in a trust typically backed substantially by structured investment products such as asset-backed securities and commercial mortgage-backed securities.

Synthetic CDOs. In contrast to CDOs that directly own the underlying debt obligations, referred to as cash CDOs, synthetic CDOs are typically collateralized substantially by derivatives contracts, such as credit default swaps, to create synthetic exposure to assets rather than holding such assets directly, which entails the risks of derivative instruments, principally counterparty risk.

CDOs are similar in structure to collateralized mortgage obligations. Unless the context indicates otherwise, the discussion of CDOs below also applies to CLOs, CBOs and other similarly structured securities.

In CDOs, the cash flows from the SPE are split into two or more portions, called tranches (or classes), that vary in risk and yield. The riskiest portion is the equity tranche, which bears the first loss from defaults on the bonds or loans in the SPE and is intended to protect the other, more senior tranches from severe, and potentially unforeseen, defaults or delinquent collateral payments (though such protection is not complete). Because they may be partially protected from defaults, senior tranches from a CDO typically have higher ratings and lower yields than the underlying collateral securities held by the trust, and may be rated investment grade. Despite protection from the equity tranche, more senior tranches can experience, and may have experienced in the past, substantial losses due to actual defaults, increased sensitivity to defaults due to collateral default, downgrades of the underlying collateral by rating agencies, forced liquidation of a collateral pool due to a failure of coverage tests, disappearance of protecting tranches, market anticipation of defaults, as well as a market aversion to CDO securities as a class.

The risks of an investment in a CDO depend largely on the type of collateral held by the SPE and the tranche of the CDO in which the Fund invests. Investment risk may also be affected by the performance of a CDO's collateral manager (the entity responsible for selecting and managing the pool of collateral securities held by the SPE trust), especially during a period of market volatility like that experienced in 2007-2008. Normally, CDOs are privately offered and sold, and thus, are not registered under the securities laws and traded in a public market. As a result, investments in CDOs may be characterized by the Fund as illiquid securities. However, an active dealer market may exist for CDOs allowing the Fund to trade CDOs with other qualified institutional investors under Rule 144A. To the extent such investments are characterized as illiquid, they will be subject to the Fund's restrictions on investments in illiquid securities. The Fund's investment in unregistered securities such as CDOs will not receive the same investor protection as an investment in registered securities.

All tranches of CDOs, including senior tranches with high credit ratings, can experience, and many have recently experienced, substantial losses due to actual defaults, increased sensitivity to future defaults due to the disappearance of protecting tranches, market anticipation of defaults, as well as market aversion to CDO securities as a class. Prices of CDO tranches have declined considerably. The drop in prices was initially triggered by the subprime mortgage crisis. Subprime mortgages make up a significant portion of the mortgage securities that collateralize many CDOs. As floating interest rates and mortgage default rates increased, the rating agencies that had rated the mortgage securities and CDO transactions backed by such mortgages realized their default assumptions were too low and began to downgrade the credit rating of these transactions. There can be no assurance that additional losses of equal or greater magnitude will not occur in the future.

In addition to the normal risks associated with debt securities and asset-backed securities (e.g., interest rate risk, credit risk and default risk), CDOs carry additional risks including, but not limited to: (i) the possibility that distributions from collateral securities will not be adequate to make interest or other payments; (ii) the quality of the collateral may decline in value or quality or go into default or be downgraded; (iii) the Fund may invest in tranches of a CDO that are subordinate to other classes; and (iv) the complex structure of the security may not be fully understood at the time of investment and may produce disputes with the issuer, difficulty in valuing the security or unexpected investment results.

Certain issuers of CDOs may be deemed to be investment companies as defined in the 1940 Act. As a result, the Fund's investment in these structured investments from these issuers may be limited by the restrictions contained in the 1940 Act. CDOs generally charge management fees and administrative expenses that the shareholders of the Fund would pay indirectly.

Swap Agreements

Generally, swap agreements are contracts between the Fund and, typically, a brokerage firm, bank or other institutional buyer (the swap counterparty) for periods ranging from a few days to multiple years. In a basic swap transaction, the Fund agrees with the swap counterparty to exchange the returns (or differentials in rates of return) and/or cash flows earned or realized on a particular notional amount or value of predetermined underlying reference instruments. The notional amount is the set dollar or other value selected by the parties to use as the basis on which to calculate the obligations that the parties to a swap agreement have agreed to exchange. The parties typically do not actually exchange the notional amount. Instead they agree to exchange the returns that would be earned or realized if the notional amount were invested in given investments or at given interest rates. Examples of returns that may be exchanged in a swap agreement are those of a particular security, a particular fixed or variable interest rate, a particular non-U.S. currency, or a basket of securities representing a particular index. The Fund customarily enters into swap agreements that are based on the standard terms and conditions of an International Swaps and Derivatives Association (ISDA) Master Agreement. ISDA is a voluntary industry association of participants in the over-the-counter (OTC) derivatives markets that has developed standardized contracts used by such participants that have agreed to be bound by such standardized contracts.

The Fund will generally enter into swap agreements on a net basis, which means that the two payment streams that are to be made by the Fund and its counter-party are netted out, with the Fund receiving or paying, as the case may be,

only the net difference in the two payments. The Fund's obligations (or rights) under a swap agreement that is entered into on a net basis will generally be the net amount to be paid or received under the agreement based on the relative values of the obligations of each party upon termination of the agreement or at set valuation dates. The Fund will accrue its obligations under a swap agreement daily (offset by any amounts the counterparty owes the Fund). If the swap agreement does not provide for that type of netting, the full amount of the Fund's obligations will be accrued on a daily basis.

During the term of a swap agreement, the Fund is usually required to pledge to the swap counterparty, from time to time, an amount of cash and/or other assets equal to the total net amount (if any) that would be payable by the Fund to the counterparty if the swap were terminated on the date in question, including any early termination payments. Periodically, changes in the amount pledged are made to recognize changes in value of the contract resulting from, among other things, interest on the notional value of the contract, market value changes in the underlying investment, and/or dividends paid by the issuer of the underlying instrument. Likewise, the counterparty may be required to pledge cash or other assets to cover its obligations to the Fund. However, the amount pledged may not always be equal to or more than the amount due to the other party. Therefore, if a counterparty defaults on its obligations to the Fund, the amount pledged by the counterparty and available to the Fund may not be sufficient to cover all the amounts due to the Fund and the Fund may sustain a loss.

Inflation Index Swaps. An inflation index swap is a contract between two parties, whereby one party makes payments based on the cumulative percentage increase in an index that serves as a measure of inflation (typically, the Consumer Price Index) and the other party makes a regular payment based on a compounded fixed rate. Each party's payment obligation is determined by reference to a specified notional amount of money. Typically, an inflation index swap has payment obligations netted and exchanged upon maturity. The value of an inflation index swap is expected to change in response to changes in the rate of inflation. If inflation increases at a faster rate than anticipated at the time the swap is entered into, the swap will increase in value. Similarly, if inflation increases at a rate slower than anticipated at the time the swap is entered into, the swap will decrease in value.

Risks of Swaps. The use of swap transactions is a highly specialized activity, which involves investment techniques and risks different from those associated with ordinary portfolio securities transactions. Whether the Fund will be successful in using swap agreements to achieve its investment goal depends on the ability of the investment manager correctly to predict which types of investments are likely to produce greater returns. If the investment manager, in using swap agreements, is incorrect in its forecasts of market values, interest

rates, inflation, currency exchange rates or other applicable factors, the investment performance of the Fund will be less than its performance would have been if it had not used the swap agreements.

The risk of loss to the Fund for swap transactions that are entered into on a net basis depends on which party is obligated to pay the net amount to the other party. If the counterparty is obligated to pay the net amount to the Fund, the risk of loss to the Fund is loss of the entire amount that the Fund is entitled to receive. If the Fund is obligated to pay the net amount, the Fund's risk of loss is limited to that net amount. If the swap agreement involves the exchange of the entire principal value of a security, the entire principal value of that security is subject to the risk that the other party to the swap will default on its contractual delivery obligations.

Because swap agreements are two-party contracts and may have terms of greater than seven days, they may be illiquid and, therefore, subject to the Fund's limitation on investments in illiquid securities. If a swap transaction is particularly large or if the relevant market is illiquid, the Fund may not be able to establish or liquidate a position at an advantageous time or price, which may result in significant losses. Participants in the swap markets are not required to make continuous markets in the swap contracts they trade. Participants could refuse to quote prices for swap contracts or quote prices with an unusually wide spread between the price at which they are prepared to buy and the price at which they are prepared to sell. However, the swap markets have grown substantially in recent years, with a large number of financial institutions acting both as principals and agents, utilizing standardized swap documentation. As a result, the swap markets have become increasingly liquid. Some swap agreements entail complex terms and may require a greater degree of subjectivity in their valuation.

Swap agreements currently are not automatically traded on exchanges and are not subject to government regulation. As a result, swap participants are not as protected as participants on organized exchanges. Performance of a swap agreement is the responsibility only of the swap counterparty and not of any exchange or clearinghouse. As a result, the Fund is subject to the risk that a counterparty will be unable or will refuse to perform under such agreement, including because of the counterparty's bankruptcy or insolvency. No limitations on daily price movements or speculative position limits apply to swap transactions. Counterparties may, however, limit the size or duration of a swap agreement with the Fund as a consequence of credit considerations. The Fund risks the loss of the accrued but unpaid amounts under a swap agreement, which could be substantial, in the event of a default, insolvency or bankruptcy by a swap counterparty. In such an event, the Fund will have contractual remedies pursuant to the swap agreements, but bankruptcy and insolvency laws

could affect the Fund's rights as a creditor. If the counterparty's creditworthiness declines, the value of a swap agreement would likely decline, potentially resulting in losses. The Fund's investment manager will only approve a swap agreement counterparty for the Fund if the investment manager deems the counterparty to be creditworthy under the Fund's Counterparty Credit Review Standards, adopted and reviewed annually by the Fund's board. However, in unusual or extreme market conditions, a counterparty's creditworthiness and ability to perform may deteriorate rapidly, and the availability of suitable replacement counterparties may become limited.

