FRANKLIN UNIVERSAL TRUST
Form N-CSR
October 31, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED

MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number: 811-05569

Franklin Universal Trust

(Exact name of registrant as specified in charter)

One Franklin Parkway, San Mateo, Ca 94403-1906

(Address of principal executive offices) (Zip code)

Craig S. Tyle, One Franklin Parkway, San Mateo, Ca 94403-1906

(Name and address of agent for service)

Registrant s telephone number, including area code: (650) 312-2000

Date of fiscal year end: 8/31

Date of reporting period: 8/31/17

Item 1. Reports to Stockholders.

Annual Report

August 31, 2017

Franklin Templeton Investments

Gain From Our Perspective®

At Franklin Templeton Investments, we re dedicated to one goal: delivering exceptional asset management for our clients. By bringing together multiple, world-class investment teams in a single firm, we re able to offer specialized expertise across styles and asset classes, all supported by the strength and resources of one of the world s largest asset managers. This has helped us to become a trusted partner to individual and institutional investors across the globe.

Contents

Visit **franklintempleton.com/investor/ products/products/closed-end-funds** for fund updates, to access your account, or to find helpful financial planning tools.

Annual Report

Franklin Universal Trust

Dear Shareholder:

This annual report for Franklin Universal Trust covers the fiscal year ended August 31, 2017.

Your Fund s Goal and Main Investments

The Fund s primary investment objective is to provide high, current income consistent with preservation of capital. Its secondary objective is growth of income through dividend increases and capital appreciation.

Performance Overview

For the 12 months under review, the Fund s cumulative total returns were +12.74% based on net asset value and +11.81% based on market price, as shown in the Performance Summary on page 5. For comparison, the Credit Suisse (CS) High Yield Index, which is designed to mirror the investable universe of the US dollar-denominated high yield debt market, produced a +8.98% total return,[1] and utilities stocks, as measured by the Standard & Poor s® (S&P®) 500 Utilities Index, which tracks all electric utility stocks in the broad S&P 500® Index, posted a total return of +15.64% for the same period.[2]

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.

Economic and Market Overview

The US economy expanded during the 12-month period ended August 31, 2017. The economy strengthened in 2017 s second quarter, after moderating in the previous two quarters, largely due to growth in consumer spending, business investment, exports and federal government spending. The manufacturing and services sectors expanded during the period. The unemployment rate decreased from 4.9% in August 2016 to 4.4% at period-end.[3] Monthly retail sales were volatile, but

grew during most of the period. Annual inflation, as measured by the Consumer Price Index, increased from 1.1% in August 2016 to 1.9% during the period.

The US Federal Reserve (Fed) raised its target range for the federal funds rate by 0.25% three times during the period, amid signs of a growing US economy, a strengthening labor market and an improvement in business spending. At its July 2017 meeting, the Fed kept its target range unchanged, but signaled it expects to begin implementing its balance sheet reduction relatively soon, provided the economy continues to evolve as anticipated.

The 10-year Treasury yield, which moves inversely to its price, shifted throughout the period. The yield rose in October 2016 due to positive economic data and signals from the Fed about the possibility of an increase in interest rates in the near term. The yield further increased in November and December, amid a bond market sell-off, based on investor expectations that possible expansionary fiscal policies under new US President Donald Trump could lead to a stronger economy and higher inflation. In July 2017, the yield rose further amid hawkish comments from key central bankers around the world. However, geopolitical tensions in the Middle East and the Korean peninsula, US political turmoil, and uncertainty on whether the Fed would raise rates again in 2017, resulted in a decline in the yield at period-end. Overall, the 10-year Treasury yield rose from 1.58% at the beginning of the period to 2.12% at period-end.

Investment Strategy

We invest primarily in two asset classes: high yield bonds and utility stocks. Within the high yield portion of the portfolio, we use fundamental research to invest in a diversified portfolio of bonds. Within the utility portion of the portfolio, we focus on companies with attractive dividend yields and with a history of increasing their dividends.

1. Source: Credit Suisse Group.

2. Source: Morningstar.

The indexes are unmanaged and include reinvestment of any income or distributions. They do not reflect any fees, expenses or sales charges. One cannot invest directly in an index, and an index is not representative of the Fund s portfolio.

3. Source: Bureau of Labor Statistics

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 8.

Manager s Discussion

The Fund s primary asset classes delivered positive results over the annual period under review. During the reporting period, the US economy continued its moderate pace of growth. The yield on the 10-year Treasury bond began the period at 1.58% and finished the period at 2.12%. Several factors drove the Treasury yield higher including investor expectations of higher inflation and continued positive trends in key economic data, particularly the labor market and consumer and business confidence. These attributes also led the Fed to increase interest rates by 25 basis points (bps) in December 2016, March 2017 and June 2017. We believe investors were not averse to risk taking during the period.

Portfolio Composition

8/31/17

	% of Total Investments*
Corporate Bonds	64.1%
Utilities Common Stocks	30.9%
Natural Resources Common Stocks	1.5%
Materials Common Stocks	0.9%
Convertible Bonds	0.3%
Convertible Preferred Stocks**	0.0%
Transportation Common Stocks**	0.0%
Escrows and Litigation Trusts**	0.0%
Short-Term Investments & Other Net Assets	2.3%

*Percentage of total investments of the Fund. Total investments of the Fund include long-term and short-term investments and other net assets, excluding long-term debt issued by the Fund.

**Rounds to less than 0.1%.

During the period, crude oil prices were volatile but range bound. The price per barrel was $45 at the beginning of the period, rose to a high of $54, and fell to a low of $42 before ending the period at just over $47. Price volatility was primarily driven by ongoing talks between major oil producing nations about controlling supply. Other major commodities followed a similar pattern. The metals and mining sector led all sectors over the period. The retail sector was on the other end of the spectrum. High yield corporates, which are highly sensitive to investors growth expectations and risk sentiment, generated positive monthly returns for the majority of the period. The CS High Yield Index returned +8.98% during the period.[2] Overall, spreads over Treasuries increased marginally from 432 to 440 basis points (bps) over the period; higher short- and medium-term Treasury yields factored into that move.

Utilities stocks, as measured by the S&P 500 Utilities Index, returned +15.64% during the period, almost in-line with the

+16.23% return of the S&P 500 index.[2] As regulated companies that must distribute a significant portion of their income as dividends, utility stock prices benefited considerably from benign global inflationary signals.

High Yield Corporate Bonds

The Fund benefited from its positions in the metals and mining and energy sectors during the period. Relative to the CS High Yield Index, our allocations to both sectors were generally overweighted, although we ended the period underweighted in the energy sector in market value terms. Oversupply in many commodities coupled with concerns over slowing growth in China led to falling prices in 2015 and early 2016. Driven by an improved balance of supply and demand, these trends reversed in early 2016 and, despite pockets of volatility, finished the period at marginally higher levels than 12 months ago.

Top 10 Holdings*

Based on Total Investments**

8/31/17 vs. 8/31/16

Issuer	**8/31/17**
Dominion Energy Inc.	2.4%
NextEra Energy Inc.	2.3%
Sempra Energy	2.2%
American Electric Power Co. Inc.	2.1%
Pinnacle West Capital Corp.	1.9%
Duke Energy Corp.	1.9%
Edison International	1.8%
CenterPoint Energy Inc.	1.4%
Navient Corp.	1.3%
PG&E Corp.	1.3%

Issuer	**8/31/16**
Dominion Resources Inc.	2.3%
Sempra Energy	2.1%
NextEra Energy Inc.	2.0%
American Electric Power Co. Inc.	1.9%
Duke Energy Corp.	1.8%
Edison International	1.8%
Pinnacle West Capital Corp.	1.7%
The Southern Co.	1.4%
Navient Corp.	1.3%
Westar Energy Inc.	1.3%

*Excludes money market funds.

**Percentage of total investments of the Fund. Total investments of the Fund include long-term and short-term investments and other net assets, excluding long-term debt issued by the Fund.

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The Fund s allocation to the health care sector detracted from relative performance over the period. Although an aging population generally helps the industry, many health care companies have faced challenges over the past year or so, in the form of uncertainty surrounding the overall direction of public health care policy in the US under the new presidential administration. Many companies have further come under pressure because of drug pricing practices. This combination of events led to lower revenue expectations for the broader health care industry, which we believe in many cases could be exaggerated.

Utility Stocks

The utilities sector, as measured by the S&P 500 Utilities Index, posted a strong return during the period, which was marginally below the return of the S&P 500 Index over the same period. Utility stock prices benefited from benign global inflationary signals, which have helped to keep long-dated US Treasuries at stable and relatively low yields. Utility stocks, given their traditional nature of paying out a significant percentage of income in the form of dividends, maintain a high level of correlation to Treasuries. We believe the financial health of the utilities sector remained intact, with most companies comfortably growing their earnings and dividends at a sustainable level in the mid-single digit range.

Thank you for your continued participation in Franklin Universal Trust. We look forward to serving your future investment needs.

Sincerely,

Christopher J. Molumphy, CFA

Senior Portfolio Manager

Glenn I. Voyles, CFA

Portfolio Manager

The foregoing information reflects our analysis, opinions and portfolio holdings as of August 31, 2017, 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 August 31, 2017

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. 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.

Performance as of 8/31/17[1]

	Cumulative Total Return[2]		Average Annual Total Return[2]	
	Based on NAV[3]	**Based on market price[4]**	**Based on NAV[3]**	**Based on market price[4]**
1-Year	+12.74%	+11.81%	+12.74%	+11.81%
5-Year	+47.64%	+35.97%	+8.10%	+6.34%
10-Year	+111.80%	+122.23%	+7.79%	+8.31%

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.

Share Prices

Symbol: FT	**8/31/17**	**8/31/16**	**Change**
Net Asset Value (NAV)	$8.24	$7.67	+$0.57
Market Price (NYSE)	$7.24	$6.84	+$0.40

Distributions (9/1/16 8/31/17)

Net Investment

Income

$0.3840

All investments involve risks, including possible loss of principal. Bond prices generally move in the opposite direction of interest rates. As 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. Stock prices fluctuate, sometimes rapidly and dramatically, due to factors affecting individual companies, particular industries or sectors, or general market conditions. In addition to having sensitivity to other factors, securities issued by utility companies have historically been sensitive to interest rate changes. When interest rates fall, utility securities prices, and thus a utilities fund s share price, tend to rise; when interest rates rise, their prices generally fall. For stocks paying dividends, dividends are not guaranteed, and can increase, decrease or be totally eliminated without notice. The Fund is actively managed but there is no guarantee that the manager s investment decisions will produce the desired results.

1. The Fund has a fee waiver associated with any investment it makes in a Franklin Templeton money fund and/or other Franklin Templeton fund, contractually guaranteed through 8/31/17. Fund investment results reflect the fee waiver; without this waiver, the results would have been lower.

2. Total return calculations represent the cumulative and average annual changes in value of an investment over the periods indicated. Return for less than one year, if any, has not been annualized.

3. Assumes reinvestment of distributions based on net asset value.

4. Assumes reinvestment of distributions based on the dividend reinvestment and cash purchase plan.

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Important Notice to Shareholders

The Fund s Board previously authorized an open-market share repurchase program, pursuant to which the Fund may purchase Fund shares, from time to time, up to 10% of the Fund s common shares in open-market transactions, at the discretion of management. This authorization remains in effect.

Financial Highlights

	Year Ended August 31,				
	2017	**2016**	**2015**	**2014**	**2013**
Per share operating performance (for a share outstanding throughout the year)					
Net asset value, beginning of year	$ 7.67	$ 7.11	$ 8.34	$ 7.61	$ 7.47
Income from investment operations:					
Net investment income[a]	0.38	0.39	0.45	0.47	0.43
Net realized and unrealized gains (losses)	0.57	0.64	(1.21)	0.73	0.17
Total from investment operations	0.95	1.03	(0.76)	1.20	0.60
Less distributions from net investment income	(0.38)	(0.47)	(0.47)	(0.47)	(0.46)
Net asset value, end of year	$ 8.24	$ 7.67	$ 7.11	$ 8.34	$ 7.61
Market value, end of year[b]	$ 7.24	$ 6.84	$ 6.10	$ 7.39	$ 6.76
Total return (based on market value per share)	11.81%	20.76%	(11.57)%	16.71%	(2.45)%
Ratios to average net assets					
Expenses before waiver and payments by affiliates	2.00%	2.13%	1.97%	1.97%	2.34%
Expenses net of waiver and payments by affiliates	1.99%[c]	2.12%[c]	1.97%[c,d]	1.97%[c,d]	2.34%
Net investment income	4.81%	5.48%	5.63%	5.76%	5.58%
Supplemental data					
Net assets, end of year (000 s)	$206,965	$192,682	$178,747	$209,674	$191,223
Portfolio turnover rate	23.25%	21.13%	20.30%	18.25%	21.95%
Total debt outstanding at end of year (000 s)	$60,000	$60,000	$60,000	$60,000	$60,000
Asset coverage per $1,000 of debt	$4,449	$4,211	$3,979	$4,495	$4,187
Average amount of senior rate fixed Notes per share during the year	$2.39	$2.39	$2.39	$2.39	$1.68

[a]Based on average daily shares outstanding.

[b]Based on the last sale on the New York Stock Exchange.

[c]Benefit of expense reduction rounds to less than 0.01%.

[d]Benefit of waiver and payments by affiliates rounds to less than 0.01%.

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Statement of Investments, August 31, 2017

		Country	Shares/ Warrants	Value
	Common Stocks and Other Equity Interests 42.9%			
	Energy 1.9%			
[a]	Chaparral Energy Inc., A	United States	27,903	$ 558,060
[a,b]	Chaparral Energy Inc., A, 144A	United States	214	4,280
[a]	Chaparral Energy Inc., B	United States	5,868	117,360
[a]	CHC Group LLC	Cayman Islands	10,468	88,978
	Enbridge Inc.	Canada	39,360	1,574,006
[a]	Energy XXI Gulf Coast Inc.	United States	12,053	125,954
[a]	Energy XXI Gulf Coast Inc., wts., 12/30/21	United States	5,433	4,618
[a]	Goodrich Petroleum Corp.	United States	19,379	166,659
[a]	Halcon Resources Corp.	United States	52,355	324,077
[a]	Halcon Resources Corp., wts., 9/09/20	United States	4,668	2,334
[a]	Linn Energy Inc.	United States	14,316	480,016
[a]	Midstates Petroleum Co. Inc.	United States	318	4,608
[a,c]	Midstates Petroleum Co. Inc., wts., 4/21/20	United States	2,256	680
[a]	Penn Virginia Corp.	United States	8,772	337,722
[a]	W&T Offshore Inc.	United States	31,460	60,089
				3,849,441
	Materials 1.1%			
	BHP Billiton PLC, ADR	United Kingdom	25,185	960,304
[a]	Freeport-McMoRan Inc.	United States	80,380	1,188,016
	South32 Ltd., ADR	Australia	10,074	117,664
[a]	Verso Corp., A	United States	3,330	17,716
[a]	Verso Corp., wts., 7/25/23	United States	350	53
				2,283,753
	Transportation 0.0%			
[a]	CEVA Holdings LLC	United States	179	53,829
	Utilities 39.9%			
	Alliant Energy Corp.	United States	80,000	3,419,200
	American Electric Power Co. Inc.	United States	75,000	5,522,250
	CenterPoint Energy Inc.	United States	122,800	3,637,336
	CMS Energy Corp.	United States	65,000	3,155,100
	Consolidated Edison Inc.	United States	40,000	3,370,800
	Dominion Energy Inc.	United States	80,000	6,301,600

DTE Energy Co.	United States	25,000	2,808,000
Duke Energy Corp.	United States	57,560	5,024,988
Edison International	United States	61,000	4,890,980
Entergy Corp.	United States	30,000	2,375,100
Exelon Corp.	United States	55,000	2,082,850
FirstEnergy Corp.	United States	60,000	1,954,800
Great Plains Energy Inc.	United States	70,000	2,148,300
NextEra Energy Inc.	United States	41,500	6,246,165
PG&E Corp.	United States	50,000	3,519,000
Pinnacle West Capital Corp.	United States	56,000	5,038,320
PPL Corp.	United States	24,500	961,380
Public Service Enterprise Group Inc.	United States	45,000	2,107,800
Sempra Energy	United States	50,000	5,896,500
The Southern Co.	United States	68,250	3,293,745
Vistra Energy Corp.	United States	5,994	106,094
WEC Energy Group Inc.	United States	40,000	2,608,800
Westar Energy Inc.	United States	60,000	3,078,600

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STATEMENT OF INVESTMENTS

		Country	Shares/ Warrants	Value
	Common Stocks and Other Equity Interests (continued)			
	Utilities (continued)			
	Xcel Energy Inc.	United States	60,000	$ 2,970,000
				82,517,708
	Total Common Stocks and Other Equity Interests (Cost $45,506,745)			88,704,731
	Convertible Preferred Stocks 0.1%			
	Transportation 0.1%			
[a]	CEVA Holdings LLC, cvt. pfd., A-1	United States	6	2,550
[a]	CEVA Holdings LLC, cvt. pfd., A-2	United States	388	126,233
	Total Convertible Preferred Stocks (Cost $587,092)			128,783
			Principal Amount*	
	Convertible Bonds (Cost $995,870) 0.4%			
	Energy 0.4%			
	CHC Group LLC/CHC Finance Ltd., cvt., zero cpn., 10/01/20	Cayman Islands	$ 538,308	831,686
	Corporate Bonds 82.6%			
	Automobiles & Components 0.7%			
	The Goodyear Tire & Rubber Co.,			
	senior bond, 5.00%, 5/31/26	United States	1,100,000	1,152,250
	senior note, 5.125%, 11/15/23	United States	300,000	314,622
				1,466,872
	Banks 2.5%			
	CIT Group Inc.,			
	senior note, 5.375%, 5/15/20	United States	500,000	538,125
	senior note, 5.00%, 8/15/22	United States	1,200,000	1,301,880
[d]	Citigroup Inc., junior sub. bond, M, 6.30% to 5/15/24, FRN thereafter, Perpetual	United States	1,100,000	1,199,000
[d]	JPMorgan Chase & Co.,			
	junior sub. bond, R, 6.00% to 8/01/23, FRN thereafter, Perpetual	United States	900,000	974,250
		United States	1,100,000	1,118,425

	junior sub. bond, V, 5.00% to 7/30/19, FRN thereafter, Perpetual			
				5,131,680
	Capital Goods 4.6%			
b	Cloud Crane LLC, secured note, second lien, 144A, 10.125%, 8/01/24	United States	300,000	336,750
	CNH Industrial Capital LLC, senior note, 3.875%, 10/15/21	United States	1,700,000	1,742,500
b	H&E Equipment Services Inc., senior note, 144A, 5.625%, 9/01/25	United States	600,000	621,000
b	HD Supply Inc., senior note, 144A, 5.75%, 4/15/24	United States	400,000	430,000
	Navistar International Corp., senior bond, 8.25%, 11/01/21	United States	800,000	808,000
	Oshkosh Corp., senior note, 5.375%, 3/01/22	United States	500,000	520,625
b	Tennant Co., senior note, 144A, 5.625%, 5/01/25	United States	1,000,000	1,048,750
b	Terex Corp., senior note, 144A, 5.625%, 2/01/25	United States	1,400,000	1,464,750
	TransDigm Inc.,			
	senior sub. bond, 6.50%, 7/15/24	United States	600,000	624,750
	senior sub. bond, 6.50%, 5/15/25	United States	100,000	103,250
b	Vertiv Group Corp., senior note, 144A, 9.25%, 10/15/24	United States	1,700,000	1,899,750
				9,600,125

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STATEMENT OF INVESTMENTS

		Country	Principal Amount*	Value
	Corporate Bonds (continued)			
	Commercial & Professional Services 1.0%			
	United Rentals North America Inc.,			
	senior bond, 5.75%, 11/15/24	United States	$ 1,400,000	$ 1,503,670
	senior bond, 5.875%, 9/15/26	United States	100,000	109,225
	senior bond, 5.50%, 5/15/27	United States	500,000	531,250
				2,144,145
	Consumer Durables & Apparel 6.1%			
b	Ashton Woods USA LLC, senior note, 144A, 6.75%, 8/01/25	United States	1,300,000	1,296,750
	Beazer Homes USA Inc.,			
	senior note, 8.75%, 3/15/22	United States	1,300,000	1,439,750
	senior note, 6.75%, 3/15/25	United States	100,000	105,750
b	Hanesbrands Inc., senior note, 144A, 4.625%, 5/15/24	United States	1,500,000	1,567,500
	KB Home,			
	senior bond, 7.50%, 9/15/22	United States	1,100,000	1,267,750
	senior note, 4.75%, 5/15/19	United States	200,000	206,000
	senior note, 7.00%, 12/15/21	United States	300,000	336,000
	Newell Brands Inc., senior note, 5.00%, 11/15/23	United States	700,000	747,761
	PulteGroup Inc., senior bond, 5.00%, 1/15/27	United States	1,700,000	1,757,375
b	Taylor Morrison Communities Inc./Taylor Morrison Holdings II Inc.,			
	senior note, 144A, 5.25%, 4/15/21	United States	400,000	409,820
	senior note, 144A, 5.875%, 4/15/23	United States	100,000	106,500
	senior note, 144A, 5.625%, 3/01/24	United States	1,000,000	1,058,750
	Toll Brothers Finance Corp., senior bond, 5.625%, 1/15/24	United States	700,000	758,625
b	Weekley Homes LLC/Weekley Finance Corp., senior note, 144A, 6.625%, 8/15/25	United States	1,700,000	1,657,500
				12,715,831
	Consumer Services 5.2%			
b	1011778 BC ULC/New Red Finance Inc., senior secured note, first lien, 144A, 4.25%, 5/15/24	Canada	900,000	913,500
b	24 Hour Holdings III LLC, senior note, 144A, 8.00%, 6/01/22	United States	1,000,000	937,800
b	Ascend Learning LLC, senior note, 144A, 6.875%, 8/01/25	United States	600,000	625,500
b	International Game Technology PLC, senior secured bond, 144A, 6.50%, 2/15/25	United States	2,200,000	2,472,250
b	Jack Ohio Finance LLC/Jack Ohio Finance 1 Corp., senior secured note, first lien, 144A, 6.75%, 11/15/21	United States	1,700,000	1,772,250
b				

	KFC Holding Co./Pizza Hut Holdings LLC/Taco Bell of America LLC,			
	senior note, 144A, 5.00%, 6/01/24	United States	600,000	628,680
	senior note, 144A, 5.25%, 6/01/26	United States	600,000	633,750
b	Silversea Cruise Finance Ltd., senior secured note, first lien, 144A, 7.25%, 2/01/25	United States	500,000	541,250
b	Wynn Las Vegas LLC/Wynn Las Vegas Capital Corp., senior bond, 144A, 5.50%, 3/01/25	United States	1,300,000	1,358,500
b	Wynn Macau Ltd., senior note, 144A, 5.25%, 10/15/21	Macau	800,000	818,000
				10,701,480
	Diversified Financials 2.6%			
b	FirstCash Inc., senior note, 144A, 5.375%, 6/01/24	United States	1,100,000	1,163,250
b	MSCI Inc., senior note, 144A, 4.75%, 8/01/26	United States	600,000	624,000
	Navient Corp.,			
	senior note, 4.875%, 6/17/19	United States	800,000	829,000
	senior note, 6.625%, 7/26/21	United States	800,000	855,000
	senior note, 7.25%, 9/25/23	United States	1,700,000	1,852,320
				5,323,570

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STATEMENT OF INVESTMENTS

		Country	Principal Amount*	Value
	Corporate Bonds (continued)			
	Energy 8.2%			
	Bill Barrett Corp., senior note, 8.75%, 6/15/25	United States	$ 1,700,000	$ 1,504,500
[e]	BreitBurn Energy Partners LP/BreitBurn Finance Corp.,			
	senior bond, 7.875%, 4/15/22	United States	200,000	36,000
	senior note, 8.625%, 10/15/20	United States	600,000	108,000
	California Resources Corp.,			
	[b] secured note, second lien, 144A, 8.00%, 12/15/22	United States	615,000	342,094
	senior bond, 6.00%, 11/15/24	United States	15,000	6,225
	senior note, 5.50%, 9/15/21	United States	10,000	4,400
	Calumet Specialty Products Partners LP/Calumet Finance Corp.,			
	senior note, 7.75%, 4/15/23	United States	800,000	764,000
	[b] senior note, 144A, 11.50%, 1/15/21	United States	300,000	349,500
	Cheniere Corpus Christi Holdings LLC,			
	senior note, first lien, 7.00%, 6/30/24	United States	600,000	685,500
	senior secured note, first lien, 5.875%, 3/31/25	United States	1,000,000	1,078,750
	CONSOL Energy Inc.,			
	senior note, 5.875%, 4/15/22	United States	300,000	301,500
	senior note, 8.00%, 4/01/23	United States	600,000	636,000
	Crestwood Midstream Partners LP/Crestwood Midstream Finance Corp.,			
	senior note, 6.25%, 4/01/23	United States	500,000	518,750
	senior note, 5.75%, 4/01/25	United States	800,000	813,000
	CSI Compressco LP/CSI Compressco Finance Inc., senior note, 7.25%, 8/15/22	United States	800,000	722,000
	Energy Transfer Equity LP,			
	senior note, first lien, 7.50%, 10/15/20	United States	1,200,000	1,360,500
	senior secured bond, first lien, 5.875%, 1/15/24	United States	200,000	216,500
[b,f]	EnQuest PLC, senior note, 144A, PIK, 8.00%, 10/15/23	United Kingdom	642,878	421,213
	Ferrellgas LP/Ferrellgas Finance Corp., senior note, 6.75%, 6/15/23	United States	700,000	666,750
	Martin Midstream Partners LP/Martin Midstream Finance Corp., senior note, 7.25%, 2/15/21	United States	600,000	615,000
[b]	Murray Energy Corp., secured note, second lien, 144A, 11.25%, 4/15/21	United States	700,000	406,875
	QEP Resources Inc., senior bond, 5.375%, 10/01/22	United States	1,600,000	1,548,000
	Sabine Pass Liquefaction LLC,			
	senior secured note, first lien, 6.25%, 3/15/22	United States	200,000	225,798
	senior secured note, first lien, 5.625%, 4/15/23	United States	500,000	554,319

	Sanchez Energy Corp.,			
	senior note, 7.75%, 6/15/21	United States	800,000	696,000
	senior note, 6.125%, 1/15/23	United States	100,000	76,750
b,f	W&T Offshore Inc.,			
	secured note, second lien, 144A, PIK, 10.75%, 5/15/20	United States	275,482	234,986
	senior secured note, third lien, 144A, PIK, 10.00%, 6/15/21	United States	246,533	178,663
	Weatherford International Ltd.,			
	senior note, 5.125%, 9/15/20	United States	200,000	194,000
	senior note, 7.75%, 6/15/21	United States	400,000	401,500
	senior note, 4.50%, 4/15/22	United States	400,000	359,000
	senior note, 8.25%, 6/15/23	United States	600,000	589,500
	WPX Energy Inc., senior note, 8.25%, 8/01/23	United States	400,000	441,000
				17,056,573
	Food, Beverage & Tobacco 3.8%			
	Constellation Brands Inc.,			
	senior bond, 4.75%, 11/15/24	United States	400,000	443,731
	senior note, 4.25%, 5/01/23	United States	500,000	539,803
	senior note, 4.75%, 12/01/25	United States	100,000	110,951

FRANKLIN UNIVERSAL TRUST

STATEMENT OF INVESTMENTS

		Country	Principal Amount*	Value
	Corporate Bonds (continued)			
	Food, Beverage & Tobacco (continued)			
b	Cott Holdings Inc., senior note, 144A, 5.50%, 4/01/25	Canada	$ 1,700,000	$ 1,787,125
b	JBS USA LLC/Finance Inc.,			
	senior bond, 144A, 5.875%, 7/15/24	United States	900,000	915,750
	senior note, 144A, 7.25%, 6/01/21	United States	800,000	822,000
b	Lamb Weston Holdings Inc.,			
	senior note, 144A, 4.625%, 11/01/24	United States	500,000	518,125
	senior note, 144A, 4.875%, 11/01/26	United States	1,000,000	1,040,150
b	Post Holdings Inc.,			
	senior bond, 144A, 5.00%, 8/15/26	United States	900,000	902,250
	senior note, 144A, 6.00%, 12/15/22	United States	300,000	316,875
	senior note, 144A, 5.50%, 3/01/25	United States	400,000	417,000
				7,813,760
	Health Care Equipment & Services 5.2%			
	CHS/Community Health Systems Inc.,			
	senior note, 7.125%, 7/15/20	United States	700,000	661,062
	senior note, 6.875%, 2/01/22	United States	200,000	166,750
	senior secured note, first lien, 6.25%, 3/31/23	United States	600,000	606,750
	DaVita Inc., senior note, 5.75%, 8/15/22	United States	500,000	515,938
b	Envision Healthcare Corp., senior note, 144A, 6.25%, 12/01/24	United States	1,500,000	1,620,000
	HCA Inc.,			
	senior bond, 5.875%, 5/01/23	United States	800,000	877,200
	senior bond, 5.875%, 2/15/26	United States	1,400,000	1,513,750
	senior secured bond, first lien, 5.875%, 3/15/22	United States	600,000	666,240
b	MPH Acquisition Holdings LLC, senior note, 144A, 7.125%, 6/01/24	United States	1,300,000	1,397,500
	Tenet Healthcare Corp.,			
	senior note, 5.50%, 3/01/19	United States	400,000	414,000
	senior note, 8.125%, 4/01/22	United States	1,000,000	1,052,500
	WellCare Health Plans Inc., senior note, 5.25%, 4/01/25	United States	1,200,000	1,260,000
				10,751,690
	Materials 11.5%			
b	American Builders & Contractors Supply Co. Inc., senior note, 144A, 5.625%, 4/15/21	United States	342,000	353,115
f	ARD Finance SA, secured note, PIK, 7.125%, 9/15/23	Luxembourg	400,000	425,500
b	Ardagh Packaging Finance PLC/Ardagh MP Holdings USA Inc., senior note, 144A, 6.00%, 6/30/21	Luxembourg	500,000	515,000

b	Axalta Coating Systems LLC, senior note, 144A, 4.875%, 8/15/24	United States	400,000	410,000
b	BlueScope Steel Ltd./BlueScope Steel Finance, senior note, 144A, 6.50%, 5/15/21	Australia	1,500,000	1,576,957
b	BWAY Holding Co., senior note, 144A, 7.25%, 4/15/25	United States	1,700,000	1,740,375
b	Cemex SAB de CV, senior secured bond, first lien, 144A, 5.70%, 1/11/25	Mexico	1,100,000	1,175,240
	The Chemours Co.,			
	senior bond, 7.00%, 5/15/25	United States	200,000	221,500
	senior note, 6.625%, 5/15/23	United States	1,100,000	1,172,875
	senior note, 5.375%, 5/15/27	United States	300,000	313,500
b	CVR Partners LP/CVR Nitrogen Finance Corp., secured note, second lien, 144A, 9.25%, 6/15/23	United States	300,000	309,000
b	Eldorado Gold Corp., senior note, 144A, 6.125%, 12/15/20	Canada	500,000	511,250
b	First Quantum Minerals Ltd.,			
	senior note, 144A, 7.00%, 2/15/21	Zambia	931,000	963,003
	senior note, 144A, 7.25%, 4/01/23	Zambia	600,000	618,000

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STATEMENT OF INVESTMENTS

		Country	Principal Amount*	Value
	Corporate Bonds (continued)			
	Materials (continued)			
b	FMG Resources (August 2006) Pty. Ltd., senior note, 144A, 4.75%, 5/15/22	Australia	$ 800,000	$ 827,136
b	Grinding Media Inc./MC Grinding Media Canada Inc., senior secured note, 144A, 7.375%, 12/15/23	United States	700,000	754,250
b	New Gold Inc., senior note, 144A, 6.375%, 5/15/25	Canada	700,000	726,250
b	Novelis Corp.,			
	senior bond, 144A, 5.875%, 9/30/26	United States	500,000	522,500
	senior note, 144A, 6.25%, 8/15/24	United States	700,000	741,125
b	Owens-Brockway Glass Container Inc.,			
	senior note, 144A, 5.00%, 1/15/22	United States	1,000,000	1,053,750
	senior note, 144A, 5.875%, 8/15/23	United States	500,000	549,688
b	Platform Specialty Products Corp.,			
	senior note, 144A, 10.375%, 5/01/21	United States	100,000	109,875
	senior note, 144A, 6.50%, 2/01/22	United States	600,000	625,500
b	Rain CII Carbon LLC/CII Carbon Corp., secured note, second lien, 144A, 8.25%, 1/15/21	United States	500,000	520,000
	Reynolds Group Issuer Inc./Reynolds Group Issuer LLC/Reynolds Group Issuer Luxembourg SA,			
	[b] senior note, 144A, 7.00%, 7/15/24	United States	200,000	214,625
	senior secured note, first lien, 5.75%, 10/15/20	United States	500,000	509,945
	[b] senior secured note, first lien, 144A, 5.125%, 7/15/23	United States	1,000,000	1,043,440
b	Sealed Air Corp.,			
	senior bond, 144A, 5.50%, 9/15/25	United States	400,000	436,000
	senior note, 144A, 6.50%, 12/01/20	United States	400,000	448,240
	Steel Dynamics Inc.,			
	senior bond, 5.50%, 10/01/24	United States	900,000	968,625
	senior bond, 5.00%, 12/15/26	United States	700,000	742,000
	senior note, 5.125%, 10/01/21	United States	400,000	411,480
	Summit Materials LLC/Summit Materials Finance Corp., senior note, 8.50%, 4/15/22	United States	1,000,000	1,132,500
b	SunCoke Energy Partners LP/SunCoke Energy Partners Finance Corp., senior note, 144A, 7.50%, 6/15/25	United States	1,200,000	1,230,000
				23,872,244
	Media 8.9%			
b	Altice U.S. Finance I Corp., senior secured bond, 144A, 5.50%, 5/15/26	United States	900,000	954,563

	AMC Entertainment Holdings Inc., senior sub. note, 5.875%, 11/15/26	United States	400,000	377,500
	AMC Networks Inc., senior note, 5.00%, 4/01/24	United States	900,000	930,375
	Cablevision Systems Corp., senior note, 8.625%, 9/15/17	United States	324,000	324,891
	CCO Holdings LLC/CCO Holdings Capital Corp.,			
	senior bond, 5.25%, 9/30/22	United States	1,700,000	1,755,250
	[b] senior bond, 144A, 5.75%, 2/15/26	United States	700,000	741,783
	Clear Channel Worldwide Holdings Inc.,			
	senior note, 6.50%, 11/15/22	United States	1,000,000	1,032,500
	senior sub. note, 7.625%, 3/15/20	United States	700,000	700,000
	CSC Holdings LLC,			
[b]	senior bond, 144A, 5.50%, 4/15/27	United States	500,000	523,750
	senior note, 6.75%, 11/15/21	United States	700,000	775,460
	senior note, 5.25%, 6/01/24	United States	700,000	720,125
	DISH DBS Corp.,			
	senior note, 6.75%, 6/01/21	United States	700,000	774,375
	senior note, 7.75%, 7/01/26	United States	800,000	941,000

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STATEMENT OF INVESTMENTS

		Country	Principal Amount*	Value
	Corporate Bonds (continued)			
	Media (continued)			
	iHeartCommunications Inc.,			
	senior secured bond, first lien, 9.00%, 3/01/21	United States	$ 1,000,000	$ 731,250
	senior secured note, first lien, 9.00%, 9/15/22	United States	100,000	72,875
b	Nexstar Broadcasting Inc., senior note, 144A, 5.625%, 8/01/24	United States	600,000	622,500
b	Radio One Inc., senior sub. note, 144A, 9.25%, 2/15/20	United States	500,000	487,500
b	Sirius XM Radio Inc.,			
	senior bond, 144A, 6.00%, 7/15/24	United States	800,000	866,224
	senior bond, 144A, 5.375%, 4/15/25	United States	700,000	741,720
	Tegna Inc.,			
	senior bond, 6.375%, 10/15/23	United States	900,000	958,500
	senior note, 5.125%, 7/15/20	United States	800,000	821,232
b	Univision Communications Inc., senior secured bond, first lien, 144A, 6.75%, 9/15/22	United States	358,000	371,783
b	Virgin Media Finance PLC, senior bond, 144A, 6.375%, 4/15/23	United Kingdom	300,000	315,750
b	Virgin Media Secured Finance PLC,			
	senior secured bond, 144A, 5.25%, 1/15/26	United Kingdom	500,000	521,250
	senior secured bond, first lien, 144A, 5.50%, 1/15/25	United Kingdom	800,000	839,000
	senior secured bond, first lien, 144A, 5.50%, 8/15/26	United Kingdom	200,000	212,500
b	WMG Acquisition Corp.,			
	secured note, first lien, 144A, 5.00%, 8/01/23	United States	200,000	207,250
	senior note, 144A, 5.625%, 4/15/22	United States	92,000	96,140
				18,417,046
	Pharmaceuticals, Biotechnology & Life Sciences 3.0%			
b	Concordia International Corp.,			
	senior note, 144A, 7.00%, 4/15/23	Canada	900,000	153,000
	senior secured note, first lien, 144A, 9.00%, 4/01/22	Canada	400,000	290,000
b	Endo Dac/Endo Finance LLC/Endo Finco Inc.,			
	senior bond, 144A, 6.00%, 2/01/25	United States	800,000	662,000
	senior note, 144A, 6.00%, 7/15/23	United States	1,000,000	840,170
	Horizon Pharma Inc., senior note, 6.625%, 5/01/23	United States	1,500,000	1,462,500
b	Jaguar Holding Co. II/Pharmaceutical Product Development LLC, senior note, 144A, 6.375%, 8/01/23	United States	500,000	525,600
b	Valeant Pharmaceuticals International, senior note, 144A, 6.375%, 10/15/20	United States	1,100,000	1,094,830
b	Valeant Pharmaceuticals International Inc.,			

senior bond, 144A, 6.125%, 4/15/25	United States	300,000	254,250
senior note, 144A, 5.625%, 12/01/21	United States	700,000	645,750
senior note, first lien, 144A, 7.00%, 3/15/24	United States	200,000	212,750
			6,140,850
Real Estate 1.2%			
Equinix Inc.,			
senior bond, 5.375%, 4/01/23	United States	1,300,000	1,361,750
senior bond, 5.875%, 1/15/26	United States	200,000	220,000
MPT Operating Partnership LP/MPT Finance Corp.,			
senior bond, 5.25%, 8/01/26	United States	300,000	312,750
senior note, 6.375%, 3/01/24	United States	600,000	654,750
			2,549,250

FRANKLIN UNIVERSAL TRUST

STATEMENT OF INVESTMENTS

		Country	Principal Amount*	Value
	Corporate Bonds (continued)			
	Retailing 1.3%			
	Dollar Tree Inc., senior note, 5.75%, 3/01/23	United States	$ 500,000	$ 530,000
	Netflix Inc., senior bond, 5.875%, 2/15/25	United States	1,100,000	1,193,500
b	PetSmart Inc.,			
	senior note, 144A, 7.125%, 3/15/23	United States	300,000	245,250
	senior note, 144A, 8.875%, 6/01/25	United States	300,000	250,500
	senior secured note, first lien, 144A, 5.875%, 6/01/25	United States	600,000	538,500
				2,757,750
	Semiconductors & Semiconductor Equipment 0.9%			
b	Microsemi Corp., senior note, 144A, 9.125%, 4/15/23	United States	261,000	299,552
	Qorvo Inc., senior bond, 7.00%, 12/01/25	United States	1,300,000	1,478,750
				1,778,302
	Software & Services 2.4%			
b	CyrusOne LP/CyrusOne Finance Corp., senior note, 144A, 5.00%, 3/15/24	United States	400,000	418,000
b	First Data Corp.,			
	secured note, second lien, 144A, 5.75%, 1/15/24	United States	1,700,000	1,794,010
	senior note, 144A, 7.00%, 12/01/23	United States	400,000	432,000
	Infor (U.S.) Inc., senior note, 6.50%, 5/15/22	United States	1,700,000	1,742,500
b	Symantec Corp., senior note, 144A, 5.00%, 4/15/25	United States	500,000	524,850
				4,911,360
	Technology Hardware & Equipment 2.5%			
b	Blackboard Inc., secured note, second lien, 144A, 9.75%, 10/15/21	United States	1,542,000	1,405,148
	CDW LLC/CDW Finance Corp., senior note, 5.00%, 9/01/25	United States	800,000	838,000
b	CommScope Technologies LLC, senior bond, 144A, 6.00%, 6/15/25	United States	900,000	960,750
b	Dell International LLC/EMC Corp.,			
	senior note, 144A, 5.875%, 6/15/21	United States	200,000	210,190
	senior note, 144A, 7.125%, 6/15/24	United States	200,000	221,646
	senior secured bond, first lien, 144A, 6.02%, 6/15/26	United States	200,000	223,643

	senior secured note, first lien, 144A, 5.45%, 6/15/23	United States	300,000	329,062
b	Tempo Acquisition LLC/Tempo Acquisition Finance Corp.,			
	senior note, 144A, 6.75%, 6/01/25	United States	1,000,000	1,025,000
				5,213,439
	Telecommunication Services 6.0%			
b	Block Communications Inc., senior note, 144A, 6.875%, 2/15/25	United States	300,000	324,187
	CenturyLink Inc.,			
	senior bond, 6.75%, 12/01/23	United States	200,000	205,000
	senior bond, 5.625%, 4/01/25	United States	300,000	286,500
b	Digicel Group Ltd., senior note, 144A, 8.25%, 9/30/20	Bermuda	900,000	869,062
b	Digicel Ltd.,			
	senior note, 144A, 6.00%, 4/15/21	Bermuda	500,000	485,095
	senior note, 144A, 6.75%, 3/01/23	Bermuda	300,000	288,677
	Hughes Satellite Systems Corp., senior bond, 6.625%, 8/01/26	United States	1,400,000	1,531,250
	Intelsat Jackson Holdings SA, senior note, 7.50%, 4/01/21	Luxembourg	900,000	848,520
b	Sprint Communications Inc.,			
	senior note, 144A, 9.00%, 11/15/18	United States	223,000	241,119
	senior note, 144A, 7.00%, 3/01/20	United States	500,000	548,750
	Sprint Corp.,			
	senior bond, 7.875%, 9/15/23	United States	500,000	572,565
	senior bond, 7.125%, 6/15/24	United States	500,000	550,625