As a result of the recent turmoil in the financial markets, legislation has been enacted that will likely result in numerous proposals by various entities to regulate the OTC derivatives markets, including, specifically, most swaps. The Fund cannot predict the outcome or final form of any of these proposals or if or when any of them would become effective. However, any additional regulation or limitation on the OTC markets for derivatives could materially and adversely impact the ability of the Fund to buy or sell OTC derivatives, including certain swaps.

Certain Internal Revenue Service positions may limit the Fund's ability to use swap agreements in a desired tax strategy. It is possible that developments in the swap markets and/or the laws relating to swap agreements, including potential government regulation, could adversely affect the Fund's ability to benefit from using swap agreements, or could have adverse tax consequences.

Derivative Instruments

The performance of derivative instruments (including currency-related derivatives) depends largely on the performance of an underlying currency, security or index and such instruments often have risks similar to their underlying instrument in addition to other risks. Derivative instruments involve costs and can create economic leverage in the Fund's portfolio that may result in significant volatility and cause the Fund to participate in losses (as well as gains) in an amount that significantly exceeds the Fund's initial investment. Certain derivatives have the potential for unlimited loss, regardless of the size of the initial investment. Other risks include illiquidity, mispricing or improper valuation of the derivative instrument, and imperfect correlation between the value of the derivative and the underlying instrument so that the Fund may not realize the intended benefits. Their successful use will usually depend on the investment manager's ability to accurately forecast movements in the market relating to the underlying instrument. Should a market or markets, or prices of particular classes of investments, move in an unexpected manner, especially in unusual or extreme market conditions, the Fund may not achieve the anticipated benefits.

of the transaction, and it may realize losses, which could be significant. If the investment manager is not successful in using such derivative instruments, the Fund's performance may be worse than if the investment manager did not use such derivative instruments at all. To the extent that the Fund uses such instruments for hedging purposes, there is the risk of imperfect correlation between movements in the value of the derivative instrument and the value of the underlying investment or other asset being hedged. There is also the risk, especially under extreme market conditions, that an instrument, which usually would operate as a hedge, provides no hedging benefits at all.

Use of these instruments could also result in a loss if the counterparty to the transaction (with respect to swap agreements, forward currency contracts and other OTC derivatives) does not perform as promised, including because of such counterparty's bankruptcy or insolvency. This risk may be heightened during volatile market conditions. Other risks include the inability to close out a position because the trading market becomes illiquid (particularly in the OTC markets) or the availability of counterparties becomes limited for a period of time. In addition, the presence of speculators in a particular market could lead to price distortions. To the extent that the Fund is unable to close out a position because of market illiquidity, the Fund may not be able to prevent further losses of value in its derivatives holdings and the Fund's liquidity may be impaired to the extent that it has a substantial portion of its otherwise liquid assets marked as segregated to cover its obligations under such derivative instruments. The Fund may also be required to take or make delivery of an underlying instrument that the investment manager would otherwise have attempted to avoid. Some derivatives can be particularly sensitive to changes in interest rates or other market prices. Investors should bear in mind that, while the Fund intends to use derivative strategies on a regular basis, it is not obligated to actively engage in these transactions, generally or in any particular kind of derivative, if the investment manager elects not to do so due to availability, cost or other factors.

The use of derivative strategies may also have a tax impact on the Fund. The timing and character of income, gains or losses from these strategies could impair the ability of the investment manager to utilize derivatives when it wishes to do so.

Annual Shareholders Meeting

September 20, 2012

At an annual Meeting of Shareholders of the Fund held on September 20, 2012, shareholders approved the election of the following persons as Trustees of the Fund.

The results of the voting are as follows:

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Dividend Reinvestment Plan

The Fund's Dividend Reinvestment Plan (Plan) offers you a prompt and simple way to reinvest dividends and capital gain distributions (Distributions) in shares of the Fund. BNY Mellon Investment Servicing (US) Inc. (Agent), P.O. Box 43006, Providence, RI 02940-3006, will act as your Agent in administering the Plan. The Agent will open an account for you under the Plan in the same name as your outstanding shares are registered. The complete Terms and Conditions of the Dividend Reinvestment Plan are contained in the Fund's Dividend Reinvestment Plan Brochure. Participants may contact the Agent at the address above to obtain a copy of the Brochure.

You are automatically enrolled in the Plan unless you elect to receive Distributions in cash. If you own shares in your own name, you should notify the Agent, in writing, if you wish to receive Distributions in cash.

If the Fund declares a Distribution, you, as a participant in the Plan, will automatically receive an equivalent amount of shares of the Fund purchased on your behalf by the Agent.

If on the payment date for a Distribution, the net asset value per share is equal to or less than the market price per share plus estimated brokerage commissions, the Agent shall receive newly issued shares, including fractions, from the Fund for your account. The number of additional shares to be credited shall be determined by dividing the dollar amount of the Distribution by the greater of the net asset value per share on the payment date, or 95% of the then current market price per share.

If the net asset value per share exceeds the market price plus estimated brokerage commissions on the payment date for a Distribution, the Agent (or a broker-dealer selected by the Agent) shall try, for a purchase period of 30 days, to apply the amount of such Distribution on your shares (less your pro rata share of brokerage commissions incurred) to purchase shares on the open market. The weighted average price (including brokerage commissions) of all shares it purchases shall be your allocated price per share. If, before the Agent has completed its purchases, the market price plus estimated brokerage commissions exceeds the net asset value of the shares as of the payment date, the purchase price the Agent paid may exceed the net asset value of the shares, resulting in the acquisition of fewer shares than if such Distribution had been paid in shares issued by the Fund. Participants should note that they will not be able to instruct the Agent to purchase shares at a specific time or at a specific price. The Agent may make open-market purchases on any securities exchange where shares are traded, in the over-the-counter market or in negotiated transactions, and may be on such terms as to price, delivery and otherwise as the Agent shall determine.

The market price of shares on a particular date shall be the last sales price on NYSE Amex, or, if there is no sale on the exchange on that date, then the mean between the closing bid and asked quotations on the exchange on such date. The net asset value per share on a particular date shall be the amount most recently calculated by or on behalf of the Fund as required by law.

The Agent shall at all times act in good faith and agree to use its best efforts within reasonable limits to ensure the accuracy of all services performed under this agreement and to comply with applicable law, but assumes no responsibility and shall not be liable for loss or damage due to errors unless such error is caused by the Agent's negligence, bad faith, or willful misconduct or that of its employees. Your uninvested funds held by the Agent will not bear interest. The Agent shall have no responsibility for the value of shares acquired. For the purpose of cash investments, the Agent may commingle your funds with those of other participants in the same Fund.

There is no direct charge to participants for reinvesting Distributions, since the Agent's fees are paid by the Fund. However, when shares are purchased in the open market, each participant will pay a pro rata portion of any brokerage commissions incurred. If you elect by notice to the Agent to have it sell part or all of your shares and remit the proceeds, the Agent will deduct brokerage commissions from the proceeds.

The automatic reinvestment of Distributions does not relieve you of any taxes that may be payable on Distributions. In connection with the reinvestment of Distributions, shareholders generally will be treated as having received a Distribution equal to the cash Distribution that would have been paid.

The Agent will forward to you any proxy solicitation material and will vote any shares so held for you first in accordance with the instructions set forth on proxies you return to the Fund, and then with respect to any proxies you do not return to the Fund in the same portion as the Agent votes proxies the participants return to the Fund.

As long as you participate in the Plan, the Agent will hold the shares it has acquired for you in safekeeping, in its name or in the name of its nominee. This convenience provides added protection against loss, theft or inadvertent destruction of certificates. However, you may request that a certificate representing your Plan shares be issued to you. Upon your written request, the Agent will deliver to you, without charge, a certificate or certificates for the full shares. The Agent will send you a confirmation of each acquisition made for your account as soon as practicable, but not later than 60 days after the acquisition date. Although from time to time you may have an undivided

fractional interest in a share of the Fund, no certificates for a fractional share will be issued. Distributions on fractional shares will be credited to your account. If you terminate your account under the Plan, the Agent will adjust for any such undivided fractional interest in cash at the market value of shares at the time of termination.

You may withdraw from the Plan at any time, without penalty, by notifying the Agent in writing at the address above or by telephone at (866) 340-2909. Such termination will be effective with respect to a Distribution if the Agent receives your notice prior to the Distribution record date. The Agent or the Fund may terminate the Plan upon notice to you in writing mailed at least 30 days prior to any record date for the payment of any Distribution. Upon any termination, the Agent will issue, without charge, stock certificates for all full shares you own and will convert any fractional shares you hold at the time of termination to cash at current market price and send you a check for the proceeds.

The Fund or the Agent may amend the Plan. You will receive written notice at least 30 days before the effective date of any amendment.

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Statement of Investments, March 31, 2013

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Statement of Investments, March 31, 2013 *(continued)*

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Statement of Investments, March 31, 2013 *(continued)*

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Statement of Investments, March 31, 2013 *(continued)*

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Statement of Investments, March 31, 2013 *(continued)*

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Statement of Investments, March 31, 2013 *(continued)*

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Statement of Investments, March 31, 2013 *(continued)*

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Statement of Investments, March 31, 2013 *(continued)*

*The principal amount is stated in U.S. dollars unless otherwise indicated.

^aNon-income producing.