FRANKLIN UNIVERSAL TRUST

STATEMENT OF INVESTMENTS

		Country	Principal Amount*	Value
	Corporate Bonds (continued)			
	Telecommunication Services (continued)			
b	Sprint Spectrum Co. LLC/Sprint Spectrum Co. II LLC, first lien, 144A, 3.36%, 3/20/23	United States	$ 1,400,000	$ 1,421,913
	T-Mobile USA Inc.,			
	senior bond, 6.50%, 1/15/24	United States	200,000	214,000
	senior bond, 6.375%, 3/01/25	United States	500,000	539,687
	senior note, 6.125%, 1/15/22	United States	100,000	104,500
	senior note, 6.00%, 4/15/24	United States	200,000	213,250
b	Wind Acquisition Finance SA,			
	secured note, second lien, 144A, 7.375%, 4/23/21	Italy	1,700,000	1,770,125
	senior secured note, first lien, 144A, 4.75%, 7/15/20	Italy	300,000	304,875
b	Zayo Group LLC/Zayo Capital Inc., senior note, 144A, 5.75%, 1/15/27	United States	1,000,000	1,063,730
				12,383,430
	Transportation 1.3%			
b	DAE Funding LLC,			
	senior note, 144A, 4.50%, 8/01/22	United Arab Emirates	700,000	714,014
	senior note, 144A, 5.00%, 8/01/24	United Arab Emirates	700,000	712,334
b	Park Aerospace Holdings Ltd.,			
	senior note, 144A, 5.25%, 8/15/22	Ireland	500,000	521,250
	senior note, 144A, 5.50%, 2/15/24	Ireland	700,000	729,750
				2,677,348
	Utilities 3.7%			
	Calpine Corp., senior bond, 5.75%, 1/15/25	United States	1,600,000	1,472,000
	Dynegy Inc., senior bond, 7.625%, 11/01/24	United States	1,700,000	1,761,625
	Ferrellgas Partners LP/Ferrellgas Partners Finance Corp., senior note, 8.625%, 6/15/20	United States	800,000	724,000
b	InterGen NV, secured bond, 144A, 7.00%, 6/30/23	Netherlands	1,000,000	975,000
	NRG Yield Operating LLC,			
	senior bond, 5.375%, 8/15/24	United States	600,000	630,000
	senior bond, 5.00%, 9/15/26	United States	900,000	924,750
	Talen Energy Supply LLC, senior note, 6.50%, 6/01/25	United States	1,600,000	1,172,000
				7,659,375
	Total Corporate Bonds (Cost $167,177,954)			171,066,120

			Shares	
	Escrows and Litigation Trusts 0.0%			
[a,c]	Midstates Petroleum Co. Inc./Midstates Petroleum Co. LLC, Escrow Account	United States	700,000	
[a,c]	NewPage Corp., Litigation Trust	United States	1,200,000	
[a]	Penn Virginia Corp., Escrow Account	United States	700,000	12,250
[a,c]	Vistra Energy Corp., Escrow Account	United States	700,000	8,120
	Total Escrows and Litigation Trusts (Cost $20,297)			20,370
	Total Investments before Short Term Investments (Cost $214,287,958)			260,751,690

FRANKLIN UNIVERSAL TRUST

STATEMENT OF INVESTMENTS

		Country	Shares	Value
	Short Term Investments (Cost $3,783,213) 1.8%			
	Money Market Funds 1.8%			
[g,h]	Institutional Fiduciary Trust Money Market Portfolio, 0.66%	United States	3,783,213	$ 3,783,213
	Total Investments (Cost $218,071,171) 127.8%			264,534,903
	Notes Payable (29.0)%			(59,973,346)
	Other Assets, less Liabilities 1.2%			2,402,946
	Net Assets 100.0%			$ 206,964,503

See Abbreviations on page 27.

Rounds to less than 0.1% of net assets.

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

[a]Non-income producing.

[b]Security 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 Fund s Board of Trustees. At August 31, 2017, the aggregate value of these securities was $86,063,300, representing 41.6% of net assets.

[c]Fair valued using significant unobservable inputs. See Note 9 regarding fair value measurements.

[d]Perpetual security with no stated maturity date.

[e]See Note 8 regarding defaulted securities.

[f]Income may be received in additional securities and/or cash.

[g]See Note 4(c) regarding investments in affiliated management investment companies.

[h]The rate shown is the annualized seven-day yield at period end.

FRANKLIN UNIVERSAL TRUST

Financial Statements

Statement of Assets and Liabilities

August 31, 2017

Assets:	
Investments in securities:	
Cost - Unaffiliated issuers	$ 214,287,958
Cost - Non-controlled affiliates (Note 4c)	3,783,213
Value - Unaffiliated issuers	$ 260,751,690
Value - Non-controlled affiliates (Note 4c)	3,783,213
Receivables:	
Investment securities sold	121,876
Dividends and interest	3,356,270
Total assets	268,013,049
Liabilities:	
Payables:	
Management fees	164,893
Distributions to shareholders	804,220
Accrued interest (Note 3)	14,350
Senior fixed rate Notes, at par value of $60,000,000 less unamortized Note issuance costs of $26,654 (Note 3)	59,973,346
Accrued expenses and other liabilities	91,737
Total liabilities	61,048,546
Net assets, at value	$ 206,964,503
Net assets consist of:	
Paid-in capital	$ 172,984,952
Distributions in excess of net investment income	(841,002)
Net unrealized appreciation (depreciation)	46,463,732
Accumulated net realized gain (loss)	(11,643,179)
Net assets, at value	$ 206,964,503
Shares outstanding	25,131,894
Net asset value per share	$8.24

Statement of Operations

for the year ended August 31, 2017

Investment income:	
Dividends:	
Unaffiliated issuers	$ 2,857,389
Non-controlled affiliates (Note 4c)	10,975
Interest:	
Unaffiliated issuers	10,666,185
Total investment income	13,534,549
Expenses:	
Management fees (Note 4a)	1,942,456
Interest expense (Note 3)	1,722,000
Transfer agent fees	87,077
Custodian fees (Note 5)	2,255
Reports to shareholders	38,306
Professional fees	77,384
Trustees fees and expenses	8,548
Amortization of Note issuance costs (Note 3)	26,113
Other	76,469
Total expenses	3,980,608
Expense reductions (Note 5)	(151)
Expenses waived/paid by affiliates (Note 4c)	(15,952)
Net expenses	3,964,505
Net investment income	9,570,044
Realized and unrealized gains (losses):	
Net realized gain (loss) from:	
Investments:	
Unaffiliated issuers	(2,029,380)
Net change in unrealized appreciation (depreciation) on:	
Investments:	
Unaffiliated issuers	16,392,768
Net realized and unrealized gain (loss)	14,363,388

Net increase (decrease) in net assets resulting from operations	$ 23,933,432

FRANKLIN UNIVERSAL TRUST

FINANCIAL STATEMENTS

Statements of Changes in Net Assets

	Year Ended August 31, 2017	2016
Increase (decrease) in net assets:		
Operations:		
Net investment income	$ 9,570,044	$ 9,789,726
Net realized gain (loss)	(2,029,380)	650,542
Net change in unrealized appreciation (depreciation)	16,392,768	15,218,867
Net increase (decrease) in net assets resulting from operations	23,933,432	25,659,135
Distributions to shareholders from:		
Net investment income	(9,650,653)	(11,724,028)
Net increase (decrease) in net assets	14,282,779	13,935,107
Net assets:		
Beginning of year	192,681,724	178,746,617
End of year	$ 206,964,503	$ 192,681,724
Distributions in excess of net investment income included in net assets:		
End of year	$ (841,002)	$ (1,619,036)

Statement of Cash Flows
for the year ended August 31, 2017

Cash flow from operating activities:	
Dividends, interest and other income received	$ 13,505,352
Operating expenses paid	(2,160,460)
Interest expense paid	(1,722,000)
Purchases of long-term investments	(58,917,935)
Sales and maturities of long-term investments	60,723,218
Net purchases of short-term investments	(1,777,528)
Cash provided - operating activities	9,650,647
Cash flow used from financing activities - distributions to shareholders	(9,650,647)
Net increase (decrease) in cash	
Cash at beginning of year	
Cash at end of year	$

Reconciliation of Net Increase (Decrease) in Net Assets resulting from Operating Activities to Net Cash Provided by

Operating Activities
for the year ended August 31, 2017

Net increase (decrease) in net assets resulting from operating activities	$ 23,933,432
Adjustments to reconcile net increase (decrease) in net assets resulting from operating activities to net cash provided by operating activities:	
Amortization of Note issuance costs	26,113
Net amortization income	71,337
Reinvested dividends from non-controlled affiliates	(10,975)
Decrease in dividends and interest receivable and other assets	19,855
Increase in receivable for investments sold	(121,876)
Increase in payables to affiliates, accrued expenses, and other liabilities	55,932
Decrease in cost of investments	2,069,597
Increase in unrealized appreciation on investments	(16,392,768)
Net cash provided by operating activities	$ 9,650,647

Notes to Financial Statements

1. Organization and Significant Accounting Policies

Franklin Universal Trust (Fund) is registered under the Investment Company Act of 1940 (1940 Act) as a closed-end management investment company and applies the specialized accounting and reporting guidance in U.S. Generally Accepted Accounting Principles (U.S. GAAP).

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. The Fund calculates the net asset value (NAV) per share as of 4 p.m. Eastern time each day the New York Stock Exchange (NYSE) is open for trading. Senior fixed rate notes issued by the Fund are carried at cost. Under compliance policies and procedures approved by the Fund s Board of Trustees (the Board), the Fund s administrator has responsibility for oversight of valuation, including leading the cross-functional Valuation Committee (VC). The VC 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. Foreign equity securities are valued as of the close of trading on the foreign stock exchange on which the security is primarily traded, or as of 4 p.m. Eastern time. The value is then converted into its U.S. dollar equivalent at the foreign exchange rate in effect at 4 p.m. Eastern time on the day that the value of the security is determined. 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.

Investments in open-end mutual funds are valued at the closing NAV.

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 VC 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 VC 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 VC 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 4 p.m. Eastern time. In addition, trading in certain foreign markets may not take place on every Fund s business day. Occasionally, events occur between the time at which trading in a foreign security is completed and 4 p.m. Eastern time 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 4 p.m. Eastern time. In order to minimize the potential for these differences, the VC 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.

When the last day of the reporting period is a non-business day, certain foreign markets may be open on those days that the Fund s NAV is not calculated, 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 by the Fund for financial reporting purposes.

b. 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 may recognize an income tax liability related to its uncertain tax positions under U.S. GAAP when the uncertain tax position has a less than 50% probability that it will be sustained upon examination by the tax authorities based on its technical merits. As of August 31, 2017, the Fund has

determined that no tax liability is required in its financial statements related to uncertain tax positions for any open tax years (or expected to be taken in future tax years). Open tax years are those that remain subject to examination and are based on the statute of limitations in each jurisdiction in which the Fund invests.

c. Security Transactions, Investment Income, Expenses and Distributions

Security transactions are accounted for on trade date. Realized gains and losses on security transactions are determined on a specific identification basis. Interest income and estimated expenses are accrued daily. Amortization of premium and accretion of discount on debt securities are included in interest income. Dividend income is recorded on the ex-dividend date except for certain dividends from securities where the dividend rate is not available. In such cases, the dividend is recorded as soon as the information is received by the Fund. Distributions to shareholders are recorded on the ex-dividend date. Distributable earnings are determined according to income tax regulations (tax basis) and may differ from earnings recorded in accordance with U.S. GAAP. These differences may be permanent or temporary. Permanent differences are reclassified among capital accounts to reflect their tax character. These reclassifications have no impact on net assets or the results of operations. Temporary differences are not reclassified, as they may reverse in subsequent periods.

d. Accounting Estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the amounts of income and expenses during the reporting period. Actual results could differ from those estimates.

e. Guarantees and Indemnifications

Under the Fund s organizational documents, its officers and trustees are indemnified by the Fund against certain liabilities arising out of the performance of their duties to the Fund. Additionally, in the normal course of business, the Fund enters into contracts with service providers that contain general indemnification clauses. The Fund s maximum exposure under

FRANKLIN UNIVERSAL TRUST

NOTES TO FINANCIAL STATEMENTS

1. Organization and Significant Accounting Policies (continued)

e. Guarantees and Indemnifications *(continued)*

these arrangements is unknown as this would involve future claims that may be made against the Fund that have not yet occurred. Currently, the Fund expects the risk of loss to be remote.

2. Shares of Beneficial Interest

At August 31, 2017, there were an unlimited number of shares authorized ($0.01 par value). During the years ended August 31, 2017 and August 31, 2016, there were no shares issued; all reinvested distributions were satisfied with previously issued shares purchased in the open market.

Under the Board approved open-market share repurchase program, the Fund may purchase, from time to time, Fund shares in open-market transactions, at the discretion of management. During the years ended August 31, 2017 and August 31, 2016, there were no shares repurchased.

3. Senior Fixed Rate Notes

On August 28, 2013, the Fund issued $60 million principal amount of a new class of five-year senior fixed rate notes (Notes). The Notes bear interest, payable semi-annually, at a rate of 2.87% per year, to maturity on August 28, 2018. The Notes are general unsecured obligations of the Fund and rank

senior to trust shares and all existing or future unsecured indebtedness of the Fund. For the year ended August 31, 2017, total interest paid by the Fund on the Notes was $1,722,000. The Fund is required to maintain on a monthly basis a specified discounted asset value for its portfolio in compliance with guidelines established in the Notes Agreement, and is required under the 1940 Act to maintain asset coverage for the Notes of at least 300%. The Fund has met these requirements during the year ended August 31, 2017. The issuance costs of $126,916 incurred by the Fund are deferred and amortized on an interest method basis over the term of the Notes. For the year ended August 31, 2017, the Fund amortized $26,113 of Notes issuance costs. Subject to certain restrictions and make whole premiums, the Fund may prepay the Notes at any time. At August 31, 2017, if the Notes were fully prepaid, the make whole premium related to the current balance of the Notes would have been approximately $677,000.

The Fund employs an income-based approach to determine the fair value of the Notes, which uses the Notes current credit rating, remaining time to maturity, stated coupon rates, the current yield of a comparable asset, and a liquidity premium. At August 31, 2017, the estimated fair value of the Notes was approximately $60,526,000. The inputs used in determining the fair value of the Notes represent Level 3 in the fair value hierarchy. See Note 9 regarding fair value measurements for additional information about fair value hierarchy and Level 3 inputs.

4. Transactions with Affiliates

Franklin Resources, Inc. is the holding company for various subsidiaries that together are referred to as Franklin Templeton Investments. Certain officers and trustees of the Fund are also officers and/or directors of the following subsidiaries:

Subsidiary	**Affiliation**
Franklin Advisers, Inc. (Advisers)	Investment manager
Franklin Templeton Services, LLC (FT Services)	Administrative manager

a. Management Fees

The Fund pays an investment management fee to Advisers of 0.75% per year of the average weekly managed assets. Managed assets are defined as the Fund s gross asset value minus the sum of accrued liabilities, other than the principal amount of the Notes.

b. Administrative Fees

Under an agreement with Advisers, FT Services provides administrative services to the Fund. The fee is paid by Advisers based on the Fund s average daily net assets, and is not an additional expense of the Fund.

c. Investments in Affiliated Management Investment Companies

The Fund invests in one or more affiliated management investment companies for purposes other than exercising a controlling influence over the management or policies. Management fees paid by the Fund are waived on assets invested in the affiliated management investment companies, as noted in the Statement of Operations, in an amount not to exceed the management and administrative fees paid directly or indirectly by each affiliate. Prior to September 1, 2013, the waiver was accounted for as a reduction to management fees. During the year ended August 31, 2017, the Fund held investments in affiliated management investment companies as follows:

	Number of Shares Held at Beginning of Year	Gross Additions	Gross Reductions	Number of Shares Held at End of Year	Value at End of Year	Dividend Income	Realized Gain (Loss)	Net Change in Unrealized Appreciation (Depreciation)
Non-Controlled Affiliates								
Institutional Fiduciary Trust Money Market Portfolio, 0.66%	1,994,710	41,334,585	(39,546,082)	3,783,213	$ 3,783,213	$ 10,975	$	$

d. Interfund Transactions

The Fund engaged in purchases and sales of investments with funds or other accounts that have common investment managers (or affiliated investment managers), directors, trustees or officers. During the year ended August 31, 2017, these purchase and sale transactions aggregated $0 and $529,125, respectively.

5. Expense Offset Arrangement

The Fund has entered into an arrangement with its custodian whereby credits realized as a result of uninvested cash balances are used to reduce a portion of the Fund s custodian expenses. During the year ended August 31, 2017, the custodian fees were reduced as noted in the Statement of Operations.

6. Income Taxes

For tax purposes, capital losses may be carried over to offset future capital gains. Capital loss carryforwards with no expiration, if any, must be fully utilized before those losses with expiration dates.

At August 31, 2017, the Fund had capital loss carryforwards of $8,755,072 expiring in 2018.

Capital loss carryforwards not subject to expiration:

Short term	$ 525,190
Long term	2,362,810
Total capital loss carryforwards	$ 2,888,000

The tax character of distributions paid during the years ended August 31, 2017 and 2016, was as follows:

	2017	2016
Distributions paid from ordinary income	$ 9,650,653	$ 11,724,028

FRANKLIN UNIVERSAL TRUST

NOTES TO FINANCIAL STATEMENTS

6. Income Taxes (continued)

At August 31, 2017, the cost of investments, net unrealized appreciation (depreciation) and undistributed ordinary income for income tax purposes were as follows:

Cost of investments	$ 218,452,489
Unrealized appreciation	$ 57,882,561
Unrealized depreciation	(11,800,147)
Net unrealized appreciation (depreciation)	$ 46,082,414
Distributable earnings - undistributed ordinary income	$ 467,531

Differences between income and/or capital gains as determined on a book basis and a tax basis are primarily due to differing treatments of defaulted securities and bond discounts and premiums.

7. Investment Transactions

Purchases and sales of investments (excluding short term securities) for the year ended August 31, 2017, aggregated $58,917,935 and $60,845,094, respectively.

8. Credit Risk and Defaulted Securities

At August 31, 2017, the Fund had 61.9% of its portfolio invested in high yield or other securities rated below investment grade and unrated securities, if any. These securities may be more sensitive to economic conditions causing greater price volatility and are potentially subject to a greater risk of loss due to default than higher rated securities.

The Fund held defaulted securities and/or other securities for which the income has been deemed uncollectible. At August 31, 2017, the aggregate value of these securities was $144,000, representing 0.1% of the Fund s portfolio. The Fund discontinues accruing income on securities for which income has been deemed uncollectible and provides an estimate for losses on interest receivable. The securities have been identified in the accompanying Statement of Investments.

9. Fair Value Measurements

The Fund follows a fair value hierarchy that distinguishes between market data obtained from independent sources (observable inputs) and the Fund s own market assumptions (unobservable inputs). These inputs are used in determining the value of the Fund s financial instruments and are summarized in the following fair value hierarchy:

Level 1 quoted prices in active markets for identical financial instruments

Level 2 other significant observable inputs (including quoted prices for similar financial instruments, interest rates, prepayment speed, credit risk, etc.)

Level 3 significant unobservable inputs (including the Fund s own assumptions in determining the fair value of financial instruments)

The input levels are not necessarily an indication of the risk or liquidity associated with financial instruments at that level.

For movements between the levels within the fair value hierarchy, the Fund has adopted a policy of recognizing the transfers as of the date of the underlying event which caused the movement.

A summary of inputs used as of August 31, 2017, in valuing the Fund s assets carried at fair value, is as follows:

	Level 1	Level 2	Level 3	Total
Assets:				
Investments in Securities:				
Equity Investments:[a]				
Energy.	$ 3,637,805	$ 210,956	$ 680	$ 3,849,441
Materials	2,283,700	53		2,283,753
Transportation		182,612		182,612
All Other Equity Investments[b]	82,517,708			82,517,708
Convertible Bonds		831,686		831,686
Corporate Bonds		171,066,120		171,066,120
Escrows and Litigation Trusts		12,250	8,120[c]	20,370
Short Term Investments	3,783,213			3,783,213
Total Investments in Securities	$ 92,222,426	$ 172,303,677	$ 8,800	$ 264,534,903

[a]Includes common and convertible preferred stocks as well as other equity investments.

[b]For detailed categories, see the accompanying Statement of Investments.

[c]Includes securities determined to have no value at August 31, 2017.

A reconciliation of assets in which Level 3 inputs are used in determining fair value is presented when there are significant Level 3 financial instruments at the end of the year.

10. New Accounting Pronouncements

In March 2017, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) No. 2017-08, Receivables Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities. The amendments in the ASU shorten the amortization period for certain callable debt securities acquired at a premium, to be amortized to the earliest call date. The ASU does not require an accounting change for securities acquired at a discount, which continues to be amortized to maturity. The ASU is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2018. Management is currently evaluating the impact, if any, of applying this provision.

11. Subsequent Events

The Fund has evaluated subsequent events through the issuance of the financial statements and determined that no events have occurred that require disclosure.

Abbreviations

Selected Portfolio

ADR	American Depositary Receipt
FRN	Floating Rate Note
PIK	Payment-In-Kind

Report of Independent Registered Public Accounting Firm

To the Board of Trustees and Shareholders of Franklin Universal Trust

In our opinion, the accompanying statement of assets and liabilities, including the statement of investments, and the related statements of operations and of changes in net assets and of cash flows and the financial highlights present fairly, in all material respects, the financial position of Franklin Universal Trust (the Fund) as of August 31, 2017, the results of its operations and its cash flows for the year then ended, the changes in its net assets for each of the two years in the period then ended and the financial highlights for each of the five years in the period then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements and financial highlights (hereafter referred to as financial statements) are the responsibility of the Fund s management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits, which included confirmation of securities as of August 31, 2017 by correspondence with the custodian and transfer agent, provide a reasonable basis for our opinion.

PricewaterhouseCoopers LLP

San Francisco, California

October 17, 2017

Tax Information (unaudited)

Under Section 854(b)(1)(A) of the Internal Revenue Code (Code), the Fund hereby reports 29.05% of the ordinary income dividends as income qualifying for the dividends received deduction for the fiscal year ended August 31, 2017.

Under Section 854(b)(1)(B) of the Code, the Fund hereby reports the maximum amount allowable but no less than $2,860,312 as qualified dividends for purposes of the maximum rate under Section 1(h)(11) of the Code for the fiscal year ended August 31, 2017. Distributions, including qualified dividend income, paid during calendar year 2017 will be reported to shareholders on Form 1099-DIV by mid-February 2018. Shareholders are advised to check with their tax advisors for information on the treatment of these amounts on their individual income tax returns.

Under Section 871(k)(1)(C) of the Code, the Fund hereby reports the maximum amount allowable but no less than $6,352,893 as interest related dividends for purposes of the tax imposed under Section 871(a)(1)(A) of the Code for the fiscal year ended August 31, 2017.

FRANKLIN UNIVERSAL TRUST

Annual Meeting of Shareholders

March 24, 2017

An annual shareholders meeting of Franklin Universal Trust (Fund) was held on March 24, 2017. At the meeting, the holders of 20,396,118 shares of the Fund s common stock were represented in person or by proxy, constituting a quorum. The following persons were elected by the shareholders to serve as Trustees of the Fund.

The results of the voting at the meeting are as follows:

Nominees	**Shares For**	**% of Voted**	**% of Outstanding Shares**	**Shares Withheld**	**% of Voted**	**% of Outstanding Shares**
Harris J. Ashton	19,664,080	96.41%	78.24%	732,038	3.59%	2.91%
Mary C. Choksi	19,701,140	96.59%	78.39%	694,978	3.41%	2.77%
Edith E. Holiday	19,670,166	96.44%	78.27%	725,952	3.56%	2.89%
Gregory E. Johnson	19,692,717	96.55%	78.36%	703,401	3.45%	2.80%
Rupert H. Johnson, Jr.	19,691,654	96.55%	78.35%	704,464	3.45%	2.80%
J. Michael Luttig	19,733,520	96.75%	78.52%	662,598	3.25%	2.64%
Larry D. Thompson	19,660,272	96.39%	78.23%	735,846	3.61%	2.93%
John B. Wilson	19,717,938	96.67%	78.46%	678,180	3.33%	2.70%

Dividend Reinvestment and Cash Purchase Plan

The Fund s Dividend Reinvestment and Cash Purchase Plan (Plan) offers you a prompt and simple way to reinvest dividends and capital gain distributions in shares of the Fund. The Plan also allows you to purchase additional shares of the Fund by making voluntary cash payments. American Stock Transfer & Trust Company, LLC (Plan Agent), P.O. Box 922, Wall Street Station, New York, NY 10269-0560, acts as your Plan Agent in administering the Plan.

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

If the Fund declares a dividend or capital gain distribution payable either in cash or in stock of the Fund and the market price of shares on the valuation date equals or exceeds the net asset value, the Fund will issue new shares to you at the higher of net asset value or 95% of the then current market price. Whenever the Fund declares a distribution from capital gains or an income dividend payable in either cash or shares, if the net asset value per share of the Fund s common stock exceeds the market price per share on the valuation date, the Plan Agent shall apply the amount of such dividend or distribution payable to participants to the purchase of shares (less their pro rata share of brokerage commissions incurred with respect to open market purchases in connection with the reinvestment of such dividend or distribution). If the price exceeds the net asset value before the Plan Agent has completed its purchases, the average purchase price may exceed the net asset value, resulting in fewer shares being acquired than if the Fund had issued new shares. All reinvestments are in full and fractional shares, carried to three decimal places. The Fund will not issue shares under the Plan at a price below net asset value.

The Plan permits you on a voluntary basis to submit in cash payments of not less than $100 each up to a total of $5,000 per month to purchase additional shares of the Fund. It is entirely up to you whether you wish to buy additional shares with voluntary cash payments, and you do not have to send in the same amount each time if you do. These payments should be made by check or money order payable to American Stock Transfer & Trust Company, LLC and sent to American Stock Transfer & Trust Company, LLC, P.O. Box 922, Wall Street Station, New York, NY 10269-0560, Attn: Franklin Universal Trust.

Your cash payment will be aggregated with the payments of other participants and invested on your behalf by the Plan Agent in shares of the Fund that are purchased in the open market.

The Plan Agent will invest cash payments on approximately the 5th of each month in which no dividend or distribution is payable and, during each month in which a dividend or distribution is payable, will invest cash payments beginning on the dividend payment date. *Under no circumstances will interest be paid on your funds held by the Plan Agent.* Accordingly, you should send any voluntary cash payments you wish to make shortly before an investment date but in sufficient time to ensure that your payment will reach the Plan Agent not less than two business days before an investment date. Payments received less than two business days before an investment date will be invested during the next month or, if there are more than 30 days until the next investment date, will be returned to you. You may obtain a refund of any cash payment by written notice, if the Plan Agent receives the written notice not less than 48 hours before an investment date.

There is no direct charge to participants for reinvesting dividends and capital gain distributions, since the Plan 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. The Plan Agent will deduct a $5.00 service fee from each of your voluntary cash payments.

The automatic reinvestment of dividends and capital gain distributions does not relieve you of any taxes which may be payable on dividends or distributions. In connection with the reinvestment of dividends and capital gain distributions, if the Fund issues new shares, shareholders receiving such shares generally will be treated as having a distribution equal to the market value of the shares received, and if shares are purchased on the open market, shareholders generally will be treated as having received a distribution equal to the cash distribution that would have been paid.

The Fund does not issue new shares in connection with voluntary cash payments. All investments are in full and fractional shares, carried to three decimal places. If the market price exceeds the net asset value at the time the Plan Agent purchases the additional shares, you will receive shares at a price greater than the net asset value.

FRANKLIN UNIVERSAL TRUST

DIVIDEND REINVESTMENT AND CASH PURCHASE PLAN

You will receive a monthly account statement from the Plan Agent showing total dividends and capital gain distributions, date of investment, shares acquired and price per share, and total shares of record held by you and by the Plan Agent for you. You are entitled to vote all shares of record, including shares purchased for you by the Plan Agent, and, if you vote by proxy, your proxy will include all such shares.

As long as you participate in the Plan, the Plan 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.

You may withdraw from the Plan without penalty at any time by notifying the Plan Agent, in writing, at the address above. If you withdraw, you will receive, without charge, stock certificates issued in your name for all full shares. The Plan Agent will convert any fractional shares you hold at the time of your withdrawal to cash at current market price and send you a check for the proceeds.

If you hold shares in your own name, please address all notices, correspondence, questions, or other communications regarding the Plan to the Plan Agent at the address noted above. If your shares are not held in your name, you should contact your brokerage firm, bank, or other nominee for more information and to determine if your nominee will participate in the Plan on your behalf.

The Fund or the Plan Agent may amend or terminate the Plan. You will receive written notice at least 90 days before the effective date of termination or of any amendment. In the case of termination, you will receive written notice at least 90 days before the record date of any dividend or capital gain distribution by the Fund.

Board Members and Officers

The name, year of birth and address of the officers and board members, as well as their affiliations, positions held with the Trust, principal occupations during at least the past five years and number of US registered portfolios overseen in the Franklin Templeton Investments fund complex, are shown below. Generally, each board member serves until that person s successor is elected and qualified.

Independent Board Members

Name, Year of Birth and Address	**Position**	**Length of Time Served**	**Number of Portfolios in Fund Complex Overseen by Board Member***	**Other Directorships Held During at Least the Past 5 Years**
Harris J. Ashton (1932) One Franklin Parkway San Mateo, CA 94403-1906	Trustee	Since 1988	140	Bar-S Foods (meat packing company) (1981-2010).

Principal Occupation During at Least the Past 5 Years:

Director of various companies; and **formerly**, Director, RBC Holdings, Inc. (bank holding company) (until 2002); and President, Chief Executive Officer and Chairman of the Board, General Host Corporation (nursery and craft centers) (until 1998).

Name, Year of Birth and Address	**Position**	**Length of Time Served**	**Number of Portfolios in Fund Complex Overseen by Board Member***	**Other Directorships Held During at Least the Past 5 Years**
Mary C. Choksi (1950) One Franklin Parkway San Mateo, CA 94403-1906	Trustee	Since 2014	134	Avis Budget Group Inc. (car rental) (2007-present), Omnicom Group Inc. (advertising and marketing communications services) (2011-present) and White Mountains Insurance Group, Ltd. (holding company) (August 2017-present).

Principal Occupation During at Least the Past 5 Years:

Director of various companies; and **formerly**, Founder and Senior Advisor, Strategic Investment Group (investment management group) (2015-2017); Founding Partner and Senior Managing Director, Strategic Investment Group

(1987 2015); Founding Partner and Managing Director, Emerging Markets Management LLC (investment management firm) (1987-2011); and Loan Officer/Senior Loan Officer/Senior Pension Investment Officer, World Bank Group (international financial institution) (1977-1987).

Edith E. Holiday (1952) One Franklin Parkway San Mateo, CA 94403-1906	Trustee	Since 2004	140	Hess Corporation (exploration and refining of oil and gas) (1993-present), Canadian National Railway (railroad) (2001-present), White Mountains Insurance Group, Ltd. (holding company) (2004-present), Santander Consumer USA Holdings, Inc. (consumer finance) (2016-present), RTI International Metals, Inc. (manufacture and distribution of titanium) (1999-2015) and H.J. Heinz Company (processed foods and allied products) (1994-2013).

Principal Occupation During at Least the Past 5 Years:

Director or Trustee of various companies and trusts; and **formerly**, Assistant to the President of the United States and Secretary of the Cabinet (1990-1993); General Counsel to the United States Treasury Department (1989-1990); and Counselor to the Secretary and Assistant Secretary for Public Affairs and Public Liaison - United States Treasury Department (1988-1989).

J. Michael Luttig (1954) One Franklin Parkway San Mateo, CA 94403-1906	Trustee	Since 2009	140	Boeing Capital Corporation (aircraft financing) (2006-2013).

Principal Occupation During at Least the Past 5 Years:

Executive Vice President, General Counsel and member of the Executive Council, The Boeing Company (aerospace company) (2006-present); and **formerly**, Federal Appeals Court Judge, U.S. Court of Appeals for the Fourth Circuit (1991-2006).

Independent Board Members (continued)

Name, Year of Birth and Address	Position	Length of Time Served	Number of Portfolios in Fund Complex Overseen by Board Member*	Other Directorships Held During at Least the Past 5 Years
Larry D. Thompson (1945) One Franklin Parkway San Mateo, CA 94403-1906	Trustee	Since 2007	140	The Southern Company (energy company) (2014-present; previously 2010-2012), Graham Holdings Company (education and media organization) (2011-present) and Cbeyond, Inc. (business communications provider) (2010-2012).

Principal Occupation During at Least the Past 5 Years:
Director of various companies; Counsel, Finch McCranie, LLP (law firm) (2015-present); Independent Compliance Monitor and Auditor, Volkswagen AG (manufacture of automobiles and commercial vehicles) (April 2017 - present); John A. Sibley Professor of Corporate and Business Law, University of Georgia School of Law (2015-present; previously 2011-2012); and **formerly**, Executive Vice President - Government Affairs, General Counsel and Corporate Secretary, PepsiCo, Inc. (consumer products) (2012-2014); Senior Vice President - Government Affairs, General Counsel and Secretary, PepsiCo, Inc. (2004-2011); Senior Fellow of The Brookings Institution (2003-2004); Visiting Professor, University of Georgia School of Law (2004); and Deputy Attorney General, U.S. Department of Justice (2001-2003).

Name, Year of Birth and Address	Position	Length of Time Served	Number of Portfolios in Fund Complex Overseen by Board Member*	Other Directorships Held During at Least the Past 5 Years
John B. Wilson (1959) One Franklin Parkway San Mateo, CA 94403-1906	Lead Independent Trustee	Trustee since 2006 and Lead Independent Trustee since 2008	114	None

Principal Occupation During at Least the Past 5 Years:
President and Founder, Hyannis Port Capital, Inc. (real estate and private equity investing) (2002-present); serves on private and non-profit boards; and **formerly**, President, Staples International and Head of Global Transformation (office supplies) (2012-2016); Chief Operating Officer and Executive Vice President, Gap, Inc. (retail) (1996-2000); Chief Financial Officer and Executive Vice President Finance and Strategy, Staples, Inc. (1992-1996); Senior Vice President Corporate Planning, Northwest Airlines, Inc. (airlines) (1990-1992); and Vice President and Partner, Bain & Company (consulting firm) (1986-1990).

Interested Board Members and Officers

Name, Year of Birth and Address	Position	Length of Time Served	Number of Portfolios in Fund Complex Overseen by Board Member*	Other Directorships Held During at Least the Past 5 Years
****Gregory E. Johnson (1961)** One Franklin Parkway San Mateo, CA 94403-1906	Trustee	Since 2013	156	None

Principal Occupation During at Least the Past 5 Years:

Chairman of the Board, Member - Office of the Chairman, Director and Chief Executive Officer, Franklin Resources, Inc.; officer and/or director or trustee, as the case may be, of some of the other subsidiaries of Franklin Resources, Inc. and of 44 of the investment companies in Franklin Templeton Investments; Vice Chairman, Investment Company Institute; and **formerly**, President, Franklin Resources, Inc. (1994-2015).

Name, Year of Birth and Address	Position	Length of Time Served	Number of Portfolios in Fund Complex Overseen by Board Member*	Other Directorships Held During at Least the Past 5 Years
****Rupert H. Johnson, Jr. (1940)** One Franklin Parkway San Mateo, CA 94403-1906	Chairman of the Board, Trustee and Senior Vice President	Chairman of the Board since 2013, Trustee and Senior Vice President since 1988	140	None

Principal Occupation During at Least the Past 5 Years:

Vice Chairman, Member Office of the Chairman and Director, Franklin Resources, Inc.; Director, Franklin Advisers, Inc.; Senior Vice President, Franklin Advisory Services, LLC; and officer and/or director or trustee, as the case may be, of some of the other subsidiaries of Franklin Resources, Inc. and of 42 of the investment companies in Franklin Templeton Investments.

Name, Year of Birth and Address	Position	Length of Time Served	Number of Portfolios in Fund Complex Overseen by Board Member*	Other Directorships Held During at Least the Past 5 Years
Alison E. Baur (1964) One Franklin Parkway San Mateo, CA 94403-1906	Vice President	Since 2012	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:

Deputy General Counsel, Franklin Templeton Investments; and officer of some of the other subsidiaries of Franklin Resources, Inc. and of 45 of the investment companies in Franklin Templeton Investments.

Interested Board Members and Officers (continued)

Name, Year of Birth and Address	Position	Length of Time Served	Number of Portfolios in Fund Complex Overseen by Board Member*	Other Directorships Held During at Least the Past 5 Years
Gaston Gardey (1967) One Franklin Parkway San Mateo, CA 94403-1906	Chief Financial Officer, Chief Accounting Officer and Treasurer	Since 2009	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:

Treasurer, U.S. Fund Administration & Reporting, Franklin Templeton Investments; and officer of 27 of the investment companies in Franklin Templeton Investments.

Name, Year of Birth and Address	Position	Length of Time Served	Number of Portfolios in Fund Complex Overseen by Board Member*	Other Directorships Held During at Least the Past 5 Years
Aliya S. Gordon (1973) One Franklin Parkway San Mateo, CA 94403-1906	Vice President	Since 2009	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:
Senior Associate General Counsel, Franklin Templeton Investments; and officer of 45 of the investment companies in Franklin Templeton Investments.

Name, Year of Birth and Address	Position	Length of Time Served	Number of Portfolios in Fund Complex Overseen by Board Member*	Other Directorships Held During at Least the Past 5 Years
Steven J. Gray (1955) One Franklin Parkway	Vice President	Since 2009	Not Applicable	Not Applicable

San Mateo, CA
94403-1906

Principal Occupation During at Least the Past 5 Years:
Senior Associate General Counsel, Franklin Templeton Investments; Vice President, Franklin Templeton Distributors, Inc. and FT AlphaParity, LLC; and officer of 45 of the investment companies in Franklin Templeton Investments.

Matthew T. Hinkle (1971) One Franklin Parkway San Mateo, CA 94403-1906	Chef Executive Officer Finance and Administration	Since June 2017	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:
Senior Vice President, U.S. Fund Administration Reporting & Fund Tax, Franklin Templeton Investments; officer of 45 of the investment companies in Franklin Templeton Investments; and **formerly**, Vice President, Global Tax (2012-April 2017) and Treasurer/Assistant Treasurer, Franklin Templeton Investments (2009-2017).

Edward B. Jamieson (1948) One Franklin Parkway San Mateo, CA 94403-1906	President and Chief Executive Officer Investment Management	President since 1993 and Chief Executive Officer Investment Management since 2002	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:
President and Director, Franklin Advisers, Inc.; Executive Vice President, Franklin Templeton Institutional, LLC; and officer and/or trustee, as the case may be, of some of the other subsidiaries of Franklin Resources, Inc. and of 10 of the investment companies in Franklin Templeton Investments.

Robert Lim (1948) One Franklin Parkway San Mateo, CA 94403-1906	Vice President AML Compliance	Since 2016	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:

Vice President, Franklin Templeton Companies, LLC; Chief Compliance Officer, Franklin Templeton Distributors, Inc. and Franklin Templeton Investor Services, LLC; and officer of 45 of the investment companies in Franklin Templeton Investments.

Kimberly H. Novotny (1972) 300 S.E. 2nd Street Fort Lauderdale, FL 33301-1923	Vice President	Since 2013	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:
Associate General Counsel, Franklin Templeton Investments; Vice President and Corporate Secretary, Fiduciary Trust International of the South; Vice President, Templeton Investment Counsel, LLC; Assistant Secretary, Franklin Resources, Inc.; and officer of 45 of the investment companies in Franklin Templeton Investments.

Interested Board Members and Officers (continued)

Name, Year of Birth and Address	Position	Length of Time Served	Number of Portfolios in Fund Complex Overseen by Board Member*	Other Directorships Held During at Least the Past 5 Years
Robert C. Rosselot (1960) 300 S.E. 2nd Street Fort Lauderdale, FL 33301-1923	Chief Compliance Officer	Since 2013	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:
Director, Global Compliance, Franklin Templeton Investments; Vice President, Franklin Templeton Companies, LLC; officer of 45 of the investment companies in Franklin Templeton Investments; and **formerly**, Senior Associate General Counsel, Franklin Templeton Investments (2007-2013); and Secretary and Vice President, Templeton Group of Funds (2004-2013).

Name, Year of Birth and Address	Position	Length of Time Served	Number of Portfolios in Fund Complex Overseen by Board Member*	Other Directorships Held During at Least the Past 5 Years
Karen L. Skidmore (1952) One Franklin Parkway San Mateo, CA 94403-1906	Vice President and Secretary	Since 2006	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:
Senior Associate General Counsel, Franklin Templeton Investments; and officer of 45 of the investment companies in Franklin Templeton Investments.