^bSecurity has been deemed illiquid because it may not be able to be sold within seven days.

^cSee Note 10 regarding restricted securities.

^dSecurity was purchased pursuant to Rule 144A under the Securities Act of 1933 and may be sold in transactions exempt from registration only to qualified institutional buyers or in a public offering registered under the Securities Act of 1933. These securities have been deemed liquid under guidelines approved by the Trust's Board of Trustees. At March 31, 2013, the aggregate value of these securities was \$93,217,990, representing 24.30% of net assets.

^eIncome may be received in additional securities and/or cash.

^fPerpetual security with no stated maturity date.

^gSee Note 9 regarding defaulted securities.

^hThe coupon rate shown represents the rate at period end.

ⁱA portion or all of the security purchased on a when-issued, delayed delivery, or to-be-announced basis. See Note 1(c).

^jAt March 31, 2013, pursuant to the Fund's policies and the requirements of applicable securities law, the Fund may be restricted from trading these securities for a limited or extended period of time due to ownership limits and/or potential possession of material non-public information.

^kSee Note 1(g) regarding senior floating rate interests.

^lThe bond pays interest and/or principal based upon the issuer's ability to pay, which may be less than the stated interest rate or principal paydown.

^mSecurity was purchased pursuant to Regulation S under the Securities Act of 1933, which exempts from registration securities offered and sold outside of the United States. Such a security cannot be sold in the United States without either an effective registration statement filed pursuant to the Securities Act of 1933, or pursuant to an exemption from registration. This security has been deemed liquid under guidelines approved by the Trust's Board of Trustees. At March 31, 2013, the value of this security was \$887,206, representing 0.23% of net assets.

ⁿThe security is traded on a discount basis with no stated coupon rate.

^oSee Note 8 regarding investments in the Institutional Fiduciary Trust Money Market Portfolio.

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Limited Duration Income Trust

Notes to Financial Statements

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

Franklin Templeton Limited Duration Income Trust (Fund) is registered under the Investment Company Act of 1940, as amended, (1940 Act) as a closed-end investment company.

The following summarizes the Fund's significant accounting policies.

a. Financial Instrument Valuation

The Fund's investments in financial instruments are carried at fair value daily. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. Under procedures approved by the Fund's Board of Trustees (the Board), the Fund's administrator, investment manager and other affiliates have formed the Valuation and Liquidity Oversight Committee (VLOC). The VLOC provides administration and oversight of the Fund's valuation policies and procedures, which are approved annually by the Board. Among other things, these procedures allow the Fund to utilize independent pricing services, quotations from securities and financial instrument dealers, and other market sources to determine fair value.

Equity securities listed on an exchange or on the NASDAQ National Market System are valued at the last quoted sale price or the official closing price of the day, respectively. Over-the-counter (OTC) securities are valued within the range of the most recent quoted bid and ask prices. Securities that trade in multiple markets or on multiple exchanges are valued according to the broadest and most representative market. Certain equity securities are valued based upon fundamental characteristics or relationships to similar securities.

Debt securities generally trade in the OTC market rather than on a securities exchange. The Fund's pricing services use multiple valuation techniques to determine fair value. In instances where sufficient market activity exists, the pricing services may utilize a market-based approach through which quotes from market makers are used to determine fair value. In instances where sufficient market activity may not exist or is limited, the pricing services also utilize proprietary valuation models which may consider market characteristics such as benchmark yield curves, credit spreads, estimated default rates, anticipated market interest rate volatility, coupon rates, anticipated timing of principal repayments, underlying collateral, and other unique security features in order to estimate the relevant cash flows, which are then discounted to calculate the fair value. Securities denominated in a foreign currency are converted into their U.S. dollar equivalent at the foreign exchange rate in effect at the close of the NYSE on the date that the values of the foreign debt securities are determined. Investments in open-end mutual funds are valued at the closing net asset value.

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Limited Duration Income Trust

Notes to Financial Statements *(continued)*

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES *(continued)*

a. Financial Instrument Valuation *(continued)*

Certain derivative financial instruments (derivatives) trade in the OTC market. The Fund's pricing services use various techniques including industry standard option pricing models and proprietary discounted cash flow models to determine the fair value of those instruments. The Fund's net benefit or obligation under the derivative contract, as measured by the fair market value of the contract, is included in net assets.

The Fund has procedures to determine the fair value of financial instruments for which market prices are not reliable or readily available. Under these procedures, the VLOC convenes on a regular basis to review such financial instruments and considers a number of factors, including significant unobservable valuation inputs, when arriving at fair value. The VLOC primarily employs a market-based approach which may use related or comparable assets or liabilities, recent transactions, market multiples, book values, and other relevant information for the investment to determine the fair value of the investment. An income-based valuation approach may also be used in which the anticipated future cash flows of the investment are discounted to calculate fair value. Discounts may also be applied due to the nature or duration of any restrictions on the disposition of the investments. Due to the inherent uncertainty of valuations of such investments, the fair values may differ significantly from the values that would have been used had an active market existed. The VLOC employs various methods for calibrating these valuation approaches including a regular review of key inputs and assumptions, transactional back-testing or disposition analysis, and reviews of any related market activity.

Trading in securities on foreign securities stock exchanges and OTC markets may be completed before the daily close of business on the NYSE. Occasionally, events occur between the time at which trading in a foreign security is completed and the close of the NYSE that might call into question the reliability of the value of a portfolio security held by the Fund. As a result, differences may arise between the value of the Fund's portfolio securities as determined at the foreign market close and the latest indications of value at the close of the NYSE. In order to minimize the potential for these differences, the VLOC monitors price movements following the close of trading in foreign stock markets through a series of country specific market proxies (such as baskets of American Depositary Receipts, futures contracts and exchange traded funds). These price movements are measured against established trigger thresholds for each specific market proxy to assist in determining if an event has occurred that may call into question the reliability of the values of the foreign securities held by the Fund. If such an event occurs, the securities may be valued using fair value procedures, which may include the use of independent pricing services.

In addition, certain foreign markets may be open on days that the NYSE is closed, which could result in differences between the value of the Fund's portfolio securities on the last business day and the last calendar day of the reporting period. Any significant security valuation changes due to an open foreign market are adjusted and reflected in the Fund for financial reporting purposes.

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Notes to Financial Statements *(continued)*

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES *(continued)*

b. Foreign Currency Translation

Portfolio securities and other assets and liabilities denominated in foreign currencies are translated into U.S. dollars based on the exchange rate of such currencies against U.S. dollars on the date of valuation. The Fund may enter into foreign currency exchange contracts to facilitate transactions denominated in a foreign currency. Purchases and sales of securities, income and expense items denominated in foreign currencies are translated into U.S. dollars at the exchange rate in effect on the transaction date. Portfolio securities and assets and liabilities denominated in foreign currencies contain risks that those currencies will decline in value relative to the U.S. dollar. Occasionally, events may impact the availability or reliability of foreign exchange rates used to convert the U.S. dollar equivalent value. If such an event occurs, the foreign exchange rate will be valued at fair value using procedures established and approved by the Board.

The Fund does not separately report the effect of changes in foreign exchange rates from changes in market prices on securities held. Such changes are included in net realized and unrealized gain or loss from investments on the Statement of Operations.

Realized foreign exchange gains or losses arise from sales of foreign currencies, currency gains or losses realized between the trade and settlement dates on securities transactions and the difference between the recorded amounts of dividends, interest, and foreign withholding taxes and the U.S. dollar equivalent of the amounts actually received or paid. Net unrealized foreign exchange gains and losses arise from changes in foreign exchange rates on foreign denominated assets and liabilities other than investments in securities held at the end of the reporting period.

c. Securities Purchased on a When-Issued, Delayed Delivery, and TBA Basis

The Fund purchases securities on a when-issued, delayed delivery, and to-be-announced (TBA) basis, with payment and delivery scheduled for a future date. These transactions are subject to market fluctuations and are subject to the risk that the value at delivery may be more or less than the trade date purchase price. Although the Fund will generally purchase these securities with the intention of holding the securities, it may sell the securities before the settlement date. Sufficient assets have been segregated for these securities.

d. Derivative Financial Instruments

The Fund invested in derivatives in order to manage risk or gain exposure to various other investments or markets. Derivatives are financial contracts based on an underlying or notional amount, require no initial investment or an initial net investment that is smaller than would normally be

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Limited Duration Income Trust

Notes to Financial Statements *(continued)*

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES *(continued)*

d. Derivative Financial Instruments *(continued)*

required to have a similar response to changes in market factors, and require or permit net settlement. Derivatives contain various risks including the potential inability of the counterparty to fulfill their obligations under the terms of the contract, the potential for an illiquid secondary market, and/or the potential for market movements which expose the Fund to gains or losses in excess of the amounts shown on the Statement of Assets and Liabilities. Realized gain and loss and unrealized appreciation and depreciation on these contracts for the period are included in the Statement of Operations.

The Fund investments in OTC derivatives are subject to the terms of International Swaps and Derivatives Association Master Agreements and other related agreements between the Fund and certain derivative counterparties. These agreements contain various provisions, including but not limited to collateral requirements, events of default, requirements for the Fund to maintain certain net asset levels and/or limit the decline in net assets over various periods of time. Should the Fund fail to meet any of these provisions, the derivative counterparty has the right to terminate the derivative contract and require immediate payment by the Fund for those OTC derivatives with that particular counterparty that are in a net liability position.

At March 31, 2013, the Fund had OTC derivatives in a net liability position for such contracts of \$15,771.

The Fund entered into OTC forward exchange contracts primarily to manage and/or gain exposure to certain foreign currencies. A forward exchange contract is an agreement between the Fund and a counterparty to buy or sell a foreign currency at a specific exchange rate on a future date. Pursuant to the terms of the forward exchange contracts, cash or securities may be required to be deposited as collateral. Unrestricted cash may be invested according to the Fund's investment objectives.