Name, Year of Birth and Address	Position	Length of Time Served	Number of Portfolios in Fund Complex Overseen by Board Member*	Other Directorships Held During at Least the Past 5 Years
Navid J. Tofigh (1972) One Franklin Parkway San Mateo, CA 94403-1906	Vice President	Since 2015	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:

Associate General Counsel, Franklin Templeton Investments; and officer of 45 of the investment companies in Franklin Templeton Investments.

Craig S. Tyle (1960) One Franklin Parkway San Mateo, CA 94403-1906	Vice President	Since 2005	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:
General Counsel and Executive Vice President, Franklin Resources, Inc.; and officer of some of the other subsidiaries of Franklin Resources, Inc. and of 45 of the investment companies in Franklin Templeton Investments.

Lori A. Weber (1964) 300 S.E. 2nd Street Fort Lauderdale, FL 33301-1923	Vice President	Since 2011	Not Applicable	Not Applicable

Principal Occupation During at Least the Past 5 Years:
Senior Associate General Counsel, Franklin Templeton Investments; Assistant Secretary, Franklin Resources, Inc.; Vice President and Secretary, Templeton Investment Counsel, LLC; and officer of 45 of the investment companies in Franklin Templeton Investments.

*We base the number of portfolios on each separate series of the U.S. registered investment companies within the Franklin Templeton Investments fund complex. These portfolios have a common investment manager or affiliated investment managers.

**Gregory E. Johnson is considered to be an interested person of the Fund under the federal securities laws due to his position as an officer and director of Franklin Resources, Inc. (Resources), which is the parent company of the Fund s investment manager and distributor. Rupert H. Johnson, Jr. is considered to be an interested person of the Fund under the federal securities laws due to his position as officer and director and major shareholder of Resources.

Note 1: Rupert H. Johnson, Jr. is the uncle of Gregory E. Johnson.

Note 2: Officer information is current as of the date of this report. It is possible that after this date, information about officers may change.

Note 3: Effective November 1, 2016, Frank A. Olson ceased to be a trustee of the Trust.

The Sarbanes-Oxley Act of 2002 and Rules adopted by the Securities and Exchange Commission require the Fund to disclose whether the Fund s Audit Committee includes at least one member who is an audit committee financial expert within the meaning of such Act and Rules. The Fund s Board has determined that there is at least one such financial expert on the Audit Committee and has designated John B. Wilson as its audit committee financial expert. The Board believes that Mr. Wilson qualifies as such an expert in view of his extensive business background and experience, including service as chief financial officer of Staples, Inc. from 1992 to 1996. Mr. Wilson has been a Member and Chairman of the Fund s Audit Committee since 2006. As a

result of such background and experience, the Board believes that Mr. Wi129

167,031

(1,966,505

)

2,408,229

Total stockholders (deficit) equity

(276,166

)

870,907

3,395,436

359,193

(4,625,536

)

(276,166

)

Total liabilities and stockholders (deficit) equity

$

887,319

$

3,425,996

$

3,884,565

$

526,224

$

(6,592,041

)

$

2,132,063

26

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Earnings and Comprehensive Income
Three Months Ended December 31, 2016

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	$	$	$ 816,051	$ 183,558	$	$ 999,609
Related party sales			748		(748)	
Cost of products sold and distribution expenses			411,323	97,326	(748)	507,901
Gross profit			405,476	86,232		491,708
Selling, general and administrative expenses	2,548	137	275,665	69,062		347,412
Depreciation and amortization	1		21,059	5,779		26,839
Operating earnings (loss)	(2,549)	(137)	108,752	11,391		117,457
Interest expense		26,749		50		26,799
Earnings (loss) before provision for income taxes	(2,549)	(26,886)	108,752	11,341		90,658
Provision (benefit) for income taxes	(990)	(10,443)	41,998	4,267		34,832
Equity in earnings of subsidiaries, net of tax	57,385	73,828	7,074		(138,287)	
Net earnings	55,826	57,385	73,828	7,074	(138,287)	55,826
Other comprehensive income (loss), net of tax				(18,668)		(18,668)
Total comprehensive income (loss)	$ 55,826	$ 57,385	$ 73,828	$ (11,594)	$ (138,287)	$ 37,158

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Earnings and Comprehensive Income
Three Months Ended December 31, 2015

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net sales	$	$	$ 806,193	$ 191,839	$	$ 998,032
Related party sales			767		(767)	
Cost of products sold and distribution expenses			400,442	104,308	(767)	503,983
Gross profit			406,518	87,531		494,049
Selling, general and administrative expenses	2,727	67	267,187	69,747		339,728
Depreciation and amortization			17,648	5,738		23,386
Operating earnings (loss)	(2,727)	(67)	121,683	12,046		130,935
Interest expense		63,919	2	22		63,943
Earnings (loss) before provision for income taxes	(2,727)	(63,986)	121,681	12,024		66,992
Provision (benefit) for income taxes	(1,059)	(24,853)	46,764	3,897		24,749
Equity in earnings of subsidiaries, net of tax	43,911	83,044	8,127		(135,082)	
Net earnings	42,243	43,911	83,044	8,127	(135,082)	42,243
Other comprehensive income (loss), net of tax				(10,221)		(10,221)
Total comprehensive income (loss)	$ 42,243	$ 43,911	$ 83,044	$ (2,094)	$ (135,082)	$ 32,022

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Cash Flows
Three months ended December 31, 2016

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net cash provided (used) by operating activities	$ 27,962	$ (41,347)	$ 104,449	$ (611)	$	$ 90,453
Cash Flows from Investing Activities:						
Capital expenditures, net of proceeds from sale of property and equipment			(20,883)	(7,125)		(28,008)
Due from affiliates			(68,741)		68,741	
Net cash used by investing activities			(89,624)	(7,125)	68,741	(28,008)
Cash Flows from Financing Activities:						
Proceeds from issuance of long-term debt		58,500				58,500
Repayments of long-term debt		(58,500)	(4)	(170)		(58,674)
Repurchases of common stock	(66,963)					(66,963)
Proceeds from exercises of stock options	14,280					14,280
Due to affiliates	25,600	31,418		11,723	(68,741)	
Excess tax benefit/shortfall from share-based compensation	(879)					(879)
Net cash (used) provided by financing activities	(27,962)	31,418	(4)	11,553	(68,741)	(53,736)
Effect of foreign exchange rate changes on cash and cash equivalents				(921)		(921)
Net (decrease) increase in cash and cash equivalents		(9,929)	14,821	2,896		7,788
Cash and cash equivalents, beginning of period		28,372	22,368	35,882		86,622
Cash and cash equivalents, end of period	$	$ 18,443	$ 37,189	$ 38,778	$	$ 94,410

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

Condensed Consolidating Statement of Cash Flows
Three months ended December 31, 2015

(In thousands)

	Parent	Sally Holdings LLC and Sally Capital Inc.	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Consolidating Eliminations	Sally Beauty Holdings, Inc. and Subsidiaries
Net cash provided (used) by operating activities	$ 59,556	$ (7,509)	$ 5,195	$ 11,887	$	$ 69,129
Cash Flows from Investing Activities:						
Capital expenditures, net of proceeds from sale of property and equipment			(34,304)	(6,271)		(40,575)
Acquisitions, net of cash acquired			(2,250)			(2,250)
Net cash used by investing activities			(36,554)	(6,271)		(42,825)
Cash Flows from Financing Activities:						
Proceeds from issuance of long-term debt		800,000				800,000
Repayments of long-term debt		(825,785)	(23)	(163)		(825,971)
Repurchases of common stock	(62,367)					(62,367)
Debt issuance costs		(12,709)				(12,709)
Proceeds from exercises of stock options	2,716					2,716
Excess tax benefit from share-based compensation	95					95
Net cash used by financing activities	(59,556)	(38,494)	(23)	(163)		(98,236)
Effect of foreign exchange rate changes on cash and cash equivalents				(659)		(659)
Net (decrease) increase in cash and cash equivalents		(46,003)	(31,382)	4,794		(72,591)
Cash and cash equivalents, beginning of period		46,003	58,851	35,184		140,038
Cash and cash equivalents, end of period	$	$	$ 27,469	$ 39,978	$	$ 67,447

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Sally Beauty Holdings, Inc. and Subsidiaries

Condensed Notes to Consolidated Financial Statements

(Unaudited)

13. Subsequent Event

On January 26, 2017, the Company s Board of Directors approved a comprehensive restructuring plan for the Company s businesses that includes a wide range of organizational efficiency initiatives and cost reduction opportunities. The Company expects to recognize the majority of the expenses related to implementation of the restructuring plan in its fiscal quarter ending March 31, 2017.

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

This section discusses management s view of the financial condition, results of operations and cash flows of Sally Beauty and its consolidated subsidiaries. This section should be read in conjunction with the audited consolidated financial statements and the related notes included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016, as well as the Risk Factors section contained in that Annual Report and information contained elsewhere in this Quarterly Report, including the consolidated interim financial statements and condensed notes to those financial statements. This Management s Discussion and Analysis of Financial Condition and Results of Operations section may contain forward-looking statements. Please see Cautionary Notice Regarding Forward-Looking Statements, included at the beginning of this Quarterly Report for a discussion of the uncertainties, risks and assumptions associated with these forward-looking statements that could cause results to differ materially from those reflected in such forward-looking statements.

Highlights for the Three Months ended December 31, 2016:

- Our consolidated net sales for the three months ended December 31, 2016, increased by $1.6 million, or 0.2%, to $999.6 million compared to $998.0 million for the three months ended December 31, 2015;

- Our consolidated net sales from company-operated stores that have been open for 14 months or longer, which we refer to as same store sales, increased 0.4% for the three months ended December 31, 2016, compared to an increase of 3.9% for the three months ended December 31, 2015;

- Our consolidated gross profit for the three months ended December 31, 2016, decreased by $2.3 million, or 0.5%, to $491.7 million compared to $494.0 million for the three months ended December 31, 2015. As a percentage of net sales, gross profit decreased by 30 basis points to 49.2% for the three months ended December 31, 2016, compared to 49.5% for the three months ended December 31, 2015;

- Our consolidated operating earnings for the three months ended December 31, 2016, decreased by $13.5 million, or 10.3%, to $117.5 million compared to $130.9 million for the three months ended December 31, 2015. As a percentage of net sales, operating earnings decreased by 130 basis points to 11.8% for the three months ended December 31, 2016, compared to 13.1% for the three months ended December 31, 2015;

- Our consolidated net earnings increased by $13.6 million, or 32.2%, to $55.8 million for the three months ended December 31, 2016, compared to $42.2 million for the three months ended December 31, 2015. As a percentage of net sales, net earnings increased by 140 basis points to 5.6% for the three months ended December 31, 2016, compared to 4.2% for the three months ended December 31, 2015;

- Our diluted earnings per share for the three months ended December 31, 2016, were $0.39 compared to $0.28 for the three months ended December 31, 2015;

- Cash provided by operations was $90.5 million for the three months ended December 31, 2016, compared to $69.1 million for the three months ended December 31, 2015; and

- During the three months ended December 31, 2016, we repurchased and subsequently retired approximately 2.5 million shares of our common stock under the share repurchase program approved by our Board of Directors (the Board) in August 2014, at an aggregate cost of approximately $67.0 million.

Overview

Description of Business

At December 31, 2016, we operated primarily through two business units, Sally Beauty Supply and Beauty Systems Group, (BSG). We believe the Company is the largest open-line distributor of professional beauty supplies in the U.S. based on store count. As of December 31, 2016, through Sally Beauty Supply and BSG, we had a multi-channel platform of 4,974 company-operated stores and supplied 181 franchised stores in North America and select South American and European countries. Within BSG, we also have one of the largest networks of professional distributor sales consultants in North America. We provide our customers with a wide variety of leading third-party branded and exclusive-label professional beauty supplies, including hair color products, hair care products, styling tools, skin and nail care products and other beauty items. Our Sally Beauty stores target retail consumers and salon professionals, while BSG targets exclusively salons and salon professionals. For the three months ended December 31, 2016, our consolidated net sales and operating earnings were $999.6 million and $117.5 million, respectively.

As of December 31, 2016, Sally Beauty Supply operated 3,797 company-operated retail stores (generally, under the Sally Beauty banner), 2,923 of which are located in the U.S., with the remaining 874 company-operated stores located in Canada, Mexico, Chile, Colombia, Peru, the United Kingdom, Ireland, Belgium, France, Germany, the Netherlands and Spain. Sally Beauty Supply also supplied 18 franchised stores located in the United Kingdom, Belgium and certain other European countries. In the U.S. and Canada, our Sally Beauty stores average approximately 1,700 square feet in size and are located primarily in strip shopping centers. Our Sally Beauty stores carry an extensive selection of professional beauty supplies for both retail customers and salon professionals, featuring an average of 8,000 SKUs of beauty products across product categories including

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hair color, hair care, skin and nail care, beauty sundries and styling tools. Our Sally Beauty stores carry leading third-party brands, such as Clairol®, CHI®, China Glaze®, OPI® and Conair®, as well as an extensive selection of exclusive-label merchandise. Store formats, including average size and product selection, for Sally Beauty Supply outside the U.S. and Canada vary by marketplace. For the three months ended December 31, 2016, Sally Beauty Supply s net sales and segment operating profit were $589.9 million and $92.5 million, respectively, representing 59.0% and 59.3%, respectively, of our consolidated net sales and consolidated operating earnings before unallocated corporate expenses and share-based compensation expense.

We believe BSG is the largest full-service distributor of professional beauty supplies in North America, exclusively targeting salons and salon professionals. As of December 31, 2016, BSG had 1,177 company-operated stores, supplied 163 franchised stores and had a sales force of approximately 900 professional distributor sales consultants selling exclusively to salons and salon professionals in the U.S., Canada and Mexico. Company-operated BSG stores, which operate primarily under the CosmoProf banner, average approximately 2,600 square feet in size and are located primarily in secondary strip shopping centers. BSG stores provide a comprehensive selection of beauty products featuring an average of 9,500 SKUs that include hair color and care, skin and nail care, beauty sundries and styling tools. Through BSG s large store base and sales force, BSG is able to access a significant portion of the highly fragmented U.S. salon industry. BSG stores carry leading third-party brands such as Paul Mitchell®, Wella®, Matrix®, Schwarzkopf®, Kenra®, Goldwell®, Joico® and Aquage®, intended for use in salons and for resale by the salons to consumers. BSG is also the exclusive source for certain well-known third-party branded products pursuant to exclusive distribution agreements with certain suppliers within specified geographic territories. For the three months ended December 31, 2016, BSG s net sales and segment operating profit were $409.8 million and $63.6 million, respectively, representing 41.0% and 40.7%, respectively, of our consolidated net sales and consolidated operating earnings before unallocated corporate expenses and share-based compensation expense.

Key Industry and Business Trends

We operate primarily within the large and growing U.S. beauty supply industry. We believe that a number of key industry and business trends and characteristics will influence our business and our financial results going forward. These key trends and characteristics are discussed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016. Please see Key Industry and Business Trends in Item 1 of such Annual Report.

Share Repurchase Program

In August 2014, we announced that the Board had approved a share repurchase program authorizing us to repurchase up to $1.0 billion of our common stock over an approximate three-year period expiring on September 30, 2017 (the 2014 Share Repurchase Program).

During the three months ended December 31, 2016 and 2015, the Company repurchased and subsequently retired approximately 2.5 million and 2.4 million, respectively, of its common stock under the 2014 Share Repurchase Program at an aggregate cost of $67.0 million and $62.4 million, respectively. We funded these share repurchases with existing cash balances, cash from operations and borrowings under the ABL facility. The Company reduced common stock and additional paid-in capital, in the aggregate, by these amounts. However, as required by accounting principles generally accepted in the United States (GAAP), to the extent that the share repurchase amounts exceeded the balance of additional paid-in capital prior to such repurchases, we recorded the excess in accumulated deficit.

As of December 31, 2016, we had approximately $498.2 million of additional share repurchase authorization remaining under the 2014 Share Repurchase Program. Please see Item 2. Unregistered Sales of Equity Securities and Use of Proceeds (c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers in Part II Other Information, of this Quarterly Report for additional information about the Company s share repurchases.

Restructuring Plan

On January 26, 2017, the Board approved a comprehensive restructuring plan for the Company s businesses that includes a wide range of organizational efficiency initiatives and other cost reduction opportunities. The Company estimates that it will incur total aggregate expenses in the range of approximately $12.0 million to $14.0 million from this restructuring, including estimated severance and related costs of $7.0 million. The Company anticipates that most of these charges will be cash expenditures and expects to recognize most of the expenses related to this restructuring in its fiscal quarter ending March 31, 2017. The estimated annualized pre-tax benefit of the restructuring initiatives is estimated to be between $17.0 million and $19.0 million, with benefits estimated in the range of $10.0 million and $12.0 million realized over the remainder of fiscal 2017.

Data Security Incidents

During the fiscal year 2014, the Company disclosed that it had experienced a data security incident (the 2014 data security incident). During the fiscal year 2015, the Company disclosed that it had experienced a second data security incident (the 2015 data security incident and, together with the 2014 data security incident, the data security incidents). The data security incidents involved the unauthorized installation of malicious software (malware) on our information technology systems, including our point-of-sale systems that, we believe may have placed at risk certain payment card data for some transactions. The costs that the Company has incurred to date in connection with the data security incidents include assessments by payment card networks, professional advisory fees and legal costs and expenses relating to investigating and remediating the data security incidents. For the three months ended December 31, 2016 and 2015, selling, general and administrative expenses reflect expenses of $0.1 million and $0.5 million, respectively, consisting of expenses related to the data security incidents. As of December 31, 2016, the Company had an aggregate accrued liability relating to the data security incidents of $15.6 million, of which approximately $2.9 million relates to loss contingencies associated with the 2014 data security incident and

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approximately $12.8 million relates to loss contingencies associated with the 2015 data security incident. The Company s estimated probable losses related to the claims made by the payment card networks in connection with the data security incidents are based on currently available information. The Company disputes the validity of these claims and intends to contest them. Estimates related to these claims may change as new information becomes available or circumstances change.

We expect to incur additional costs and expenses related to the data security incidents in future periods. These costs and expenses may result from potential additional liabilities to payment card networks, governmental or third party investigations, proceedings or litigation and legal and other fees necessary to defend against any potential liabilities or claims, and further investigatory and remediation costs. As of December 31, 2016, the scope of these additional costs and expenses, or a range thereof, cannot be reasonably estimated and, while we do not anticipate these additional costs and expenses or liabilities would have a material adverse impact on our business, financial condition and operating results, these additional costs and expenses could be significant. Please see Risk Factors *We may be adversely affected by any disruption in our information technology systems,* *Unauthorized access to confidential information and data on our information technology systems and security and data breaches could materially adversely affect our business, financial condition and operating results* and *We have experienced data security incidents and are not yet able to determine the full extent or scope of the potential liabilities relating to these data security incidents* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2016.

Other Significant Items

Derivative Instruments

As a multinational corporation, we are subject to certain market risks including changes in market interest rates and foreign currency fluctuations. We may consider a variety of practices in the ordinary course of our business to manage these market risks, including, when deemed appropriate, the use of derivative instruments such as foreign currency forwards and options (hereafter, foreign exchange contracts) and interest rate swaps. Currently, we do not purchase or hold any derivative instruments for speculative or trading purposes.

Foreign Currency Derivative Instruments

We are exposed to potential gains or losses from foreign currency fluctuations affecting net investments in subsidiaries (including intercompany balances not permanently invested) and earnings denominated in foreign currencies, as well as exposure resulting from the purchase of merchandise by certain of our subsidiaries in a currency other than their functional currency and from the sale of products and services among the parent company and subsidiaries with a functional currency different from the parent or among subsidiaries with different functional currencies. Our primary exposures are to changes in exchange rates for the U.S. dollar versus the Euro, the British pound sterling, the Canadian dollar, the Chilean peso, and the Mexican peso. In addition, we currently have exposure to the currencies of several other countries located in South America and from time to time we may have exposure to changes in the exchange rate for the British pound sterling versus the Euro in connection with the sale of products and services among certain European subsidiaries of the Company. The recent vote by Britain to leave the European Union and related or other disruptive events in the European Union could result in increased foreign currency fluctuation, including fluctuation in currencies in which we operate. Our various foreign currency exposures at times offset each other, sometimes providing a natural hedge against foreign currency risk. In connection with the remaining foreign currency risk, the Company from time to time uses foreign exchange contracts to effectively fix the foreign currency exchange rate applicable to specific anticipated foreign currency-denominated cash flows, thus limiting the potential fluctuations in such cash flows resulting from foreign currency market movements.

The Company uses foreign exchange contracts to manage the exposure to the U.S. dollar resulting from certain of its Sinelco Group subsidiaries purchases of merchandise from third-party suppliers. Sinelco s functional currency is the Euro. As such, at December 31, 2016, the Company holds foreign currency forwards which enables it to sell approximately 12.0 million ($12.6 million, at the December 31, 2016 exchange rate) at a weighted average contractual exchange rate of 1.1243. The foreign currency forwards discussed in this paragraph are with a single counterparty and expire ratably through September 15, 2017.

The Company also uses foreign exchange contracts to mitigate its exposure to changes in foreign currency exchange rates in connection with certain intercompany balances not permanently invested. As such, at December 31, 2016, the Company holds: (a) a foreign currency forward that enables it to sell approximately 3.9 million ($4.1 million, at the December 31, 2016 exchange rate) at a contractual exchange rate of 1.0465, (b) foreign currency forwards which enable it to sell approximately 6.3 million Canadian dollars ($4.7 million, at the December 31, 2016 exchange rate) at a weighted average contractual exchange rate of 1.3443, (c) a foreign currency forward that enables it to sell approximately 31.9 million Mexican pesos ($1.5 million, at the December 31, 2016 exchange rate) at a contractual exchange rate of 20.7025 and (d) a foreign currency forward that enables it to buy approximately £0.21 million ($0.26 million, at the December 31, 2016 exchange rate) at a contractual exchange rate of 1.2254. All the foreign currency forwards discussed in this paragraph are with a single counterparty (not the same counterparty as that on the forwards discussed in the preceding paragraph) and expire on or before March 31, 2017.

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The Company s foreign exchange contracts are not designated as hedges and do not currently meet the requirements for hedge accounting. Accordingly, the changes in the fair value (i.e., marked-to-market adjustments) of these derivative instruments, which are adjusted quarterly, are recorded in selling, general and administrative expenses in our consolidated statements of earnings. During the three months ended December 31, 2016 and 2015, selling, general and administrative expenses include net gains of $1.8 million and $1.0 million, respectively, in connection with all of the Company s foreign currency derivative instruments, including marked-to-market adjustments. Please see Item 3 Quantitative and Qualitative Disclosures about Market Risk Foreign currency exchange rate risk contained in this Quarterly Report on Form 10-Q and Note 14 of the Notes to Consolidated Financial Statements in Item 8 - Financial Statements and Supplementary Data contained in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016 for additional information about the Company s foreign currency derivative instruments.

Share-Based Compensation Awards

The Company granted approximately 1.5 million and 1.4 million service-based stock options and approximately 22,000 and 23,000 service-based restricted share awards to its employees during the three months ended December 31, 2016 and 2015, respectively. Upon issuance of such grants, the Company recognized accelerated share-based compensation expense of $1.1 million and $1.3 million in the three months ended December 31, 2016 and 2015, respectively, in connection with certain employees who are eligible to continue vesting awards upon retirement under the provisions of the Sally Beauty Holdings, Inc. Amended and Restated 2010 Omnibus Incentive Plan (the 2010 Plan). The Company also granted approximately 39,000 and 26,000 service-based restricted stock units to its non-employee directors during the three months ended December 31, 2016 and 2015, respectively.

In addition, the Company granted approximately 146,000 and 152,000 performance-based restricted stock units (Performance Unit or Performance Units) to its employees during the three months ended December 31, 2016 and 2015, respectively, under the 2010 Plan. Under the terms of these Performance Unit awards, a grantee may earn from 0% to 200% of his or her target units, with the ultimate number of units earned upon settlement (and the expense recognized) dependent on the Company s level of achievement with respect to certain specified cumulative performance targets during the three-year period specified in each award (the Performance Period) and satisfaction of the employee service condition. Periodic expense for Performance Unit awards, which is estimated quarterly, is based on the Company s projected performance during the Performance Period compared to the performance targets contained in the award. Please see Note 7 of the Condensed Notes to Consolidated Financial Statements included in Item 1 of this Quarterly Report for more information about the Company s Performance Unit awards.

For the three months ended December 31, 2016 and 2015, share-based compensation expense charged against earnings and included in selling, general and administrative expenses for all share-based compensation arrangements were $3.8 million and $4.2 million, respectively, including the accelerated share-based compensation expense discussed above.

Other Items

During the three months ended December 31, 2015, the Company redeemed in full its 6.875% senior notes due 2019 (the senior notes due 2019) primarily with the net proceeds from its December 2015 issuance of $750.0 million principal amount of its 5.625% senior notes due 2025. For the three months ended December 31, 2015, the Company recorded a loss on extinguishment of debt of $33.3 million, including a call premium of $25.8 million and unamortized debt issuance costs associated with the senior notes due 2019 ($7.5 million) expensed, in connection therewith.

Results of Operations

The following table shows the condensed results of operations of our business for the three months ended December 31, 2016 and 2015 (dollars in thousands):

	Three Months Ended December 31,					
		2016			2015	
Net sales	$	999,609	100.0%	$	998,032	100.0%
Cost of products sold and distribution expenses		507,901	50.8%		503,983	50.5%
Gross profit		491,708	49.2%		494,049	49.5%
Total other operating costs and expenses		374,251	37.4%		363,114	36.4%
Operating earnings		117,457	11.8%		130,935	13.1%
Interest expense		26,799	2.7%		63,943	6.4%
Earnings before provision for income taxes		90,658	9.1%		66,992	6.7%
Provision for income taxes		34,832	3.5%		24,749	2.5%
Net earnings	$	55,826	5.6%	$	42,243	4.2%

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Key Operating Metrics

The following table sets forth, for the periods indicated, information concerning key measures we rely on to gauge our operating performance (dollars in thousands):

	Three Months Ended December 31,	
	2016	**2015 (a)**
Net sales:		
Sally Beauty Supply	$ 589,859	$ 601,439
BSG	409,750	396,593
Consolidated	$ 999,609	$ 998,032
Gross profit	$ 491,708	$ 494,049
Gross profit margin	49.2%	49.5%
Selling, general and administrative expenses	$ 347,412	$ 339,728
Depreciation and amortization	$ 26,839	$ 23,386
Earnings before provision for income taxes:		
Segment operating earnings:		
Sally Beauty Supply	$ 92,526	$ 106,464
BSG	63,600	65,493
Segment operating earnings	156,126	171,957
Unallocated expenses (b)	(34,855)	(36,834)
Share-based compensation expense	(3,814)	(4,188)
Operating earnings	117,457	130,935
Interest expense (c)	(26,799)	(63,943)
Earnings before provision for income taxes	$ 90,658	$ 66,992
Segment operating profit margin:		
Sally Beauty Supply	15.7%	17.7%
BSG	15.5%	16.5%
Consolidated operating profit margin	11.8%	13.1%
Number of stores at end-of-period (including franchises):		
Sally Beauty Supply	3,815	3,711
BSG	1,340	1,303
Consolidated	5,155	5,014
Same store sales growth (decline) (d)		
Sally Beauty Supply	(0.6)%	2.4%
BSG	2.6%	7.2%
Consolidated	0.4%	3.9%

(a) Certain amounts for the prior fiscal period have been reclassified to conform to the current fiscal period presentation.

(b) Unallocated expenses consist of corporate and shared costs and are included in selling, general and administrative expenses in our consolidated statements of earnings.

(c) For the three months ended December 31, 2015, interest expense includes a loss on extinguishment of debt of $33.3 million in connection with the Company s December 2015 redemption of its senior notes due 2019.

(d) For the purpose of calculating our same store sales metrics, we compare the current period sales for stores open for 14 months or longer as of the last day of a month with the sales for these stores for the comparable period in the prior fiscal year. Our same store sales are calculated in constant dollars and include internet-based sales (which are not separately material for each of the periods presented herein) and the effect of store expansions, if applicable, but do not generally include the sales from stores relocated until 14 months after the relocation. The sales from stores acquired are excluded from our same store sales calculation until 14 months after the acquisition.

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The Three Months Ended December 31, 2016 compared to the Three Months Ended December 31, 2015

The table below presents net sales, gross profit and gross profit margin data for each reportable segment (dollars in thousands):

	Three Months Ended December 31,			
	2016	2015	Increase (Decrease)	
Net sales:				
Sally Beauty Supply	$ 589,859	$ 601,439	$ (11,580)	(1.9)%
BSG	409,750	396,593	13,157	3.3%
Consolidated net sales	$ 999,609	$ 998,032	$ 1,577	0.2%
Gross profit:				
Sally Beauty Supply	$ 324,183	$ 330,325	$ (6,142)	(1.9)%
BSG	167,525	163,724	3,801	2.3%
Consolidated gross profit	$ 491,708	$ 494,049	$ (2,341)	(0.5)%
Gross profit margin:				
Sally Beauty Supply	55.0%	54.9%	0.1%	
BSG	40.9%	41.3%	(0.4)%	
Consolidated gross profit margin	49.2%	49.5%	(0.3)%	

Net Sales

Consolidated net sales increased by $1.6 million, or 0.2%, for the three months ended December 31, 2016, compared to the three months ended December 31, 2015. Consolidated net sales for the three months ended December 31, 2016, are inclusive of a net negative impact from changes in foreign currency exchange rates of $15.7 million, or 1.6% of consolidated net sales, including the impact of a stronger U.S. dollar in the three months ended December 31, 2016. Company-operated Sally Beauty Supply and BSG stores that have been open for 14 months or longer contributed an increase in consolidated net sales of approximately $4.2 million, or 0.4% of consolidated net sales, and sales through our BSG distributor sales consultants contributed an increase in net sales of approximately $1.7 million, or 0.2% of consolidated net sales, compared to the three months ended December 31, 2015. Other sales channels (including sales from stores that have been open for less than 14 months, sales to our BSG franchise-based businesses, incremental sales from businesses acquired in the preceding 12 months and sales from our Sally Beauty Supply non-store sales channels) in the aggregate experienced a net decrease in sales of approximately $4.3 million, or 0.4% of consolidated net sales, compared to the three months ended December 31, 2015.

For the three months ended December 31, 2016, consolidated net sales reflect a 0.4% same store sales growth rate compared to a growth rate of 3.9% for the three months ended December 31, 2015.

The $1.6 million increase in consolidated net sales was driven by increases in unit volume in our BSG segment (including increases in sales at existing BSG stores and the incremental sales from 36 BSG company-operated stores opened or acquired during the last 12 months) and increases in average unit prices in our BSG segment (resulting from changes in product mix), as more fully discussed below. These increases were partially offset by decreases in average unit prices in our Sally Beauty Supply segment, as more fully discussed below.

Sally Beauty Supply. Net sales for Sally Beauty Supply decreased by $11.6 million, or 1.9%, for the three months ended December 31, 2016, compared to the three months ended December 31, 2015. Net sales for Sally Beauty Supply for the three months ended December 31, 2016, are inclusive of a net negative impact from changes in foreign currency exchange rates of

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approximately $15.7 million, or 2.6% of Sally Beauty Supply s net sales. In the Sally Beauty Supply segment, company-operated stores that have been open for 14 months or longer experienced a decrease in net sales of approximately $6.2 million, or 1.0% of the segment s net sales, compared to the three months ended December 31, 2015. Other sales channels (including sales from stores that have been open for less than 14 months and sales from our non-store sales channels, which include the catalog and internet sales of our Sinelco Group subsidiaries) in the aggregate experienced a decrease in sales of approximately $5.4 million, or 0.9% of the segment s net sales, compared to the three months ended December 31, 2015.

For the three months ended December 31, 2016, the Sally Beauty Supply segment s same store sales declined at a rate of 0.6%, compared to a growth rate of 2.4% for the three months ended December 31, 2015, primarily as a result of a decrease in the number of customer transactions at the segment s U.S. stores.

The $11.6 million decrease in the Sally Beauty Supply segment s net sales reflects a decrease in average unit prices resulting from increased promotional activity and a change in product mix, primarily in connection with the introduction of certain products with lower average unit prices in the preceding 12 months.

Beauty Systems Group. Net sales for BSG increased by $13.2 million, or 3.3%, for the three months ended December 31, 2016, compared to the three months ended December 31, 2015. The BSG segment s net sales were not materially affected by changes in foreign currency exchange rates during the three months ended December 31, 2016. In the BSG segment, company-operated stores that have been open for 14 months or longer contributed an increase in net sales of approximately $10.4 million, or 2.6% of the segment s net sales, and sales through our distributor sales consultants contributed an increase in net sales of approximately $1.7 million, or 0.4% of the segment s net sales, compared to the three months ended December 31, 2015. Other sales channels (including sales from stores that have been open for less than 14 months, sales to our franchise-based businesses and incremental sales from businesses acquired in the preceding 12 months) in the aggregate contributed a net increase in net sales of approximately $1.1 million, or 0.3% of the segment s net sales, compared to the three months ended December 31, 2015.

For the three months ended December 31, 2016, the BSG segment s net sales reflect a 2.6% same store sales growth rate compared to a growth rate of 7.2% for the three months ended December 31, 2015. The BSG segment s same store sales growth rate for the three months ended December 31, 2015 was positively affected by the introduction of certain third-party brands and the expansion of exclusive distribution rights in certain geographies of the U.S.

The $13.2 million increase in the BSG segment s net sales is primarily the result of increases in unit volume (at both existing stores and the impact of incremental sales from 36 company-operated stores opened or acquired during the last 12 months) and increases in average unit prices (resulting from changes in product mix, principally as a result of the introduction of certain third-party brands with higher average unit prices in the preceding 12 months).

Gross Profit

Consolidated gross profit decreased by $2.3 million, or 0.5%, for the three months ended December 31, 2016, compared to the three months ended December 31, 2015, principally as a result of lower net sales in our Sally Beauty Supply segment and lower gross profit margins in our BSG segment (as more fully described below), partially offset by higher sales volume in our BSG segment. Consolidated gross profit as a percentage of net sales, or consolidated gross profit margin, decreased by 30 basis points to 49.2% for the three months ended December 31, 2016, compared to 49.5% for the three months ended December 31, 2015, as more fully described below.

Sally Beauty Supply. Sally Beauty Supply s gross profit decreased by $6.1 million, or 1.9%, for the three months ended December 31, 2016, compared to the three months ended December 31, 2015, principally as a result of lower sales. Sally Beauty Supply s gross profit as a percentage of net sales was 55.0% for the three months ended December 31, 2016, compared to 54.9% for the three months ended December 31, 2015. The increase in the segment s gross margin reflects less promotional activity in certain international geographies, partially offset by incremental promotional activity in the U.S.

Beauty Systems Group. BSG s gross profit increased by $3.8 million, or 2.3%, for the three months ended December 31, 2016, compared to the three months ended December 31, 2015, principally as a result of higher sales volume, partially offset by a lower gross profit margins. BSG s gross profit as a percentage of net sales decreased by 40 basis points to 40.9% for the three months ended December 31, 2016, compared to 41.3% for the three months ended December 31, 2015 primarily as a result of incremental promotional activity, lower vendor allowances and a shift in product mix (to lower margin product) resulting primarily from changes in customer preferences.

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Selling, General and Administrative Expenses

Consolidated selling, general and administrative expenses increased by $7.7 million, or 2.3%, for the three months ended December 31, 2016, compared to the three months ended December 31, 2015. This increase was attributable in part to incremental expenses (including rent and other occupancy-related expenses) resulting from stores opened or acquired in the preceding 12 months (approximately 140 net additional company-operated stores added since December 31, 2015, which represents a 2.9% increase in the number of company-operated stores). In addition, the increase reflects higher employee compensation and compensation-related expenses of $4.2 million (including incremental wages in connection with Sally Beauty Supply and BSG stores added since December 31, 2015 and wage increases for sales staff at existing Sally Beauty Supply and BSG stores, partially offset by the absence during the three months ended December 31, 2016 of expenses of $0.9 million incurred in connection with the management transition plans disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016), incremental expenses related to on-going upgrades to our information technology systems (approximately $2.0 million) and incremental professional fees principally associated with corporate information technology and data security initiatives (approximately $1.1 million). The increase in selling, general and administrative expenses was partially offset by higher net foreign exchange gains of $0.8 million, as further discussed in Note 10 of Notes to Condensed Notes to Consolidated Financial Statements located elsewhere in this Quarterly Report. Selling, general and administrative expenses, as a percentage of net sales, were 34.8% for the three months ended December 31, 2016, compared to 34.0% for the three months ended December 31, 2015.

Depreciation and Amortization

Consolidated depreciation and amortization increased by $3.5 million to $26.8 million for the three months ended December 31, 2016, compared to $23.4 million for the three months ended December 31, 2015. This increase reflects the incremental depreciation and amortization expenses associated with capital expenditures made in the preceding 12 months (mainly in connection with store openings in both operating segments, with store remodels in the Sally Beauty Supply segment, primarily in the U.S., and with ongoing information technology upgrades), partially offset by the impact of assets that became fully depreciated in the preceding 12 months.

Operating Earnings

The following table sets forth, for the periods indicated, information concerning our operating earnings for each reportable segment (dollars in thousands):

	Three Months Ended December 31,			
	2016	2015	(Decrease)	
Operating Earnings:				
Segment operating earnings:				
Sally Beauty Supply	$ 92,526	$ 106,464	$ (13,938)	(13.1)%
BSG	63,600	65,493	(1,893)	(2.9)%
Segment operating earnings	156,126	171,957	(15,831)	(9.2)%
Unallocated expenses	(34,855)	(36,834)	(1,979)	(5.4)%
Share-based compensation expense	(3,814)	(4,188)	(374)	(8.9)%
Operating earnings	$ 117,457	$ 130,935	$ (13,478)	(10.3)%

Consolidated operating earnings decreased by $13.5 million, or 10.3%, for the three months ended December 31, 2016, compared to the three months ended December 31, 2015, primarily as a result of lower net sales in our Sally Beauty Supply segment and lower gross profit margins in our BSG segment, partially offset by increased net sales in our BSG segment and lower unallocated expenses, as more fully discussed below. Operating earnings as a percentage of net sales, or consolidated operating profit margin, decreased by 130 basis points to 11.8% for the three months ended December 31, 2016, compared to 13.1% for the three months ended December 31, 2015. This decrease reflects higher consolidated operating expenses as a percentage of consolidated net sales, as more fully discussed below, as well as a lower consolidated gross profit margin, as described above.

Sally Beauty Supply. Sally Beauty Supply s segment operating earnings decreased by $13.9 million, or 13.1%, for the three months ended December 31, 2016, compared to the three months ended December 31, 2015. This decrease was primarily a result of the incremental expenses (including rent and other occupancy-related expenses) related to 104 net additional company-operated stores (stores opened during the past 12 months, which represents a 2.8% increase in the number of Sally Beauty Supply company-operated stores) operating during the three months ended December 31, 2016, compared to the three months ended December 31, 2015. In addition, the decrease in Sally Beauty Supply s segment operating earnings reflects higher employee compensation and compensation-related expenses of $2.9 million (including incremental wages in connection with stores added since December 31, 2015 and wage increases for sales staff at existing stores), higher depreciation expense associated primarily with recent store openings and remodels (approximately $2.1 million) and higher expenses related to recent upgrades to our information technology systems (approximately $2.1 million). Segment operating earnings, as a percentage of net sales, decreased 200 basis points to 15.7% for the three months ended December 31, 2016, compared to 17.7% for the three months ended December 31, 2015. This decrease reflects higher segment operating expenses as a percentage of the segment s net sales, including the expense increases discussed in this paragraph.

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Beauty Systems Group. BSG s segment operating earnings decreased by $1.9 million, or 2.9%, for the three months ended December 31, 2016, compared to the three months ended December 31, 2015, primarily a result of the incremental expenses (including rent and other occupancy-related expenses) related to 36 net additional company-operated stores (stores opened or acquired during the past 12 months, which represents a 3.2% increase in the number of BSG company-operated stores) operating during the three months ended December 31, 2016, compared to the three months ended December 31, 2015, higher employee compensation and compensation-related expenses of $3.7 million (including incremental wages in connection with stores added during the past 12 months and wage increases for sales staff at existing stores) and higher expenses related to recent upgrades to our information technology systems of approximately $1.0 million. Segment operating earnings, as a percentage of net sales, decreased by 100 basis points to 15.5% for the three months ended December 31, 2016, compared to 16.5% for the three months ended December 31, 2015. This decrease reflects higher segment operating expenses as a percentage of the segment s net sales, including the expense increases discussed in this paragraph, as well as the decrease in the segment s gross profit margin described above.

Unallocated Expenses. Unallocated expenses, which represent certain corporate costs (such as payroll, employee benefits and travel expenses for corporate staff, certain professional fees, certain new business development expenses and corporate governance expenses) that have not been charged to our operating segments, decreased by $2.0 million, or 5.4%, for the three months ended December 31, 2016, compared to the three months ended December 31, 2015. This decrease was due primarily to lower employee compensation and compensation-related expenses of $2.4 million (including the absence during the three months ended December 31, 2016 of expenses of $0.9 million incurred in connection with the management transition plans disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016).

Share-based Compensation Expense. Total compensation expenses related to share-based compensation arrangements decreased by $0.4 million to $3.8 million for the three months ended December 31, 2016, compared to $4.2 million for the three months ended December 31, 2015 mainly due to a reduction in awards to retirement-eligible grantees during the three months ended December 31, 2016, compared to the three months ended December 31, 2015.