The Fund entered into OTC credit default swap contracts primarily to manage and/or gain exposure to credit risk. A credit default swap is an agreement between the Fund and a counter-party whereby the buyer of the contract receives credit protection and the seller of the contract guarantees the credit worthiness of a referenced debt obligation. The underlying referenced debt obligation may be a single issuer of corporate or sovereign debt, a credit index, or a tranche of a credit index. In the event of a default of the underlying referenced debt obligation, the buyer is entitled to receive the notional amount of the credit default swap contract from the seller in exchange for the referenced debt obligation, a net settlement amount equal to the notional amount

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Limited Duration Income Trust

Notes to Financial Statements *(continued)*

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES *(continued)*

d. Derivative Financial Instruments *(continued)*

of the credit default swap less the recovery value of the referenced debt obligation, or other agreed upon amount. Over the term of the contract, the buyer pays the seller a periodic stream of payments, provided that no event of default has occurred. Such periodic payments are accrued daily as an unrealized appreciation or depreciation until the payments are made, at which time they are realized. Payments received or paid to initiate a credit default swap contract are reflected on the Statement of Assets and Liabilities and represent compensating factors between stated terms of the credit default swap agreement and prevailing market conditions (credit spreads and other relevant factors). These upfront payments are amortized over the term of the contract as a realized gain or loss on the Statement of Operations. Pursuant to the terms of the credit default swap contract, cash or securities may be required to be deposited as collateral. Unrestricted cash may be invested according to the Fund's investment objectives.

At March 31, 2013, the Fund held \$277,287, in a U.S. Treasury Note, as collateral for derivatives.

See Note 11 regarding other derivative information.

e. Restricted Cash

At March 31, 2013, the Fund held restricted cash in connection with investments in certain derivative securities. Restricted cash is held in a segregated account with the Fund's custodian and is reflected in the Statement of Assets and Liabilities.

f. Mortgage Dollar Rolls

The Fund enters into mortgage dollar rolls, typically on a TBA basis. Mortgage dollar rolls are agreements between the Fund and a financial institution to simultaneously sell and repurchase mortgage-backed securities at a future date. Gains or losses are realized on the initial sale, and the difference between the repurchase price and the sale price is recorded as an unrealized gain or loss to the Fund upon entering into the mortgage dollar roll. In addition, the Fund may invest the cash proceeds that are received from the initial sale. During the period between the sale and repurchase, the Fund is not entitled to principal and interest paid on the mortgage backed securities. The risks of mortgage dollar roll transactions include the potential inability of the counterparty to fulfill its obligations.

The Fund is investing in mortgage dollar rolls as an alternate form of leverage. As a result, the mortgage dollar rolls are considered indebtedness or a senior security for purposes of the asset coverage requirements under the 1940 Act.

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Limited Duration Income Trust

Notes to Financial Statements *(continued)*

1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES *(continued)*

g. Senior Floating Rate Interests

The Fund invests in senior secured corporate loans that pay interest at rates which are periodically reset by reference to a base lending rate plus a spread. These base lending rates are generally the prime rate offered by a designated U.S. bank or the London InterBank Offered Rate (LIBOR). Senior secured corporate loans often require prepayment of principal from excess cash flows or at the discretion of the borrower. As a result, actual maturity may be substantially less than the stated maturity.

Senior secured corporate loans in which the Fund invests are generally readily marketable, but may be subject to some restrictions on resale.

h. Income and Deferred Taxes

It is the Fund's policy to qualify as a regulated investment company under the Internal Revenue Code. The Fund intends to distribute to shareholders substantially all of its taxable income and net realized gains to relieve it from federal income and excise taxes. As a result, no provision for U.S. federal income taxes is required.

The Fund may be subject to foreign taxation related to income received, capital gains on the sale of securities and certain foreign currency transactions in the foreign jurisdictions in which it invests. Foreign taxes, if any, are recorded based on the tax regulations and rates that exist in the foreign markets in which the Fund invests. When a capital gain tax is determined to apply the Fund records an estimated deferred tax liability in an amount that would be payable if the securities were disposed of on the valuation date.

The Fund recognizes the tax benefits of uncertain tax positions only when the position is more likely than not to be sustained upon examination by the tax authorities based on the technical merits of the tax position. As of March 31, 2013, and for all o>

Share-based compensation represents the cost related to share-based awards, typically stock options or stock grants, granted to employees, non-employees, officers and directors. Share-based compensation is measured at grant date, based on the estimated aggregate fair value of the award on the grant date, and such amount is charged to compensation expense on a straight-line basis (net of estimated forfeitures) over the requisite service period. For the three month periods ended March 31, 2016 and 2015, the share-based compensation expense of \$11,000 and \$77,000, respectively, is reflected in general and administrative expenses in the consolidated Statements of Income.

Share-based awards have historically been made as stock options, and recently during the third quarter 2015 as stock grants, issued pursuant to the terms of the Company's stock option and stock incentive plans, (collectively, the "Plans"), described below. The Plans may be administered by the Board of Directors or the Compensation Committee of the Board or by another committee appointed by the Board from among its members as provided in the Plans. Presently, the Plans are administered by the Company's Compensation Committee of the Board of Directors. As of March 31, 2016, the Plans authorized the issuance of 6,000,000 shares of the Company's common stock and, as of March 31, 2016 there were 4,439,023 shares of the Company's common stock available for issuance for future stock option grants or other stock based awards.

Stock option awards, which allow the recipient to purchase shares of the Company's common stock at a fixed price, are typically granted at an exercise price equal to the Company's stock price at the date of grant. Typically, the Company's stock option awards have vested from immediately to two years from the grant date and have had a contractual term ranging from three to ten years.

During the three month periods ended March 31, 2016 and 2015, the Company issued options to purchase no shares of common stock and 70,000 shares of common stock, respectively. As of March 31, 2016 there was \$4,000 of unrecognized compensation cost related to non-vested previously granted option awards.

Effective July 25, 1997, the Company adopted its 1997 Employee Stock Option Plan, which was amended on August 19, 1999, ("1997 Plan") pursuant to which 2,000,000 shares of common stock were reserved for issuance upon the exercise of options designated as either (i) incentive stock options ("ISOs") under the Internal Revenue Code of 1986, as amended (the "Code"), or (ii) nonqualified options. ISOs could be granted under the 1997 Plan to employees and officers of the Company. Non-qualified options could be granted to consultants, directors (whether or not they are employees), employees or officers of the Company. Stock appreciation rights could also be issued in tandem with stock options. Effective June 11, 2007, the Company's ability to grant options or stock appreciation rights under the 1997 Plan expired.

Effective September 10, 2004, the Company adopted its 2004 Stock Incentive Plan ("2004 Plan") pursuant to which 2,500,000 shares of common stock were reserved for issuance (i) upon the exercise of options, designated as either ISOs under the Code or nonqualified options, or (ii) as stock, deferred stock or other stock-based awards. ISOs could be granted under the 2004 Plan to employees and officers of the Company. Non-qualified options, stock, deferred stock or other stock-based awards could be granted to consultants, directors (whether or not they are employees), employees or officers of the Company. Stock appreciation rights could also be issued in tandem with stock options. Effective September 10, 2014, the Company's ability to grant options or other awards under the 2004 Plan expired.

Effective August 27, 2008, the Company adopted its 2008 Stock Incentive Plan ("2008 Plan") pursuant to which 3,000,000 shares of common stock were reserved for issuance (i) upon the exercise of options, designated as either ISOs under the Code or nonqualified options, or (ii) as stock, deferred stock or other stock-based awards. ISOs may be granted under the 2008 Plan to employees and officers of the Company. Non-qualified options, stock, deferred stock or other stock-based awards may be granted to consultants, directors (whether or not they are employees), employees or officers of the Company. Stock appreciation rights may also be issued in tandem with stock options. Unless the 2008 Plan is sooner terminated, the ability to grant options or other awards under the 2008 Plan will expire on August 27, 2018.

ISOs granted under the 2008 Plan may not be granted at a price less than the fair market value of the common stock on the date of grant (or 110% of fair market value in the case of persons holding 10% or more of the voting stock of the Company). Nonqualified options granted under the 2008 Plan may not be granted at a price less than the fair market value of the common stock. Options granted under the 2008 Plan expire not more than ten years from the date

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of grant (five years in the case of ISOs granted to persons holding 10% or more of the voting stock of the Company).

Effective September 17, 2014, the Company adopted its 2014 Stock Incentive Plan (“2014 Plan”) pursuant to which 3,000,000 shares of common stock were reserved for issuance (i) upon the exercise of options, designated as either ISOs under the Code or nonqualified options, or (ii) as stock, deferred stock or other stock-based awards. ISOs may be granted under the 2014 Plan to employees and officers of the Company. Non-qualified options, stock, deferred stock or other stock-based awards may be granted to consultants, directors (whether or not they are employees), employees or officers of the Company. Stock appreciation rights may also be issued in tandem with stock options. Unless the 2014 Plan is sooner terminated, the ability to grant options or other awards under the 2014 Plan will expire on September 17, 2024.

ISOs granted under the 2014 Plan may not be granted at a price less than the fair market value of the common stock on the date of grant (or 110% of fair market value in the case of persons holding 10% or more of the voting stock of the Company). Nonqualified options granted under the 2014 Plan may not be granted at a price less than the fair market value of the common stock. Options granted under the 2014 Plan expire not more than ten years from the date of grant (five years in the case of ISOs granted to persons holding 10% or more of the voting stock of the Company).

All stock options have been granted to employees and non-employees at exercise prices equal to or in excess of the market value on the date of the grant.