Interest Expense

Interest expense decreased by $37.1 million to $26.8 million for the three months ended December 31, 2016, compared to $63.9 million for the three months ended December 31, 2015. The decrease in interest expense was principally due to a loss on extinguishment of debt of $33.3 million, for the three months ended December 31, 2015, in connection with our debt refinancing in December 2015, and by lower interest expense on the senior notes due 2025 compared to the senior notes due 2019. Please see Liquidity and Capital Resources below for additional information about the Company s debt.

Provision for Income Taxes

The provision for income taxes was $34.8 million and $24.7 million, and the effective income tax rate was 38.4% and 36.9%, for the three months ended December 31, 2016 and 2015, respectively. The increase in the effective income tax rate was primarily due to a tax benefit recognized in the three months ended December 31, 2015 in connection with the enactment of retroactive U.S. legislation reinstating certain tax credits.

The annual effective tax rate for the full fiscal year 2017 is currently expected to be in the range of 37.5% to 38.5%, versus a comparable actual tax rate for the full fiscal year 2016 of 37.0%.

Net Earnings and Diluted Earnings per Share

As a result of the foregoing, consolidated net earnings increased by $13.6 million, or 32.2%, to $55.8 million for the three months ended December 31, 2016, compared to $42.2 million for the three months ended December 31, 2015. Net earnings, as a percentage of net sales, increased by 140 basis points to 5.6% for the three months ended December 31, 2016, compared to 4.2% for the three months ended December 31, 2015. Diluted earnings per share for the three months ended December 31, 2016 were $0.39 compared to $0.28 for the three months ended December 31, 2015.

Financial Condition

December 31, 2016 Compared to September 30, 2016

Working capital (current assets less current liabilities) increased by $3.3 million to $687.4 million at December 31, 2016, compared to $684.2 million at September 30, 2016. The ratio of current assets to current liabilities was 2.45 to 1.00 at December 31, 2016, compared to 2.40 to 1.00 at September 30, 2016. The change in working capital reflects a decrease of approximately $13.2 million in current liabilities, partially offset by a decrease of approximately $9.9 million in current assets. The decrease in

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current assets as of December 31, 2016, is principally due to a decrease in trade accounts receivable and other accounts receivable, in the aggregate, of $5.3 million and a decrease of $12.9 million in other current assets, as discussed below, partially offset by an increase in cash and cash equivalents of $7.8 million (please see Liquidity and Capital Resources below for a description of our sources and uses of cash). The decrease in current liabilities is principally due to a decrease of $33.7 million in accrued liabilities, partially offset by an increase of $8.3 million in accounts payable and an increase of $12.3 million in income taxes payable, as discussed below.

Trade accounts receivable and other accounts receivable, in the aggregate, decreased by $5.3 million to $78.7 million at December 31, 2016, compared to $84.0 million at September 30, 2016 due primarily to the timing of collections from customers and vendors of balances outstanding and the impact of foreign currency translation adjustments. Other current assets decreased by $12.9 million to $42.0 million at December 31, 2016, compared to $54.9 million at September 30, 2016 due primarily to the application of certain income tax receivable balances against income taxes currently payable ($14.7 million), partially offset by the timing of payments of prepaid expenses in the ordinary course of our business. Accounts payable increased by $8.3 million to $279.6 million at December 31, 2016, compared to $271.4 million at September 30, 2016 due primarily to the timing of payments to suppliers mainly in connection with purchases of merchandise inventory and capital expenditures in the ordinary course of our business. Accrued liabilities decreased by $33.7 million to $180.9 million at December 31, 2016, compared to $214.6 million at September 30, 2016, due primarily to the timing of payments of interest on the senior notes due 2022, the senior notes due 2023 and the senior notes due 2025 (in the aggregate, $25.5 million) and the timing of payments of employee compensation and compensation-related expenses ($6.7 million). Interest on the senior notes due 2022, the senior notes due 2023 and the senior notes due 2025 is payable semi-annually, during the Company s first and third fiscal quarters. Income taxes payable increased by $12.3 million to $14.3 million at December 31, 2016, compared to $2.0 million at September 30, 2016 due primarily to the impact of current period earnings before income taxes and the timing of U.S. federal estimated income tax payments, partially offset by the application of certain income tax receivable balances against income taxes currently payable, as discussed above.

Total stockholders deficit, for the three months ended December 31, 2016, increased by $12.8 million primarily as a result of our repurchase and subsequent retirement of approximately 2.5 million shares of our common stock for approximately $67.0 million and foreign currency translation adjustments, net of tax, of $18.7 million, partially offset by net earnings of $55.8 million, and share-based compensation expense, the impact of exercises of stock options and other share-based compensation activity, in the aggregate, of approximately $17.0 million.

Liquidity and Capital Resources

We broadly define liquidity as our ability to generate sufficient cash flow from operating activities to meet our obligations and commitments. In addition, liquidity includes the ability to obtain appropriate debt and equity financing and to convert into cash those assets that are no longer required to meet existing strategic and financial objectives. Therefore, liquidity cannot be considered separately from capital resources that consist of current or potentially available funds for use in achieving long-range business objectives and meeting debt service commitments. Please see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016 for additional information on our liquidity and capital resources.

We are highly leveraged and a substantial portion of our liquidity needs will arise from debt service on our outstanding indebtedness and from funding the costs of operations, working capital, capital expenditures and share repurchases. As a holding company, we depend on our subsidiaries, including Sally Holdings LLC (Sally Holdings), to distribute funds to us so that we may pay our obligations and expenses. The ability of our subsidiaries to make such distributions will be subject to their operating results, cash requirements and financial condition and their compliance with relevant laws, and covenants and financial ratios related to their existing or future indebtedness, including covenants restricting Sally Holdings ability to pay dividends to us. If, as a consequence of these limitations, we cannot receive sufficient distributions from our subsidiaries, we may not be able to meet our obligations to fund general corporate expenses. Please see Risk Factors *Risks Relating to Our Business*, and *Risks Relating to Our Substantial Indebtedness* in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2016.

We may from time to time repurchase or otherwise retire or refinance our debt (through our subsidiaries or otherwise) and take other steps to reduce or refinance our debt. These actions may include open market repurchases of our notes or other retirements of outstanding debt. The amount of debt that may be repurchased, or refinanced or otherwise retired, if any, will be determined in the sole discretion of our Board of Directors and will depend on market conditions, trading levels of the Company s debt from time to time, the Company s cash position and other considerations.

At December 31, 2016, cash and cash equivalents were $94.4 million. Based upon the current level of operations and anticipated growth, we anticipate that existing cash balances (excluding certain amounts permanently invested in connection with foreign operations), funds expected to be generated by operations and funds available under the ABL facility will be sufficient to meet our working capital requirements, fund share repurchases and potential acquisitions and finance anticipated capital expenditures, including information technology upgrades and store remodels, over the next 12 months.

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However, there can be no assurance that our business will generate sufficient cash flows from operations, that anticipated net sales and operating improvements will be realized, or that future borrowings will be available under our ABL facility in an amount sufficient to enable us to service our indebtedness or to fund our other liquidity needs. In addition, our ability to meet our debt service obligations and liquidity needs are subject to certain risks, which include, but are not limited to, increases in competitive activity, the loss of key suppliers, rising interest rates, the loss of key personnel, the ability to execute our business strategy and general economic conditions. Please see Risk Factors in Part I of our Annual Report on Form 10-K for the fiscal year ended September 30, 2016.

We utilize our ABL facility for the issuance of letters of credit, for certain working capital and liquidity needs and to manage normal fluctuations in our operational cash flow. In that regard, we may from time to time draw funds under the ABL facility for general corporate purposes including funding of capital expenditures, acquisitions, interest payments due on our indebtedness and share repurchases. The funds drawn on an individual occasion during the three months ended December 31, 2016 have varied in

amounts up to $32.0 million, total amounts outstanding have ranged from zero up to $39.5 million and the average daily balance outstanding was $7.0 million. During the three months ended December 31, 2016, the weighted average interest rate on our borrowings under the ABL facility was 4.1%. The amounts drawn are generally paid down with cash provided by our operating activities. As of December 31, 2016, there were no borrowings outstanding under the ABL facility and Sally Holdings had $480.0 million available for borrowings under the ABL facility, subject to borrowing base limitations, as reduced by outstanding letters of credit.

We are a holding company and do not have any material assets or operations other than ownership of equity interests in our subsidiaries. The agreements and instruments governing the debt of Sally Holdings and its subsidiaries contain material limitations on their ability to pay dividends and other restricted payments to us which, in turn, constitute material limitations on our ability to pay dividends and other payments to our stockholders. Please see *Long-Term Debt Covenants* below.

Share Repurchase Programs

In August 2014, we announced that the Board had approved a share repurchase program authorizing us to repurchase up to $1.0 billion of our common stock over an approximately three-year period expiring on September 30, 2017.

During the three months ended December 31, 2016 and 2015, the Company repurchased and subsequently retired approximately 2.5 million and 2.4 million shares, respectively, of its common stock under the 2014 Share Repurchase Program at an aggregate cost of $67.0 million and $62.4 million, respectively. We funded these share repurchases with existing cash balances, cash from operations and borrowings under the ABL facility. The Company reduced common stock and additional paid-in capital, in the aggregate, by these amounts. However, as required by GAAP, to the extent that share repurchase amounts exceeded the balance of additional paid-in capital prior to us recording such repurchases, we recorded the excess in accumulated deficit.

As of December 31, 2016, we had approximately $498.2 million of additional share repurchase authorization remaining under the 2014 Share Repurchase Program. Future repurchases of shares of our common stock are expected to be funded with existing cash balances, funds expected to be generated by operations and funds available under the ABL facility.

Historical Cash Flows

Historically, our primary source of cash has been funds provided by operating activities and, when necessary, borrowings under our ABL facility. The primary uses of cash have been for share repurchases, capital expenditures, repayments and servicing of long-term debt and acquisitions. The following table shows our sources and uses of funds for the three months ended December 31, 2016 and 2015 (in thousands):

	Three months ended December 31, 2016	Three months ended December 31, 2015
Net cash provided by operating activities	$ 90,453	$ 69,129
Net cash used by investing activities	(28,008)	(42,825)
Net cash used by financing activities	(53,736)	(98,236)
Effect of foreign currency exchange rate changes on cash and cash equivalents	(921)	(659)
Net increase (decrease) in cash and cash equivalents	$ 7,788	$ (72,591)

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Net Cash Provided by Operating Activities

Net cash provided by operating activities during the three months ended December 31, 2016 increased by $21.3 million to $90.5 million, compared to $69.1 million during the three months ended December 31, 2015, mainly due to changes in the components of working capital ($47.8 million), an increase in net earnings ($13.6 million) and an increase in depreciation and amortization ($3.5 million), partially offset by a decrease in loss on extinguishment of debt ($33.3 million) and a decrease in deferred income taxes ($9.0 million).

Net Cash Used by Investing Activities

Net cash used by investing activities during the three months ended December 31, 2016 decreased by $14.8 million to $28.0 million, compared to $42.8 million during the three months ended December 31, 2015. This decrease reflects lower capital expenditures related primarily to Sally Beauty Supply store refreshes (mainly in the U.S.) and lower investments in information technology upgrades in the three months ended December 31, 2016, compared to the three months ended December 31, 2015 ($12.6 million), and less cash used for acquisitions, net of cash acquired, in the three months ended December 31, 2016 ($2.3 million).

Net Cash Used by Financing Activities

Net cash used by financing activities during the three months ended December 31, 2016 decreased by $44.5 million to $53.7 million, compared to $98.2 million during the three months ended December 31, 2015, primarily due to decrease in net repayments of debt and the payment of debt issuance costs, in the aggregate, of $38.5 million mainly in connection with our redemption of the senior notes due 2019 and issuance of the senior notes due 2025 in December 2015, and an increase in proceeds from exercises of stock options, net of tax shortfall, resulting from share-based compensation activity of $10.6 million, partially offset by an increase in share repurchases under the 2014 Share Repurchase Program ($4.6 million).

Long-Term Debt

Outstanding Long-Term Debt

In the fiscal year 2011, Sally Holdings entered into a $400 million, five-year asset-based senior secured loan facility (the ABL facility). The availability of funds under the ABL facility, as amended in June 2012, is subject to a customary borrowing base comprised of: (i) a specified percentage of our eligible credit card and trade accounts receivable (as defined therein) and (ii) a specified percentage of our eligible inventory (as defined therein), and reduced by (iii) certain customary reserves and adjustments and by certain outstanding letters of credit. The ABL facility includes a $25.0 million Canadian sub-facility for our Canadian operations. In the fiscal year 2013, the Company, Sally Holdings and other parties to the ABL facility entered into a second amendment to the ABL facility which, among other things, increased the maximum availability under the ABL Facility to $500.0 million (subject to borrowing base limitations), reduced pricing, relaxed the restrictions regarding the making of Restricted Payments, extended the maturity to July 2018 and improved certain other covenant terms.

In the fiscal year 2012, Sally Holdings and Sally Capital Inc. (collectively, the Issuers), both indirect wholly-owned subsidiaries of the Company, issued $750.0 million aggregate principal amount of their senior notes due 2019 and $850.0 million aggregate principal amount of their 5.75% Senior Notes due 2022 (the senior notes due 2022), including $150.0 million of the aggregate principal amount of the senior notes due 2022 issued at par plus a premium. Such premium is being amortized over the term of the senior notes due 2022 using the effective interest method. The net proceeds from these debt issuances were used to retire outstanding indebtedness in the aggregate principal amount of approximately $1,391.9 million, (substantially all of which was incurred in 2006 in connection with our separation from The Alberto-Culver Company (Alberto-Culver), and for general corporate purposes. In the fiscal year 2016, the Company redeemed in full the senior notes due 2019 at a redemption premium equal to 103.438% primarily with the net proceeds from the issuance of the 5.625% Senior Notes due 2025 (the senior notes due 2025), as further discussed below.

In the fiscal year 2014, the Issuers issued $200.0 million aggregate principal amount of their 5.5% Senior Notes due 2023 (the senior notes due 2023) at par. The Company used the net proceeds from this debt issuance, approximately $196.3 million, to repay borrowings outstanding under the ABL facility of $88.5 million (which borrowings were primarily used to fund share repurchases) and for general corporate purposes, including share repurchases.

In the fiscal year 2016, the Issuers issued $750.0 million aggregate principal amount of their senior notes due 2025 at par. The Company used the net proceeds from this debt issuance (approximately $737.3 million), as well as existing cash balances, to redeem in full the senior notes due 2019, at a total redemption cost of $775.8 million, excluding accrued interest. In connection with our redemption of the senior notes due 2019, we recorded a loss on extinguishment of debt in the amount of approximately $33.3 million, including a redemption premium in the amount of approximately $25.8 million and unamortized deferred financing costs associated with the senior notes due 2019 of approximately $7.5 million.

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As of December 31, 2016, the principal amount of long-term debt (excluding capitalized leases) is as follows (dollars in thousands):

	Principal Amount(a)		Maturity Dates	Interest Rates(b)
ABL facility	$		July 2018	(i) Prime plus (0.50% to 0.75%) or; (ii) LIBOR (c) plus (1.50% to 1.75%)
Senior notes due 2022		850,000	June 2022	5.750%
Senior notes due 2023		200,000	Nov. 2023	5.500%
Senior notes due 2025		750,000	Dec. 2025	5.625%
Total	$	1,800,000		

(a) Amounts reported above do not reflect unamortized premium of $5.3 million related to notes with an aggregate principal amount of $150.0 million of the senior notes due 2022 or unamortized debt issuance costs in the aggregate amount of $22.9 million, at December 31, 2016.

(b) Interest rates shown represent the coupon or contractual rate related to each debt instrument listed.

(c) When used in this Quarterly Report, LIBOR means the London Interbank Offered Rate.

Long-Term Debt Covenants

We are a holding company and do not have any material assets or operations other than ownership of equity interests of our subsidiaries. The agreements and instruments governing the debt of Sally Holdings and its subsidiaries contain material limitations on their ability to pay dividends and other restricted payments to us which, in turn, constitute material limitations on our ability to pay dividends and other payments to our stockholders.

Borrowings under the ABL facility are secured by the accounts, inventory and credit card receivables (and related general intangibles and other property) of our domestic subsidiaries (and, in the case of borrowings under the Canadian sub-facility, such assets of our Canadian subsidiaries and, solely with respect to borrowings by SBH Finance B.V., intercompany notes owed to SBH Finance B.V. by our foreign subsidiaries). The senior notes due 2022, the senior notes due 2023 and the senior notes due 2025 (which we refer to collectively as the Senior Notes or the senior notes due 2022, 2023 and 2025) are unsecured obligations of the Issuers and are jointly and severally guaranteed by the Company and Sally Investment, and by each material domestic subsidiary of the Company. Interest on the senior notes due 2022, 2023 and 2025 is payable semi-annually, during the Company s first and third fiscal quarters.

The ABL facility and the indentures governing the senior notes due 2022, 2023 and 2025 contain other covenants regarding restrictions on asset dispositions, granting of liens and security interests, prepayment of certain indebtedness and other matters and customary events of default, including customary cross-default and/or cross-acceleration provisions. As of December 31, 2016, all the net assets of our consolidated subsidiaries were unrestricted from transfer under our credit arrangements.

The senior notes due 2022 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after June 1, 2020 at par, plus accrued and unpaid interest, if any, and on or after June 1, 2017 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to June 1, 2017, the notes may be redeemed, in whole or in part, at a redemption price equal to par plus a make-whole premium as provided in the indenture, plus accrued and unpaid interest, if any.

The senior notes due 2023 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after November 1, 2021 at par, plus accrued and unpaid interest, if any, and on or after November 1, 2018 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to November 1, 2018, the notes may be redeemed, in whole or in part, at a redemption price equal to par plus a make-whole premium as provided in the indenture, plus accrued and unpaid interest, if any.

The senior notes due 2025 carry optional redemption features whereby the Company has the option to redeem the notes, in whole or in part, on or after December 1, 2023 at par, plus accrued and unpaid interest, if any, and on or after December 1, 2020 at par plus a premium declining ratably to par, plus accrued and unpaid interest, if any. Prior to December 1, 2020, the notes may be redeemed, in whole or in part, at a redemption price equal to par plus a make-whole premium as provided in the indenture, plus accrued and unpaid interest, if any. In addition, on or prior to December 1, 2018, the Company has the right to redeem at par plus a specified premium, plus accrued and unpaid interest, if any, up to 35% of the aggregate principal amount of notes originally issued, subject to certain limitations, with the proceeds from certain kinds of equity offerings, as defined in the indenture.

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The ABL facility does not contain any restriction against the incurrence of unsecured indebtedness. However, the ABL facility restricts the incurrence of secured indebtedness if, after giving effect to the incurrence of such secured indebtedness, the Company s Secured Leverage Ratio exceeds 4.0 *to* 1.0. At December 31, 2016, the Company s Secured Leverage Ratio was less than 0.1 *to* 1.0. Secured Leverage Ratio is defined as the ratio of (i) Secured Funded Indebtedness (as defined in the ABL facility) *to* (ii) Consolidated EBITDA (as defined in the ABL facility) for the most recently completed 12 fiscal months.

The ABL facility is pre-payable and the commitments thereunder may be terminated, in whole or in part, at any time without penalty or premium.

The indentures governing the Senior Notes contain terms which restrict the ability of Sally Beauty s subsidiaries to incur additional indebtedness. However, in addition to certain other material exceptions, the Company may incur additional indebtedness under the indentures if its Consolidated Coverage Ratio, after giving pro forma effect to the incurrence of such indebtedness, exceeds 2.0 *to* 1.0 (Incurrence Test). At December 31, 2016, the Company s Consolidated Coverage Ratio was approximately 6.1 *to* 1.0. Consolidated Coverage Ratio is defined as the ratio of (i) Consolidated EBITDA (as defined in the indentures) for the period containing the most recent four consecutive fiscal quarters, *to* (ii) Consolidated Interest Expense (as defined in the indentures) for such period.

The indentures governing the Senior Notes also restrict Sally Holdings and its subsidiaries from making certain dividends and distributions to equity holders and certain other restricted payments (hereafter, a Restricted Payment or Restricted Payments) to us. However, the indentures permit the making of such Restricted Payments if, at the time of the making of such Restricted Payment, the Company satisfies the Incurrence Test as described above and the cumulative amount of all Restricted Payments made since the issue date of the applicable senior notes does not exceed the sum of: (i) 50% of Sally Holdings and its subsidiaries cumulative consolidated net earnings since July 1, 2006 (for the senior notes due 2022 and the senior notes due 2023) or since October 1, 2015 (for the senior notes due 2025), *plus* (ii) the proceeds from the issuance of certain equity securities or conversions of indebtedness to equity, in each case, since the issue date of the applicable senior notes *plus* (iii) the net reduction in investments in unrestricted subsidiaries since the issue date of the applicable senior notes *plus* (iv) the return of capital with respect to any sales or dispositions of certain minority investments since the issue date of the applicable senior notes *plus* (v) $350 million (for the senior notes due 2025). Further, in addition to certain other baskets, the indentures permit the Company to make additional Restricted Payments in an unlimited amount if, after giving pro forma effect to the incurrence of any indebtedness to make such Restricted Payment, the Company s Consolidated Total Leverage Ratio (as defined in the indentures) is less than 3.25 *to* 1.00. At December 31, 2016, the Company s Consolidated Total Leverage Ratio was approximately 2.7 *to* 1.0. Consolidated Total Leverage Ratio is defined as the ratio of (i) Consolidated Total Indebtedness, as defined in the indentures, *minus* cash and cash equivalents on-hand up to $100.0 million, in each case, as of the end of the most recently-ended fiscal quarter *to* (ii) Consolidated EBITDA (as defined in the indentures) for the period containing the most recent four consecutive fiscal quarters.