The Company determines the fair value of share based awards at the grant date by using the Black-Scholes option-pricing model, and is incorporating the simplified method to compute expected lives of share based awards with the following weighted-average assumptions:

Three Month Period Ended March 31, Assumptions	2016	2015
Dividend yield	-	0 %
Risk free interest rate	-	.83%-1.69 %
Expected volatility	-	59%-66 %
Expected lives	-	3-5 years

A summary of the activity for stock options issued under the Company's Plans for the indicated periods is presented below:

Stock Option Plan Totals	Shares	Weighted Average Exercise Price
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Outstanding at December 31, 2014	3,280,874	\$	1.98
-Cancelled	(132,500)	\$	3.72
-Exercised	(679,291)	\$	1.65
-Granted	164,506	\$	3.28
Outstanding at December 31, 2015	2,633,589	\$	2.06
-Exercised	(120,125)	\$	1.36
Outstanding at March 31, 2016	2,513,464	\$	2.09

The following is the weighted average contractual life in years and the weighted average exercise price at March 31, 2016 of:

	Number of Options	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
Options outstanding	2,513,464	1.9 years	\$ 2.09
Options vested	2,505,130	1.9 years	\$ 2.09

The following is the intrinsic value at March 31, 2016 of:

Options outstanding	\$3,050,000
Options exercised in 2016	\$253,000

The intrinsic value of options exercised during the year ended December 31, 2015 was \$1,309,000.

Note 3 - Debt

Bank Credit Line

On June 22, 2012, a subsidiary of Hudson entered into a Revolving Credit, Term Loan and Security Agreement (the "PNC Facility") with PNC Bank, National Association, as agent ("Agent" or "PNC"), and such other lenders as may thereafter become a party to the PNC Facility. Under the terms of the PNC Facility, as amended by the First Amendment to the PNC Facility, dated February 15, 2013, Hudson may borrow up to a maximum of \$40,000,000 consisting of a term loan in the principal amount of \$4,000,000 and revolving loans in a maximum amount up to \$36,000,000. Amounts borrowed under the PNC Facility may be used by Hudson for working capital needs and to reimburse drawings under letters of credit. At March 31, 2016, total borrowings under the PNC Facility were approximately \$29,808,000, and there was approximately \$10,200,000 available to borrow under the revolving line of credit. The effective interest rate under the PNC Facility was 4.00% at March 31, 2016.

Interest on loans under the PNC Facility is payable in arrears on the first day of each month with respect to loans bearing interest at the domestic rate (as set forth in the PNC Facility) and at the end of each interest period with respect to loans bearing interest at the Eurodollar Rate (as defined in the PNC Facility) or, for Eurodollar Rate Loans (as defined in the PNC Facility) with an interest period in excess of three months, at the earlier of (a) each three months from the commencement of such Eurodollar Rate Loan or (b) the end of the interest period. Interest charges with respect to loans are computed on the actual principal amount of loans outstanding during the month at a rate per annum equal to (A) with respect to Domestic Rate Loans (as defined in the PNC Facility), the sum of the Alternate Base Rate (as defined in the PNC Facility) plus one half of one percent (.50%) and (B) with respect to Eurodollar Rate Loans, the sum of the Eurodollar Rate plus two and one quarter of one percent (2.25%).

Hudson granted to PNC, for itself, and as agent for such other lenders as may thereafter become a lender under the PNC Facility, a security interest in Hudson's receivables, intellectual property, general intangibles, inventory and certain other assets.

The PNC Facility contains certain financial and non-financial covenants relating to Hudson, including limitations on Hudson's ability to pay dividends on common stock or preferred stock, and also includes certain events of default, including payment defaults, breaches of representations and warranties, covenant defaults, cross-defaults to other obligations, events of bankruptcy and insolvency, certain ERISA events, judgments in excess of specified amounts, impairments to guarantees and a change of control. The PNC Facility contains a financial covenant to maintain at all times a Fixed Charge Coverage Ratio of not less than 1.10 to 1.00, tested quarterly on a rolling twelve month basis. Fixed Charge Coverage Ratio is defined in the PNC Facility, with respect to any fiscal period, as the ratio of (a) EBITDA of Hudson for such period, minus unfinanced capital expenditures (as defined in the PNC Facility) made by Hudson during such period, minus the aggregate amount of cash taxes paid by Hudson during such period, minus the

aggregate amount of dividends and distributions made by Hudson during such period, minus the aggregate amount of payments made with cash by Hudson to satisfy soil sampling and reclamation related to environmental cleanup at the Company's former Hillburn, NY facility during such period (to the extent not already included in the calculation of EBITDA as determined by the Agent) to (b) the aggregate amount of all principal payments due and/or made, except principal payments related to outstanding revolving advances with regard to all funded debt (as defined in the PNC Facility) of Hudson during such period, plus the aggregate interest expense of Hudson during such period. EBITDA as defined in the PNC Facility shall mean for any period the sum of (i) earnings before interest and taxes for such period plus (ii) depreciation expenses for such period, plus (iii) amortization expenses for such period, plus (iv) non-cash charges.

On October 25, 2013, the Company entered into the Second Amendment to the PNC facility (the "Second PNC Amendment") which, among other things, waived the requirement to comply with the minimum fixed charge coverage ratio covenant of 1.10 to 1.00 for the fiscal quarter ended September 30, 2013, under the PNC Facility, and suspended the minimum fixed charge ratio covenant until the quarterly period ended March 31, 2015.

On July 2, 2014, the Company entered into the Third Amendment to the PNC Facility (the "Third PNC Amendment") which, among other things, extended the term of PNC Facility. Pursuant to the Third PNC Amendment, which was effective June 30, 2014, the Termination Date of the PNC Facility (as defined in the PNC Facility) was extended to June 30, 2018.

On July 1, 2015, the Company entered into the Fourth Amendment to the PNC Facility (the "Fourth PNC Amendment"). The Fourth PNC Amendment redefined the "Revolving Interest Rate" as well as the "Term Loan Rate" (as defined in the PNC Facility) as follows:

"Revolving Interest Rate" shall mean an interest rate per annum equal to (a) the sum of the Alternate Base Rate (as defined in the PNC Facility) plus one half of one percent (.50%) with respect to Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and one quarter of one percent (2.25%) with respect to the Eurodollar Rate Loans.

"Term Loan Rate" shall mean an interest rate per annum equal to (a) the sum of the Alternate Base Rate plus one half of one percent (.50%) with respect to the Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and one quarter of one percent (2.25%) with respect to Eurodollar Rate Loans.

On April 8, 2016, the Company entered into the Fifth Amendment to the PNC Facility (the "Fifth PNC Amendment"). Pursuant to the Fifth PNC Amendment, the Maximum Loan Amount (as defined in the PNC Facility) has been increased from \$40,000,000 to \$50,000,000, and the Maximum Revolving Advance Amount (as defined in the PNC Facility) has been increased from \$36,000,000 to \$46,000,000. Additionally, pursuant to the Fifth PNC Amendment the Termination Date of the Facility (as defined in the PNC Facility) has been extended to June 30, 2020.

The Company was in compliance with all covenants, under the PNC Facility as of March 31, 2016. The Company's ability to comply with these covenants in future quarters may be affected by events beyond the Company's control, including general economic conditions, weather conditions, regulations and refrigerant pricing. Although we expect to remain in compliance with all covenants in the PNC Facility, as amended, depending on our future operating performance and general economic conditions, we cannot make any assurance that we will continue to be in compliance.

The commitments under the PNC Facility will expire and the full outstanding principal amount of the loans, together with accrued and unpaid interest, are due and payable in full on June 30, 2020, unless the commitments are terminated for any reason or the outstanding principal amount of the loans are accelerated sooner following an event of default.

Note 4 - Acquisitions

On November 5, 2014 the Company purchased certain assets from Polar Technologies, LLC ("Polar") related to its refrigerant reclamation business and facilities in Nashville, Tennessee; Ontario, California; and San Juan, Puerto Rico; hiring approximately thirty-two Polar employees associated with the business. The purchase price for this acquisition was \$8,035,000. A portion of the purchase price is to be paid in the future pursuant to the purchase agreement. The preliminary asset allocation reflected in the December 31, 2014 financial statements was approximately \$5,435,000 of tangible assets, approximately \$2,335,000 of intangible assets, and approximately \$265,000 of goodwill. The intangible assets will be amortized over a period of 2 to 10 years. The goodwill recognized as part of the acquisition, is deductible for tax purposes.

As of December 31, 2015 the valuation and allocation of the purchase price for Polar has been finalized resulting in an increase in tangible assets of \$165,000, as well as an increase in goodwill of \$170,000 and a decrease in intangible assets of \$335,000. This final valuation has been reflected in the December 31, 2015 financial statements.

The results of the Polar operations are included in the Company's consolidated statement of operations from the date of acquisition and are not material to the Company's financial position or results of operations.

On January 16, 2015, the Company acquired certain assets of a supplier of refrigerants and compressed gases, and also hired three employees associated with the business. The purchase price for this acquisition was \$2,424,000 cash paid at closing and the assumption of a liability of \$20,000, and a maximum of an additional \$3,000,000 earn-out. The preliminary asset allocation was approximately \$1,606,000 of tangible assets, approximately \$1,500,000 of intangible assets, and approximately \$2,338,000 of goodwill.

As of December 31, 2015 the valuation and allocation of the purchase price for this acquisition has been finalized. As part of that process it has been determined that the earn-out payable that had been previously recorded at the maximum earn out of \$3,000,000 per the purchase agreement was overstated by approximately \$1,000,000. This adjustment to the earn-out payable resulted in lowering the purchase price from approximately \$5,400,000 to approximately \$4,400,000. The final valuation resulted in a reduction in goodwill by approximately \$1,900,000, and increase in intangible assets of approximately \$800,000 and an increase in current assets of approximately \$100,000. This final valuation as well as the respective changes in the amortization of intangibles has been reflected in the December 31, 2015 financial statements.