The ABL facility also restricts the making of Restricted Payments. More specifically, under the ABL facility, Sally Holdings may make Restricted Payments if availability under the ABL facility equals or exceeds certain thresholds, and no default then exists under the facility. For Restricted Payments up to $30.0 million during each fiscal year, borrowing availability must equal or exceed the lesser of $75.0 million or 15% of the borrowing base for 45 days prior to such Restricted Payment. For Restricted Payments in excess of that amount, borrowing availability must equal or exceed the lesser of $100.0 million or 20% of the borrowing base for 45 days prior to such Restricted Payment and the Consolidated Fixed Charge Coverage Ratio (as defined below) must equal or exceed 1.1 to 1.0. Further, if borrowing availability equals or exceeds the lesser of $150.0 million or 30% of the borrowing base, Restricted Payments are not limited by the Consolidated Fixed Charge Coverage Ratio test. The Consolidated Fixed Charge Coverage Ratio is defined as the ratio of (i) Consolidated EBITDA (as defined in the ABL facility) during the trailing twelve-month period preceding such proposed Restricted Payment minus certain unfinanced capital expenditures made during such period and income tax payments paid in cash during such period to (ii) fixed charges (as defined in the ABL facility). In addition, during any period that borrowing availability under the ABL facility is less than the greater of $40.0 million or 10% of the borrowing base, the level of the Consolidated Fixed Charge Coverage Ratio that the Company must satisfy is 1.0 to 1.0. As of December 31, 2016, the Consolidated Fixed Charge Coverage Ratio was approximately 3.4 *to* 1.0.

When used in this Quarterly Report, the phrase Consolidated EBITDA is intended to have the meaning ascribed to such phrase in the ABL facility or the indentures governing the senior notes due 2022, 2023 and 2025, as appropriate. EBITDA is not a recognized measurement under GAAP and should not be considered a substitute for financial performance and liquidity measures determined in accordance with GAAP, such as net earnings, operating earnings and operating cash flows.

We are currently in compliance with the agreements and instruments governing our debt, including our financial covenants. Our ability to comply with these covenants in future periods will depend on our ongoing financial and operating performance, which in turn will be subject to economic conditions and to financial, market and competitive factors, many of which are beyond our control. Further, our ability to comply with these covenants in future periods will also depend substantially on the pricing of our products, our success at implementing cost reduction initiatives and our ability to successfully implement our overall business strategy. Please see Risk Factors Risks Relating to Our Substantial Indebtedness in Item 1A of our Annual Report on Form 10-K for the fiscal year ended September 30, 2016.

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Capital Requirements

During the three months ended December 31, 2016, capital expenditures were approximately $25.9 million, including amounts incurred but not paid at December 31, 2016 (approximately $1.7 million). For fiscal year 2017, we anticipate capital expenditures in the range of approximately $115.0 million to $120.0 million, excluding acquisitions. These capital expenditures will primarily fund (a) the addition of new stores, (b) the remodel, expansion or relocation of existing stores, (c) upgrades to our distribution centers in the U.S., as well as (d) certain corporate projects in the ordinary course of our business, including ongoing technology upgrades.

Contractual Obligations

There have been no material changes outside the ordinary course of our business in any of our contractual obligations since September 30, 2016.

Off-Balance Sheet Financing Arrangements

At December 31, 2016 and September 30, 2016, we had no off-balance sheet financing arrangements other than operating leases incurred in the ordinary course of business, and outstanding letters of credit related to inventory purchases and self-insurance programs. Such letters of credit totaled $20.0 million and $21.6 million at December 31, 2016 and September 30, 2016, respectively.

Inflation

We believe inflation has not had a material effect on our results of operations.

Critical Accounting Estimates

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and disclosure of contingent assets and liabilities in the financial statements. Actual results may differ from these estimates. We believe these estimates and assumptions are reasonable. We consider accounting policies to be critical when they require us to make assumptions about matters that are highly uncertain at the time the accounting estimate is made and when different estimates that our management reasonably could have used have a material effect on the presentation of our financial condition, changes in financial condition or results of operations.

Our critical accounting estimates, as described in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016, include the valuation of inventory, vendor rebates and concessions, retention of risk, income taxes, assessment of long-lived assets and intangible assets for impairment and share-based payments. There have been no material changes to our critical accounting estimates or assumptions since September 30, 2016.

Recent Accounting Pronouncements and Accounting Changes

Recent Accounting Pronouncements

The Company has not yet adopted and is currently assessing the potential effect of the following pronouncements on its consolidated financial statements:

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Income Taxes* (ASU 2015-17) which aims to simplify the classification of deferred taxes on the balance sheet. More specifically, ASU 2015-17 will require that all deferred tax assets and liabilities, and any related valuation allowance, be reported as noncurrent in a classified balance sheet. The new guidance will replace the existing practice of reporting deferred taxes for each tax jurisdiction (or taxing component of a jurisdiction) as (a) a net current asset or liability *and* (b) a net noncurrent asset or liability. The new guidance does not change the existing requirement that only permits offsetting assets and liabilities within the same jurisdiction. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted. The Company has completed a preliminary assessment of the potential impact of adopting ASU 2015-17 on its financial statements. At December 31, 2016, the adoption of ASU 2015-17 would have resulted in a decrease in current assets of $40.0 million and a decrease in current liabilities of $1.4 million. In addition, the adoption would have resulted in an increase in noncurrent assets of $3.0 million and a decrease in noncurrent liabilities of $35.6 million. At December 31, 2016, the Company has not made a decision to early adopt ASU 2015-17. The when-adopted impact of this new standard on the Company s financial statements may materially differ from these preliminary estimates, including as a result of changes in tax rates resulting from the enactment of tax legislation in the future.

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In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which will require lessees to report on their balance sheets a right-of-use asset and a lease liability in connection with most lease agreements classified as operating leases under the current guidance. The lease liability will be measured initially based on the present value of future lease payments, subject to certain conditions. The right-of-use asset will be measured initially based on the amount of the liability, plus certain initial direct costs. The new guidance will further require that leases be classified at inception as either (a) operating leases or (b) finance leases. For operating leases, periodic expense will generally be flat (straight-line) throughout the life of the lease. For finance leases, periodic expense will decline (similar to capital leases under current rules) over the life of the lease. The new standard must be adopted using a modified retrospective transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption is permitted. The Company has completed a preliminary assessment of the potential impact of adopting ASU 2016-02 on its financial statements. As disclosed in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2016, adoption of ASU 2016-02 would have resulted in recognition of a right-of-use asset in the estimated amount of approximately $600.0 million and a lease liability for a similar amount in the Company s consolidated balance sheet as of September 30, 2016. The Company does not believe adoption of ASU 2016-02 will have a material impact on the Company s results of operations. At December 31, 2016, the Company has not made a decision to early adopt ASU 2016-02. The amount of the right-of-use asset and the lease liability ultimately recognized by the Company may materially differ from this preliminary estimate, including as a result of future organic growth in our business and potential acquisitions.

In March 2016, the FASB issued ASU No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*, intended to simplify various aspects of how share-based payments are recorded and presented on the financial statements. For example, the new guidance will require that all the income tax effect related to share-based payments be recorded in income tax expense. The new guidance further removes the current requirement to delay recognition of a windfall tax benefit until it reduces current taxes payable. In addition, the new standard will require that excess tax benefits and shortfalls from share-based compensation awards be reported as operating activities in the statement of cash flows. For public companies, these amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. Early adoption is permitted.

In addition, the Company has not yet adopted the following recent accounting pronouncements and does not believe, based on its preliminary assessment, that their adoption will have a material effect on its consolidated financial position and results of operations:

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers* (ASU 2014-09) which will supersede Accounting Standards Codification (ASC) Topic 605, *Revenue Recognition*. In August 2015, the FASB deferred the effective date of this new standard by one year. A core principle of the new guidance is that an entity should measure revenue in connection with its sale of goods and services to a customer based on an amount that depicts the consideration to which the entity expects to be entitled in exchange for each of those goods and services. For a contract that involves more than one performance obligation, the entity must (a) determine or, if necessary, estimate the standalone selling price at inception of the contract for the distinct goods or services underlying each performance obligation and (b) allocate the transaction price to each performance obligation on the basis of the relative standalone selling prices. In addition, under the new guidance, an entity should recognize revenue when (or as) it satisfies each performance obligation under the contract by transferring the promised good or service to the customer. A good or service is deemed transferred when (or as) the customer obtains control of that good or service. The new standard permits the use of either the retrospective or cumulative effect transition method. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early application is permitted, but no earlier than December 16, 2016. The Company has not yet selected a transition method.

In January 2017, the FASB issued ASU No. 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business* (ASU 2017-01). ASU 2017-01, which must be applied prospectively, provides a narrower framework to be used to determine if a set of assets and activities constitutes a business than under current guidance and is generally expected to result in greater consistency in the application of ASC Topic 805, *Business Combinations*. For public companies, this amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017. Early application is permitted under certain conditions.

Accounting Changes

In April 2015, the FASB issued ASU No. 2015-05, *Customer s Accounting for Fees Paid in Cloud Computing Arrangement*. This pronouncement provides guidance to determine whether a cloud-based computing arrangement includes a software license. If a cloud-based computing arrangement includes a software license, the customer must account for the software element of the arrangement consistent with the acquisition of other software licenses. Otherwise, the customer must account for the arrangement as a service contract. The new standard permits the use of either the prospective or retrospective transition method. As required, the Company adopted the provisions of ASU No. 2015-05, prospectively, in the first quarter of its fiscal year ending September 30, 2017 and its adoption did not have a material impact on the Company s consolidated financial statements.

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In September 2015, the FASB issued ASU No. 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments* (ASU 2015-16) which eliminates the prior requirement to recognize measurement-period adjustments to provisional amounts retrospectively. Instead, ASU 2015-16 requires the acquirer to recognize measurement-period adjustments, as well as the impact on earnings of changes in depreciation, amortization and similar items (if any) resulting from the change to the provisional amounts, in the period when the amount of each measurement-period adjustment is determined. As required, the Company adopted the provisions of ASU 2015-16 in the first quarter of its fiscal year ending September 30, 2017 and its adoption did not have a material impact on the Company s consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

As a multinational corporation, we are subject to certain market risks including foreign currency fluctuations, interest rates and government actions. We consider a variety of practices to manage these market risks, including, when deemed appropriate, the occasional use of derivative financial instruments. Currently, we do not purchase or hold any derivative instruments for speculative or trading purposes.

Foreign currency exchange rate risk

We are exposed to potential gains or losses from foreign currency fluctuations affecting net investments in subsidiaries (including intercompany balances not permanently invested) and earnings denominated in foreign currencies, as well as exposure resulting from the purchase of merchandise by certain of our subsidiaries in a currency other than their functional currency and from the sale of products and services among the parent company and subsidiaries with a functional currency different from the parent or among subsidiaries with different functional currencies. Our primary exposures are to changes in exchange rates for the U.S. dollar versus the Euro, the British pound sterling, the Canadian dollar, the Chilean peso, and the Mexican peso. In addition, we currently have exposure to the currencies of several other countries located in South America and from time to time we may have exposure to changes in the exchange rate for the British pound sterling versus the Euro in connection with the sale of products and services among certain European subsidiaries of the Company. The recent vote by Britain to leave the European Union and related or other disruptive events in the European Union could result in increased foreign currency fluctuation, including fluctuation in currencies in which we operate. For each of the fiscal years 2016, 2015 and 2014, less than 20% of our consolidated net sales were made in currencies other than the U.S. dollar. For the three months ended December 31, 2016, consolidated net sales are inclusive of an approximately $15.7 million net negative impact from changes in foreign currency exchange rates and other comprehensive income (loss) reflects approximately $18.7 million in foreign currency translation adjustments, net of tax. For the three months ended December 31, 2016, fluctuations in the U.S. dollar exchange rates did not otherwise have a material effect on our consolidated financial condition and consolidated results of operations.

A 10% increase or decrease in the exchange rates for the U.S. dollar versus the foreign currencies to which we have exposure would have impacted our consolidated net sales by approximately 1.7% in the three months ended December 31, 2016 and would have impacted our consolidated total assets by approximately 2.3% at December 31, 2016.

Our various foreign currency exposures at times offset each other, sometimes providing a natural hedge against foreign currency risk. As more fully disclosed in our Annual Report on Form 10-K for the fiscal year ended September 30, 2016, the Company uses from time to time foreign exchange contracts to mitigate its remaining exposure to changes in foreign currency exchange rates. There have been no material changes to the aggregate notional amount of foreign exchange contracts held by the Company since September 30, 2016. At December 31, 2016, the aggregate net fair value of all foreign exchange contracts was $0.7 million, consisting of contracts in an asset position of approximately $0.8 million and contracts in a liability position of approximately $0.1 million.

The Company s foreign currency derivatives are not designated as hedges and do not currently meet the requirements for hedge accounting. Accordingly, the changes in fair value of these derivative instruments, which are adjusted quarterly, are recorded in our consolidated statements of earnings. Selling, general and administrative expenses reflect net gains of $1.8 million and $1.0 million for the three months ended December 31, 2016 and 2015, respectively, in connection with all of the Company s foreign currency derivatives instruments, including marked-to-market adjustments.

Interest rate risk

We and certain of our subsidiaries are sensitive to interest rate fluctuations primarily as a result of borrowings under our ABL facility from time to time. In order to enhance our ability to manage risk relating to cash flow and interest rate exposure, we and/or our other subsidiaries who are borrowers under our ABL facility may from time to time enter into and maintain derivative instruments, such as interest rate swap agreements, for periods consistent with the related underlying exposures. There were no borrowing under the ABL facility outstanding at December 31, 2016 and the Company held no interest rate swaps or similar derivative instruments.

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We have no exposure to interest rate fluctuations in connection with our senior notes due 2022, 2023 and 2025, as the interest rates on such debt instruments are fixed.

Credit risk

We are exposed to credit risk on certain assets, primarily cash equivalents, short-term investments and accounts receivable. We believe that the credit risk associated with cash equivalents and short-term investments, if any, is largely mitigated by our policy of investing in a diversified portfolio of securities with high credit ratings.

We provide credit to customers in the ordinary course of business and perform ongoing credit evaluations. We believe that our exposure to concentrations of credit risk with respect to trade receivables is largely mitigated by our broad customer base and that our allowance for doubtful accounts is sufficient to cover customer credit risks at December 31, 2016.

Item 4. Controls and Procedures.

Controls Evaluation and Related CEO and CFO Certifications. Our management, with the participation of our principal executive officer (CEO) and principal financial officer (CFO), conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2016. The controls evaluation was conducted by our Disclosure Committee, comprised of senior representatives from our finance, accounting, internal audit, and legal departments under the supervision of our CEO and CFO.

Certifications of our CEO and our CFO, which are required in accordance with Rule 13a-14 of the Exchange Act, are attached as exhibits to this report. This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

Limitations on the Effectiveness of Controls. We do not expect that our disclosure controls and procedures will prevent all errors and all fraud. A system of controls and procedures, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the system are met. Because of the limitations in all such systems, no evaluation can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. Furthermore, the design of any system of controls and procedures is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how unlikely. Because of these inherent limitations in a cost-effective system of controls and procedures, misstatements or omissions due to error or fraud may occur and not be detected.

Scope of the Controls Evaluation. The evaluation of our disclosure controls and procedures included a review of their objectives and design, our implementation of the controls and procedures and the effect of the controls and procedures on the information generated for use in this report. In the course of the evaluation, we sought to identify whether we had any data errors, control problems or acts of fraud and to confirm that appropriate corrective action, including process improvements, was being undertaken if needed. This type of evaluation is performed on a quarterly basis so that conclusions concerning the effectiveness of our disclosure controls and procedures can be reported in our Quarterly Reports on Form 10-Q and our Annual Reports on Form 10-K. Many of the components of our disclosure controls and procedures are also evaluated by our internal audit department, by our legal department and by personnel in our finance organization. The overall goals of these various evaluation activities are to monitor our disclosure controls and procedures on an ongoing basis and to maintain them as dynamic systems that change as conditions warrant.

Conclusions regarding Disclosure Controls. Based on the required evaluation of our disclosure controls and procedures, our CEO and CFO have concluded that, as of December 31, 2016, we maintain disclosure controls and procedures that are effective in providing reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to our management, including our CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting. During our most recent fiscal quarter, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings.

We are involved, from time to time, in various claims and lawsuits incidental to the conduct of our business in the ordinary course. We carry insurance coverage in such amounts in excess of our self-insured retention as we believe to be reasonable under the circumstances and that may or may not cover any or all of our liabilities in respect of these matters. We do not believe that the ultimate resolution of these matters will have a material adverse impact on our consolidated financial position, cash flows or results of operations.

We are subject to a number of U.S., federal, state and local laws and regulations, as well as the laws and regulations applicable in each foreign country or jurisdiction in which we do business. These laws and regulations govern, among other things, the composition, packaging, labeling and safety of the products we sell, the methods we use to sell these products and the methods we use to import these products. We believe that we are in material compliance with such laws and regulations, although no assurance can be provided that this will remain true going forward.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors contained in Item 1A. Risk Factors in Part I of our Annual Report on Form 10-K for the fiscal year ended September 30, 2016, which could materially affect our business, financial condition or future results. There have been no material changes from the risk factors disclosed in such Annual Report. The risks described in such Annual Report and herein are not the only risks facing our company.

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

(a) Not applicable

(b) Not applicable

(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following table provides information about the Company s repurchases of shares of its common stock during the three months ended December 31, 2016:

Fiscal Period	Total Number of Shares Purchased (1)		Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)(2)		Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
October 1 through October 31, 2016	607,512	$	25.84	607,512	$	549,432,437
November 1 through November 30, 2016	1,258,573		26.29	1,258,573		516,342,276
December 1 through December 31, 2016	679,505		26.75	679,505		498,166,210
Total this quarter	2,545,590	$	26.31	2,545,590	$	498,166,210

(1) The table above does not include 8,558 shares of the Company s common stock surrendered by grantees during the three months ended December 31, 2016 to satisfy tax withholding obligations due upon the vesting of equity-based awards under the Company s share-based compensation plans.

(2) In August 2014, the Company announced that its Board of Directors approved a share repurchase program authorizing the Company to repurchase up to $1.0 billion of its common stock over an approximate three-year period expiring on September 30, 2017.

Item 3. Defaults Upon Senior Securities.

Not applicable

Item 4. Mine Safety Disclosures.

Not applicable

Item 5. Other Information.

(a) Not applicable

(b) Not applicable

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Item 6. Exhibits.

Exhibit No.	Description
3.1	Third Restated Certificate of Incorporation of Sally Beauty Holdings, Inc., dated January 30, 2014, which is incorporated herein by reference from Exhibit 3.3 to the Company s Current Report on Form 8-K filed on January 30, 2014
3.2	Sixth Amended and Restated Bylaws of Sally Beauty Holdings, Inc., dated July 30, 2015, which is incorporated herein by reference from Exhibit 3.1 to the Company s Current Report on Form 8-K filed on August 6, 2015
10.1	Form of Severance Agreement between each of Matthew Haltom and the Company effective as of November 5, 2012, Christian A. Brickman and the Company effective as of June 2, 2014, Mark G. Spinks and the Company effective July 31, 2015; Sharon Leite and the Company effective February 1, 2016 and Donald T. Grimes and the Company effective as of December 12, 2016, which is incorporated herein by reference from Exhibit 10.3 to the Company s Current Report on Form 8-K filed on November 5, 2012
31.1	Rule 13a-14(a)/15d-14(a) Certification of Christian A. Brickman*
31.2	Rule 13a-14(a)/15d-14(a) Certification of Donald T. Grimes*
32.1	Section 1350 Certification of Christian A. Brickman*
32.2	Section 1350 Certification of Donald T. Grimes*
101	The following financial information from our Quarterly Report on Form 10-Q for the fiscal quarter ended December 31, 2016, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Earnings; (ii) the Consolidated Statements of Comprehensive Income; (iii) the Consolidated Balance Sheets; (iv) the Consolidated Statements of Cash Flows; and (v) the Condensed Notes to Consolidated Financial Statements.

* Included herewith

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SIGNATURES

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

	SALLY BEAUTY HOLDINGS, INC. (Registrant)	
Date:		February 2, 2017
By:	/s/ Donald T. Grimes Donald T. Grimes Senior Vice President, Chief Financial Officer and Chief Operations Officer For the Registrant and as its Principal Financial Officer	