The adjusted earn-out payable of approximately \$2,000,000 consists of approximately \$1,100,000 for the fiscal year ended December 31, 2015 and approximately \$900,000 for the fiscal year ending December 31, 2016. For the fiscal year ended December 31, 2015 the actual earn-out was approximately \$800,000 resulting in a year end adjustment to reduce the payable by approximately \$300,000 which has been reflected in the December 31, 2015 statements of operations as Other Income. As of December 31, 2015 approximately \$445,000 of the 2015 earn-out has been paid and the remaining balance of \$371,000 is recorded as a current liability on the December 31, 2015 balance sheet.

The earn out payable for the fiscal year ending December 31, 2016 of approximately \$900,000 has been recorded in other current liabilities on the December 31, 2015 balance sheet. As of March 31, 2016 there is no change in the estimated earnout.

The intangible assets are being amortized over a period ranging from two to ten years. The goodwill recognized as part of the acquisition will be deductible for tax purposes. The transaction also provides for additional employee compensation for years 2017 through 2019, based on certain revenue performance. The total additional employee compensation, if any, cannot exceed \$3,000,000.

The results of the acquired business operations are included in the Company's consolidated statements of operations from the date of acquisition, and are not material to the Company's financial position or results of operations.

Pro Forma Information

Pro forma revenues and results of operations as if the businesses had been acquired on January 1, 2014 are not presented, as the acquisitions are not material to our financial position or our results of operations.

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

Certain statements, contained in this section and elsewhere in this Form 10-Q, constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve a number of known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include, but are not limited to, changes in the laws and regulations affecting the industry, changes in the demand and price for refrigerants (including unfavorable market conditions adversely affecting the demand for, and the price of refrigerants), the Company's ability to source refrigerants, regulatory and economic factors, seasonality, competition, litigation, the nature of supplier or customer arrangements that become available to the Company in the future, adverse weather conditions, possible technological obsolescence of existing products and services, possible reduction in the carrying value of long-lived assets, estimates of the useful life of its assets, potential environmental liability, customer concentration, the ability to obtain financing, any delays or interruptions in bringing products and services to market, the timely availability of any requisite permits and authorizations from governmental entities and third parties as well as factors relating to doing business outside the United States, including changes in the laws, regulations, policies, and political, financial and economic conditions, including inflation, interest and currency exchange rates, of countries in which the Company may seek to conduct business, the Company's ability to successfully integrate any assets it acquires from third parties into its operations, and other risks detailed in the Company's Form 10-K for the year ended December 31, 2015, and in the Company's other subsequent filings with the Securities and Exchange Commission ("SEC"). The words "believe", "expect", "anticipate", "may", "plan", "should" and similar expressions identify forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date the statement was made.

Critical Accounting Policies

The Company's discussion and analysis of its financial condition and results of operations are based upon its consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. Several of the Company's accounting policies involve significant judgments, uncertainties and estimations. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. To the extent that actual results differ from management's judgments and estimates, there could be a material adverse effect on the Company. On a continuous basis, the Company evaluates its estimates, including, but not limited to, those estimates related to its allowance for doubtful accounts, inventory reserves, and valuation allowance for the deferred tax assets relating to its net operating loss carry forwards ("NOLs") and commitments and contingencies. With respect to accounts receivable, the Company estimates the necessary allowance for doubtful accounts based on both historical and anticipated trends of payment history and the ability of the customer to fulfill its obligations. For inventory, the Company evaluates both current and anticipated sales prices

of its products to determine if a write down of inventory to net realizable value is necessary. In determining the Company's valuation allowance for its deferred tax assets, the Company assesses its ability to generate taxable income in the future. Goodwill represents the excess of the purchase price over the fair value of the net assets acquired in business combinations accounted for under the purchase method of accounting. The Company tests for any impairment of goodwill annually. Intangibles with determinable lives are amortized over the estimated useful lives of the assets currently ranging from 2 to 10 years. The Company reviews these useful lives annually to determine that they reflect future realizable value. The Company utilizes both internal and external sources to evaluate potential current and future liabilities for various commitments and contingencies. In the event that the assumptions or conditions change in the future, the estimates could differ from the original estimates.

Overview

Sales of refrigerants continue to represent a significant portion of the Company's revenues. The Company's refrigerant sales are primarily HCFC and HFC based refrigerants and to a lesser extent CFC based refrigerants that are no longer manufactured. Currently the Company purchases virgin HCFC and HFC refrigerants and reclaimable HCFC, HFC and CFC refrigerants from suppliers and its customers. Effective January 1, 1996, the Clean Air Act (the "Act") prohibited the production of virgin CFC refrigerants and limited the production of virgin HCFC refrigerants, which production was further limited in January 2004. Federal regulations enacted in January 2004 established production and consumption allowances for HCFCs and imposed limitations on the importation of certain virgin HCFC refrigerants. Under the Act, production of certain virgin HCFC refrigerants is scheduled to be phased out during the period 2010 through 2020, and production of all virgin HCFC refrigerants is scheduled to be phased out by 2030. In April 2013 the EPA published a final rule providing for the production or importation of 63 million and 51 million pounds of HCFC-22 in 2013 and 2014, respectively. In October 2014, the EPA published the Final Rule providing further reductions in the production and consumption allowances for virgin HCFC refrigerants for the years 2015 through 2019. In the Final Rule, the EPA has established a linear annual phase down schedule for the production or importation of virgin HCFC-22 that started at approximately 22 million pounds in 2015 and is being reduced by approximately 4.5 million pounds each year and ends at zero in 2020.

The Company has created and developed a service offering known as RefrigerantSide® Services. RefrigerantSide® Services are sold to contractors and end-users whose refrigeration systems are used in commercial air conditioning and industrial processing. These services are offered in addition to refrigerant sales and the Company's traditional refrigerant management services, which consist primarily of reclamation of refrigerants. The Company has created a network of service depots that provide a full range of the Company's RefrigerantSide® Services to facilitate the growth and development of its service offerings.

The Company focuses its sales and marketing efforts for its RefrigerantSide® Services on customers who the Company believes most readily appreciate and understand the value that is provided by its RefrigerantSide® Services offering. In pursuing its sales and marketing strategy, the Company offers its RefrigerantSide® Services to customers in the following industries: petrochemical, pharmaceutical, industrial power, manufacturing, commercial facility and property management and maritime. The Company may incur additional expenses as it further develops and markets its RefrigerantSide® Services offering.

Results of Operations

Three month period ended March 31, 2016 as compared to the three month period ended March 31, 2015

Revenues for the three month period ended March 31, 2016 were \$28,167,000, an increase of \$6,064,000 or 27% from the \$22,103,000 reported during the comparable 2015 period. The increase in revenues was attributable to an increase in refrigerant revenues of \$6,162,000, offset slightly by a decrease in RefrigerantSide® Services revenues of \$98,000. The increase in refrigerant revenue is primarily related to an increase in the selling price per pound of certain refrigerants sold, which accounted for an increase in revenues of \$3,395,000, as well as an increase in the number of pounds of certain refrigerants sold, which accounted for an increase in revenues of \$2,767,000. The decrease in RefrigerantSide® Services was primarily attributable to a decrease in the number of jobs completed compared to the same period in 2015, offset by an increase in the average selling price per job completed in the first three months of 2016 compared to the first three months of 2015.

Cost of sales for the three month period ended March 31, 2016 was \$20,645,000 or 73% of sales. The cost of sales for the three month period ended March 31, 2015 was \$16,578,000 or 75% of sales. The decrease in the cost of sales percentage from 75% for the three month period ended March 31, 2015 to 73% for the three month period ended March 31, 2016 is primarily due to the increase in the selling price per pound of certain refrigerants sold for the three month period ended March 31, 2016 compared to the same period in 2015.

Operating expenses for the three month period ended March 31, 2016 were \$2,503,000, an increase of \$248,000 from the \$2,255,000 reported during the comparable 2015 period. The increase in operating expenses is due to an increase in selling expenses of \$157,000, primarily due to selling payroll and advertising expenses, as well as an increase in general and administrative expenses of \$91,000, primarily related to increases in professional fees.

Interest expense for the three month period ended March 31, 2016 was \$271,000, compared to the \$207,000 reported during the comparable 2015 period.

Income tax expense for the three month period ended March 31, 2016 was \$1,804,000 compared to income tax expense for the three month period ended March 31, 2015 of \$1,170,000. For 2016 and 2015 the income tax expense was for federal and state income tax at statutory rates applied to the pre-tax income.

Net income for the three month period ended March 31, 2016 was \$2,944,000, an increase of \$1,051,000 from the \$1,893,000 net income reported during the comparable 2015 period, primarily due to the increase in revenues partially offset by an increase in operating expenses and income tax expense.

Liquidity and Capital Resources

At March 31, 2016, the Company had working capital, which represents current assets less current liabilities, of \$43,531,000, an increase of \$5,022,000 from the working capital of \$38,509,000 at December 31, 2015. The increase in working capital is primarily attributable to net income.

Inventory and trade receivables are principal components of current assets. At March 31, 2016, the Company had inventories of \$55,284,000, a decrease of \$6,613,000 from \$61,897,000 at December 31, 2015. The decrease in the inventory balance is primarily due the timing and availability of inventory purchases and the sale of refrigerants. The Company's ability to sell and replace its inventory on a timely basis and the prices at which it can be sold are subject, among other things, to current market conditions and the nature of supplier or customer arrangements and the Company's ability to source CFC based refrigerants (which are no longer being produced), HCFC refrigerants (which are currently being phased down leading to a full phase out of virgin production), or non-CFC based refrigerants. At March 31, 2016, the Company had trade receivables, net of allowance for doubtful accounts, of \$15,840,000, an increase of \$11,426,000 from \$4,414,000 at December 31, 2015. The Company's trade receivables are concentrated with various wholesalers, brokers, contractors and end-users within the refrigeration industry that are primarily located in the continental United States.

The Company has historically financed its working capital requirements through cash flows from operations, the issuance of debt and equity securities, and bank borrowings.

Net cash used by operating activities for the three month period ended March 31, 2016, was \$5,723,000 compared with net cash used in operating activities of \$812,000 for the comparable 2015 period. Net cash used in operating activities for the 2016 period was primarily attributable to an increase in trade accounts receivable and prepaid and other assets, as well as a decrease in accounts payable and accrued expenses, offset in part by net income and the utilization of the deferred tax asset, as well a decrease in inventory.

Net cash used by investing activities for the three month period ended March 31, 2016, was \$133,000 compared with net cash used by investing activities of \$2,483,000 for the comparable 2015 period. The net cash used by investing activities for the 2016 period was primarily related to investment in general purpose equipment for the Company's Champaign, Illinois facility. The net cash used by investing activities for the 2015 period was primarily related to the acquisition of a refrigerant and compressed gases supplier, as well as investment in general purpose equipment for the Company's Champaign, Illinois facility.

Net cash provided by financing activities for the three month period ended March 31, 2016, was \$5,765,000 compared with net cash provided by financing activities of \$2,821,000 for the comparable 2015 period. The net cash provided by financing activities for the 2016 period was primarily due to the proceeds from short term borrowings, partially offset by the repayment of long term debt.

At March 31, 2016, the Company had cash and cash equivalents of \$1,167,000. The Company continues to assess its capital expenditure needs. The Company may, to the extent necessary, continue to utilize its cash balances to purchase equipment primarily for its operations. The Company estimates that the total capital expenditures for 2016 will be approximately \$1,800,000.

The following is a summary of the Company's significant contractual cash obligations for the periods indicated that existed as of March 31, 2016 (in 000's):

	Twelve Month Period Ended March 31,					
	2017	2018	2019	2020	2021	Total
Long and short term debt and capital lease obligations:						
Principal	\$ 26,141	\$ 122	\$ 4,078	\$ 11	\$ 1	\$ 30,353
Estimated interest (1)	914	902	807	0	0	2,623

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Operating leases	1,144	803	167	14	7	2,135
Acquisition earn out /License payable	1,197	0	0	0	0	1,197
Total contractual cash obligations	\$ 29,396	\$ 1,827	\$ 5,052	\$ 25	\$ 8	\$ 36,308

(1) The estimated future interest payments on all debt other than revolving debt are based on the respective interest rates applied to the declining principal balances on each of the notes.

On June 22, 2012, a subsidiary of Hudson entered into a Revolving Credit, Term Loan and Security Agreement (the “PNC Facility”) with PNC Bank, National Association, as agent (“Agent” or “PNC”), and such other lenders as may thereafter become a party to the PNC Facility. Under the terms of the PNC Facility, as amended by the First Amendment to the PNC Facility, dated February 15, 2013, Hudson may borrow up to a maximum of \$40,000,000 consisting of a term loan in the principal amount of \$4,000,000 and revolving loans in a maximum amount up to \$36,000,000. Amounts borrowed under the PNC Facility may be used by Hudson for working capital needs and to reimburse drawings under letters of credit. At March 31, 2016, total borrowings under the PNC Facility were approximately \$29,808,000, and there was approximately \$10,200,000 available to borrow under the revolving line of credit. The effective interest rate under the PNC Facility was 4.00% at March 31, 2016.

Interest on loans under the PNC Facility is payable in arrears on the first day of each month with respect to loans bearing interest at the domestic rate (as set forth in the PNC Facility) and at the end of each interest period with respect to loans bearing interest at the Eurodollar Rate (as defined in the PNC Facility) or, for Eurodollar Rate Loans (as defined in the PNC Facility) with an interest period in excess of three months, at the earlier of (a) each three months from the commencement of such Eurodollar Rate Loan or (b) the end of the interest period. Interest charges with respect to loans are computed on the actual principal amount of loans outstanding during the month at a rate per annum equal to (A) with respect to Domestic Rate Loans (as defined in the PNC Facility), the sum of the Alternate Base Rate (as defined in the PNC Facility) plus one half of one percent (.50%) and (B) with respect to Eurodollar Rate Loans, the sum of the Eurodollar Rate plus two and one quarter of one percent (2.25%).

Hudson granted to PNC, for itself, and as agent for such other lenders as may thereafter become a lender under the PNC Facility, a security interest in Hudson's receivables, intellectual property, general intangibles, inventory and certain other assets.

The PNC Facility contains certain financial and non-financial covenants relating to Hudson, including limitations on Hudson's ability to pay dividends on common stock or preferred stock, and also includes certain events of default, including payment defaults, breaches of representations and warranties, covenant defaults, cross-defaults to other obligations, events of bankruptcy and insolvency, certain ERISA events, judgments in excess of specified amounts, impairments to guarantees and a change of control. The PNC Facility contains a financial covenant to maintain at all times a Fixed Charge Coverage Ratio of not less than 1.10 to 1.00, tested quarterly on a rolling twelve month basis. Fixed Charge Coverage Ratio is defined in the PNC Facility, with respect to any fiscal period, as the ratio of (a) EBITDA of Hudson for such period, minus unfinanced capital expenditures (as defined in the PNC Facility) made by Hudson during such period, minus the aggregate amount of cash taxes paid by Hudson during such period, minus the aggregate amount of dividends and distributions made by Hudson during such period, minus the aggregate amount of payments made with cash by Hudson to satisfy soil sampling and reclamation related to environmental cleanup at the Company's former Hillburn, NY facility during such period (to the extent not already included in the calculation of EBITDA as determined by the Agent) to (b) the aggregate amount of all principal payments due and/or made, except principal payments related to outstanding revolving advances with regard to all funded debt (as defined in the PNC Facility) of Hudson during such period, plus the aggregate interest expense of Hudson during such period. EBITDA as defined in the PNC Facility shall mean for any period the sum of (i) earnings before interest and taxes for such period plus (ii) depreciation expenses for such period, plus (iii) amortization expenses for such period, plus (iv) non-cash charges.

On October 25, 2013, the Company entered into the Second Amendment to the PNC facility (the "Second PNC Amendment") which, among other things, waived the requirement to comply with the minimum fixed charge coverage ratio covenant of 1.10 to 1.00 for the fiscal quarter ended September 30, 2013, under the PNC Facility, and suspended the minimum fixed charge ratio covenant until the quarterly period ended March 31, 2015.

On July 2, 2014, the Company entered into the Third Amendment to the PNC Facility (the "Third PNC Amendment") which, among other things, extended the term of PNC Facility. Pursuant to the Third PNC Amendment, which was effective June 30, 2014, the Termination Date of the PNC Facility (as defined in the PNC Facility) was extended to June 30, 2018.

On July 1, 2015, the Company entered into the Fourth Amendment to the PNC Facility (the "Fourth PNC Amendment"). The Fourth PNC Amendment redefined the "Revolving Interest Rate" as well as the "Term Loan Rate" (as defined in the PNC Facility) as follows:

“Revolving Interest Rate” shall mean an interest rate per annum equal to (a) the sum of the Alternate Base Rate (as defined in the PNC Facility) plus one half of one percent (.50%) with respect to Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and one quarter of one percent (2.25%) with respect to the Eurodollar Rate Loans.

“Term Loan Rate” shall mean an interest rate per annum equal to (a) the sum of the Alternate Base Rate plus one half of one percent (.50%) with respect to the Domestic Rate Loans and (b) the sum of the Eurodollar Rate plus two and one quarter of one percent (2.25%) with respect to Eurodollar Rate Loans.

On April 8, 2016, the Company entered into the Fifth Amendment to the PNC Facility (the “Fifth PNC Amendment”). Pursuant to the Fifth PNC Amendment, the Maximum Loan Amount (as defined in the PNC Facility) has been increased from \$40,000,000 to \$50,000,000, and the Maximum Revolving Advance Amount (as defined in the PNC Facility) has been increased from \$36,000,000 to \$46,000,000. Additionally, pursuant to the Fifth PNC Amendment the Termination Date of the Facility (as defined in the PNC Facility) has been extended to June 30, 2020.

The Company was in compliance with all covenants, under the PNC Facility as of March 31, 2016. The Company’s ability to comply with these covenants in future quarters may be affected by events beyond the Company’s control, including general economic conditions, weather conditions, regulations and refrigerant pricing. Although we expect to remain in compliance with all covenants in the PNC Facility, as amended, depending on our future operating performance and general economic conditions, we cannot make any assurance that we will continue to be in compliance.

The commitments under the PNC Facility will expire and the full outstanding principal amount of the loans, together with accrued and unpaid interest, are due and payable in full on June 30, 2020, unless the commitments are terminated for any reason or the outstanding principal amount of the loans are accelerated sooner following an event of default.

Inflation

Inflation has not historically had a material impact on the Company's operations.

Reliance on Suppliers and Customers

The Company participates in an industry that is highly regulated, and changes in the regulations affecting our business could affect our operating results. Currently the Company purchases virgin HCFC and HFC refrigerants and reclaimable, primarily HCFC and CFC, refrigerants from suppliers and its customers. Under the Act the phase-down of future production of certain virgin HCFC refrigerants commenced in 2010 and is scheduled to be fully phased out by the year 2020, and production of all virgin HCFC refrigerants is scheduled to be phased out by the year 2030. To the extent that the Company is unable to source sufficient quantities of refrigerants or is unable to obtain refrigerants on commercially reasonable terms or experiences a decline in demand and/or price for refrigerants sold by it, the Company could realize reductions in revenue from refrigerant sales, which could have a material adverse effect on the Company's operating results and financial position.

For the three month period ended March 31, 2016, two customers each accounted for 10% or more of the Company's revenues and, in the aggregate these two customers accounted for 44% of the Company's revenues. At March 31, 2016, there were \$5,085,000 in outstanding receivables from these customers.

For the three month period ended March 31, 2015, two customers each accounted for 10% or more of the Company's revenues and, in the aggregate these two customers accounted for 42% of the Company's revenues. At March 31, 2015, there were \$2,325,000 in outstanding receivables from these customers.

The loss of a principal customer or a decline in the economic prospects of and/or a reduction in purchases of the Company's products or services by any such customer could have a material adverse effect on the Company's operating results and financial position.

Seasonality and Weather Conditions and Fluctuations in Operating Results

The Company's operating results vary from period to period as a result of weather conditions, requirements of potential customers, non-recurring refrigerant and service sales, availability and price of refrigerant products (virgin or reclaimable), changes in reclamation technology and regulations, timing in introduction and/or retrofit or replacement of refrigeration equipment, the rate of expansion of the Company's operations, and by other factors. The Company's business is seasonal in nature with peak sales of refrigerants occurring in the first half of each year. During past years, the seasonal decrease in sales of refrigerants has resulted in losses particularly in the fourth quarter of the year. In addition, to the extent that there is unseasonably cool weather throughout the spring and summer months, which would adversely affect the demand for refrigerants, there would be a corresponding negative impact on the Company. Delays or inability in securing adequate supplies of refrigerants at peak demand periods, lack of refrigerant demand, increased expenses, declining refrigerant prices and a loss of a principal customer could result in significant losses. There can be no assurance that the foregoing factors will not occur and result in a material adverse effect on the Company's financial position and significant losses. The Company believes that to a lesser extent there is a similar seasonal element to RefrigerantSide® Service revenues as refrigerant sales. The Company is continuing to assess its RefrigerantSide® Service revenues seasonal trend.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." The core principle of ASU 2014-09 is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should apply the following steps: (1) identify the contract(s) with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. The guidance also specifies the accounting for some costs to obtain or fulfill a contract with a customer. The new standard also will result in enhanced disclosures about revenue, provide guidance for transactions that were not previously addressed comprehensively (for example, service revenue and contract modifications) and improve guidance for multiple-element arrangements. For a public entity, the amendments in this Update are effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early application is not permitted. An entity should apply the amendments in ASU 2014-09 either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application. The Company is currently evaluating the effects of ASU 2014-09 and therefore cannot estimate the effects, if any, on historical or future revenue recognition at this time.

In April 2015, the FASB issued ASU 2015-03, "Interest - Imputation of Interest (Subtopic 835-30) - Simplifying the Presentation of Debt Issuance Costs." ASU 2015-03 requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. For public business entities, the amendments in ASU 2015-03 are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, with early adoption permitted for financial statements that have not been previously issued. An entity should apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. Upon transition, an entity is required to comply with the applicable disclosures for a change in an accounting principle. These disclosures include the nature of and reason for the change in accounting principle, the transition method, a description of the prior-period information that has been retrospectively adjusted, and the effect of the change on the financial statement line items (that is, debt issuance cost asset and the debt liability). The adoption of ASU 2015-03 will have no impact on the Company's results of operations and an immaterial impact on the Company's balance sheets.

In September 2015, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update No. 2015-16, "Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments", or ASU 2015-16. This amendment requires the acquirer in a business combination to recognize in the reporting period in which adjustment amounts are determined, any adjustments to provisional amounts that are identified during the measurement period, calculated as if the accounting had been completed at the acquisition date. Prior to the issuance of ASU 2015-16, an acquirer was required to restate prior period financial statements as of the acquisition date for adjustments to provisional amounts. The amendments in ASU 2015-16 are to be applied prospectively upon adoption. The Company adopted ASU 2015-16 in the fourth quarter of 2015. The adoption of the provisions of ASU 2015-16 did not have a material impact on its results of operations or financial position.

In November 2015, the FASB issued ASU 2015-17, "Income Taxes (Topic 740) - Balance Sheet Classification of Deferred Taxes." ASU 2015-17 requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The amendments in ASU 2015-17 apply to all entities that present a classified statement of financial position. The current requirement that deferred tax liabilities and assets of a tax-paying component of an entity be offset and presented as a single amount is not affected. For public business entities, the amendments in ASU 2015-17 are effective for financial statements issued for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Earlier application is permitted for all entities as of the beginning of an interim or annual reporting period.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. The accounting applied by a lessor is largely unchanged from that applied under previous GAAP. The recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee also have not significantly changed from previous GAAP. Under ASU 2016-02, a lessee should recognize in the statement of financial position a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. If a lessee makes this election, it should recognize lease expense for such

leases generally on a straight-line basis over the lease term.

For finance leases, a lessee is required to do the following: 1. Recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position; 2. Recognize interest on the lease liability separately from amortization of the right-of-use asset in the statement of comprehensive income; and 3. Classify repayments of the principal portion of the lease liability within financing activities and payments of interest on the lease liability and variable lease payments within operating activities in the statement of cash flows.

For operating leases, a lessee is required to do the following: 1. Recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position; 2. Recognize a single lease cost, calculated so that the cost of the lease is allocated over the lease term on a generally straight-line basis; and 3. Classify all cash payments within operating activities in the statement of cash flows.

In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The modified retrospective approach includes a number of optional practical expedients that entities may elect to apply. These practical expedients relate to the identification and classification of leases that commenced before the effective date, initial direct costs for leases that commenced before the effective date, and the ability to use hindsight in evaluating lessee options to extend or terminate a lease or to purchase the underlying asset. An entity that elects to apply the practical expedients will, in effect, continue to account for leases that commence before the effective date in accordance with previous GAAP unless the lease is modified, except that lessees are required to recognize a right-of-use asset and a lease liability for all operating leases at each reporting date based on the present value of the remaining minimum rental payments that were tracked and disclosed under previous GAAP. For public entities, ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early application of the amendments in this Update is permitted. The Company is currently evaluating the impact of the adoption of ASU 2016-02 on its consolidated financial statements.

Item 3 - Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Sensitivity

We are exposed to market risk from fluctuations in interest rates on the PNC Facility. The PNC Facility is a \$50,000,000 secured facility. Interest on loans under the PNC Facility is payable in arrears on the first day of each month with respect to loans bearing interest at the domestic rate (as set forth in the PNC Facility) and at the end of each interest period with respect to loans bearing interest at the Eurodollar rate (as set forth in the PNC Facility) or, for Eurodollar rate loans with an interest period in excess of three months, at the earlier of (a) each three months from the commencement of such Eurodollar rate loan or (b) the end of the interest period. As of March 31, 2016 interest charges with respect to loans are computed on the actual principal amount of loans outstanding during the month at a rate per annum equal to (A) with respect to Domestic Rate Loans (as defined in the PNC Facility), the sum of the Alternate Base Rate (as defined in the PNC Facility) plus one half of one percent (.50%) and (B) with respect to Eurodollar Rate Loans, the sum of the Eurodollar Rate plus two and one quarter of one percent (2.25%). The outstanding balance on the PNC Facility as of March 31, 2016 was \$29,808,000. Future interest rate changes on our borrowing under the PNC Facility may have an impact on our consolidated results of operations.

Refrigerant Market

We are also exposed to market risk from fluctuations in the demand, price and availability of refrigerants. To the extent that the Company is unable to source sufficient quantities of refrigerants or is unable to obtain refrigerants on commercially reasonable terms, or experiences a decline in demand and/or price for refrigerants sold by the Company, the Company could realize reductions in revenue from refrigerant sales, or inventory write-downs, which could have a material adverse effect on our consolidated results of operations.

Item 4 - Controls and Procedures

Disclosure Controls and Procedures

The Company, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures, as defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended ("Exchange Act"), as of the end of the period covered by this report. Based on that evaluation, the Chief Executive

Officer and the Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective and provided reasonable assurance that information required to be disclosed in reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission, and that such information is accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Because of the inherent limitations in all control systems, any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Furthermore, the Company's controls and procedures can be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the control and misstatements due to error or fraud may occur and not be detected on a timely basis.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) during the quarter ended March 31, 2016 that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1 - Legal Proceedings

For information regarding pending legal matters, refer to the Legal Proceedings Section in Part I, Item 3 of the Company's Form 10-K for the year ended December 31, 2015. There have been no material changes to such matters during the quarter ended March 31, 2016.

Item 6 - Exhibits

<u>Exhibit Number</u>	<u>Description</u>
10.1	Fifth Amendment to Revolving Credit, Term Loan and Security Agreement between Hudson Technologies Company, and PNC Bank, National Association, dated April 8, 2016 (1)
10.2	Second Amended and Restated Revolving Credit Note, dated April 8, 2016, by Hudson Technologies Company as borrower in favor of PNC (1)
10.3	Guarantors' Ratification dated April 8, 2016, by the Company and Hudson Holdings, Inc. (1)
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer 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	Interactive Data Files Pursuant to Rule 405 of Regulation S-T

(1) Incorporated by reference to the comparable exhibit filed with the Company's Current Report on Form 8-K filed April 14, 2016.

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.

HUDSON TECHNOLOGIES, INC.

By: /s/ Kevin J. Zugibe May 6, 2016
Kevin J. Zugibe **Date**
Chairman and
Chief Executive Officer

By: /s/ James R. Buscemi May 6, 2016
James R. Buscemi **Date**
Chief Financial Officer

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